inFocus

Financial Framework
wealth and estate planning

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Hello and welcome to our latest newsletter. This month we're focusing on Environmental, Social and Governance (ESG) investing. What does it mean? Should you be considering it as part of your investments? What do we think about it? As ever, this communication is designed to provide you with an overview. Should you wish to discuss it in more detail then please contact your usual consultant.

What is ESG Investing?

Environmental, Social and Governance (ESG) Investing is a growing area of investment. Over the last couple of years, it has moved from being a relatively niche area of investing to become a key are of consideration for advisers and their clients. To provide a small idea of how it has grown, a 2018 study by the US Forum for Sustainable and Responsible Investment found that more than $1 of every $4 under professional management in the US was classified as either socially responsible or one of its subsets, impact investing.

Perhaps unsurprisingly, ESG is firmly on the regulator's agenda as well. EU regulation due next year will require advisers to take account of their clients' views regarding ESG preferences and how we take them into account when recommending a suitable investment through the funds that are part of our investment proposition.

In light of this, businesses are increasingly incorporating ESG considerations into their business models. As you would expect, fund managers are interrogating and scrutinising outputs with due consideration during their review and selection process, whilst savers are increasingly expecting their advisers, and the fund managers they use, to consider the impact of businesses' actions on wider society and the environment.

Before we look at how this may affect you, we're going to provide an overview of exactly what all the terms mean.

ESG, SRI and Impact Investing: What's the difference?

ESG, SRI and impact investing are often used interchangeably by clients and professionals alike, with the assumption that they all match in meaning and approach. However, there are distinct differences in approach and outcomes that will affect how client portfolios are constructed and which investments may be considered suitable for each approach.

ESG

ESG refers to the environmental, social, and governance practices of an investment that may have a material impact on the performance of that investment. The integration of ESG factors is used to enhance traditional financial analysis by identifying potential risks and opportunities beyond technical valuations. While there is an overlay of social consciousness, the main objective of ESG valuation remains financial performance.

There are a number of factors that go into ESG investments. It should be noted that investments with good ESG scores have the potential to drive returns, whilst those with poor ESG scores may inhibit returns.

:: Environmental factors include energy consumption, pollution, climate change, waste production, natural resource preservation and animal welfare.
:: Social factors include human rights, child & forced labour, community engagement, health & safety, stakeholder relations and employee relations.
:: Governance factors include quality of management, board independence, conflicts of interest, executive compensation, transparency & disclosure and shareholder rights.

Socially Responsible Investing (SRI)

Socially responsible investing goes one step further than ESG by actively eliminating or selecting investments according to specific ethical guidelines. This could be due to an investor's religion, personal values, or political beliefs. Unlike ESG analysis which shapes valuations, SRI uses ESG factors to apply negative or positive screens on the investment universe.

For example, an investor may wish to avoid any mutual fund or exchange-traded fund (ETF) that invests in companies engaged in firearms production because they hold anti-conflict beliefs. Alternatively, an investor may opt to allocate a fixed portion of their portfolio to companies that contribute to charitable causes.

Other negative SRI screens include:

:: Alcohol, tobacco, and other addictive substances
:: Gambling
:: Production of weapons and defence tools
:: Terrorism affiliations
:: Human rights and labour violations
:: Environmental damage

For clients engaged in socially responsible investing, making a profit is still important, but must be balanced against principles. The goal is to generate returns without violating one's social conscience.

Impact Investing

Impact or thematic investing places the positive outcomes as the consideration of utmost importance, meaning the investments need to have a positive impact in some way. So, the objective of impact investing is to help a business or organization accomplish specific goals that are beneficial to society or the environment. Investing in a non-profit dedicated to the research and development of clean energy, regardless of whether success is guaranteed, is an example.

In conclusion

Clearly the above highlights that, despite them often being grouped together, ESG, SRI and Impact investing are very different strategies. There is a significant difference in the emphasis placed on the outputs from these types of investment, with ESG being most closely aligned to a 'traditional' investment mandate of achieving maximum returns for a given level of risk (while still incorporating progressive beliefs) through to impact investing where the clear focus is on the suitability of the inputs and selecting companies solely on their likely societal benefit, even if this comes at a cost to the returns generated for the investor.

It is our role as your adviser to discuss your personal investment philosophy, your financial objectives and to work with you to ensure you access a portfolio that is tailored to your requirements. A good starting point is understanding these terms and being able to discuss each option with your adviser so they can find the best fit for your circumstances and beliefs. What we are sure of is that no-one should switch all their investible assets into one class of investment or into one sector. Investing in ESG, SRI or Impact should be seen as a diversifier, whilst benefiting society, the environment and enhancing governance.

What does this mean for our clients?

When we next speak with you, we will be discussing this in depth. We have prepared specific question sets to run through with you to find out how you feel about these subjects. In preparation for that, we thought it was sensible to provide you with the types of questions we will be asking. All that we ask is that you have a look through the questions and start to give them some thought.

You can find them on the next page.

Environmental, Social and Governance Questions

1. How strongly do you feel about environmental factors such as climate change, and a company's environmental footprint and activities?
2. How strongly do you feel about social issues such as diversity, equal opportunities and working conditions?
3. How strongly do you feel about issues involving corporate governance (which is the way a company is run)?
4. How important is it to you to invest in companies that take environmental, social and governance - or 'ESG' factors - into account?
5. Is an ESG strategy something you want to apply to your entire portfolio or a portion of your invested capital? If so, what proportion do you wish to be allocated to these strategies?
6. Do you want this to apply to your existing holdings as well, or just new monies to be allocated?

Socially Responsible Investing Questions

1. Do you have any religious, personal or political beliefs that would lead you to want to specifically include or exclude any particular investments in your portfolio?
2. If it is important, do you require part or your entire portfolio to be invested in these strategies and, if so, what proportion to be allocated?
3. Are you more focussed on 'including the good' or 'excluding the bad'?
4. Are there any sectors or industries you'd wish to avoid, even if meant you would potentially earn less on your investment?

Impact Investing Questions

This process simply begins by asking what your priority for investing is. Is it a return on capital invested or a positive outcome for your investments? You will then be asked to provide a list of societal or environmental benefits that you wish to support through the allocation of your portfolio.

We're here to help

As ever, there is no one-size fits all approach. At Financial Framework Wealth & Estate Planning we continually monitor the market and work with you to ensure your investments and other financial plans are working as hard as they can for you in these challenging times. If you'd like to discuss this investment update, then please get in touch.

For more information call: 01943 663143

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