How to align your investments with your principles

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Many of us are making more ethical and sustainable choices as consumers, but we can also make a positive impact with our savings and investments.

Almost half of Brits (47%) now want to both make money and make a positive difference to the world, according to YouGov research in September 2017 for the Good Money Week campaign. This should come as no surprise as British consumers are making more ethical and sustainable choices than ever before.

- **Investment Doctor: "I want to invest my pensions ethically" (https://www.moneywise.co.uk/investing/funds/investment-doctor-i-want-to-invest-my-pensions-ethically)**

But are we reflecting the same concerns in our savings and investments? The evidence suggests not. More than half (53%) of us are now choosing to avoid buying products and services if we have concerns about the retailer's activities or the origin or impact of our purchases, according to a survey commissioned by not-for-profit organisation Ethical Consumer and Triodos Bank in 2016.

By contrast, in the investment world, ethical and sustainable investment funds are still niche, representing just 1.2%, or £14.4 billion, of the total assets held by funds in the UK. The ethical banking space is also comparatively small, managing just £21 billion of a possible £125 billion.

So why aren't more of us aligning our money with our principles? One argument is that investment jargon makes this a confusing area.

What began in the 1980s with a single fund called Friends Provident Stewardship, which didn't invest in so-called 'sin stocks' such as arms, tobacco and gambling, has evolved into a vast array of investment strategies and labels.

“There are so many different definitions – ‘ethical investment’, ‘socially responsible investment’, ‘sustainable finance’, ‘environmental and social governance’ – that most investors must be thoroughly confused,” says Mark Dampier, head of research at fund platform Hargreaves Lansdown.

In the ethical banking space, the entrance of big US hedge fund investors to rescue Co-Operative Bank has also muddied the waters, raising questions over whether ethical banking can be sustainable and profitable.

Another common objection is the subjectivity of the term ‘ethical’.

“Often when I tell people what I do, I am asked: ‘Oh. So what’s ethical then?’ in quite a challenging way,” says Olivia Bowen, co-founder of Castlefield – an investment and advisory business that specialises in ethical investment and saving. This is a problem for Mr Dampier too, who observes that one man’s ethical exclusion is another man’s everyday norm – such as smoking or drinking alcohol, for example.

How do ethical funds perform?

The most prevalent objection to ethical and sustainable investing is the assumption that investors must sacrifice performance for their principles. “In 1984, I was told that buying good companies would mean outperformance, but it didn’t,” says Mr Dampier, who points out that the exclusion of tobacco stocks from Friends Provident Stewardship led to significant underperformance over the years.

Times have, however, changed. Tobacco consumption has slowed dramatically in the developed world – in the UK, it is down 33% since 1976, according to the Office for National Statistics’ Adult Smoking Habits report.

Meanwhile, we now face entirely new challenges such as climate change and mass automation. This shift is reflected in markets and the types of companies we can now invest in – from advanced biotechnology firms, to electric car and wind turbine manufacturers, to internet leaders. Many of the fund managers and investors that recognised this shift have reaped the rewards.

Analysing ethical and sustainable funds as a group is notoriously difficult as the Investment Association, the trade body that represents UK investment managers, has not created a separate sector for them.

We asked fund data firm FE Analytics to do a comparison. It split funds into two groups: generalist funds (excluding funds that invest in only one asset such as gold or oil) and ethical or sustainable generalist funds (excluding those that only invest in one asset class as well, such as solar energy or property). The generalist funds’ universe consists of more than 1,200 funds, while the ethical group contains less than 40.

Over the 10 years to 31 October 2017, the average generalist fund returned 91%, while the average ethical or sustainable generalist fund returned 87%.

- **Moneywise Fund Awards 2017: Funds with star quality (https://www.moneywise.co.uk/investing/funds/moneywise-fund-awards-2017-funds-star-quality)**

More interesting, however, is how this is changing. Over the past five years, ethical and sustainable generalist funds have outperformed their mainstream rivals by 10% – returning 77% compared to 67% – while over three years they have returned 37% compared to 35%. Over one year, they have delivered 13% compared to 11%. In other words, since 2012, generalist ethical and sustainable funds have broadly outperformed their mainstream rivals.

These figures are supported by several pieces of research. In 2014, the Harvard Business School found that companies with strong corporate sustainability practices significantly outperform their peers over the long term. In 2015, global investment index provider MSCI found that environmental, social and governance (ESG) investment strategies (which invest in companies with strong practices in areas such as the environment and human rights) had outperformed the MSCI World index since 2007. Meanwhile, an October 2016 study by Barclays Bank into fixed income found that introducing environmental, social and governance factors resulted in a steady performance benefit.

Click on the table below to see a larger version.

