

## Bull & Bear

### Gavin Smith on Specialist



(IA) Specialist: Over three years

	3yr % chg	Rank	Vol monthly	Fund size (£m)	Morningstar rating™
<b>Top 5</b>					
<b>First State Indian SubcontnAllCap</b>	107.60	1	7.11	8.70	
<b>Neptune Russia &amp; Greater Russia</b>	96.67	2	4.42	195.47	★★★★
<b>Pictet-Russian Equities</b>	88.90	3	5.52	429.82	★★★★
<b>HSBC GIF BRIC Markets Equity</b>	88.06	4	4.72	120.63	★★★
<b>HSBC GIF Brazil Equity</b>	85.41	5	9.53	259.84	★★
<b>Bottom 5</b>					
<b>Waverton Absolute Return</b>	-3.53	189	0.71	32.74	
<b>LF Waverton Alternatives</b>	-3.75	190	0.73	37.38	
<b>SGW Global Gold &amp; Res</b>	-10.74	191	7.54	44.97	★★★★
<b>TC South River Gold and Prec Mtls</b>	-13.15	192	6.80	2.21	★★★
<b>Junior Gold</b>	-34.75	193	10.17	11.05	★
<b>SECTOR AVERAGE</b>	<b>32.95</b>		<b>3.78</b>	<b>602.25</b>	

Performances calculated bid to bid, net income re-invested, GBP to 01/06/19. Source: © 2019 Morningstar.

The popularity of ESG investing has grown significantly in recent years. Strong ESG practices, such as a higher-quality board and management team; a diverse, skilled and stable workforce; and efficient use of resources (such as energy and water) can lead to higher and more persistent profitability for a firm.

Perhaps surprisingly, however, there is limited evidence that ESG insights can produce alpha for investors. Why is it a challenge for investors to generate higher returns from ESG?

Put simply, the benefits from readily observable ESG attributes are already priced in. This means many companies' stock prices already reflect their ESG benefits. Investors need to be more refined in their search for ESG, focusing on insights undervalued by the market.

A further challenge for investors is that companies can engage in ESG window-dressing. These companies that look attractive from an ESG perspective may in fact be 'bad' companies. In order to generate ESG alpha, investors need to be able to avoid the threat of alpha dilution posed by such traps.

The growth in ESG investing also puts pressure on all firms to improve their ESG practices. If all firms improve, we will see a compression of ESG standards across the market. Less dispersion in ESG standards, although beneficial to the populace, unfortunately equates to lower alpha potential.

To help investors overcome these challenges, more and higher quality ESG data is needed. If more

### Bull Points

Stronger ESG practices attempt to produce stronger and more persistent profitability for a firm

To unearth ESG alpha, investors need companies to disclose more and higher quality data

### Bear Points

Most ESG insights have limited alpha potential

ESG window-dressing and a compression of ESG standards across the market are additional obstacles to the generation of ESG alpha

companies disclosed more ESG data, particularly using similar metrics to peers; allowed their ESG data to be audited and released information on a more regular basis, investors would stand a fighting chance of unearthing alpha from ESG.

Investors may also need to rethink how ESG is evaluated. It would help to focus less on the effort a company exerts (such as policies and committees) and more on the measurable impact of their behaviour. Here, alternative (or big) data could help generate the necessary ESG insights.

Ultimately, ESG investing is still in its infancy. Deeper, critical thought and more refined approaches are needed to capture any ESG alpha that is available.

Gavin Smith is managing director and client portfolio manager at QMA