Investing Responsibly and Thoughtfully. ESG and all that.

ESG investing has been an excellent growth opportunity for the investment industry to demonstrate innovation and introduce new products and services. For investors seeking to obtain both purpose and returns, the experience has been mixed.

I believe that the human species seeks to make things better, that we are inherently good, even if our efforts are sometimes thwarted by circumstances. Every action we take has complex and numerous consequences for the world around us. Consumption, investment, trade and social interaction, have diverse and complex positive and negative impact on the environment and society. I believe that we, collectively, have a grand purpose, which is beyond the knowing of the individual, but that we can know our own purpose and that it is our duty to pursue that purpose.

In our pursuit of purpose, we should be thoughtful regarding all we do including how we think, behave, communicate, consume, trade and invest. We should certainly be clear about antecedents but further, about consequents as well. Investment orthodoxy focuses on antecedents, on knowing how things work so that investment theses may be sound. The thoughtful investor extends the analysis to consequents so that they are aware of the possible impact of their decisions. The data we consider include business models and financial and commercial metrics. Lately, ESG has opened the door to considering the non-commercial impact of our actions, but it opens the door but a crack. ESG factors are a subset of the data we should consider. Other factors that bear consideration include geopolitics and ethics.

The thoughtful investor asks, is this a good business model, do we need it, do we want it, can we provide it economically, what is the economic cost, what is the cost to the environment, to society, to geopolitical and strategic relations, to the mindset, worldview, for shareholder, management, customers, suppliers, competitors, today, tomorrow and in the future. Not all considerations deserve the same weight, not all things can be quantified, but the extent and limits of our knowledge should be considered in the decision to invest or not. The thoughtful consumer, worker or producer should ask the same.

We have much to thank the ESG community for for opening our eyes. To do it justice, we must go a little further to including other metrics so that our decisions are informationally efficient and based on as much knowledge as possible.

What ESG also brought us was the aspiration to validation, through better measurement and systematic processes. The investment industry is a highly efficient one and in its pursuit of scale has systematized the process of considering ESG factors. Other factors outside of ESG may not be so easy to measure or quantify. As it is, social factors are difficult to measure, hence the pragmatic bias towards environmental factors which are more tractable. The aspiration to measure is a good one but its limits should be recognized, especially when one widens the scope of factors that influence investment decisions. One general issue is that long term impacts can be very significant due to compounding effects and yet, long term forecasting suffers from greater uncertainty. Theories of change improve consistency yet introduce complexity and uncertainty. The honest pursuit of thoughtful and responsible investing requires that we consider such tradeoffs and make decisions in the face of many unknowables. This adds to the concept of risk taking introducing non-commercial or non-financial risks to the analysis.

Where an investor invests with an impact objective, other responsibilities arise. Is the impact desirable? What are the non-financial consequences of an error? Is the strategy or solution desirable or efficient? Is the investor sufficiently qualified to make these determinations?

If no one can be sure they are right, then perhaps the better solution is to harness the opinion of the collective since the collective decision is based on a larger information set. Harnessing the information of mass decision makers is simply the free market at work.

One slightly inconvenient question arises. If we employ a voting system such as the free market to process our information, should it be one person one vote, and what does this say about concentrations of votes in the hands of the few?

From a practical perspective what it means is that ESG and Impact investments become simply Impact and Financial investments. The distinction is between all the things that could influence our investments and all the things that could be impacted by our investments. Whenever we invest in anything, all the things that could impact our investments should be considered. When we invest in impact investments, we additionally have to consider the things that could be impacted by our investments. The concept of ESG investing falls away or is diminished, not because it is less important but because it is subsumed into a much wider concept of thoughtfulness.

With this standard of thoughtfulness, the application of a simple exclusion methodology (to rule out the sin industries and environmentally unsustainable industries), results in a practical and comprehensive basis for an investment framework.