The Importance of Profit and Sound Financing in Socially Responsible Investment

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Abstract: Socially Responsible Investment (SRI) has grown exponentially in recent years. The rising importance of social, environmental, and governance (ESG) aspects in decision making as well as in asset allocation is undeniable. However, important challenges must be addressed. The dramatic increase in ESG investments has coincided with a period of extremely low rates and massive liquidity injections. Also, the definition of socially responsible investment is too broad and can generate misunderstandings (an approximation to the correct definitions can be found in Sandberg et al., 2009). Additionally, I find that a significant part of funds that follow ESG principles can fall into the trap of investing in heavily subsidized and high-debt sectors. Investors should monitor the risk of concentration, the soundness of profit estimates, and strength of balance sheets to avoid rent-seeking and depending heavily on subsidies and grants. Furthermore, I find that performance of ESG and SRI funds has been monitored only in a period of low rates, high liquidity, rising asset valuations, and bullish markets. More tools have to be used to monitor risk as markets enter a consolidation phase. I find that it is essential to focus on real economic returns in a mid-cycle environment as well as monitoring excess leverage to avoid the risk of a very important reduction in ESG investments in a market correction phase for markets with rising interest rates. I conclude that strong fundamental analysis, diversification, and avoiding herd mentality are essential to prevent large outflows and a negative impact on ESG growth once the cycle changes.

Keywords: Socially Responsible Investment; SRI; ESG; impact investment; cost of capital; Shareholder Activism; downside risk; corporate governance; climate change; financial ratios; financial risk; financing; environment; social; governance

JEL Classification: G32; G34; M14

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Introduction

In broad terms, Socially Responsible Investment (SRI) can be defined as an investment approach that considers environmental, social, and governance (ESG) factors in portfolio selection and asset management. For the purpose of this study, the broad term that includes ESG and impact investing is considered. Impact investors represent a unique class of investors that differs from socially responsible investing, from other types of for-profit investors, such as venture capitalists and angel investors, and from traditional philanthropists (Roundy et al., 2017) looking to generate a measurable social or environmental impact. Impact investment looks to act in a similar way to that of social movements, and it looks not just to influence, but to practice change.

Although the definition of SRI can be broad and heterogeneous (Sandberg et al., 2009), I focus on the Global Sustainable Investment Association (GSIA) definitions of sustainable investment, which have emerged as a global standard of classification.

These are:

1. Negative/exclusionary screening: the exclusion from a fund or portfolio of certain sectors, companies, or practices based on specific ESG criteria;
2. Positive/best-in-class screening: investment in sectors, companies, or projects selected for positive ESG performance relative to industry peers;
3. Norms-based screening: screening of investments against minimum standards of business practice based on international norms;
4. ESG integration: the systematic and explicit inclusion by investment managers of environmental, social, and governance factors into financial analysis;
5. Sustainability-themed investing: investment in themes or assets specifically related to sustainability (for example clean energy, green technology, or sustainable agriculture);
6. Impact/community investing: targeted investments, typically made in private markets, aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose; and
7. Corporate engagement and shareholder action: the use of shareholder power to influence corporate behavior, including through direct corporate engagement (i.e., communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines (GSIA, 2017).

Global responsible investing totaled US $23 trillion in 2017, a rise of 25% since 2014. Additionally, the global green bond market is estimated to reach US $250–300 billion in 2018, up from US $155 billion in 2017 (Goldman Sachs, 2018). Previously, global sustainable investment assets grew 61% from 2012 to 2014 (GSIA, 2017).

Despite a strong growth, SRI can be considered still a niche market. The SRI market share is above 10% in industrialized countries, but only because a broad definition is used. If only restrictive strategies are considered, SRI market share is considerably less (Capelle-Blancard and Monjon, 2010).

