Investing with Conscience

Socially responsible investing

CHARLES STANLEY *Direct*

Your guide to socially responsible investing

The human impact on the environment means changes to the way society and industry operates are necessary, while societal problems such as poverty and inequality need to be tackled.

Choosing investments that take account of these issues is what we call “investing with conscience”, or socially responsible investing.

What does all the different terminology mean?

To help you understand the meanings behind all the different terminology used, we have provided some descriptions throughout the guide.

What is socially responsible investing?

An investment approach that considers social and environmental good as well as financial return. It is often used as an umbrella term that encompasses various approaches, one of which involves incorporating ESG factors in an investment process.

Is socially responsible investing the same as ethical investing?

No, albeit they have similarities; 'ethical' investing focuses on avoiding investing in companies involved in areas deemed harmful to society and the environment, such as weapons, gambling, tobacco and coal mining, sometimes also referred to as 'negative screening' or 'exclusion'. Certain investments might also be excluded for not complying with international standards of conduct, for example, the UN Human Rights Declaration. Exclusions are often based on beliefs about industries, countries and risks and potentially can impact on financial returns positively or negatively. Because there can be different views as to what constitutes harmful activity, it is always important to read the fund or portfolio literature so that you understand the basis on which your investment will be managed.

What is ESG?

Environmental, social and governance (or ESG), are non-financial considerations that inform investment decisions based on an assessment of the risks these factors pose to your investments. ESG is not about what a company manufactures or sells, but how it goes about it.

Environmental

Takes into account the impact companies are having upon the planet today and in the future.

- Pollution, waste and emissions
- Raw material sourcing
- Native bio-systems and species
- Renewable energy and efficiency
- Recycling

Social

Takes into consideration the social impact the companies are having upon people in the world.

- Human rights
- Workers conditions and rights
- Corporate citizenship
- Wider community
- Consumer protection

Governance

Considers the structure, procedures and practices by which a company is controlled and directed, including the diversity of senior management and their remuneration.

- Business ethics
- Equity and Diversity
- Fair treatment of labour
- Health & safety
- Shareholder rights

What is corporate governance?

The structure, procedures and practices by which a company is controlled and directed. Effective governance takes into account the interests of all stakeholders, for example, customers, employees, suppliers, shareholders, investors and the wider community affected by the company's activities.

What is ESG integration?

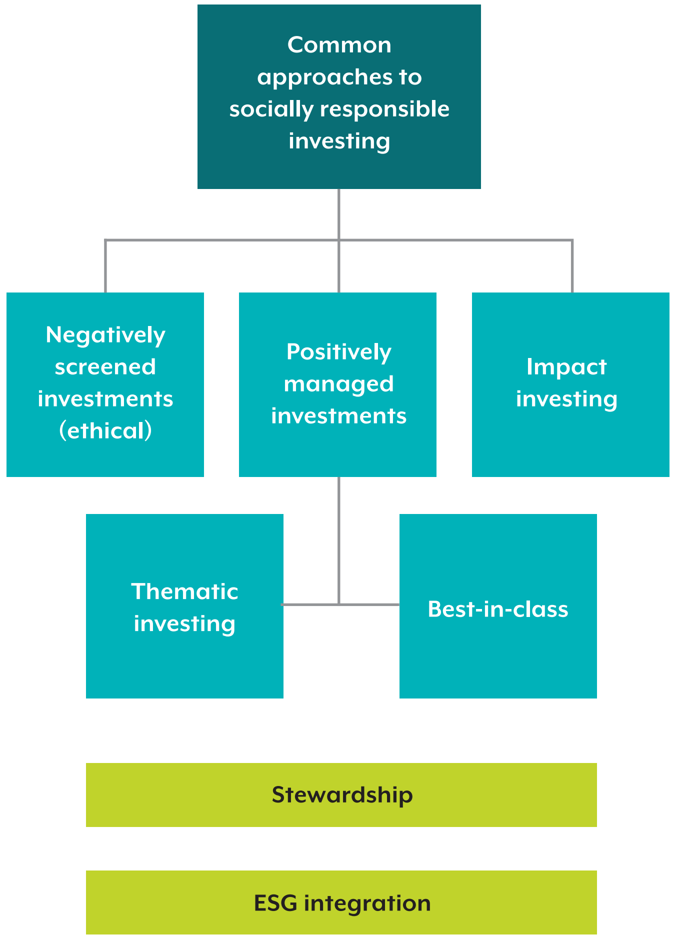
Using ESG factors does not automatically mean a fund or investment portfolio is 'sustainable' or 'ethical', simply that ESG factors are included systematically in that manager's financial analysis – often from the perspective of the impact that ESG factors may have on an investment's potential financial return.

