

ESG Unmasked

The Jewish people have a long history of being successful merchants. There is a classic book written by Edward Kritzler that proposes that the pirates of the Caribbean were nothing more than Jews rebelling against the Spanish & Portuguese inquisitions. Cecil John Rhodes left a lasting legacy in Africa, and lines are drawn as to whether people believe it is a good or bad one. Sadly, the hunt for profit often brings out man's worst characteristics. Enter the world of ESG investing - the hunt for profit without harm. It is probably the secular trend of our time in the investment arena. Many people think this is just about 'green' (or sustainable) business but it goes far further than that.



**Robin
Gibson**

In 2015, the United Nations adopted a series of Sustainable Development Goals. Their website describes the objectives as follows:

The Sustainable Development Goals (SDGs), also known as the Global Goals, were adopted by the United Nations in 2015 as a universal call to action to end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity.

The 17 SDGs are integrated - they recognize that action in one area will affect outcomes in others, and that development must balance social, economic and environmental sustainability.

There are 17 key areas of focus:

1. No Poverty
2. Zero Hunger
3. Good Health & Well Being
4. Quality Education
5. Gender Inequality
6. Clean Water & Sanitation
7. Affordable & Clean Energy
8. Decent Work & Economic Growth
9. Industry innovation & infrastructure
10. Reduced Inequalities
11. Sustainable Cities & Communities
12. Responsible Consumption & Production
13. Climate Action
14. Life Below Water
15. Life on Land
16. Peace, Justice & Strong Institutions
17. Partnership for the Goals

SPEED READ

- ESG stands for Environmental, Social, and Governance. A three-legged approach to evaluating the ethical behaviour of companies.
- Increasingly, asset managers are being required to evaluate companies through an ESG lens. This trend is being driven by social media, press narratives, and investor demand.
- While there is a notional belief that this trend is counterproductive to good investment returns, early research suggests that it is actually good for business and can even enhance returns.
- As ESG drives behaviour there will be winners and losers and plenty of volatility. A sensible investment strategy remains the best way to deal with the risks and unlock long-term value.

Now you could easily laugh and roll your eyes from a South African perspective, but there is no doubt that there is a concerted effort to drive these goals throughout the business and investing community and they are going to impact the movement of markets. What follows are some consequences of these goals that investors may face:

1. Increased volatility

Markets struggle terribly with uncertainty. A political policy can be awful, but at the same time certain. If the market understands it, they will price it in and move forward. A fluctuating policy will lead to greater pricing of the risk. When a share is priced for a greater risk, it trades well lower than what its inherent metrics might suggest (which,

incidentally, is why we believe there is so much upside for South African companies for even a small improvement in our economy and political environment). Risk is more subjective than objective which can lead to serious price volatility as the market tries to understand the risk of ESG to every major company.

2. Outsized profits and share moves

A great example here is Thungela Coal, spun out of Anglo American as part of its “responsible transition away from coal”. The transition was ostensibly forced by pressure from sovereign wealth funds threatening to sell out of Anglo if they didn’t reconsider their ownership of this asset. Simultaneously, banks were shying away from financing greenfield coal projects so little new supply was coming onstream. Enter the Russia-Ukraine conflict and as a major supplier (Russia) was squeezed out of the market. Europeans were forced to look for alternatives. Thungela was superbly poised. The share price tripled between January and September 2022. Not bad for a market pariah.

The point is the transition from one way of doing things to another way is seldom quick or easy. Coal as a source of power production, while unloved, is still central to many countries’ electricity production. The risk for investors is in not overpaying for the wrong assets at the wrong time. The coming years will unveil many similar disparities.

3. The Risk of Disruption

The classic and obvious example here is Tesla and the motor vehicle industry. Electric cars are on everyone’s lips (but perversely often recharged using coal-powered energy!) and while there are other electric vehicle manufacturers, Tesla has become the poster child for the industry. Here lies some of the greatest risk – Tesla rose meteorically between the start of 2020 and the end of 2022 from just under \$30 a share to over \$400 a share (12 times or a compound annual return of 136%). However, it has since collapsed to around \$145 a share - a decline of 64% from the peak - on multiple concerns including the ability to deliver, price, and competition to name a few, sucking a few late-entry investors with it. Overall, the share has delivered just short of 44% per annum since the end of 2018 but depending on the timing some have either scored massively or almost lost their shirt.



Tesla is considered an ESG darling and a disruptor but it is not alone, other car companies are innovating too.

