



## **Valeria Dinershteyn, Northern Trust**

Valeria Dinershteyn, Director of Sustainable Investing Client Engagement for EMEA at Northern Trust Asset Management, is verantwoordelijk voor educatie en innovatie wat betreft duurzame beleggingsmogelijkheden. Valeria ondersteunt klanten bij het ontwikkelen van nieuwe strategieën met betrekking tot ESG- en klimaatoverwegingen. Zij geeft regelmatig presentaties over duurzame beleggingsoplossingen op evenementen van Northern Trust en de sector. Valeria heeft een bachelor in Linguistics en Social Studies van de St. Petersburg State Polytechnical University, een master in Financial Management van de Nyenrode Business Universiteit en is CFA charterholder.

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**Hoe beïnvloeden ESG-gerelateerde overwegingen de beleggingsresultaten?**

# BALANCING ESG AND PORTFOLIO OBJECTIVES & RISKS

VALERIA DINERSHTEYN

DIRECTOR OF SUSTAINABLE INVESTING CLIENT ENGAGEMENT FOR EMEA



**NORTHERN TRUST**  
ASSET MANAGEMENT

# INCORPORATING ESG IN PORTFOLIOS

1

Are we achieving the goals we set out for?

2

What does that mean for our portfolio in terms of risk?

3

Case study of climate considerations in a low vol portfolio

# THE RISK REPORT ESG SPECIAL EDITION

RISK INSIGHTS SERIES

Key findings from a six-year analysis of institutional portfolios through an ESG lens:

**1,300+**

INVESTMENT STRATEGIES

**\$250+ billion**

EQUITY PORTFOLIO ASSETS

**88 institutional**

INVESTORS

*Five Key Discoveries:*

Uncompensated risks were prevalent in portfolios with higher ESG scores.

Portfolios with higher ESG scores experienced a greater dilution of active risk.

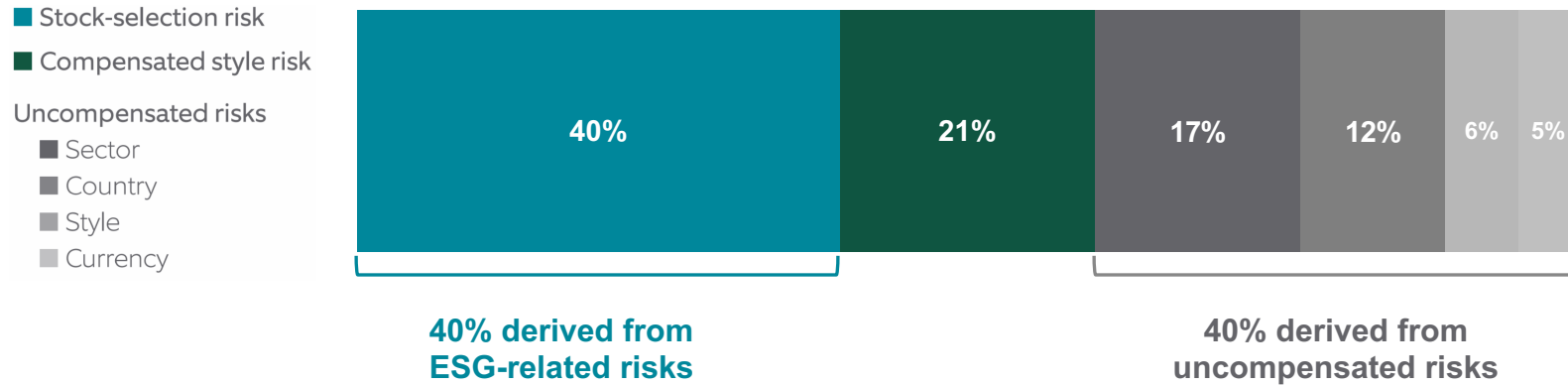
Active managers caused a larger drag on portfolio ESG scores.

ESG was highly sensitive to over-diversification.

Benchmarks outpaced investors on environmental scores, but not governance.

