

Performance and Impact: Can ESG equity portfolios generate healthier financial returns?

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Issue Theme: Challenges and Opportunities with ESG Integration into Investment Portfolios

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Abstract

Investors have yet to aggressively integrate Environment, Social and Governance (ESG) factors into portfolio construction due in part to concerns about data quality and availability or uncertainty around how ESG integration might affect returns. A chief obstacle to overcoming these concerns is the abundance of ESG indicators with a paucity of data-fill. In order to test the hypothesis that using ESG criteria for security selection need not be detrimental to returns, we review which ESG performance metrics are disclosed by a critical threshold of mid and large cap companies in relevant sectors, and then use this data to rate firms from the S&P 500. This information is used to construct ESG portfolios (comprised of firms which score in the top half) and test their performance against a market capitalization weighted benchmark. We then review how investors can reduce their investable universe by a random factor and still outperform the market capitalization weighted benchmark, using non-market capitalization weighting schemes. Finally we field test this hypothesis with a live risk-weighted ESG portfolio (superior resource productivity, responsible tax and compensation practices, diverse boards, clean revenue exposure) and test its performance against a market capitalization weighted benchmark. The results demonstrate it is not necessary for an ESG factor to have predictive power over future security prices in order to be applied in a fiduciary compliant context.

The implication is that an ESG portfolio can be built in a manner to potentially outperform a market capitalization weighted index without requiring the strong view that ESG can provide a forecast of future returns, and only requiring the view that ESG has a non-significant relationship with future returns. The value of this implication to the broader field of study is that, with proper portfolio construction, investors can align their capital with their values, whether these be ESG, gender-lens, faith-based, or something else.

Introduction

While an increasing number of investment managers are incorporating sustainability criteria into portfolio construction, most are not doing so. The integration of environmental, social, and governance (ESG) data has presented challenges and obstacles to many portfolio managers for at least three, sometimes overlapping reasons. The first reason is that the data itself is incomplete and inaccurate, with diminishing corporate transparency in mid-cap and small public companies as well as emerging and frontier markets. The combination of these challenges, along with the fact that ESG data sources don't always agree on the underlying facts has been an obstacle to adoption, as explored by Montiel et al. The second reason is that while simple exclusionary values (screens) provide comfort to clients who wish to avoid sectors of the economy they abhor, e.g. tobacco, in the view of some portfolio managers, any reduction in an investable universe increases risk of benchmark underperformance. Recent research by Bank of America (2017) suggests that rather than increasing risk, ESG screening may be the most effective means for reducing risk. The fear of underperformance is not borne out in the literature. In the most exhaustive review to date of over 2300 studies by Friede, Busch and Basse, they found that roughly 90 per cent of studies find a nonnegative ESG to corporate financial performance relationship.

And thirdly, portfolio managers have varying views on materiality. In a previous paper (Khan, Serafeim, Yoon, 2015) research showed that companies with good ratings on material sustainability issues outperformed companies with bad ratings on material issues over long time frames. At the same time, companies with good ratings on immaterial sustainability issues did not outperform companies with bad ratings on these issues.

For portfolio managers focused on short-term returns, taken together, data quality, availability, materiality, and diversification have given these managers ample reasons to avoid inclusion of ESG inputs. Despite these barriers

as Amel-Zadeh and Serafiem (2017) find, there are a growing number of investors who are seeking to use ESG inputs which are linked to financial performance.

In this paper we review ESG data options that can be used by investors to split groups of companies based on whether they align or do not align with a specific values-based preference. We then demonstrate how ESG factor integration is no better or worse than random security selection allowing us to leverage academic research showing how random security selection combined with risk efficient weighting can lead to benchmark outperformance. We then review a field test of this approach in the US Equities (large cap) market with live product. The clear implication of this study extends beyond ESG, to a broader field of values-aligned investing.

State of the data

This paper first reviews options under four categories: raw data-points disclosed by companies which are in the public domain, transparent thematic ratings by issue-focused non-profits, revenue segmentation techniques, as well as nascent big-data attempts.

While some of the major data providers such as Bloomberg and Thomson Reuters count over 400 ESG indicators, the vast majority of these are not currently reported by over 95% of mid and large-cap companies. There are numerous initiatives afoot to narrow down this vast ocean of data to a smaller, more relevant and usable size including the World Federation of Exchange's ESG Recommendations and Guidance document (World Federation of Exchanges, 2015), which include 33 key ESG performance indicators for exchanges to consider in relation to sustainability disclosure in their own markets, the London Stock Exchange Group's Guidance for issuers on the integration of ESG into investor reporting and communication, which identifies 34 quantitative indicators (London Stock Exchange Group, 2017), the Sustainability Accounting Standards Board's

