Insights

ESG for systematic FX trading

Environmental, Social, and Governance data as a complementary source in a fundamental strategy

Abstract

This article explains how we incorporate ESG data within our systematic FX trading strategies. Our approach uses an in-house data acquisition, cleansing, restructuring, and standardisation pipeline. Our proprietary algorithm dynamically assesses ESG indicators in order to promote the most compatible and demote the least compatible factors depending on recent FX market data. Our 10 years backtest shows incorporating this data as part of a systematic FX strategy can generate uncorrelated signals and be used as a complementary source to other types of economic data.

Introduction

ESG data comprise of a wide variety of factors. Their main emphasis is to measure how much a company, business or country considers, includes, and evaluates its contribution in: (1) incorporating environmental risks (2) social criteria and (3) transparency in governance, within its decision makings, investments and implementation of regulations. Recently, there has been a remarkable raise in the investors' interest to consider the performance of a company or potential investment's ESG criteria. Could a hedge fund incorporate ESG factors as "alternative data" and use this information to establish a strategy? Our answer to this question is - Yes!

In this paper, we propose our solution to utilising ESG indicators as part of a systematic FX trading strategy, and we explain how it is possible to use countries' ESG performance to establish a fundamental strategy. Our approach is based on a scalable data preparation stage, which transforms raw data into a standardised clean format that is usable within a relative value (RV) investment strategy. Following this stage, an algorithm dynamically checks the compatibility of the ESG indicators with the incoming market prices and assigns importance weights to them: compatible indicators are promoted, while those less compatible to the current market are demoted.

Our results show that this ESG integration within a systematic FX trading pipeline can generate uncorrelated signals, which can be used as a complementary source next to other types of economic data.

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