Some critics of social investment state that it reflects four characteristics of neo-liberalism: the de-politicization of the economy and of welfare reform; the economic understanding of the state; the extension of economic rationale to noneconomic domains; and the anthropology of human capital (Laruffa, 2017). The evidence suggests the opposite. SRI investment has been a fundamental driver of improvement in infrastructure, water supply, and clean energy and has proven to be a major force in the constant improvement in corporate governance. Furthermore, detaching economic rationality as well as real economic and shareholder return from SRI makes it vulnerable, and causes more damages than benefits, as it leaves behind debt, malinvestment, and negatively impacts future investments. Total shareholder return becomes the most powerful tool for the ongoing success of the economy and for progress (Bainbridge, 1993), and it is exactly the same in ESG and SRI.
The main criticism seems to come from a view that financial and social logic are not complementary but opposite. History shows the opposite. Although the term social investment is relatively new, the reality is that most of the economic decisions made in history have embraced profit and social content, as the first would simply vanish once a majority of members in society finds that the activity is negative for its wellbeing. This negative view of profit seems also to come from a perception of the negative implications of monopolies, ignoring that such monopolies cannot exist without the support and acquiescence of governments. Financial logic complements social.

Investors find that there is a way to generate profits and contribute to change, and this creates a virtuous circle by which the entire economic ecosystem improves its ESG factors, and more capital is deployed for social and environmental change. Investors select stocks, bonds, and private equity based on social and ethical considerations and use their power as a shareholder or bondholder to communicate with companies and convince them to make positive social changes, from environmental practices to human rights. This is not only limited to quoted and large investments. Investing in the community helps make a difference locally (Domini, 2001).

Defining the boundaries and depth of SRI and ESG must be a conscious work on the part of financial institutions. Sustainable investing requires an evaluation of a fund’s values and investment beliefs. Values distinguish the investment mission and goals of a fund; beliefs distinguish the investment strategy (Hall, 2018). That is why it needs to be properly explained to investors and fund participants. There may be a varied and wide understanding of what SRI means. For example, I find that many funds do not invest in fossil fuel companies, and coal seems to be a clear barrier to investment. However, it is different in natural gas because of its importance in the process of decarbonization.

However, much work needs to be done in order to continue to expand best practices and the positive impact of ESG. Studies also find a worrying trend. High social scores do not generate positive returns in Japan, and strong corporate governance yields significantly negative abnormal returns in Asia Pacific (Dorfleitner et al., 2013). This may be explained by the expectations of higher GDP growth and, in the case of Japan, the special interests historically assumed in corporations and their relationship with government bodies. However, I find that the more recent data show that Asia Pacific stocks and bonds that were usually outperforming despite low ESG factors have underperformed consistently in 2018. In the case of Japan, abnormally high expectations of growth due to the implementation of the government stimulus plan, called Abenomics, may have been a stronger factor in driving the performance of SRI funds, offsetting fundamentals and ESG components. This impact has also faded in the recent period that we cover in the analysis (2018 to November), as the market expectations of high growth and strong impact from demand-side government and central bank stimuli faded away. However, even in these cases, recent history shows that higher ESG factors positively affect the valuation and performance of companies, both through their systematic risk profile (lower costs of capital and higher valuations) and their idiosyncratic risk profile (higher profitability and lower exposures to tail risk) (Giese et al., 2017).

The importance of ESG engagement is more evident as a tool to reduce downside risk, and in times when investors are optimistic, these factors may appear secondary. However, there is empirical evidence that companies that successfully engage in ESG activities have lower exposure to economic losses and downside risk factors (Hoepner et al., 2018).

Another analysis that may help answer the criticism against the economic return-driven social investment is understanding the accumulation of social capital. Individual incentives, not group membership, drive social capital accumulation, showing that there are very little, if any, social multipliers (Glaeser et al., 2000).

