

Case Championship:

ESG Integration in Portfolio Construction and Valuation Models

Background

Environmental, Social, and Governance (ESG) factors have increasingly influenced investment decisions, leading to the emergence of sustainable investing. As investors prioritize long-term sustainability over short-term profits, integrating ESG criteria into portfolio construction and valuation models has become paramount. This case challenges students to explore how they can effectively integrate ESG factors into investment strategies while delivering financial returns.

Case Structure

Part 1: Data Collection and Analysis

1. ESG Metrics:

- o Identify and select a set of ESG metrics relevant to the chosen industries (e.g., carbon intensity, board diversity, labor practices).
- o Use data sources such as MSCI, Sustainalytics, or Bloomberg to gather ESG ratings and scores.

2. Financial Data:

- o Collect historical stock prices, earnings reports, and key financial ratios for companies within the selected industries.
- o Utilize platforms like Yahoo Finance, Google Finance, or company investor relations pages.

3. Market Analysis:

- o Analyze broader market trends and sector-specific data.
- o Gather insights on ESG trends impacting investment flows (e.g., regulatory changes, consumer demand for sustainable products).

Part 2: Portfolio Construction

1. Selection Criteria:

- o Establish selection criteria for asset inclusion based on ESG performance, financial stability, and growth potential.
- o Consider diversification across sectors, risks, and returns.

2. Portfolio Design:

- o Construct at least three different portfolios: one traditional (non-ESG), one partially integrated ESG, and one fully integrated ESG portfolio.
- o Detail the rationale behind each portfolio's construction.

3. Performance Metrics:

- o Define key performance metrics to evaluate the portfolios, including risk-adjusted returns, Sharpe Ratio, ESG score improvement, and others.

- o Compare the performance of ESG-integrated portfolios to the traditional portfolio over a designated time frame.

Part 3: Valuation Models

1. Valuation Techniques:

- o Choose appropriate valuation models (DCF, Comparable Company Analysis, etc.) to assess the companies within the portfolios.
- o Integrate ESG factors into the models (e.g., adjust discount rates for companies with high ESG risks).
- o Analyze how integrating ESG criteria changes the projected valuations.

2. Scenario Analysis:

- o Conduct a scenario analysis to assess how different ESG outcomes (positive or negative) could impact the companies' future financial performance (e.g., regulatory shifts, consumer trends).

Part 4: Presentation

1. Final Report:

- o Prepare a comprehensive report summarizing the portfolios, valuation models, and impacts of ESG integration. Include visual aids such as charts, graphs, and comparisons to bolster arguments.
- o Discuss potential risks and mitigations associated with ESG investments.

Evaluation Criteria

- **Data Analysis:** Quality and relevance of data used.
- **Integrative Approach:** Depth of ESG integration and its relevance to portfolio construction.
- **Risk Management:** Consideration of ESG-related risks and strategic responses.
- **Financial Performance:** Clarity in performance metrics and comparisons made.

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