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 maze

We're here to help

The last few years have seen a substantial rise in the popularity of sustainable and ethical investments, driven by an increasing desire for investors to know where their money is going and what it is being used for. However, while these funds 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 actually benefit from being a more conscientious investor. Here, we'll provide answers to those questions and help guide you through investing's moral maze.

WHY INVEST RESPONSIBLY?

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

Climate change, in particular, has become a key concern for many people, with the messages and actions of environmental campaigners such as Greta Thunberg 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.

A GROWING TREND

Perhaps unsurprisingly then, we have witnessed a period of significant growth in the sustainable and ethical investment funds market. According to the most recent statistics collated by the Global Sustainable Investment Alliance, worldwide sustainable investing assets totalled more than $30 trillion, which represents an increase of 34% over two years from 2016–2018.

Fund inflows suggest this trend may continue in the post-Covid era, with the pandemic outbreak and subsequent lockdown seeming to have sparked a period of reflection and reassessment among a significant proportion of the population. One of the lasting legacies of coronavirus, with regards to the investment arena, may therefore be to push sustainable and ethical investing even more to the fore, further encouraging investors to make a positive impact with their money.

THE MORAL MAZE

While interest in sustainable and ethical investing has undoubtedly surged recently, 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 reflects a screening process. This process can be negative or positive and involves filtering investment opportunities based on moral or ethical judgements.

Negative screening 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. ESG has developed from Ethical Investing using positive screening to be a focus for individual companies, countries and therefore for investors. 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.

However, ethical investing can restrict your choice of companies and funds to invest in, which may lead to less diversity in your portfolio (and less diversity can mean higher risk).

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 sustainable and ethical investing, then please do get in touch.

The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not a guide to future performance and past performance may not necessarily be repeated.

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
Ethical investing is the practice of selecting investments based on ethical or moral principles. This is typically done by filtering out harmful activities (negative screening) and proactively seeking to invest in companies that are committed to making a positive impact through their environmental, social and governance (ESG) practices (positive screening).

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 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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