# Socially Responsible Investing: Value and Values

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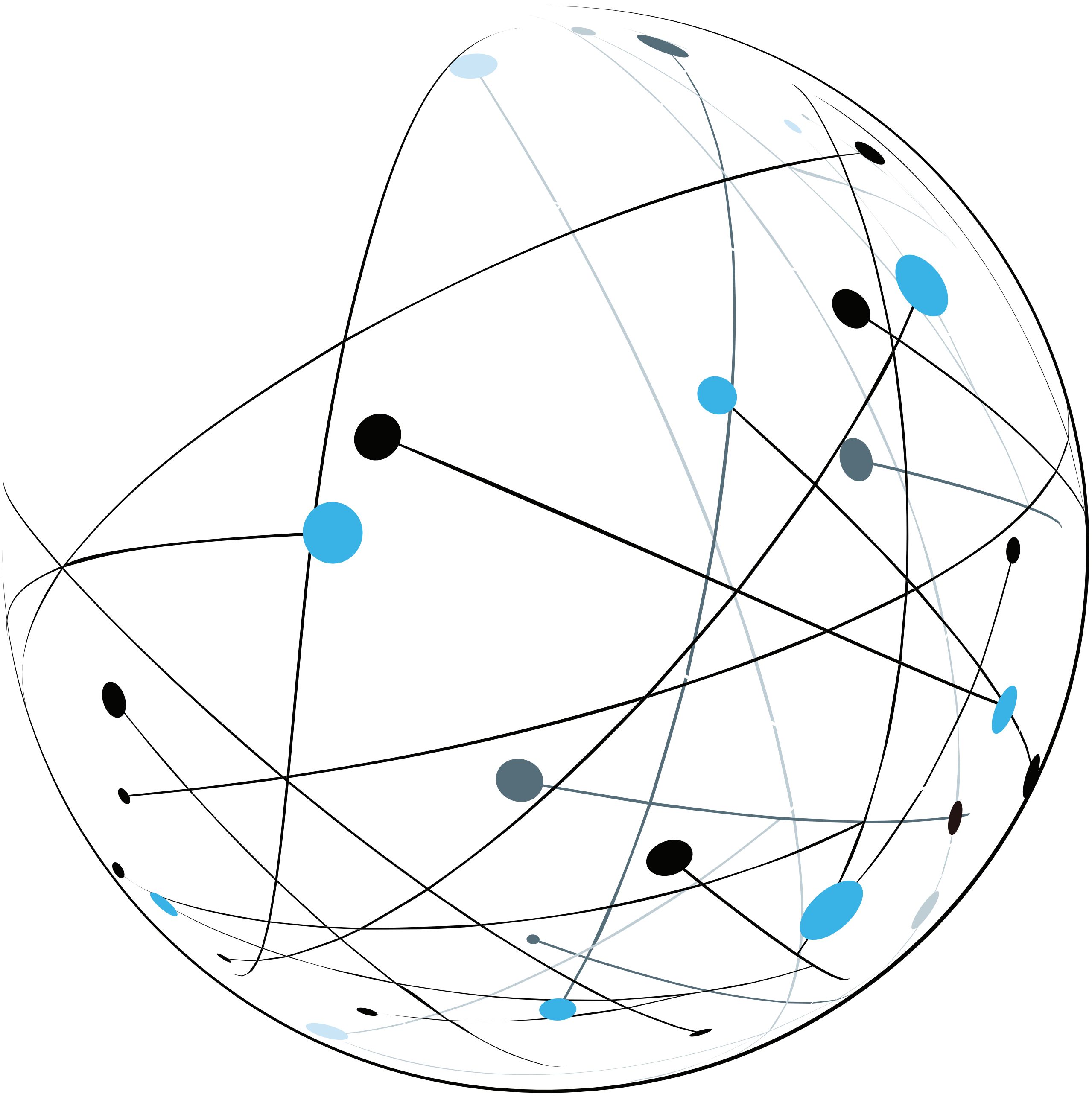
JBWere



Investment literature is littered with many terms, often used interchangeably, to cover the concept of taking non-financial factors into account in the investment process with the aim of earning both a better financial return and social 'return'. The term socially responsible investment (SRI) is often used interchangeably with concepts such as ethical investing, impact investing, sustainable investment and integration of environmental and social factors. At JBWere, we consider SRI to be an umbrella term that covers all approaches that seek to integrate non-financial factors into the investment research, analysis, selection and monitoring process.

