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A decade of defence: AXA IM Sustainable Equity Strategy Anniversary

Q&A with Ram Rasaratnam, CIO of AXA IM Equity QI

- AXA IM Sustainable Equity Strategy will reach a significant 10-year milestone in August 2024
- The strategy has been aiming to help achieve investor objectives via a core defensive equity allocation, following a factor-based investment approach with a focus on the Low Volatility and the High Quality factors
- We put some questions to Ram Rasaratnam, CIO of Equity QI, about the strategy on its anniversary

Can you explain factor investing in simple terms?

Factor investing can be thought of simply as a way to understand and explain how companies with certain similar characteristics behave as a group. Once a particular pattern is identified and verified as a factor, it can be used ex poste to help explain returns or ex ante to help quantify risk and return.

Our view, however, is that factor investing is fundamental investing. Factors should tell us something about the earnings of a company and how they stack up relative to peers at a given point in time. Take the value factor, for example, where we investors seek to buy earnings now for less than they may be worth in the future. Similarly quality factors may try to model things like profitability, persistency in earnings and potentially earnings change, all of which are fundamentally anchored insights into a company's fundamentals.

What does 'quant' investing describe?

Quant investing is just investing at scale. We aim to replicate what analysts do, but using computers, models, and data to try and do it in a repeatable way across a broader universe.

We think that our models allow us to do this bigger, better and faster. We believe it gives us an edge when we're investing.

Does factor investing and quant investing go hand in hand?

I think so. As mentioned previously, if we think of ourselves as fundamental investors, we look at markets through the prism of factors to try and capture better fundamentals. I use quant methodologies as a way of building better versions of factors.

What factors are important for the Sustainable Equity QI strategy?

This is a strategy that focuses primarily on the quality and low volatility factors as we believe that the combination of these can help to deliver robust performance through the economic cycle. This is because our analysis shows that companies with high-quality earnings help capture returns when markets rise, while investing in less volatile stocks may reduce participation in market downturns. This asymmetric return profile is what may make this a core defensive global equity proposition.

Is there something unique about the strategy's approach to quality?

We believe quality is more than just buying high return on equity (ROE) companies. Analysing the operations and activities of companies allows us to identify companies that have truly sustainable, repeatable earnings. We do think about quality in a proprietary way and build our own models and signals; one of the ways in which we do that is to forecast how that quality may change in the future, which differentiates our approach from simpler definitions of this factor. Ideally, we seek to identify companies that have profitability moats and can defend their earnings in the face of the volatile world that we see.

Do you use any other factors in this strategy?

While not explicitly used for stock selection, we do use valuation insights to help us avoid stocks that we deem to have speculative valuations, as we believe these may carry a risk of disappointment if lofty growth ambitions fail to materialise.

Is responsible, or 'ESG (Environmental, Social and Governance),' focused investing synonymous with sustainable investing"?

I think ESG investing is, simply, investing. Sustainability is a concern for society and as such affects all actors in society, including companies. How a company generates earnings is directly impacted by how it treats its employees and cares for its surrounding environment. It is increasingly easy to measure these features, and relate them to earnings, whether that is in the form of a brand that is in populist decline or rise, or perhaps a fine for poor corporate behaviour. This all affects fundamentals, which means that for me sustainable investing is just investing.

The biggest misunderstanding occurs when investors think about it as something separate or different to their core equity allocations. We think sustainability should go to the heart of your investments and should be a core part of your equity allocation.

Which letter among ESG resonates the most in this context?

All three are clearly important. I think 'E' tells you something about a company's activities and how they're going to impact the environment. 'G' tells you something about how they go about these activities, their corporate governance culture, and so on. At present, if I had to pick one to highlight, I'd choose 'S' for the companies' behavioural impact on our global society. How companies behave towards employees, clients, customers, and the world in general for me is the most important element and understanding that goes to the heart of what we're all trying to achieve as ESG investors.

Can you tell us a little bit about how you go about integrating responsible investment ideas into this strategy?

In common with equity strategies across AXA IM we integrate responsible investment ideas in three ways. First, we integrate ESG data in our research and portfolio construction - where possible, incorporating ESG ideas into the signals we deploy - and then targeting specific ESG KPIs when we implement our ideas into portfolios. Second, there are classes of stock that we choose to exclude - certain sectors and industries that we think ultimately are harmful for both society and investors in terms of their outcomes. The third pillar is engagement - exclusion alone doesn't change corporate behaviour. We benefit from our scale as an investment manager but also from having a large insurance parent company, which allows us to engage with companies in a meaningful way.

Where does this type of strategy fit within an overall portfolio?

We see this strategy as part of an investor's core allocation to global equities given its focus on fundamentals and ESG information that may inform our view of those fundamentals. We think that building a portfolio of high-quality companies - often household names with strong brands - while seeking to avoid volatile stocks can lead to long-term outperformance across the market cycle. That we aim to do this at a reasonable price also lends weight to our view that this is a core strategy that can be held for the long term.

Tell us why you believe the sustainable equity strategy may be suitable for investors in this environment.

We know that there are geopolitical risks out there, with persistent uncertainty around inflation and interest rates and how these may impact growth. In the face of that uncertainty, our focus on quality remains paramount and may help investors trying to navigate this uncertainty – finding stocks with stable, persistent, and repeatable earnings we think we will be rewarded while uncertainty persists. Markets are also likely to remain uncertain, and we may see spikes in volatility as inflation weighs on growth and corporate earnings. The low volatility component of this strategy we think could help reduce risk in such a scenario, and the blend of these two factors together we think is well suited for what may come for the rest of this year and into the next.

The strategy is actively managed with deviation expected in term of constitution and performance compared to benchmark that is likely to be significant.

Risks

Risk Profile
Risk of capital loss.

Risk Factors
Global investments, ESG, Method and model

Sustainability Risks Given the strategy's Investment Strategy and risk profile, the likely impact of the Sustainability Risks on the strategy's returns is expected, according to the Management Company, to be low.

Method for Calculating Global Exposure
Commitment approach.

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No assurance can be given that our investment strategies will be successful. Investors can lose some or all of their capital invested. Our strategies are subject to risks including, but not limited to: equity; emerging markets; global investments; investments in small and micro capitalisation universe; investments in specific sectors or asset classes specific risks, liquidity risk, credit risk, counterparty risk, legal risk, valuation risk, operational risk and risks related to the underlying assets.

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