What is positive screening?

Rather than avoiding investment in certain areas, the manager will assess each sector for opportunities to invest in companies with stronger ESG characteristics than their industry peer group, for example by looking for 'best-in-class' companies in which to invest or favouring those that contribute more positively to society or the environment. This implies that no particular area or sector is explicitly excluded, unless combined with 'negative screening', and 'best in class' companies in any sector may be considered. Certain investments focusing on a particular theme, such as clean energy or climate change solutions, may also use this broad approach in order to target areas of interest.

What is negative screening?

Avoiding investing in companies engaged in what are perceived to be harmful activities, such as tobacco, gambling or manufacturing weapons. Negative screening, or 'exclusion', is how many values-based ethical funds operate. You should always read the fund or portfolio literature to understand the basis on which your investment will be managed.



What is thematic investing?

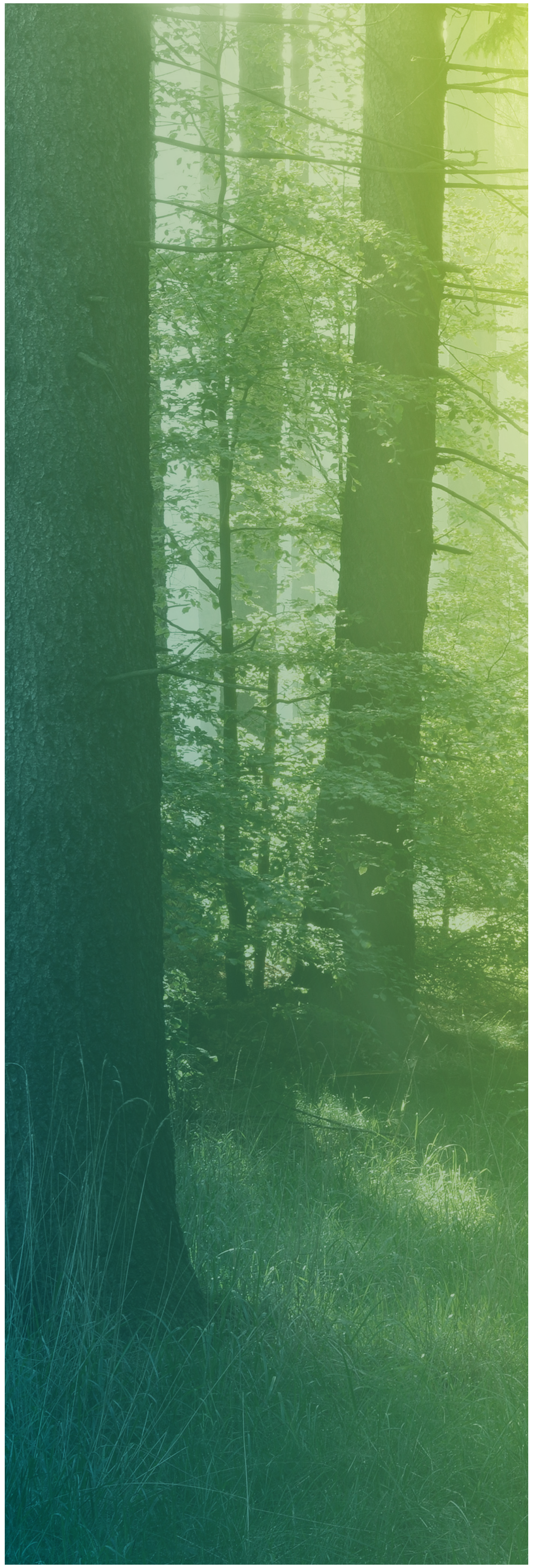
An investment approach that focuses on certain areas of activity, in this context one or more specific ESG categories. Examples of themes include resource scarcity, renewable energy and equal opportunities. By identifying and harnessing themes, investors hope to benefit from higher growth or profitability in those areas.

