

# The diversity of Sustainable and Responsible Investing



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What does ethical investing mean to you? Does it conjure up ideas of specialist funds with strict exclusion criteria, run by a manager content to work away in a small corner of the market and missing out on the big returns? Or does it seem more like the passing investment trend currently hitting the headlines because of a number of fund houses jumping onto the 'green' bandwagon?

Whatever your opinion, the facts are getting harder to ignore. Sustainable and Responsible Investing (SRI) and Ethical funds are increasing their share of the investment market, especially in the UK, where according to EIRIS there is now almost £9 billion invested into Britain's green and ethical funds, divided among nearly 100 different green and ethical mandates. What was previously seen as a relatively niche area for a few well intentioned investors is now clearly very big business.

## Moving towards the mainstream

The most recent shift in ethical investment has seen the industry move even closer towards mainstream investing. The focus increasingly is on companies providing solutions to challenging social or environmental issues such as climate change. Regulatory changes and shifts in consumer behaviour have created opportunities for the private sector to develop and scale-up the technologies that can provide workable solutions to these problems. The result has been the emergence of a range of funds aimed at financing new technologies, ranging from wind and wave power to businesses offering educational and healthcare services around the world. Some of these funds are unapologetically mainstream; focusing simply on what companies do and largely ignoring the Corporate Social Responsibility (CSR) issues of how they do it. Others funds choose to take a more holistic approach, demanding that those companies focused on providing solutions to sustainability challenge are still operating responsibly. This standpoint takes the logical – and pragmatic – view that companies developing renewable energy also need to be held to account for their actions.

## Ethical fund performance – how does it compare?

For fund managers, as well as avoiding or prioritising certain types of companies, there has been a long-running debate about the financial performance of their funds. Critics argue that by limiting the range of companies that these funds can invest in, they also limit the returns that they can make.

While initially this might seem to make sense, there is a solid body of evidence that finds the reverse. On balance, companies that pay attention to social and environmental issues appear simply to be better-managed companies than those that don't. Limiting your universe, as critics had originally seen SRI, looks like quite a good idea if you are effectively screening out companies that are badly managed. More to the point, every fund manager, SRI-focused or mainstream, has exclusion criteria of their own (for example, whether they are looking for income or capital growth stocks), and chances are their list of companies in which they cannot or will not invest will be considerably longer than the list of companies that they can invest in. Each manager has to cut their cloth according to their particular investment mandate and under a particular set of constraints. It could be argued that mainstream fund managers worth their salt would look to actively avoid companies with a reputation for lacking corporate or social responsibility, simply as a matter of good business sense, but until this more long-term approach is applied across all funds, those with an SRI slant look to be setting the investment trend by rewarding better governance and increased responsibility from companies with more investment. The inherent benefits of taking a more long-term investment approach should also not be ignored.

There are a number of reasons why SRI and long-termism should be natural bedfellows. Firstly, to incorporate an analysis of corporate responsibility into investment decision-making requires an inherently long-term outlook. SRI investors are keen to have a deeper understanding of how the companies they invest in are managed, and how management can ensure that the growth profile and returns generated are sustainable over time. Secondly, SRI investors often apply a research-intensive approach to understand key themes influencing the direction and shape of future economic development, which hopefully will enable investors to identify those companies that are more likely to succeed over time. Through a long-term and active ownership approach SRI investors are able to →

exercise stewardship over their investment holdings. Over time managers are able to develop a deeper understanding of an industry and a company's position within that, through building a consistent relationship with company management.

Ethical and SRI funds have proven popular over the last few years, as companies with an active focus on environmental issues have benefited from growing political and consumer support. However, 2008 has brought an altogether more turbulent market, and clean-tech and other SRI funds have not remained immune to the downturn. But even so, the outlook remains promising. New legislation - focusing in particular on climate change, but also championing social issues such as

healthcare and product safety - continues to be developed in the UK, EU, US and beyond, serving to provide continued good news for investors in these sectors. What is clear is that the ethical investment sphere will continue to evolve at a rapid pace, which can only be a good thing for investors, and for society as a whole. At Henderson we are proud sponsors of the first National Ethical Investment Week, which will be held between 18th and 24th May this year, because we have long held the opinion that ethical and SRI investing practices are becoming an increasingly important part of mainstream investing. The standard arguments trotted out against ethical portfolios are looking more and more threadbare.

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