industry standards (SASB, 2015) and Morgan Stanley’s global framework (Morgan Stanley, 2015), which each offer a focused set of specific indicators for each industry. Nevertheless, the vast majority of ESG indicators are not reported by mid and large-cap companies with a market capitalization over \$2 billion (let alone small cap), which limits their practical application. In fact, we were only able to identify 24 indicators related to performance—not policy—for which at least 10 per cent of mid and large-cap companies in any given industry reported for the 2014 performance year as of December 31, 2016. Up to twenty of these indicators (depending on the industry) are included in the Corporate Citizenship Score (see Table 1) used in this paper to split companies into values aligned and non-aligned segments. The four factors which meet the 10 per cent reporting threshold for at least one industry that are not included are: certified palm oil as a percentage of total palm oil produced/used/processed, fleet average fuel efficiency, % power asset financing for renewable energy, and total amount of corporate or group donations / community investments made to registered not-for-profit organisations.

Table 1. Corporate Citizenship Rating Methodology

KPI	Methodology
Energy Intensity	Revenue (converted to USD using PPP exchange rate) / (Energy use – renewable energy use)
Carbon Intensity	Revenue (converted to USD using PPP exchange rate) / GHG emissions: scope 1 & 2
Water Intensity	Revenue (converted to USD using PPP exchange rate) / Water use
Waste Intensity	Revenue (converted to USD using PPP exchange rate) / Non-recycled or reused waste generated
Innovation Capacity	R&D expenses / revenue – three year trailing
Percentage Tax Paid	Cash tax amount paid / EBITDA – five year trailing
CEO-Average Employee Pay	CEO compensation / average employee compensation
Pension Fund Status	75% (total DB and DC employer contributions/ FTE employees percentile-ranked against peers) + 1/4(fair value of DB plan assets/FTE employees percentile-ranked - (1-(fair value of DB plan assets/liability percentile-ranked))
Safety Performance	Fatalities and lost time incidents

Employee Turnover	Number of departures / average total employees
Leadership Diversity	Female representation on board of directors, executive management team and existence of a female CEO
Clean Capitalism Pay Link	Mechanisms that link senior executive pay to clean capitalism targets
Supplier score	<ul style="list-style-type: none"> ▪ The company's largest supplier as determined by Bloomberg ▪ Largest supplier will be scored using the same new methodology for the 2017 Global 100 minus the "Supplier score" KPI. ▪ Primary data source: Bloomberg and CDP
Clean Air Productivity score	<ul style="list-style-type: none"> ▪ Revenue (converted to USD using PPP exchange rate) / VOC emissions (25%) ▪ Revenue (converted to USD using PPP exchange rate) / Nox emissions (25%) ▪ Revenue (converted to USD using PPP exchange rate) / Sox emissions (25%) ▪ Revenue (converted to USD using PPP exchange rate) / Particulate matter emissions (25%)

Of these 20 indicators, some have near 100% disclosure because they are part of regulatory disclosures, such as % female board directors or cash taxes paid as percentage of EBITDA. The majority, however, fall within the domain of voluntary disclosures. For the past five years, the annual State of Sustainability Disclosure Report published by Corporate Knights and Aviva has tracked mid and large-cap company disclosure of the seven first-generation indicators. These indicators achieve at least a 10 per cent report rate by mid and large-cap companies for the majority of industries (Corporate Knights & Aviva, 2016). As Figure 1 illustrates, with the exception of payroll, all of the indicators are not disclosed by the majority of mid and large-cap firms across most sectors.

Figure 1. The seven sustainability indicators – disclosure by mid and large-cap companies and as a percentage of the total number of large companies (2014 performance year), Source: Corporate Knights and Aviva, 2016

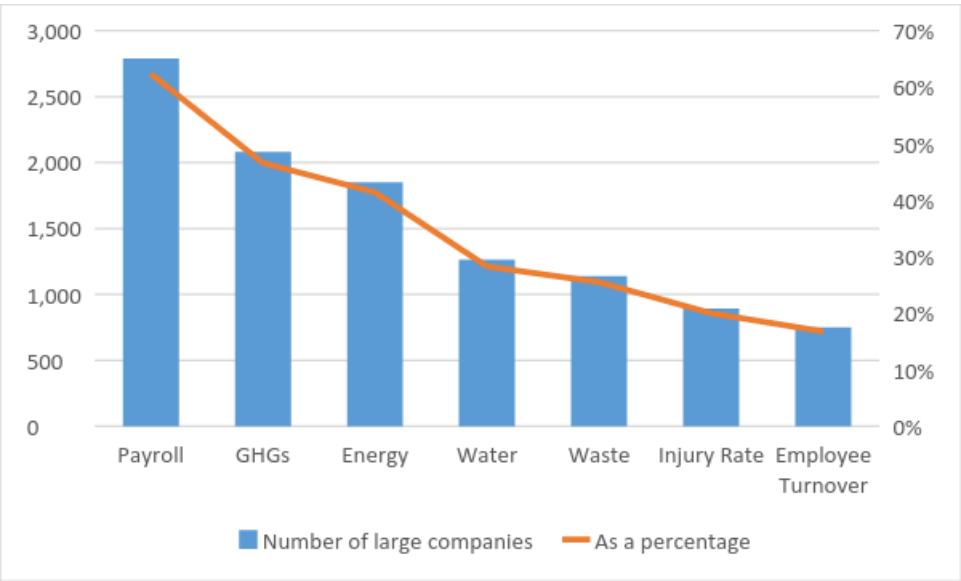


Table 2. Disclosure rate by GICS sector, 2014, Source: Corporate Knights and Aviva 2016

