2020: THE YEAR NO ONE PREDICTED

Since the very beginning of the global coronavirus pandemic, the world has witnessed markets succumbing to a bout of sickness. With the stock market in turmoil due to the onset of this ‘sickness’, an all-time high drop of 5.3% was seen in FTSE100 (share index consisting of the top 100 UK companies), on the day coronavirus was declared a pandemic. This multi-faceted shock to economies has been widespread and unprecedented. In case of the UK market, prior to coronavirus, domestic politics and Brexit had dominated the workings of the economy. Just as the country looked to have found a firmer footing, the pandemic hit. Sterling slumped to multi-decade lows against the US dollar, following a synchronized rush for dollars and its safe haven properties. Whilst the effects of coronavirus are still very much ongoing and the full extent of the damage still unknown, a step back to gain perspective on current market on goings is necessary to pave a path for predicting future trends.

The coronavirus pandemic has brought about the fastest bear market plummet in history, with global stocks having had their best and worst sessions on consecutive days. As a result, very few companies appear to have weathered the storm; the number of economic winners generated by coronavirus pandemic being extremely limited and concentrated. Companies such as Amazon, Netflix and Zoom capitalised on lockdown measures and the strong presence of tech in the market, to ride out this period on a high. Meanwhile, amid the collapse of the stock market during the peak coronavirus period, a number of bio-technology, pharmaceutical and medical companies have also generated substantial profits. Beyond this, other big winners of the pandemic are certain private equity funds, hedge funds and institutional investors who are able to take advantage of the stock market collapse to buy valuable assets at extremely low prices.

However, the emergence of coronavirus and its catastrophic impact on economies has also marked the first real test of investor dedication to sustainability. The health crisis highlights the linkages between sustainability issues, the economy and corporate financial performance heightening investor focus on such issues.

What is ESG investing?

The original form of this type of investing, often known as ethical investing, was just exclusionary screening out of companies or industries based on specific criteria, such as a significant portion of the firm’s profit coming from: alcohol, gambling, tobacco or weapons. Such funds, however, usually had lower returns and higher risk compared to equivalent funds which had not been screened.

However, ESG investing involves searching out and including companies based on desired ESG characteristics rather than just excluding firms with undesirable business activities. The approach involves a systematic consideration of specified ESG issues throughout the entire investment process in order to increase returns and reduce risk.

As ESG funds seems to have met the Covid-19 challenge with flying colours, investors have injected record sums into sustainable investment funds, providing a glimmer of hope to active managers hammered by the relentless flight of investment into passive products. Funds that invested according to environmental, social and governance principles attracted net inflows of $71.1bn globally between April and June this year, pushing assets under management in the funds to a new high of just over $1tn. Research showed that the amount of new money invested in ESG equity funds between April and July exceeded the combined flows for the previous five years. At the end of April 2020, Federated Hermes polled 200 advisers and found that 82 per cent had seen a rise in client requests to allocate capital to ESG focused funds.

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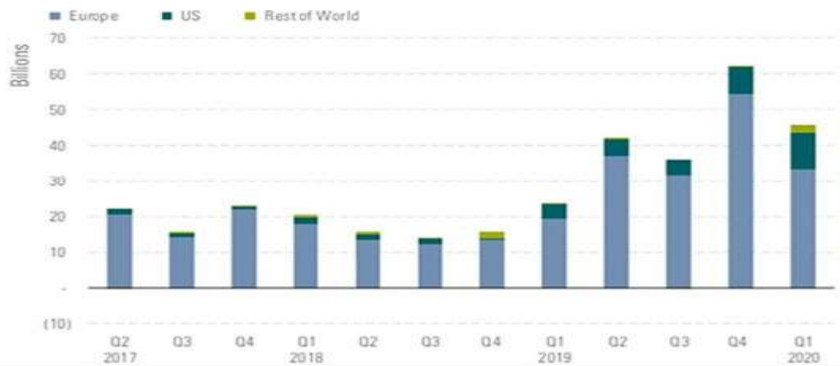
A Morningstar research analysed the market downturn in quarter 1 of 2020 caused by COVID-19 and found that 51 out of 57 (89 per cent) of sustainable indices outperformed their counterparts from the broad market. The reason for this can be attributed to the fact that companies with higher ESG scores tend to have better corporate governance policies, care more about the treatment of their employees and produce more sustainable products. Thus, during times of market distress there is a flight to quality, which benefits these higher ESG-rated firms.

Exhibit 2 - Quarterly Global Sustainable Fund Flows (USD Billion)



Source: Morningstar Direct, Manager Research. Data as of March 2020.

In the same vein, as the world endures the lasting effects of the coronavirus pandemic, several businesses and industries have also suffered from heavy losses. Due to widespread stay-at-home orders, the travel industry has been hit particularly hard. United Airlines, the second largest airline in the United States and Boeing, one of the biggest manufacturers of commercial aircraft have both seen their stock prices drop by over 60%. Even Norwegian Cruise Line, one of the largest cruise lines, have experienced losses of around 80%. Moreover, because social distancing is all but an unsolvable problem in the running of businesses, such as theatres and casinos, the entertainment industry has also suffered. Only businesses with a strong online presence, offering home entertainment, have experienced significant growth.

Additionally, in the heavy industrial and manufacturing sectors, there have not only been lower demand but also lower levels of supply. As production lines needed to be adapted in the wake of new safety and health regulations, the efficiency of production in these industries fell. As the manufacturing industry rides on reduced production costs due to efficient processes, these regulations led to a lot of hindrances in production and ultimately the profits of manufacturing industries. Then again, there are also the cases of energy companies which suffered from the problem of 'too much' supply. They face not just the catastrophic decline in oil and gas use, amid nationwide shelter-in-place guidelines, but also a global supply war involving Saudi Arabia and Russia that could tamp down prices for more than a year. Interestingly three of the hardest hit funds during this crisis period have all been global energy funds, with Schroder Global Energy, Guinness Global Energy and Meridian Global Energy funds being down by 11.5%, 10.6% and 6.6% respectively since the start of the year.

The COVID-19 pandemic has fundamentally changed the world as we knew it. People are living differently, getting used to everyday new norms, and in many ways altering their consumer behaviour. Thus, the habits people have formed over this period will very likely endure past the crisis and permanently change people's lifestyle and behaviour. As the realization, investing responsibly is consistent with a trustee's fiduciary duty of seeking higher returns becomes more prevalent, providers of different financial products are now under the increasing regulatory pressure to incorporate ESG factors in their products. Thus, as suggested by research a longer-term consequence of this pandemic will be to focus on sustainable investing; either go green or go home!

Sources: Morningstar Direct and The Financial Times

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