Performance of ethical funds ranked over three years

Fund name	1 year %	3 year %	5 year %	10 year %
F&C Responsible Global Equity 2 Acc in GB	18	63	119	144
Liontrust Sustainable Future European Growth 2 Acc in GB	21	60	102	95
EdenTree Amity European B TR in GB	22	60	112	118
Impax Environmental Markets A GBP in GB	12	57	109	92
Standard Life Investments European Ethical Equity Ret Platform 1 Acc in GB	19	56	97	47
Henderson Global Care Growth I GBP TR in GB	19	56	130	142
Liontrust Sustainable Future Global Growth 2 Acc in GB	18	53	106	98
Standard Life Investments UK Ethical Ret Platform 1 Acc in GB	29	51	93	107
Aberdeen Multi Manager Ethical Portfolio I Acc in GB	12	51	96	87
Liontrust Sustainable Future UK Growth 2 Acc in GB	22	50	97	91
Jupiter Ecology I Acc TR in GB	15	50	101	83
Liontrust UK Ethical 2 Acc in GB	26	48	98	83
Liontrust Sustainable Future Absolute Growth 2 Acc in GB	17	47	93	95
Royal London Sustainable Leaders Trust C Acc TR in GB	16	44	104	110
Stewart Investors Asia Pacific Sustainability B GBP Acc in GB	5	43	94	234
Liontrust Sustainable Future Managed 2 Inc TR in GB	16	42	81	87
Mirova Europe Sustainable Equity IAE EUR in GB	15	42	76	51
Premier Ethical C Inc TR in GB	22	42	113	124
F&C Responsible UK Equity Growth 2 Acc in GB	21	40	87	76
EdenTree Amity International B TR in GB	12	37	72	110
Halifax Ethical C in GB	9	35	81	84
Aberdeen Responsible UK Equity I Acc in GB	16	35	56	64
EdenTree Amity UK B TR in GB	15	34	71	97
Henderson Inst Global Care Managed I Acc in GB	11	34	79	92
F&C Responsible UK Income 2 Inc TR in GB	14	33	71	67
Kames Ethical Equity B Acc in GB	15	33	81	101
Henderson Global Care UK Income I Inc TR in GB	12	32	85	83
Aberdeen Ethical World Equity I Acc in GB	10	31	57	78
SJP Ethical L Acc in GB	9	30	53	65
L&G Ethical Trust I Acc in GB	12	27	68	63
7IM Sustainable Balance C Acc in GB	6	23	46	51
Kames Ethical Cautious Managed B Acc in GB	9	23	54	85
Jupiter Responsible Income I Acc in GB	11	21	59	49
Rathbone Ethical Bond Inst Acc in GB	9	21	42	87
Liontrust Sustainable Future Corporate Bond 2 Inc TR in GB	7	21	33	71
Family Charities Ethical Inc TR in GB	9	20	44	11
Royal London Ethical Bond M Acc TR in GB	6	19	34	76
Standard Life Investments Ethical Corporate Bond Ret Platform 1 Acc in GB	4	16	28	[illegible]
Kames Ethical Corporate Bond B Acc in GB	3	16	27	62
F&C Responsible Sterling Bond C Inc TR in GB	4	16	25	71
AVERAGE % TOTAL RETURN	**14**	**38**	**77**	**87**

Note: Shows all generalist ethical and sustainable funds with at least a 10 year track record. Source: FE Analytics, 31 October 2017

(https://www.moneywise.co.uk/sites/default/files/ethical-investing-table-web.jpg)

How to choose an ethical fund

The first step to finding the right investment fund is to figure out what type of ethical or sustainable investor you are.

Julia Dreblow, an industry expert who helps financial advisers understand ethical and sustainable funds, suggests the following approach: “People interested in this space usually fall into one of three categories: those with strong ethical views; those who recognise the world is changing and want to align their portfolios for a better return; and those who want to make a real positive impact with their money,” she says.

Type 1: You have very strong views on animal testing or arms

You should focus on traditional ethical funds that filter out the companies that engage in these practices. Both **Liontrust UK Ethical** (https://www.moneywise.co.uk/fund-information/Liontrust-UK-Ethical/NUUKE1) and **Kames Ethical Cautious Managed** (https://www.moneywise.co.uk/fund-information/Kames-Ethical-Cautious-Mgd/O9F82) are good choices for no animal testing. **Unicorn UK Ethical** (https://www.moneywise.co.uk/fund-information/Unicorn-UK-Ethical-Income/MPFYQ) – which has a comprehensive screen that includes all major ‘sin’ areas – and the **BMO F&C Responsible Global Equity** (https://www.moneywise.co.uk/fund-information/F-C-Responsible-Gbl-Eq/FPNAS) (from the people behind Friends Provident Stewardship) are also good choices.

Type 2: You want to profit from a world that is changing for the better

You should focus on funds that concentrate on the environmental, social and governance credentials of the companies they invest in (often called ESG). If you have just a passing interest, then a passive fund such as the **UBS MSCI World Socially Responsible UCITS ETF** might do. However, if you want to combine investing in companies leading in governance with those making active positive change, then the Liontrust Sustainable Future range is a good choice. The investment team is one of the longest established in the industry – having started at Aviva in 2000 – and the funds all have strong performance records.

