BRUNSWICK

Capital Markets

COVID-19

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What We're Hearing

COVID-19 has raised doubts about whether ESG and climate considerations can remain at the top of company priorities. The Wall Street Journal – never a believer in ESG in the best of times - declared, “Businesses that were planning to help save the world are now simply saving themselves.”

Does ESG matter during a pandemic?

We say yes. It’s more important than ever. Contrary to the idea of ESG as a luxury good to be applied during bull markets, coronavirus is creating a sustainability crisis that shines a spotlight on how well companies are run and the resilience of businesses during challenging periods.

In fact, events last week suggest that the COVID outbreak has intensified existing media, academic and regulatory focus on corporate responsibility.

Newsflow included an in-depth article from the Financial Times about how coronavirus has forced an investor rethink on social issues, suggesting that the epidemic has deepened investor attention on how companies treat their employees, customers and suppliers.

The latest study from Harvard University further revealed the link between ESG and corporate resilience during COVID-19. The research showed that companies which responded well during the crisis received positive reputational benefits, encouraging inflows into the stock and outperformance versus their peers, even after factors like firm size, profitability, dividend yield, valuation and sectors were considered. These effects were stronger for firms that received more coverage from news outlets, suggesting that attention to these activities drove the positive investor and market response.

On the regulatory front, UK and European leaders met for the Petersberg Climate Dialogue, taking steps toward commitment to a green recovery. That means governments are focusing on economic recovery strategies that can promote sustainability and modernise economies, including:

- Policies to promote resource efficiency and reduction in pollutants like carbon dioxide
- Rapid implementation of policies to promote low-carbon transformation
- Targeted support like tax incentives to companies whose activities promote the circular economy

What this means for investors

Investors are looking for winners and losers from this pandemic. Increasingly, the winners will be companies with strong ESG credentials.

With the sector growing in size and prominence – total assets managed in ESG funds have reached $30 trillion - ESG integration is now the buzzword amongst institutional investors. Investment banks have engaged in a war for talent to hire ESG specialists into their sell-side analyst teams to model and value company ESG activities.

The traditional assumption that investing for sustainability equals surrendering performance is being challenged by the recent returns of top ESG investments. During the coronavirus rout in March, U.S. stocks in the top quintile of ESG rankings outperformed the S&P 500, while companies with lower scores saw bigger downward revisions in their earnings prospects for 2020 and 2021, according to Bloomberg.

Strong ESG factors also appear to protect investor portfolios from the downside. During the first quarter, nearly 60% of the biggest U.S. sustainable and ESG mutual funds and ETFs lost less in market value than the S&P 500, according to data from Factset.

How should companies respond?

Companies should be using their COVID-19 communications to align their ESG activities to the reporting metrics investors care about, by increasing transparency and collecting the relevant financial data. Because of a lack of data, some companies have been able to hide behind positive public declarations about how they value their employees, suppliers and communities.

Such statements are now being put to the test. The standardization efforts of the Sustainable Accounting Standards Board (SASB), the European Union, and the Task Force on Climate-related Financial Disclosure (TCFD) are taking promising steps forward, allowing investors to assess which companies are living up to their words. Aligning sustainability efforts with standardized reporting frameworks demonstrates how companies manage risk, deliver results and generate value for investment portfolios. Recently, both BlackRock and Legal & General warned that they will hold companies to account if they do not meet ESG expectations during the crisis.

Companies that show how their ESG activities are linked to financial performance during this pandemic period can strengthen their reputation, raise their profile amongst potential investors, and retain the goodwill of their current shareholders. Those who don't will be left in the cold. As Warren Buffett famously said, "Only when the tide goes out do you discover who's been swimming naked."

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