Finding value in ESG

TAM Europe Asset Management discusses.

The start of 2022 has seen ESG investing arrive at a fork in the road. In recent years, a dual mandate of positive financial returns coupled with generating a positive societal or environmental impact was consistently successful and led to exponential demand for what has become a burgeoning area of the investment world. TAM have no doubts that, over a multi-year investment horizon, investors will enjoy both having their cake (capital growth) and eating it (contributing to socially desirable outcomes) as the world transitions to a brighter and greener future.

The environmental and sustainable champions often found in ESG portfolios are fundamentally growth stocks, priced on their potential to grow and thrive in the future. However, the current economic landscape remains a factor, which is looking less accommodative for these stocks. The US Federal Reserve has signalled, they are looking to raise interest rates quicker and more aggressively than the lofty valuations of these growth stocks have accounted for (high interest rates erode the current price investors are prepared to pay for future growth).

Thus, ESG & growth stocks have sold off aggressively. MSCI's World Growth Equity index finished January at -8.44% losses, rebounding from -13.11% four days earlier. The MSCI's World Value index however, posted -0.32% for the month. Value stocks, often bucketed with cyclical stocks, are companies which are viewed as undervalued compared to their fundamentals or their potential to profit in the current leg of the business cycle.

Although the innate growth bias of ESG investing is par for the course when looking at a long-term opportunity, TAM endeavour to utilise a wide spectrum of the investable ESG universe to provide exposure, where appropriate, to growth alternatives.

One such alternative is European Financials. We believe banks are primed to see an increase in profitability from a rise in borrowing costs for consumer and business loans when the European Central Bank raise rates. Further, they should fare well from the heightened volatility we are seeing in markets via increased Investment Bank trade commissions. This upside is all from a relatively low base, with European Bank stocks trading at vastly lower multiples than their US counterparts, who have already seen a large rally on the prospect of the US Federal Reserve reining in stimulus. We believe this position will provide crucial exposure to value and cyclical tailwinds whilst growth stocks may see a period of relative pressure.

We can only invest in this opportunity due to identifying a strategy with strong ESG credentials. The chosen fund is Article 8 compliant in accordance with the EU's Sustainable Finance Disclosure Regulation (SFDR). A globally recognised standard of sustainability disclosure that came into force in March 2021. The fund has received a triple-A ESG Rating and a 10/10 ESG Quality score from MSCI placing which is the highest possible MSCI certification. Not only that but it is in the top 1% for ESG investing in both the Equity Sector Financials peer group and in the global universe of c34,000 funds. This is the highest possible position within Lipper's Global Classification Scheme. The fund was also categorised in the lowest possible classification for carbon intensity with no 'brown revenues' generated or investable 'ESG laggard' companies included whatsoever.

We are cognisant that MSCI's research focuses heavily on the 'G' of ESG in its ratings (Governance). Therefore, more holistically, research shows leading banks and issuers are embracing sustainable finance practices with ESG considerations increasingly applied to banks' decisions. Many banks are developing their own sustainable finance frameworks alongside wider legislation and are issuing green & social loans, sustainability bonds & sustainability linked instruments.

TAM have run ethically minded portfolios for over eight years and have embraced new regulation, ESG certification tools and new opportunities, and we continue to use them to benefit our clients' portfolios. This fund forms part of a diverse strategy that provides exposure to many exciting facets of ESG investing and enables TAM to remain at the forefront of the growing opportunities in the marketplace. Our continually evolving framework means TAM can take steps to insulate the portfolio against shorter-term headwinds whilst prioritising fantastic long-term opportunities for positive impact and growth as we build for a more sustainable tomorrow.

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Combining expertise to build tailored solutions for your clients

A case study by OneLife.

In brief: George, a UK national, is married to Emma under the "separation of assets" regime.They have two children, Kate and Will, and the whole family are resident in France.

Objectives

- ***Invest** what is not needed to fund George and his family's lifestyle*
- *Have funds available as security for a potential **property acquisition***
- *Plan his **wealth transfer efficiently** and gradually to his spouse in **the context of their "separation of assets" marital regime**, and ultimately to his children*

1.1 Life planning - objectives

George has just received GBP 600,000 from the sale of a house that he inherited a few years ago from his parents.

George would like to integrate it into his financial planning for his retirement and prepare the transfer process of his assets.

- As George already has a securities account, he would like now, with the support of a specialist advisor, to **invest in European equities and possibly in "paper" real estate** to diversify his assets.
- He would also like to be able to use this savings if he decides to **finance the purchase of a house** for his retirement.
- Lastly, George is keen to secure the **transfer of his assets to Emma and his children** in the event of his decease, under favourable tax conditions.

1.2 The OneLife solution

With support from the experts at OneLife, George's broker develops a **bespoke Luxembourg life assurance solution**, flexible enough to combine several investment tools within the same policy:

- **George** will be the **policyholder and life assured**;
- By incorporating a **beneficial split ownership clause**, on George's decease **Emma will become the usufructuary** and his **children the bare owners**;
- A "**Buy & Hold**" Specialised Insurance Fund ('SIF') will invest in a series of French **unlisted bonds**, issued by one or more French companies investing in real estate. The bonds will be held until maturity, as provided for under Buy & Hold SIF rules;
- Other liquidities will be invested in an "**advisory management**" SIF. George will be assisted by his financial investment advisor to best allocate his investments among investment funds specialising in **European equities**, considering the other investments directly held by George, in order to develop a complementary strategy.

1.3 Realisation of the objectives

1.3.1 From the wealth management point of view

- **Combining** the SIF Buy & Hold and the SIF Advisory investment vehicles will enable George to meet his **investment objectives**;
- In the event of a real estate purchase in the future, the SIF Advisory Management portion of the policy will enable George to access a **Lombard loan or provide security for a loan** without having to redeem the policy, allowing continuation of his asset and succession planning objectives.

1.3.2 From the tax point of view

1.3.2.1 During the lifetime of the policy

- **As long as George does not redeem his policy**, whether partially or entirely, the identified solution will remain **tax neutral** for him, as is the holding of French bonds within the policy.
- Other forms of income and/or those which emanate from other countries from UCITS investments may nevertheless be subject to withholding tax when they are paid in the country of origin of each asset within the policy.

1.3.2.2 On the death of George

- Application of the **favourable life assurance tax regime** for the premiums paid by George as they have been paid before his70th birthday of the person whose life is insured (Art. 990 I General French Tax Code;
- Thanks to the split ownership of the beneficiary clause, **the usufruct will be transferred to Emma** and the **bare ownership to the children**, with favourable tax treatment depending on the age of the usufructuary (Emma) at the time of policy settlement and in accordance with French tax law. On the decease of the usufructuary, the children will acquire full ownership without additional taxation;
- The wording of the beneficiary clause also enables flexibility to be retained. Accordingly, if Emma does not need the funds when the policy is settled, she may waive her usufruct and full ownership will pass on to their children, Kate and Will.

1.4 Conclusion

George has fully met his investment and wealth planning objectives through a legally and fiscally fully secure bespoke solution, built up jointly by OneLife experts and his broker.

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