momentum

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Sustainable investing to celebrate Earth Day!

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The relevance of sustainability-focused investment strategies seems to be increasing; for example the UN calling on investors to align portfolios with the Paris Agreement and divest from fossil fuel investments. Many firms are launching new Environmental, Social and Governance (ESG) compliant versions of their strategies to meet this demand, so we wanted to share our thoughts on the space.

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What is sustainable investing? A common definition is an investment strategy that seeks to consider both financial return and social/environmental good to create a positive change. Sustainable investing isn't really a new thing – as early as the 18th century, the Quakers, a Christian group, forbade its members from investing in businesses related to the slave trade.

Today there are several forms of sustainable investing with a more or less active approach: negative screening - where an investor excludes certain securities from investment based on ESG criteria, shareholder activism - when an investor attempts to positively influence corporate behaviour, or positive investing - when an investor actively looks for companies that have a positive impact. An interesting question is whether and how a sustainable approach fits with traditional equity investment styles?

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Quality investing is the most natural fit for this approach as looking at sustainability issues is a key component of evaluating a business' quality and its ability to sustain its returns over the long term. Quality orientated managers are most likely to engage with ESG through shareholder activism or a positive investing approach rather than simple negative screening. Some will be more or less strict, avoiding fossil fuel businesses which are threatened by a move towards renewable energy for example, but also perhaps sugary drinks businesses which could be impacted by new regulation to curb obesity or even more purely on the grounds of the negative impact to society.

There is also a place for sustainable investing in high growth strategies to identify future winners or losers, but it can be difficult to assess sustainability criteria for newer business models. One surprising example could be Tesla. The company has experienced strong demand because of its eco-friendly image but some argue that electrical cars can be equally or more environmentally destructive as vehicles with combustion engines, due to the impact of producing such powerful lithium-ion batteries in large quantities.
But sustainable investing seems to be less compatible with a deep value approach. Most managers in this space only use negative screening, trying to avoid ESG scandals that could impair the value of a business. Few are actively looking for truly "sustainable" businesses. This is probably due to the fact that these managers focus on the cheapest segments of the market which tend to be more "dirty" businesses; for example the materials or industrials sectors. It is harder for deep value managers to fully integrate a philosophy of sustainable investing without losing some key components of their investible universe. While less a natural fit than with other styles, it doesn't mean that sustainable investing won't become important for value managers as the issues are raised on the investors and regulators' agendas.

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As regulatory pressures increase and investors become more self-conscious about the social and environmental credentials of their portfolio, we believe that sustainable investing will become less a simple option for investors but more a permanent reality and part of their investment process.

Market Focus

- Brent crude rose 2% to $73.7 a barrel
- Gold fell 0.7% to 1,337.8 an ounce
- US and European treasuries decline, yields rise
- China and the US look towards reconciliation on trade

US

- The Dow Jones rose 0.4% to close the week at 24,463
- US sanctions against Russia have rocked metal markets worldwide. Aluminium prices have risen over 30% since the beginning of April and Nickel prices are at a three-year high
- The Nasdaq 100 rose 0.6% to 6,667.7
- Google is aiming to protect itself from the EU's General Data Protection Regulation (GPDR) which could seriously disrupt its $20bn targeted advertising model. It's seeking to be granted 'controller' status , a significant advantage in how it handles user data
- The S&P 500 index rose 0.5% to 2,670

UK

- UK unemployment is down to 4.2% which is the lowest level since 1975
- Mark Carney hinted that he may not raise interest rates in May - a surprise given the unemployment data
- UK inflation slowed to the weakest in a year at 2.5% in March. This was down from 2.7% in February
- Retail sales declined 1.2% during a very cold March with clothing and household goods hit the hardest
- The FTSE 100 rose 1.4% to 7,368

Europe

- Eurozone inflation rose 1.3% in March from the previous year which was below expectations of 1.4%. Core inflation remained at 1% for a third month.
- The Euro Stoxx 50 index rose 1.4% to 3,488
- Composite PMI for the Eurozone remained unchanged at 55.2 in April. This points to slower growth but robust fundamentals: Service PMIs increased though manufacturing PMI is at a one-year low.

Asia

- The US Treasury Secretary Steven Mnuchin is considering a visit to Beijing in an attempt to diffuse recent trade disputes, a move that would be welcomed by the Chinese Ministry of Commerce
- The Hang Seng index fell 1.3% to 30,418
- The Nikkei 225 rose 1.8% to 22,162
- Hostilities cool between North Korea and South Korea

Past performance is not indicative of future returns.
Source: Bloomberg, returns in local currency unless otherwise stated.