

Progress is never linear

The market for ESG focused investment opportunities continue to grow at truly breakneck speed. According to Bloomberg, 2020 saw ESG assets surmount $35 trillion up 35% from 2016 alone, now comprising a third of global assets under management.

ESG is now at a point where it is fundamentally reshaping the financial industry. Within such a paradigm shift, long-term opportunities readily materialise and there are now a multitude of ways to obtain exposure to the growing ESG universe. It is the job of TAM as a Discretionary Fund Manager to navigate the increasingly omnifarious marketplace to identify and build a portfolio of the best ESG investments.

There will be periods, however, where market forces and macroeconomic headwinds temporarily transcend the long-term investment case expressed in our asset allocations. TAM acknowledged this in a client note in March after a marked rotation to value stocks and cyclical sectors in the market. As outlined in that note:

“ESG funds invest in high quality companies, whose shares are highly valued compared to their earnings,

given their strong growth prospects. Coupled with the exclusions of 'sin stocks', which is often the case with ESG funds, this leads to a bias towards sectors such as Technology and Healthcare and away from the more cyclical sectors such as Energy, Financials and Industrials. Therefore, when these sectors, which are naturally underweighted in ESG funds, perform well, as we are currently seeing, it is inevitable that ESG-orientated investments will underperform."

When these factors drive returns, as they have begun to again in recent weeks, it can be easy to lose sight of the bigger picture. Upon considering the last twelve months, three of the top four leading sectors in the MSCI All Countries World Index have been those typically referred to as value. The Energy sector for example has more than doubled the returns seen in the Information Technology sector in the last year with banks driving the returns of the Financials sector to similar heights.

This hasn't been the only headwind for ESG investing this year. Some corners of the ESG market suffered from a deluge of exuberance, driving valuations higher a little too quickly when the incredible opportunities were brought to the mainstream. One such opportunity is derived from the global effort to transition to renewable energy sources. TAM identified this as a generational growth opportunity and chose the Schroder Global Energy Transition fund as a market leader, primed to benefit from multi-year structural growth in this space by investing across the whole supply chain. From clean energy production to distribution and storage.

Put simply, global emissions must fall by at least 33% from 2010 levels by 2030 to limit climate change to the <2% target set out in the 2015 Paris Climate Accord, but they are still increasing. Clear targets for renewable energy set by global superpowers are providing resolute assurance on the investment case with the share of electricity generated from renewables expected to increase from 20% closer to 85% by 2050. However, research from the International Energy Agency last month found that investment in this space needs to triple in the next decade to reach net zero by 2050 and until that happens, we are likely to see volatility in the clean energy markets.

So, how can we navigate short-term volatility whilst remaining invested in the incredible upside potential? Firstly, TAM works with experienced active managers who are well versed in marrying short and long-term objectives. In our Energy Transition example, Schroder's ability to navigate a market fraught with exuberance meant that when there was a rerating to the downside of valuations following a strong rally, the fund was able to protect capital, capturing only 40% of the downside seen in the benchmark MSCI Global Alternative Energy.

Secondly, TAM incorporate their own risk management through diversifying across an array of ESG themes via multiple asset classes. We have the flexibility to tilt our portfolio towards macroeconomic tailwinds where possible, most recently a rotation into UK dividend payers through the BMO Responsible UK Equity Income fund. TAM are also comfortable taking some risk off the table via reducing clients' equity holdings when the situation calls for it and are currently keeping this exposure below the benchmark whilst uncertainty persists.

Lastly, it is imperative to remember that many of the funds we work with are investing in companies that are continually making a positive impact across environmental, social and governance factors. From

engaging with firms to calculate carbon emissions to investing in companies that work to increase the quality of education in the UK. Many of our funds are currently releasing impact and engagement reports for 2020/21, upon which we will be compiling a report to show just how much difference your investments are making.

When investing in a long-term theme it is important to remember that progress is rarely linear. TAM remain cognisant of latent effects of the COVID pandemic driving certain corners of the market in the short term and have been working to arm your portfolio for these contingencies. In the meantime, the ESG investment case continues to rapidly go from strength to strength. There is a clear market shift towards renewable energy and electric vehicles coupled with accelerated commitments to CO2 reductions by Governments ahead of the COP26 summit next month in what is just a small sign of the now unquestionable future of ESG. Therefore, we continue to view volatility as opportunity.

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