The New York Times

Investing With a Conscience, but Done by a Robot

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APRIL 6, 2016

“No one wants to be patronized with a moral argument,” said Andreas Feiner, head of ESG research at Arabesque Partners. “You tell investors that these companies are going to perform better.” Credit Nicole Bengiveno/The New York Times

Cracker Barrel Old Country Store, the company behind a chain of down-home restaurants, might not seem an obvious model for advanced financial technology. Its specialty is vintage: vintage food, and in its gift shops, vintage toys and vintage music in the form of hymnal CDs.

Yet an upstart fund manager called Arabesque Partners has determined that Cracker Barrel is among the most attractive investments out there in a special category that takes into account environmental, social and governance factors — known in the industry as ESG.

And even more intriguing: The calculation was not made by a human analyst, but by a robotic one.

In the most recent full quarter for which data was available, Cracker Barrel represented 1.31 percent of the Arabesque Prime fund, which factors in a company’s sustainability and corporate responsibility track record before investing. That was more than any other stock, including more obvious suspects like Unilever, the consumer goods giant that is obsessed with sustainability, and Xinyi Solar Holdings, a big maker of solar panel components.

Arabesque is one of a growing number of investors that are leaning on mountains of new data about companies’ environmental, social and governance performances in hopes of making more profitable trades.

New firms like Arabesque are making ESG data a core part of their strategy. Goldman Sachs has filed with the Securities and Exchange Commission to start an ESG-focused exchange-traded fund. And the biggest money managers in the world, including BlackRock, now regularly incorporate ESG analysis as they compose their portfolios.

The motivation is not entirely about ethics. Underpinning the strategy is a belief that companies that take better care of the environment and their communities will perform better in the long run.

“No one wants to be patronized with a moral argument,” said Andreas Feiner, head of ESG research at Arabesque. “You tell investors that these companies are going to perform better.”

And yet even among the most strident capitalists, there is a growing sense that doing well by doing good is in vogue.

“We have the opportunity to marry making money with a purpose,” Mr. Feiner said. “That is a very rare thing in finance.”

What makes the Arabesque position in Cracker Barrel all the more surprising is that it wasn’t a fund manager who made the decision to invest. It was an algorithm.

Arabesque bills itself as the first firm exclusively focused on ESG investing through quantitative analysis — that is, with algorithms, rather than humans, picking the stocks. It has two funds, with about $50 million under management. Its Prime fund is fully invested in equities and rebalanced quarterly, while its Systematic fund moves money to cash holdings during periods of market volatility and is rebalanced daily.

To make these decisions, Arabesque’s technology relies on an expanding universe of data concerning the ESG performance of thousands of companies. Among the biggest suppliers of such information are Bloomberg, Sustainalytics and MSCI. Bloomberg said that about 15,000 of its customers regularly accessed the ESG data it provided through its terminals.

To compile the data, firms like Bloomberg mine regulatory filings, company sustainability reports and websites to find seemingly obscure information, such as how much nitrous oxide a manufacturer emits each year, how many employees died on the job, and how many women are in management positions.

Once firms like Arabesque get their hands on the data, they add it to their algorithms and place their faith — and funds — in the wisdom of the machine.

Arabesque has gone further than most, turning over the entire composition of its funds to algorithms rather than to humans. But many traditional institutional investors are moving in similar directions. At Newton, part of BNY Mellon, ESG considerations are part of the everyday investment decisions.

“To make the best risk-adjusted return decision, what I am doing is thinking more broadly and more holistically about things that a lot of investors don’t traditionally think about,” said Sandra Carlisle, head of responsible investment at Newton. “Take climate change. It’s very clear that that manifests itself in physical risk, in all sorts of things. That was not something that we were thinking about in the 20th century.”

BNY Mellon scoops up data from Bloomberg and Sustainalytics, as well as RepRisk, which does broad ESG analysis; CDP, which focuses on carbon emissions; and Institutional Shareholder Services, a corporate governance specialist.

About 15 years ago, the accounting scandals at Enron and WorldCom began to focus investors’ attention on the importance of corporate governance. After that, investors began to wonder if environmental and social factors should be on their radar, too.

“The door opened a crack so you could have a conversation about the possibility of these things,” said Michael Jantzi, chief executive of Sustainalytics, one of the main providers of ESG data.

Now there is little doubt that ESG issues can have meaningful effects on stocks. Shares in coal companies have plunged in recent years, pushed down by growing environmental concerns and increased regulation. Since the Deepwater Horizon disaster, more investors are scrutinizing the health and safety data of oil and gas companies. After world leaders agreed in Paris in December to try to cap greenhouse gas emissions, stocks in many fossil fuel companies fell.

“More and more people are realizing that this is a smart thing to do when you’re making investments,” Ms. Carlisle said. “Better to know than not to know.”