## UNCOMPENSATED RISKS

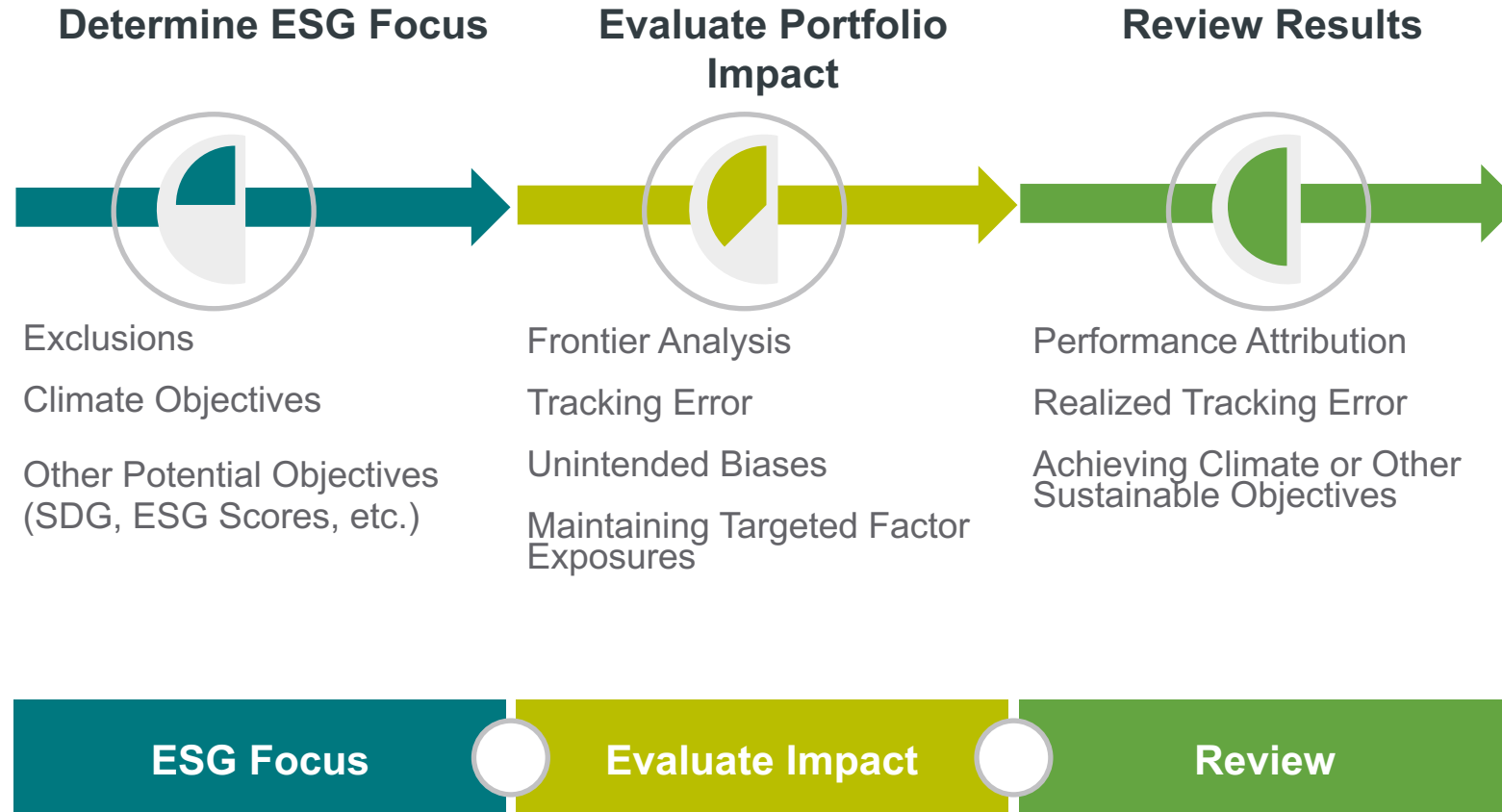
### BREAKDOWN OF ACTIVE RISK IN PORTFOLIOS WITH HIGHER-ESG RATINGS\*



Source: Northern Trust Asset Management. Data as of December 31, 2021. Please note, numbers on the page may not sum to 100% due to rounding. \*Higher ESG-Rated Portfolios are determined by ranking all portfolios in the study by ESG score and breaking them into quintiles. Higher-rated portfolios fall into the top quintile.

