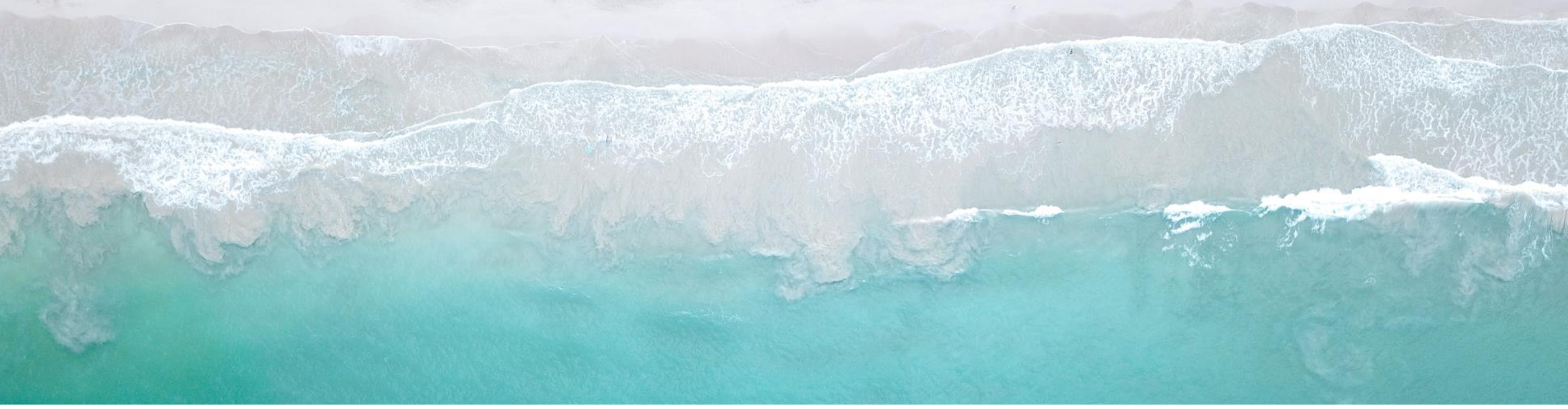

BUSTING MYTHS AND AVOIDING CROWDS TO GO LONG-SHORT ON ESG

Among the misinformation surrounding ESG investing is the idea that shorting is irresponsible. Impact Cubed would like to bust that myth and point out that if ESG is good for long only, it is doubly good for long-short. But only for investors that act soon, while risk premia do not yet reflect future realities.

It has been argued – largely unsuccessfully – that a manager who takes short positions in companies falling down on ESG metrics are profiting from organisations that pollute more, avoid paying their employees' health care benefits, or externalize other operating costs onto taxpayers (rather than shareholders). For example, if Company A does not meet its emissions-reduction plan, and its share price suffers, then holding a short position in the firm brings with it a return. A responsible investor could therefore profit from an organization continuing to operate unsustainably.

This is a one-dimensional – and incorrect – way of looking at the matter.

Society is going through a necessary transformation. It's not only climate action – we also need to address social inequalities, ensure we have adequate health care for aging populations, maintain our natural resources and preserve biodiversity and native habitats. Publicly listed companies are a big lever in these transformations.

Facilitating these transformations is about finding new technologies and moving capital away from operations that are causing harm. Investors can be powerful fuel to speed up the change. By shorting businesses that are harming the environment or societal health while also investing in those that are finding solutions for global problems, capital is doubly diverted - away from unsustainable businesses and towards those that can help create a more sustainable society.

It is argued that this dynamic can be achieved by simply going long-only with an overweight to ESG-focused securities. There is some truth in this. An active manager underweighting bad ESG stocks relative to a conventional market benchmark is effectively "shorting" those companies.

The reality, however, is that most benchmarks are market cap weighted so underweights to small-cap names don't add much to a portfolio's impact. Taking short positions in these companies, on the other hand, could have a much more pronounced outcome, both in investment performance and in moving capital to flee unsustainable companies.

As ESG investing has grown in popularity, trades for “green” companies have become crowded. But for now, much of the “brown” in the short side is untapped with industries such as steel, dairy farming, and concrete being potential targets.

Backing better solutions while funding those trades with stocks representing part of the problem is also an underexplored opportunity. For example, a manager looking to invest in sustainable food supplies may choose a long basket of securities focused on plant-based foods while shorting firms that produce more carbon-intensive animal-based products. Likewise, a portfolio could be constructed focused on consumer health – backing companies seeking to improve people’s wellbeing and shorting those producing products with negative health consequences, such as firms focused on tobacco, fast food, or gambling.

Ultimately, a long-short strategy can help facilitate the movement of capital away from harmful operations and towards those offering solutions, allowing managers to avoid crowds and generate greater value by taking full advantage of sustainable trends.

ABOUT IMPACT CUBED

Impact Cubed provides ESG analytics and investment solutions for building more sustainable portfolios with greater impact. It combines an award-winning approach to integrating impact into risk and return with technology-enhanced portfolio design and management. The outcome is a seamless approach to customized sustainable investing.

You can find out more about our data and portfolio models at www.impact-cubed.com and if you would like to contact us at info@impact-cubed.com we would be happy to hear from you.