THINK WORLD CLASS

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by Sanlam

Making a difference through responsible investing

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The Sanlam Investments Multi-Manager research team provides manager research capabilities to Glacier Invest as its investment partner. For more on Glacier Invest, visit glacierinvest.co.za.

Sanlam Investments' 2023 Sustainable Asset Manager award is a testament to the Group's outstanding commitment to incorporating environmental, social, and governance (ESG) principles into our investment decisions, as well as our dedication to becoming Africa's leading sustainable investment house. For Sanlam Investments' Multi Manager (SIMM), the award underlines our ongoing promise to our clients to deliver value through responsible and sustainable investing practices. We are one of South Africa's largest multi-manager teams, adopting a deliberate strategy to incorporate ESG investing into our decision-making processes to reduce risk, seize opportunities, and advance sustainable investing. In this article, we will be exploring trends impacting ESG factors as well as how SIMM incorporates these sustainability principles into our portfolio management processes.

Understanding the ESG paradox

The investment industry has been shifting towards responsible investing since its inception in 2006 and has since shown both strong assets under management growth and positive asset flows. Over the past 18 months, the ESG framework has come under increased scrutiny, with anti-ESG sentiment gaining momentum on the back of tough times characterised by geopolitical wars, economic uncertainties, and social upheavals. The "ESG paradox" arises from the tension between financial objectives and sustainability goals.

Economic downturns, recessions, and financial crises across the world have created a sense of urgency for short-term financial gains impacting ESG investing. The hard reality is that many ESG funds underperformed in 2022, having previously outperformed for the same reason – their concentration in technology stocks – and while investors like the idea of sustainable investing, they appear to be conflicted between ethical and practical investment motivations.

Geopolitical tensions such as trade wars, sanctions, and political instability require investors to carefully navigate the risks presented. When looking at the Russia-Ukraine crisis that began in 2022, for example, we saw many managers sacrifice their ESG values in search of superior carbon-intensive returns. ESG-cognisant managers who have typically been underweight in oil and gas companies have seen their portfolios struggle relative to their counterparts who have proposed a short-term boost to the sector despite its broad support for net-zero objectives. Ironically, inflated oil prices may incentivise oil and gas companies to invest a portion of their profits into clean energy technologies and pursue net-zero goals with more rigour. We must therefore start decarbonising portfolios to stop driving some of these risks. The sooner we start, the easier the transition; the longer the delay to decarbonise, the more extreme the carbon reduction required will be, resulting in an even bigger shock to the portfolio.

Globally, we have seen an increase in social unrest movements for justice, and growing wealth inequality brings social issues to the forefront. By factoring ESG principles into their decision-making, investors have the opportunity to support companies that demonstrate a genuine commitment to addressing social concerns. Companies are now being asked to take positions on nearly everything, from climate change and racial, gender, and LGBTQ+ equality to autocracy and misinformation. Companies are no longer able to retreat to the sidelines as these ethical concerns need to be addressed head-on.

Engaging with companies and exercising active ownership rights is a powerful tool for navigating the ESG paradox. Shareholders can advocate for improved ESG practices, transparency, and alignment with sustainability goals. In South Africa, the increased reporting of governance failures in a number of entities, like Steinhoff, VBS Mutual Bank, EOH, and Tongaat Hulett among others, has meant that the inclusion of ESG factors into the investment process should not be seen as a value destructive tick-box exercise, but rather as a step towards doing the right thing and achieving superior long-term investment returns. In these instances, we observed that funds that were exposed to these companies' shares paid the price in performance and the reputations of their managers.

The case for ESG investing

Results from the Sanlam ESG Barometer indicate that ESG investments globally are expected to reach US$53 trillion by 2025, close to a third of projected total assets under management globally. In fact, the importance of ESG was highlighted in a survey conducted by PWC in 2021 where 79% of investors said that "ESG risks are an important factor in investment and decision-making" with a further 49% of investors said that they are "willing to divest from companies that aren't taking sufficient action on ESG issues. Research from The Economist Intelligence Unit (EIU) has also found that younger generations are more concerned about companies' ESG performance than older generations. As a result, younger investors are increasingly considering ESG factors when deciding which companies to invest in.

Applying ESG factors to portfolio management

By leveraging the expertise of specialised investment managers, a multi-manager approach to ESG investing enables broader diversification, access to specialised knowledge, and active engagement with investee companies. It allows investors to benefit from the ESG integration capabilities of multiple managers while achieving their sustainable investment objectives.

At SIMM, we do not directly analyse underlying securities, but rather mandate investment managers to carry out the function on our behalf. Our emphasis is on how investment managers approach and implement their ESG mandate.

Once the investment manager is selected, SIMM constructs a portfolio by allocating capital across different managers or strategies considering diversification across geographies, sectors, and asset classes to mitigate risks and capture various ESG investment opportunities. The portfolio construction process aims to achieve the desired risk-return profile while ensuring alignment with ESG goals.

Each investment manager within the multi-manager portfolio incorporates ESG factors into their investment process.

SIMM emphasises active ownership and engagement with investee companies. We encourage investment managers to exercise their shareholder rights, vote on ESG-related resolutions, and engage in dialogue with company management. Active engagement aims to influence corporate behaviour, improve disclosure practices, and drive positive change in companies' ESG practices and performance.

We follow a scoring process to assess how each asset manager incorporates ESG factors into their investment process, strategy, and mandate requirements, monitoring the actions taken by the asset manager thereafter to ensure ESG compliance.

The shift towards sustainable investing

ESG investing represents a fundamental shift in the way investment decisions are made. It recognises that financial returns alone aren’t sufficient in today's complex world, where environmental, political, and social challenges are pressing. Choosing ESG investments ensures investors’ portfolios are prepared for the changes that must occur to make the global economy more sustainable, like reaching net-zero emissions by 2050.

We embody the hope that one day, sustainable investing will simply be considered “investing”. After all, when we invest in making the planet a safer, more sustainable, and productive place, we all benefit.

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