# CONSIDERATIONS FOR INTEGRATING ESG

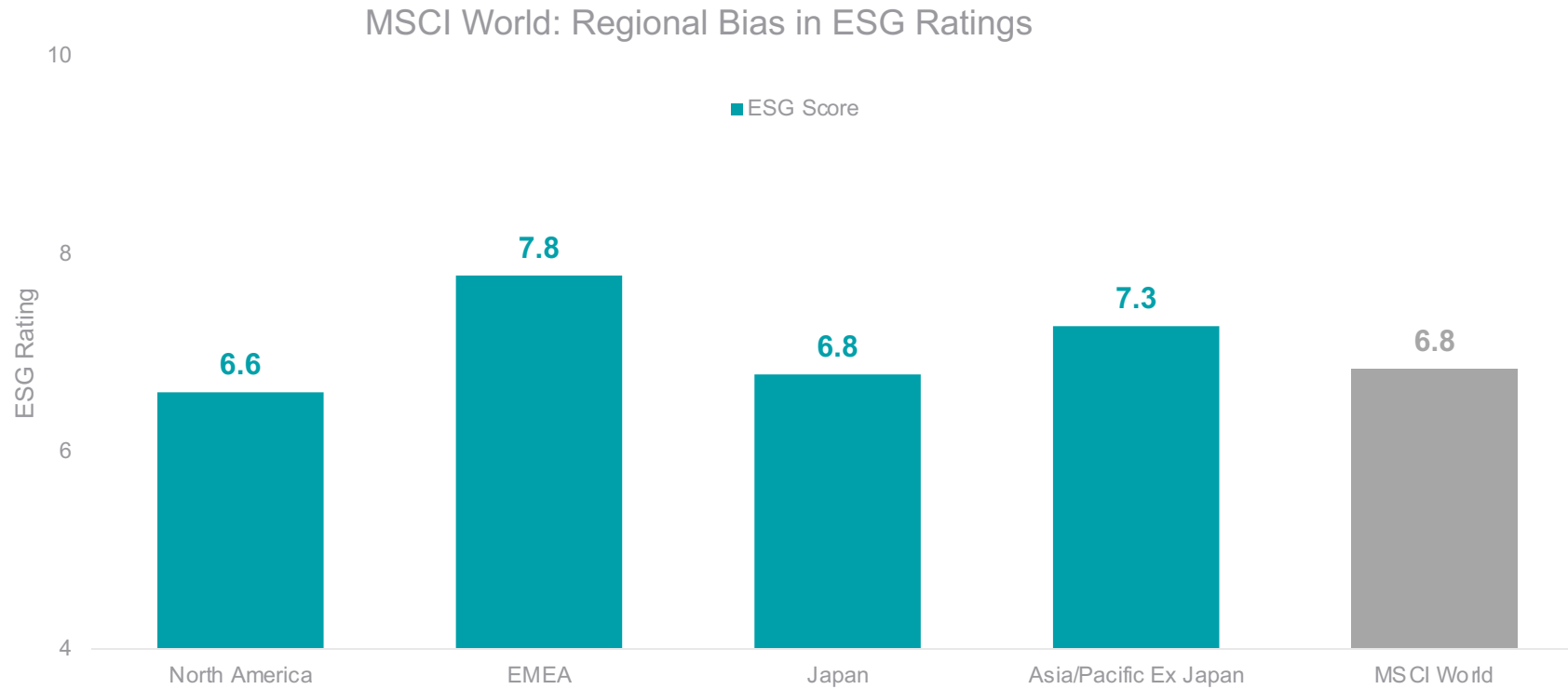
*Sustainability outcomes should be achieved without material impact to factor exposures*



Please note that this information reflects current processes and that all steps of the analysis may not be taken for each investment.