In the debate about SRI there is always difficulty in analyzing social return on investment. Social Return on Investment (SROI) analysis is an outcome-based approach that corporations as well as Non-Governmental Organizations (NGOs) can use to evaluate the social value created by their investments and to forecast the potential value created by those investments (Moore, 2018). An outcome-based approach and an analysis of monetization of activities from different organizations can help understand the true social impact and real economic return of the projects and activities of an organization.
Since 2007, the funds under management in the SRI market alone in Europe have multiplied by 6 to 11 billion euros. The bond market and funds that only invest in companies that have the most demanding requirements of corporate social responsibility is growing, and investors demand that companies take more measures in environmental aspects, labor rights, and respect for human rights.

That is why, today, remaining in the rankings of Corporate Social Responsibility (CSR) is increasingly difficult. It is no longer enough to comply with a series of basic requirements, but each time the indexes carry out a more detailed follow-up of specific actions by the companies. Corporations are increasingly aware that CSR can play a valuable role in ensuring that the invisible hand acts, as intended, to produce the social good. It can also act to improve corporate profits and guard against reputational risks (Heal, 2004). The important factor is understanding CSR as more than a public relations campaign or a cost center, but as an investment.

In addition, competition is very important. In 2018, a record number of 993 companies participated in the RobecoSAM Corporate Sustainability Assessment (CSA, 2018), the leading survey in this field. This represents an increase of 5.4% over the participation of 2017. This questionnaire is sent to the largest companies in the world and has been published for 20 years.

The Dow Jones Sustainability Index is one of the main indices when assessing the quality and social commitment of companies and includes those that demonstrate a better positioning in compliance with the criteria of sustainability and corporate responsibility.

For companies, investing in improving their processes and respecting the environment and social rights is evidently profitable, and for investors too. In analyzing corporate financial performance (CFP), roughly 90% of studies find a non-negative ESG–CFP relation. More importantly, the large majority of studies report positive findings, with the positive ESG impact on CFP remaining stable over time (Friede et al., 2015).

From 1990 to 2016, the social responsibility index (MSCI KLD 400) has given an average annual return of 10.46% compared to the S&P 500 of 9.93% per annum (Bloomberg, Marketwatch).

Additionally, every day there are more fixed income investment funds that put sustainability conditions in their investment decisions. The leading companies in the sustainability indexes are also financed in bond markets at rates lower than the average of their sectors, and with greater demand in their debt and hybrid instrument issuances. Integrating ESG investing into fixed income holdings is key in redirecting substantial capital to sustainable investments. Apart from the rapid rise and strength of the green bond market (Goldman Sachs, 2018), corporate issuers are integrating ESG factors—including more active engagement with issuers of debt (Levy, 2018).

As these indexes become more popular, it becomes more difficult to gain access to leadership positions, and competition is fierce. A large multinational cannot afford not to be in the social responsibility rankings and knows that investors value it increasingly. For this reason, investment in social and environmental aspects grows at double digits per year. This benefits society, and everyone—from investors to companies—sees benefits with an evident multiplier effect. I find that there is evidence of the positive impact of this growing competition to access sustainability indices (Lacalle, 2017).

The growing importance of ESG factors in corporate management as well as investment decisions is a strong driver of change. Investment decisions at fund and company levels are increasingly adopting the best practices of ESG requirements, and this trend is unlikely to stop. Not just because ESG factors are popular or because it is a positive marketing factor, which they are, but because companies and funds are finding that profitability does not need to be compromised, and risks are greatly reduced. Companies find that investing without considering ESG does not generate higher profitability, but they also find that costs of not following ESG and socially responsible principles are rising, both from a corporate image perspective as well as in earnings, as fines and penalties reach multibillion US dollar figures. Only taking into account the top ten corporate fines shows a US $90 billion figure (Censible, 2017).

