RESPONSIBLE INVESTING

Bridge to ESG Integration: A Lens for Quality

By: Lance Garrison, CFA | December 5, 2023

When selecting a strategy, one of the first questions that investors should ask is, "What am I trying to accomplish?" Intentionality matters and, at Atlanta Capital, we are clear on ours: Our goal is quality.

Our focus on environmental, social and governance (ESG) factors reflects our belief that integrating ESG into investment decisions improves the investment selection process, can enhance risk-adjusted returns and generate opportunities through companies that we expect will benefit from secular growth trends associated with ESG issues. In short, we use ESG to generate alpha.

Let's take the global energy system as an example of how some companies are navigating some of today's ESG issues. The global energy transition includes three big investable themes right now:

- Shifting to clean energy sources
- Reducing greenhouse gas concentrations
- The Inflation Reduction Act (IRA)

The IRA has accelerated the U.S. energy transition with significant growth prospects and a large total investment opportunity. Blue hydrogen, green hydrogen and carbon capture all represent great secular growth opportunities.

When investors consider those three big themes, a couple of companies stand out as leaders, especially in green hydrogen and carbon capture. We favor those types of companies because we believe they have the experience, technology and asset network to be significant players in the clean energy transition—which, in turn, we believe will generate alpha.

More broadly, we look for pricing power and sustainability. One example is a global leader in cleaning and sanitizing chemical solutions with high recurring revenue and pricing power—something that's important in any market, but especially in an inflationary one. Notably, their products help customers reduce energy and material costs. With most companies trying to improve resource efficiency, that creates a durable and defensive business model where they're being pulled into business sales and there is no real competition. We consistently tie fundamentals and sustainability together in this way.

Nevertheless, investors seeking the benefits of diversification have faced significant headwinds during 2023. This was a year where low quality led, along with a striking narrowing of the market. The top five names in the benchmarks account for 42% of the Russell 1000 Growth Index and the top seven companies drove 84% of the return in the S&P 500, as of November 30, 2023. The concentration has been so extreme that indices are struggling to meet diversification requirements. Nasdaq had to rebalance for concentration, for the first time ever, after its own concentration rules were breached.

This concentration is not something that can last. We focus on having a repeatable process that seeks to consistently beat the market over time—but that doesn't mean trying to beat the market every year. Instead, we take a conservative approach with strong downside mitigation.

Bottom line: Keeping up in the up markets and protecting assets in down markets may help outperform over the long-term with less risk. And ESG is a big part of that alpha.

Standard & Poor's 500 Index is an unmanaged index of large-cap stocks commonly used as a measure of U.S. stock market performance.

Russell 1000 Growth Index is an unmanaged index of the growth segment of the 1,000 largest U.S. stocks.

Alpha is the excess return or value added (positive or negative) of the portfolio's return relative to the return of the benchmark.

Green Hydrogen is derived from water electrolysis using renewable electricity.

Blue Hydrogen occurs when natural gas is split into hydrogen and CO_2.

Carbon Capture encompasses technologies that can combat climate change by reducing CO_2 emissions.

Risk Considerations*: Investing involves risk including the risk of loss. There is no guarantee that any investment strategy, including those with an ESG focus, will work under all market conditions. Investors should evaluate their ability to invest for the long term, especially during periods of downturn in the market.*

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