HB Dobbin FINANCIAL PLANNING

HOW TO INVEST ETHICALLY IN 2021 & BEYOND

Earn returns while making an impact.

Most people invest because they want their money to grow – to prepare for the future, to save up for a major purchase, or to provide a comfortable lifestyle for their family.

That might seem at odds with the idea of putting your money towards a good cause, and creating change in the wider world, but it doesn't have to be. With ethical investing, you can do both.

This type of investment has been around for a while now, with some of the earliest examples dating back to Methodist and Quaker practices in the 18th century – although more recently, the first "socially responsible" funds launched in the 1970s.

In the last few years, ethical investing has really started to take off, with increasing awareness of issues like climate change and workers' rights making consumers more conscious about the ethical impacts of their money.

Responding to the growing demand for sustainable financial products, the UK Government is set to launch its first ever NS&I green bond later this year, allowing savers to put their money towards environmentally-focused projects like offshore wind farms, electric vehicles and more.

But for those more interested in investing than low-risk cash saving, things can be a little more complicated. There are more products on the market than ever, but sifting through them to work out which one is right for you – and whether it really is as ethical as it claims to be – can be tricky.

ARE ETHICAL INVESTMENTS A GOOD IDEA?

Historically, ethical investing has been seen as a well-intentioned but ultimately less profitable version of traditional investing, mainly because it narrows down the pool of investments open to you, which can exclude those with potentially higher returns.

More recently, however, more evidence has emerged that ethical investments can provide just as much ROI, if not more.

Global investment company Morningstar published research in June last year that analysed the performance of 4,900 funds over 10 years, and found 58.8% of sustainable funds had outperformed the average for traditional ones.

Funds with a high environmental, social and governance (ESG) rating also withstood the initial impacts of COVID-19 on the markets, outperforming traditional funds in all but one category.

Morningstar said this was partly because they were more heavily invested in sectors like technology and healthcare than they were in oil and gas, but it also said other factors came into play.

"Companies that score high on ESG tend to be well-run businesses that treat their stakeholders well, address their environmental challenges, enjoy more conservative balance sheets, and have lower levels of controversies," wrote Hortense Bioy, global head of sustainability research at Morningstar. "As such, they tend to be more resilient during market downturns."

There are no guarantees when it comes to returns on any kind of investment, so always think carefully about your own capacity for risk and ability to bear losses before making a decision.

HOW DOES ETHICAL INVESTING WORK?

There's no standard way to define an ethical investment. Even if you narrow it down to environmental concerns, approaches generally vary.

Do you cut out oil and gas companies altogether, or do you include those that also provide renewable energy? Do you invest in companies that try to limit their environmental impact while going about their usual business, or do you look for the ones that are actively making a change to the wider world?

Investment managers use various, often overlapping methods to decide which funds are 'ethical' and which are not.

A method known as 'dark green investing', for instance, works by excluding companies that do not meet its criteria. Dark green funds avoid companies involved in harmful sectors or practices.

'Light green' investments, by comparison, focus on positive screening instead by investing in companies that are seeking to do good. This might be by limiting their environmental impact, supporting local communities or improving workers' conditions.

Other approaches include 'impact investing', which aims to make a measurable environmental or social impact as well as a financial return, or 'best-in-class' funds that aim to pick out the most ethical companies from unethical sectors – for example, the oil company with the best track record.

You might also choose a faith-based fund that only includes investments that align with your religious beliefs.

NAVIGATING THE JARGON

A major challenge for ethical investors is understanding what the terminology around the subject actually means.

ESG has become something of a buzzword of late, and it can be hard to understand what a 'green' fund does, compared to a 'responsible' or 'sustainable' one.

Research conducted by *Which?* in May 2020 found a lot of people struggled with the terminology used by fund managers to describe types of ethical investments.

Only 10% of investors – and 6% of non-investors – picked the most widely-used definition of 'ethical investing', which was "applying negative and/or positive ethical or 'values-based' screens to help sift investments".

The lack of agreed and regulated terminology, and the rush to meet consumer demand for these products, has unfortunately left the sector vulnerable to so-called 'greenwashing'.

Some investment firms have used 'green' or 'ethical'-looking terminology to make their products appeal more to ESG-conscious consumers, without actually putting practical measures in place to track the impacts of those investments.

That's left many people concerned that ethical investments may not really be making the positive impact they claim to make.

This confusion should become clearer as regulation improves and more consistent monitoring frameworks are put in place.

Initiatives to standardise environmental impact reporting are already on the way, with new rules already published by the EU and the FCA in the UK expected to publish its own similar rules in 2021 for implementation in 2022.

For the time being, though, your best option is to thoroughly research any investments you're considering, looking for funds that are as transparent as possible about what they do.

Not every business that meets one of your expectations will meet the others, so consider issues that are important to you.

A company might have a great track record for low carbon emissions, for example, but a poor performance when it comes to working conditions, so you might prefer to screen it out regardless of its green credentials.

The same study from *Which?* found climate change and the environment was the top concern for ethical investors (27%) followed by workers' rights (21%), tobacco, gambling and weapons (all 20%), and gender equality (14%).

With your preferences in mind, check them against the investment fund's policy. Does the fund include or exclude companies according to criteria you're happy with?

If you're still not sure or need more advice on your choice of investments, we can talk through your requirements.

Contact us to talk about ethical investments.

IMPORTANT INFORMATION