What is impact investing?

Impact funds usually target firms making a measurable positive impact on society or the environment, as well as generating a financial return. They might, for instance, invest in companies directly tackling challenges such as climate change, water management, pollution or inequality. Impact investing is often associated with lower financial returns, though this is not always the case.

What is best-in-class?

A term used to describe a company leading in its sector in terms of it ESG credentials, relative to its peers. Unlike a 'negative screening' approach, Best-in-Class would not be looking to exclude all companies in a particular sector. An example would include investing in the most energy efficient/lowest carbon energy producer.



How does ESG apply in the real world?

Below are some examples of ESG issues that, once crystallised, had a material impact on shareholder returns and the wider economy.

Environmental issue

Negative environmental & financial impact

BP – Deepwater Horizon oil disaster

In 2010, BP reported the biggest oil spill on record in the Gulf of Mexico, one of the largest environmental disasters in history. The five million barrels that leaked into the ocean caused huge local environmental marine wildlife and tourism for years following.

In the immediate aftermath of the disaster, BP's share price halved; that year it reported a loss and suspended the dividend. In addition the cost of the clean-up was reported to be in excess of $65bn – showing how an event like this can impact on the environment, the economy, the company and on its shareholders.

Social issue

Positive social impact & financial impact

Ben and Jerry's - Philanthropy

In 1985 Ben & Jerry's took an decision, unprecedented at the time, to commit 7.5% of the company's annual pre-tax profits to philanthropy. In 2000 the company was acquired by Unilever, a global company with over 400 brands. Unilever continues to support the Foundation through an annual allocation that takes into account Ben & Jerry's ice cream sales. Whilst the social element of ESG tends not to correlate strongly with the value the stock market places on a company's earnings, it nonetheless contributed to the attractiveness of the company, both as a brand and as a place to work.

In 2015, the annual contribution amounted to $2.8 million, continuing to drive the mission to engage employees in philanthropy and social change work in the local community, and to support grassroots activism and community organising for social and environmental justice around the country.

Governance issue

Negative environmental & financial impact

Volkswagen – Emissions scandal

In 2015 Volkswagen admitted using software in roughly eleven million of its vehicles to manipulate the level of nitrous oxide in diesel emissions when the vehicles were tested.

When this scandal broke the share price fell 40% and has remained below the pre-scandal level. It is estimated that the total cost of "emissions gate" to Volkswagen is €34 billion.

