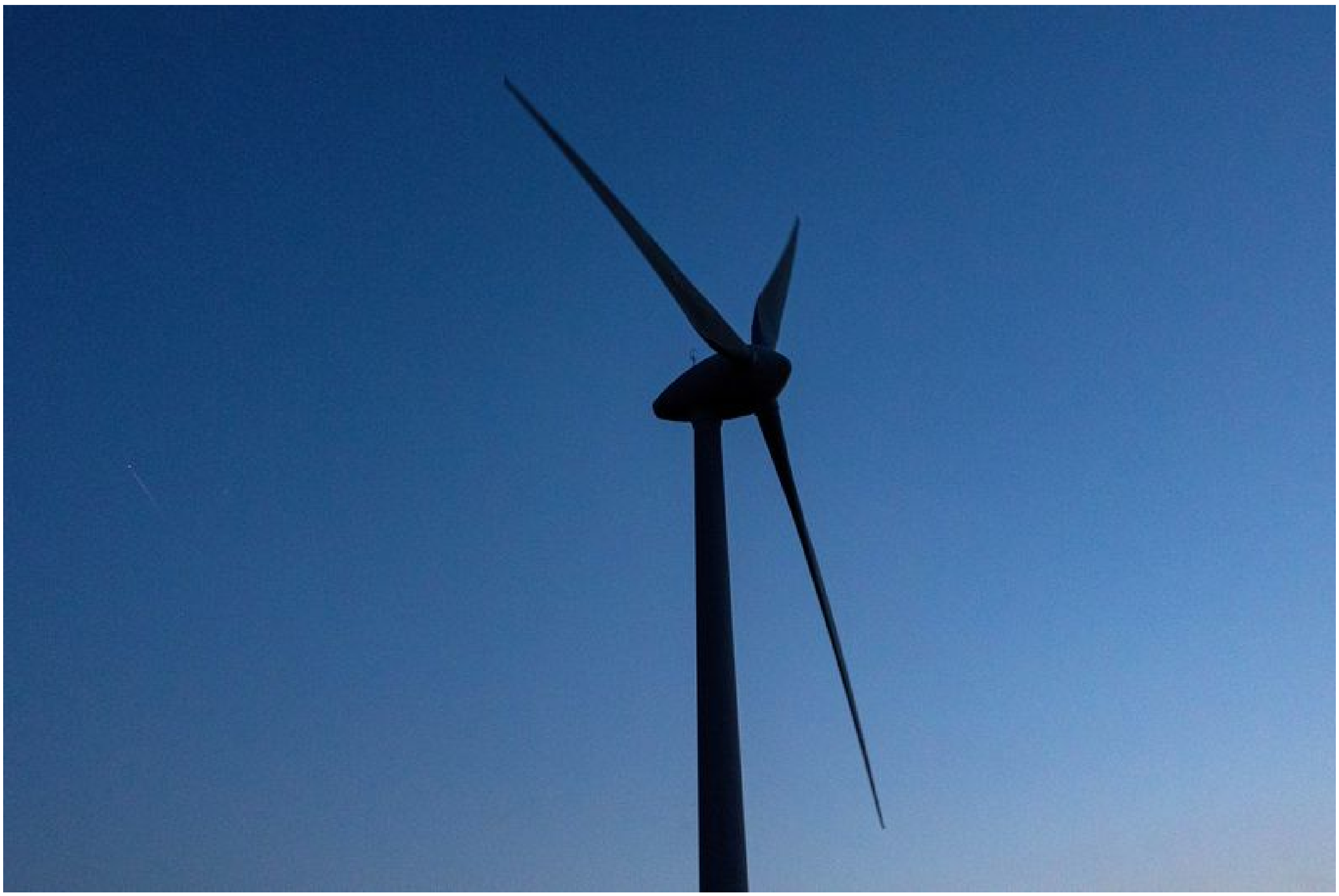
Green

ESG Investing

How ESG's Reckoning May Eventually Pay Dividends

Greenwashing and middling returns bedevil the investing strategy now, but some see a better future for the unification of sustainability and finance.



Photographer: Krisztian Bocsi/Bloomberg

By Tim Quinson
June 29, 2022, 6:00 AM EDT

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A lot has been written lately about how ESG is in crisis. At best, critics see the embattled investment strategy at a critical crossroads; at worst, they judge the inexorable primacy of Wall Street greed over species survival as having doomed it from the start.

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Roughly $2.7 trillion sits in funds that claim to focus on financial risks tied to the environment, social issues and corporate governance. While investors were already skeptical given all the spectacular examples of marketing sleight-of-hand and brazen greenwashing, this year's bear market has induced more scrutiny of one of ESG's financial promises, namely that it helps limit losses in downturns.

Regulators are circling, investors are starting to flee ESG-labeled funds, and politicians and even some billionaires are questioning the industry's relevance. Analysts at Credit Suisse Group said the possibility of asset outflows is "a real risk" in the second half of this year, particularly with interest rates rising around the world.

QuickTake: A Basic Guide to ESG Investing and Why it Faces a Backlash

But not everyone is writing ESG's epitaph just yet. In fact, some see good coming out of ESG's current trial by fire.

Yale University professor Todd Cort and Georg Kell, chairman of Arabesque asset management, wrote in an opinion piece published by Barron's several months back that the debate about "the validity of ESG heralds not the end of ESG investing but instead a transition toward major improvement."

