

GUIDE TO ETHICAL INVESTMENTS

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PURPOSE

Did you know that you could save the world? Well you can certainly help anyway!

If you're a working Australian, you have superannuation. If you're like approximately 80% of Australia's working population, your super is invested in the "default" option of your super fund.

So how comfortable are you being a part owner Tabcorp and Crown, Australia's two largest gambling businesses? How about Rio Tinto and BHP, large extractors of coal for the world's energy sector?

Sometimes it's hard to feel like you can have an impact, particularly on global issues such as climate change. Yet recently, when the Australian National University (ANU) in Canberra decided that their endowment portfolio would no longer invest in fossil fuels because of global warming concerns, the issue was deemed of sufficient importance for our Prime Minister and Treasurer to comment publicly. Tony Abbott was quoted as saying the divestment was a "stupid decision". He described coal as being "good for humanity".

So decisions on where your money is invested can have an impact on the world. A company's share price is determined by supply and demand. If more people want to sell than want to buy, the price drops. And if a company's share price drops, its ability to fund growth through borrowing or issuing new shares is restricted.

Investing ethically means giving some thought to how your money is invested. It means taking control. And such action will have an impact.

HOW DO I INVEST ETHICALLY?

Your superannuation is a good place to start, though of course you can equally invest non-super money with ethical considerations too. The first step is to take an interest in your superannuation savings. Most people leave their super in the default option chosen by their employer, and give it minimal thought until retirement is imminent. To have your superannuation invested ethically requires you to take some control.

The next step is to determine what are the ethical considerations you wish to incorporate into your portfolio?

Below is an extract of the questionnaire we use with our clients during our discussion concerning their investment preferences:

| What are your issues of concern? | Of no concern | Of some concern | Of high concern |
|--------------------------------------------------------|---------------|-----------------|-----------------|
| Environmental: | | | |
| Incorporating climate change into investment decisions | | | |
| Sustainable use of air, sea and land | | | |
| Preservation of endangered ecosystems | | | |
| Uranium mining and nuclear development | | | |
| Supporting R&D in areas of sustainability | | | |
| Social: | | | |
| The impact of gambling in our community | | | |
| Protecting human rights and dignity | | | |
| Protecting animal rights and dignity | | | |
| Reducing poverty, empowering communities | | | |
| Tobacco production and sale | | | |
| Governance: | | | |
| Boardroom ethics | | | |
| Worker exploitation | | | |
| Active shareholder engagement | | | |

Once we understand your ethical concerns, as well as your broader financial objectives, we will develop a strategy for you. Depending on the ethical concerns you want to incorporate into your investment strategy, and the level of involvement that you wish to have, we could use specialist fund managers to invest your retirement savings. We may also build a portfolio of direct Australian shares so that you can see exactly what you are invested in (and not invested in). Very often, to achieve appropriate diversification, a combination of both will be used.

There are numerous product and administrative solutions that can facilitate taking this level of active interest in how your money is invested. In some cases, a Self Managed Super Fund (SMSF) structure may suit – we have vast experience dealing with this structure, and can assist you in all facets should this be appropriate for your needs.

Thousands of Australian's invest their savings with ethical considerations imbedded in their strategies. You can too. You can have an impact. You just need to take action.

DISPELLING THE ETHICAL INVESTMENT MYTH

Do a bit of Googling on ethical or responsible investment and it won't take you long to find the nay-sayers argue that investing ethically costs more for a lesser return. It is the case that to invest ethically requires digging a little bit more deeply than would otherwise be the case. This extra research costs money. However if it were true that the more you research, the poorer the outcome, we might as well close all scientific laboratory's now, save our money on university research, and adopt the Amish approach that things are right as they are now, and we'll just stick with that.

Investing ethically means investing sustainably. A company that sells tobacco products does so in the knowledge that its product kills its customers. Aside from the moral issues, that doesn't sound like a very good business and therefore investment proposition. Surely a business whose products lead to their customers flourishing has much better long term prospects.

