**ESG Investing in Equity Markets**

**= Fall 2022 =**

**Mondays & Wednesdays, 3:50pm to 5:20pm**

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| **COURSE ASSISTANT** |  |

**REQUIRED COURSE MATERIAL**

All readings and cases can be accessed by control/clicking on the syllabus. Most supplemental readings will be accessible through Yellowdig.

**REQUIRED PREREQUISITES: CAPITAL MARKETS AND INVESTMENTS**

 **CONNECTION WITH THE CORE**

This course builds on knowledge from the Capital Markets and Statistics courses (B8306). Specifically, statistical techniques are used to evaluate portfolio risk and return. In addition, concepts introduced in Capital Markets like Beta, the Capital Asset Pricing Model, Sharpe Ratios, and Active and Passive Management are used in ESG investing and periodically referenced.

**COURSE DESCRIPTION AND OBJECTIVES**

As you probably know, more and more Asset Managers are re-evaluating their Investment Guidelines to consider Environmental, Social and Governance factors.

This process raises a series of interesting questions:

* How specifically is a company rated on ESG guidelines? Is there subjectivity in the process?
* Does consideration of ESG factors improve investment performance?
* For investors who emphasize ESG factors for reasons other than investment performance, how do they measure positive societal impact?
* How does an Asset Manager use the power of the Proxy vote and Corporate Engagement to affect change in the Environmental, Social and Governance policies of the Companies they own shares of?

This course tries to answer the questions just raised as well as address other issues Equity Investors face. Its main topics cover:

* Reviewing the building blocks needed to evaluate a company on ESG, specifically, company disclosures and rating methods.
* Comparing historical returns, risks and costs of portfolios that incorporate ESG factors versus ones that don’t
* Evaluating how Active and Passive Equity managers incorporate ESG factors into their portfolio management process,
* Exploring how ESG factors into investment decisions in Alternative Asset Classes like Hedge Funds, Private Equity and Venture Capital
* Exploring how Asset Managers use the power of the vote and other forms of engagement to affect change in Corporate Behavior

**ASSIGNMENTS**

All assignments must be posted in Canvas before class. Some assignments will be Type A, some Type B.

For Type A assignments, each student must participate in a group discussion regarding the assignment before submission and review and if needed edit the final submission.
**Collaboration across groups is not allowed. Please hand in one solution per group.**

For Type B Assignments, each student should attempt to answer the questions on their own before collaborating with other students. Each student should hand in their own submission for Type B assignments.

**METHOD OF EVALUATION**

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| --- | --- |
| Class Attendance and Participation  | 50% |
| Assignments | 30% |
| Final Project | 20% |

I reserve the right to downgrade (including failing) any student who misses a significant number of classes or does not complete all the assignments.

Note there is a Final Project in the Method of Evaluation. The Project involves evaluating the ESG risks and opportunities for a company you select. It is due at the end of the semester.

**COURSE OUTLINE**

**SECTION 1 – Building Blocks**

1. ESG Introduction (10/24)

After a quick review of the course structure, I introduce Environmental, Social and Governance investing in public Equity Markets. I then provide some historical perspective on how this process began and the current size of the asset base following ESG guidelines.

1. How Companies are Rated on ESG Factors (10/26)

We start the class with a discussion of the “On Climate and Conscious” article. Then we compare the different methods used to classify companies according to ESG standards. Included in our discussion is a review of three companies using the MSCI methodology

Readings:

* [On Climate and Conscious](https://www.advisorperspectives.com/articles/2020/02/24/on-climate-and-conscience-an-essay-and-pamphlet) (Blair)
* [Four Things No One Will Tell You About ESG Data](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3420297) (Kotsantonis, Serafeim)
* [The Devil is in the Details](https://www.leggmason.com/content/dam/legg-mason/documents/en/insights-and-education/whitepaper/lm-qs-the-devil-is-in-the-details-0919.pdf) (LaBella, Sullivan, Russell, Novikov)
* [MSCI ESG Ratings Methodology](https://www.msci.com/documents/1296102/21901542/MSCI%2BESG%2BRatings%2BMethodology%2B-%2BExec%2BSummary%2BNov%2B2020.pdf) (MSCI)

Assignments:

Assignment 1 – On Climate and Conscious Questions (Type B)

1. Does ESG Investing Improve Return? (10/31)
In this class we discuss ESG portfolio performance. Some investors argue that accounting for ESG considerations will improve risk-adjusted return in addition to allowing you to own a portfolio that better reflects your values. In other words, you can do well by doing good. This class attempts to answer the question theoretically and empirically.

Readings:

* [Sustainable Reality](https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf) (Morgan Stanley)
* [Morningstar's ESG-Screened Indexes Protect on the Downside](https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/ESG_Indexes_Risk_Analysis_February2020.pdf?utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=20489)
1. The Role of the Sustainable Accounting Standards Board/Innovations in

 Climate Reporting (11/02)

A guest speaker who is a member of the SASB Board will lead a discussion on the development of accounting standards to measure material exposures a company has to Environmental, Social and Governance Factors.

