

FUTURE OF FINANCE: MANAGING THE RESURGENCE OF NON-ESG STOCKS UNDER STRICT COMPLIANCE

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Abstract

The global financial landscape is undergoing a transformative shift as the resurgence of non-Environmental, Social, and Governance (non-ESG) stocks challenges the decades-long dominance of sustainable investment trends. While ESG-based investing gained substantial momentum over the past decade, recent market dynamics indicate renewed investor interest in non-ESG assets, driven by profitability considerations, geopolitical volatility, energy market disruptions, and shifting macroeconomic conditions. This paper examines the contemporary future of finance by investigating how financial institutions can strategically balance financial performance and regulatory compliance amid the re-emergence of non-ESG stocks in capital markets. Through conceptual and analytical approaches grounded in recent financial market literature, regulatory reports, and investment trend data, this study identifies critical risk factors, compliance challenges, and adaptive strategies for sustainable portfolio governance. The findings demonstrate that stricter compliance mechanisms, transparent disclosure systems, and hybrid investment frameworks are essential to managing the coexistence of ESG and non-ESG assets in future financial markets. This research contributes to sustainable finance discourse by proposing an integrated compliance-centered governance model that enables institutions to navigate evolving investment realities while maintaining regulatory adherence and fiduciary responsibility.

Keywords: Non-ESG stocks, sustainable finance, compliance management, ESG investing, financial governance, portfolio management, regulatory frameworks

INTRODUCTION

The global investment landscape has experienced a paradigm shift driven by the rise of Environmental, Social, and Governance (ESG) investing frameworks. Over the past decade, institutional investors—including pension funds, sovereign wealth funds, and asset managers—have increasingly prioritized ESG criteria as fundamental to investment decision-making, reflecting growing concerns about climate change, social equity, and corporate governance (GSIA, 2023). The integration of ESG principles into investment strategies has become mainstream, with global sustainable investment assets exceeding \$35 trillion as of 2023 (MSCI ESG Research, 2023).

However, a counterintuitive phenomenon has emerged in global capital markets: the resurgence of non-ESG stocks, particularly in sectors such as fossil fuels, mining, defense, and conventional manufacturing. This resurgence presents a paradox for modern finance—while ESG investing continues to be championed as the future of responsible investment, non-ESG assets have demonstrated superior short-term profitability and resilience during periods of macroeconomic uncertainty and commodity price volatility (Krueger et al., 2020). This dichotomy reflects a fundamental tension in contemporary investment philosophy: the balance between long-term sustainability objectives and short-term financial returns.

The comeback of non-ESG stocks is fundamentally driven by macroeconomic realities rather than ideological preference. Recent geopolitical instabilities, including international conflicts and

supply chain disruptions, combined with elevated inflation rates and energy security concerns, have created market conditions favoring traditional energy and commodity-dependent sectors (IEA, 2023). Investors, facing inflationary pressures and seeking higher short-term returns, have increasingly reallocated capital toward non-ESG sectors, creating a competitive dynamic with ESG-focused investments.

Simultaneously, regulatory frameworks governing financial markets have become increasingly stringent. The European Union's Sustainable Finance Disclosure Regulation (SFDR), the International Sustainability Standards Board (ISSB) standards, and various national climate risk disclosure mandates have imposed comprehensive compliance requirements on financial institutions managing both ESG and non-ESG assets (European Commission, 2021; ISSB, 2023). These regulatory developments create a complex environment where institutions must navigate the coexistence of sustainability mandates with market realities favoring non-ESG returns.

This research addresses a critical gap in contemporary finance literature: how can financial institutions, portfolio managers, and regulatory bodies effectively manage the simultaneous existence of ESG and non-ESG assets within increasingly strict compliance frameworks? The central premise of this study is that the future of finance will not be characterized by the complete dominance of either ESG or non-ESG investment paradigms, but rather by the development of sophisticated hybrid governance models that allow for controlled exposure to non-ESG assets while maintaining regulatory compliance and fiduciary responsibility.

The originality of this research lies in its recognition that contemporary investment ecosystems must accommodate multiple investment philosophies simultaneously. Unlike previous literature emphasizing the superiority of ESG investing, this study acknowledges the persistent relevance of non-ESG assets and proposes integrated governance mechanisms that balance profitability with compliance, thereby offering practical insights for institutions navigating this evolving landscape.

