ESG Now Podcast

“In Times of Crisis ESG Matters”

Transcript, 11 April, 2025

Mike Disabato (00:00):
What's up everyone? And welcome to the weekly edition of ESG Now, where we cover how our environment, our society and corporate governance effects and are affected by our economy. I'm your host Mike Deto and this week we talk about what has happened to the performance of ESG indexes during previous market selloffs. Thanks as always for joining us. Stay tuned. Alright, so there was a bit of a market sell off this week that was ignited after the Trump administration announced sweeping global tariffs on April 2nd, which were then partly paused yesterday, April 9th. Though that being said, the US did boost tariff on China to 125%, which China then responded with an increase of tariffs of their own to 84%. So there's that, and of course this all is as of April 10th as we are recording and things may have changed, maybe even dramatically since you're listening. But regardless, when the 90 day pause was announced, there was a brief moment of relief on Wall Street, but stocks were bounding a bit from the thrashing they received over the last couple of days.
(01:15):
But now right at this moment, it seems like that relief has been short-lived and some analysts have said the US is already in recession, while others are pointing to recession being a likely outcome in the US of all this uncertainty and trade can flag oration. There was also this dramatic sell off of the normally safe US government bonds amid signs of poor demand at a treasury auction the other day. So we are indeed not out of pain times yet. Now, let's be honest, during these market selloffs, during these times of uncertainty, sustainability considerations are sometimes said to be thrown to the wayside with everyone worried about 4 0 1 Ks being halved. There isn't much time, some say to think about whether a company is cutting its emissions or taking care of its workforce properly because well at least there is a workforce to take care of.
(02:04):
But is that dismissal a good idea just financially speaking? Is that a good idea? If during a time of systemic risk all investors care about is protecting their downside, should they say, well, sustainability go over there for a bit while we figure out how to solve this kerfluffle? Well, to find out, it would depend on how forgive the term ESG factors performed during other moments of systemic risk. So we thought that is what we would spend this cheery episode by looking at how ESG factors fared in these moments of downturn in systemic or market ride risk. Now, we don't have great data for what was going on with ESG during the 2008 great recession, but we have great data for a couple of other market selloffs. There's the COVID-19 selloff, there's the selloff that happened when Russia invaded Ukraine. And for a quote, fun exercise, it's a selloff that just happened this week.
(02:57):
So to help me with this, I have with me today Xin Xw, who is part of our research team and focuses on studying the financial performance of either the data that goes into our ESG factors or our ESG factors in general. So here's what she did just to set the stage here. She looked at how some of our ESG focus indexes performed compared to a benchmark the MSCI aqui index, which is just an index that represents a global set of companies. Now the study looked at index performance, which you can invest

in, but an index is a good proxy for what is happening to ESG factors and market downturns. One of these indexes called the MSCI aqui ESG Leaders Index, which selects the top 50% ESG rated companies per sector. One is called the MSCI, aqui, SRI index, the SRI being socially Responsible investing, which selects the top 25% ESG rated companies per sector. And the other is called the MSCI Aqui Universal Index, which uses a wait tilt approach towards the higher rated ESG companies away from the lower rate of ones. So what did she find out? Let's get into the findings right away. Enough about the background and the methodology on that. Well, let's start off with the least recent to the most recent history, shall we First, what shaped up during the COVID-19 selloff? The worst of which was from January, 2020 to April, 2020.

Xinxin Wang (04:19):
So we look at these M-S-C-I-G indices and their performance during covid and what we found is that M-S-C-I-E-G indices outperformed their benchmark during covid market selloff.

Mike Disabato (04:33):
Okay, so outperformance during the covid selloff. Now, you know, I'm obviously on the side of ESG here, let's not pretend otherwise. I worked for a company called M-S-C-I-E-S-G research, and I'm not saying you should run into an ESG strategy right now, but during the covid selloff, when you adjust for factors like size, region, and style, the ESG index has outperformed. You hear what Shichen just said, companies that prioritize sustainability consistently showed greater resilience in terms of crises. Great. So here's Shichen getting into the technical details, the whys of how she got to that finding for the COVID-19 selloff.

Xinxin Wang (05:05):
So when we talk about why most typical analysis people will look at is called return attribution analysis. So this exercise essentially is to attribute returns to underlying drivers. For example, country factor, industry factor style factor and style factor can include value, momentum, et cetera. And also ESG factor and ESG factor essentially is the factor after you're controlling for all the other ones. What is the ESG component added to the returns? So we ran the outperformance during COVID through our return attribution analysis and what we found is that the ESG factor contributed positively to the outperformance of these M-S-C-I-E ESG indices.