# REGION BIASES EMBEDDED IN ESG RATINGS

*EMEA has significantly higher ESG Scores than other regions*



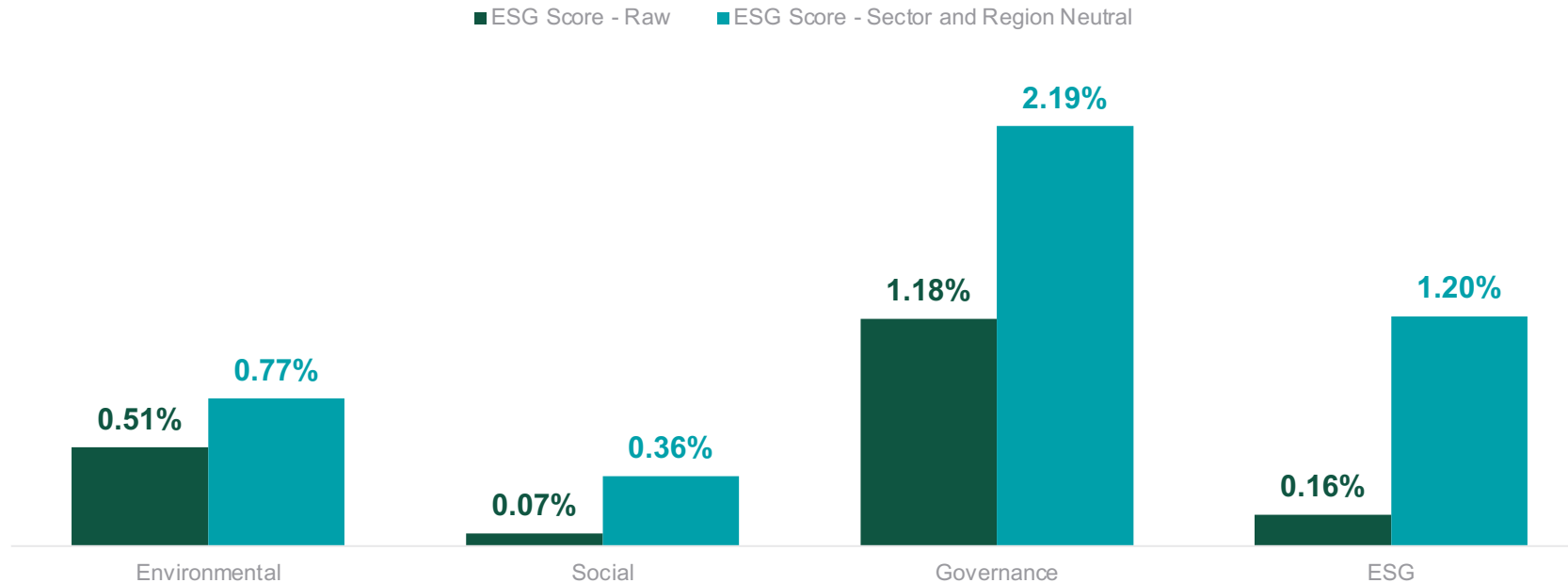
Source: Northern Trust, MSCI. As of 30-Sep-2022. It is not possible to invest directly in an index. Indexes are the property of their respective owners, all rights reserved. The case study presented is intended to illustrate products and services available at Northern Trust. They do not necessarily represent experiences of other clients nor do they indicate future performance. Individual results may vary.



# BIASES HAVE ADVERSELY IMPACTED PERFORMANCE

*Avoiding unintended sector and region exposures has helped ESG and pillar performance.*

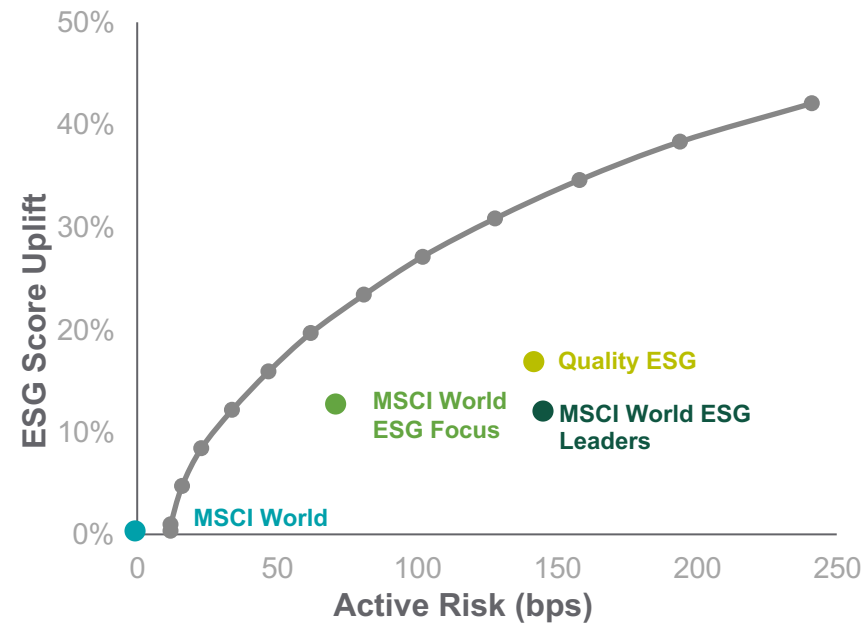
Excess Returns of Highest ESG Scoring Companies vs. MSCI World Index