LITERATURE REVIEW AND HYPOTHESIS FORMULATION

The Evolution of ESG Investing

ESG investing emerged as a formalization of responsible investment principles, expanding beyond ethical considerations to encompass environmental stewardship, social responsibility, and governance standards (Schoenmaker & Schramade, 2019). Friede et al. (2015), in a comprehensive meta-analysis of over 2,000 empirical studies, found that in approximately 90% of cases, companies demonstrating strong ESG performance also demonstrated superior long-term financial performance. This finding has become foundational to ESG investment theory, suggesting that sustainable practices enhance corporate resilience, reduce operational risks, and improve stakeholder relations.

The theoretical rationale for ESG investing rests on the premise that environmental and social risks represent material financial risks with long-term implications (Giese et al., 2019). Climate-related risks, labor disputes, and governance failures can erode shareholder value, increase cost of capital, and trigger regulatory sanctions. By integrating ESG metrics into valuation models, institutional investors argue they are identifying companies more likely to sustain long-term profitability and market position.

ESG frameworks have gained institutional legitimacy through support from major institutional investors, development organizations, and governmental bodies. The UN Principles for Responsible Investment (PRI), with over 5,000 signatory institutions managing more than \$120 trillion in assets, have legitimized ESG investing as a fiduciary standard (UNPRI, 2023). This institutional backing has driven regulatory development, with governments worldwide implementing ESG disclosure mandates and climate risk reporting requirements.

The Paradox: Non-ESG Stock Resurgence

Contradicting the narrative of ESG dominance, empirical market data reveal a persistent and growing appetite for non-ESG assets, particularly during periods of macroeconomic stress and market volatility. Krueger et al. (2020) documented that ESG-focused investors exhibit significant portfolio volatility during economic downturns, often reallocating capital away from ESG assets toward higher-yielding, lower-ESG-rated securities when faced with margin pressure and return requirements.

The resurgence of non-ESG stocks is empirically evident across multiple dimensions. First, oil and gas companies experienced unprecedented profitability in 2021-2023 due to surging energy prices driven by the Russian invasion of Ukraine and global energy supply constraints (IEA, 2023). Second, defense sector companies benefited from elevated geopolitical tensions and military spending increases. Third, mining companies capitalized on commodity supercycles driven by inflation and supply chain bottlenecks. In all these cases, non-ESG sectors substantially outperformed ESG-focused alternatives on a total return basis.

This phenomenon challenges the theoretical assumption that ESG performance and financial performance are perfectly aligned. While Friede et al. (2015) demonstrated long-term correlations, the short-to-medium term evidence reveals significant performance divergence during macroeconomic stress periods. As noted by Berg et al. (2022), ESG rating methodologies themselves lack standardization, with major ESG rating agencies showing correlation coefficients as low as 0.38, suggesting that ESG quality is ambiguously defined and inconsistently measured across the investment industry.

The resurgence of non-ESG stocks reflects rational investor behavior under uncertainty. During inflation, commodity price booms, and geopolitical instability, investors prioritize near-term cash flows and capital preservation over long-term sustainability objectives. Institutional investors, despite publicly stated ESG commitments, face pressure to meet return targets and portfolio rebalancing requirements, creating incentives to allocate capital to non-ESG assets when market conditions favor them (IMF, 2023).

Regulatory Compliance and Financial Governance

The intensification of regulatory frameworks governing financial institutions has fundamentally altered the investment landscape. The SFDR (European Commission, 2021) requires financial institutions to explicitly disclose the sustainability characteristics and potential negative impacts of investments, effectively requiring transparency regarding non-ESG holdings. The ISSB standards (2023) establish global benchmarks for ESG data transparency, while national regulators have implemented climate risk disclosure requirements (e.g., SEC climate rules in the United States).

These compliance frameworks create dual pressures on financial institutions: (1) regulatory mandates to avoid material ESG risks and conduct sustainability due diligence, and 2) fiduciary obligations to generate competitive returns, which may necessitate exposure to non-ESG assets during favorable market conditions. Baker et al. (2022) demonstrated that regulatory compliance costs and reputational risks associated with non-ESG holdings have become material factors in institutional investment decision-making.

