

Why buy good companies?



In a world of geopolitical tension, rapid innovation and rising costs, long-term investing starts with identifying resilient, well-run companies. By focusing on fundamentals, governance and how businesses adapt to structural change, sustainability becomes a practical conclusion – not a separate style of investing.

Uncertainty is a fact of life for investors. What investment to buy, when to buy it, how much to pay for it and when to sell it: every stage of the process can offer more questions than answers.

And we see uncertainty today when looking at markets. In the last 12 months we've seen massive tariffs imposed – and then reduced; war continue in Ukraine and start in Iran; and hype and concerns around artificial intelligence.

Helping clients navigate this uncertainty is a key role for asset managers and advisers alike. It's why a diversified, long-term approach is what so many investors decide on – it's a proven approach to try to smooth the highs and lows in individual investments and ride out shorter-term volatility.

In our view, sustainable investing is an approach that is designed to cope with change and uncertainty. Most headlines in recent years have been around new funds, new definitions, new focus and new regulatory influence. Why does this help investors who perhaps are less worried about the sustainable or ESG factors?

We think there are two sides to sustainable investing. Both are valuable, and in our view, investors get both, whichever is their priority. The first is that as an investor, you know that your money is working in way that aims to provide certain positive social or environmental outcomes. The second is that you know that this is an approach that targets a positive financial outcome.

At Royal London Asset Management, we believe that these two sides co-exist – that it is not the case that having one means the other is negatively impacted. Indeed, we think that each of these aspects strengthens the other. Let's explore why.

Sustainable investing is just buying good companies

When looking at equity investing, the principle underlying our investment approach is a simple one. Identify companies with long-term, structurally value-creating businesses, and buy their shares at a fair price. That's it.

We carry out analysis of a company's ability to create returns over the cost of capital alongside structural growth factors – one of which is how attractive a sector is. We then combine this with cashflow and valuation measures to see what is already reflected in current share prices.

This means we have a framework for assessing long-term drivers of change. This helps us look at new industries, such as artificial intelligence, but also how new factors will impact existing industries – for instance cyber security: a 'new' consideration that can affect any company.

How do you think about the future?

In our view, this focus on structural drivers has to be built into the process. Where will this industry or sector be in ten years? This is one reason why we don't own oil companies: these will have short-term periods of strong performance, but the trend is only going one way. Indeed, we think that every period of high oil prices only pushes the pace of moving to alternatives even higher. How many people will look at high petrol prices this spring and decide to go electric? How many governments will want to reduce reliance on oil-producing countries and create more reliable energy sources closer to home? If you think the answer is 'none', then buy oil, but we see acceleration in these trends, not a slowing.

What does a good company do?

As well as financial aspects mentioned above, we think that the behaviour of a company and its management matters: being more energy efficient is less costly; having a best-in-class safety profile helps to attract and retain talent; clear governance structures make management more accountable. Some of these factors are labelled as ESG. I think that is accurate, but in a way, it doesn't matter: these issues will affect the share price. So even if you dislike the idea of 'ESG', you should still want your investment manager to be looking at these and building them into investment decisions.

What does a good company not do?

A useful way to think about some of the factors we've identified is whether you want to buy shares in companies that would fail our tests. A majority shareholder who is also a CEO who decides to fill the board with yes-men and goes in a direction that causes sales to drop massively? A company that cuts corners on safety of employees? A company that is found to have sourced lots of goods based on child labour? For these sorts of issues, it is not just the short-term impact, but long-term reputational damage can destroy a company's long-term prospects.