GICS Sector	Energy	GHGs	Water	Waste	Employee turnover	Injury rate	Payroll
Consumer Discretionary	38%	46%	24%	22%	11%	13%	61%
Consumer Staples	52%	51%	34%	32%	18%	27%	70%
Energy	37%	44%	33%	26%	20%	30%	44%
Financials	35%	30%	22%	19%	17%	12%	64%
Health Care	40%	31%	28%	26%	11%	20%	55%
Industrials	46%	52%	31%	28%	15%	23%	74%
Information Technology	38%	45%	22%	22%	12%	13%	46%
Materials	56%	57%	46%	42%	26%	40%	70%
Telecommunications Services	52%	55%	29%	30%	34%	29%	80%
Utilities	44%	51%	39%	32%	25%	27%	66%

Despite the limited disclosure rates for any particular performance indicator, it is still possible to design a rules-based rating system based on these indicators to identify which companies are lagging and which are leading, whereby companies are scored in a way that takes into account firm size and industry type. There are a variety of ways to deal with a firm's non-disclosure of a relevant indicator. This Corporate Citizenship Score used in this paper awards a score of zero in such cases.

Complementing the raw indicators publicly disclosed by companies, there is an emerging ecosystem of transparent thematic ratings by issue-focused non-profits. In addition to Just Capital (2017), which rates 1000 American Companies on a range of indicators intended to reflect American values, we identified 12 non-profit efforts to rate companies on a particular theme with a replicable methodology. The ratings (see Table 3 for detailed descriptions of each) range from focusing on how well pharmaceutical companies are providing access

to medicine for developing country diseases, to how well food companies are doing providing nutritious food, to per cent of cap-ex on projects that are likely to be stranded assets in a world that adheres to its Paris Agreement Commitments, to human rights performance, child or forced labor in the textile, food or tech hardware supply chain, deforestation, animal welfare impact of food companies, and influence on climate policy.

Table 3. Non-Profit Thematic Ratings

Ranking Topic	Ranking Source and Details
Access to Medicine score	The Index analyses 20 of the world's largest research-based pharmaceutical companies on how they make medicines, vaccines and diagnostics more accessible in low- and middle-income countries.
Access To Nutrition Score	<p>The Access to Nutrition Index (ATNI) is founded on the premise that Food & Beverage manufacturers can make a strong contribution to addressing poor nutrition and related diseases. By assessing and ranking the world's largest manufacturers on their nutrition-related commitments, practices and performance globally, ATNI aims to encourage companies to:</p> <p>Increase consumer access to nutritious and affordable foods and beverages through actions related to product formulation, pricing and distribution; and</p> <p>Responsibly exercise their influence on consumer choice and behavior through actions in areas such as marketing, labeling and promoting healthy diets and active lifestyles.</p>
Animal Welfare	The Business Benchmark is the first global measure of company performance on animal welfare and, since its inception in 2012 has established itself as a catalyst for influencing change in corporate practices on animal welfare management and reporting.
% of Upstream Capex Outside 2D budget (% band)	This new analysis provides a way of understanding whether the supply options of the largest publicly traded oil and gas producers are aligned with demand levels consistent with a 2 degree Celsius (2D) carbon budget. By allocating the carbon budget to potential oil and gas projects, through applying the economic logic of a carbon supply cost curve, it is possible to identify which companies have the highest exposure to potential capital expenditure (capex) to 2025. This report provides a snapshot of the potentially unneeded capex spend for 69 global oil and gas companies – highlighting for the first time, the wide-ranging degree of exposure amongst companies in the sector.