After reviewing the significant and growing body of research, JBWere has developed a coherent and considered SRI framework for the benefit of our clients – the first private wealth manager in Australia to do so. There are three core pillars in our approach to SRI (see Diagram 1):

- Integration of Environmental, Social and Governance (ESG) factors;
- Screening based on Ethical, Moral or Religious beliefs (Ethical Investing); and
- Impact Investment.

**Diagram 1: Socially Responsible Investing – the JBWere Approach**


Responsible investments now represent more than half of all professionally managed assets.

## Responsible Investment - Large and Growing Quickly

The global responsible investment industry has grown rapidly, particularly in Europe and the United States (US). According to the Global Sustainable Investment Alliance (GSIA), the worldwide 'sustainable investment' market grew from US$13.3 trillion at the start of 2012 to US$22.9 trillion at the start of 2016, with its share rising to 26.3% of all professionally managed assets in the regions surveyed by the GSIA (see Tables 1 and 2).[1]

**Table 1: Responsible investment assets by region, 2014 – 2016 (US$ billion).**

| | 2014 | 2016 | Growth |
|---|---|---|---|
| **Europe** | $10,775 | $12,040 | 12% |
| **United States** | $6,572 | $8,723 | 33% |
| **Canada** | $729 | $1,086 | 49% |
| **Australia** | $148 | $516 | 249% |
| **Asia (ex Japan)** | $45 | $52 | 16% |
| **Japan** | $7 | $474 | 6,690% |
| **Total** | $18,276 | $22,890 | 25.2% |

Source: Global Sustainable Investment Alliance.

Note: The GSIA does not draw a distinction between responsible investment and SRI.

**Table 2: Proportion of responsible investment assets to total professionally-managed assets.**

| | 2014 | 2016 |
|---|---|---|
| **Europe** | 58.8% | 52.6% |
| **United States** | 17.9% | 21.6% |
| **Canada** | 31.3% | 37.8% |
| **Australia** | 16.6% | 50.6% |
| **Asia (ex Japan)** | 0.8% | 0.8% |
| **Japan** | | 3.4% |
| **Total** | 30.2% | 26.3% |

Source: Global Sustainable Investment Alliance.

In Australia, responsible investments now represent more than half of all professionally managed assets, with exceptional growth of 249% between 2014 and 2016. This growth has been accompanied with growing sophistication. A clear majority of Australia's largest superannuation funds have made some form of public commitment to responsible investing, along with leading institutions such as Universities and the Future Fund.

1 Global Sustainable Investment Alliance (2015), 'Global Sustainable Investment Review 2014', February.

## The JBWere Approach

We consider SRI to be a broad umbrella term which covers a range of approaches to integrating non-financial measures in the investment management process. Below we provide more information on the differing approaches.

### Integration of Environmental, Social and Governance (ESG) factors

ESG integration involves considering a broader range of factors (see Table 3) when analysing potential investments. We believe the integration of ESG factors enhances the investment process.

**Table 3: Examples of ESG factors**

| Environmental | Social | Governance |
|---|---|---|
| Climate change/ carbon, sustainable natural resources/ agriculture, water green building/ smart growth, clean technology, pollution/toxics. | Workplace safety, labour relations, human rights, diversity and anti-bias issues, community development, workplace benefits, poverty alleviation. | Executive compensation, board diversity, corporate political contributions, board independence, anti-corruption policies. |

Source: US SIF Foundation

The integration of ESG factors into the investment process is in our view best practice investment management - it effectively involves taking into account as much information as possible when assessing the risk and return characteristics of each potential investment. It is important here to note that ESG integration is about how effectively a company is being managed in the broadest sense, it is not a 'values' based judgement based on the nature of the activities the company undertakes (e.g. tobacco production).

Extensive research supports our belief that over the long term integrating ESG will deliver better portfolio outcomes.

A significant amount of research has been undertaken to assess if companies that have a better ESG rating, do in fact perform better. The key meta-studies have found the following:

- *UNEP Finance Initiative and Mercer (2007)* – Out of 20 academic and broker studies, half produce evidence of a positive relationship between ESG factors and portfolio performance.
- *Fulton, M., Kahn, B.M. and Sharples, C. (2012)* – "overwhelming" evidence that firms with high ratings for CSR (Corporate Social Responsibility) and ESG factors have a lower (ex-ante) cost of capital in terms of debt and equity. Strong CSR and ESG factors are correlated with corporate financial outperformance.
- *Friede, G., Busch, T. and Bassen, A. (2015)* – findings of about 2,200 individual studies conclude that the business case for ESG investing is empirically well-founded, with roughly 90% of studies finding at least a non-negative relationship between ESG factors and corporate financial performance, and a majority reporting positive findings.