Portfolio governance models must therefore address a critical challenge: how to maintain regulatory compliance while managing legitimate non-ESG exposures. Traditional compliance frameworks treated ESG and non-ESG assets as mutually exclusive categories. Contemporary governance requires integrated approaches that recognize non-ESG holdings as potentially material yet manageable risks within diversified portfolios.

Hybrid Governance Models

Recent institutional practice has increasingly shifted toward hybrid portfolio governance models that accommodate both ESG and non-ESG holdings within comprehensive compliance frameworks. Rather than excluding non-ESG assets entirely, sophisticated institutions implement multi-layered risk monitoring systems that combine:

- Enhanced due diligence procedures for non-ESG holdings (controversy screening, regulatory risk assessment)
- Real-time ESG and regulatory risk monitoring dashboards
- Transparent sustainability reporting that explicitly discloses non-ESG exposures and mitigation strategies
- Dynamic rebalancing mechanisms that adjust allocations based on compliance risk assessment

This approach reflects recognition that absolute exclusion of non-ESG assets may reduce portfolio resilience during specific macroeconomic scenarios while potentially underperforming for fiduciaries obligated to maximize risk-adjusted returns.

Table 1. Comparison of ESG vs. Non-ESG Investment Characteristics

Dimension	ESG Stocks	Non-ESG Stocks
Primary Objective	Long-term sustainability & social impact	Profit maximization & capital appreciation
Risk Profile (Long-term)	Lower reputational & environmental risk	Higher regulatory & compliance risk
Short-term Profitability	Moderate, stable growth	Often superior during commodity booms
Regulatory Scrutiny	High disclosure compliance	Increasing scrutiny under SFDR/ISSB
Investor Base	Long-term, values-aligned investors	Return-focused, tactical investors
Market Cycle Performance	Relatively stable	Highly cyclical, volatile
Compliance Burden	Aligned with regulatory expectations	Requires enhanced transparency

RESEARCH METHODS

This study employs a qualitative-analytical research approach grounded in contemporary financial literature, regulatory publications, and empirical market data. The research design incorporates three methodological components:

Literature Analysis

Comprehensive review of peer-reviewed academic literature from Scopus-indexed journals addressing: (1) ESG investing performance and theory, (2) non-ESG stock market dynamics, (3) regulatory compliance frameworks, and (4) portfolio governance mechanisms. The temporal scope encompasses literature from 2015-2024 to capture both the evolution of ESG thinking and recent market developments.

Regulatory Framework Analysis

Systematic examination of major international regulatory frameworks governing sustainable finance, including: the European Union Sustainable Finance Disclosure Regulation (SFDR), International Sustainability Standards Board (ISSB) standards, Task Force on Climate-related Financial Disclosures (TCFD) recommendations, and the Securities and Exchange Commission's climate risk disclosure rules. Analysis focuses on compliance requirements, disclosure mandates, and implications for institutional portfolio management.

Market Performance Analysis

Integration of empirical market data from financial databases and industry reports documenting: (1) comparative performance of ESG vs. non-ESG equity indexes, (2) institutional capital flows toward different asset classes, (3) price correlations during macroeconomic stress periods, and (4) sector-specific performance during commodity supercycles and geopolitical disruptions.

Thematic Content Analysis

Inductive content analysis of findings from literature review, regulatory documents, and market data, organized around three recurring themes: (1) financial performance dynamics of non-ESG stocks under macroeconomic volatility, (2) institutional and regulatory compliance challenges in managing mixed portfolios, and (3) emerging governance strategies that balance profitability with regulatory obligations. This analytical framework enables identification of strategic patterns, governance best practices, and policy implications relevant to contemporary finance institutions navigating the ESG/non-ESG investment dichotomy.

RESULTS AND DISCUSSION

Evidence of Non-ESG Stock Resurgence

Empirical market data unequivocally demonstrate substantial renewed investor interest in non-ESG stocks across multiple dimensions. Energy companies experienced historically high profitability in 2021-2023, with major oil and gas producers reporting unprecedented cash flows. The IEA (2023) World Energy Outlook confirmed that global fossil fuel demand increased rather than declined, despite decades of sustainability advocacy, reflecting genuine economic needs rather than investor preference deviation.

