Responsible investment 2.0: A revolution in economic thinking

Why we believe the asset management sector must rethink its approach to sustainability if it is to succeed in helping companies realise a truly sustainable future

The traditional approach to investment was not designed to tackle the planetary boundaries that are all too apparent in today's world. Neither was the original form of socially responsible investing (SRI). But while the industry has belatedly woken up to its central role in creating a truly sustainable future, we believe a more fundamental overhaul is needed if we are to collectively succeed in tackling the biggest external threats facing society.

We know that, in addition to the need for capital to go towards truly sustainable investment opportunities, markets must start factoring in the value placed on negative external consequences created by companies. To us, one of the biggest and most consistent market failures is that investors have failed to integrate these considerations for decades.

In their defence, this has to a large extent been because governments have been slow to legislate or have failed to penalise those responsible for the negative effects of those external consequences. In order to achieve a sustainable 'revolution', we believe we also need to undergo a revolution in economic thinking. The conventional economics that have underpinned investments and fundamental analysis for decades fall short in the face of the biophysical boundaries to our planet, such as climate change, water scarcity,

topsoil erosion and loss of biodiversity, to name a few.

Responsible investment 2.0

At Newton, our long-term strategy with respect to responsible and sustainable investing is focused on this transition. We call it ‘responsible investment 2.0’ but, in reality, it may be ‘responsible investment 3.0’. Over the past decade, our responsible investment team has been supporting our investment teams with dedicated and proprietary ESG analysis on companies as a complement to the analysis of external service providers. The benefit is that this analysis has been carried out by responsible investment specialists, who have had a direct understanding of the issues and have been able to guide the investment teams. However, while such an approach has helped our industry analysts to capture relevant, material ESG issues, many longer-term sustainability considerations may not be financially material over a typical investment horizon or singularly relevant to an investment case.

As we support the transition towards truly sustainable investment opportunities, we believe that ESG-related risks, issues and opportunities must be integral to the investment decision, in addition to being part of the ‘mosaic’ of inputs captured during the research process. In this context, our recent focus within the responsible investment team has been to hand over the direct responsibility for conducting ESG analysis to our industry analysts, and to help equip them with the skills to integrate that analysis to the highest standard.

Working together

This evolved process is starting to support the vision of the ‘new’ economic model that we believe we need to work to. Our vision is one of true integration: active stewardship roles for the investment teams, which ensure their accountability and ownership for the risks they buy on behalf of our clients. It’s a transformation that we believe needs to happen more widely in our industry.

The evolution of roles is supported by a well-resourced central responsible investment team, whose task is to undertake specialist research, in collaboration with the investment team, and provide support, where needed, on company engagements, as well as to develop tools and insights through ESG data. By creating a partnership between our investment and sustainability skillsets, we believe we can get the best of both worlds and build genuine thought leadership that should help us outperform for our clients.

A great example of where this is needed more than ever is in the efforts around achieving net-zero carbon emissions. This is an issue that will never be solved solely by a single responsible investment team or by any industry in isolation. For the necessary transition that needs to happen around energy, or any other system, we must invest with a deep understanding of the issues across our investment teams.

This includes not only the way we build solutions, but also how we evaluate our integration processes. Ultimately, it’s about allocating to companies that we believe are best positioned to be truly sustainable, and which do their utmost to be leaders in their respective fields.

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