Intelligence MEMOS

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To: Canadian ESG Observers

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Re: **SUSTAINABLE FINANCE AND ITS CRITICS**

Attacks abound on sustainable finance, which had grown to $3 trillion US in global mutual fund and ETF assets by the end of 2021. That number has sunk with the stock market, but the flows into ESG-flavoured holdings remain positive, despite the denunciations.

On the right, some disregard the risks and opportunities posed by the climate crisis and see only offending values.

On the left, the only acceptable shade of green must be dark green – the EU's highest sustainability ranking.

And in between, others denounce ESG investments (environmental, social and governance) for being a mess of poorly defined and poorly measured criteria, not always leading to superior portfolio performance.

Sustainable finance faces a high bar to hurdle.

Finance is already complicated, catering to a wide range of needs in terms of investment horizon, risk appetite and beliefs about how best to beat the market.

And there is no question that sustainable finance, with its new pile of requirements, doesn't make it any easier. Investors need quality information for informed choices, and the field is still a mess.

But progress toward ESG uniformity is being made, and the new International Sustainability Standards Board (ISSB) is expected to soon set out some rules.

These standards are intended for investors and will be limited to information useful for gauging the value of a company, but not assessing its full impact on the environment and society. European regulations insist on both types of information. Elsewhere, corporate impact disclosure will remain voluntary for a time, guided by the Global Reporting Initiative, whose standards will complement those of the ISSB.

This ESG information will remain raw material that investors will have to interpret and integrate into their decision-making grid.

This still young science continues to evolve, at unequal speeds from one manager to another.

And not everyone will agree to the answers to difficult questions: Should all oil companies be excluded? If so, what about the other major GHG emitters, steelmakers and airlines? And banks, which pollute little, but which finance the oil companies? Where to stop?

Is it better to invest in exemplary companies, even if they are expensive? Or rather in those who have a tainted balance sheet, but who are determined to clean it up and whose shares could therefore rise?

In other words, do you want to decarbonize your portfolio or the economy? It is not easy to do both well.

Investing only in renewable energies is a risky bet. Diversifying a portfolio involves questionable trade-offs, however.

S&P 500 ESG index managers have been blamed for excluding Tesla, with its erratic governance and union-busting practices, to retain ExxonMobil, which compares favorably to other oil companies.

Some investors will give up the ESG mix in favor of products targeting the environment or the diversity and integration of women and minorities. But there will always be customers who want to consider a variety of risks and opportunities.

In short, there is no single recipe, because not everyone wants the same meal.

Unfortunately, individual investors are often tempted by a nicely worded item on the menu. Back in the kitchen, investment managers know this and some play the ambiguity to the point of greenwashing.

Fortunately, regulators are asking for more transparency and punishing unsubstantiated claims. The savvy investor will look at the ingredient list and ask to see the chef's recipe. For yields and for our children.

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