Mike Disabato (05:58):
The ESG component is isolated. So what HIN did is she used what's called an equity factor model, and we have an equity factor model called the Barra model. But the details of that I'm not going to get into, but because it's just too model driven for us right now, and it's not that important, but it was the equity factor model that allowed her to isolate the ESG factor and attribute the outperformance to it. And again, this is a chosen timeline by us, it's a look back and all that. But during the covid sell off companies with more sustainable practices did better than their laggard peers. So that's the detail I want you to focus in on for that one societal crisis. But don't worry, we've got two more to go and things might shape up differently. Who knows? So now we have Russia's invasion of Ukraine. Russia invaded Ukraine on February 24th, 2022. So we started looking at the returns of the indexes a day before that happened and then ended our study period on May 31st, 2022, which was the period that we saw the most dramatic selloff due to the invasion. This one was not as dramatic as covid, this selloff wasn't, but it was indeed a selloff. So what did Xin find?

Xinxin Wang (07:01):
We found that M-S-C-I-E-S-G indices underperformed their benchmark during this period of time when the Russia invaded Ukraine. And that was between February 23rd to the end of May, 2022. But the ESG factor return was actually positive for the global market as well as the US market. So during that period of time when Russia invaded Ukraine, the ESG factor return was positive, which means that all else equal companies with higher ESG rating outperformed those with lower rating given their exposure to this particular factor. So meaning even though overall the indices performance was lower than their

benchmark, the e ESG factor actually contributed positively to these e ESG industry performance given their positive exposure to the factor.

Mike Disabato (07:57):

So underperformance during the Russia invasion of Ukraine sell off for our ESG indexes. But when you isolate the ES g factor and remove all the noise, you see that sustainability priorities lessen that underperformance by being a positive contributor. So there's a little bit of blue sky in that dark clouds there. Okay, so two down, one to go. And this last one is looking at the past seven days that have shortened many of our respective lives. It was a pretty big market swing that happened since the announcement on April two of the global tariffs by the Trump administration. And while we saw some momentary cooling recently, the selloff seems to have resumed, but who knows? Anyway, what Chin Chin did is she looked at April 1st, the day before Liberation Day when the tariffs were announced to April 8th the day before everything calmed down for a quick second. And what did she find out

Xinxin Wang (08:47):

In this case? I found that all of them outperformed their benchmark starting April 1st, the day before the selloff ending April 8th. So that's consistent to what we observe during Covid as well as Ukraine crisis.

Mike Disabato (09:01):

Okay. And I know this was only seven days and that's a pretty concise window of analysis, but we wanted to have a bit of fun as the world melted down. So let's dig into this and speculate why the outperformance might have happened. Well, we've done research and it shows that companies that manage their sustainability risks better have lower stock specific risk. And we've also shown that there's a positive relationship between good governance and lessening stock drawdowns or mass selloffs. We've also looked at the environmental pillar and the social pillar of ESG and how those factors underlying those pillars may have been a positive contributor for stock performance. We've even done some podcasts on these things actually, if you want to learn more about those claims and hear me drone on a bit more. But this is tariffs. We're talking about the increase of the cost of the supply chain, which is a web of pretty complex stuff.

(09:54):

And when you account for all the parts and the parts of the parts and the border crossing that has to happen for the parts of the parts of the parts, it's kind of impossible for me to say what actually happened that caused this outperformance or easily say that. So really right now we don't have an idea. We would've to do longer subsets of data and we would've to have a bit more time and a bit more analytical window to actually look into this. But I think it's still an important question to think about and it should be kept in mind that with all of the chaos going on right now, it does seem like the sort of things like supply chain oversight, labor standards emissions, new tech development with regards to clean tech governance and the well running of companies in general does seem to have a useful and positive correlation with either stock out performance or protecting your downside risks. Now of course, that's based on historical returns. It might not happen in the future because the future seems to be way more chaotic than anyone is able to predict, but still was a nice exercise for us to complete and these ESG factors seem to matter during market selloffs.

(11:05):

And that's it for the week. I want to thank you so much for listening. I want to thank Chen for talking to me about the news with a sustainability twist. If you like what you heard, don't forget to rate and review us. It helps other people discover our podcast and subscribe wherever you get your podcast. Thanks again and talk to you soon.

Speaker 3 (11:33):

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