This extensive research and evidence supports our belief that over the long term, integrating ESG into the investment research, analysis, selection and monitoring process will deliver better portfolio outcomes. As such, at JBWere we have chosen to enhance our investment process across all asset classes by considering ESG factors as an intrinsic part of that process for all our clients.

To enable us to integrate ESG factors into our process, we have established a partnership with MSCI (Morgan Stanley Capital International), the leading provider of ESG Research globally. MSCI have over 170 ESG Research analysts, and provide research to 47 of the top 50 global asset managers. We have worked closely with MSCI to garner a deep understanding of their research process and develop a framework for integrating the ESG outputs into our investment research and portfolio construction process.

### Integration of Negative Screens (Ethical Investing)

Another manner in which clients may choose to invest in a socially responsible manner is by the exclusion of entire sectors, companies or geographical regions on a moral, ethical or religious basis.

Under this approach, holdings are not excluded on the basis of organisational performance or ESG factors, but rather because of the activities undertaken by the company. At JBWere, we manage in excess of $5bn for institutions and organisations (e.g. charities, religious entities, educational institutions etc) that seek to align their investments with their values. Examples of activities that are excluded on a moral, ethical or religious basis include:

- Alcohol
- Tobacco
- Gambling
- Nuclear Power
- Weapons
- Abortion and Contraceptives
- Adult Entertainment
- Animal Testing and Cruelty

Unlike the integration of ESG, which seeks to enhance long term returns, the use of negative screens has the potential to reduce long term returns by reducing the size of the investment universe. Research has found that imposing an increasing number of negative screens significantly reduces the ability to construct fully diversified portfolios.[2] This is an important finding for countries with a relatively small universe of stocks like Australia.

At JBWere, through our partnership with MSCI we have access to the data and research that allows our clients to understand the activities of the companies that are held in their portfolio. We are able to identify the level of revenue that a company generates through all activities and hence our clients can be confident that their portfolio is being managed in line with their morals, ethics and religious beliefs. Where holdings are excluded, we work closely with our clients to redirect exposure so that we can build an appropriately diversified portfolio within the constraints of the exclusions.

## Integration of Impact Investments

Impact investments are investments made into companies, organisations and funds with the intention to generate social and environmental impact alongside a financial return. This is a relatively new market and has evolved as some investors seek to address the world's most pressing challenges in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services including housing, healthcare, and education.

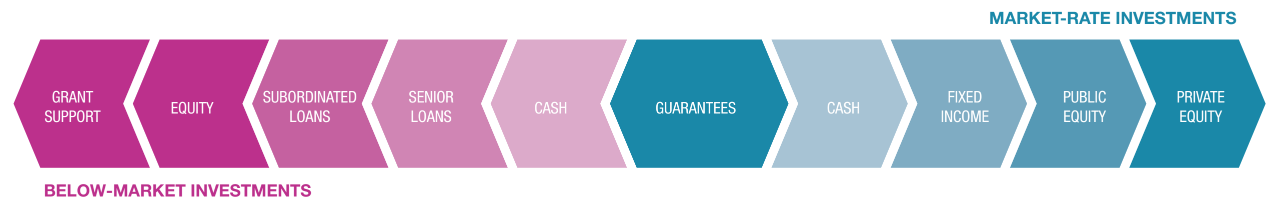
There are four core characteristics that define impact investment:[3]

1. *Intentionality*: An investor's intention to have a positive social or environmental impact through investments is essential to impact investing.
2. *Investment with Return Expectations*: Impact investments are expected to generate a financial return on capital or, at a minimum, a return of capital.
3. *Range of Return Expectations and Asset Classes*: Impact investments target financial returns that range from below market (sometimes called concessionary) to risk-adjusted market rate, and can be made across asset classes, including but not limited to cash equivalents, fixed income, venture capital, and private equity.
4. *Impact Measurement*: The issuer and investor must be committed to measurement and reporting on the social and environmental performance and progress of underlying investments, ensuring transparency and accountability.

JBWere has been at the forefront of the impact investment movement, having co-authored the foundation research report, Impact Investment in Australia, with the Federal Government in 2014. The market has evolved since that time, and continues to evolve quickly as new and differently structured deals are created.

For clients who seek to explore impact investments, our leading specialists in the Investment Strategy Group and Philanthropic Services team are available to guide you through the potential risks of the investment, how it may be incorporated into portfolios and the broader social and environmental impact of such investments.

**IMPACT INVESTING ASSET CLASS/RETURN RATE SPECTRUM**




Source: Global Impact Investment Network (GIIN)

2 Humphrey, J.E. and Lee, D.D. (2011), 'Australian Socially Responsible Funds: Performance, Risk and Screening Intensity', Journal of Business Ethics, Vol. 102, pp. 519-535

3 Global Impact Investment Network (GIIN).

## MSCI – Our SRI research partner

JBWere is proud to be the first private wealth manager in Australia to develop a truly integrated approach to socially responsible investing.

