ESG and Stock Price Resilience

In the past few months, businesses that have strong Environmental, Social and Governance (ESG) credentials have performed better on stock markets than index averages[1]. Higher ESG scores through benchmarks, frameworks and ESG ratings have demonstrated better risk management and resilience, increasing investor confidence that you can *'weather the storm'* now, and in the future.

Those sceptical of ESG stocks have long said that investors were willing to invest during a bull market but would abandon their ESG stocks during times of uncertainty in favour of higher returns. However, during the current crisis, the opposite has been true. ESG stocks have performed better than their non ESG counterparts. By the end of March 2020, 59% of U.S. ESG Exchange Traded Funds (ETFs) were doing better than the S&P 500 Index, while 60% of European ESG ETFs beat the MSCI Europe Index[2]. Data from Morningstar direct shows that more than 70% of ESG funds across all asset classes performed better than their counterparts during the first four months of the year.

What is helping ESG stocks to perform better? Analysts explanations have focused on the 'S' in ESG, looking at companies' social practices and treatment of employees. As Teresa O'Flynn, Global Head of Sustainable Investing for BlackRock puts it, *'a non-financial risk can very quickly become a financial risk'*[3]. Reputational risk from employee treatment as well as controversial furloughing can damage companies. For example, after furloughing staff, Liverpool FC faced huge backlash from fans who believed *'it just felt wrong…we expect more from football clubs'*. Liverpool FC has since made a U-turn on its decision to furlough staff, acknowledging *'We believe we came to the wrong decision last week and are truly sorry for that'*[4]. ESG companies with strong social practices are seen to manage these reputational and social risks better, which has been key in stock price resilience.

Possibly the most important reason that ESG-focused investments have performed so well is that these companies have better risk management. COVID19 has highlighted the non-financial dangers that can very quickly impact company bottom lines. Investors argue that when ESG considerations are integrated through corporate frameworks, companies become better at predicting and mitigating risks. This improved risk management is believed to have helped maintain higher levels of investor confidence in ESG companies.

ESG led resiliency in stock price performance during the current crisis will pave the way for an increase in investor demand within companies that take ESG seriously. Companies with ESG policies, benchmarks, or frameworks have been shown to produce more resilient stock prices. ESG benefits, coupled with this new evidence of positive financial performance, will further catalyse investor desire for sound ESG strategies from their investments.

The Environmental, Social and Governance (ESG) Strategy Series offers a topical and practical perspective on how ESG can benefit business. Each month, our sustainable business team will provide the best of their insight, findings, and project experience on how ESG can build value. We welcome inquiries and feedback at info@orbisadvisory.com or esg@itpenergised.com

1. https://www.ft.com/content/dd47aae8-ce25-43ea-8352-814ca44174e3
2. https://www.bloomberg.com/news/articles/2020-03-31/esg-stock-resilance-is-paving-the-way-for-a-surge-in-popularity?sref=X7rIMzds
3. BlackRock 'Accelerating Sustainability' webcast, 13th May 2020
4. https://www.bbc.co.uk/sport/football/52191140
5. https://www.bloomberg.com/news/articles/2020-03-31/esg-stock-resilance-is-paving-the-way-for-a-surge-in-popularity?sref=X7rIMzds