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Capital Management

COVID-19 Update:

Environmental, Social and Governance (ESG) investing is gaining popularity: Here's what investors need to know

ESG investing, which takes into account the sustainable and social impact of an investment alongside its financial metrics, was once considered a passing trend, but this investment option seems to be rising in popularity among many investors. ESG funds attracted $21.4 billion in new assets for 2019 — a significant increase from the $5.4 billion figure recorded in 2018, according to Morningstar.

The trend isn't showing any signs of slowing down either. In fact, ESG investing has been gaining steam, especially with younger investors. According to Morgan Stanley's September 2019 Sustainable Signals survey, 95% of millennials expressed interest in ESG investments and 67% reported being actively invested in sustainable products since 2017.

The coronavirus pandemic is putting the spotlight on companies following ESG guidelines and prompting a new wave of investors to give ESG a look. Here's what investors should know:

1. The stocks of companies with strong societal and governance practices are performing well.
Current events are showcasing which companies embrace some or all aspects of ESG. While there have been periods of both outperformance and underperformance of ESG indices over time, indices with an ESG-focus largely outperformed in the first half of 2020. For instance, through 06/30/2020, the MSCI ACWI fell 6.25% while the MSCI ACWI ESG Leaders Index fell by only 4.97%. In addition, the S&P500 ESG Index outperformed the S&P500 Index by 1.75% in the first half of the year. This is in part due to the reduction of traditional energy companies from ESG indices. According to a Morningstar report looking at mutual funds, during the first quarter of 2020 when stocks saw steep declines, 70% of sustainable mutual funds recorded returns in the top halves of their broad-based peer groups and 44% of those funds scored within the first quartile of their peer groups. What's attractive to investors now is not only making a positive difference in the world by investing in companies that adhere to ESG principles, but also the prospect of mitigating long term ESG related risks.

2. Influential investment firms are starting to incorporate ESG principles.
BlackRock and Goldman Sachs, for example, have increased their focus on ESG investing, with each releasing its own report on ESG criteria. Larry Fink announced in January that sustainability would be Blackrock's "New Standard" for investing. In its Sustainable Signals Survey from September of 2019, Morgan Stanley found that only 52% of investors were pursuing sustainable investments due to concerns about a financial trade-off. However, the opposite has been true throughout the COVID-19 crisis and the implementation of ESG principles at the largest investment firms could sway public opinion of ESG. Overall, companies that effectively manage ESG risks are doing quite well in the current environment, and we expect to see more large companies following objective ESG criteria in the foreseeable future.

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3. The pandemic is prompting greater emphasis on the "S" (social) and "G" (corporate governance) aspects of ESG.

While the environmental ("E") component of ESG is important, the factors that highlight a company's ability to navigate a global pandemic come from the "S" and "G" portions of ESG. According to S&P Global, companies that do well in the social category are more likely to properly support their workers from a health and safety standpoint, think about the social impact of supply chains, avoid reputational damage, etc. Companies with high governance scores employ proper corporate governance that guides actions during times of crises, ensures fiduciary responsibilities are emphasized across all departments, avoids corruption and instability, etc.

4. ESG is part of a broader trend towards stakeholder capitalism.

ESG investments is also encouraging "stakeholder capitalism" — or the idea that an entity should benefit customers, employees and suppliers, along with its shareholders. Major corporations like J.P. Morgan, Apple and Amazon are showing investors that these factors are important to them by managing risk and focusing attention on the long-term.

Overall, the impact of the pandemic is helping to popularize a new kind of investing — one that is more focused on building a long-term sustainable business model, while putting a greater emphasis on principles like governance. The trend had already been gaining traction among investors in recent years and is generating even greater momentum amid the unprecedented developments of 2020.

Please send your questions, comments, and feedback to info@mai.capital.

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