AWFM Fact File

"Ethical Investing"

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Ethical Investment Considerations

For a number of years, environmental issues have increasingly moved to centre stage and particularly as our news updates regularly feature articles on climate change and global warming. Many of our clients are concerned about both environmental issues as well as issues associated with health and global human rights. As such they want to consider the possibility of investing on an ethical basis.

We welcome and endorse this level of engagement. This Fact File is designed to help you to briefly consider some of the aspects of investing in ethical funds or with an ethical overlay.

<u>Background & History</u>
Ethical investing can be traced back hundreds of years when many influential religious organisations avoided investing in such areas as gambling, arms production and alcohol production. The first retail ethical investment fund was launched in the UK in 1984.

<u>Different Approaches</u>
The origins of Ethical investing had a one-dimensional *exclusion* approach. Now however we have very different approaches, as summarised below:

1. <u>Ethical Investing</u> – has 4 broad strategies for identifying companies that are suitable for inclusion in the portfolio:
    a. **Screening** – a fairly clear-cut approach which includes or excludes as follows:
        i. Generally this approach would use a "<u>Negative screening</u>" to screen out those companies which invested in areas not deemed to be acceptable for the fund. This type of approach may specifically exclude: alcohol production/sales, genetic engineering, nuclear power, pornography etc.
        ii. It can however also use "<u>Positive screening</u>" to specifically seek out companies who are making a difference. Suitable investments might include for example those companies who are working actively on their: community involvement, employee welfare rights, environmental policies, packaging reduction etc.
    b. **Thematic investment** – key themes are used to identify "<u>industries of the future</u>" that are positively trying to improve the world. Such companies might include non-air public transport, recycling & waste management etc.
    c. **Preference/best of sector** – allowing investment within a specific sector to invest in the companies which may not be deemed "ethical" in their own right, but the company is the <u>most responsible</u> of all companies within the sector.
    d. **Engagement** – with this style, rather than using a screening approach, it takes the position that investors can change a bad company's ethics and policies better from the inside as an investor than from the outside as a protestor. Thus the fund manager/investor will use their shareholding stake in the company to <u>actively influence</u> the environmental and social policies of the company for good.
2. <u>Socially Responsible Investing (SRI)</u> – is a broader definition which takes into account all of the factors mentioned above. The approach is that good social and environmental practise is directly linked to the good management of companies which in turn leads to the good performance of the company and share price.

Whilst to some extent it is good to have choice, it is also important to note the potential for confusion and additional layers of complication for an investor with very firmly held views on a particular subject. Only an individually managed direct approach to investing can really solve this issue, although even then it is by no means easy to obtain detailed information on the way a company is run. For most investors who wish to engage broadly in an ethical overlay to their investments, the fund approach is likely to be acceptable.

When considering investing ethically, it should be noted that there is no such thing as a perfect company or stock to invest in. We believe it is therefore about making a stand as far as is possible and to actively engage in this process, if this is something that you feel strongly about. So investing ethically or with an ethical bias is more about making a conscious step in this direction and also being prepared for some compromise.

Limitation of Fund Choice

If we are running investment funds for you within a model portfolio, in comparison to the wider investment universe, you do need to be aware that there are a limited number of funds available in the ethical investment market (at the time of writing there are only 59 funds out of a wider universe of about 2,000 funds). If we are using a Discretionary Fund Manager, the investment options will be wider as the DFM will apply their own principles to stock selection within a given ethical criteria after discussion with you. In both instances however we feel an obligation to point out to clients that this approach inevitably restricts choice and will therefore quite likely impact on the *relative* performance of your investments.

However, where appropriate we will encourage our clients to make an ethical stand on their investments as well as engaging in helping to protect and preserve the environment in every other aspect of their lives.

Fund Performance & Risk

Investors seeking an ethical overlay to their funds will almost certainly be accepting that profit is not the key driver to their portfolio. This means that they will probably not be investing in the best performing fund from a growth perspective and they will probably be accepting a marginally higher degree of risk as their investment will inevitably to some extent be shepherded towards newer markets and more volatile companies. Sometimes this approach may also reward the Ethical investor when compared to the non-Ethical alternatives.

A Wider Issue

The ethical & socially responsible issue touches many areas of life such as:

- Your preferred normal mode of transport
- The way you treat your staff or those less fortunate than yourself
- The business activity(s) you are engaged in
- Your attitude to recycling
- Your charitable giving

There is also the issue of using companies and products which you do not necessarily agree with but which are to some extent essential products – for example banking and mortgage arrangements.

A Personal Choice

We recognise that it is up to clients to decide how they would like their investments managed. We have therefore designed model portfolios with standard funds with an Ethical alternative. We will seek to ask clients at any early stage of the investment process, whether they would like us to manage their investments based on an Ethical portfolio. This will usually be part of the risk profiling process.

Resources

The following resources are useful as a starting point:

- Ethical Investment Research Services (EIRIS) – www.eiris.org
- Ethical consumer – www.ethicalconsumer.org

Summary

This is a complicated and diverse issue which we will be happy to discuss with you individually.

If you have any questions or need an independent review of your financial planning or investment arrangements, please contact us to discuss your situation further. AW Financial Management LLP is an Independent Financial Adviser regulated by the Financial Conduct Authority.

Information given in this document should not be taken as advice as it is intended for guidance only. If you wish to have an assessment of your own situation, you should contact the office for advice.