

## Investment Strategy – How to action an Ethical Investment strategy

Ethical investing or Socially Responsible Investing (SRI) describes a strategy which combines an investor's intention to maximise both financial return and social return. Ethical Investors focus on how companies handle Environmental, Social and Governance (ESG) issues. For example, investors may favour companies which are environmentally responsible, support workplace diversity, and increase product safety and quality over those that do not.

Domestically, interest in ethical investing has continued to rise with investments in core responsible investments growing by 51% during 2013 (2014 numbers are yet to be published) to over \$25 billion and those following broad strategies increasing by 13% to \$153 billion.

There are two main reasons why investors invest ethically:

- To ensure the companies they invest in align with their ethical standards; and
- To invest in sustainable companies that will maximise financial return and social return in the long run.

There are many techniques used by ethical investors; however, according to the Global Sustainable Investment Alliance there are five major techniques. These techniques generally fall into two categories: Core responsible investing or Broad responsible investing.

### Core Responsible Investment Strategies:

- Screening of investments – negative and positive screening
- Sustainability-themed investing
- Impact/community investing
- Corporate engagement and shareholder action

### Broad Responsible Investment Strategies

- Integration of ESG factors into the overall investment decision making process

There are three main approaches investors have undertaken to implement an ethical investment strategy. They include:

- Investing in direct investments using ethical filters;
- Investing in ethically-managed strategies; and
- Investing in managed strategies and reviewing these strategies regularly to ensure there are no significant exposures to unwanted industries or companies.

### Approach 1: Direct Investing

Ethical and sustainable investment policies can be very personal and specific to each individual. Accordingly, selecting an 'off the shelf' strategy may not be appropriate for every investor and a customised strategy may need to be pursued. Customised ethical strategies can be implemented through either direct investing or via a Separately Managed Account (SMA) service.

In the case of direct investing, investors can set their own ethical constraints with regard to the industries and specific companies they are not comfortable having exposure to. Questions to be considered include, are there specific industries to exclude? Are there specific companies? How should we measure the significance of a company's participation in an activity viewed as unethical? For example, is it 5% or 10% or 20% of revenue, or is it a percentage of profit? How frequently will these measures be reviewed?

There are SMA offerings, which allow investors to select from a range of fund managers to manage a portfolio on a discretionary basis, whilst the investor maintains beneficial ownership of the underlying holdings. Where a fund manager has recommended an investment in a company that may not pass the customised ethical filter it is excluded and the proceeds are invested in cash. This strategy

allows investors to implement their own ethical filters without having to dedicate additional time to manage the direct portfolio themselves.

### Approach 2: Investing in ethical managed strategies

Whilst the concept of ethical investing has been in existence for decades, and interest levels have grown significantly over the last 10 years, there are still only limited options available for investors seeking ethical management funds, (even fewer options if you are investing outside of Australian equities).

There are currently around 30 ethical funds in our market place, which have generated mixed results. One strategy taking a different approach to investment is the Generation Wholesale Global Share Fund (Generation). Whilst ethical/sustainable strategies have historically focused on excluding companies involved in unwanted activities, Generation undertakes a more proactive approach to investment management. Generation's approach is based on the premise that the following sustainability factors will ultimately drive the success of businesses over the long term and therefore looks to identify companies likely to succeed in these areas:

- economic health;
- environmental; and
- social and governance.

Aside from these strategies we believe the market lacks depth in high-quality ethical / sustainable strategies. The lack of depth limits the ability for investors to construct appropriately diversified portfolios solely using ethically managed funds.

### Approach 3: Investing in managed strategies with regular reviews for unethical exposure

Acknowledging the lack of high-quality ethical strategies available in our market, another approach is to

## Investment Strategy - Implementing an Ethical Investment Strategy (continued)

invest in managed funds that may not have any specific ethical filters and review these investments regularly to ensure no unwanted significant exposures arise. This requires transparency of the underlying strategies. The potential downside is that there may be increased turnover at the fund level, depending on the ethical filters put in place.

### Finding the right approach

The decision as to which approach is the most appropriate strategy for each investor will depend on a number of factors. These include:

- the importance placed on ethical issues;
- the balance between the desire to implement an ethical investment policy with the aim to maximise risk-adjusted returns; and
- the potential time commitment required to undertake a more active direct investing strategy.

When it comes to what works best for each investor it may very well be that a combination of all three approaches across the asset classes. For example, in the case of Australian fixed interest and equities a direct approach may be appropriate, while a specific ethical strategy and traditional strategies are used across global fixed interest and equities.

If you are currently reviewing your ethical investment policy, or would like to, please speak to your adviser.

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