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AN INTRODUCTION TO

➤ Sustainable and Ethical Investing

GETTING TO GRIPS WITH THE BASICS



Investing responsibly
The moral maze
Ethical investing

ESG and Sustainable Investing
The terminology
We're here to help



Although the concept of ethical investing has been around for decades, interest in this sector has grown in the last decade or so as these investments have traversed from niche products into the mainstream. A key reason for this growth in interest has been increased levels of consumer awareness across a range of social and environmental issues.

However, while these products have now become an established part of the mainstream investment landscape, many people remain confused about the terminology associated with this type of investing and are unclear how they can potentially benefit from being a more conscientious investor. Here, we'll provide answers to those questions and help guide you through investing's moral maze.

Climate change, in particular, has become a key concern for many people, with the messages and actions of environmental campaigners keeping the subject firmly at the top of the media agenda. This has made it almost impossible for people to ignore the impact their actions, as well as those of corporations, are having on the planet. As a result, many investors are increasingly looking to invest in the world's future and allocating funds towards companies whose values and practices are clearly aligned to their own personal beliefs.

INFLOWS AND OUTFLOWS

Inflows and outflows to sustainability funds have ebbed and flowed over the years. Interestingly, the pandemic was a turning point for fund inflows, with global investors pouring in \$45.6bn into ESG focused funds in the first quarter of 2020, compared with global outflows of \$384.7bn for the overall fund universe, according to Morningstar. It seems investor focus shifted, sparking a period of reflection and reassessment, keen to make a positive impact with their money. More recently, fund inflows have tempered, with wide regional variance evident.

Europe is the largest sustainable fund market, with 84% of global sustainable fund assets. In the region during 2023, \$76bn of sustainable fund inflows were registered, compared with \$149bn the previous year. Morningstar cite a few reasons for this decline, including the challenging macro environment, such as *'high interest rates, inflation, and fears of recession in parts of the world... which has led investors to favour government bonds, an area that has limited ESG products.'*

In addition to flagging greenwashing as a concern and *'the ever-changing regulatory environment,'* they also state *'it is fair to assume that some investors took a more cautious approach to ESG investing (2023) in the wake of the underperformance of*

ESG and sustainable strategies in 2022, partly due to their typical underweight in traditional energy companies and overweight in technology and other growth sectors. While the technology sector rebounded in 2023, other popular sectors in sustainable strategies continued to underperform. Renewable energy companies, for example, have been particularly affected by soaring financing costs, materials inflation, and supply chain disruptions, among other issues.'

THE MORAL MAZE

The different terminology used to define these types of investments does have the potential to confuse prospective new investors. The use of acronyms, as well as a lack of industry-wide standard definitions for sustainable and ethical investing, only adds to this air of confusion.

As a result, the concept of sustainable and ethical investing is often interpreted in different ways by different people. There are, however, a number of common terms used within the sector and gaining an insight into their meaning and the key difference between the terms can help investors navigate their way through the terminology maze.

ETHICAL INVESTING

One of the most commonly used terms is ethical investing which involves

The value of investments and income from them can go down. You may not get back the original amount invested. Some funds will carry risks in return for higher potential rewards and can involve greater risk than is customarily associated with funds investing in larger, more established companies.



actively avoiding those types of firms or industry sectors which are deemed to have a negative impact on society or the environment. This approach is also known as negative screening as it involves filtering out specific types of investment based on a series of moral or ethical judgements.

For instance, investment criteria may exclude all oil and gas companies regardless of whether or not a firm operating in the sector generates any form of green energy. Other types of excluded 'sin stocks' typically include tobacco producers, alcohol companies, weapons manufacturers, the gambling industry and any firm involved in animal testing.

Positive screening tries to include companies that add something to the community, that have good corporate governance and working practices. Forms of positive screening include: investing in companies that sell positive products like educational material or essential necessities of life (food, clothing, electricity, water or housing).

Using a mixture of the two types of screening lets the fund manager consider more arguments.