Source: Northern Trust, MSCI. From 31-Jan-2007 through 30-Sep-2022.. Performance reflects the performance of the top quintile of ESG minus the MSCI World benchmark. Please see important information on Hypothetical Returns at the end of this presentation. For illustrative purposes only. **Past performance is not indicative of future results.** Returns reflect the reinvestment of dividends and other earnings and are shown before the deduction of investment management fees. Returns of the indexes also do not typically reflect the deduction of investment management fees, trading costs or other expenses. It is not possible to invest directly in an index. Indexes are the property of their respective owners, all rights reserved. The case study presented is intended to illustrate products and services available at Northern Trust. They do not necessarily represent experiences of other clients nor do they indicate future performance. Individual results may vary.

# ACHIEVING RETURN OBJECTIVES WITHOUT COMPROMISING ESG

## MSCI WORLD ESG FRONTIER



Source: Northern Trust Quantitative Research, MSCI. Frontier data as of 9/30/2022. It is not possible to invest directly in any index. A security rating is not a recommendation to buy, sell or hold securities. The rating may be subject to revision or withdrawal at any time by the assigning rating organization. Each rating should be evaluated independently of the other ratings. Carbon Emissions Intensity measure the average emission rate of CO<sub>2</sub> from a given source relative to the intensity of a specific activity. Carbon Reserves measure potential emissions assuming all carbon in reserves and future carbon emissions are combusted.

Efficient frontiers generated with the MSCI Barra GEMLT risk model, MSCI controversy criteria, and MSCI ESG ratings. Business involvement includes Tobacco, Conventional Weapons, Controversial Weapons, Civilian Firearms, For-Profit Prisons, Unconventional Oil & Gas, Arctic Oil, and Thermal Coal Power. For optimization details refer to the appendix.

# ACHIEVING RETURN OBJECTIVES WITHOUT COMPROMISING ESG

## PORTFOLIO CHARACTERISTICS

	Optimized Portfolios		
	MSCI World ESG Leaders	MSCI World ESG Focus	Quality ESG
<b>Factor Content</b>			
Factor Exposure?	x	x	✓
<b>ESG Profile</b>			
ESG Score Uplift	+12%	+13%	+17%
Potential Emissions Reduction	-72%	+4%	-81%
Carbon Intensity Reduction	-44%	-32%	-61%
<b>Exclusions</b>			
Business Involvement	✓	✓	✓
Controversy	✓	✓	✓

Source: Northern Trust Quantitative Research, MSCI. Frontier data as of 9/30/2022. It is not possible to invest directly in any index. A security rating is not a recommendation to buy, sell or hold securities. The rating may be subject to revision or withdrawal at any time by the assigning rating organization. Each rating should be evaluated independently of the other ratings. Carbon Emissions Intensity measure the average emission rate of CO<sub>2</sub> from a given source relative to the intensity of a specific activity. Carbon Reserves measure potential emissions assuming all carbon in reserves and future carbon emissions are combusted.

Efficient frontiers generated with the MSCI Barra GEMLT risk model, MSCI controversy criteria, and MSCI ESG ratings. Factor exposure represents an approach that integrates the Northern Trust Quality factor along with third party ESG ratings. Business involvement includes Tobacco, Conventional Weapons, Controversial Weapons, Civilian Firearms, For-Profit Prisons, Unconventional Oil & Gas, Arctic Oil, and Thermal Coal Power. Naïve ESG portfolio is a cap-weighted version of companies that pass a minimum ESG Score threshold and excludes business involvements and controversies as described above. Optimized ESG Portfolio maximizes ESG content for a desired level of ESG Score uplift and excludes business involvements and controversies as described above.

# Case Study: Integrating Low Volatility and Low Carbon Objectives

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# EQUITY FACTORS

*Six main equity style factors have historically provided a return premium, backed by extensive investment research.*

## Quality

The Quality factor targets companies with efficient management, profitability, and strong cash flows. Quality strategies seek to provide excess returns by investing in companies that are better positioned for short and long term growth.

## Value

The Value factor targets companies that trade at low valuations. Value strategies seek to provide excess returns as companies grow and their current valuations become more in line with normalized and prospective valuations.