Direct costs include regulatory fines, out-of-court settlements, and the cost of product recalls. However, it is often the damage to company and/or brand reputation that has the larger and longer-term impact (EIRIS, 2007).
Socially Responsible Investment movements have proven to be a deciding factor in bringing SRI concerns into financial institutions and creating a positive force for change without rejecting economic rationality, and it is this factor that makes these new social movements successful at playing a prominent role in reforming economic and political institutions (Arjaliès, 2010). Furthermore, social movement organizations can play a key role in changing organizational landscapes and creating opportunities for the growth of new types of organizations (Hiatt et al., 2009). This has been an important force in the creation of new companies in disruptive sectors, but sustainability of cash flows and real economic return must remain as key pillars of the strategy in order to avoid the pitfalls of investing in ideas that never become realistic and sustainable businesses.

Investors have also seen the benefits of SRI and ESG in portfolios both in fixed income, as in equities or private equity, as shown in surveys (GIIN, 2018), and market studies from financial institutions and consulting firms (Goldman Sachs, 2018; Morgan Stanley, 2018; Schroders, 2017; Ernst and Young, 2017). The exponential rise in private equity investment in the past decade has been led by infrastructure and clean energy, and in 2017 private asset managers raised a record sum of nearly US $750 billion globally (McKinsey, 2018).

The subject of profitability and social investing has been discussed numerous times in the literature. However, I believe that there is not enough analysis of risk and concentration. While some authors argue that there is no clear link between SRI and financial performance (Sjöström, 2011), other studies show the opposite. These studies find evidence on the fact that European and North American stock portfolios with high Environmental, Social, and Governance scores show a significant financial outperformance in the long run, with the exception of the combination of governance and Europe (Dorfleitner et al., 2013). This is particularly interesting because European companies do tend to show high levels of governance and environment protection policies, but other factors have a larger impact on performance, such as the reality of the business models, low earnings growth, and comparatively lower margins as well as external factors such as the risks inherent to the Eurozone’s political landscape.

A significantly higher relevance of the impact of SRI comes from investing in the top stocks and shorting those with low ESG scores. This implies even higher abnormal returns for the investor (Dorfleitner et al., 2013). I find this is an important and often overlooked point. It is not just that companies with high ESG scores perform better in the financial markets, it is that stocks with low ESG scores perform consistently worse.

However, investors must pay attention to the risk of concentration, exposure to debt, and dependence on government subsidies. In the case of private equity and impact investing, this is more important than in liquid asset investing because the holding period, exit, and availability of opportunities differ dramatically from quoted equities and bonds.

The correlation between size, volatility, and performance is evident. Volatility of returns decreases with increasing size of deal. It is an important outcome, an indicator that investors have expertise in seeding, growing, and scaling social enterprises, and that they are able to manage risk effectively. Holding periods at exit have been about five years in both average and median terms, which is shorter than the approximately ten years of typical private equity deals. Deals yielded a wide range of IRR (internal rate of return) no matter the holding period (Exhibit 13). Viewed another way, this also implies that social enterprises with strong business models do not need long holding periods to generate value for shareholders (Friede et al., 2015).

The risk of noneconomic returns and highly subsidized investments is rarely analyzed in SRI literature, and it must be noted that rising deficit spending and governments’ reliance on debt to finance current spending are integral factors of the risk in investments that depend on government support. As such, I believe that analyzing the country’s risk and sustainability of public accounts should be a key factor in SRI investment. Governments that rely on deficit spending to finance rising current expenditure and ignore real economic return often find themselves in debt crises that have in the past led to regulatory cuts and increases in the weighted average cost of capital (WACC) for private investors. Lord Maynard Keynes warned about the risk of nonreal economic return government spending (Brown-Collier and Collier, 1995).

I have analyzed the portfolio construction, risks, and exposures of some of the leading SRI and ESG funds to try to provide a clearer picture of the risks of concentration, trend-following, and excess leverage.
Findings

The literature on socially responsible investment remains focused on the definition of what ESG and SRI really mean as well as returns. As such, there are numerous studies that show the evidence of solid profitability of ESG and SRI investments in a rising market and during a period in which central banks have expanded their balance sheets to unprecedented levels. I find that the analysis of the profitability of SRI funds in a period of abnormally low volatility, excess liquidity, and historically low interest rates might disguise significant levels of risk-taking that may compromise the growth in future investments and the reputation of SRI when markets fall and a significant correction reaches equities and, more importantly, private equity.