A company that extracts fossil fuel faces two challenges. One - as it dig's out the material, that material isn't "growing" back. Eventually that mine is all mined out. For the business to continue, it needs to spend money searching for a new mine. And so it's constantly chasing its tail, using money from one productive mine, to find more resources to replace what it is extracting. Its second problem is that the world is taking action on greenhouse gases. Now that action may be less than what the scientists say needs to occur, but never the less, most governments around the world are taking some action. So for fossil fuel extractors, they also face a global headwind against their industry. So does this make for a good investment?

How about a company that manufactures products in a third world country and exploits its workers. At some point that exploitation is revealed, with the consequent brand damage immeasurable. Would it not be prudent for an investor to understand if this type of risk exists before making an investment? Simply analysing a profit and loss statement won't inform you of that potential risk.

Ethical or responsible investment should not be considered "feel good" investment (though hopefully it has that effect for you). Ethical investment makes sense. Don't you want your money invested in businesses that have positive relationships with a growing customer base? Isn't it more likely a business will grow and prosper if it is producing a good or service which benefits the communities in which it operates?

But enough on the logic. What do the numbers say? The Responsible Investment Association of Australasia is an industry body that represents fund managers, asset consultants, research house and the like. RIAA's membership manage over \$500billion. In their annual Benchmark Report for 2014 they found:

1. In Australian equities, core responsible equities funds have outperformed both the ASX300 index, and the large cap Australian Equities fund average, over 1, 3, 5, and 10 years (all measurement periods).
2. In International equities, they have outperformed the MSCI global index, and the large cap international equities fund average over 5 and 10 years, though they have underperformed over 1 and 3 years.

So yes, responsible investment typically does cost a little more, but that extra research leads to proven superior returns. Who wouldn't be prepared to pay for that?

WHAT DO “ETHICAL” FUND MANAGERS DO?

So you have chosen to invest your savings in a way that takes ethics into consideration. You've decided that the best way to do this is via specialist fund managers. So what do these fund managers do, that other fund managers don't?

The foundation stone for any ethically oriented fund manager is the acronym ESG – Environmental, Social, and Governance. Sometimes you will also see this approach described as Socially Responsible Investment, or Sustainable Investment.

Let's have a look at some of the issues a fund manager might consider:

- Environmental – climate change, impact on the local environment, production of hazardous waste, sustainability.
- Social – gender and cultural diversity, human rights, community impacts, animal welfare.
- Governance – management structure, employee relations, reporting and disclosure.

Fund managers will either conduct research themselves, or source research from specialist research houses. Most funds will have a negative screen, which means they will not hold shares in companies operating in certain industries. Provided a company does not get caught in one of these screens, the fund manager is free to invest in it.

Perpetual's Ethical SRI Australian Share fund is a successful example of an ethically managed fund. It applies a negative screen to eliminate companies deriving more than 5% of revenue from alcohol, gambling, tobacco, uranium, coal-seam gas and the weapons and armament industries, and assesses performance in areas such as human rights, the environment, occupational health and safety, work and labour standards, animal rights and corporate governance. The negative screens bring the investment universe down from about 450 potential stocks to approximately 200 companies. The fund managers will then build a portfolio from these 200 stocks, using normal financial assessment criteria.

In addition to negative screens, some fund managers might also apply a positive screen. This would lead them to favour stocks that they believe are doing positive things in the ESG space. A company developing renewable energy might be an example of this.

Most fund managers that offer specific ethical products, would be signatories of the UNPRI. This is the United Nations Principles for Responsible Investing. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices.

HOW CAN GUIDANCE HELP?

We are a financial planning firm that creates bespoke investment solutions for our clients. If you want your retirement savings invested fossil fuel free, with no alcohol or gambling exposure, and with a broad ethical overall applied to all investments held, we can provide you with a solution. We can access a range of options to suit your investment balance, and the degree of involvement you wish to have.

WHAT NEXT?

Phone 03 9870 6544 to book an initial appointment where we can explore your needs and how we might be able to help.

Send us an email, and we will call you to arrange an appointment.

We welcome your feedback and look forward to working with you over the coming years.

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