



Systematic strategies as a force for good in responsible investment

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INTRODUCTION

In recent years, the concept of responsible investment (RI) has gained significant traction across the hedge fund industry. As global asset owners become increasingly attuned to the importance of environmental, social and governance (ESG) factors in their portfolios, managers are starting to integrate RI into their investment processes. Indeed, we at Man Group are part of a growing list of signatories to the UN-supported Principles for Responsible Investing (PRI), which is making positive headway in the hedge fund space.

As the broad hedge fund universe begins to get on board with RI, we believe it's worth paying particular attention to the role of quantitative strategies. Indeed, at first glance, systematic approaches – where decisions are taken by algorithms and machines, rather than humans capable of normative judgement – may not seem likely to be natural leaders in embedding ESG-related principles. But this relatively small group of strategies within the hedge fund universe has a specific role to play, and this article sets out some of the ways that quant strategies seek to be positioned to develop repeatable and consistent RI frameworks.

SOME QUANT STRATEGIES ARE ALREADY EMBEDDING RI WITHOUT FANFARE

For investors considering the best ways to express their worldviews, we believe it is often important to look behind the explicit label of a strategy. Cynicism about the motivation of hedge funds is understandable – where some investment managers may be tempted simply to monetise the buzzword of 'responsibility', building marketing brands around explicit 'ESG' strategies, but really only paying lip-service to the more serious effort of RI: making investors more accountable, transparent and informed of non-financial factors. Of course, this backfired a decade ago, when the advent of renewable energy technologies inspired a number of 'cleantech' funds, several of which soon closed down due to poor and volatile returns.

However, in recent years, we have begun to see quantitative investment strategies embedding RI practices without marketing their products with overt 'ESG' labels. Unlike discretionary approaches, quant strategies face inherent limitations in terms of active engagement with company management, but many of them seek to practice RI in other ways. For example, many have adopted explicit policies around ESG, enhanced stewardship via proxy voting, or established formal RI committees. This is an important development – since we believe real improvement in industry-wide responsibility is about improving investment practices across the

board, rather than confining progress to a narrow set of specialist 'ESG' or 'RI' labelled products.

ESG SCORES ARE IN THE EYE OF THE BEHOLDER – BUT QUANT STRATEGIES PROVIDE A CONSISTENT LENS FOR DATA

It's no secret that the range of composite ESG scores available to investors today pose challenges for investors. Many active managers rely on these scores, compiled by specialist ESG research agencies, to inform decisions about what constitutes a responsible company. However, these scores are subjective, and the analysis of companies can vary substantially between ratings providers, given the lack of standardised definitions: academic research continues to point to the significant divergence between them¹. Instead of relying on these scores, quantitative strategies can use their extensive capabilities to dig further into the raw data – allowing them to develop their own 'scoring' systems to understand and compare companies. Over time, we believe quantitative analysis has the potential to help develop a more rigorous and consistent framework for comparing companies' ESG credentials.

IDENTIFYING PATTERNS IN ESG DATA AND COMPANY PERFORMANCE

Taking their data research capabilities a step further, quantitative investment approaches also have the potential to identify relationships between ESG data and company performance. Using the same tools they use to analyse other aspects of company information, systematic approaches can help derive statistically significant correlations to understand how these factors might impact performance over time. They can also analyse patterns in existing ESG scores (those subjective measures we highlighted before) – for example, studying the change in scores, beyond the scores themselves, can potentially be a useful indicator of performance². We believe that ESG-related signals, like other factors, exist – but are rarely persistent. In other words, they modulate over time. Consider how volatility in the carbon price has modulated the environmental signal for investors over the past decade, for example. Or how corporate governance reform efforts in South Korea and in Japan have made this governance signal more important regionally. In this context, quantitative investment approaches have the potential to draw important observations about the role of ESG factors in investment – which qualitative analysis alone cannot achieve.

1. Source: Chatterji, A., Durand, R., Levine, D., Touboul, S. 'Do Ratings of Firms Converge? Implications for Managers, Investors and Strategy Researchers'. HEC Paris Research Paper, November 2014. Available [here](#).

2. Source: Joint study by European Centre for Corporate Engagement (ECCE) at Maastricht University and Dutch firm, NN Investment Partners, 2016.

WHAT DOES THIS MEAN FOR DISCRETIONARY MANAGERS?

Of course, while we believe that quantitative strategies have a role to play in RI – and we expect this to expand over the coming years – they also have the potential to support discretionary managers in their adoption of RI processes. As with so many areas of investment, we believe that the line between quantitative and discretionary approaches is thinner than ever, and we could see discretionary managers making use of quant capabilities over the coming years. More broadly, research into ESG factors – as they modulate over time and influence company performance – could help managers identify regimes and rotations which impact portfolios.

In the shorter term, however, we believe quantitative strategies may be at an advantage when it comes to turning raw ESG data into the potential for portfolio outperformance. As the investment industry continues to make progress towards ingraining RI principles across the board, we believe that quant approaches are likely to matter more than ever.

Find out more about Responsible Investment at Man Group: [man.com/responsible-investment](https://www.man.com/responsible-investment)



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Steven Desmyter is Man Group's Head of Responsible Investment and Chair of the Responsible Investment Committee. He has presented and commented widely on the state of responsible investing over the last decade with particular experience in ESG integration in Europe. He is also Head of Sales for EMEA at Man Group, based in London, and is a member of the Executive Committee. Steven previously worked at Goldman Sachs in the European Equities Division covering institutional clients. Steven holds a Master in Economics and Finance from the University of Ghent, Belgium, and the University of Kiel, Germany. He also holds an MBA from SDA Bocconi, Milan, Italy.



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Jason Mitchell is Man Group's Sustainability Strategist and a member of the Responsible Investment Committee. Besides having managed environmental and sustainability strategies, he speaks and publishes widely on responsible investing. He is also part of Man GLG's ('GLG') European and International Equity team. He has worked at GLG from 2004 to 2008 and from 2010 to present, taking two years off from 2008 to 2010 to advise the UK government on infrastructure development across Sub-Saharan Africa. He has managed global, long-only sustainability and environmental strategies from 2010 to 2015, as well as managed a long-short strategy focused on global telecoms and media from 2004 to 2008. Prior to GLG Partners, he was an investment analyst with Pequot Capital and Andor Capital. Jason has chaired the United Nations-supported Principles for Responsible Investing (PRI) Hedge Fund Advisory Committee since 2014, and is a member of the Plastic Disclosure Project Steering Committee. Jason graduated from the London School of Economics with an MSc in International Political Economy and the University of California, Berkeley with a BA in English Literature and Classics. He was named one of Institutional Investor's 2011 Hedge Fund Rising Stars, and is a Fellow of the British American Project. His articles and comments on sustainable investing have appeared in Institutional Investor, Wall Street Journal, CNBC Squawk Box, Aftenposten, Global Times, Responsible Investor, Ethical Markets, ALMA Journal and Investment Europe. He has also written widely on the European refugee and migrant crisis, with articles most recently appearing in the London Review of Books, Christian Science Monitor and Huffington Post. He is a contributing author in Sustainable Investing: Revolutions in theory and practice (Routledge: 2017) and Evolutions in Sustainable Investing: Strategies, Funds and Thought Leadership (Wiley Finance: 2012).

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