I will focus on the available data of concentration, risk, and leverage. I have analyzed a basket of SRI funds, both in equities and fixed income, with assets under management that exceed the US $50 billion figure, according to their combined public data, using the monthly and yearly investor newsletters that show volatility, main holdings, and key market metrics as well as the main holdings.

I find that the focus on financial returns alone misses several important factors. SRI should be sustainable as investment as well. Being as exposed to boom and bust cycles as other strategies is likely to cause more damage than benefit in the long run.

SRI concentration on climate change, which is around 80% of the total invested funds (GSIA, 2017; Schroders, 2017) also tends to disguise a heavy dependence on government subsidies and public spending.

Multiples paid for renewables (Deloitte, 2017) and infrastructure (Ernst and Young, 2017) are elevated and have been rising to all-time highs because of low rates and high liquidity.

Leverage ratios in the main holdings of ESG funds can be between 15% and 20% higher than on comparable names. This may be a function of more stable and regulated returns, but it must be considered when economic and credit cycles change.

However, at the fund level, I find that most SRI and ESG funds have lower leverage and Beta (market) exposure than the broad indices (I consider the MSCI World and S&P 500 as the main broad indices).

Despite this, volatility and Value at Risk of the funds I have analyzed are not significantly dissimilar to the broad indices. Only 10% of the funds analyzed show significantly lower volatility and value at risk levels than the average comparable institutional funds and indices. I assume that a significant difference is 20% or higher.

I believe the correction seen in markets in the period between September and November 2018 can be a very good example of future risks because:

(a) The correction has been widespread;
(b) It has been mostly driven by external factors such as liquidity reduction and rate hikes from the main central banks; and
(c) The impact of the correction has affected equities and fixed income alike.

I find that this period, although short, is a good example of what can happen in a more severe correction, even a recession or a crisis. As most of the scholar studies and empirical data for SRI and ESG funds are not available for the past financial crisis of 2008, there is very little evidence of the behavior, risks, and imbalances in portfolio construction of SRI funds. Most of them were created or saw the biggest rise in assets under management after the financial crisis.

Using the rise and market correction of 2018 as an example, I find that:

- From January to November 2018, volatility of the basket of SRI funds was 5% lower than the S&P 500, 12.5% lower than the Dow Jones Industrial Index, and, more importantly, almost 5% lower than the FTSE 4 Good benchmark. However, average volatility, at 14.4%, was only slightly above the MSCI World Index, although performance of SRI funds has been better than the MSCI World Index. Surveys indicate a similar trend, although returns are highly correlated to the broad markets (RIAA KPMG, 2018).
- All the analyzed SRI funds have underperformed the S&P 500 and the Dow Jones Industrial but significantly outperformed the Stoxx 600 and MSCI World Index. This is likely due to a portfolio construction that has historically underweighted US companies and favored European companies. I find that SRI investors should address the underweighted US equities and bonds, particularly as ESG factor improvement is significant and, in many cases, larger than in emerging markets. Surveys show that there is a risk of excess concentration (Morgan Stanley, 2018).

- These findings are consistent with previous literature. The majority of SRI indices have not performed significantly differently than their conventional benchmarks on a risk-adjusted basis (Barwick-Barrett, 2015).

- Other studies have shown this divergence. Most of funds concentrate their investments in blue chip stocks in the two sectors “non-cyclical consumer goods” and “non-cyclical services”. There are only few differences between German and Swiss funds and their US counterparts: the German and Swiss funds invest more in utilities, whereas the US funds also prefer the sector “information technologies”. Another result is that most of the global funds and indices concentrate their blue-chip investments in European companies (Schroder, 2003).