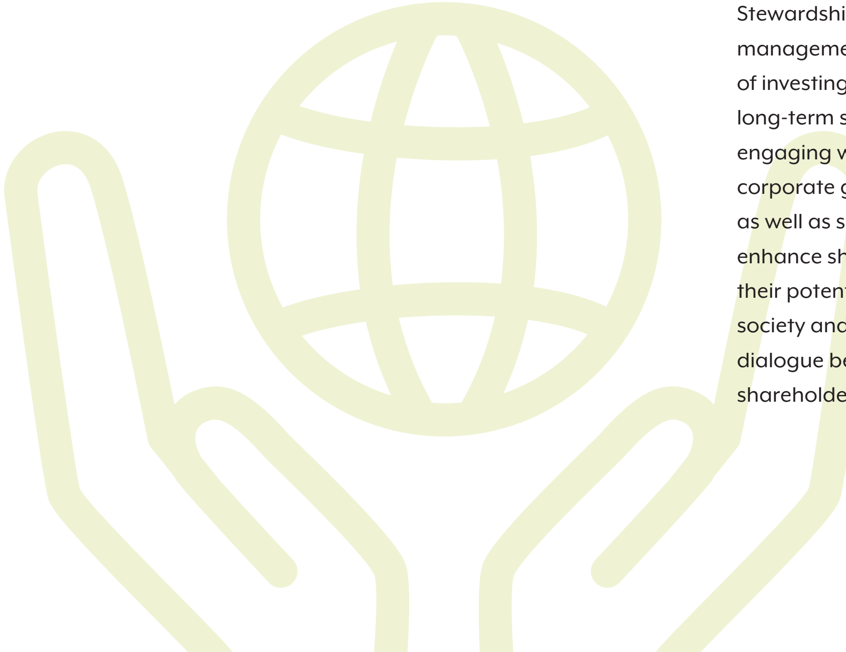
Whilst ostensibly about the environment, this scandal runs somewhat deeper and, at the minimum, highlights poor governance and a weak control structure within the company.

What about engagement?

Engagement can be a powerful tool for bringing about positive change.

When investing in funds, the fund's website and literature should carry information on the manager's approach to stewardship, including how the manager engages with the companies and issuers in which the fund is invested. This is increasingly common, with some managers believing that engagement is a more effective way to bring about positive change, rather than simply avoiding certain activities or sector. Such managers will adopt an activist approach that works with a company's management to improve practices or reconsider the company's strategy.

As an investor in the shares of a company, you can engage with a company's management yourself by exercising your voting rights at shareholder meetings. These events can bring a material change to an organisation, by voting on resolutions that impact the way in which the company is operated, such as the appointment and remuneration of board members or financial considerations such as dividend approval or rights issues.



What is stewardship / active ownership?

Stewardship is defined in general terms as the responsible management of something entrusted to one's care. In terms of investing, stewardship typically aims to promote the long-term success of companies through monitoring and engaging with their strategy, performance, risk, structure, and corporate governance, including culture and remuneration as well as social and environmental issues. The goal is to enhance shareholder value and help companies to achieve their potential, as well as leading to long-term benefits for society and the economy. It will likely involve a significant dialogue between investor and company and actively voting at shareholder meetings.

What is engagement

Purposeful dialogue by investors with companies on ESG and other matters in order to promote responsible business practice by them. Engagement can help drive positive change as well as enhance an investors' research, providing insight into company strategy, competitive positioning and efforts to manage risks and opportunities.

Does investing with a conscience mean giving up returns?

Investing with a conscience, where this involves the exclusion of investment engaged in activities not compatible with an investor's values, may involve some compromise of financial returns, as this approach may reduce the number of possible investment opportunities available to the investor. Limiting the number of opportunities by excluding certain areas or stocks according to any factor can incur an 'opportunity cost', in terms of the potential performance foregone.

Yet there is evidence that some responsible investing approaches can lead to higher shareholder returns. Businesses that address short term risks whilst adapting to longer term structural trends should have more chance of success than ones that don't. Poor environmental, social and governance practices, meanwhile, ultimately might be harmful to a business. Responsible investing means favouring companies that value long term sustainability, not just short term profitability, and in the long run that can lead to better long-term returns for shareholders.

This is why we believe all investors should be conscious of ESG criteria when assessing investments. After all, to ignore them could mean not fully assessing the risks to which an investment is exposed. Companies are also aware there is increasing emphasis on transparency and high standards that go far beyond the traditional financial metrics on which investors have historically focused. Ultimately, this affects the extent to which they can attract capital and the rates at which they can borrow, so they have a vested interest in improving their business practices. The more people invest responsibly, the greater the pace of corporate change.