## Low Volatility

The Low Volatility factor targets companies with less price and fundamental volatility. Low Volatility strategies seek to provide excess returns by minimizing losses in recessions while participating in the growth seen in expansionary phases.

## Dividend Yield

The Dividend Yield factor targets companies that pay large dividends. Dividend Yield strategies seek to provide excess returns by receiving larger dividends than the benchmark and reinvesting them for long-term capital appreciation.

## Momentum

The Momentum factor targets companies that have strong market sentiment and analyst sentiment. Momentum strategies seek to provide excess returns by investing in companies with strong tailwinds for higher growth than the benchmark.

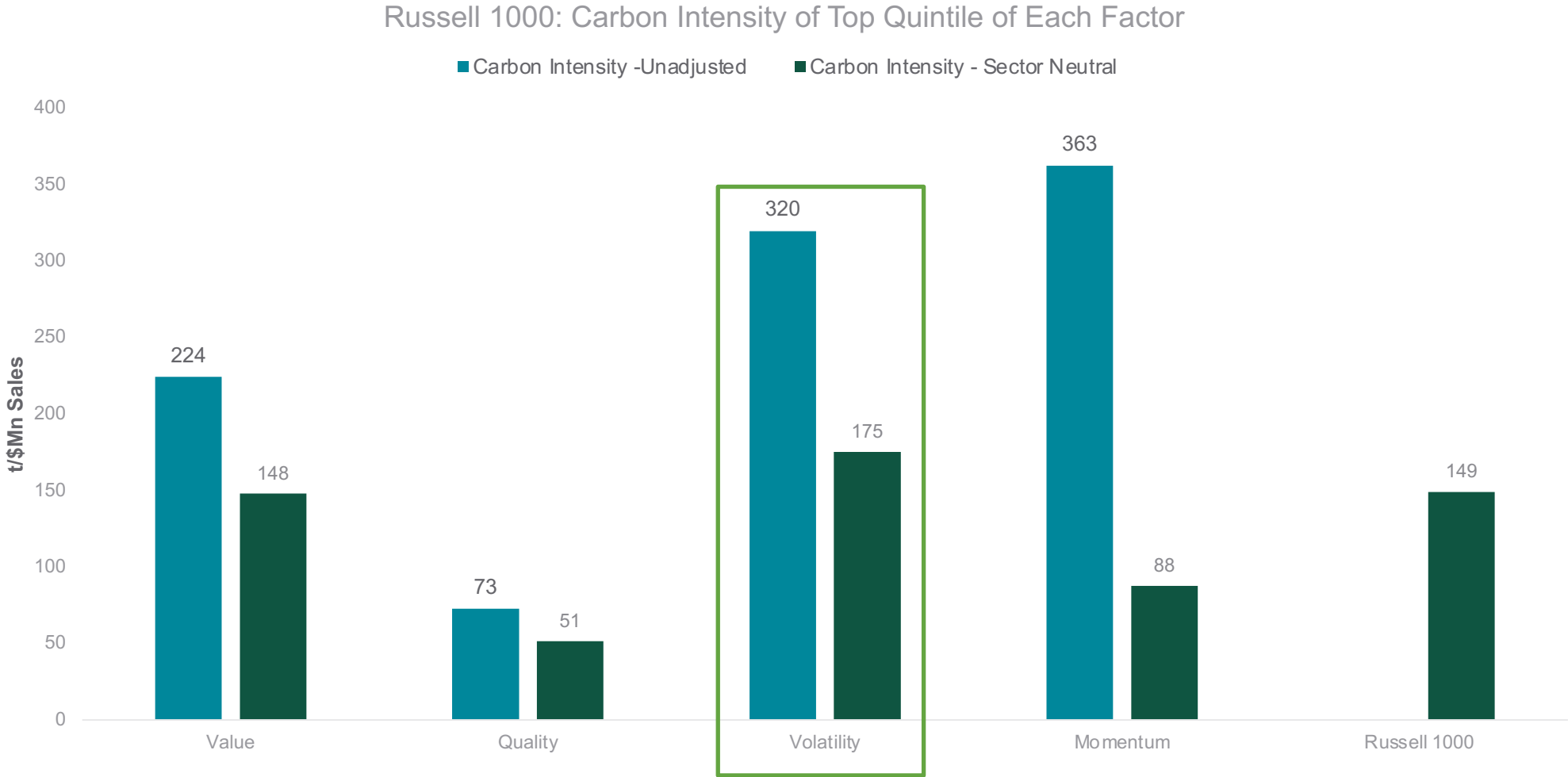
## Size

The Size factor targets companies of smaller market capitalization. Size strategies seek to provide excess returns by investing in companies of smaller size that have more room to grow within their industries and geographies.