- Despite high levels of diversification, SRI funds have seen large losses in the six months to November 2018. Correlation with the broad market has proven to be substantially higher than what the volatility and fundamental thesis of investment would suggest.

- Correlation between fixed income SRI and broad fixed income markets has been very high, at 95%, suggesting that SRI investments are as exposed to a sell-off as most indices and are very sensitive to rate increases and inflation expectations. However, it must be noted that volatility and correlation with sovereign bond indices has improved significantly, and the year-to-date losses of fixed income SRI have been between 5% and 12% lower than European debt indices.

- The high correlation of SRI debt with broad corporate debt and high yield should be something to monitor in the future. I find that yields of SRI bonds have risen in tandem with average corporate spreads and high yield, suggesting a level of risk that may be significantly higher than investors perceive.

I find that some of the factors that might explain the high correlation with broad markets could be summarized in the following:

- The big components of SRI indices and the largest positions in the funds we have analyzed using public data (funds only publish their top positions) tend to have higher debt ratios and lower returns (as return on invested capital, ROIC, versus the weighted average cost of capital, WACC).

- The Bank of International Settlement has identified a large increase in recent years of “zombie companies” (corporations that cannot pay their interest expense with operating income). Zombies are less productive and may crowd out growth of more productive firms by locking resources (so-called “congestion effects”). Specifically, they depress the prices of those firms’ products, and raise their wages and their funding costs, by competing for resources. On average, labor productivity and total factor productivity of zombie firms are lower than those of their peers: the distribution of productivity of zombies is clearly shifted towards the lower end (Banerjee and Hofmann, 2018).

- I find that a relevant portion of quoted companies with large SRI and ESG components also fall under the category of possible zombies. Although the percentage, between 6% and 12%, is not dissimilar to the total quoted US companies that can be categorized as zombies (10%, or US $2.3 trillion of market capitalization), it is worth noting that the risk attached to these investments is likely to be the same as other non-ESG firms with similar balance sheets and cash flow imbalances.

- The main sectors affected by the rise of zombie firms are energy, information technology, and real estate (Banerjee and Hofmann, 2018). Within these, fossil fuels and real estate account for almost 50% of the market capitalization at risk. It is worth noting that these companies tend to have low ESG and SRI factors. However, sectors favored by investors with high ESG factors that have significant exposure to the risk of zombie firms are renewables, within energy, information technology, consumer discretionary, utilities, healthcare,
telecommunications, and consumer staples. Investors must monitor this risk, as the change of cycle can lead to a wave of defaults and market valuation falls.

- Furthermore, the preferred style and theme of many ESG and ISR investments, climate change, tends to be populated by corporations and bond holders with large exposure to government subsidies as well as higher debt ratios, although this can partially be explained by the stability and predictability of cash flows. Debt to EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) of ESG funds’ major holdings can be between 10% and 15% higher than their index peers.

- I find a positive trend in most corporations with ESG and SRI factors. There has been decreases in debt-to-equity ratios since 2010, particularly in the utilities and renewables sector as well as healthcare and information technology. Furthermore, dependence on subsidies has also diminished significantly since 2008, with some of the major holdings of the analyzed funds in the renewables, infrastructure, and water sectors, reducing subsidized revenues by up to 50%.

- I find that fixed income funds may have been forced to look for riskier investments in the period of high liquidity and lowering of interest rates. SRI and ESG funds tend to have a very healthy combination of investment-grade bonds with low risk, but the rising proportion of “high-yield” is evidently a reflection of what has been a norm in most investors’ portfolio construction, the so-called “search for yield” as the lowest risk bonds yielded low or even negative real yields. Up to 5% of the Eurozone and European Union issuers with high ESG and SRI factors can be zombie firms and even companies with no revenues at all, although the latter is a much smaller percentage, at 1% of large positions analyzed.

