

MEINUNG

ESG and the madness in crowds

Fashion is contagious. Currently particularly fashionable is ESG. But this trend will fade, as have most other fads in investment management. But you still need to get the timing right.

Alexander M. Ineichen

04.08.2020, 02.27 Uhr

Deutsche Version

ESG (Environmental, social and corporate governance) investing is fashionable at the moment while anything related to fossil energy isn't. Fashion is contagious and going with the consensus is human. One example for a finance-unrelated lemming-like behaviour is having your underarms tattooed as a professional soccer player. Tattoo-less Cristiano Ronaldo, the Portuguese star striker, who was once described as a mix between Roger Federer and Kim Kardashian, will soon be alone.

Gustave Le Bon put it well in 1895. Contagion is a phenomenon that applies to any social behaviour, of which financial markets are only one example.

Man, like animals, has a natural tendency to imitation... The opinions and beliefs of crowds are specially propagated by contagion, but never by reasoning.¹

—Gustave Le Bon (1841-1931), French polymath

One parallel between fashion and investment fads is that the seller has an incentive to induce them. If you sell hoodies, you want all youths to wear hoodies. And then, when the youths are all wearing hoodies, you go after the middle-aged by tricking them into thinking they're youthful and look good by wearing a hoody. With ESG it's the same: you sell the belief that you outperform and do good.

Hoodies, tattooed underarms, latest financial fad; they are all related. Nietzsche, arguably an authority on madness, said the following on group think:

Madness is rare in the individual – but with groups, parties, peoples, and ages it is the rule.

—Friedrich Wilhelm Nietzsche (1844-1900), German philosopher

Investment legend Bernard Baruch, quoting Schiller, the German writer, not Shiller, the American Nobel Laureate, a phonetical namesake, thinks that collective idiocy is applicable to Wall Street:

Anyone taken as an individual is tolerably sensible and reasonable – as a member of a crowd, he at once becomes a blockhead.²

—Friedrich Schiller (1759-1805), German writer

Whether it's fashion, gimmicks, tattoos, Pokémon, cryptocurrencies, or investment products, doesn't matter that much. Group think and herding applies. One aspect of professional investment management is that the manager has an incentive to hug the consensus; to be conventional. The portfolio managers of a fund are often serious employees of a firm; rather than eccentric, entrepreneurial college drop-outs. This means they are exposed to career risk, rather than entrepreneurial risk. Keynes made this point well on what he called «the game of professional investment»:

Worldly wisdom teaches us that it is better for reputation to fail conventionally than to succeed unconventionally.³

—John Maynard Keynes (1883-1946), British economist

Being a contrarian is very chic

The incentive to seek convention is high. In institutional money management equities were long perceived as too speculative and institutional investors were mostly invested in bonds and cash-like instruments. This changed in the 1980s and 1990s. Some European institutional investors bought their first stock in the late 1990s, i.e., just before they halved for the first time in the early 2000s.

Scepticism towards consensus thinking is part of many investors' DNA, though. It is probably a *sine qua non* for the greatest investors. Mario Gabelli, an American value investor and frequent Barron's roundtable participant, put it as follows:

*Conventional wisdom results in conventional returns.*⁴

—Mario Gabelli (b. 1942), American investor

This was not lost on Coco Chanel, not of Barron's roundtable, but of *No. 5* fame:

*In order to be irreplaceable one must always be different.*⁵

—Gabrielle “Coco” Chanel (1883-1971), French fashion designer and businesswoman

The funny thing is that nearly all investors know all this. Average thoughts result in average ideas, resulting in average performance. Since everyone knows this, it is not

enough to be a contrarian. At times it feels as if contrarianism is the consensus (which it cannot be by definition). One ought to be, to use Barton Biggs' wit, a «contra-contrarian».

