Global Perspectives 2021

UK sustainable equity: backing responsible businesses emerging stronger from the coronavirus crisis

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- As the Covid-19 crisis unfolded, it became clear that the pandemic was bringing the S in environmental, social and governance (ESG) investing more to the fore.
- We believe companies that invest in their people and products while delivering positive sustainable outcomes are better placed to achieve superior investment returns. Governments around the world are focusing their Covid-19 recovery plans on sustainability.
- As we enter 2021 we have increased exposure to companies where underlying business models and growth opportunities remain intact and are positioned for sustainable success.
- We see value in the wider UK market. There are plenty of sustainable global leaders in the benchmark, the FTSE All-Share index, which we feel is trading at too-wide-a-discount relative to other international indices. The certainty around Brexit should remove a key overhang for the UK.

There can be no doubt that 2020 was an unprecedented and difficult year for businesses and employees. As the Covid-19 crisis unfolded, it became clear that the pandemic was bringing the S in environmental, social and governance (ESG) investing more to the fore.

We kept in close contact with our investments, paying particular attention to the safety and wellbeing of employees. With some businesses suffering sharp declines in revenue and temporary closure of operations, our focus also turned to financial robustness such as liquidity, cashflow, working capital and balance sheets. We needed to be sure we are invested in companies with strong and sustainable business models that are going to survive the pandemic and to identify those that should emerge stronger with opportunities to gain market share.

A prime example is catering group Compass, which serves a broad range of sectors including healthcare, education, sports and leisure and offices. Though its businesses supporting hospitals, schools and key business remained open through the beginning of the pandemic, other areas were closed. Unsure how long the crisis would last and its severity, the company raised equity in the market as it wanted to emerge from the pandemic with a stronger balance sheet.[1] This improved financial position should equip it to win contracts from failing rivals and positions it well for any economic upturn in 2021.

Another company well-placed is Smith & Nephew, the medical device maker. In April, it collaborated with the University of Oxford to produce ventilators to help the global effort.[2] Elsewhere, however, sales suffered as many elective surgeries such as hip and knee replacements were delayed, leading to a derating in the stock price. The company has managed costs and cashflow well during the crisis, preparing it for a return in demand.

Sustainable businesses set for future success

We believe companies that invest in their people and products while delivering positive sustainable outcomes are better placed to achieve superior investment returns. Governments around the world are focusing their Covid-19 recovery plans on sustainability: green infrastructure, clean energy and electric vehicles. In the UK, opportunities will be thrown up by Prime Minister Boris Johnson's 10-point plan for a green industrial revolution covering clean energy, transport, nature and innovative technologies.

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We see opportunities for companies such as Johnson Matthey, which is a pioneering manufacturer of catalytic converters for combustion engines. As countries like the UK transition towards electric vehicles, there is likely to be rising demand for catalytic converters as emissions standards become stricter.

We are also interested to see how engineering and energy consultants John Wood Group performs as it makes a huge push into renewables. It is pinning its growth strategy on rising demand for offshore wind and green hydrogen, which it predicts will also revolutionise how homes are heated.

[1] Reuters.com, Compass raises 2 billion pounds as pace of recovery in question, 19 May 2020.
[2] https://www.smith-nephew.com/news-and-media/media-releases/news/update-on-oxvent-ventilator-programme/ 29 April 2020.
The mention of stocks is not a recommendation to deal.

Sustainable opportunities in the UK market

Our defensive positioning in 2020 cushioned us from the worst bouts of market volatility. As we enter 2021 we have increased exposure to companies where underlying business models and growth opportunities remain intact and are positioned for sustainable success. This stance should underpin performance as consumer and business activity starts to return to normal and the green revolution continues apace.

> *As countries like the UK transition towards electric vehicles, there is likely to be rising demand for catalytic converters as emissions standards become stricter*

We also see value in the wider UK market. There are plenty of sustainable global leaders in the benchmark, the FTSE All-Share index, which we feel is trading at too-wide-a-discount relative to other international indices such as the S&P 500 or FTSE Europe, where in both cases dividend yields are lower and price-to-earnings ratios higher. This is despite 77%[3] of the FTSE All-Share's earnings coming from outside the UK.

This stark anomaly provides a fruitful hunting ground for our fund managers, who are backed by one of the UK's largest teams of investment professionals specialising in UK equities, as well as by an entirely independent and well-resourced responsible investment team.

[3] Bloomberg/Columbia Threadneedle analysis, as at 30 November 2020.

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