AN INTRODUCTION TO ESG INVESTING

Alliance Trust Savings

We're all interested in making the most of our money and using it to make a positive difference to our own financial future. But what if you could do that in a way that also helped to make the world a better place? That's what ESG investing is all about.

MAKING A DIFFERENCE WITH YOUR MONEY

ESG stands for Environmental and Social Governance. It's one of the fastest growing themes in investment today. Global investment research specialists, MSCI, define ESG investing as "the consideration of environmental, social and governance factors alongside financial factors in the investment decision-making process"[1].

ENVIRONMENTAL

Concerns how companies take account of issues like climate change and the impacts of their operations and products on the living world.

SOCIAL

How a company operates in its community, covering matters such as working conditions, health and safety and employee relations.

GOVERNANCE

Company leadership in issues such as executive pay, bribery and corruption and board diversity.

These are the principles – the ESG criteria – that more and more fund managers are paying attention to when they invest in companies.

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Please be aware that the value of investments can fall as well as rise, so you could get back less than you invest.

[1] MSCI – ESG 101

ESG INVESTING IS IN DEMAND

The ESG criteria are becoming more important for investment managers partly because more and more of us want to know that at least some of the money we invest is going to help make a positive difference to the world. Or at least won't be supporting companies that don't match up to the ESG criteria at all.

That's probably been driven by a combination of factors – greater awareness of the effects of climate change, greater focus on good corporate behaviour following the 2008 financial crisis and an increasingly high media profile for responsible investing, for example.

More than a third of UK adults surveyed for Good Money Week 2018 said they would be unhappy to discover that something they had invested in was unethical[2].

BUT THERE ARE SOME CHALLENGES

However, more than half of those surveyed for Good Money Week didn't know that sustainable and ethical financial products existed[3]. And it hasn't always been easy to invest in a way that reflects your principles but still gives you a decent chance of achieving the returns you need.

But the sector is now growing rapidly, with a vast range of funds to choose from. If anything, the biggest challenge investors now face is working out what the different types of funds do and how they invest, as there are so many approaches to investing responsibly.

For example, some funds that promote themselves as having an ethical or ESG focus might invest in companies you don't approve of. But that could be because their approach is not to exclude companies with poor practices from their portfolios, but to use their shareholdings to try and influence them to change for the better – hopefully then improving their financial performance over the longer term.

2. Good Money Week – Public Polling 2018

3. Good Money Week – New Good Money Week/YouGov poll results announced

LEARNING TO SPEAK ESG

Familiarising yourself with some of the jargon and labels associated with ESG can be a good place to start. Here are some of the terms you're likely to come across.

1

Engagement

Investing in companies with the aim of improving their behaviour and policies. May include companies associated with poor ethical practices.

2

Green funds

Invest in companies and technologies seen as being positive for the environment.

3

Impact investing

Focusing on projects or (usually small) companies making a positive social impact, such as those making tangible differences in areas such as water storage, food waste and energy.

4

Negative screening

Where funds exclude companies engaged in certain activities. Examples can include gambling, tobacco, alcohol, pornography, child labour and military and nuclear power.

5

Positive screening

Where funds invest specifically in companies that deliver benefits to the community, for example through activities like recycling, environmental technology, public transport and education.

6

Responsible investment

Investing that aims to incorporate ESG factors into the investment decision making process.

7

Shareholder activism

Where investors use their shareholdings to push for change at a company.

8

Socially responsible investment (SRI)

A broad term for investments that aim to deliver both financial gains and positive social impacts.

There are overlaps in meaning and approach between some of these labels, and some important differences too. As an example, impact investing differs from other forms of ESG investment in that it focuses on companies having positive impacts that can be identified and measured in social as well as financial terms.

BLENDING PRINCIPLES WITH PROFITS

ESG investing doesn't have to mean compromising on your opportunities to achieve investment growth. There is a growing school of thought that investing in companies that are built for the future naturally promotes sustainable long-term returns.

In fact, although we always need to be clear that past performance is not necessarily a guide to future performance, research shows that the MSCI KLD 400 Social Index has outperformed the S&P 500 since 1990, despite being restricted to companies with 'strong sustainability profiles'[4].

That might be why almost four in 10 global investors under 35 recently told the 2018 UBS Investor Watch survey that they already have some sustainable investments in their portfolios[5], while 82% of UK investors think the returns of sustainable investments will match or surpass those of traditional investments[6].

4. Financial Times – Sustainable investing can propel long-term returns – 18 September 2018
5. UBS Investor Watch 2018, Volume 2 – Return on values
6. UBS – Return on values (highlights page)

MAKING A POSITIVE DIFFERENCE

The idea behind ESG investing is making a positive difference with your money. For your own future and, in the longer-run, that of others too. Whether it's right for you will always depend on your own personal circumstances. But with the sector growing fast, if you'd like to begin exploring whether it might be, now could be as good a time as any to ask.

BECOMING AN ESG INVESTOR

As for all investment decisions, research is essential to make sure you understand the options available and which are most likely to meet your personal objectives for the level of investment risk you are willing to and can afford to take. The key investor information provided by a fund (known as the KIID or KID depending on the type) is usually a good place to start.

GET SUPPORT IF YOU NEED IT

If you find it challenging to work your way through the jargon and labels to find investments that are right for you, you are not alone. More than seven in 10 of the global investors polled in the UBS Investor Watch survey said they find the language around this area of investing "perplexing" and struggle to distinguish between the various types of options[7].

You may find it helpful to get advice from a professional financial adviser. Like fund managers, more and more financial advisers are able to meet the needs of investors who want to make the most of their money in an ethically and responsible way.

From helping you to get a better sense of your objectives as an ESG investor, to identifying the funds that match those objectives and comparing them to identify the options most suitable for you, a financial adviser can act as your trusted guide.

7. USB Investor Watch – Return on values 2018

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