Corporate Human Rights Benchmark	The Benchmark ranks 98 of the world's largest publicly traded companies, from 3 at risk sectors, on human rights performance.
Forest 500	The Forest 500 is the world's first rainforest rating agency. It identifies and ranks the most influential companies, financial institutions, and governments in the race towards a deforestation-free global economy. By objectively identifying and ranking the 500 powerbrokers that have large-scale influence over forest risk commodity supply chains, the Forest 500 holds companies, financial institutions, and governments accountable for their actions. The results and insights from the Forest 500 indicate shortcomings and gaps in powerbrokers' commitments, highlighting where greater action is required to achieve overarching deforestation commitments. Specifically, the Forest 500 assesses 250 companies, 150 investors and lenders, 50 jurisdictions, and 50 other powerbrokers, each selected based on their exposure to forest risk commodity supply chains.
Sustainable Fishing	Carting Away the Oceans report evaluates and ranks major grocery stores on their commitments to sustainable seafood.
Human Rights Campaign (Equality)	Human Rights Campaign Foundation's 2017 Corporate Equality Index is the national benchmarking tool on corporate policies and practices pertinent to lesbian, gay, bisexual and transgender employees.
InfluenceMap Performance	The rankings measure how a corporation or trade association (influencer) behaves towards 2C aligned climate and energy policy. For corporations, the score (from A to F) can be viewed as an indicator of readiness for a transition to low carbon policy globally.
Know the chain	In 2016 KnowTheChain has benchmarked 60 large global companies in the Information & Technology Communication, Food & Beverage, and Apparel & Footwear sectors on their efforts to address forced labor and human trafficking in their supply chains.
Sustainable Cotton	Rank a Brand scored company performance across three areas: policy, sourcing and use, and traceability. Most points were available for sourcing and use with companies assessed according to volumes used from Better Cotton, Cotton made in Africa, Organic, and Fairtrade – the four standards judged to be sustainable for this research.
Sustainable Palm oil	WWF Palm Oil Buyer Score Card evaluates major retailers, consumer goods manufacturers and food service companies from the US, Canada, Europe, Australia, Japan and India to see what per cent of their palm oil is sourced sustainably.

The advantage of these ratings is that they are performed by credible actors employing transparent methodologies endorsed by institutional investors. The coverage is not universal nor is it intended to be, rather these thematic ratings focus on the biggest, most relevant companies. While these ratings will not help an investor to discern on the suitability of an unrated smaller company in a relevant sector, it can be used with some confidence to identify which sector-relevant rated large actors are onside or offside.

In addition to raw indicators disclosed by companies and thematic ratings by non-profits, there are revenue-exposure ratings that can help investors to identify which companies have more or less revenue exposure to specific clean energy or sustainable development related themes. Private databases offer climate-related or sustainable development goals revenue exposure percentages for most large publicly traded equities. These databases include but are not limited to Bloomberg's New Energy Revenue Exposure field, MSCI's green revenue metrics and SDG revenue metrics, and FTSE-Russell's Environmental Markets and Low Carbon Economy database, and the oekom Sustainability Solutions Assessment which offers investors the extent to which companies further or hinder the attainment of the UN SDGs or individual sustainability topics (such as climate change, water, health) through its product and service range.

In addition to these private ratings, it is also possible for investors to invent their own or use non-proprietary taxonomies for sustainable development or clean energy themes, which can then be matched to segmented revenue databases such as Factset Revere, Thomson Reuters or Bloomberg to generate thematic revenue exposure scores.

Big data attempts also offer promise for factoring in real-time ESG information which the above three sources do not do. We reviewed three notable efforts aimed at doing this by RepRisk, Arabesque S-Ray, and TruValue. RepRisk synthesizes data from media, stakeholders, and other public sources external to the company to produce

daily data feeds for companies on a range of themes. Arabesque S-Ray combines over 200 environmental, social and governance (ESG) metrics with news signals from over 50,000 sources across 15 languages to rate companies on Human Rights, Labor Rights, the Environment, and Anti-Corruption (GC Score), as well as an industry-specific assessment of companies' performance on financially material sustainability criteria (ESG Score). TruValue's Insight360 data feeds aims to provide investors with daily feeds of data and analyses on ESG factors for public companies and industries.

We find the approaches used by RepRisk, Arabesque S-Ray, and TruValue to be a useful first cut to help investors identify which companies may be on or offside a particular set of values, but independent human review is still advisable before acting on these signals. Over time, advances in artificial intelligence and machine learning may be obviate this need, but for the moment issues related to discerning credible news from “fake news” or sponsored content (an area of increasing sophistication by companies), or parsing out a product or company's incidental or direct relevance to a mention on the internet, inhibit the reliability of these feeds.

In this section we have reviewed four types of data sources: raw data reported by companies, thematic ratings by non-profits, revenue exposure, and real-time ratings powered by big data scrubbed from the internet.

For the purpose of this paper we used elements of the first three types of data to split 500 US large cap firms into an ESG aligned list and an ESG non-aligned list. The client mandate in this instance was to avoid tobacco, thermal coal, and weapons, which is revenue-tested. The mandate went on to stipulate inclusion of best in class and exclusion of worst-in-class. In cases where a company is scored worst-in-class by one of the non-profit thematic ratings (included in Table 3), it is automatically classified as non-aligned. The remaining securities, generally more than 90% of the starting universe, are scored on three equally weighted factors: % female board

directors, overall corporate citizenship score (see Table 1) and % exposure to new energy sources (BNEF New Energy Exposure). The companies with composite scores in the top half remain eligible for the portfolio.