Accordingly, by taking ESG into account investors are likely to deliver better results – both in terms of long-term shareholder returns and environmental and social impacts – which is why this form of investing is here to stay. Indeed, we believe it will soon become standard practice for ESG characteristics to be considered prominently alongside traditional financial metrics.

The Spectrum of Capital

Choices and strategies for investors on the 'spectrum of capital'

Approach	Traditional	Responsible	Sustainable	Impact Driven ('Finance first')	Impact Driven	Impact Driven ('Impact first')	Philanthropy	Philanthropy
Financial goals	Target competitive risk-adjusted financial returns				Uncharted returns	Below-market returns	Partial capital preservation	Complete capital loss
Impact Goals		Avoid harm and mitigate ESG risks						
			Benefit all stakeholders					
				Contribute to solutions				
Description	Limited or no regard for ESG practices or societal impact	Mitigate risky ESG practices, often in order to protect value	Adopt progressive ESG practices that may/are expected to enhance value	Address societal challenges that generate competitive financial returns for investors	Address societal challenges where returns are unknown, or investors risks largely unknown	Address societal challenges that require a below-market financial return for investors	Address societal challenges by supporting non-commercially viable models, inc. guarantees	Address societal challenges with donations or with the expectation of full capital loss

The 'Impact economy'

Source: Bridges Impact + and the Impact Management Project

Your approach to socially responsible investing

As we have tried to show, socially responsible investing means different things to different people.

It is important to remember there is no such thing as the perfect fund or company. The multiplicity of broad approaches outlined above are useful ways to frame the questions that you ask of yourself, and of the funds and companies in which you choose to invest. These approaches are not mutually exclusive, they are complementary, meaning that as an investor you should decide for yourself which approach, or combination of approaches, best fit your own values.

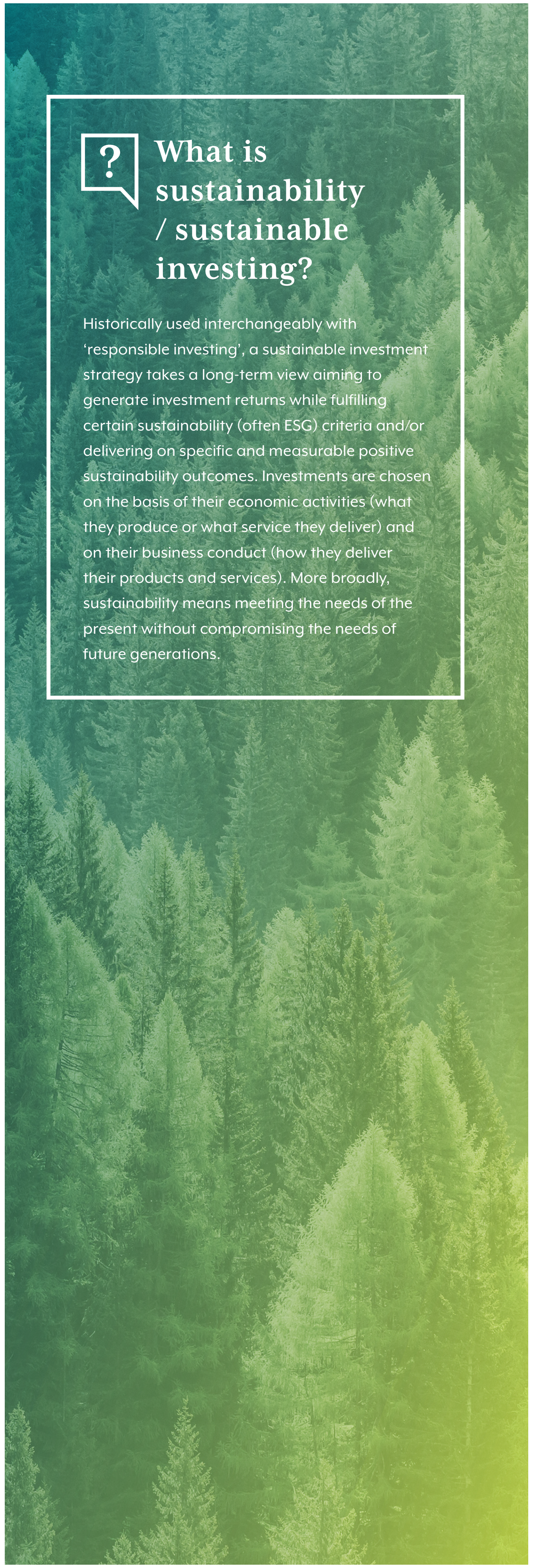
Having decided the approach that best suits you, you should always read with great care the literature and reports for a company or fund in which you are considering investing.