*Being a contrarian is very chic. The only trouble is that now everyone is a contrarian... Therefore, instead of being contrarians, perhaps we should be contra-contrarians.*⁶

—Barton Biggs (1932-2012), American strategist, investor and Wall Street legend

You still need to get the timing right, as one contrarian put it:

*The trick of being contrarian is to be early, not just different.*⁷

—Dean LeBaron (b. 1933), Adventure capitalist

The recent outperformance of ESG is mainly a function of a lower weight in old commodity related activities such as fossil energy and mining of metals. If there is mean reversion of these activities akin to the years after 2000, ESG will fade, as have most other fads in investment management. Judging by recent performance of gold and silver mining companies, the mean reversion has already started.

Alexander Ineichen



Alexander M. Ineichen is the founder of Ineichen Research and Management AG, and has been a CAIA Association member since 2003. He started his financial career in origination of risk management products at Swiss Bank Corporation in 1988. From 1991 to 2005, he had various research functions within UBS Investment Bank in Zurich and London related to equity derivatives, indices, capital flows, and alternative investments. Mr. Ineichen has written extensively on investment topics. He is the author of the two popular UBS research publications, «In Search of Alpha-Investing in Hedge Funds» (October 2000) and «The Search for Alpha Continues-Do Fund of Hedge Funds Add Value?» (September 2001), as well as two books, *Absolute Returns-The Risk and Opportunities of Hedge Fund Investing* (Wiley Finance, 2002) and *Asymmetric Returns-The Future of Active Asset Management* (Wiley Finance, 2006). He is

also the author of AIMA's «Roadmap to Hedge Funds» that has been published in 2008 and updated in 2012. Mr. Ineichen holds the Chartered Financial Analyst (CFA) and the FRM designations.

¹ Le Bon, Gustave (1895, 1982) «The Crowd – A Study of the Popular Mind», Second edition, Atlanta: Cherokee Publishing Company. First published in 1895 in French («Psychologie des Foules»).

² As quoted by Bernard Baruch in his Foreword to the 1932 edition of Extraordinary Popular Delusions and the Madness of Crowds (1841), by Charles Mackay.

³ From Keynes, John Maynard (1936) «The General Theory of Employment, Interest and Money», Harcourt, Brace & World, New York, Chapter 12.

⁴ As quoted in «500 of the most witty, acerbic and erudite things ever said about money», 2002, Petersfield: Herriman House Ltd.

⁵ As quoted in «Coco Chanel: Her Life, Her Secrets» (1971) by Marcel Haedrich.

⁶ Biggs, Barton (2006) «Hedgehogging», Hoboken: John Wiley & Sons, p. 143.

⁷ Mintz, Steven L. (1994) «Five Eminent Contrarians – Careers, Perspectives and Investment Tactics», Burlington: Fraser Publishing Company, p. 3.



INTERVIEW

«Der Aktienmarkt preist ein extrem positives Szenario ein»

Der auf Risikomanagement und «Nowcasting» spezialisierte Marktbeobachter Alexander Ineichen warnt vor der hohen Bewertung der US-Börsen und den optimistischen Prognosen zur Entwicklung der Wirtschaft.

Mark Dittli 26.05.2020



MEINUNG

Der Traum von der grossen Erholung wird platzen

Die Märkte steigen dank der gewaltigen Stimulierungsmassnahmen. Mehr als ein Strohfeuer ist das aber nicht. Dafür ist der Zustand der Weltwirtschaft zu fragil.

Felix W. Zulauf 02.06.2020



MEINUNG**Timing ist unsere Pflicht als Investoren**

An der Börse geht es nicht darum, recht zu haben, sondern das Richtige zu tun. Es spricht viel dafür, dass die Marktteilnehmer auf die Covid-19-Pandemie überreagiert haben und nun in einer Schockstarre verharren, die für weitere Avancen spricht.

Alfons Cortés 28.05.2020



Copyright © The Market Media AG. Alle Rechte vorbehalten. Eine Weiterverarbeitung, Wiederveröffentlichung oder dauerhafte Speicherung zu gewerblichen oder anderen Zwecken ohne vorherige ausdrückliche Erlaubnis von The Market Media AG ist nicht gestattet.