SOCIALLY RESPONSIBLE INVESTING

IS THE GRASS GREENER ON THE OTHER SIDE?

Socially Responsible Investing, Ethical Investing, Impact Investing – the myriad of terms which investors are now faced with all date back to the idea of Responsible Investing which was developed in the 18th century by Quakers and Methodists. Religious groups, such as the Quakers, provided their members with guidelines detailing the types of companies in which they should invest, based on moral grounds.

Despite the fact that making investment decisions based on morals and ethics isn't a new idea, it has risen in prominence as global warming and human-caused damage to the environment have become social causes at the forefront of our consciousness.

KEY DIFFERENCES

Though many people associate Socially Responsible Investing with companies which look to either do no harm to, or improve, the environment, the scope of the sector has now widened and encapsulates environmental stewardship, consumer protection, human rights, and racial or gender diversity. This type of investing is now being referred to as 'ESG investing', as it focuses on environmental issues, social justice and corporate governance.

As the sector becomes more cluttered, with more and more options available to investors, it is imperative that people are aware of the key differences between terminology used by investment managers and how this determines what their fund is aiming to achieve;

Ethical Investing: most early entrants into the market labelled themselves as 'ethical funds' and employed negative screening to determine what companies and industries they could invest in. A fund employing negative screening simply avoids certain industries because of the negative or damaging effects of their products – examples include tobacco and armaments. Such funds are often referred to as 'light green funds'.

Sustainable Investing: a large number of the sector's largest funds now refer to themselves as 'sustainable funds'. Rather than determine what can't be invested in, sustainable funds employ positive screening and aim to identify companies in sustainable industries such as renewable energy, healthcare and education. Sustainable funds may also be referred to as 'dark green funds'.

Impact Investing: impact funds can be said to go one step further and seek investments which deliver social and/or environmental benefit and contribute to the solutions we as a society want, while still seeking to deliver a financial return. Examples include companyies involved providing social housing and clean water distribution.

As an individual investor, you must be clear in what you seek to achieve from your investments, and ensure that your chosen funds align to your goals. Some funds may label themselves as 'ethical' simply because they do not invest in oil companies. However, they may still invest in companies which make large profits from supplying machinery or credit to oil companies.

There is often a misconception that in order to invest in a socially responsible manner, investors must be willing to sacrifice returns, as you are effectively narrowing the pool of investments at your disposal. However, many of the most profitable companies in the world have become so due to the fact that they have a sustainable business model, are governed effectively and seek innovation, and therefore may be eligible to be included in many sustainable funds.

POSITIVE RETURNS

I have examined data that shows the performance of an index of companies who are considered as world leaders in their approach to environmental issues, social justice and corporate governance, compared to an index of worldwide companies which takes no regard to these issues. Interestingly, over a five-year period from 27/04/15 to 27/04/20, which includes the recent downturn in world financial markets, they have performed in a broadly similar manner, with the index of World ESG Leaders slightly outperforming (+54.09%) the non ESG index (+51.59%)[1].

Examples of the positive returns available when investing in a socially responsible manner can be seen in some of the funds contained in Kelland's list of approved funds. The Fusion Wealth Ethical Balanced Portfolio has a three-year cumulative performance to the period ending 27 April 2020 of 13.91%. To put this in perspective, the Fusion Wealth 05 Active Portfolio, which has the same fund manager and seeks to take a similar level of risk as the Ethical Balanced Portfolio – but does not take consideration of ethical issues when selecting where to invest – returned 5.55% in the same period. The positive performance of the Fusion Wealth Ethical Balanced Portfolio is even more impressive when it's considered that over the same period of time, the FTSE 100 returned -8.55%.

However, this article is not proposing that investors funnel their entire investment portfolio into ESG funds at the expense of their current investments. Inflows into ESG funds rose dramatically in 2019, with over £4.4 billion invested[2]. However, was this due to the fact that the underlying companies were worthy of this investment, or due to investors jumping on the bandwagon chasing potential returns?

DIVERSIFIED RANGE

At Kellands, we continue to promote the benefits of investing in a diversified range of asset classes and fund management styles, and we believe that in order to maximise the balance between risk and reward, Sustainable Investments can play an important role in this.

Each individual investor has their own needs and goals, and it is clear that many are now wanting to incorporate their wish of being more socially responsible into their investment planning. At Kellands, we seek to provide investment solutions which assist clients in meeting their goals, whatever they may be. ■

If you would like any further information regarding the sustainable investments options available to you, please do not hesitate to contact your adviser.

Source data:

[1] Financial Express, 2020

[2] https://www.ftadviser.com/investments/2019/10/30/esg-funds-see-124m-inflows-per-week/