Wellington Pushes ESG 2.0 Focusing on Alpha More Than Altruism

by Charles Stein
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About 30 analysts and portfolio managers at Wellington Management get together every couple of weeks to discuss climate change.

They talk about science, but mostly they focus on a subject far more vital to a $1 trillion investment firm: how to make money. The goal is to identify stocks and bonds that might be vulnerable in a future of rising seas or that could benefit if more countries decide to tax carbon.

Welcome to ESG 2.0, the latest way money managers deal with environmental, social and governance issues. In the first wave of socially responsible investing, the idea was to rid portfolios of companies that offend certain customers. Now, social concerns are treated like any other factor in the research process. Just like earnings trends or management talent, exposure to climate change matters if it influences how a security may perform.

"We want to integrate the information as part of the mosaic of the investment decision, not compartmentalize it," Carolina San Martin, Wellington's head of ESG research since early last year, said in an interview at the firm's downtown Boston headquarters. "We are interested in the alpha potential of ESG -- how does it impact performance?"

Wellington, the low-profile, 90-year-old firm that runs some of Vanguard Group's most popular active mutual funds, started the climate-change group early this year. It's not alone in expanding its ESG focus. Acadian Asset Management, a Boston firm overseeing $100 billion, builds ESG factors into its quantitative investing models. J.P. Morgan Asset Management and Standard Life Aberdeen Plc have added language to their prospectuses citing ESG considerations as part of the investment process.

No 'Crusade'

"It's not about leading a crusade," said Euan Stirling, who runs a 22-member ESG team at Edinburgh-based Standard Life. "It is about achieving the best outcomes."

The integrated approach appeals even to those skeptical that socially conscious investing -- a movement that took hold in the 1970s and '80s with the anti-apartheid campaign and then turned its attention to companies such as gunmakers and tobacco sellers -- produces higher returns.

"Using ESG as your sole metric is silly," said Daniel Wiener, chief executive officer of Newton, Massachusetts-based Adviser Investments, which oversees $5.5 billion. "Using it as one more category of analysis is fine."

Vanguard Connection

Wellington, which traces its roots to a Philadelphia accountant who created the first balanced mutual fund in the U.S., rarely talks publicly about its results or clients -- a mix of sovereign wealth funds, endowments and mutual funds.

Arguably its most famous employee was Jack Bogle, who was fired as CEO in 1974 and went on to launch Vanguard. Bogle didn't hold a grudge: Wellington today is Vanguard's largest subadviser, managing $360 billion for the world's biggest mutual fund company.

Wellington has been refining its ESG process since 2011, when European clients began expressing an interest in the subject. San Martin has doubled her team to eight analysts, each of whom covers a sector. They don't write reports but instead offer their views on companies to portfolio managers who decide how much weight, if any, to give them.

The ESG team also participates in hundreds of meetings each year with corporate executives, gauging how serious a company is about social issues and letting it know what matters to Wellington.

"Better managements recognize these issues are being considered as part of our investment decisions," said the firm's Nataliya Kofman, a manager on the $927 million Vanguard Global Wellington Fund who incorporates ESG considerations.

Murky Results

The ESG team's impact on performance is difficult to measure, acknowledges San Martin, who joined Wellington in 2005 after earning a master's in international finance from Johns Hopkins University.

"It's hard to run an attribution analysis and say we added so many basis points," she said.

As anecdotal evidence of success, San Martin pointed to a regional bank that raised a red flag for a Wellington analyst earlier this year because the board of directors had weak oversight. The fund manager who owned the stock, already bothered by other reservations, decided to sell. The bank, which San Martin declined to name, missed earnings estimates and the shares immediately plunged 10 percent.

Climate change will affect all asset classes, from municipal bonds in seacoast cities to stocks of companies whose supply chains could be disrupted by deteriorating weather, Wellington wrote in a February research paper. "Our greatest exposure to the effects of climate change resides in our clients portfolios," the firm said.