Other big-name vehicle manufacturers have been much more pedestrian in their returns and in some cases have made losses. Nonetheless, many have paid dividends and have not cost an investor 60% of their capital. We are going to see many more disruptors in the years to come, but the existing companies are doing more than you think. If you don’t time the ride right, it could be a painful experience! Often in these situations, investors feel like they are losing out to their neighbour, and while on some levels that is true, what is usually revealed is that very few people have the kind of exposure to these assets to warrant the hubris around the braai. If they do, then they deserve the results because the risks were bigger at the beginning.

“We are going to see many more disruptors in the years to come, but the existing companies are doing more than you think.”

Harvard House does not specifically evaluate shares using an ESG framework, however we are aware that companies are increasingly operating in this environment.

For Harvard House, the security of the dividend remains of paramount importance and so much of our research time rests in establishing the strength of the balance sheet and the dangers to cash flow. Escalating income is our panacea to all ills. It may be a bit boring compared to identifying the Thungela or Tesla in the mix, but it also helps eliminate being the “Johnny come lately” who suffers the hangover without the party!



Topic: **TBC**

Natal Midlands

Date:	TBC
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	TBC
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

The details of our next Insight seminar will be published shortly.



[Harvard House is on Facebook](#)



[Harvard House is on YouTube](#)

CONTACT DETAILS:

For more information on the range of products and services offered by Harvard House Investment Management and its associated companies (including Harvard House, Chartered Accountants), or for any financial advice, please contact the Company at:

HARVARD HOUSE GROUP



3 Harvard Street, Howick, 3290, South Africa



P.O. Box 235, Howick, 3290, South Africa



+27 (0) 33 330 2164



+27 (0) 33 330 2617



admin@hhgroup.co.za



www.hhgroup.co.za

The information contained in this newsletter comes from sources believed to be reliable, but Harvard House Investment Management (Pty) Ltd, Harvard House Financial Services Trust, Harvard House Insurance Brokers and Harvard House, Chartered Accountants (collectively known as the Harvard House Group), do not warrant its completeness or accuracy. Opinions, estimates and assumptions constitute our judgment as of the date hereof and are subject to change without notice. Past performance is not indicative of future results. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Any investor who wishes to invest with the Company should seek additional advice from an authorized representative of the firm. The Company accepts no liability whatsoever for any loss or damages whatsoever and howsoever incurred, or suffered, resulting, or arising, from the use of this newsletter. The contents of this newsletter does not constitute advice as contemplated in the Financial Advisory and Intermediary Services Act (FAIS) of 2002.

The Harvard House unit trusts are registered under the Boutique Collective Investments. Custodian: Standard Executors & Trustees: Tel (021) 007-1500. Collective Investments are generally medium to long term investments. The value of participating interests may go down as well as up and past performance is not necessarily a guide to the future. Collective Investments are traded at ruling prices and can engage in script lending. Forward pricing is used. Commission and incentives may be paid and if so, are included in the overall cost. This fund may be closed to new investors. Collective Investment prices are calculated on a Net Asset Value basis and auditor's fees, bank charges, trustee and RSC levies are levied against the portfolio. The portfolio manager may borrow up to 10% of portfolio NAV to bridge insufficient liquidity. Boutique Collective Investments (RF) Pty Ltd ("BCI") retains full legal responsibility for the third party named portfolio. Boutique Collective Investments is a member of ASISA and is an authorised Financial Services Provider. Should you have any further queries or complaints regarding the suite of units trusts offered by The Harvard House Group please contact: Boutique Collective Investments Call Centre, Tel: (021) 007-1500, Email: clientservices@bcis.co.za. For your information, the FAIS ombudsman provides an independent and objective advisory service. Should you not be satisfied with the outcome of a complaint handled by Boutique Collective Investments, please write to, The Ombudsman, PO Box 74571, Lynnwoodridge, 0040. Telephone (012) 470 9080/99. Fax (012) 348 3447. Email: info@faisombud.co.za

Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.

Harvard House Investment Management (Pty) Ltd*, Licence no: 675 Harvard House Insurance Brokers*, License no. 44138

Harvard House Financial Services Trust*, Licence no: 7758 * Authorised financial service providers in terms of FAIS (2002)

Harvard House Investment Management (Pty) Ltd*, Licence no: 675

Harvard House Insurance Brokers*, License no. 44138

Harvard House Financial Services Trust*, Licence no: 7758

* Authorised financial service providers in terms of FAIS (2002)