After ESG scoring is complete, ~200 of the original SP500 remain eligible for inclusion.

Our theory on why ESG factors aren't prejudicial to performance

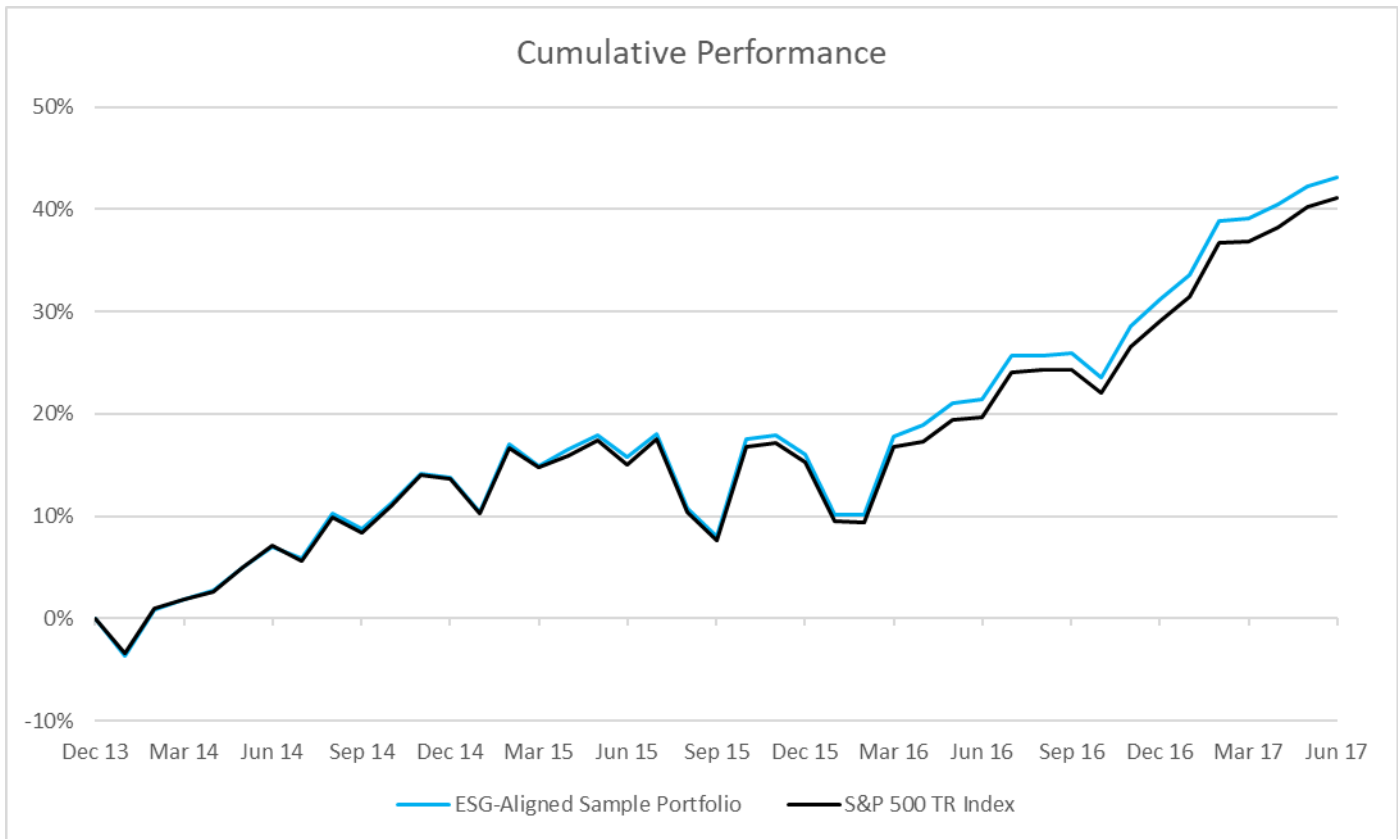
A scoring function S can be created from a combination of ESG indicators as long as the function results in an ordered set of stocks, and the top N can be retained. Most investors would be fearful of doing this as it would be akin to a random selection of securities from the portfolio. More recently, this theory has been contradicted by Arnott et al. (2013), who show how a series of equally weighted random portfolios of 30 stocks (sampled from the benchmark) outperform the same cap-weighted benchmark over a 40-year period. The implication for investment managers is that buying firms with less carbon, or any other ESG metric, can be done in a fiduciary-compliant manner provided that the weights are chosen to maximize some risk-to-return goal. For factors assumed to influence security prices, Amenc, Goltz & Lodh (2012) create reduced universe portfolios based on various factors (size, volatility, dividend, etc.) and achieve a superior result compared to the market capitalization weighted benchmark in all cases except one (the high volatility stocks weighted to reduce portfolio volatility). These techniques resulted in greater risk-adjusted performance relative to the market capitalization weighted benchmark, driven mainly by using a risk-to-return weighting scheme. These findings were also bore out in an analysis by Balkissoon & Heaps, (2014), which used carbon efficiency scores to create carbon-reduced portfolios. Amenc & Shirbini (2012) show how market capitalization inefficiencies are

compounded in a reduced investable universe (ESG screens), which furthers the case for the above weighting techniques to be implemented on an ESG-reduced universe.

