Drawing the line on Technology

KING&SHAXSON
Asset Management I Rewarding your Values

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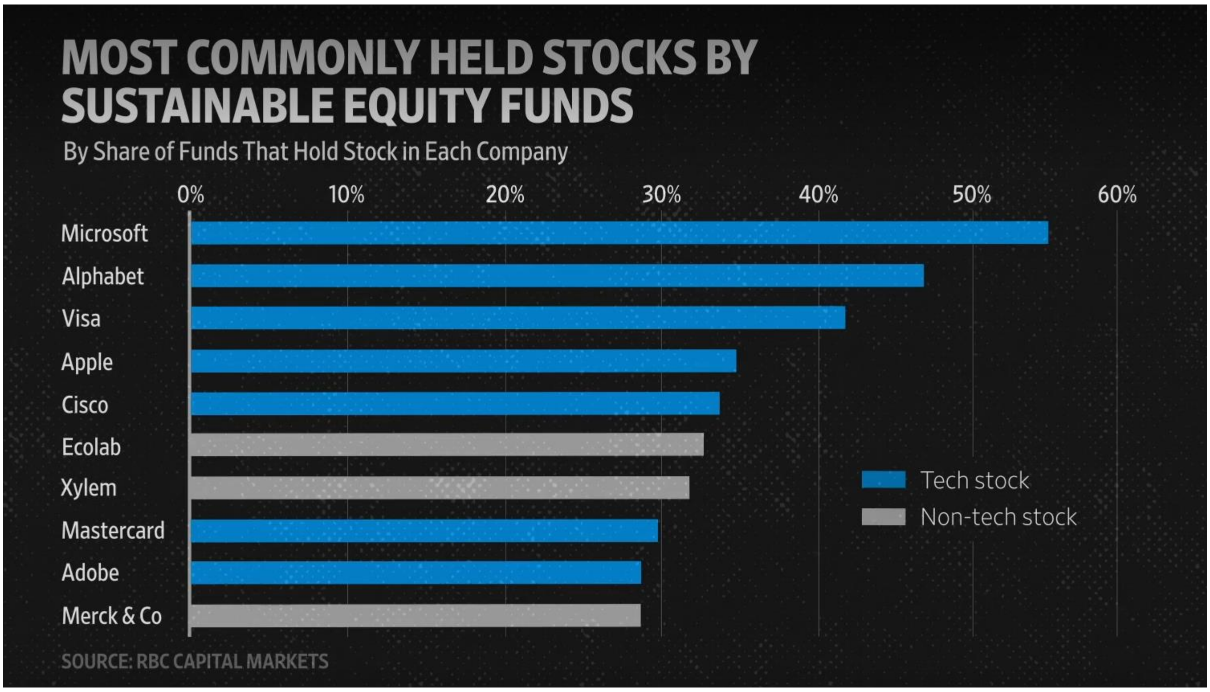
Last year saw ESG and Impact funds underperform for the first time in over a decade. This led to a chorus of criticism from its opponents, often attacking the exposure of "ESG" funds to technology stocks, who were winners during the 2020 pandemic, but then left aside as markets focused on reflation in 2021.

Technology not only plays a larger part in everyone's life, but it has been instrumental in many of the core ESG and Impact sectors. The Internet of Things has changed the way we operate, both in the workplace and at home. It has enabled a safer and less energy-intensive life through better management of resources, remote management, and working.

However, where to draw the line has become a decisive factor in ESG and Impact fund selection. How fund houses and fund managers screen their portfolios, determined by their screening policies and objectives, is key. This means funds and investment strategies that sit alongside each other in terms of risk and on the spectrum of capital, may have very different holdings due to the ESG and Impact approach and screening policies of the asset manager.

One area where this is very apparent is technology, and in particular with regards to the tech giants that dominate US equity markets, often referred to as the FAANGS (Facebook owner Meta, Amazon, Apple, Netflix, and Google owner Alphabet).

Some ESG labelled funds include some of the names above, others do not. These stocks carry significant weight in global markets; therefore, they have a significant impact on the performance and ESG profile of a portfolio.



The most common technology stock held in ESG funds, as seen above, is Microsoft. It has one of the highest third-party ESG ratings. The company offers software and cloud solutions used by millions globally, positioning it for a digital transformation, but also importantly positioning them well for a cleaner and low carbon future. We would separate them from the concerns we have with some of the FAANG stocks mentioned above, although there is some controversy, we feel they are non-structural and dealt with in a manner we would expect. For us, it is acceptable to be held in the model portfolios, alongside other tech names such as Visa or Mastercard.

Elsewhere, Alphabet and Apple are two other common names held in ESG funds, but we have also seen some lighter green funds own Amazon and other tech names such as Tencent or Alibaba. The critics highlight that a large number of funds with an ESG label hold these companies, despite various social and governance issues. Our policy at King and Shaxson Asset Management has been that none of these investments make the grade.

Whilst we acknowledge that some of the ESG issues these companies face is a result of their growth and success, as well as an increased awareness around data and market power, these issues are of less concern to us than the more structural, cultural, and systemic issues. These focus around the China-related supply chain with regards to Apple, but also taxation and longer-term employee issues for others.

Whilst some ESG funds are big tech-heavy because of their lighter screens, we prefer to apply the stricter screen. In essence, none of these technology stocks are pushing for a true global positive impact, whereas there are other technology areas that are. The importance of looking under the bonnet of collective investments and ensuring both client's and investment's ESG considerations are aligned has never been more prevalent.

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