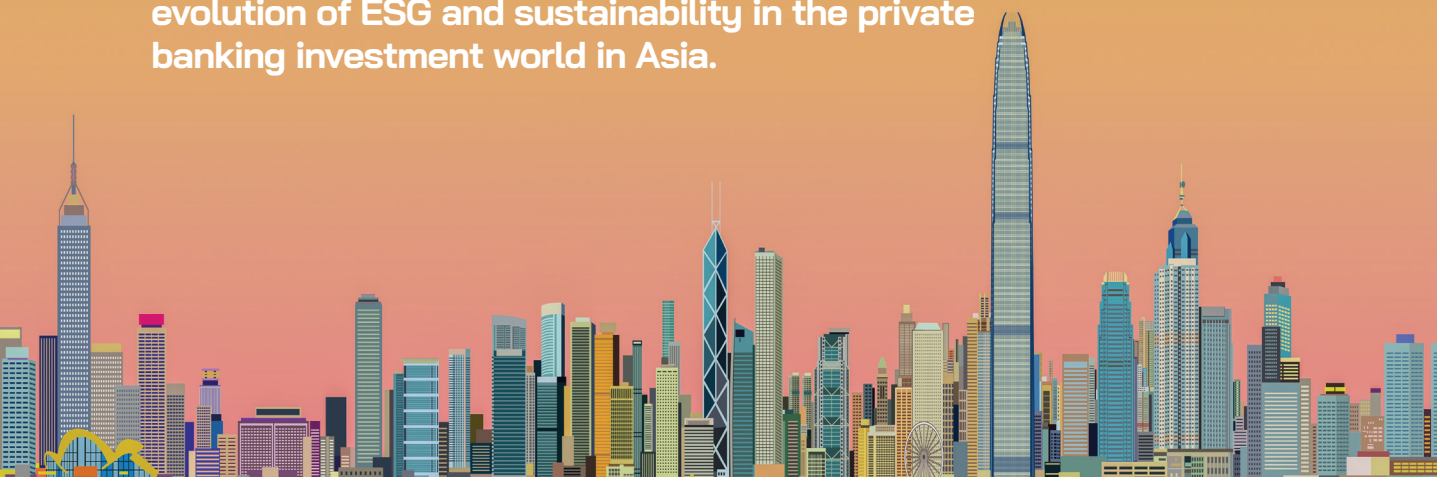
Lombard Odier's Asia CIO on Deep-Dive ESG Analysis and why Capital will Increasingly Migrate to ESG

As the world's leading global investors continue to embrace ESG, what progress is being achieved amongst wealthy investors in Asia, and specifically, are Asia's private clients jumping increasingly on the ESG express? If they are, why and are they pleased thus far? If not, then why not? We asked Jean-Louis Nakamura, Chief Investment Officer for Asia at Lombard Odier and Chief Executive Officer of the Hong Kong operations, for his bird's eye perspectives on the evolution of ESG and sustainability in the private banking investment world in Asia.



GET IN TOUCH

View Jean-Louis Nakamura's LinkedIn Profile

Find out more about Lombard Odier

JEAN-LOUIS NAKAMURA
Lombard Odier

Jean-Louis opened by reporting the growing interest in ESG in Hong Kong and Mainland China. "And we also have rising interest to see what can be done in China not only in terms of ESG strategies but also incidentally in terms of temperature alignments and low carbon strategies," he said. "It is clear that environmental issues are increasingly important for political and policy agendas. In short, we will see increasing prominence for ESG and sustainable products and strategies in this part of the world."

He pointed to a survey Lombard Odier had conducted in 2021 among private investors. "We learned yet again how a very significant and increasing proportion of HNWIs are convinced that the inclusion of ESG criteria and sustainability in their investment strategy will lead to better returns and better resilience of the portfolio in the future."