Toward the end of the class, a second guest speaker on the work they have done on rating companies on Climate Solutions

Guest Speakers: t/b/d

Readings:

* [Netflix Report](https://ir.netflix.net/governance/ESG/default.aspx)
* Article on SEC Climate Change Reporting

SECTION 2 – Best Practices in Asset Management

1. Case Study: Generation Investment Management (11/09)

Generation Investment Management, founded by Al Gore and David Blood, was one of the first investment managers that believed it could generate superior financial returns by investing in sustainable companies that created long-term value for society.

In discussing the case, we review their mission and investment approach with a focus on one of their holdings, John Deere, Inc.

Readings:

* [Generation Investment Management](https://hbsp.harvard.edu/tu/4be2b02f) (HBS Case)

Assignments:

Assignment 2 – Generation Investment Management Questions (Type A)

1. Analyzing ESG Risks and Opportunities in Stock Valuation (11/14)

As you probably know, most active managers employ Fundamental Analysis of companies to select stocks. More and more, those managers take into an account ESG factors in their analysis. Two guests will go through a Financial Analysis of a company with and without consideration of ESG factors and discuss how ESG considerations impact the multiple stocks in the Utility industry trade at.

Guest Speaker: t/b/d

1. Case Studies: Wellington Global Impact/Public Equities Impact Investing
 at BlackRock (11/16)

The Wellington and BlackRock Cases describe the creation of Mutual Funds designed to outperform its benchmark as well as have a positive societal impact. In class we will discuss both cases.

Readings:

* [Wellington Global Impact](https://hbsp.harvard.edu/tu/6c6eaf6e) (HBS case)
* [Public Equities Impact Investing at BlackRock](https://hbsp.harvard.edu/tu/1628f1da) (HBS case)

Assignments:

Assignment 3 – Questions on Wellington Global Impact/BlackRock Cases (Type A)

1. Passive and Factor Based ESG Investing (11/21)

Investors looking for a low-cost way to obtain ESG equity exposure can look to a fund designed to track an ESG index. We start class by comparing the different ESG indices which ties to our earlier work on ESG classification systems. We then move to the use of Exchange Traded Funds (ETFs) on ESG Indices, a popular vehicle for investors

Toward the end of the class, we will discuss how Quantitatively based Factor portfolios are impacted by ESG considerations

1. ESG Investing in Hedge Funds (11/28)

Short selling is an important component of many Hedge Fund strategies. Short selling can also be used to change the net amount Carbon Emissions coming from a portfolio of companies.

With the help of a guest speaker(s), we explore how a quantitatively oriented asset manager uses short-selling strategies to reduce the Carbon Emissions of an Equity Portfolio without sacrificing a material amount of Expected Return

Note there is some disagreement on how to measure short selling in the context of measuring the ESG components of a portfolio, most notably, Carbon Emissions which we will discuss

Readings:

* [Clearing the Air: Responsible Investment](https://www.aqr.com/Insights/Research/White-Papers/Clearing-the-Air-Responsible-Investment)
* [Responsible Asset Selection: ESG in Portfolio Decisions](https://www.aqr.com/Insights/Research/Alternative-Thinking/Responsible-Asset-Selection-ESG-in-Portfolio-Decisions)

Guest Speakers: t/b/d

1. ESG Investing in Private Equity Markets (11/30)

Some investors believe that it is easier to manage a company to provide non-financial benefits in private markets. The reasons they cite is that new companies are saddled with legacy policies and investors in private markets are under less pressure to deliver strong financial results in the short-term and can focus on achieving their mission.

In this class we will discuss two HBS cases, one on Private Equity Firms and ESG, the other a case on Goldman Sachs and Imprint.

Readings:

* US Private Equity Firms: ESG and Impact (A)
* Goldman Sachs: Making an Imprint in Impact Investing

SECTION 3 – Corporate Engagement and Activism/The Future

1. Influencing Corporate Behavior (12/05)
By reviewing the BlackRock case we explore how asset managers use Proxy Voting and Corporate Engagement to influence the behavior of the companies they own. We then discuss how the Hedge Fund, Engine 1, influenced the Board of Exxon to alter its policy on environmental sustainability

Readings:

* [Public Equities Impact Investing at BlackRock](https://hbsp.harvard.edu/tu/1628f1da) (HBS case)
* [Larry Fink’s 2022 Letter to CEOs](https://www.blackrock.com/us/individual/2021-larry-fink-ceo-letter)

Assignments:

Assignment 5 – Questions on BlackRock Case and Engine 1 Reading (Type A)

1. The Future of ESG Investing (12/07)

A group of industry experts will share their views on the future of ESG investing. Please come to the class with questions.