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PRIVATE WEALTH

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Refining Sustainable Investing Through Active Management

A changing world is requiring new levels of nuance and insight.

In recent years, the landscape of sustainable investing has undergone a significant transformation, with investors and asset managers reevaluating their approaches to stewardship and engagement. As the limitations of the "ESG" acronym (environmental, social and governance) become increasingly apparent amid evolving regulation and economic changes, there is a growing shift toward a more nuanced understanding of sustainable investing—one that emphasizes active management and informed decision-making.

In our view, this evolution is particularly crucial as large passive managers begin to step back from stewardship roles, leaving a gap that active managers are uniquely positioned to fill. By drawing on their deep understanding of business models and industry dynamics, active managers can offer thoughtful perspectives to company management, driving meaningful change in financially material governance, environmental and social domains.

What's the role of stewardship in sustainable investing? And how can active management make a difference—especially in navigating the economic impacts from climate transition? We offer some thoughts below.

STEWARDSHIP AND VALUE CREATION

In the evolving landscape of sustainable investing, we believe active management stands out as a powerful approach to achieving long-term investment success and meaningful change via strategies designed for investors that have such ambitions. Unlike passive strategies, active management can involve a hands-on approach where portfolio managers leverage their deep understanding of businesses to offer insightful perspectives and engage constructively with company management.

When it comes to sustainable investing, active managers may be uniquely positioned to navigate complex issues, thanks to fundamental research capabilities and industry expertise. This allows them to contextualize risks and opportunities within a company's specific business model, plug data gaps and make informed investment decisions that go beyond surface-level assessments.

We have long believed that stewardship of client assets should be a critical part of the investment process as we seek to protect and enhance overall value for our clients. We look to be true long-term partners to the companies we invest in on behalf of our clients, aiming to foster a relationship built on mutual understanding and shared goals. In our view, stewardship can serve as a bridge between investors and companies. This involves not only integrating financially material environmental, social and governance factors into analysis, but also engaging directly with issuers to drive long-term value creation.

It helps to be deeply rooted in investment analysis, which can shape the dialogue. For example, our firm's approach to engagement is based on the fundamental analysis conducted by our analysts and portfolio managers, who are focused on creating economic value while reducing risk. We believe that engaging with issuers is an essential part of being a longterm owner. By creating dialogue on financially material environmental, social and governance topics, it becomes possible to improve company performance and reduce risk. This proactive communication can help to address financially material sustainability issues, promote responsible company management and unlock new opportunities.

It is hard to overstate the importance of governance, as it forms the backbone of effective stewardship. How a portfolio manager prioritizes engagements may depend on the severity of environmental, social and governance concerns, potential economic exposure and the manager's relative influence on specific situations. By employing a variety of engagement tools, including company meetings, written communication and proxy voting, it is possible to conduct meaningful dialogue with companies. Such a bottom-up approach can not only encourage the implementation of specific ideas, but also enable the sharing of best practices across an investment organization.

In an era where large passive managers are increasingly exiting the world of stewardship and engagement, the value of active management is becoming even more pronounced. A commitment to stewardship is not just about fulfilling fiduciary responsibilities, but also actively contributing to better-functioning capital markets. Moreover, the willingness to innovate and demonstrate leadership in this space can help drive sustainable value creation on behalf of clients for the long term.

FOCUS ON CLIMATE

As the world grapples with the realities of climate change, the transition to a low-carbon economy presents both challenges and opportunities for businesses and investors. Navigating this transition requires a deep understanding of the implications for business models—a task that we believe is ideally suited to active managers.

At our firm, we work to assess the multifaceted financial impact of climate transition on companies. Through fundamental research and direct engagement with company management, we seek to evaluate how businesses are adapting to new environmental regulations, shifting consumer preferences, and technological advancements. In our view, such nuanced understanding is critical to identify both risks and opportunities in a rapidly changing landscape.

Analytical tools including our proprietary Net-Zero Alignment Indicator (see page 4) are central to our approach, providing a comprehensive assessment of a company's climate transition readiness. By drawing on extensive data and qualitative insights from research analysts, the indicator creates a robust framework for evaluating companies' alignment with achieving net-zero carbon emission goals. This enables us to undertake targeted engagements with companies on financially material climate risks and opportunities.

The potential impact of emerging technologies like generative artificial intelligence on energy demand underscores the importance of an active approach to judging climate transition scenarios. As energy consumption patterns evolve, it is important to continuously update analyses and strategies to reflect new realities, ensuring that portfolios remain resilient and aligned with long-term sustainability goals.

POLICY AND REGULATION: A KEY VARIABLE

In our view, active management is also valuable in understanding how varying regulatory and policy landscapes shape transition scenarios. Different regions may adopt distinct approaches to climate regulation, influencing the pace and direction of transition. With the ability to make informed judgments and adapt strategies accordingly, active managers are well equipped to navigate these complexities.

In the intricate tapestry of climate transition, regulation and policy play pivotal roles in shaping the pathways and scenarios that businesses must navigate. Key factors include emissions targets, incentives for renewable energy, supply chain dynamics and the political balance between economic growth and environmental considerations. In our opinion, the variation in regulatory frameworks across different regions and between different governments underscores the necessity of judgment and adaptability in investment strategies.

With a deep understanding of regulatory landscapes and policy developments, active managers are positioned to assess how these factors affect business models and investment prospects. Research analysts and investment teams are then equipped to make informed judgments about which companies appear best positioned to thrive under specific regulatory conditions. At our firm, we engage with industry leaders to advocate for thoughtful regulation that supports sustainable growth and innovation.

The dynamic nature of regulation and policy also demands ongoing vigilance and flexibility. With an ability to quickly adapt strategies and portfolios, active managers are uniquely positioned to navigate these changes and seek to capitalize on emerging opportunities.

COMMITMENT IS KEY

In an era of rapid change, active management emerges as an important tool for capital stewardship. As we navigate the evolving landscape shaped by regulation and technological advancements, commitment to active stewardship will likely be key to unlocking value and achieving resilient, long-term investment success.

Harvard Case Study: Measuring Climate Readiness

In 2023, Harvard Business School conducted an in-depth case study on our approach to integrating climate-related risks and opportunities into investment strategies. "Investing in the Climate Transition at Neuberger Berman" explored the firm's development of the Net-Zero Alignment Indicator and its role in fostering active engagement with companies on climate transition.

The Harvard case study highlighted the limitations of traditional climate transition strategies that often focused on divestment from high-carbon sectors, relying predominantly on carbon emissions as a singular metric. Recognizing the need for a more comprehensive and nuanced approach, we sought to create a framework that would not only assess companies' alignment with global net-zero goals, but also facilitate meaningful engagement.

As detailed in the case study, we created the Alignment Indicator to provide a robust assessment of companies' climate transition readiness. The indicator uses over 40 quantitative data points from environmental, social and governance data providers, complemented by qualitative insights from our research analysts. It evaluates companies based on six sub-indicators, including long-term ambition and decarbonization strategy, categorizing them into alignment statuses that range from "Not Aligned" to "Achieving Net Zero." This framework allows us build investment portfolios for clients aligned with their climate objectives.

The Harvard case study provided recognition to what we believe is a pioneering approach to navigating the complexities of the climate transition. Importantly, it highlighted our commitment to going beyond divestment, focusing instead on engaging with companies to understand their own plans to mitigate financially material climate transition risk.

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