Expanding beyond carbon-reduced portfolios, we analyzed the impact of ESG factors, representing good corporate citizenship, on portfolio performance. Good corporate citizens are companies which score in the top half on the composite of metrics outlined in Table One. These companies are considered ESG-Aligned.

In order to determine the value of a broad portfolio of ESG-Aligned companies, we analyzed the members of the S&P 500 Index. For each January 1st starting in 2014, the holdings of the index were divided into two groups: ESG-Aligned companies, and ESG-Not-Aligned companies. Next, we readjusted the percentage of the basket after eliminating the ESG-Not-Aligned, yielding a new weight to reflect the percentage share within the ESG-Aligned group (sample portfolio). The sample portfolio is rebalanced each January 1st and the constituents drift in weight between these rebalances. The performance of the sample portfolio would likely improve with quarterly rebalancing.

The sample portfolio portrays a remarkably similar return and risk profile to the S&P 500 TR Index (SP500TR). Although the sample portfolio outperformed from January 1, 2014 through June 30, 2017, the annualized amount was minimal at 0.46%. The sample portfolio and the SP500TR are correlated 0.9982 and the tracking error was small at 0.65%.



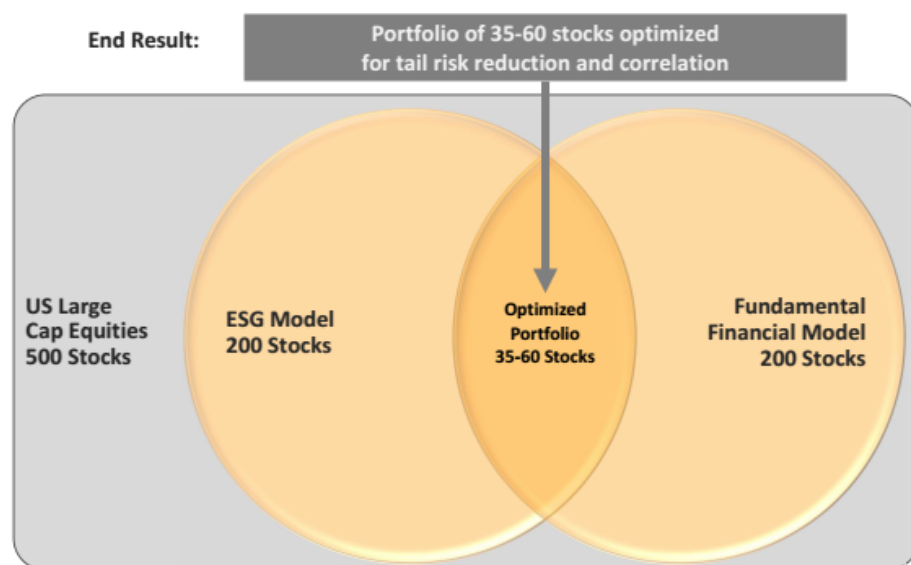
Further, the distribution of returns of the sample portfolio was quite similar to that of the SP500TR. The skewness of the sample portfolio for the period was 0.1653 and the SP500TR was 0.1338. The kurtosis of the sample portfolio for the period was 3.535 and the SP500TR was 3.364. The closeness of the two distributions show that the sample portfolio exhibits extremely similar risk profiles. These analyses clearly demonstrate how splitting a portfolio based on ESG factors is akin to random selection.

Putting the theory into practice

Given a preference or scoring function S , any series of ESG indicators that has coverage for the variables of interest can be used, as long as that function can create an ordered set of securities. With an ordered set of securities we can cut a benchmark in half, effectively randomly sampling the securities that are preferred by the

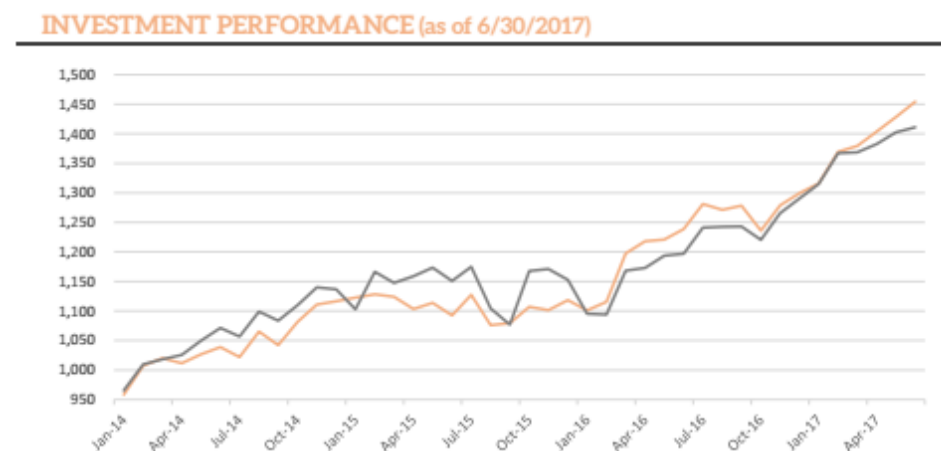
investor. We then intersect this set with securities from a predictive model based on standard fundamental ratios. Finally we optimize this set to maximize diversification and reduce tail risk as shown in Figure 2.

