KING & SHAXSON
ethical investing

Investment Review

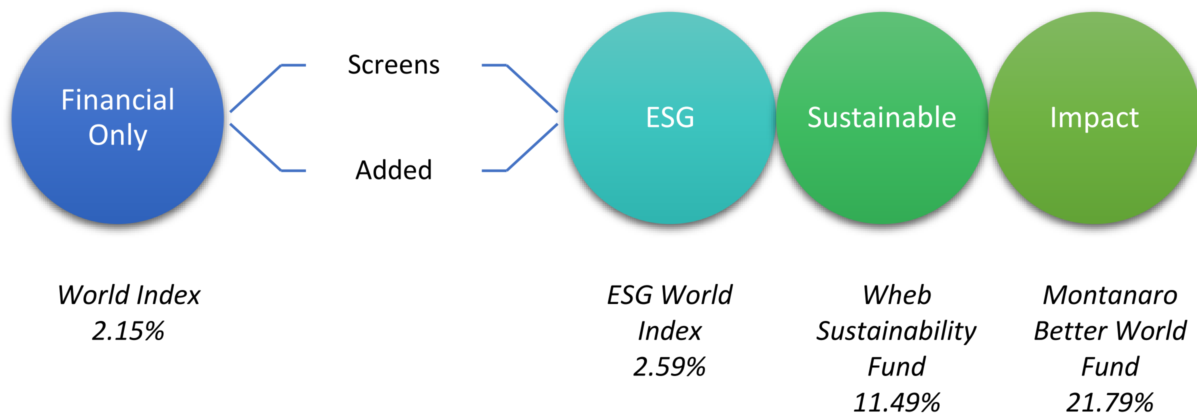
Valuable lesson in how performance differs

If anyone has seen a presentation from us over the years, this year's market moves are a good example of what we mean by responsible and sustainable investments behave differently to the general market.

The doom and gloom of the covid-19 crisis has seen technology stocks, or more generally, the work from home trade performing well. The dominance of very large mega-cap companies, known as the FAANGs, has seen them take on an even larger weight in market indices, at times distorting the underlying struggle of many other sectors throughout the crisis.

On top of this, the 'build back better' trade has seen sustainable and impact investments rally ahead of the broader market. We have recently commented on the returns mirroring the move down the spectrum of capital, where ESG has outperformed conventional, whilst sustainable and then impact has moved further ahead.

This is exampled in the below image, using two of our core sustainable and impact funds:



(Source FE Analytics & Bloomberg. Performance data: 9 months to end of Sept 20)

Investors who have focussed on tech, sustainable and impact, have seen holdings propel to dizzy heights, as they were truly the only area of growth at a time of great market uncertainty and depressed yields. Most other sectors failed to replicate the V shaped recovery, and as a result, valuations are extremely depressed, but depressed for a good reason. Many of these companies' futures hang in the balance.

On the initial downturn back in March this year, investors focussed on responsible and sustainable investments didn't see the equivalent shock that played out in some indices. Oil & gas companies, airlines, cruise companies, big banks etc. were the worst hit, and these are companies and sectors that many ethical investors are keen to avoid.

Therefore, portfolios were characterised by relatively lower drawdowns and lower volatility. On the whole, the negative screen prevailed, but other key positive sectors such as public transport were also hit. Nonetheless, ethical investors fared better than most in the immediate crash.

However, what we have recently seen is a rotation out of growth stocks and into value (albeit a move that we feel has move room to run in the months ahead). This initial move was triggered by a positive announcement regarding a vaccine against covid-19. All of a sudden, the reflation trade was on, and investors cashed in their growth stocks and switched into many beaten up sectors. An almost mirrored event to what we saw earlier this year.

Over this period we did note that sustainable investments lagged markets such as the UK's main bourse, primarily due to the screening effect. These types of moves make it important to understand the impact a positive and negative screen will have on a portfolio versus the broader market. As it is clear that it can move both ways.

As mentioned, some sustainable investments came under pressure, and this moves is something we want to highlight to investors, as some would question why this is.

In simple terms, investors do not have an endless sum of cash, so in order to invest elsewhere (or rotate), they need to raise funds from other parts of their portfolio. As with tech, some investors have cashed in from highly valued sustainable stocks, in order to rotate their money into undervalued holdings.

However, it's important to note that not all value stocks are screened from portfolios, so there is upside to be had as a responsible investor. Take for example mass transport, where we have seen a sharp rebound from many of the bus and train companies.

Disclaimer

Please remember that the value of investments and the income arising from them may fall as well as rise and is not guaranteed. Investors should be aware of the underlying risk associated with investing in shares of small-cap stocks and emerging markets. These can prove to be more volatile than in more developed stock markets.

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