Investing for impact: the evidence

2019 EDITION

WHY WOULD I INVEST FOR IMPACT?

Investing that does well and does good.

"That sounds great, but surely you can't have both?". It's something we hear a lot at Tribe. However, we fundamentally believe the answer to this question is that you can have both.

In a previous paper "Investing for Humans[1]" we looked at some of the behavioural evidence in support Impact investing. Now we want to take a look at the academic and financial markets evidence.

WHAT IS TRIBE'S PHILOSOPHY THEN?

Our investment philosophy is simple: We want to invest in well run companies solving big challenges. The logic is:

First, sustainable or responsible companies are less likely to be hit by adverse regulation, reputational controversy or customer apathy. We don't want to invest in badly-run businesses.

Second, companies at the forefront of the sustainability revolution are inherently more focused on creating systemic change and are aware of the wider regulatory and environmental picture. This, in our opinion, makes them naturally future-focused, growth businesses which in turn present the biggest global opportunities. At some point we are all going to need cleaner energy and we are all going to need more effective healthcare.

Sure, we might have missed out on some good dividends from cigarette companies, but this is an industry that is in structural decline and systematically killing its clients (7m a year, according to the WHO[2]). We would much rather focus our attention on sectors experiencing growth that are attracting both consumers and government support. We're taking a long term view, with investment principles focused on the future - trying to avoid businesses that we don't think will exist in the future.

AREN'T YOU RESTRICTING YOUR INVESTMENT UNIVERSE?

The argument is that by only investing in sustainable companies you are narrowing your investable universe. This is unavoidably true.

The reality is that all investment requires some constraint. Any investment manager has to choose to focus on an area which they believe will deliver long term returns and active managers will want to focus on where they can add value. It's the same for Tribe.

Narrowing the universe allows an investment manager like Tribe to focus on an area in which they have a particular strength or advantage. So the debate isn't whether your constraint allows you better investment options compared to being completely unconstrained (logic says it can't). Instead, it's whether your constraint is the best use of your time and resources, or even more simply: is it better than everyone else's?

To put this another way: we don't see constraints; we have conviction.

We've made the choice to seek out well managed companies that are solving some of the world's biggest challenges such as energy, education, health, financial inclusion and environmental degradation. We look for companies that are long term drivers of growth. We believe that a focus on sustainability is additive to our understanding of companies, our portfolio risk management and our financial return.

Tribe | A NEW WEALTH ORDER

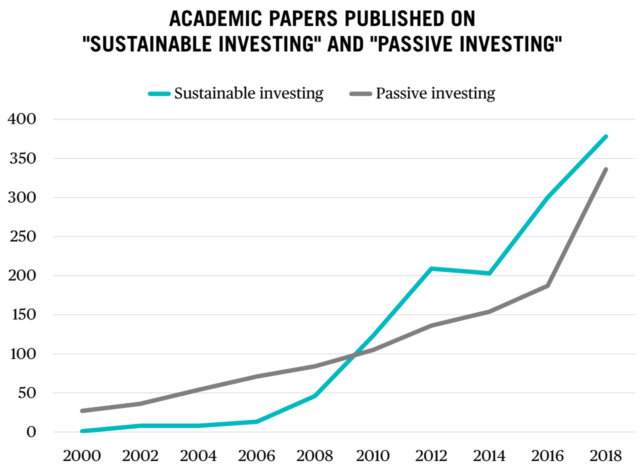
SO THAT'S THE PHILOSOPHY, BUT WHAT DOES THE RESEARCH SAY?

While much of the research in the sector has only been conducted recently, it is overwhelmingly positive with regards to sustainable investing. A 2015 Morgan Stanley study[3] found "across 10,000 funds, sustainable equity funds had equal or higher median returns, with equal or lower volatility, than traditional funds."

Furthermore, Hamburg University[4] conducted a meta-study (a study of studies) reviewing 2,200 different papers like the two above. Their conclusion: 90% of the studies showed positive or neutral effects of sustainable investing on returns. They recommend that "long-term responsible investing should be important for all kinds of rational investors".

The conclusion is that companies that score well when evaluated based on sustainability factors deliver a better financial return. It would appear that, compared to traditional investing, sustainability-focused investing results in superior risk-adjusted returns over time.

"Long-term responsible investing should be important for all kinds of rational investors."



Source: Tribe, Google Scholar

INTERESTING, WHY DO YOU THINK THIS IS?

There are several reasons.

One is that these companies are often more appealing. It appears that customers are willing to pay more for ethical goods, especially millennials. Stanford Business school recently did a study[5] on whether consumers would pay more for fair trade coffee. The researchers found sales of the two most popular bulk coffees rose by almost 10% when the coffees carried a fair-trade label as compared with the placebo label.

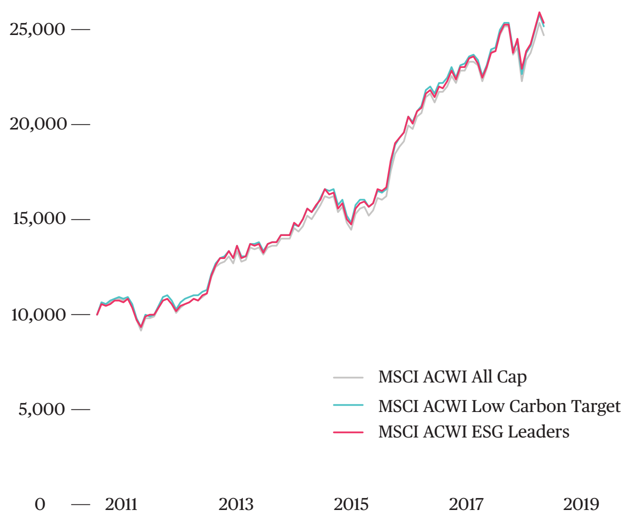
They're also well run. Eccles, Ioannou and Serafeim[6] found that over 18 years high sustainability companies outperform low sustainability firms in both share price performance and accounting performance. Not only that, they also found that using analyst's forecasts of annual earnings, the market tends to underestimate the profitability of high sustainability companies compared to low sustainability companies, so these companies are often undervalued.