Figure 2. Optimization Venn Diagram of ESG Integration, Source: Stance Capital, 2017



This process allows us to switch out any ESG screen or model and intersect with any source of alpha or edge or manager edge, similar to how value managers or fundamental managers will have their picks. The only requirement is that the manager has sufficient breadth in their edge and they can identify a large enough candidate pool.

Figure 3. Investment Performance of ESG+Fundamentals+Efficient Weighting vs Benchmark, Source: Stance Capital, 2017



		Last 3 months	YTD	Last 1 year	Last 2 years	Last 3 years	ITD
	Stance Equity (Net)	5.44%	11.91%	17.37%	33.09%	40.01%	45.42%
	S&P 500 TR	3.09%	9.34%	17.90%	22.60%	31.70%	41.10%

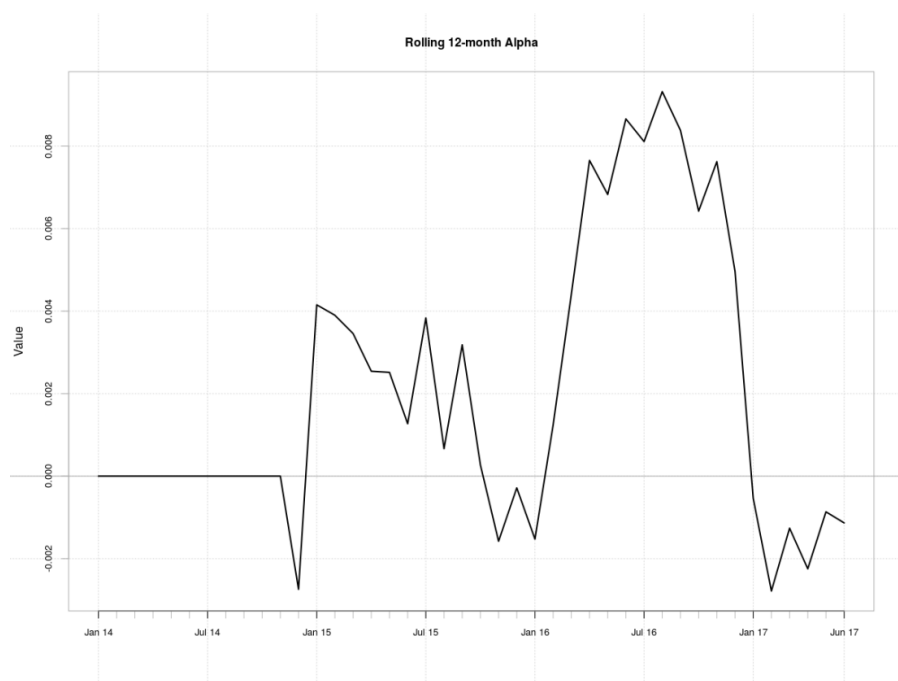
As shown in Table 3, our cumulative performance net of fees has been better than benchmark SP500TR, however given the lower level of risk we take it quickly becomes apparent that the product offers superior risk-adjusted performance v. benchmark.

Table 4. Investment Performance of ESG+Fundamentals+Efficient Weighting vs Benchmark, Source: Stance Capital, 2017

	Stance Equity	S7P 500 TR
Cumulative Return	45.42%	41.10%
Annualized Return	11.29%	10.34%
Standard Deviation	8.37%	10.10%
Sharpe	1.35	1.02
Alpha	4.51%	0.00%
Beta	0.64	1.00
Treynor	17.57%	10.34%
Max Drawdown	4.61%	8.36%
Up Capture	81.7%	100.00%
Down Capture	51.22%	100.00%
R-Squared Adjusted	59.23%	100.00%
Correlation	0.78	1.00
Downside Deviation	2.37%	2.83%
Value at Risk	-2.99%	-3.74%
Sortino	72.91%	54.89%

