Emerging Manager Monthly

MARKETING | 11.01.23 | NOVEMBER 2023 ISSUE

Equity Manager RadiantESG Sees Bright Future For Strategies

By LAUREN ALBANESE

RadiantESG Global Investors continues to focus on the future of investing with its recent launch of three ESG and listed impact equity strategies as model portfolios earlier this year.

The Orinda, Calif.-based firm, which also offers U.S. small-cap core and growth strategies, added the portfolios known as Positive Trend Quality, One Life and Positive Transformation "to demonstrate a broader range of capabilities," according to Co-Founder and CEO Heidi Ridley.

The Positive Trend Quality portfolio is a global broad market analog to the U.S. small-cap core strategy and typically holds between 120 and 150 global mega-, large- and mid-cap names targeting an alpha of 2% with lower-than market total volatility; One Life focuses on 60 to 80 global all-cap stocks targeting an alpha of 3% with market-like total volatility; and Positive Transformation consists of between 60 and 80 global all-cap stocks targeting an alpha of 3% with market-like total volatility.

Kathryn McDonald, who leads RadiantESG alongside Ridley as co-founder and head of investments and sustainability, noted that the new quality portfolio is benchmark aware unlike the two listed impact strategies that are benchmark agnostic, provide "very good sector diversification and country diversification" and "start with an impact universe that is made up of stocks that have a significant portion of their product line positively associated with the United Nations' Sustainable Development Goals."

Specifically, the One Life strategy seeks "companies that are at the intersection of planetary health, human health, and animal health," while Positive Transformation "is a much more technology and innovation-driven impact strategy that's looking for companies that are going to be at the nexus of the transformation that we see in terms of the greening of the energy grid or advances in transportation, and next-generation infrastructure," McDonald said.

"We like to say that we brought the best of the DNA of a systematic firm because that enables us to do detailed analysis of all of the companies in our global universe," Ridley added. "Quantitative managers typically have hundreds of stocks, and many are held for risk purposes only; a byproduct of this is that they don't like to talk about individual positions, rather features of companies or whole portfolios. In contrast, we're building 60 to 80 stock portfolios – or in the case of Positive Trend Quality it's closer to 100

–doing very important qualitative review of all of the positions before we trade. This is especially critical when dealing with alternative information like ESG. We really want to make sure that the models have captured everything, and at the same time, we want to make sure that every position in the portfolio has legitimately earned its place to be there.”

As RadiantESG builds out its investment solutions, the HSBC RadiantESG US Smaller Companies Fund surpassed its one-year track record in June 2023 with strong performance, an achievement McDonald credits to the firm’s overall investment approach.

“The opportunity set for our US Small Cap strategies starts with the smallest 3000 companies in the U.S.,” she said. “Rather than invest in the very speculative, ‘pie in the sky’ ideas, we look for companies that are achieving real economic traction. We want companies that have strong earnings quality, good analyst sentiment and that are not overpriced. At the same time, the company must have really compelling ESG and/or impact characteristics. You can think of our strategy as investing at the intersection of those two ideas: fundamentals and ESG/impact. We’re very pleased with the performance we’ve achieved to date; we’ve been able to add significant alpha both in bear market and bull market environments.”

The fund, which RadiantESG sub-advises for its financial backer HSBC Asset Management, had $23 million in assets as of June 30 and returned 8.82% net-of-fees for the quarter compared to 6.41% for the Russell 2500 Growth Index.

RadiantESG utilizes three proprietary lenses to assess ESG opportunities facing companies across all of its strategies: an ESG Mosaic data platform that brings in granular information from various sources to assess a company’s ecosystem; a metric called Credible Intent that assesses how believable ESG statements are that companies are making; and a Positive Change Model, which looks to identify companies that are ESG leaders, ESG evolvers and impact leaders.

“Our sole motivation for considering company-level ESG and impact characteristics in our investment process is that we believe it will lead to portfolios with better risk adjusted returns,” Ridley said. “ESG and impact represents economic information that leads us to a clearer picture of the totality of the threats and opportunities a company may face and importantly, how it’s competitively positioned for a future that’s likely to look very different from the past. Ours is not a values-driven approach; it’s not an effort to express personal, political or ideological views. It is also not primarily exclusions-driven, rejecting big swaths of the market. Given that ESG can mean different things to different people, we try to be very clear about our approach and our philosophy. What I think we do very well is demonstrating ‘Here’s what we say we’re doing at the front end. Now let me show you how it affects the portfolio via very detailed, KPI-driven reporting. We don’t simply say, ‘our score is X versus the portfolio.’”

Despite differences in how ESG is interpreted, Ridley noted that she and McDonald simply “view ESG investing as common-sense investing” and found it “very gratifying” to establish RadiantESG in July 2021 and “lean into our convictions, to walk the talk, do what we say, say what we do as a firm.”

The duo previously worked together at Rosenburg Equities and put a lot of thought into establishing RadiantESG's investment team, which includes CIO Harry Prabandham, Head of Data and Technology Mauricio Bustos and Senior Portfolio Manager Kevin Lin, all of whom had "a very shared understanding of the importance of ESG and impact in terms of it being part of the investment process" and were "also aligned around the idea of a systematic (but not pure quant) approach to investing," McDonald said.

She considers the breadth of the team and its "desire to design an investment process that is likely to serve us well over a full earnings cycle or over di erent market environments" as some of the firm's greatest strengths, recognizing that that collaborative dynamic didn't happen overnight.

"I've been doing this now for close to 25 years and that has been something that I think you can really only learn through experience and over time," McDonald continued. "We're very lucky to have this senior group of people who all have that lived experience in equity investing, bringing these skills to bear in a very challenging environment — but things are always going to be exciting in the equity market!"

Still, Ridley "is always surprised when we're having conversations with potential investors, and they disproportionately focus on the risks that might come with a small investment boutique."

"We've done certainly everything we can to mitigate those risks, like having a strategic backer with access to capital and building an institutional quality business," she said. "It's unfortunately rare that people focus on the incredible benefits of smaller firms: creativity, innovation, flexibility, and nimbleness — and out-of-the-box thinking without focus-grouping everything to death! I think the environment has had its challenges, but I also feel like it's been an incredible opportunity to build something from scratch exactly the way we wanted it, exactly the way we thought it should work."

Although RadiantESG gets "plenty of 'Keep me posted' comments" from potential investors who want "to see a three-year track record and $100 million under management," the firm is "still very encouraged" that "people do seem genuinely interested in what we're doing and validating that it's pretty differentiated," according to Ridley.

"Now that we've crossed two years of being in business, 21 months of live track record in our flagship strategy, and having turned the mutual fund we subadvise around to be in a position of strength from both performance as well as the story and the positioning, we're really deep in engaging with consultants who are an important constituents, as well as prospective clients both in the U.S. and outside of the U.S.," she added.