A decade of Responsible Investing

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There has always been some confusion about what Responsible Investing is, and that confusion has only increased over the last decade. There is certainly a lot more interest now from investors in the space than there was a decade ago, many now expect that their wealth should have a conscience. And proponents of the sector like to point out that you don't necessarily need to give up good returns to assuage that conscience.

We started managing what is now the Alphinity Sustainable Share Fund in 2010. The three biggest shifts in Responsible Investing we point to since then are:

(a) the way people define it
(b) the screens they use and
(c) collaboration between investors.

What is it?

There are a lot of terms used which are all subtly different and mean different things to different people. There is ESG (Environment, Social and Governance), Ethical, Socially Responsible, and more recently Impact and Sustainable funds. While they are often seen as pretty much the same thing, the funds themselves will likely end up investing in very different things and you need to do some research to make sure you are comfortable with the companies that end up in the portfolio.

ESG investing these days is fairly mainstream, and most managers would at least say they take ESG into account. It primarily takes a risk management approach, ensuring a company has proper governance and the social licence to operate. The problem is, a company's ESG performance is not easy to assess and there is no definitive measure of performance. There are a number of different research providers and each comes up with different views about what constitutes good practice and what does not. We have some highly qualified external experts that sit on a committee to adjudicate on these grey areas.

Defining Ethical Investing is challenging, as everyone's ethics are different. For instance one person might see a company operating nuclear reactors as ethical as it is producing power without CO_2 emissions; another person will see the same company as highly unethical as its by-product, radioactive waste, is difficult to treat and will last for hundreds of years. Socially Responsible Investing is similar: what is thought by one person as being responsible is different to what another might think.

Proving Impact is a difficult thing to do, and there is heated debate within the Responsible Investing industry about what can credibly claim to be an Impact fund, how that impact is measured, and what sort of assets can credibly claim impact. There is a school of thought that listed equity funds should not claim impact: if it is buying shares on the secondary market, that it is just aligning itself with what would have happened anyway. (Taking that train of thought to its logical conclusion, you could argue that buying shares in, say, coal mining or armaments companies is also harmless as that activity is going to happen anyway too! We do NOT agree with that).

Some argue that the only true impact comes from direct investment into projects that are, almost by definition, not available to investors in the listed space and therefore only open to very large investors: a large investor putting say $100m into building affordable housing can point to a very tangible impact on the people it is helping. That option is not available to us under our mandate, nor does it appeal to us to be locked into illiquid assets. There are however other ways to impact on listed companies, for instance by influencing its decision-making process, although again, showing a direct linkage between agitation and change can be a challenge. And when a company is supported by equity investors, its share price tends to go up, which increases its ability to pursue activities that 'do good'.

The most recent trend is Sustainable Investing but again, you can define this in various ways. The Alphinity Sustainable Share Fund (Fund) has used the UN's Sustainable Development Goals (SDGs) as a framework for determining whether a company can be considered to be 'sustainable', with the Alphinity Compliance Committee making the final determination. While it is not easy to do, we expect the SDGs will become more widely adopted in the future by other investors.

Screens

A decade ago, most funds in this space just applied negative screens: they would identify companies involved in products or services they wanted to avoid and remove them from the investable universe. Negative screens are a little frustrating from an equity manager's point of view as whenever you restrict the investable universe you limit the possible outcome. Many in the industry like to say that you will earn better returns as the companies you leave out underperform, but that's not the case all of the time. Sometimes 'bad' companies can do very well, although we've generally been able to find other positions to compensate when that's been a headwind.

As equity investors, we are predisposed to looking for positive opportunities, and a few years ago we shifted the focus of our Fund towards positive screening. We wanted to proactively invest in companies doing good, rather than just avoid the negatives. Of course, there are still some industries we screen out – tobacco, gambling, fossil fuels and so on, as these are incongruent with the achievement of SDGs – but most of our effort is expended on looking for companies whose products or services do 'good'. As mentioned above, we've defined 'good' as those that can make a net contribution to achieving one or more of the Sustainable Development Goals. These are 17 Goals covering themes like poverty, health improvement, clean and affordable energy, clean water, equality, reliable infrastructure and so on. If the Goals are achieved the world and many of its poorest people will be much better off. While very much big picture, the purpose of these Goals is very hard to argue against, and we have aligned the Alphinity Sustainable Share Fund with those Goals. Some of them require government action to achieve, but some certainly can be helped along by products and services produced by listed companies.

We're always looking for companies which can help to meet one or more of the Goals, have good ESG characteristics and fit our investment process which looks for reasonably valued companies in an earnings upgrade cycle.

Collaboration

Alphinity signed onto the Principles for Responsible Investment (PRI) a few months after we started the company but over the last decade PRI has become almost universal, not just in Australia but around the world, and its members are now cumulatively accountable for several trillion dollars across all asset classes. It was a global initiative, first propagated by the United Nations but now self-sustaining, which aims to provide a positive influence on the world from the enormous amount of capital we investors have at our disposal. PRI is primarily an organisation for asset owners, such as pension and wealth funds, but fund managers like us are often more responsible for directing that capital into the assets where most of the impact takes place. The PRI, and local organisations like the Responsible Investment Association of Australasia of which we are also a member, provide forums for fiercely competitive fund managers to collaborate with each other in order to achieve an aim for the betterment of society. While we alone might have some influence through our ownership of 2 or 3% of a company's shares, getting a few people together who own similar amounts just magnifies the voice. Provided the views are well founded, this can be a source for good.

The next decade

As we head into our second decade, we feel very positive about the prospects for Responsible Investing. The industry is well-established and gaining in prominence. Sustainable Investing in particular has a bright future. By investing in companies that do good (by which we mean their activities are supportive of the SDGs) and do it well (by which we mean they have strong ESG practices), investors can be assured that their capital is being invested in a manner that is aligned with their values. And by using Alphinity's unique and robust investment process, we aim to do this without compromising their returns.

More information

To find out more, please contact your local Fidante Partners Business Development Manager, email bdm@fidante.com.au or call the Fidante Partners' Adviser Services Team on 1800 195 853.