Sustainable investing: Take the long road

by Mike Fox

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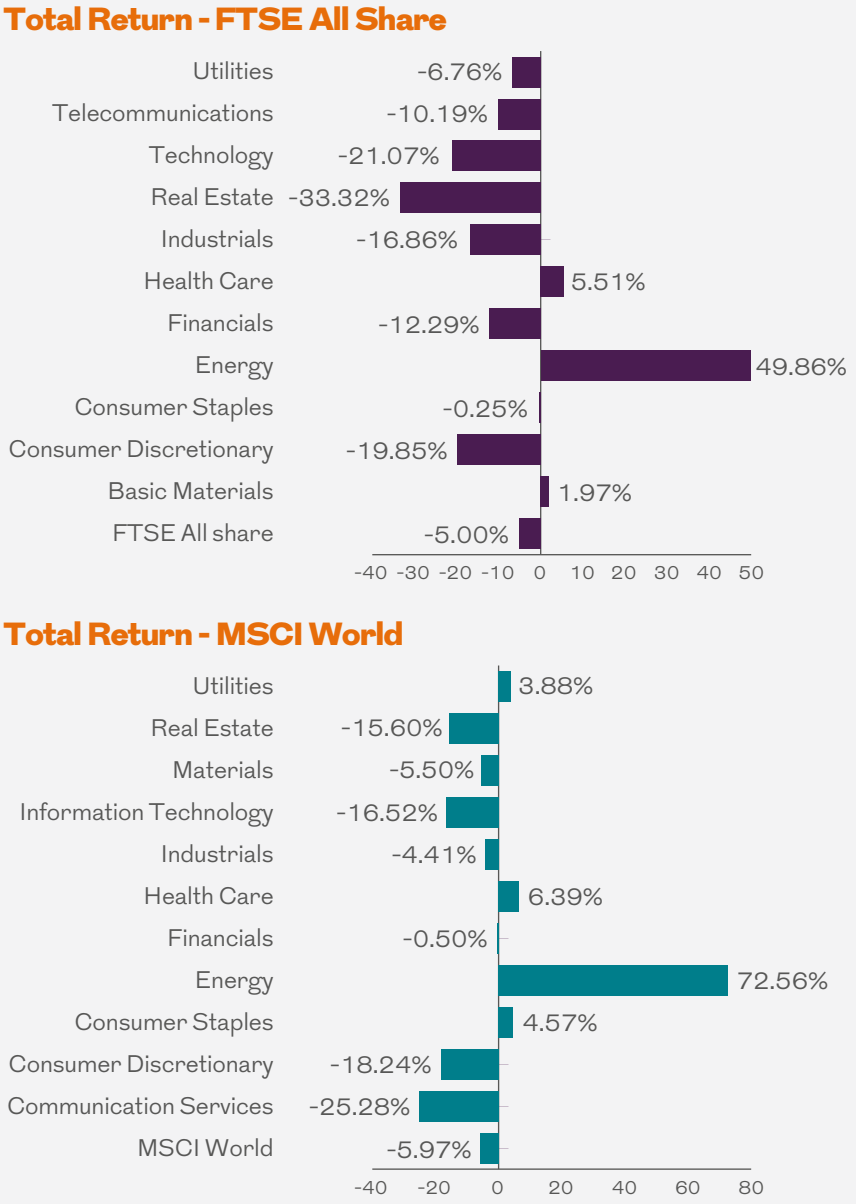
Mike is Head of Sustainable Investments and co-fund manager of the Sustainable Leaders, World and Diversified trusts as well as the Global Sustainable Equity fund. He has managed the Sustainable Leaders Fund since November 2003. Prior to this, Mike worked as a Deputy fund manager at the Co-operative employee pension fund for two years and as an investment analyst covering the utility, support services and media sectors. Mike originally trained and qualified as a Chartered Accountant with Ernst & Young in Manchester. Mike has won five Fund Manager of the Year awards, in 2015, 2017, 2019, 2020 and 2021. Mike has spent the majority of his career assessing environmental, social and governance issues and how they influence investment decisions. He is a specialist in sustainable investing and one of the few fund managers in this area with such long tenure.

For anyone with a historical perspective of investment markets, 2022 will go down as one of the most historic and memorable. The scale and speed of change in key asset markets, such as equity and debt, has been at times breath taking. This in itself reflects a fundamental reassessment of the outlook for investment markets that was not captured or considered by outlooks a year ago.

At the start of 2022, a reasonable view would have been that inflation was indeed transitory, created by the supply chain bottle necks we saw in the wake of the pandemic, which in turn would have been expected to work through by the end of the year. What was unknowable at the time was the structural shift in energy and commodity markets that would be created by Russia invading Ukraine. This created a skewness to markets which is unprecedented, leading to energy being the only area of material positive returns this year within equity markets (figure 1).

Figure 1: Equity sector returns for first 10 months of 2022



Source RLAM: FTSE All share and MSCI World indices sector returns 31 December 2021 to 31 October 2022.

Past performance is not a guide to future performance.

Sustained impact

Given how wrong outlooks were generally for 2022, what can we predict with certainty for sustainable investors in 2023? In our outlook for 2022 we suggested it could be a tougher year for sustainable strategies due in the main to higher valuations prevalent in longer duration growth stocks. This proved to be true – although valuations reset to a degree much greater than we expected due to inflation and interest rates both rising faster and further than anyone forecast.

We now feel that that much of this valuation reset has occurred and that even if inflation and interest expectations rise further, it is hard to envision a further shift as large as the one that has already occurred. It is also worth noting that we suggested that the drivers sitting behind the drive to a more sustainable society had reached critical mass and if anything were accelerating. This is certainly true, as from what we can see sustainability – in terms of investments, corporate behaviour and investor interest is booming.

Eyes on the prize

There are many descriptions or constructs used to describe the framework for sustainable investing. Cleaner, healthier, safer and more inclusive would be one we feel most affiliated to. Meeting the needs of today without compromising the needs of the future would be another. Both give direction to solving problems rather than creating them and having a positive role in society.

At times it can feel like we have more problems than we can ever solve as a society but, as in the pandemic, it is wrong to be short optimism and long pessimism. We see many of the most investable trends in their early stages. Digitisation, turning fatal diseases into chronic, and decarbonising society are all areas we expect to be talking about and investing in both 2023 and well beyond. Although coal and armaments may be a solution to current problems, they are unlikely to create the future path for society and investors.

Perhaps though the greatest lesson of 2022 is how unforecastable the future is. A year ago most investors would have had a sunny disposition, aided by markets at all-time highs and a global economy which was growing rapidly. If a year can create this much difference in the investment environment, the range of outcomes for the coming year is surely wide. A year from now will we be talking about inflation or deflation? Will we be talking about recession or recovery? Will we be talking about peace or war? All of these questions are fundamental to markets but largely unknowable.

To us it is more rational to invest by observable certainties than unobservable uncertainties. That the world will be more sustainable in the future than the past is really an assertion that solutions will overcome problems. And investing in sustainable funds is an assertion that companies providing solutions to problems will become more profitable, and those causing problems will become less so. Our outlook for 2023 therefore is a bifurcated one: uncertainty in the macro, certainty in the micro. Following the latter is the path we would recommend.

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