"High Sustainability firms tend to generate significantly higher stock returns, suggesting that in fact, the integration of such issues into a company's business model and strategy may be a source of competitive advantage for a company in the long-run. A more engaged workforce, a more secure license to operate, a more loyal and satisfied customer base, better relationships with stakeholders, greater transparency, a more collaborative community, and a better ability to innovate may all be contributing factors to this potentially persistent superior performance in the long-term."

OK, THAT'S ENOUGH STUDIES – CAN YOU SHOW ME WHAT'S HAPPENED IN THE MARKETS?

The chart below shows the performance of the broad MSCI ACWI index compared to two generic sustainable and impact indices: high scoring ESG firms (ESG Leaders) and low carbon producing businesses (Low Carbon Target). Whilst these indices are one of many interpretations of sustainable investing, both of these have outperformed the main index over the past decade. They also did this with lower risk (as measured by standard deviation).

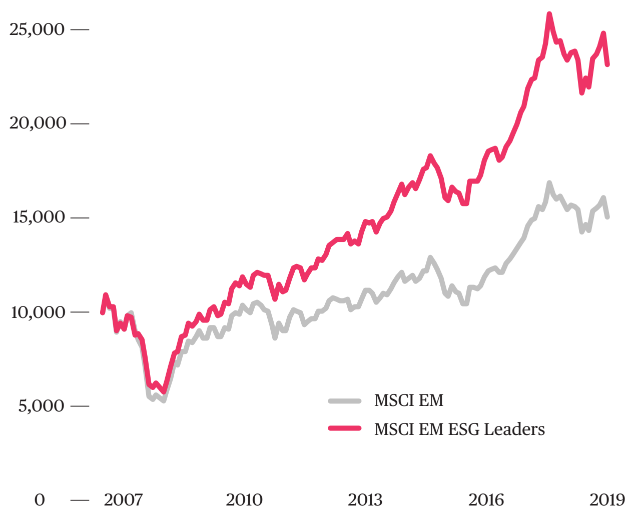
BROAD MARKET INDEX VERSUS ESG AND IMPACT INDICES



Source: MSCI 2019

The difference is even more stark in Emerging Markets (EM). Compare the MSCI Emerging Markets Leaders index (which includes 417 companies that score highly on ESG) to the normal MSCI EM benchmark (below):

BROAD EMERGING MARKET INDEX VERSUS ESG EMERGING MARKET INDEX



Source: MSCI 2019

In the words of the Financial Times, "The outperformance of ESG strategies is beyond doubt."[7]

When it comes to handling market volatility, 2018 provided plenty of examples of sustainable funds outperforming. A snapshot review in February, when investors got their first real taste of post-Great Financial Recession volatility[8], found that sustainable equity funds fared better than their peers. In fact, the review found that there wasn't a broad market sustainable index fund that didn't beat the main market in this period.

Then, later in the year there was a longer period of volatility and the results were similar. Over 65% of sustainable US exchange traded funds (ETFs) beat the US benchmark, this rose to over 70% of sustainable ETFs when looked at globally.

These numbers were confirmed by Morningstar who found nearly 70% of sustainable funds were in the top half of their mainstream peers across the fourth quarter, and a similar amount outperformed for the full calendar year as well.

Blackrock looked at the data from 2012 through to the end of 2018. They found that across various geographies ESG funds performed the same, if not better and had similar volatility as well as smaller drawdowns than the broader market.

	US	
	Traditional	Sustainable
Annualised return	15.8%	15.8%
Volatility	9.5%	9.6%
Sharpe ratio	1.62	1.60
Maximum monthly drawdown	-13.9%	-13.8%

	Global ex-US	
	Traditional	Sustainable
Annualised return	10.5%	11.1%
Volatility	11.4%	11.6%
Sharpe ratio	0.88	0.92
Maximum monthly drawdown	-23.3%	-22.6%

	Emerging Markets	
	Traditional	Sustainable
Annualised return	7.8%	9.1%
Volatility	14.4%	14.3%
Sharpe ratio	0.51	0.61
Maximum monthly drawdown	-35.2%	-33.0%

"The outperformance of ESG strategies is beyond doubt"

SO WHAT DOES THIS ALL MEAN?

Fundamentally, we believe that investing responsibility doesn't mean giving up performance. It means the opposite: it appears to enhance performance through improved risk management and investing in companies of the future. And yes, we have reduced our investable universe, but who doesn't? We are focused on the best bit already, validated by literally thousands of studies as well as real market performance.

So that's the reality in the narrow field of investment theory. There are many other reasons for impact investing beyond financial results, and if you consider how much change you can create in the world through investing positively, really the question becomes

WHY WOULDN'T YOU DO THIS?

1 Tribe Impact Capital 2017
2 World Health Organisation, Tobacco Factsheet May 2017
3 Sustainable Reality, Morgan Stanley, 2015
4 ESG and Financial Performance, Friede, Busch & Bassen, 2015
5 "Will consumers actually pay for fair trade?", Stanford Business, 2015
6 The Impact of Corporate Sustainability on Organisational Processes and Performance, 2011
7 Financial Times, 3 September 2017
8 Sustainable Funds Outperformed During the Early-February Market Swoon, Morningstar, 2018