ESG & COVID-19

Four Market Trends to Watch

Responsible Investment Association

The global pandemic has impacted all of us on a deeply personal level. It has wreaked havoc on our society and our economy, destroying consumer demand and bringing much commerce to a virtual standstill. Just as physical distancing and video meetings are the new normal for social activity, volatility and uncertainty are the new normal for markets.

Fundamentally, we are dealing with a crisis of public health – a crisis for people. For long-term investors, this raises questions about the steps that companies are taking to keep their people safe, well and employed. After all, companies are made of people, and the most resilient companies will be the ones that protect and retain their talent to position themselves for success when the recovery begins.

The pandemic is having myriad impacts on markets, including the market for responsible investments (RI) that incorporate environmental, social and governance (ESG) factors. Here are four market trends to watch at the crossroads of ESG and COVID-19.

'S' is Moving to the Forefront

Given the people-focused nature of this crisis, corporate reputations could thrive or plummet based on how companies treat their people and communities. Research shows that over 80% of market value is based on intangible assets, such as brand and reputation. In the COVID-19 era, this puts a spotlight on the "Social" dimension in ESG.

In past crises, employees have often been viewed as disposable resources. But in the age of social media, ESG reporting and CEOs denouncing the idea that shareholder interests should be top priority, it is less acceptable for a public company to build a recovery strategy based on layoffs. Over 300 institutional investors managing more than US$8 trillion in assets have made this clear in a public statement on how companies are responding to the pandemic. Investors and financial decision makers are asking companies to take every measure possible to retain workers, since unbridled unemployment will only deepen the crisis.

Employee health and safety, including mental wellness, are also moving front and centre. Flexibility has become essential for childcare considerations. So, while social factors had previously been overshadowed by climate change in the ESG space, they are now moving to the forefront as companies will be remembered for how they treated their people and the communities in which they operate.

Investors and consumers can track the good deeds being done by Canadian companies in a new database curated by Canadian Business for Social Responsibility and Upswing Solutions.

ESG is Delivering Better Performance

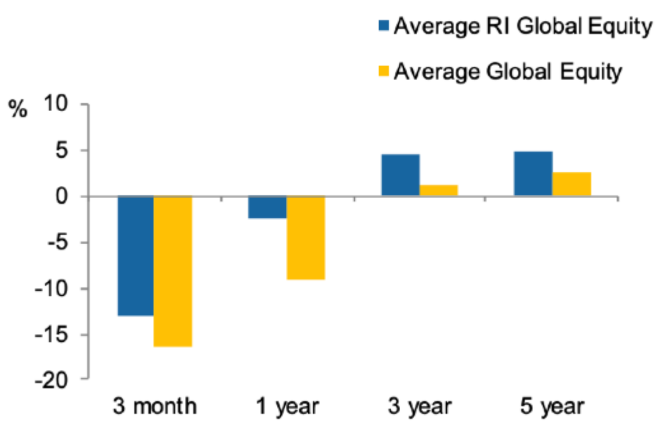
The pandemic's financial impacts have been enormous, as stock markets continue to struggle following a historic collapse. But after the explosion of ESG in 2019, driven by the idea that ESG factors impact investment performance, it's only natural for investors to wonder how responsible investments are performing relative to the broader market in 2020.

The early data indicates that RI funds are indeed losing less than their counterparts, which further strengthens the case for incorporating ESG issues into investment decisions. In the Canadian market, data provided by Fundata shows that a staggering 83% of RI funds outperformed the average return from assets in the same category in Q1, and 80% of RI funds outperformed over the one-year period ending March 31, 2020.

Responsible Investment Defined

Responsible investment (RI) refers to the incorporation of environmental, social and governance (ESG) factors into the selection and management of investments. Incorporating ESG factors into investment decisions is often a successful long-term strategy for investors. The evidence shows that responsible investments usually meet or exceed the performance of traditional investments.

GLOBAL EQUITY PERFORMANCE



Similarly, in the U.S. market, a Morningstar analysis of 206 RI funds found that 70% of RI equity funds outperformed their peers in Q1. As for the indexes, the MSCI World ESG Leaders Index outperformed the MSCI World Index by 1.36%, and the MSCI Canada ESG Leaders Index beat the MSCI Canada index by 68 basis points in Q1.

The evidence suggests that ESG factors are delivering actual return on investment in both actively managed and passive strategies. In the pandemic context, this data supports the argument that incorporating ESG issues into investment decisions can strengthen risk management and lead to financial outperformance.

Investment is Still Flowing into ESG Funds

Jon Hale, Morningstar's head of sustainability research, recently analyzed the amount of investment flowing into mutual funds and ETFs in the U.S. market. Despite the downturn, the data shows that RI funds set a record for inbound investment in Q1. The 314 RI funds in the U.S. market attracted net investment of approximately US$10.5 billion in Q1, surpassing the previous record set in Q4 of last year. Research from Morgan Stanley and Bloomberg found similar trends.

Although market-wide flow data is not currently available for Canadian funds, the U.S. represents a large sample which is likely to be part of a broader global trend. The available data illustrates that investors remain interested in ESG funds, and perhaps even more so in the pandemic context, which is creating a sense of urgency around societal issues.

Impact Investment Opportunities are on the Rise

The pandemic is shining a light on impact investments, as unique opportunities emerge for investors to help address the crisis by investing in organizations that are helping those most affected by COVID-19. For example, the U.S.-based ImpactAssets runs a donor-advised fund (DAF) that provides financing for fledgling social enterprises and nonprofits in need during the economic downturn. The firm estimates it will see more than US$143 million invested through its DAF by the end of Q2 — more than the total for all of 2019.

Here in Canada, Vancity was first out of the gate with a new product that enables the individual investors to directly support those most impacted by COVID-19. The B.C.-based credit union launched its Vancity Unity Term Deposit on March 23rd "to maximize the financial help available to people so they can get back on their feet" during this time of financial hardship. Investors benefit from a fixed rate of return while helping to address the pandemic's negative social consequences in their community.

These market signals indicate that impact investment opportunities are on the rise as investors seek to help their communities through the crisis.

Conclusion

The evidence suggests that COVID-19 has strengthened the case for incorporating ESG factors into investment decisions, and that the general market movement towards ESG will not be hindered by this downturn. Rather, this crisis is likely to accelerate the adoption of ESG and impact strategies as societal issues move to the forefront and investors feel a greater sense of urgency to make an impact and align their investments with societal objectives.

Want to learn more about responsible investing? Contact your financial advisor.

About the RIA

The Responsible Investment Association (RIA) is a nonprofit, membership-based organization dedicated to the advancement of responsible investment in Canada. The RIA's membership is composed of over 400 institutional investors and investment professionals who practice and support responsible investing.

Learn more at www.riacanada.ca