Past performance is not indicative of future results. There can be no assurance that any portfolio investment objectives will be achieved, or that any investment will achieve profits or avoid incurring substantial losses. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment.

# CARBON INTENSITY FACTOR BIASES

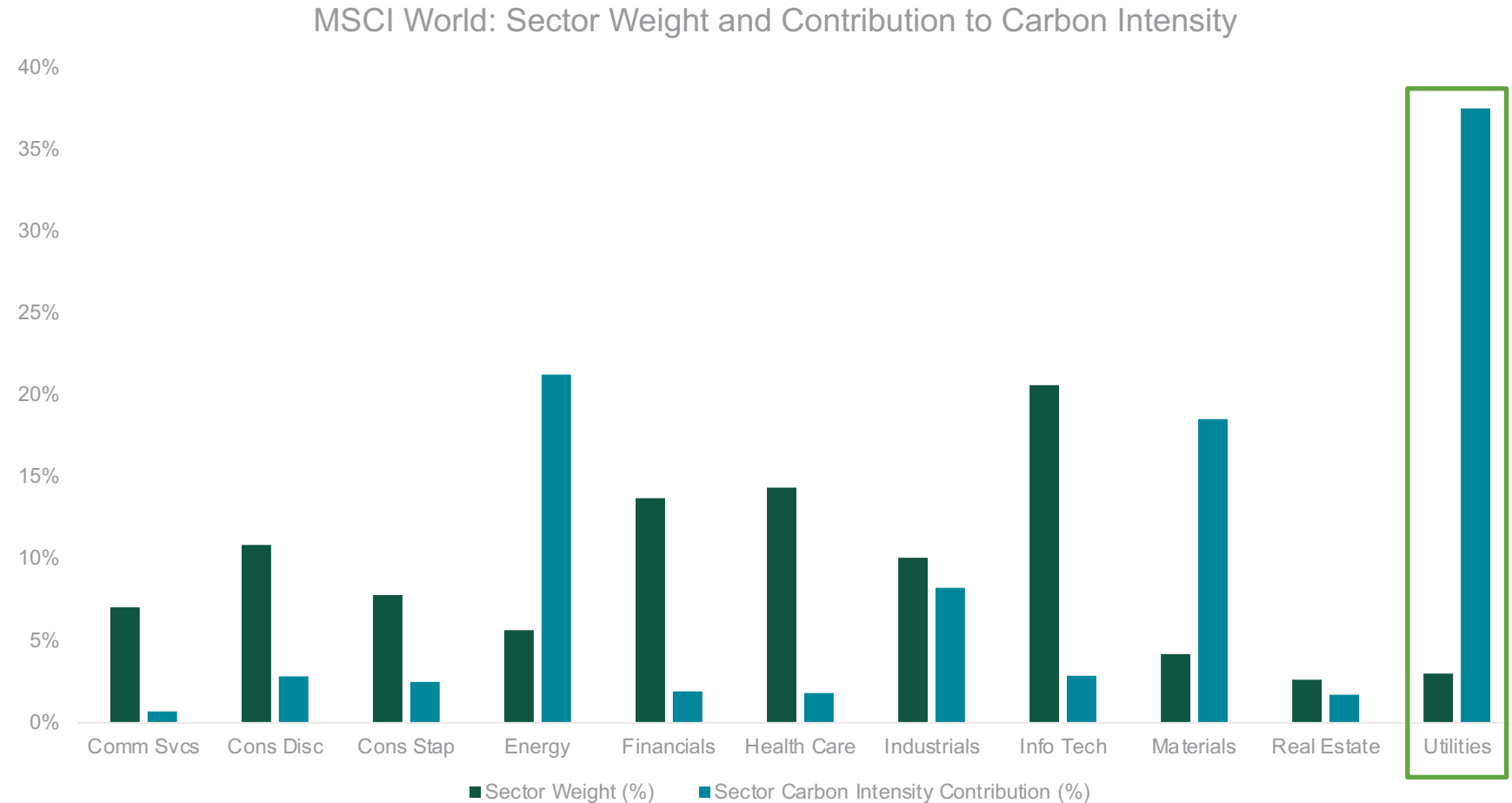
*Controlling for sectors in factor design has a significant impact on carbon intensity*



Source: Northern Trust Quantitative Research, FTSE-Russell. MSCI FaCS definitions used. As of 14-October-2022.

