Social alpha: The next step in evolving fiduciary duty

For the first time recently, I was asked by a client to demonstrate our social alpha: "So, I understand your performance alpha drivers, now please explain your social alpha drivers?"

I found the question very interesting, particularly given my belief the fiduciary duty of asset managers will evolve to take account more directly of what we deliver to society.

This is exactly what our client was asking, albeit using a different term.

The fact that social alpha was separated from performance alpha was logical as delivering the former will not automatically improve the latter.

'Doing good' hopefully translates into 'doing well' over time but it is not a directly correlated relationship.

A company's decision to allocate investment towards a more sustainable future does not necessarily benefit short-term profit maximisation or its short-term share price performance.

However, it should result in better long-term risk-adjusted performance over time with better sustainable growth for companies.

Investors seeking to monetise social alpha need to have a long-term view when they invest in equities.

How do we demonstrate social alpha? When we talk about performance alpha, we focus on explaining the sub-component of performance attribution influenced by the Brinson model: bottom-up stock selection, top-down allocation and active risk management.

For me, creating social alpha means investing towards a sustainable goal and supporting the systemic transformation of businesses to be a force for good.

Asset managers can demonstrate social alpha by prioritising investments in companies or projects that are aligned with the UN Sustainable Development Goals (SDGs).

These 17 goals are a call to action for all of us to promote prosperity while protecting the planet, and we use them across our public and direct private equity portfolios to provide an assessment of how each investment contributes to society.

17

Number of interlinked global goals designed to be a "blueprint to achieve a better and more sustainable future for all"

7%

Replacements do not currently exist for cement which accounts for 7% of carbon emissions

Asset managers can also demonstrate social alpha by strengthening momentum behind the 1.5 degree goal and committing to a net zero policy.

For example, all our equity funds are classified at least Article 8 according to the SFDR legislation, meaning they contribute to at least one SDG.

We measure greenhouse gas emissions for each company we invest in, including scope 3 downstream, and assess the trajectory for each portfolio's temperature to make sure we are aligned with COP 21 pledges.

For direct private equity investment, the main economic activities of the companies we invest in need to make a clear and positive contribution to at least one SDG.

In May 2021, for example, we invested on behalf of our Unigestion Direct II fund in a US company providing alcohol monitoring devices and services for people convicted of 'driving under influence.'

This company, therefore, contributes to SDG 16 (Peace, Justice & Strong Institutions) by reducing re-offending and jail sentences, and the risk of alcohol offenders harming society through drunk driving.

The second way to produce social alpha is to be an active owner. All portfolio managers, even passive investors, should be activists for good. Not short-term activists to make share prices jump quickly but long-term activists, ensuring long-term sustainable goals are in place for the companies they invest in.

Key identifiers of successful engagement is the delivery of concrete outcomes. Effective engagement generates change and these changes should be measured. This means putting in place ESG goals, KPIs and an escalation policy when things do not go as expected.

Investing in companies making a positive contribution to SDGs does not mean only focusing on a few enabling companies. We should also invest in historical businesses undergoing transformation.

Much can be achieved by improving processes in the existing economy. Replacements do not currently exist, for example, for cement, which accounts for 7% of carbon emissions.

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Asset managers need to work with this sector to help drive innovation that adapts production toward more energy efficient materials.

Data is also key. As I have highlighted previously, data is still scarce and noisy in the ESG space and will remain so for the next few years until the International Sustainability Standards Board has been fully implemented.

This is a pitfall and an opportunity. One of the headwinds active managers have faced in the past 20 years is that financial information has increasingly been priced efficiently and performance alpha from fundamental bottom-up stockpicking became more difficult to produce.

With ESG data, we are at the start of the process and that is why social alpha could become long-term performance alpha.

The progress of companies on the sustainability front is not necessarily captured efficiently in ESG databases so fundamental analysts have an edge – understanding before ESG databases whether a company is on a better route or not. Bottom-up stock selection leading to active overweights, underweights and exclusions has all its 'raison d'être'.

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