Table 2. Primary Drivers of Non-ESG Stock Resurgence

Driver	Mechanism	Impact
Energy Security Crisis	Russia-Ukraine conflict, supply chain disruption	Fossil fuel demand surge, price elevation
Inflation & Monetary Tightening	Central bank rate increases, cost-of-living pressures	High short-term returns in commodity sectors attractive
Geopolitical Tensions	International conflicts, regional instability	Defense sector profitability, commodity volatility
Commodity Price Boom	Supply constraints, demand surge	Mining, agriculture, energy sector outperformance
ESG Underperformance Periods	Renewable energy underperformance in 2022-2023	Capital reallocation toward traditional energy

The resurgence reflects rational investor behavior rather than ideological shift. Institutional investors managing defined benefit pension plans, sovereign wealth funds, and mutual funds face mandatory return requirements. During periods when non-ESG sectors deliver superior returns, fiduciary obligations create incentives for capital allocation to these assets, effectively overriding ESG preference constraints.

The cyclical nature of this phenomenon warrants emphasis: non-ESG stock prominence is not permanent but rather responds to macroeconomic conditions. During commodity booms, geopolitical instability, and inflationary periods, non-ESG sectors naturally outperform. This suggests that intelligent portfolio governance must accommodate tactical non-ESG allocations rather than treating ESG/non-ESG as a binary choice.

Compliance Challenges in Mixed Portfolios

The integration of non-ESG holdings within compliance frameworks has created substantial

institutional challenges. SFDR requirements, for example, mandate that financial institutions classify investments into three categories based on sustainability characteristics, requiring explicit disclosure of non-ESG exposures. This transparency requirement, while laudable from a disclosure perspective, creates reputational risks and potential regulatory scrutiny.

The primary compliance challenges identified include:

Challenge 1: Materiality Assessment

Financial institutions must determine which ESG factors are material to specific investments and industries. For energy companies, climate risk is undeniably material. However, SFDR's prescriptive approach sometimes requires disclosure of factors that may not meaningfully affect financial performance, creating information overload while potentially understating genuine financial risks.

Challenge 2: Greenwashing Prevention vs. Reasonable Disclosure

Regulatory frameworks attempt to prevent "greenwashing" (exaggerating sustainability credentials) but can create situations where institutions cannot openly discuss legitimate non-ESG holdings without triggering regulatory scrutiny or reputational consequences, even when such holdings serve fiduciary purposes.

Challenge 3: Standardization Gaps

ISSB standards attempt global harmonization of ESG reporting, but implementation varies substantially across jurisdictions. Energy companies face different regulatory requirements in the US, EU, and Asia, complicating global portfolio compliance.

Challenge 4: Real-Time Monitoring Requirements

Modern compliance frameworks increasingly require real-time monitoring of ESG metrics and compliance status, demanding substantial technology investment and operational capability development from financial institutions.

Table 3. Hybrid Portfolio Governance Framework for ESG and Non-ESG Assets

Governance Component	ESG Assets	Non-ESG Assets	Integration Strategy
Risk Assessment	ESG scoring models (MSCI, Sustainalytics)	Controversy screening, regulatory risk assessment	Dual risk scoring system
Performance Monitoring	ESG metric tracking, sustainability KPIs	Regulatory compliance monitoring, litigation risk tracking	Integrated risk dashboard
Reporting & Disclosure	Sustainability impact reporting, SFDR Article 8/9 classification	Explicit exposure disclosure, risk mitigation strategies	Transparent integrated reporting
Portfolio Rebalancing	Long-term strategic allocation	Tactical short-term allocation	Dynamic rebalancing based on risk/return optimization
Stakeholder Communication	Sustainability narrative, impact metrics	Compliance-centered disclosure, risk management emphasis	Multi-faceted stakeholder communication
Compliance Auditing	ESG data accuracy verification	Regulatory compliance verification, exposure	Comprehensive governance audit

monitoring

Hybrid Governance Models: A Strategic Necessity

Rather than adopting absolute exclusion strategies, sophisticated financial institutions increasingly implement hybrid governance models that strategically accommodate non-ESG assets within comprehensive compliance and risk management frameworks. These models rest on several key principles:

Principle 1: Risk-Based Asset Classification

Rather than treating assets as uniformly ESG or non-ESG, institutions classify investments along continuous risk spectrums. A renewable energy company with governance failures may represent greater ESG risk than an energy company with exemplary governance and transparent climate risk disclosure. This nuanced classification enables more accurate risk assessment than binary categorization.

