Quantum leap

Mike Fox – Head of Sustainable Investments

Mike Fox believes that Covid-19 has done more for sustainable investing in four months than the last 10 years.

The last few months have turned the world upside down with Covid-19 leading to lockdowns unprecedented even in wartime. The social and financial costs are still unknown, but the impact has been staggering. Financial markets fell precipitously in March, only to recover some or all of their losses, buoyed by huge stimulus packages and an end to lockdowns.

Yet it would be a mistake to conclude that life will be back to normal for some time. And some things will never go back to how they were – there really will be a 'new normal', even when social distancing, facemasks and other measures are a distant memory. The pandemic will catalyse changes that were already happening, having a considerable impact on financial markets.

Sustainable investing had already experienced a remarkable surge into the mainstream in recent years. This had taken a bit of getting used to. I've spent much of my career on the margins of investment management, often unable to persuade investors of the merits of considering environmental, social and governance (ESG) factors.

This started to change around 2016, but the last four months have arguably seen more change than the previous decade. There are several forces at play here. It's far too early to make grand pronouncements about the impact on society, but the existential threat posed by Covid-19 seems to have started a process of reflection about how we live. People seem more aware of their relationship to society and the environment, and expect governments to keep them safe. There is an increased awareness of some potential drawbacks of globalisation, particularly in extended supply chains.

Many companies that had focused on shareholders at the expense of their wider stakeholders – sweating financial, physical and human assets to increase their returns on capital – have struggled. Conversely, businesses that have a positive relationship with their customers, employees and other social and environmental stakeholders, as well as their shareholders, have been more resilient.

The strong performance of sustainable funds shouldn't be a surprise. Sustainable investing is about identifying companies that provide solutions to global challenges, such as climate change and pandemics, rather than companies that exacerbate these problems. We also invest in companies that show ESG leadership in their sectors. This applies to both equity and credit in our sustainable multi asset funds.

Additionally, in sustainable equities, we favour companies with good long-term growth potential and strong balance sheets. Value creation and valuation are key factors in our investment process. It is understandable that companies that meet these criteria have done well in a period of profound societal challenge and economic distress.

Performance is about what you invest in and what you don't. It's an obvious point, but in the recent financial meltdown and recovery, certain sectors have stood out. In particular, the technology and healthcare sectors have performed well as remote working has become mandatory for many and authorities have sought a response to the virus.

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Sustainable investing isn't a magic bullet, though. Active investment has been a key factor in performance. In healthcare, we prefer companies with broad pharmaceutical research and development capabilities and effective distribution across therapeutic categories, rather than looking for the single winner of the race to develop a vaccine. We have also benefitted from owning companies that have strong positions in diagnostic testing.

In technology, the key to remote working has been the cloud, through which so many digital solutions operate. Other technology subsectors have also performed strongly, including digital payments systems, ecommerce platforms and remote medical patient monitoring. Likewise, software companies are thriving, in areas such as virtual safety testing, digital documentation and architectural design.

The trend to digitisation was already underway, of course, but has accelerated hugely. Satya Nadella, CEO of Microsoft, recently said that Covid-19 has led to two years of digital transformation in two months. The challenge for investors is to identify whether these trends are one-off boosts or will lead to a sustained uplift in growth.

Performance has also benefitted from not owning sectors that have performed poorly, such as energy, leisure and travel, or being underweight banks, which have performed poorly on the fall in yields and increased risk of defaults. Some of these sectors should recover as long as the companies aren't dragged down by their leveraged balance sheets, but energy and business travel feel particularly vulnerable.

There have been various step changes brought on by Covid-19. Some may peter out, but others will continue and accelerate trends that were already in play. Having been boosted by the pandemic over recent months, sustainable investing is well placed to continue to benefit from the societal and political changes that it has catalysed.

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