ALASKA HIGHWAY NEWS

Brad Brain: Tell me more about this ESG investing

Brad Brain / Alaska Highway News
AUGUST 24, 2020 01:33 PM
Smart Money

Brad Brain: "ESG investing is a newer term, but it is not a new concept. Previously these types of products were more commonly referred to as 'socially responsible' investing. While they have been around for decades in one form or another, they haven't really gained the traction that some people feel they should have."
Photo By GETTY IMAGES

So what is meant by ESG investing? Well, as a matter of fact, that's a really good question.

The short answer is that ESG stands for environmental, social, and governance. It is laudable to invest in a way that is intended to encourage positive social change.

But, like many things in life, ESG investing isn't always quite so simple.

What got me thinking about this topic was when I attended an investment conference and we took a look at a "Low Carbon" exchange traded fund. Indeed, that was the name of it: "Low Carbon." As it turns out, one of the investments inside the "low carbon" exchange traded fund was Shell, an oil and gas company.

Believe it or not, including Shell in a low carbon ETF is a very defendable decision. Shell does a lot of work in natural gas, and natural gas is a green decision when you compare it to alternatives, especially coal.

Still, I fully expect that a lot of people that would be attracted to a "low carbon" ETF would be surprised and disappointed to find that they actually owned Shell stock. And 12 other oil and gas companies.

And, for what it's worth, a couple of cigarette manufacturers and a big agricultural chemical company.

ESG investing is a newer term, but it is not a new concept. Previously these types of products were more commonly referred to as "socially responsible" investing. While they have been around for decades in one form or another, they haven't really gained the traction that some people feel they should have.

Historically the biggest concern has been product performance. While supporters will claim that ESG investing should not lag other investment options, there have been performance issues with at least some ESG products. If nothing else at least the perception of lagging performance is probably the main reason why ESG investing has not seen more uptake. It's probably fair to say the jury is still out on whether ESG investing does not have to come at the sacrifice of performance.

But performance is not the only question mark. When you have oil and gas companies in "low carbon" portfolios, how do you even define ESG? Clearly it takes more than a superficial labelling.

One of the holdings in an ESG fund that I looked at is Berkshire Hathaway. To me, it is totally unsurprising to find Berkshire Hathaway in an ESG fund. It is a very well-respected firm that has acted admirably.

Yet I remember Berkshire Hathaway annual meeting I attended years ago, and there were a handful of protestors that were not in favour of a hydroelectric project that a Berkshire subsidiary was associated with. I think the strong consensus was the protest was unfounded, but for those few people I would expect that an investment in Berkshire would not be welcome.

When you really dig into an ESG portfolio, the issue eventually becomes we live in a world where everything is connected to everything. So while it is easy enough to screen out an arms manufacturer, do you also screen out the bank that they work with? Even if that same bank also works with other customers that do great things? Inevitability there will be some subjectivity involved.

The bottom line is that there are many nuances to ESG investing. I think a wise approach is to define what it is that the investor is looking for before jumping in. If someone wants a strict adherence to no fossil fuels then that "low carbon" ETF that holds oil and gas companies will be unacceptable, but it could be perfectly fine for an investor that defines making a difference in some other way.

Brad Brain is a Portfolio Manager with Aligned Capital Partners Incorporated (ACPI). ACPI is regulated by the Investment Industry Regulatory Organization of Canada (www.iiroc.ca) and a Member of the Canadian Investor Protection Fund (www.cipf.ca). This publication is for informational purposes only and shall not be construed to constitute any form of investment advice. The views expressed are those of the author and may not necessarily be those of ACPI. Content is prepared for general circulation and has been prepared without regard to the individual financial circumstances and objectives of persons who receive it.