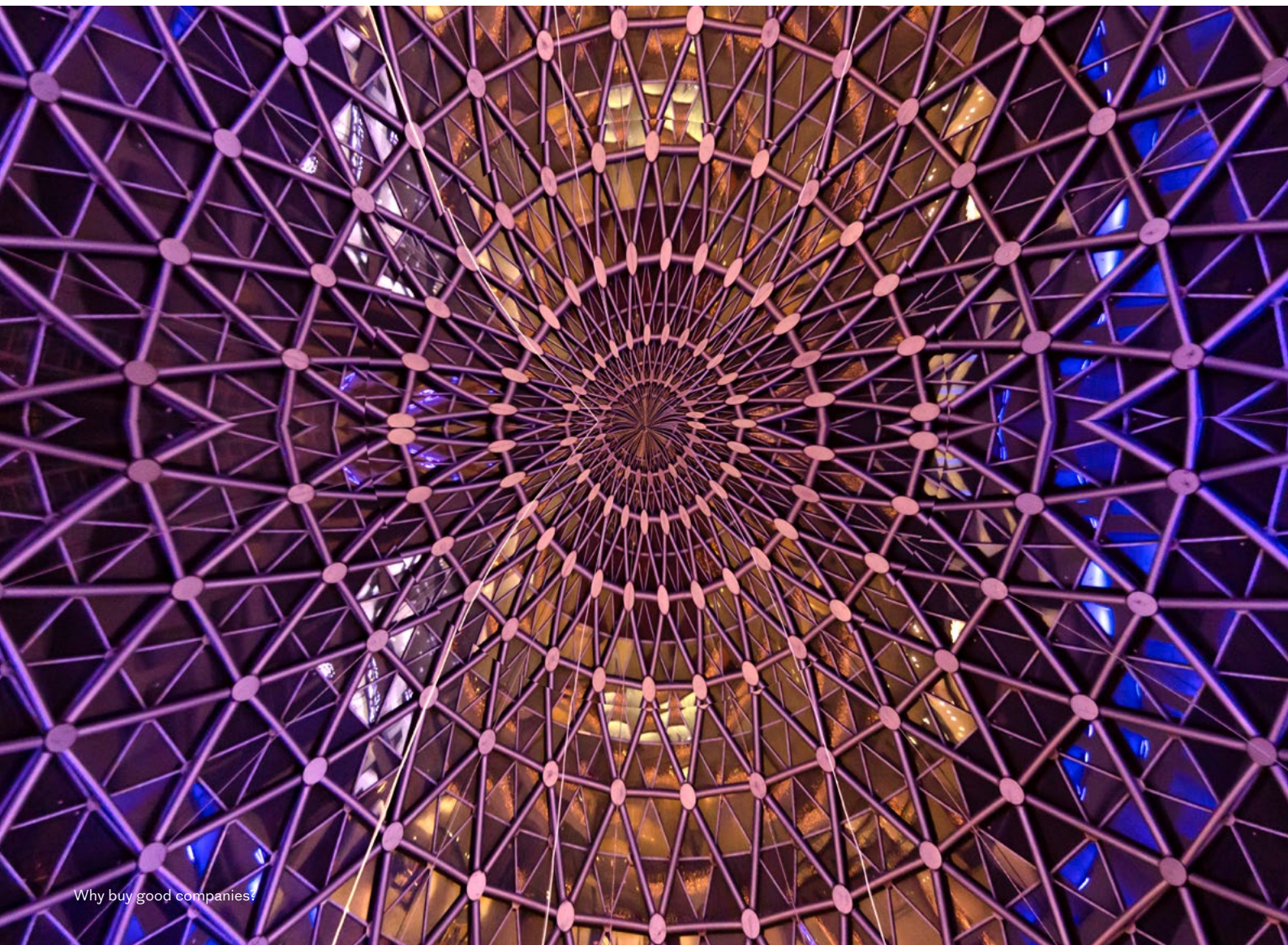
Alongside these more ESG-related issues, good companies also don't over-lever their balance sheet, spend billions on vanity projects, let their costs run out of control or ignore market trends that may help protect or grow their market share.

When you put all of this together, we create a framework that can flex with the future. A framework built to identify underappreciated or unrecognised growth or quality in new and existing markets, or help assess disruptive change – an essential element given we know for certain that the world will look different in ten years' time. The same disciplines that help us identify high-quality, resilient companies – strong governance, thoughtful management of people and operations, and an ability to adapt to structural change – also shape how we think about sustainability.

In that sense, sustainable investing isn't a separate style of investing; it's the natural destination of focusing on long-term value creation and avoiding risks that can quietly compound over time.

It's just good investing

The 'debate' around sustainable or ESG investing is, in our view, missing the point. In our view, good investing looks at all the factors that affect your investment. The current noise around 'too much ESG' means that some think you should ignore these factors. We're fine with that: if others are ignoring things that will affect the share price of a company, it creates more opportunities for us. The long-term success of this approach over the last 20 years is there for all to see. We're just as confident about the next 20.



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