

The ABCs of ESG

Interview on Bloomberg U.S.

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Interviewer 1: Alix Steel, Bloomberg

Interviewer 2: David Westin, Bloomberg

Alix: What's ESG? I hate the question. But I think it's important to how you define it.

Savita: What does ESG stand for? Environmental, social and governance, and it's basically a way of looking at companies using attributes or factors that we haven't really thought about as financial analysts. So when you go to business school and you learn Finance 101, you learn about book value, you learn about earnings, you learn about valuations and growth, but you don't learn about things about board diversity or employment policies around paternity leave, and these are the types of factors that we're looking at in this ESG report.

David: So we'll look at why that's so important. But first of all how do I know that I'm measuring ESG, because when you have the more traditional things, I've got GAP, I've got institutions who are saying we know that those numbers are right, but you get into ESG, it gets a little more murky.

Savita: It's very soft, absolutely. So what we tried to do in our report was look at this, you know, marry these myriad data items and say what matters and what doesn't, and it turns out, you know, there's all sorts of things that we measure in ESG. It can be, you know, reliance on a part-time workforce. Is that a bad thing? It's a bad thing for the employee. It doesn't feel as confident in its prospects, but it's probably a good thing for the company because they have more flexibility around hiring and earnings volatility. So there's a lot of different aspects that we measure here. And what we found is that some actually drive financial returns. So for example, speaking of the financial crisis, which we're celebrating, I don't know if that's the right word.

David: Commemorating.

Savita: Commemorating the anniversary today. So if you look at financials from 2005 to 2007, if you had just watched one metric, which was compensation policy for leadership, that would have told you that financials was deteriorating and it also would have told you which companies were going to stick around and which were going to go away. It was really interesting to see that there was a tell in what was going on in a couple of years with the financial crisis.

Alix: So then how do you do that? I mean, looking back is one thing. How do you do it going forward? Do you look at a sector you like and then differentiate by ESG? Or is it the other way around?

Savita: Absolutely. That's exactly right, Alix. So you look at a sector you like and it's a very stock specific call. Within the tech sector there are some companies that have diverse boards, there are some companies that don't. So that's how you differentiate within sectors. And think about, you know, a diverse board, why does that matter? Well if you have board diversity, there's more checks and balances at the top of the leadership structure of an organization and they don't all kind of go off the cliff together. And I think that that's some of the bad decisions that we've seen that have taken companies under have been a lack of checks and balances at the top level of the organization.

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David: One of the points you make in your report is that ESG may be necessary, but it's not sufficient in the sense that it's good to have ESG, but ESG by itself won't get you there.

Savita: Absolutely. Yes. So I mean, I'm a finance person and we're in the business of trying to generate alpha and make money for our clients. So what we found was that ESG married to other fundamental factors like earnings growth or valuation, or all the things that we did learn about in business school actually is a great way to think about structuring a portfolio. But what I find really interesting about this theme is if you look at the next generation of investors, which are millennials, millennials are very keen on ESG, and I think you have a chart.

David: Yes, there's a chart that shows that, actually.

Savita: Millennial or just different trends in terms of investments.

David: The millennials are the ones in the middle. Those are the ones that spike way up.

Savita: Right. So millennials basically, almost 90% of millennials either currently invest in impact-oriented investments or they want to. And this is the future of investing. So Alix, you mentioned the flows that could potentially move into this. If you think about the generation that's going to get the money and generate the wealth, and start to invest, millennials are very, very dedicated to investing in good companies.