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ESG INTEGRATION IN ACTION—PORTFOLIO MANAGEMENT

Global Equities

Sustainability drives success in a post-coronavirus world

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Crisis causes change. We know this as human beings and as experienced global investors. The 2008 global financial crisis (GFC) led to a reckoning in how businesses were run, especially in financial services. The GFC ultimately redefined fiduciary responsibilities, shifting emphasis toward clients and shareholders. Fueled by government bailouts, new regulations, and shareholder activism, the crisis led to more transparency and fundamentally changed the financial world—in most ways for the better.

The coronavirus pandemic has pulled forward many disruptive trends to a staggering degree. Social distancing and the shuttering of brick-and-mortar businesses accelerated e-commerce and communication adoption by years. Businesses leaned on technology to help employees work-from-home—something that for many may become a more permanent way of life even after the pandemic wanes.

However, even as governments around the world have applied unprecedented monetary and fiscal policy stimulus to create and protect jobs, they have struggled to ease growing societal pressures.

One of the consequences of the pandemic has been an intensified debate about how to address various dimensions of inequality, both societal and economic.

Given this environment, it is more important than ever for companies to incorporate sustainability into their long-term strategies. Sustainability is fundamentally intertwined with visionary thought, disciplined leadership (especially in a crisis), being on the right side of societal change, and addressing the needs of others.

“Sustainability is fundamentally intertwined with visionary thought.

With Great Power Comes Great Responsibility

Just as the GFC was a reckoning for financial companies, so has the current health crisis been for the technology sector. Big tech companies like Apple, Amazon, and Netflix are not unfamiliar with ESG controversy. Their business models have driven and benefited from tremendous societal changes in the way we communicate, shop, and watch TV. While these societal shifts have driven topline growth, they also have created operational risks. With so much at stake, many technology companies have been taking material steps to address their approach to ESG considerations in human capital management and ethics (such as supporting increased payment of international taxes).

It's not just large firms that are recognizing their importance in supporting and improving our lives. Since the onset of the pandemic, smaller companies have also seen the difference they make to help us through challenging times. E-commerce platforms are playing a pivotal role in helping small businesses transition from offline to online. In health care, there are several smaller, niche biotech companies that are at the forefront of the coronavirus battle due to their capabilities in creating accurate testing, serology research, and vaccine support.

Never in history has such a collective focus been applied to a problem, and the hope is that society can emerge with a greater sense of shared goals from this period. We are seeing the results of this shift firsthand. Companies are initiating discussions on ESG considerations and outlining detailed plans, where historically it was more common for us to begin the conversation. The conversation around ESG has always been important to us, as we believe it creates better companies over the long term.

How Do We Factor in ESG?

One reason we feel we are well suited to the era's increasing focus on ESG is that we fully embed ESG analysis within our investment process. With an emphasis on durability and positive change, we feel informed and seek to invest in companies on the right side of change with respect to the next stage of the ESG journey. Our Responsible Investing team provides analysis on industry-level and stock-specific ESG issues, which we then incorporate into our company-specific analysis and investment theses. We also screen the entire portfolio using our proprietary Responsible Investing Indicator Model not only to help understand the characteristics that relate to ESG, but also to make us aware of any elevated exposures to specific ESG factors.

Integrating ESG is Crucial to Finding Good Growth Companies

A changing economic landscape powered by technology has brought significant disruption to societies around the world, and it has become clear that some form of intersection between society, companies, investors, and governments is crucial to perpetuating economic stability and success. The coronavirus pandemic has accelerated the adoption of sustainability trends by years, making it critical to understand this increased emphasis and how it will reshape the investment landscape.

ESG is a permanent part of this new order. Businesses will need to think carefully about their effect on industries, people, and ultimately the planet. Companies that understand these connections are often the innovators that are positioning themselves for real and future growth. We believe this is a good disruption that we seek to be on the right side of.

This is an illustrative example of how ESG factors may be incorporated into the investment process by Portfolio Managers. The views expressed may differ from those of other Investment Professionals at T. Rowe Price.

Key investment areas for potential long-term sustainability and impact

MATERIALS

Catastrophic weather events have demonstrated the reality of climate change.

Portfolio opportunities can arise by identifying companies that address climate change through carbon capture and storage, sustainable packaging, or green alternatives that are actively reducing their carbon footprints.

UTILITIES

Utilities can be instrumental in sustainability initiatives due to their large infrastructure, potential for durable income streams, and an ability to invest in renewables to aid in the energy transition.

Opportunities can be found in high-quality, well-run utilities that dedicate significant resources into renewable energy infrastructure.

HEALTH CARE

The pandemic intersected a period of growing demand and cost for health care provision and created a bifurcated landscape.

It has also pulled forward telehealth trends by years, and companies that provide these services have been seeing rapid adoption while helping patients to maintain essential and safe communication with doctors.

TECHNOLOGY

Given rising political and societal oversight, tech companies are rapidly addressing their responsibilities to act as good stewards of sustainability, even if it comes at the expense of short-term returns.

We actively engage with a number of large tech companies to help guide their ESG journeys and influence their decision-making where possible.

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