

The Profitability of Sustainable & Responsible Investing: A Structured and Systematic Approach for Optimal Portfolios

Executive summary

This paper focuses on Sustainable & Responsible Investing (SRI) – often referred to as ESG (Environmental, Social and Governance) investing. We have a separate paper that focuses on constructing portfolios aligned to the UN Sustainable Development Goals (SDG).

The growth of sustainable investing has been driven by the strategy's ability to enhance returns, align with the interests of key beneficiaries and stakeholders as well as strengthen risk management by capturing non-financial data into stock pricing.

To construct sustainable portfolios, we differentiate between creating sustainability *compliant* vs. sustainability *maximised* portfolios. A sustainability *compliant* portfolio means that the stocks are not against principles in sustainability and can adopt other investment styles (e.g. momentum, dividend etc.). This is usually achieved by adopting negative / positive screening to an investment universe.

For sustainability *maximised* portfolios, we explicitly include expected returns *and* ESG in the function to maximise in our optimiser. Thus, the latter portfolios are optimal with returns/sustainability maximised; and risks and transaction costs minimised. The difference is subtle but significant in terms of achieving the investment mandate: whether the portfolio maximises sustainability (without compromising returns); or is sustainability compliant but can pursue other investment styles.

Our optimiser can also be combined with other factors such as dividend, momentum to create blended portfolio. We can also cope with granular data on E, S or G pillar so that client's preference within the individual pillar can be incorporated into the strategy construction.

We adopt historical point-in-time data of global stocks and demonstrate that if done correctly, one can achieve sustainability objectives without compromising returns. We find that a pure ESG maximisation and ESG emphasised strategies yield similar returns vs. other investment styles; but will have up to two times higher ESG scores and achieve more SDGs.

Our approach can be even more profitable, with similarly high sustainability metrics, if ESG investing is combined with the right global theme. Showcasing our solution, we were the [Principles for Responsible Investment \(PRI\) 2021 Awards](#) finalist – the PRI is a London based global proponent for sustainable investing whose 4,000+ signatories control over USD 100 trillion.

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