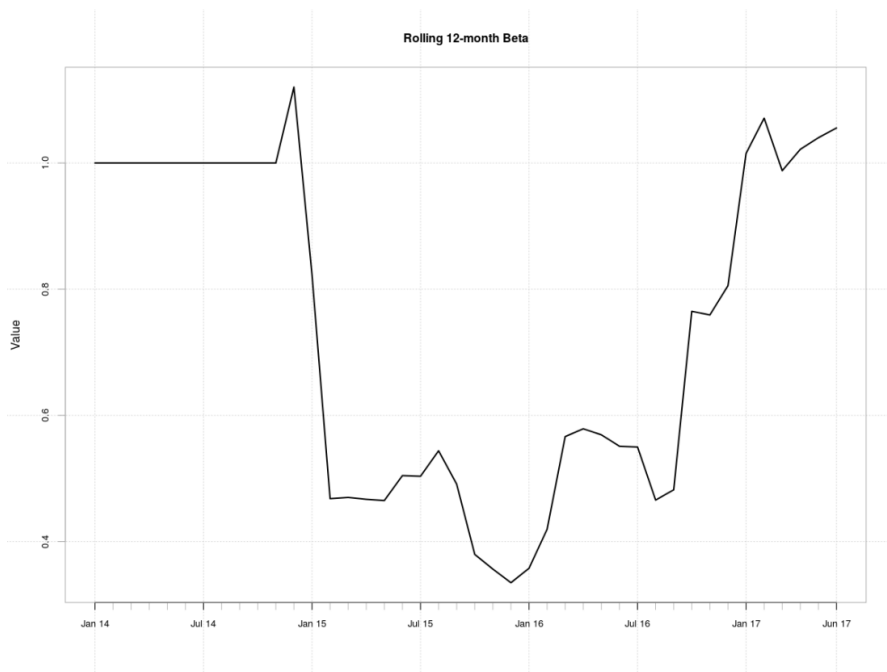
Looking at the rolling alpha (single factor vs the SP500), in Table 4, we see how the product has generated positive alpha in most periods net of fees.

Figure 4. Rolling Alpha



Looking at the rolling beta (single vs the SP500) in Figure 5, the ESG portfolio has run a lower beta for most of the period.

Figure 5. Rolling 12 Month Beta



Finally, we perform Fama-French Regression in order to identify if we are outperforming due to manager skill or some other factor in Table 5.

Table 5. Fama-French Regression

	Estimate	Std. Error	t value	Pr(> t)
(Intercept)	0.0049690906	0.0025231995	1.9693609836	0.0562343451
Mkt.RF	0.0060868267	0.0008425365	7.2244068435	1.22482436163804E-008
SMB	0.0002779498	0.0010044042	0.276731006	0.7834863845
HML	-0.0010309457	0.0009493289	-1.0859731058	0.284332129

What we can see is that the alpha is significant at the 10% level and the most significant factor in explaining our returns is the market risk premium with the size and value factors not useful.

We see an alpha that is slightly significant at the 10% significance level, which may be an artifact of our low sample size or potential over fit from the other two factors, however our single factor alpha is significant at the 5 percent level. We have back tested portfolios using gender diversity, carbon, water, and as long as the weighting is optimized using non-market capitalization schemes, investors can expect outperformance over a longer period.

Conclusion

With over 1750 asset owners and manager signatories from 50 countries representing \$70 trillion aligned around the Principles for Responsible Investment, incorporation of ESG data into investment portfolios is on the rise and likely here to stay. This said, considering the scope and scale of ESG, it is surprising that the value of ESG appears to be both misunderstood and poorly positioned. Our view is that good ESG behavior (around material issues) is a proxy for good management, but that is all it is. Other variables (including cost) being equal, most investors would rather invest in a well-managed company, as doing so will likely mitigate future tail risk, and further position the investment for long-term out-performance.

But portfolio managers are largely incentivized (compensated) for near-term results, and given it's not clear that ESG considerations will provide an immediate performance edge, managers that don't buy into the benefits of ESG are not being penalized for their point of view. Nor do they fully understand the potential of ESG.

The ESG screen and split field test presented in this paper demonstrates the ability to generate compelling risk-adjusted and absolute out-performance using ESG criteria. Given the limited role ESG selection criteria has played in the performance of our use case, we were able to model similar risk-adjusted and absolute benchmark out-performance across a range of values based strategies including: gender, faith, and low carbon. As long as

ESG criteria mimics random security selection, ESG factors can be used to split an investable universe, which can be expected to outperform the benchmark when combined with fundamental value screens and risk efficient weighting.

This is a powerful result as it allows portfolio managers to create portfolios that take into account the preferences of their clients while also being able to generate excess after fee returns. These results imply that if investment managers can provide non-financial utility in the form of better ESG impact for their clients, ESG investing is no longer a question of “why,” but “why not?”

This study adds to the growing body of work around the value of ESG integration in that it demonstrates the potential for ESG outperformance, while placing ESG factor integration within the context of its utility, which is the ability to align capital with values without sacrificing performance. And the extension of this learning is that the values need not be limited to ESG, but can include any other ethical preferences as well.

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