Green light

NATHAN PRIOR ANALYSES RECENT DATA TO SHOW OPPORTUNITIES IN THE EXPANDING FIELD OF SUSTAINABLE INVESTING

As public concern for the environment, including the impact of climate change, reaches its highest levels yet, there is a growing realisation that investors have a significant role to play in addressing the environmental and social challenges the world is facing. Recent documentaries and interviews by Sir David Attenborough and the actions of young activists such as Greta Thunberg are having an impact on more people, with society reaching a tipping point.

In many areas of our lives, there is a trade-off between our own ethics and the ability of society to match them.

This article will use recent research to illustrate that a performance lag should not be expected from sustainable investments, regardless of where investors fall on the green investment spectrum.

DO I HAVE TO GIVE UP RETURNS?

The simple answer is no. The reality is that socially responsible investment has progressed, and pressure is making the industry change. This question is derived from past experience of 'ethical' portfolios, whereby 'sin stocks' like tobacco and oil were negatively screened out during a period of time when those companies were highly profitable. This is no longer the case; modern mandates are not solely exclusionary and are focused on more positive attributes that are attractive even from a pure investment perspective.

For example, companies that are delivering sustainable solutions are seeing revenues grow, and those that are not are seeing revenues fall. As long-term investors, should we be investing in the makers of combustion engines or a company that makes key components for electric motors?

ISN'T IT HIGHER RISK?

Again, the answer is no, if implemented correctly. Risk for most people can be defined by the potential scale of how much they can lose. If a diversified portfolio is switched for a concentrated fund that focuses on small companies with emerging 'green' technologies, then risk is increased. That is not because the investment is 'sustainable'; it is because a more concentrated portfolio of smaller companies is now being invested in.

However, if a well-diversified, multi-asset portfolio is switched to a similarly diversified portfolio that includes sustainable attributes, then there is no reason why it should be higher risk.

Recent research by Partners Wealth Management into multi-asset managers offering sustainable mandates has indicated that a sustainable portfolio taking the same level of overall risk as a regular portfolio does not result in a reduction in returns or an increase in risk. In fact, the good-quality managers[1] identified achieved better risk-adjusted returns, both in positive and negative market conditions, as illustrated in the table below. Additionally, recent Bloomberg analysis indicated that the average environmental, social and governance (ESG) fund had fallen by about half the decrease of the S&P 500 in the first quarter of 2020.

CONCERNS ABOUT 'GREENWASHING'

'Greenwashing' describes products or investments that give the impression of being sustainable but might not actually be so. However, there is no agreed definition of what is sustainable or, indeed, whether sustainable is even the right word. Should it be responsible, ESG, light green, dark green or ethical? The choices and different meanings make this a difficult sector for clients to navigate without advice.

It is important if considering this area of investment not to simply take the name on the tin. Instead, investors need to consider what is important to their clients and then try to identify the solutions that match their view. They may want to exclude exposure to certain things or invest in companies that might not be perfect today, but are trying to improve, or perhaps invest in companies that are having a direct positive impact on the things they care about.

As with any investments, it is essential that you understand what your clients' objectives are and then ensure the solution they have chosen really does have the correct components to match them.

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Name	3 years to 31/03/2020	2017	2018	2019	Q1 2020
Blended sustainable portfolios	**10.01%**	**9.56%**	**-3.27%**	**16.45%**	**-7.84%**
MPI GBP medium risk	*-1.88%**	*7.72%*	*-4.67%*	*12.86%*	*-12.78%**
ARC balanced PCI	*-1.90%**	*6.69%*	*-5.10%*	*11.73%*	*-11.00%**
UT mixed investment 20-60%	*-3.69%*	*7.11%*	*-5.08%*	*11.88%*	*-12.87%*

*Latest estimates[2]

1 The definition of 'good-quality manager' is based on criteria around not only performance, but also risk controls, realism of returns across client accounts, defined investment process, etc. 2 Data sourced from FE fundinfo.

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