Charles Stanley's approach

Charles Stanley's core values are caring, fair and progressive.

These provide an overarching framework within which Charles Stanley operates, including our view on responsible investing. We believe there is a compelling case for all investors to adopt a responsible investment approach.

Charles Stanley is a signatory of the United Nations' Principles of Responsible Investment (PRI), a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. By signing up to the Principles, Charles Stanley is making a public commitment to responsible investment, acknowledging the impact of environmental, social and governance issues.



What is sustainability / sustainable investing?

Historically used interchangeably with 'responsible investing', a sustainable investment strategy takes a long-term view aiming to generate investment returns while fulfilling certain sustainability (often ESG) criteria and/or delivering on specific and measurable positive sustainability outcomes. Investments are chosen on the basis of their economic activities (what they produce or what service they deliver) and on their business conduct (how they deliver their products and services). More broadly, sustainability means meeting the needs of the present without compromising the needs of future generations.

Charles Stanley Direct – Socially Responsible Funds on our Foundation Fundlist

To help you narrow down the field and provide ideas for your own research, take a look at our Foundation Fundlist.

Selected by Charles Stanley's Collectives Research team, this list highlights what we consider to be good quality options for new investment in each of the major sectors. Socially responsible funds on the list have been selected for their investment credentials as well as their genuine commitment to having a positive impact on society and the environment.

Foundation Fundlist Fund: Baillie Gifford Positive Change	Investment sector: Global
Fund philosophy:	**Our view:**
This sustainability-themed fund aims to contribute toward a more sustainable and inclusive world by investing in companies addressing critical challenges in areas such as social inclusion, education, quality of life and the environment. The managers aim to generate and measure the positive impact from investments as well as make money, and there is an active approach to engagement and voting.	An adventurous option investing in shares in companies from around the world. The managers search for exceptional, fast-growing businesses and run a high-conviction, concentrated portfolio, which increases risk as well as return potential. We believe the managers are patient investors with a strong process for identifying future winners.

What is greenwashing?

Organisations accused of 'greenwashing' are those that, for marketing purposes, present themselves or their products as more focused on environmental or sustainability issues than they really are.

Foundation Fundlist Fund: **EdenTree Amity International**	Investment sector: **Global**
Fund philosophy: Edentree is owned by a large national charity and has been a pioneer in socially responsible investment. This fund uses both positive and negative screening. Negative screening is fairly strict and excludes areas such as alcohol, tobacco and weapon production, gambling. Meanwhile, the fund prioritises companies that make a positive contribution to society and the environment through sustainable and socially responsible practices. There is an active approach to engagement and voting.	**Our view:** The managers invest in shares in companies from around the world. Unlike many funds the aim is to uncover shares that stand out as offering good value – perhaps because their sustainable attributes have been overlooked. We believe the fund offers a differentiated portfolio and important diversification from more the more common growth-oriented global equity funds that use ESG criteria.

