ESG INVESTING

ESG Still Matters. 3 Defensive Stocks That Make the Grade.

By Teresa Rivas Follow

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General Mills is on the short list of one ESG portfolio fund. (GABBY JONES/BLOOMBERG)

Now doesn't seem like a great time to be an ESG investor.

The White House targeting gender identity, states suing sustainable fund managers, and companies from Amazon ↓ AMZN -0.49% to Target rolling back DEI initiatives.

Yeah, not great.

Yet, portfolio manager Bill Davis is shutting out all the noise and sticking to his guns. The term ESG has been a lightning rod for a long time, but it is—and always has been—simply "a proxy for finding a well managed company."

"If you're a long-term holder, like a pension fund, and you have a long-term obligation," he writes, "I would argue that if you're not thinking about governance risk or climate risk you actually are not acting in a fiduciary manner on behalf of your fund holders."

Davis puts his money where his mouth when it comes to the actively managed Hennessy Stance ESG exchange-traded fund, which doesn't invest in tobacco, fossil fuel, weapons, and similar areas. He does make exceptions based on company principles.

The fund uses an algorithm to rank S&P 500 companies by various risk factors and metrics, and identifies those most likely to generate positive alpha and minimize harm. It also helps avoid being reactionary to the zigzags of U.S. policy these days.

That strategy, which also avoids large positions, hasn't distinguished itself in these past few years when the Magnificent Seven tech stocks and a handful of other megacaps drove index performance—the fund, though, does have positions in Google, Apple, and Netflix.

Still, Davis stands firm. The strategy can show its worth when investors are more concerned with downside risk protection.

Tesla is a case in point.

The company isn't one the fund would invest in because "stating the obvious, it's so poorly governed and it's been obvious for years that it would get where it is today, which is complete erosion of the brand," Davis says.

"A lot of investors look at Tesla and get excited it's part of the Mag7 but they're not paying attention to the fact that it has a part-time CEO that spends more time eroding the brand than doing anything else and a lack of independence on the board."

There are plenty of companies, though, that Davis feels differently about. He likes drug distributor Cardinal Health —peer to *Barron's* pick McKesson—because healthcare remains a safe haven and Cardinal has done particularly well—doubling the S&P 500 in recent years. Its earnings growth profile is good and "it's a solid company with large enough scale to have pricing power."

Also making the cut is Atmos Energy. Davis cites the natural-gas utility's relative momentum—the shares are up nearly 30% in the past year—and its defensive qualities. Although the fund shies away from fossil fuels, distributors like Atmos

that are transparent, focused on reducing greenhouse gas emissions, do fit the bill.

Davis owns staple General Mills as well, again for its defensive qualities, including a 4% yield, and its size—big enough to exert pricing power. He does see only modest upside, but also “low downside, so it’s a good fit for our portfolio.”

Luckily for Davis and other ESG managers, many companies are forging ahead with sustainability initiatives and transparency, as *Barron’s* reported in February.

These factors are already intertwined in how they operate “not for the singular goal of being do-gooders, but because sustainability is often synonymous with efficiency and good business,” we wrote.

Maybe there are some good deeds that go unpunished.

Write to Teresa Rivas at teresa.rivas@barrons.com