Mining down to the detail

He said there is more information when you mine and dig deeper into the findings, discovering differences between countries and also between generations, and between men and women. "But the big picture," he reiterated, "is the strong and rising interest and focus on this subject and a greater tendency to include these metrics and factors in their investment decisions, already today or sooner rather than later."

He expanded on the reasons why clients are willing to follow ESG. "There is no single answer," he explained. "However, some of them firmly believe that the companies in which they put their money should have certain ESG attributes. Others are concerned about reputational matters. Some are increasingly convinced, as we are, that the sustainability of business models, their compatibility with a carbon-free trajectory for the global economy and their level of protection against physical climate or other environmental risks are becoming key in assessing the long-term risk adjusted return of a company. But there are impediments, and this centres on the limitations on the transparency and metrics of the data."

Lombard Odier's long ESG history

He explained that Lombard Odier realised this some years back. "We saw that an increasing number of clients were interested in going beyond understanding and assessing business practices. So, we moved to enlarge the analysis and to go beyond the traditional ESG approach to what we call a fully integrated sustainability approach. We focus on more than the ESG scoring of the business practices – and we believe our approach is already quite refined – and developed the analytical framework to understand more about the business model."

"We saw that an increasing number of clients were interested in going beyond understanding and assessing business practices. So, we moved to enlarge the analysis and to go beyond the traditional ESG approach to what we call a fully integrated sustainability approach. We focus on more than the ESG scoring of the business practices – and we believe our approach is already quite refined – and developed the analytical framework to understand more about the business model."

For example, he reported that a mining company with an advanced approach to decarbonisation could end up with a better overall assessment than a software company with a low carbon footprint but no plan to contain it in the future.

Looking beyond the numbers

"You have clients who want to have 'safe' companies in a rapidly evolving world," he observed.

"These investors want to have a portfolio whose trajectory is more in alignment with the Paris Agreement. To do so, you need different layers of assessment covering business practices, business models, business locations, and to ultimately understand which company can survive the kind of world we will be facing in 20, 30, 40 years."

He expanded on this, adding that from a pure methodology point of view, it is actually extremely complicated to isolate what will be a theoretical, pure ESG performance. "To isolate performance as a pure ESG factor is a major methodological challenge as ESG ratings might be correlated with other factors," he stated. "Secondly, if there was a direct correlation between ESG and performance in the past, we would not be in such a bad environmental situation as we are in today."

To win you must pay up

In short, he explained that as ESG-driven capital allocation did not pay enough in the past, there was no major momentum towards its adoption. "But regulation is now coming along as well, and we are extremely confident that sustainability started to pay and will pay increasingly in the future."

He explained that Lombard Odier is one of the very few asset managers and private banks to launch a natural capital strategy, which began some 24 months ago. "This natural capital strategy directs capital towards the circular economy and businesses inspired by the regenerative power of nature, and it has performed very well. However, it is skewed toward small and midcap, which have actually performed very well in the recent years but more recently have struggled somewhat. So, in reality, it is difficult to state what precise proportion of the strong performance of this natural capital strategy in the last 24 months was only due to ESG or sustainability."

"These investors want to have a portfolio whose trajectory is more in alignment with the Paris Agreement. To do so, you need different layers of assessment covering business practices, business models, business locations, and to ultimately understand which company can survive the kind of world we will be facing in 20, 30, 40 years."

Skewed allocations

Jean-Louis drew his commentary towards a close by remarking that traditional ESG factors tend to favour the environmental dimension and especially low carbon emitters. That, he explained, is the reason that the same names always appear high up the ESG rankings, such as Microsoft, Alphabet and others. But he said there should be higher ratings related to transitioning – in other words, companies that might not be low carbon yet, but that have a clear strategy and intention to contribute to decarbonisation.

Look beyond, look to the future

"Typically, today," he observed, "an ESG-centred portfolio might be made up of large tech companies, which have a relatively low carbon footprint, but they might not actually have a definitive commitment to be carbon neutral by 2030. This is why you need, again, to go beyond traditional ESG metrics and traditional ESG approaches." ■