Cort reiterated Friday that ESG isn't going away. The combination of regulatory and technological changes, the impact of the climate crisis and evolving social norms will make ESG factors even more important going forward in assessing market valuations, he said in an interview.

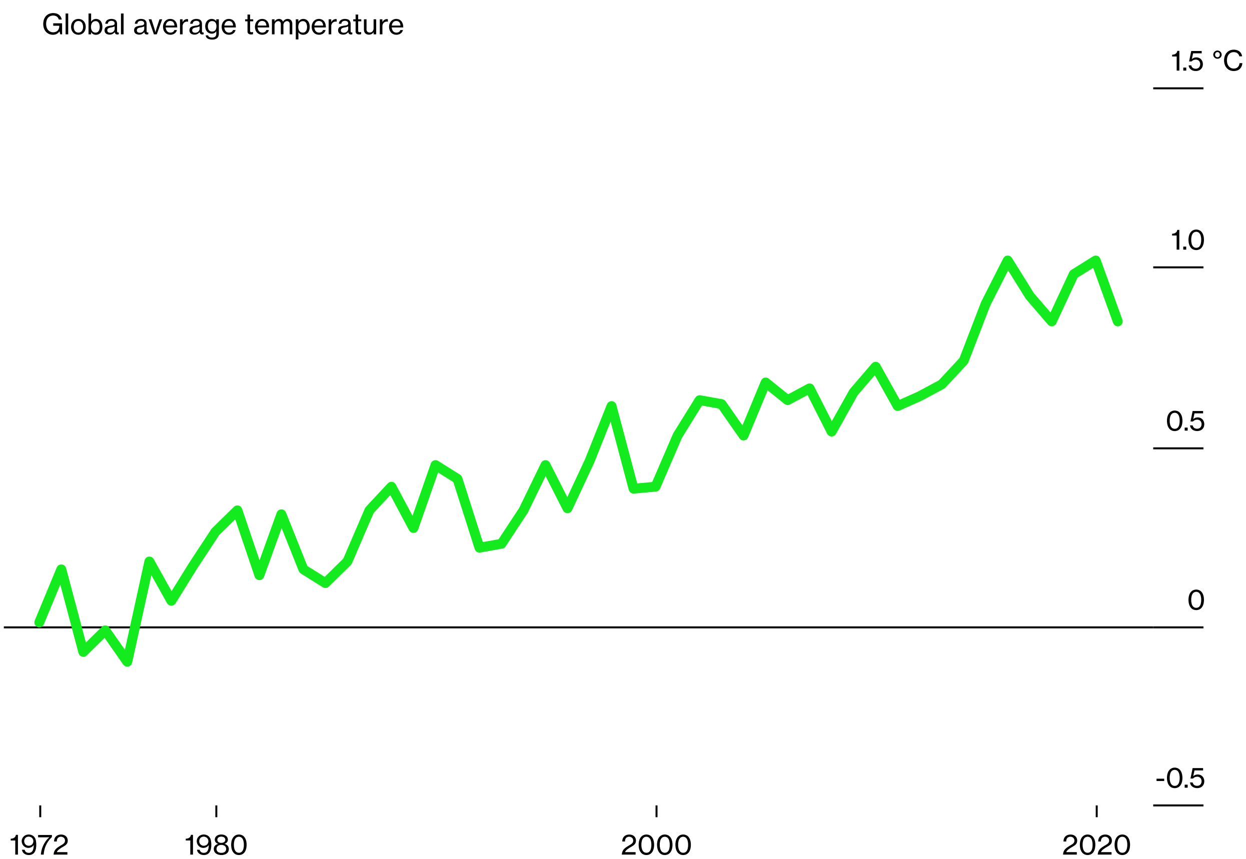
While the link between ESG and financial performance is difficult to assess in the short term, the opposite is the case over the long term because companies' failure to decarbonize their operations will cause “enormous and potentially irreversible damage,” Cort and Kell wrote in their commentary, entitled “ESG 2.0 Is in the Making.”

Moreover, there is a real danger that the current backlash against ESG will slow the movement of capital toward more sustainable investments just as that money is most urgently needed, they said.

A report released in February by the world’s top climate scientists certainly painted a depressing picture. It said the breakneck speed of global warming far exceeds the pace of efforts to protect billions of vulnerable people. The consequences are dire, including an increase in heat-related illness and death, with more food-borne and infectious disease.

50 Years of Heat

Emissions have warmed the atmosphere about 1.1°C since the 19th century



Source: NASA GISS

Many companies are developing “smarter, cleaner and more agile” business models to address the climate crisis and this adherence to ESG will play a central role in the energy transition, said Cort, who is faculty co-director for the Yale Center for Business and the Environment and the Yale Initiative on Sustainable Finance.

He singled out three companies for what he described as their successful ESG capabilities: Hannon Armstrong Sustainable Infrastructure Capital Inc., Unilever Plc and Natura & Co.

Hannan Armstrong will benefit from its links to the solar industry that will prosper from government subsidies as countries take steps to improve energy infrastructure, Cort said.

Unilever is known worldwide for its sustainable consumer brands, while Brazil-based Natura is unique among companies located in non-OECD countries for having strong risk-management systems that are committed to address ESG challenges, he said.

"While the potential slowdown of capital in the short term isn't great considering society's need, it will allow the market to clarify and focus on which ESG aspects are financially material in the long run," Cort said.

Bloomberg Green publishes Good Business every week, providing unique insights on ESG and climate-conscious investing.