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# CORPORATE EXCELLENCE INSIGHTS

Hérens Quality AM is a specialized provider of systematic Quality Investment Solutions and one of the few providers of Quality equity investment strategies worldwide. Corporate Excellence Insight is our monthly publication that includes a brief update on markets and our thoughts about major trends that are impacting the investment management industry.

## MARKET UPDATE: MOMENTUM PAUSED

In August, the stock market's upward momentum paused as investors assessed whether the recent economic data would prompt the Federal Reserve to raise interest rates again before the year concludes. Also, second-quarter earnings were mixed due to rising costs and economic uncertainty.

### 3.8%

**U.S. UNEMPLOYMENT RATE ROSE TO 3.8% FROM 3.5%**

U.S. job growth picked up in August, but the unemployment rate jumped to 3.8% and wage gains moderated, suggesting that labor market conditions were easing and cementing expectations that the Federal Reserve will not raise interest rates this month.

### -\$83bn

**ELECTRIC CARMAKER VINFAST LOSES \$83bn IN MARKET VALUE IN ONE DAY**

The unprofitable and thinly traded Vietnamese maker of electric cars tumbled 44% in one day. And yet, VinFast at the end of August was still worth more than dozens of more established companies including BMW, Volkswagen, GM, and Ford.

### -30%

**NEW HOME SALES IN CHINA DECLINED BY THIRD IN JUNE AND JULY**

China's real estate troubles are accelerating. Prospective home buyers are holding back on making purchases, leading to weak sales that compound the urgent need for policymakers to step up support for the industry.



## MONTHLY TOPIC: INVESTING FOR A GREEN FUTURE

With growing awareness of environmental issues, many asset owners are seeking ways to align their investments with sustainability themes. But what exactly does it mean – to invest sustainably? About 40% of global sustainable investing assets fall under ESG integration strategy, but ESG integration, while an important part of the investment process, does not promise that funds will be invested in companies that directly help the planet or the society.

Investors who wish to ensure that their money is allocated towards companies which actively help drive environmental sustainability, might want to look into thematic funds. However, such funds clearly lag behind on most crucial indicators of financial health and contain a considerable share of companies that are not yet profitable.

Unlike some companies in 'green' ETFs, HQAM x OHOR Sustainable Quality Portfolio companies are already well-established leaders in their fields, giving investors an opportunity to participate in sustainable transformation while not compromising on quality of their investments.

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# Building Wealth while Saving the Planet

## Sustainability is becoming a must

With growing awareness of environmental issues, many asset owners are seeking ways to align their investments with sustainability themes. According to Deutsche Bank's survey, majority of asset owners agree that their investment should have a positive impact on the world<sup>1</sup>. Younger generations are especially at the forefront of this trend: only 2% of baby boomers and 16% of Gen X often or exclusively use investments that take ESG factors into account, compared to 1/3 for millennials<sup>2</sup>. ESG investing has become so popular that in 2022, as Republican politicians led calls to boycott BlackRock over its sustainable investment policies, a contrarian movement emerged: anti-ESG funds, which invest in industries ESG products purposefully exclude. Unsurprisingly, though, such funds failed to take off.

## Company making a difference vs. Company being an A-grader in ESG

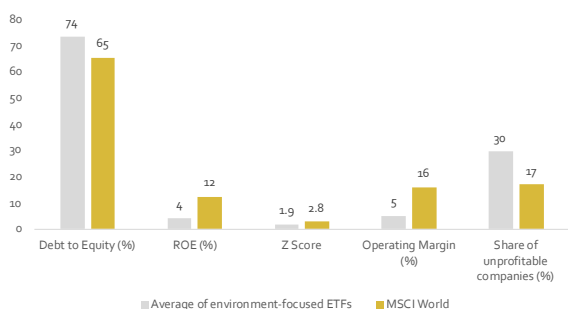
But what exactly does it mean – to invest sustainably? About 40% of global sustainable investing assets fall under ESG integration strategy<sup>3</sup>, which considers how successfully a company manages its material sustainability factors as part of a holistic analysis of the business. ESG integration is therefore not about investing in companies that do good for the planet – it's about a careful assessment of risks and opportunities that company is exposed to from ESG perspective.