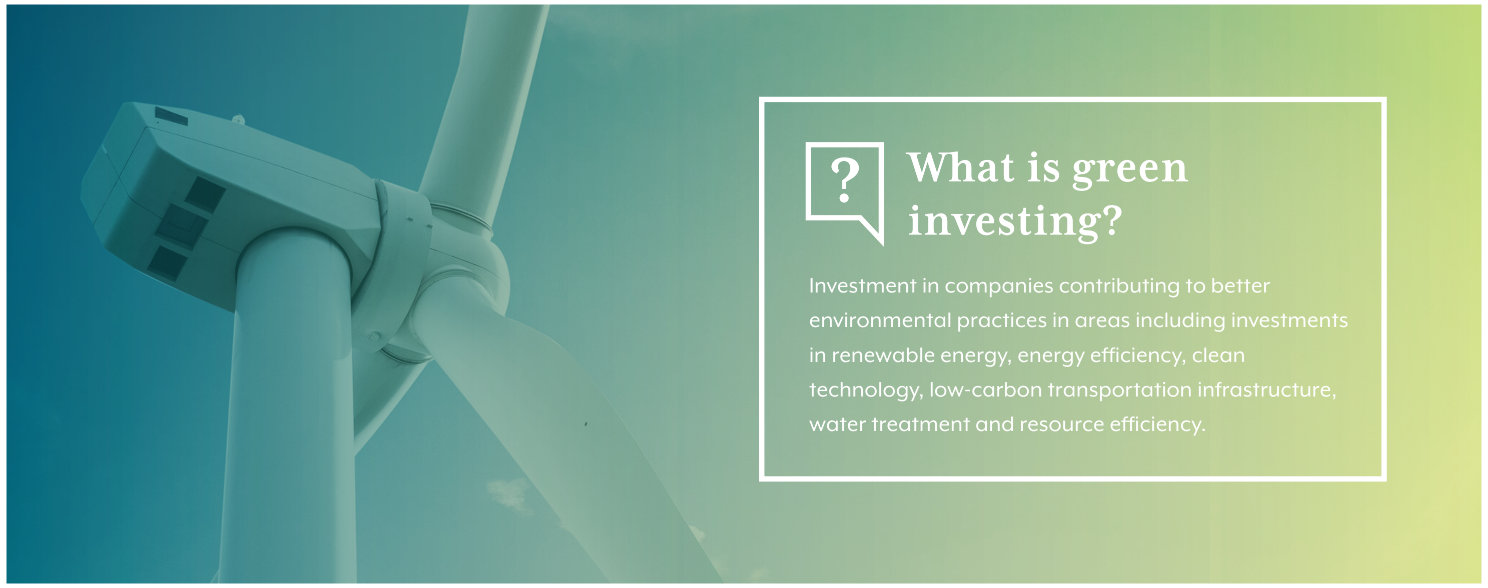
Foundation Fundlist Fund: **WHEB Sustainability**	Investment sector: **Global**
Fund philosophy: WHEB Asset Management targets opportunities created by the transition to a low carbon and sustainable global economy, a sustainability-themed approach with an emphasis on positive screening. The manager has been highly innovative in quantifying the environmental and social benefits of an investment in the fund through annual reports and an online calculator. They also regularly engage with investee companies on ESG issues.	**Our view:** The fund invests in shares of companies from around the world and should be considered moderately adventurous. There is some exposure to higher risk smaller firms, plus companies providing solutions to sustainability challenges can be more economically-sensitive. The managers are highly experienced in sustainable and impact investing and have a clear philosophy and approach.

Foundation Fundlist Fund: **Liontrust Sustainable Future UK Growth**	Investment sector: **UK All Companies**
Fund philosophy: This fund uses positive screening to invest in UK company shares that meet the managers' rules for environmental and social responsibility. They aim to buy attractively valued companies that offer a product or service benefiting from strong environmental or social trends, or can generate superior potential performance through strong environmental, social and governance credentials.	**Our view:** We believe this represents a strong option for those wishing to invest in UK shares. The management team is highly regarded having established a track record at Aviva and Alliance Trust prior to joining Liontrust. There is a bias to quality 'growth' companies due to the focus on sustainability themes likely to benefit from long-term trends.