- The rising exposure of ESG and SRI fixed income funds to high yield is likely to be a main factor when explaining the relatively high correlation to other debt markets in a correction.

It is critical for investors to reduce concentration and implement strong fundamental analyses and a very strict scrutiny of financial leverage.

**Conclusion**

The risk of ESG becoming a fashion or a buzz, instead of a trend (Capelle-Blancard and Monjon, 2010), was identified as an important problem after the financial crisis. I believe we can say that this risk has greatly diminished but is not over. To continue to see the exponential growth in ESG investment, as well as the rising commitment to socially responsible activities of corporations and investors, it is critical to reinforce the characteristics of sustainability and social impact but also low-risk and long-term profitability.

Without the essential components of low risk and financial strength, ESG investment can suffer greatly in a recession or a change of the credit and economic cycle.

I have analyzed a group of funds in the SRI and ESG category to try to reach a conclusion on the risks of concentration, exposure, and debt.

I find it is quite positive to conclude that SRI investors are not taking an extraordinary level of risk compared to other styles and strategies. There is an evident concentration in investments focused on climate change, and that is the highest risk, as well as the relatively higher corporate debt and volatility and regulatory risk of cash flows. It is also positive to see a style change in sector allocation. Heavily subsidized energy is a much smaller proportion of the overall portfolio construction of funds than it was in 2010. However, a large increase in investments in information technology and disruptive technologies also carries out a higher risk, given the early nature of many businesses and the lack of predictability of cash flows.

The high level of correlation of ESG funds with the broad markets and main indices in a sell-off and market correction is an important element to analyze in order to avoid the risk of a prolonged market correction creating a slump in investment into what is otherwise a positive driver for social and environmental change.

Nonconventional monetary policy, low rates, and high liquidity may have caused a shift towards riskier, more indebted, and more volatile investments. These factors must be addressed when analyzing investment in ESG and
SRI, particularly as investments become less liquid. The risk of a bubble in ESG investment is not evident, as the investable universe grows and the number of sectors widen, but it is not inexistent, especially as the exposure to indebted, subsidized, and regulated names adds the trend of adding highly volatile and unpredictable information technology investments.

Socially Responsible Investment needs to be sustainable as well in its financial ratios. Investors are correctly focused on performance and an increasingly demanding scrutiny of ESG factors in their investments. These are positive drivers and essential to continue to increase the universe and impact society while attracting more capital. However, stakeholders, investors, and managers need to achieve profitability, sustainability, and avoid a large outflow of capital when the economic cycle changes, which would be negative for current and future growth of ESG investments. This can only be achieved by placing significantly more importance on cash flow and balance sheet strength as well as paying careful attention to the risk of dependence on sovereign risk.

Socially responsible investment cannot be a bubble nor participate in the excesses that other styles commit by falling into the traps of low rates, high liquidity, momentum-chasing, and trend-following.

The next wave of socially responsible investment will come in a period of rising rates and diminishing liquidity. This is when ESG and SRI will prove the real value and sustainability of the strategy. It can only succeed by placing a capital importance on balance sheet strength and strong, predictable, and sustainable real economic returns.

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Fund universe: AXA Tresor Court Terme, Candriam SRI Bond Euro Short Term, BNP Paribas Sustain, Pimco Income, MS Global Fixed Income Opportunities, Muzinich Funds Bondyield ESG, Petercam Bond Emerging Mkts Sustainable, BNP Sust. Active Allocation, Candriam SRI Defensive Asset Allocation, Sycomore Partners, Brown Advisory US Sustainable Growth, MFS Global Concentrated, Mirova Euro Sust. Equity, NN L Global Sustainable Equity, Pictet European Sust. Equities, Groupama Euro Capital Durable, Oddo Avenir Europe.

Indices: S&P 500 SRI Index, MSCI SRI Global, FTSE4Good EEUU, FTSE4Good Europe, FTSE4Good Global.