For example, a few months ago Elon Musk expressed his discontent with the fact that Tesla, the pioneer of clean mobility, has lower ESG scores than tobacco producers. While Tesla's contribution to sustainable future is not under question and Company also manages its own carbon emissions rather well, under ESG integration, an analyst will also assess topics, such as labor management and governance, both of which have been points of controversies for Tesla and at times have directly contributed to poor performance of the Company's share price. Therefore, ESG integration is an important part of the investment process, even if it does not promise that funds will be invested in companies that directly help the planet or the society.

## Caveats of investing in a green future

Investors who wish to ensure that their money is allocated towards companies which actively help drive environmental sustainability, might want to look into thematic funds. However, underlying holdings of these funds must be scrutinized, as many companies that do good for the planet are unfortunately far from quality. Looking at a sample of some of the most popular environmental ETFs (9 funds), they clearly lag behind on most crucial indicators of financial health (Fig. 1) and contain a considerable share of companies that are not yet profitable.

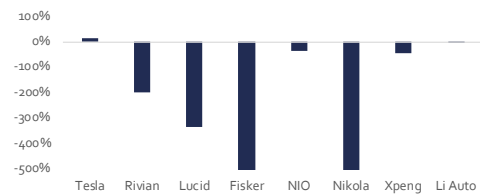
Figure 1: Financial quality of environmental ETFs vs. MSCI World (as of 29/08/2023)



Source: Hérens Quality AM, Refinitiv

This picture is hardly surprising, given challenging environment that many companies providing environmentally-friendly solutions face. The most vivid example is the EV market: while EVs are penetrating the automotive industry, the business is very capital-intensive and requires massive scale to achieve profitability. Hence, among pure-plays, only the leader, Tesla, currently commands positive profit margins (Fig. 2) – and even its profitability has recently been dented as competition becomes cutthroat.

Figure 2: Net profit margin of EV companies (TTM, as of 29/08/2023)

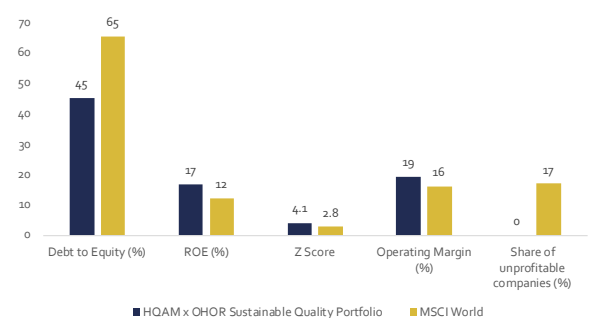


Source: Hérens Quality AM, Refinitiv

## Quality companies that help save the planet

Of course, there are exceptions, and we have some quality companies that provide solutions for a sustainable planet on our radar. As can be seen on Fig. 3, our HQAM x OHOR Sustainable Quality Portfolio, which combines Quality at Attractive Valuation approach with ESG integration and an additional environmental theme overlay, has an excellent financial quality profile. While staying true to our established investment approach, the Portfolio also requires that its companies show how their products or services help drive environmental sustainability.

Figure 3: Financial quality of HQAM x OHOR Sustainable Quality Portfolio vs. MSCI World (as of 29/08/2023)



Source: Hérens Quality AM, MSCI

One noteworthy example of such company is Tomra Systems, a Norwegian pioneer of reverse vending machines. Thanks to Company's invention, 44 billion beverage containers are collected for recycling each year. While the number is stunning, it is, in fact, only 3% of total containers used annually – the world certainly needs more of Tomra's machines. In other cases, enablers of a greener future are found in places where you would not even expect. For example, did you know that a well-known German semiconductor manufacturer Infineon has provided chips for 50% of currently installed wind and solar capacity? Combined with Infineon's leading position in solutions for EVs, Company's technology enables almost 100 million metrics tons of CO<sub>2</sub> reduction annually – equal to emissions from nearly 22 million cars.

We strongly believe that ESG should be an indispensable part of any investment portfolio, but for investors who wish to take their ESG commitments a step further, quality universe also has plenty of companies to offer. Unlike some companies in 'green' ETFs, whose business models have not yet been proven, HQAM x OHOR Sustainable Quality Portfolio companies are well-established leaders in their fields, with a solid track record of profitable growth, offering investors an opportunity to participate in sustainable transformation while not compromising on quality of their investments.

## References

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