Type 3: You want to make a real positive impact with your money

For those interested in making active, positive change, funds that focus on a single sector or issue may be useful. One of the newest launches in this space is the **Columbia Threadneedle UK Social Bond fund** (https://www.moneywise.co.uk/fund-information/Threadneedle-UK-Scl-Bd/JTFYN), which lends to small community businesses with social reporting and research undertaken by Big Issue Invest. Other popular funds include **WHEB Sustainability** (https://www.moneywise.co.uk/fund-information/FP-WHEB-Sustainability/FFFQ9) – which has a strong environmental focus – as does **Jupiter Ecology** (https://www.moneywise.co.uk/fund-information/Jupiter-Ecology/RWE) and **Impax Environmental Markets** (https://www.moneywise.co.uk/fund-information/Impax-Envt-Mkts-O10P/ITVEM).

Other investment options

You could also consider some niche options – from renewable energy investment trusts, to crowdfunding sites that invest your money directly into local renewable energy projects, to direct investment in start-up ethical and sustainable businesses. However, these are high-risk investments and generally only suitable for more experienced investors.

Good sites to find out more include: **Abundance** (Abundanceinvestment.com), which offers investments in UK energy projects; **Community Shares** (Communityshares.org.uk), which features businesses that serve a community purpose; **Ethex** (Ethex.org.uk), which features businesses that set out to do good; and **Trillion Fund** (Trillionfund.com), which features renewable energy investments.

- **Take some risk to find an income stream (https://www.moneywise.co.uk/investing/funds/take-some-risk-to-find-income-stream)**

Take specialist advice

If you have investible assets of more than £250,000 (as usually anything below this doesn't justify the fees), you may want to head straight for an independent financial adviser that specialises in ethical investment, such as Castlefield – which has offices in London, Manchester, and Salisbury – which can help you to build bespoke portfolios based on your principles.

For a full list of financial advisers that specialise in ethical and sustainable investment, visit the Ethical Investment Association's website (Ethicalinvestment.org.uk).

Make your investments tax efficient

The best place to invest in ethical and sustainable funds will depend on your circumstances. However, do consider using a tax-efficient wrapper to hold your investments, such as a Stocks and Shares Isa, where your money can grow free of capital gains and income tax.

Alternatively, if you're prepared to lock the money away until you're 55, you could use a self-invested personal pension (Sipp) and get upfront tax relief on the contributions, depending on your rate of income tax.

You can invest in ethical funds within an Isa or Sipp wrapper on most of the major DIY investment platforms, which allow you to open an account and invest anything from £25 a month within minutes.

The choice of ethical and sustainable funds varies across platforms, though, so do check their selection first. Also keep an eye on fees and charges – especially for Sipps – as these can also vary widely. There is more information on which investment platform to choose at www.moneywise.co.uk/investment-platforms (http://www.moneywise.co.uk/investment-platforms).

For the more esoteric investments outlined in other investment options, you can typically open an account directly with the platform or company.

You can also invest ethically through your workplace pension. Although the choice of ethical and sustainable funds is often limited, there are usually one or two options. Those who are interested in switching their pension into an ethical and sustainable fund should contact their pension provider and ask for a list of the funds available, then select the one that is most aligned with their principles.

As Ms Bowen observes, if you are interested in investing this way, the most important thing is to do what you can: “I think it’s about joining the movement. The most important thing is to demonstrate with your money that you support this sector.”

The ethical investor: “I want to make investments that are financially prudent”

Hannah Gilbert, a 42-year-old from north-west London, has been investing in ethical and sustainable funds for more than 15 years.

“I started through my workplace pension,” she says. “There were only two choices: Aegon Ethical Equity and Scottish Equitable Socially Responsible Equity, so I split my fund between the two.”

These days, Hannah has a wide range of different holdings across her pension and Stocks and Shares Isa, as well as some direct investments into the Trillion Fund – a community renewable energy fund – and start-up ethical fashion brand Birdsong. On why she invests ethically, Hannah puts it down to pragmatism. She says: “I want to make investments that are financially prudent over the long term and, over the long term, ethical, social and governance factors are real risks.”

JARGON BUSTER

Ethical Investment: A process of screening out 'sin stocks' such as arms, tobacco and gambling.

Socially Responsible Investment (SRI): Investment in companies actively providing solutions to social and environmental challenges.

Environmental, Social and Governance (ESG) criteria: A way of highlighting companies according to how well they follow corporate governance rules, and benefit the environment and society.

TOP TIP: How to analyse ethical funds

To find out more about ethical funds you can use 3D Investing's Fund Analyst tool at 3dinvesting.com/ ethical-funds/How to align your investments with your principles

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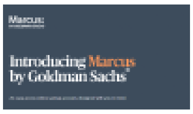

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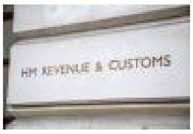

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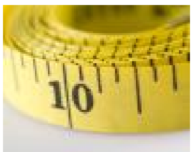

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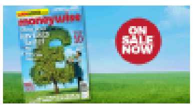

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