ESG Investing: Loved On The Way Up And On The Way Down

Needless to say that the events of the last several months have caused large scale disruptions to lives of the global population. Perhaps one of the only beneficiaries from the enforcement of global lockdowns across the world is our environment.

Our air quality has improved due to the fewer cars on the road, our skies are free from the condensation trails left by aircrafts, while in Italy, the Venice canals have never looked clearer, as motorised boats and giant cruise ships have disappeared.

All this has led us to question whether this COVID-19 induced market sell-off will have changed the outlook for ethical, social & governance (ESG) investing. Will people, having witnessed these tangible differences to our society and the environment from small changes to behaviour, become more conscious of this when making their investment decisions in the future? And will they recognise the merits of investing ethically in market downturns such as these, as a way to protect capital by mitigating risks that become exacerbated during periods of market stress?

What we have seen over recent months is that ethically-orientated companies have been loved on the way up and equally on the way down. Many of our ESG funds held within the TAM Ethical portfolios have continued last year's outperformance during this heavy market sell-off, losing less than their benchmark and peers.

What this has proven to us is the importance of owning quality companies, which is at the centre of most ESG-focused strategies. But we can also see this in stock market performance in general, not just in ethical stocks. Over the month of March, where we experience the heaviest market falls, the US stock market fell in the region of 12% as measured by the S&P 500 index, versus the declines of the FTSE All Share and MSCI Europe indexes of around 15% and 14%, respectively. We put this relative outperformance of the US stock market down to its quality bias.

Quality is assessed in several ways, relating to the soundness of a company's balance sheet, how stretched it is in terms of leverage, and whether it has a competitive advantage in its products or services that can drive long-term returns? Companies performing well on ESG issues tend to tick many of these boxes.

Of course, we cannot claim that ESG stocks are immune from market sell-offs, and they have indeed seen negative returns over the last few months. The difference we believe, is that these stocks have the long-term growth story still intact, meaning there is scope for strong rebounds once the short-term noise fades and markets return to looking at fundamentals.

Ethical investing was already on track to transforming the investment landscape even before the coronavirus outbreak, which we believe will only serve to accelerate the pace of this transformation. The virus has brought to light not only issues concerning the 'E' in ESG as mentioned above, but there has also been a strong emphasis on employee health and safety and general labour practices, relating to the 'S', as well matters surrounding a company's pay structure and dividend payments, concerning the 'G'.

When we eventually come out the other side of this historic period for markets, we believe it will be those quality companies who have continued to focus on adhering to sound ESG principles, standing stronger than ever and ready to fill the gaps where others have failed.