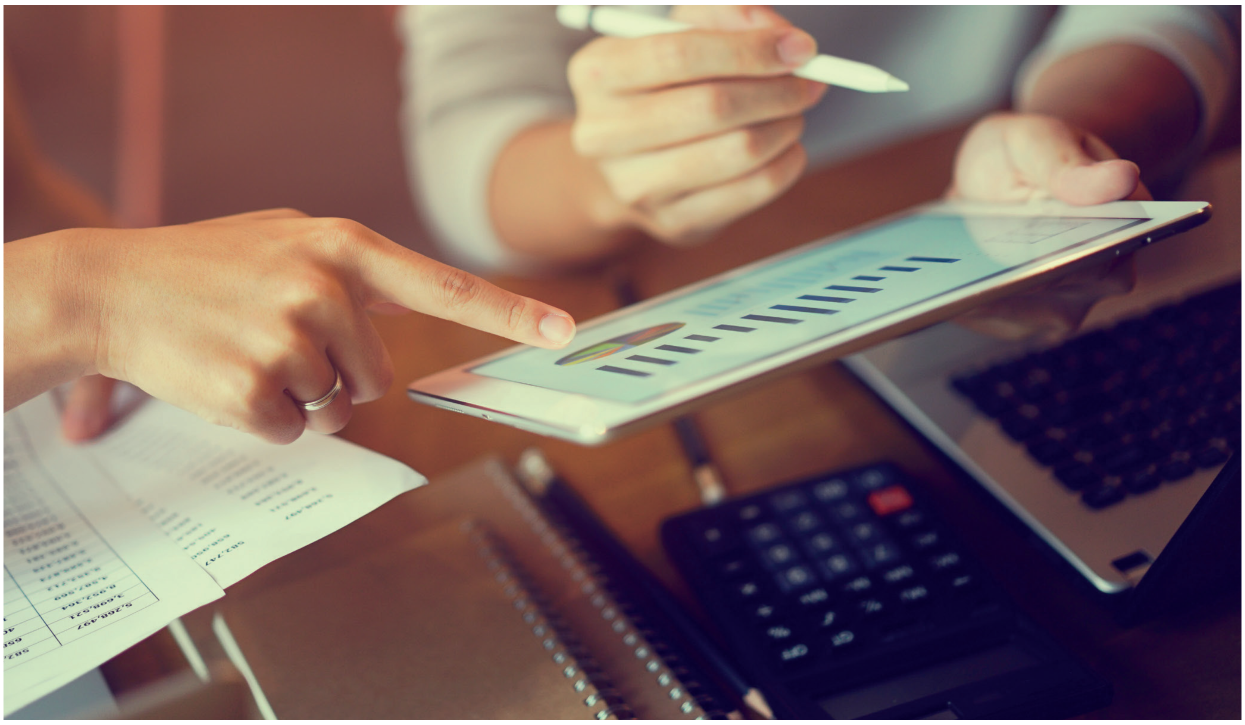
Thinking like a business owner

The recent global backlash to the UK government's tax-cutting plans – along with geopolitical uncertainty, energy security concerns in Europe and ongoing tension between inflation and interest rates – has added significantly to this year's equity market volatility.

It is natural that macroeconomic noise dominates at present, however as active global equity investors who think like long-term business owners, we continue to look ahead and focus on the heroes of our portfolios – our companies.



More than just the numbers

When considering a company's capital, we look not only at traditional financial reporting, but also at the extra-financial factors giving great companies a competitive advantage.

Although such accounting does a good job of listing a company's assets and liabilities on its balance sheet, it is just one form of capital: financial capital. Other forms of capital exist, such as human and environmental. Few would want to invest in a company with poor human capital, yet financial reporting does not reflect that data. And to take the example further, in the wake of the pandemic, companies willing to optimise flexible ways of working will be able to create satisfied personnel… or to put it another way, engaged, motivated human capital.

Through an 'active ownership' mindset and integration of ESG factors into our analysis, we understand the risks and opportunities facing companies. This enables us not only able to reduce risk and uncover alternative sources of alpha, but also to achieve a responsible allocation of capital.

On the other side of the coin

In the same way that a company can borrow against financial capital by taking out loans or selling bonds, it can also borrow against extra-financial capital, for example, borrowing from employees by compromising on training, or borrowing from the environment by not tidying up after oneself.

These companies are considered contingent liabilities. Such liabilities do not appear in financial accounts, but are created when a company chooses to compromise the future in order to flatter short-term results. They might be deferred for a period of time but ultimately cannot be avoided, thus impacting the value of a business and resulting in negative financial consequences for shareholders, when they become realised.

Conclusion

We believe investing is not simply renting a share for a period, but taking an ownership stake in a business and accepting the responsibility that ownership entails. We use ESG as a tool to focus on the idiosyncratic aspects of a business, and by avoiding companies with weak ESG practices and instead paying attention to long-term drivers of sustainable corporate performance, we can exploit what we believe is a persistent market inefficiency and turn that into alpha.

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