Socially Responsible Investing Enhances Portfolio Performance: New Study

(3BL Media/Justmeans) – Socially Responsible Investing (SRI) has steadily gained popularity since early 1990s. However, some investors continue to be skeptical, holding on to a market view that SRI portfolios may not perform as strongly as the others. A recent study by New Amsterdam Partners refutes this outdated stance: it shows a positive linkage between stocks with higher ESG (Environmental, Social and Governance) ratings and superior returns and reduced price volatility.

The study strongly reaffirms the core principle of sustainability that if a company's ESG practices do not conform to international standards, then corporate performance will become unsustainable over time. New Amsterdam employed the Thomson Reuters Corporate Responsibility Ratings (TRCRR) to carry out the study. The TRCRR was developed by Thomson Reuters in partnership with S-Network Global Indexes. It provides a transparent system for rating and ranking the ESG performance of about 5,000 companies around the world. The TRCRR incorporates key sustainability factors such as carbon footprint, water usage, labor practices and board independence.

The findings of the study demonstrate a strong association between ESG ratings and performance of the stock portfolio. On average, the companies with higher returns had higher ESG ratings. The highest return stocks that active portfolio managers seek to identify invariably turned out to be the ones that had better ESG profiles. The findings clearly indicate that an active manger seeking out the truly outperforming stocks can improve the chances of doing so by eliminating stocks with lower ESG ratings.

The study suggests that investors should logically view low ESG rated stocks as the ones with potentially higher investment risk. It found that eliminating such companies from the portfolio reduced portfolio volatility. The results of the study were also consistent when risk-adjusted returns data was used instead of simple returns. Higher risk-adjusted return stocks almost always had higher average ESG ratings as compared to the lowest risk-adjusted return stocks. The stocks with maximum risk-adjusted return that active managers seek were always from the non-lower ESG group.

The co-author of the study, Indrani De, said that it is clear that asset managers can actively make use of a company's ESG information and exclude the stocks with lower ESG in order to improve their stock-picking and portfolio construction ability.

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