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FACTSHEET

Sustainable Investing

Strategies to meet some of the most pressing global challenges ahead

Sustainable investing has gathered momentum across the world in the past decade as investors look for financial returns while helping to achieve a positive impact on the world around them.

Long viewed as a niche asset class catering to wealthy individuals and institutions that wanted to avoid controversial industries, the phrase 'sin stocks' emerged to describe firms linked to industries perceived by some to be unethical, such as tobacco, alcohol or gambling. Such funds will exclude these stocks or screen them out, but each investor has views on what is and isn't ethical.

CLOSE EVALUATION

Rather than merely screening out certain stocks, sustainable investing is about closely evaluating a range of environmental, social and governance issues, known as 'ESG'.

This could be analysing a company's track record on pollution from its factories, or how socially responsible it is in the communities it operates.

On corporate governance issues, it is a matter of judging how well the interests of shareholders, customers and staff are managed. Well-managed companies that care about the sustainability of the world in which they operate should have a better long- term future. Sustainable investment is really about integrating ESG considerations into the investment decision-making process, with a view to enhancing returns.

ENHANCED PERFORMANCE

Studies by Friede, Busch & Bassen (2015) and Morgan Stanley, to name but two, found that companies focused on ESG had, on average, enhanced financial performance.

A study by Empirical Research, which has been evaluating and monitoring 60 ESG factors since November 2014 for US stocks, found that those companies with better ESG scores outperformed those with lower.

BETTER UNDERSTANDING

By examining ESG issues, investors gain a better understanding of not just what companies do but how they do it. ESG analysis puts companies into a wider global context and helps to identify which ones have the most resilient models.

Investors can choose investments based on moral beliefs and personal values, but that would be ethical investing rather than sustainable investing.

ENVIRONMENTAL ISSUES

It would be easy to assume that the 'E' of ESG dominates the other two. Many of the thematic investment funds in the space focus on environmental issues, from water shortage to new environmental technologies. And environmental issues, especially in the wake of the COP 21 Climate Change talks in Paris in 2015, are high up on investors' minds. However, social and governance issues are of increasing importance.

Rising inequality and strapped governments has led to the introduction of Living Wages in a number of regions, putting pressure on costs. Changing consumer tastes and new regulation has seen the introduction of sugar taxes and ongoing declines in sugary drink consumptions. CEO pay and boards are rarely out of the headlines.

HOLISTIC LOOK

Successful ESG investment processes take a holistic look at the changing world companies have to navigate and assess the performance of their investment across a number of factors. They engage where performance is lacking, pushing companies to improve their performance in ESG factors across the board and accepting the need for continual improvement in these areas.

The bulk of ESG data that we have is disclosed by large companies operating in developed markets. This does not mean that ESG considerations are not pressing for those in emerging markets.

LOWER VOLATILITY

A 2013 report by UBS, analysing the World Economic Forum (WEF) Corporate Governance Index and emerging market equities valuations, concluded that companies that score well on governance are valued more highly and have lower volatility.

Evaluating how companies manage stakeholders and environmental and social change is relevant whatever the market. With emerging markets, it may just take more investigation.

We tend to think mostly about equities, but it doesn't end there. With bonds, for instance, ESG analysis helps identify risks to a borrower's ability and willingness to repay debts. A well-managed company should be less likely to stumble into value-destroying disasters and be better positioned to repay investors who lend them money. ■

DO YOU HAVE AN APPETITE FOR SUSTAINABLE INVESTING?

The gap between the values of companies on the right or wrong sides of those trends may grow ever wider as a result. By investing in sustainable businesses, investors may increase their chances of success. To and out more, please contact us.

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