INTUITION
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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.

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

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.

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!

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

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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

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:

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