

Boutique equity research head on how ESG filter turned fund's performance around

Stefan Schuetz said introducing an ESG filter in 2018 made Tareno's Global Water Solutions fund less volatile.

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Stefan Schuetz (pictured), head of the equity research team at Tareno in Basel, told *Citywire Switzerland* that introducing an ESG filter in January 2018 made the firm's [Global Water Solutions fund](#) less volatile.

He said: 'We always carried an overweight in Asia. We thought, "water is a big issue there, we need to be invested".'

'The potential never made it down to the bottom level of the companies. The momentum was very bad and we fell behind in peer-group comparison.'

'We made up our mind that the difference came from underperforming companies with sound fundamentals but a bad market environment and, on top of that, very loose handling of ESG criteria in these companies. Now, when we came up with the filter, almost all of them dropped out immediately.'

The integrated ESG filter influences the weighting of a share in the portfolio, as well as whether it is included or not. Schuetz believes that the filter's introduction has limited drawdown and volatility in the fund.

The fund's improved stability after selling off holdings in a number of Asian companies is an example of the difficulties many firms face with trying to apply ESG standards in different regions.

'We frequently had governance issues, companies that were delisted and excluded from trading and that hurt performance,' he said.

The fund now has 48.6% of its exposure domiciled in the US, followed by the UK on 14% and Japan on 8.4%. Japan is the only country in Asia that is named as having a large weighting on the fund's documents.

When asked what the ESG filter removed from the portfolio, Schuetz said: 'There were a handful of small and mid-cap private Chinese-based companies with a Hong Kong listing and you never know whether the owner of the company is really aligned with the other shareholders. There are sometimes very complex organisational structures behind these companies. It's hard to really have a solid view of them. Some of them don't even exist any more.'

To replace the non-ESG compliant holdings, Tareno combined increasing its stake in existing investments with bringing new companies into the portfolio.

'Before, we just invested in companies we liked, and now, we invest in companies we like and they have the necessary score to be on our shortlist,' he said.

The fund, which has a split of approximately 60% to 40% of retail to institutional investors, has returned 10.6% in the last three years, ranking 23rd out of 44 funds for total return, 10th for standard deviation and 22nd for maximum drawdown in Citywire's Global Themes category. Schuetz believes that this is a good return.

Schuetz sees water as a good additional investment.

'Water's a satellite. Water's not a core product, that's for sure. We would add it to any core portfolio as a satellite with between 2% and 5% weight given the strategy.'

Coronavirus

While the coronavirus brings some challenges, he thinks water companies should be able to adjust sufficiently. Some of the companies Tareno has held could be hit by a lack of demand.

'Geberit might be effected, for example. They do residential as well, which might balance their portfolio, but the commercial construction and all the companies that have exposure to water infrastructure for commercial buildings might suffer.

'Watts Water is geared toward the construction industry and that's definitely got to hurt them so we reduced that position a bit.

'We do see projects being postponed and companies cutting capital expenditure. This might be because they expect the government to launch an infrastructure programme and they'd rather wait for these funds instead of funding the project themselves.'

By contrast, the fund has increased exposure to Thermo Fisher, which supplies water testing equipment and Xylem, which offers solutions to digitalisation in the industry.

Schuetz said that Tareno is discussing launching a private equity vehicle for water investors but noted that it would have to build up the expertise first by looking for cooperation partners.