# RISK CONTROLS ESPECIALLY IMPORTANT IN LOW VOLATILITY

*Low Volatility strategies can be inherently high carbon due to sector exposures*

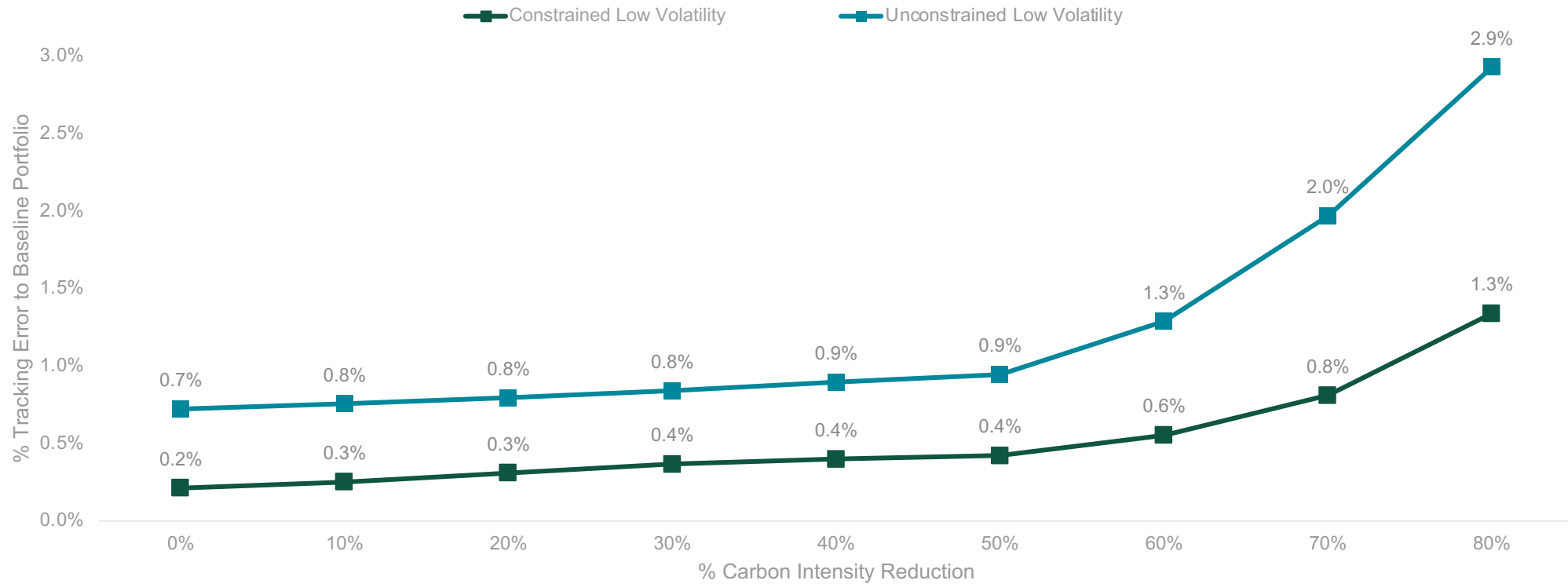


Source: Northern Trust Quantitative Research, MSCI. It is not possible to invest directly in any index. As of 14-October-2022.

# FRONTIER ANALYSIS: CARBON INTENSITY REDUCTION

*Risk controls allow for more seamless integration of carbon intensity at various levels*

How much does the portfolio at each frontier point differ from the original portfolio without carbon footprint objective?



Source: Northern Trust Quantitative Research, Unconstrained Low Volatility represents a minimum variance optimization without any sector constraints. As of 14-October-2022.



## KEY TAKEAWAYS



Momentum in adoption of sophisticated sustainable and climate aware strategies is growing, but challenged by data limitations



Sustainability objectives need to be implemented without dilution of financial and factor exposures



While achieving ESG objectives, it is imperative to consider what that does to the risk and unintended biases of your portfolio

A photograph of a modern, multi-level escalator system with glass railings and metal steps, viewed from a low angle looking up.

# Hartelijke dank voor uw aandacht