

The Rise of Ethical Investing



Amanda Tovey
Investment Manager

Whilst the concept of ethical investing has been around for many years, we have begun more recently to see a notable increase in interest from clients.

A YouGov 2013 survey for National Ethical Investment Week showed 65% of British investors want to be offered a sustainable and ethical option when choosing their investments.

So what is ethical investing?

Ethical investing can also be referred to as SRI (Social and Responsible Investments) or ESG (Environmental, Social and Governance) investing. Ultimately all of these have a similar end goal for clients, incorporating social, environmental and corporate governance issues into the way the funds are managed.

Some funds will look to exclude stocks dependent on predefined criteria such as armaments, animal welfare, tobacco and alcohol production and environmental impact; this is referred to as **negative screening**.

Other funds will look to reward and seek out companies which they consider are providing a positive contribution to society such as those providing social funds or clean energy; referred to as **positive screening**.

In many cases a fund will combine a combination of the two approaches starting with a negative screen to exclude certain areas and then applying a positive screen to help identify the most attractive companies.

Is poor performance of ethical funds a myth or reality?

There seems to be a historical misconception that sustainable investment or ethical funds must generate worse investment returns than traditional funds. There is no evidence to support this although it should be remembered that due to the requirement to exclude large areas of the market such funds would likely underperform if an area such as oil or mining was driving the market forward.

However most investors argue that a well-run company will perform better and adherence to good governance and corporate policy is part of a good management process.

80% of CEOs see sustainability as a way to gain competitive advantage. With huge buy in from CEOs around the world and proof of the positive relationship between corporate investment in sustainability and stock price, this is a conversation that is not going to go away.

Source: Accenture (2013) and Morgan Stanley (2015)

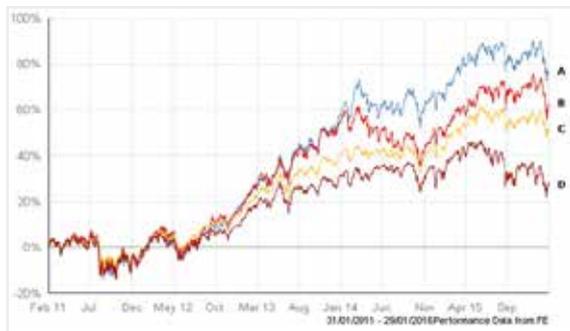
There is emerging evidence that sustainable companies perform better than their less sustainable peers with a generally positive relationship between corporate social performance and corporate financial performance. It has also been clearly demonstrated that unethical behaviour can be of financial detriment to companies as such behaviour can lead to legal action and fines. For example, when oil companies have caused pollution; fines imposed by regulators on the banks who acted in an unethical manner.

A study by Mercer, 2015 concluded that regulations and legislation increase costs for polluting companies, so lower polluting companies should continue to prosper.

The graph below shows the performance of three UK ethical funds versus the FTSE All Share. Due to the ethical restrictions in place most ethical funds will have a mid and small cap bias as many large cap stocks are automatically excluded (such as tobacco companies) making the All Share the most appropriate benchmark.

The graph below shows the performance of three UK ethical funds versus the FTSE All Share. Due to the ethical restrictions in place most ethical funds will have a mid and small cap bias as many large cap stocks are automatically excluded (such as tobacco companies) making the All Share the most appropriate benchmark.

Performance of three UK Ethical Funds versus the FTSE All Share



- A - Premier Ethical
- B - Standard Life UK Ethical
- C - F&C Responsible UK Income
- D - FTSE All Share

Performance figures are calculated from 31/01/2011 to 29/01/2016 net of fees in sterling. Unit Trust prices are calculated on a bid-to-bid basis. OEICs, Investment Trust and Share prices are calculated on a mid to mid basis, with net income reinvested: Source: FE Analytics, Whitechurch Securities. The value of investments and any income will fluctuate and investors may not get back the full amount invested. Currency exchange rates may affect the value of investment.

Benchmarking performance within the ethical sector can prove problematic with most managers preferring to benchmark themselves against the FTSE All Share. Whilst there are ethical benchmarks these all vary in makeup which makes a true comparison difficult. As an example the FTSE 4 Good Index only excludes tobacco and armaments absolutely as its criteria allows for inclusion of all other sectors as long as the company

can has good environmental, social and governance practices. This allows for the inclusion of oils and miners, gambling companies and those producing and distributing alcohol amongst others.

How ethical is ethical?

No corporation is perfect; however many companies do exist largely because their products improve general quality of life or reduce environmental pollutions.

There is an array of funds available with the words 'sustainable', 'social' or 'ethical' in the title. However when you dig a little deeper you often find that the actual criteria is very weak and just paying lip service to the idea of being socially responsible or environmentally conscious.

Sustainable investment funds should have a publically disclosed set of criteria against which they measure companies and invest accordingly, and they should disclose the companies the funds are invested in so individuals can raise concerns with the fund managers. There should be full transparency about the investment process and most managers will be willing to discuss any ethical concerns or issues a client would have around investment choices. In most cases the managers will also be engaging with the companies at management level regarding the company's practices on the basis that if people require companies to act in a responsible and sustainable way in order for them to invest this will act as a driver for positive change.

How are Whitechurch responding to this changing trend?

Whitechurch will be launching a range of ethical portfolios at the beginning of March 2016. If you would like further information about our services, please contact our Discretionary Liaison Team on dfm@whitechurch.co.uk or 0117 916 6175.

Whitechurch Investment Team, February 2016

FOR PROFESSIONAL USE ONLY - SHOULD NOT BE RELIED UPON BY RETAIL CONSUMERS

This publication is issued and approved by Whitechurch Securities Limited which is authorised and regulated by the Financial Conduct Authority. Registered in England and Wales No.1576951

The views and opinions expressed are those of the Whitechurch Securities Investment Managers. Opinions are based on information which Whitechurch consider correct and reliable and are subject to change without notice. We have made great efforts to ensure the contents of this publication are correct at the date of printing and do not accept any responsibility for errors or omissions.

This publication is intended to provide information of a general nature and any opinion expressed should not be treated as a specific recommendation to make a particular investment or follow a particular strategy. Professional advice should be sought before making any investments. Past performance is not necessarily a guide to future performance. Value of investments can fall and investors may get back less than they invested.

Head Office: The Old Chapel, 14 Fairview Drive, Redland, Bristol, BS6 6PH

Telephone: 0117 916 6150

Website: www.whitechurch.co.uk