

BANOR AND SUSTAINABILITY

ALL THAT GLITTERS IS NOT ESG “AND WE IDENTIFY THE REAL SECURITIES”

By Sergio Luciano

We are quick to say ESG: it is the new mantra of big international finance, it is the criterion indicated by BlackRock as the "North Star" for its investments and endorsed by the American Roundtable, but it is also a financial trend and, as such, is susceptible to retracement. The top Italian AMC able to speak on the subject with full credibility is surely Banor, which has followed sustainable criteria in its asset allocation since more innocent times and knows exactly why they matter, beyond the trend. "Our job is to separate form from substance", *Investire* was told by **Angelo Meda**, Head of Equities and ESG Research Manager for Banor SIM, "by removing all metrics that are not significant, but often communicated in full regalia by companies so that good things are said about them, and by focusing on those that have a tangible impact on financial performance, which guides the valuation of companies in the long term".

So choosing ESG criteria pays off?

The pandemic is bringing forth a series of structural changes in many parts of our lives. In the financial world, among other things, it has brought increased attention to sustainability issues. This is seen by the trend in the number of ETFs/specialised funds that were already growing before 2019 and further accelerated parabolically in the months following the arrival of COVID. From a superficial analysis, it would appear that investing with some simple best-in-class or exclusion ESG filters leads to better results. For example, if we look at the return of the MSCI Europe ESG index since year start, we see an outperformance of around 10 percentage points with respect to the non-ESG equivalent. If, however, we extend the analysis horizon to 10 years, we see that the same ESG index actually had a lower return, in spite of this strong recovery since year start. As a matter of fact, in the short term, like all speculation, focus on sustainability issues can lead to high performance because of significant incoming financial flows for a number of securities, but if they are not followed in the long term by financial returns and tangible performance on the key sustainability indicators in the respective sector, this effect diminishes quickly and risks moving into greenwashing territory.

Insurers say that compliance with ESG principles offers strong support for risk management and therefore qualifies companies that practice this as reliable over time. Do you agree?

ANGELO MEDA WEIGHS IN: “WE ARE AWARE OF WHICH METRICS ARE RELEVANT FOR FINANCIAL PERFORMANCE”



ANGELO MEDA, HEAD OF EQUITIES AND ESG RESEARCH MANAGER FOR BANOR SIM

It is correct, even if this is only one side of the story, especially in terms of equities. Various studies, including our study in 2018 in collaboration with the Politecnico di Milano, show that companies with a better ESG rating have seen less volatility in the return on capital and higher stability in profits and dividends, therefore making them a less volatile investment. However, it is not enough to use the ESG analysis as a mere tool for risk management. It is also necessary to consider the long-term creation of value deriving from the adoption of ESG good practice in order to see the other side of the story and identify which companies are able to capitalise on the opportunities created by this. In terms of bonds, on the other hand, ESG analysis is an excellent tool for risk management. Given the characteristics of bond instruments, where the main risk is associated with the issuer's default and can therefore be considered an asymmetric risk (i.e. a large loss, albeit with a small probability of occurrence), adding an analysis of the issuer's sustainability makes it possible to further define the risk of the instruments in the portfolio.

BANOR SIM

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In environmental and social terms, however, the increasing levels of commitment required by ESG compliance opens enormous gaps in social and legal dumping. Faults which the West has done very little, until now, to counter and has often even used them to its advantage. How can things be improved?

When a market segment literally sees a boom in interest, it is normal for opportunistic behaviour to appear from what you might call the “sly foxes on the block”. Even in the ESG world, with milder practices such as greenwashing or more serious ones like social dumping, we are seeing a series of unedifying conduct from market participants, regardless of their role as issuer or asset manager. The ideal solution would be a higher level of awareness from the end, retail or institutional investor about these questionable practices, which lead to a negative image with the related consequences for guilty parties that only use ESG aspects to their own benefit without integrating them into their strategy. Intervention from the legislator, especially when seeking to create clarity with initiatives like the European Taxonomy, should make these key issues clearer, thus leaving the market with the freedom to self-govern based on the evolution of the ESG world, which is still at its very early stages in terms of academic and non-academic research.

Let’s talk about Banor. How are you getting on and what strategic lines have you chosen for post-COVID?

Banor is continuing its path of growth that it began 20 years ago. Values such as independence, transparency and sustainability have proven, like in all previous crises, to be very important in demonstrating the focus that we have towards customers, by earning the loyalty of existing customers and continuously bringing in new ones. As in all sectors, it is necessary to continue investing in order to remain one step ahead of the competition. In the asset management sector, investing means hiring new people and spending time—the scarcest resource that we have at our disposition—on research so that we can continuously refine and improve our analysis and investment processes. From this point of view, the ongoing and long-standing collaboration with the Politecnico di Milano School of Management is important, in that it brought about a Sustainability Observatory that produces regular academic studies and supports the upcoming Master's in Sustainable Finance. This year, the study in collaboration with Professor Giudici shows that, not only is the absolute level of the sustainability rating important, so is its trend over time. There is, therefore, a relationship—which is very important for the high yield bond asset class—between

FOR US, ESG ANALYSIS IS AN EXCELLENT TOOL FOR RISK MANAGEMENT

performance and the improvement/worsening of the sustainability rating of companies, thus requiring a dynamic and forward-looking analysis similar to the traditional financial analysis even for sustainability issues.

Now let’s talk about the current economic scenario. The Monetary Fund has broken the taboo of restructuring excessive debts, but could we live with the maxi-debt that the entire West has accumulated over these months or should we intervene with extraordinary measures?

The last recessions brought about a sharp increase in international public debt, transferring debt from the private to the public sector. The United States, for example, will return to over 100% of debt/GDP, values it only ever reached after the Second World War. There is, however, no magic number, no debt/GDP value beyond which restructuring should be triggered. Compared to the past, in fact, the central banks hold an increasingly higher portion of public debt, a share that ranges between 15% for the USA and 44% for the Bank of Japan. There is no historical precedent for this situation, but the initial thought in the event of a sovereign debt crisis would go to the monetisation of debt, i.e. freezing or cancelling what is held by the central banks. This is something that is categorically excluded by the most virtuous countries, such as Germany, but it could be necessary in an emergency given the financial interactions between economies that would not be able to support the weight of some government defaults. The issues touched upon by the International Monetary Fund, i.e. more transparency around public debt, more realistic future economic growth estimates and new legislation for restructuring are moving towards creating a more favourable environment for a more orderly restructuring than what took place recently, with the case of Argentina and its ongoing legal aftermath. Nevertheless, it is likely that we will have to live with higher levels of debt than in the past and with new solvency indicators, for example public debt not held by the central banks.