ESG AND SUSTAINABLE INVESTING

Another common term, or more accurately three-letter acronym, is ESG.

This refers to the three key factors used by investment companies to evaluate corporate behaviour:

- **E**nvironmental criteria – for example, carbon emissions, waste management and air or water pollution
- **S**ocial criteria – for example, human rights, labour standards and data security
- **G**overnance – for example, board diversity, business ethics and executive remuneration.

In essence, sustainable investing uses ESG principles in order to actively select those companies that have a positive impact on the world. This approach is therefore less restrictive than ethical investing as it allows for the fact that organisations are typically not either all good or all bad. So, under a sustainable investment strategy, a fund manager would be allowed to invest in an oil company that was developing clean, renewable energy sources.

ARE THESE FUNDS HIGHER RISK?

In the early days of ethical investing there was a definite perception that investors were putting principles before profit, with ethical investments generally considered to be significantly more risky than their traditional counterparts. Nowadays, however, with a much wider choice of stocks available to ethical and sustainable investors, this style of investing can provide a compelling investment opportunity capable of generating long-term stable and sustainable returns.

IT CAN PAY TO HAVE MORALS

Over the last few years, growing evidence has emerged to suggest that those companies who successfully incorporate ESG risk management policies are capable of generating good long-term risk adjusted returns, implying that investors can satisfy both their morals and their financial return expectations – or, to put it another way, there does appear to be growing evidence that it literally can pay to have principles.

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WE'RE HERE TO HELP

We're only a phone call away, so if you have any questions or would like to discuss any aspect of equity release, then please do get in touch



➤ The terminology

BEST-IN-CLASS INVESTMENTS

This involves investing in those companies that lead their peer groups in terms of ethical and sustainable policies.

DIVESTMENT

The sale of an asset for social or political goals, for example, the selling of South African assets during the apartheid era or, more recently, selling investments in fossil fuel-related assets.

ESG: ENVIRONMENTAL, SOCIAL AND GOVERNANCE

The three central factors used to measure the sustainability and ethical impact of an investment.

ETHICAL INVESTING

A policy which applies specific rules based on moral or ethical judgements as the primary filter for avoiding companies or industry sectors that do not meet investment criteria.

EXCLUSION

A strategy designed to exclude those companies, sectors or countries that are not aligned to an investor's values.

GREEN INVESTING

A policy of selecting companies considered to be positive for the environment, such as those offering

alternative sources of energy or those with a proven track record in reducing their environmental impact.

IMPACT INVESTING

An investment strategy which targets those companies that have a positive social and/or environmental impact whilst demonstrating high levels of accountability and governance.

NEGATIVE SCREENING

A strategy which incorporates an investor's moral principles by filtering out specific activities or industries, such as tobacco, alcohol, pornography or gambling.

POSITIVE SCREENING

A policy which selects those companies that are outperforming their peers in relation to ESG measures or those best positioned to solve specific long-term ESG challenges.

RESPONSIBLE INVESTING

This term is synonymous with ESG investing and aims to take into account different kinds of social, environmental or governance factors in investments.

SIN STOCKS

Also known as vice stocks, these relate to companies associated with activities considered either unethical or immoral,

such as weapons manufacturers, the gambling industry or firms involved in animal testing.

SOCIALLY RESPONSIBLE INVESTING (SRI)

Another three-letter acronym, SRI is one of the oldest ethical investment strategies, which involves focusing on a range of social issues, such as labour rights.

STEWARDSHIP

Purposeful dialogue between shareholders and boards, designed to ensure a company's long-term strategy and day-to-day management is effective and aligned with shareholder interests.

SUSTAINABLE INVESTING

An investment style that takes into account a range of environmental issues, such as global warming.

THEMATIC INVESTING

An investment strategy which aims to identify trends at a macro-level and the underlying investments positioned to benefit from the emergence of those trends.

VALUES-BASED INVESTING

A policy that seeks to prioritise investors' sustainability objectives, rather than attempting to maximise returns in isolation.

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Warning statement

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