We have chosen to partner with MSCI (Morgan Stanley Capital International) to ensure that our investment specialists, our advisers and our clients have the highest quality data and insight to ensure our processes and approach continue to keep pace with international best practice.

MSCI has been awarded the IRRI[4] Award for Best Firm for SRI Research and Best Firm for Corporate Governance Research in both 2015 and 2016. MSCI rates 6,200 companies (11,000 total issuers including subsidiaries) and more than 350,000 equity and fixed income securities globally. The diagram below articulates the breadth of the MSCI offering and insight which is in only available as a client of JBWere.

## JBWere – Your Partner for Socially Responsible Investment

JBWere is the pre-eminent wealth management firm in Australia and New Zealand. JBWere provides a wide range of investment, advisory, financing, securities, asset and wealth management services to a substantial and diversified client base. Beyond high net worth individuals and families, those who have entrusted us with their assets include 'for purpose' groups and organisations, government organisations and financial institutions.

Since 1840, JBWere has been delivering world-class investment advice and superior service to our discerning clients. Our investment and partnership with MSCI is founded on our commitment to excellence, to ensure our offering continues to lead the market, so that our clients may continue to have access to international best practice through the expertise of our people.

## Breadth of ESG offering

MSCI ESG Ratings is the flagship tool. We rate 6,400 companies (11,800 total issuers including subsidiaries) and more than 400,000 equity and fixed income securities globally.

| Msci Esg Research | | | | Output |
|---|---|---|---|---|
| ESG integration | Screening – Values Alignment | | Impact Investing | |
| ESG Ratings | Business Involvement Screening | Norms & Controversies Screening | Sustainable Impact Metrics | |
| **ESG Ratings**<br>**Equity:** 6,400 Issuers<br>**Fixed Income:** 400,000 Securities<br>**Funds and ETFs:** 26,000<br><br>**Carbon Metrics**<br>**Equity:** MSCI ACWI IMI<br>**Funds and ETFs:** 26,000 | **Equities:** All publicly traded companies<br>**Fixed Income:** Over 500,000 Securities<br>**Funds and ETFs:** 26,000 | **Equities:** ACWI IMI (over 10,000 Issuers)<br>**Fixed Income:** Over 300,000 Securities<br>**Funds and ETFs:** 26,000 | **Environmental Impact Metrics:**<br>**Equity:** MSCI ACWI IMI<br>**Funds and ETFs:** 26,000<br><br>**Social Impact Metrics:**<br>**Equity:** MSCI ACWI<br>**Funds and ETFs:** 26,000 | Company, industry, and thematic reports<br><br>Portfolio analytics<br><br>Feeds & platforms: MSCI ESG Manager, Barra©, RiskMetrics© RiskManager, FactSet, Barclays POINT, RIMES StyleResearch, Aladdin |

Source: Morgan Stanley Capital International

Please contact your JBWere Adviser or the Authors to explore how we can help you manage your investments in line with international best practice.

4 Independent Research in Responsible Investment.

# About the Authors

**James Wright,**
**Chief Investment Officer**

James joined JBWere in September 2013. In his role as Chief Investment Officer, James leads JBWere's Investment Strategy Group which undertakes investment and economic research and develops asset allocation and portfolio strategies for JBWere clients. He has over 25 years' experience in economics and portfolio management. Prior to joining JBWere, James was the Chief Investment Officer of ING Investment Management, responsible for over $24 billion in funds under management in Australian equities, private equity, property and fixed income. James has also worked at Treasury Corporation of Victoria and the Commonwealth Treasury in Canberra.

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**Shamal Dass,**
**Head of Philanthropic Services**

Shamal joined the Philanthropic Services team in November 2012 and has led the team since November 2014. His responsibilities include the provision of specialist strategic advice to both for-purpose organisations and private clients in areas ranging from the structuring of philanthropic giving, governance, capacity building, sustainability, donor relations and organisational strategy. Shamal also works in partnership with JBWere advisers to develop tailored investment management solutions that allow clients to fulfil their mission. Prior to joining JBWere, Shamal worked within the financial services and trustee industries gaining significant experience in advising high net worth individuals on their philanthropic structures, managing trusts and foundations (including PAFs), and constructing charitable foundation investment portfolios. Shamal serves as Deputy Chair and Treasurer of the Arts Health Institute and is an Advisory Committee member for the Centre for Social Impact.

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