Principle 2: Compliance-Centered Portfolio Restructuring

Institutions implementing hybrid models prioritize regulatory compliance through:

- Enhanced due diligence systems that thoroughly assess non-ESG holdings

- Real-time compliance monitoring dashboards tracking regulatory changes and institutional exposure
- Transparent disclosure frameworks that honestly communicate non-ESG exposures and mitigation strategies
- Dynamic rebalancing mechanisms that adjust allocations in response to compliance risk changes

Principle 3: Fiduciary Duty Alignment

Hybrid models explicitly recognize that fiduciary duty encompasses generating competitive risk-adjusted returns, which may necessitate tactical non-ESG allocations during favorable market conditions. This approach harmonizes fiduciary responsibility with sustainability commitments by viewing both as legitimate institutional objectives.

Principle 4: Stakeholder Engagement

Institutions adopting hybrid models engage actively with stakeholders (beneficiaries, regulators, civil society) to establish explicit governance policies regarding non-ESG holdings. Transparency regarding governance choices, risk assessment methodologies, and performance objectives builds institutional credibility.

Empirical Performance Evidence

Market data from 2020-2024 provides compelling evidence supporting the analytical framework proposed in this study. The MSCI World Index (ESG-focused) significantly underperformed the MSCI World Energy Index during 2021-2023, despite decades of narrative predicting energy sector obsolescence. Similarly, defense sector stocks substantially outperformed broad market indexes during geopolitical stress periods.

These performance dynamics demonstrate that intelligent portfolio governance requires tactical flexibility rather than dogmatic adherence to ESG-only frameworks. Institutions that maintained modest non-ESG allocations during commodity booms achieved superior risk-adjusted returns compared to pure ESG portfolios while maintaining overall sustainability objectives

CONCLUSION

The resurgence of non-ESG stocks in contemporary global capital markets reflects genuine macroeconomic dynamics rather than ideological regression from sustainability commitments. While ESG investing remains foundational to long-term investment strategy and institutional values, the realities of financial markets necessitate intelligent accommodation of non-ESG assets within governance frameworks.

Key Findings

This study demonstrates that:

- Non-ESG Stock Resurgence is Structural: Non-ESG stocks have demonstrated sustained relevance and periodic outperformance, driven by genuine economic factors rather than investor sentiment shifts.
- Regulatory Compliance is Achievable: Strict compliance frameworks, while demanding,

can effectively accommodate non-ESG holdings through enhanced due diligence, transparent disclosure, and dynamic risk monitoring.

- Hybrid Governance Models are Effective: Integration of ESG and non-ESG assets within comprehensive governance frameworks enables institutions to optimize risk-adjusted returns while maintaining fiduciary responsibility and regulatory compliance.

Practical Implications

- For portfolio managers: Implementation of hybrid governance models requires developing dual competencies—maintaining ESG expertise while building sophisticated non-ESG risk assessment capabilities. Regular portfolio rebalancing based on compliance risk assessment, rather than ad-hoc allocation decisions, enhances governance quality.
- For policymakers: Regulatory frameworks should acknowledge the legitimate role of non-ESG assets in diversified portfolios while maintaining transparency requirements. Harmonization of ESG disclosure standards across jurisdictions would reduce compliance complexity and improve market efficiency.
- For institutional investors: Explicit governance policies addressing ESG and non-ESG allocation strategies, developed through stakeholder engagement, enhance institutional credibility and align investment approaches with fiduciary responsibilities.

Future Research Directions

This conceptual study would benefit from empirical validation through quantitative research analyzing:

- Comparative risk-adjusted returns of pure ESG vs. hybrid governance portfolios across market cycles
- Compliance cost analysis comparing portfolio governance approaches
- Stakeholder perception studies assessing institutional credibility under different governance frameworks
- Cross-jurisdictional regulatory compliance analysis

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