Foundation Fundlist Fund: **Threadneedle UK Social Bond Fund**	Investment sector: **UK Corporate Bonds**
Fund philosophy: This fund, a partnership between Columbia Threadneedle and Big Issue Invest, takes an impact investing approach, supporting social and economic development in the UK and targeting positive social benefits. It seeks to back companies and organisations in supporting activities in areas such as affordable housing, education, social care, financial inclusion, community services, transport and the environment.	**Our view:** This is a bond fund investing in the debt of companies and institutions rather than in shares. Bonds are generally lower risk than shares but unlike cash capital is not secure. Investors should expect a modest return, primarily in the form of income. Bond funds like this one can offer exposure to finely targeted social outcomes through investments backing various organisations including charities, housing associations, mutual associations, financial institutions and government agencies.

Foundation Fundlist Fund: **Stewart Investors Asia Pacific Sustainability**	Investment sector: **Asia**
Fund philosophy: Sustainable investing has been a central part of this team's ethos since the 1980s. The approach is centred on the responsible stewardship and active ownership of capital, and in this fund the managers will only select companies they believe have the best long-term sustainability credentials. They scrutinise management integrity, interaction with employees, suppliers, and customers, and the impact on the local community and environment.	**Our view:** The fund shares the same process, management team and overall philosophy as Stewart's larger, more established funds that have specialised in Asian markets for several decades. The area is higher risk, though by prioritising good-quality businesses and analysing the sustainability performance of companies the team believes it can better identify hidden risks and enhance long term returns for investors.

Foundation Fundlist Fund: **Rathbone Ethical Bond**	Investment sector: **UK Corporate Bonds**
Fund philosophy: This bond fund applies a broad range of positive and negative screens. Thematic research is conducted through topics such as climate change, clean energy, human rights, community investment and employee welfare. The bulk of the portfolio is invested in the bonds of multinational companies and institutions that pass the screens, and there are also a number of charity and green bonds in areas such as social housing, sustainable transport and renewable power.	**Our view:** This is a broad corporate bond fund. Risk is generally lower than shares, but unlike cash capital is not secure. The manager aims to build a portfolio of high quality investment grade bonds and provide a decent income. As certain sectors are excluded on ethical grounds, such as oil & gas, and tobacco, the fund tends to have heavier exposure in financials through insurers and banks. At times this could add to the risk, but we think this is a strong option for UK bond exposure for investors looking for a decent yield.



What is green investing?

Investment in companies contributing to better environmental practices in areas including investments in renewable energy, energy efficiency, clean technology, low-carbon transportation infrastructure, water treatment and resource efficiency.

When considering the socially responsible nature of a fund we examine:

- the features and extent of ESG policies and criteria, as well as any blanket ethical exclusions;
- how engagement is put into practice, for instance through voting and communication with company management and board members;
- how the ESG framework might reflect the UN's Sustainable Development Goals, 17 targets set by the UN for delivery by 2030 that include a mix of ESG issues.

The process for considering a socially responsible fund's investment credential mirrors that of the wider Foundation Fundlist. We seek to ensure chosen funds excel in our three "P's", People, Process and Performance, by examining key characteristics such as risk, style, sustainability and governance, charges, operations, inflows/outflows and capacity constraints. There is more information on this process on our Foundation Fundlist page. All of the investments chosen for the list are based on merit rather than for any commercial reason. We have our customer's best interest at heart, and our selection process is entirely independent.

Inclusion does not imply a specific recommendation, and any fund should be considered carefully to ensure it fits in with personal views as well as the level of risk required.

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This guide does not constitute personal advice based on your circumstances and the contents should not be considered as a personal recommendation to deal. Investment decisions in funds and other collective investments should only be made after reading the Key Investor Information Document, Supplemental Information Document and/or Prospectus. If you are unsure of the suitability of any investment please seek professional advice.

Investors should be aware that past performance is not a reliable indicator of future results and that the price of shares and other investments, and the income derived from them, may fall as well as rise and the amount realised may be less than the original sum invested.

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