WHAT IS ESG INVESTING?

PERPETUAL
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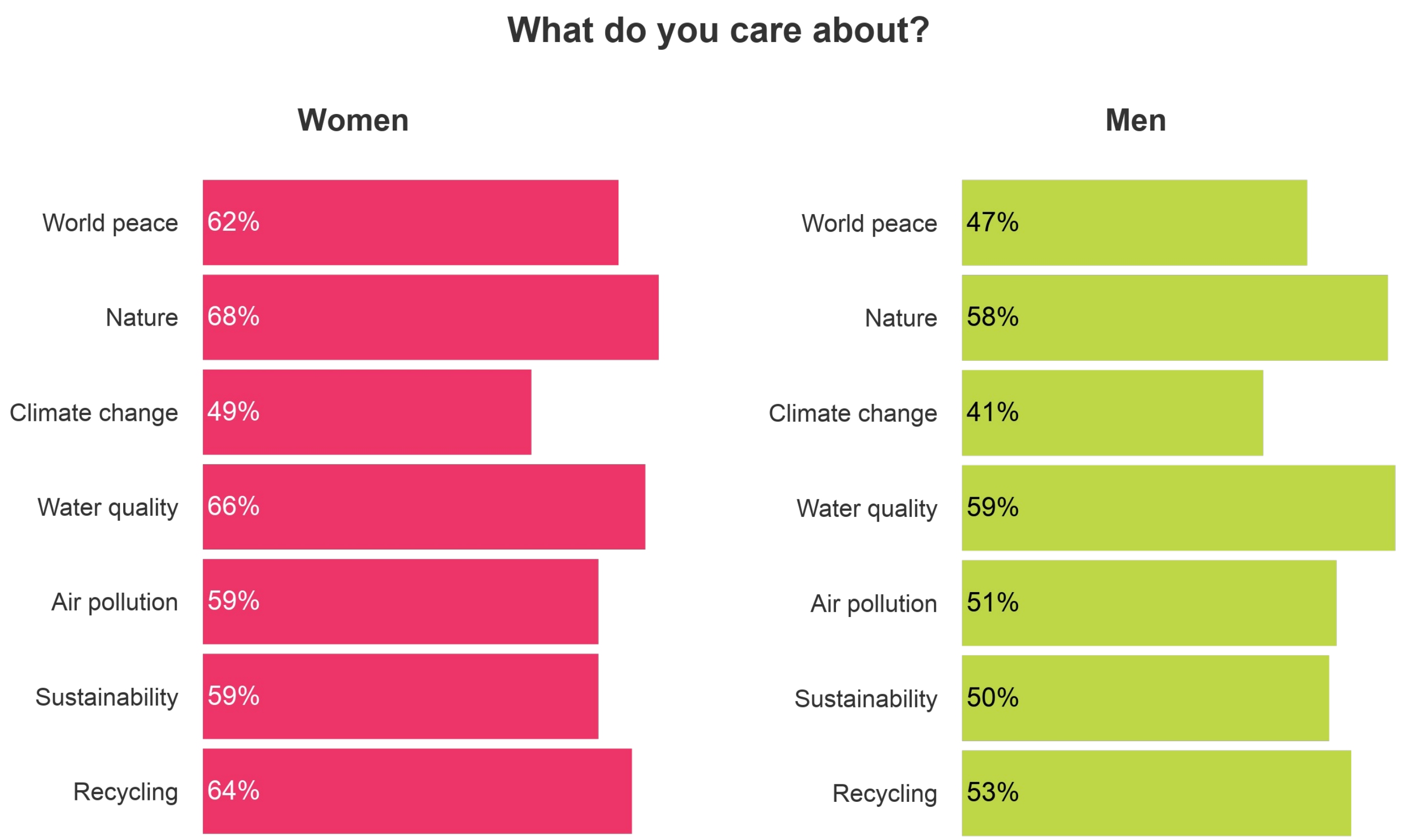
ESG investing means choosing the companies you invest in based on Environmental, Social and Governance (ESG) factors. Essentially, it's a new acronym to identify sustainable, ethical, or responsible investing and it's come along at the right time as interest in these types of investments is growing rapidly.

When we asked 3,000 Australians what they cared about most last year we found that they cared, A LOT, about the environment. This is probably why we've also noticed a groundswell of support from investors for ESG investing and not just from the younger generation — it's from investors of all ages and particularly from women.

So, if you're interested in ESG investing you're not alone – our research found that women were, in general, more interested in sustainable investing than men.



Source: Lembit, G., (2019) 'What do you care about', Perpetual Client Insights and Analytics, released 26 September 2019

So, what is ESG investing really all about?

- Environmental factors include everything to do with the environment from a company's carbon footprint to how it manages waste or minimises water use.
- Social factors encompass a company's policies, track record and commitment on social issues like diversity and human rights as well as how it treats its employees, customers and suppliers.
- Governance refers to a company's internal processes including Board appointments and regulatory engagement and compliance, to its policies on bribery and corruption and executive pay.

As you can see, this is a lot of ground to cover.

Where do you start?

The first step is to ask yourself what really matters to you. What are the industries and practices you want to avoid or encourage through your investments? It's really a personal question that nobody else can answer for you as it depends on your own personal values and morals.

There are a growing number of ESG investment funds and all of them decide their investments in different ways and include and exclude different companies, from different industries. For example, some ESG funds decide not to invest in fossil fuels, while others try to include companies that pay their employees and suppliers fairly. That's why you should have a clear picture of your preferences before you start. It will make it much easier to find the right investments for you.

But, does ESG investing have lower returns?

In short, no. It's a myth that ESG investing has lower returns. In fact, it may lead to better long-term returns by safeguarding your investment portfolio against ESG risks that may not be considered by more mainstream investments. Removing these risks may improve long-term performance while still allowing you to invest in what matters to you.

So, be clear on what matters to you (and know that you shouldn't have to make a financial sacrifice of your moral) then…

How do you find the right companies to invest in?

Once you're clear on what matters to you, the easiest way to find the right ESG portfolio is to rely on someone else to do the screening for you. There are many professional fund managers or investment companies which will use some version of ESG screening to put together investment options for you. Most superannuation funds in Australia also offer an 'ethical' or 'responsible' option which takes ESG factors into account. If you have a financial adviser or stockbroker, you can also ask them what kind of ESG screening they offer or recommend.

The other option, if you are interested and have time, is to do things yourself. Most public companies (the ones you can buy shares in) now publish information on their websites which will help you to screen them. The two main ways which people use to screen companies are ‘positive’ and ‘negative’ screening.

- Negative screening is where you decide not to invest in companies based on certain criteria. For example, you might choose not to invest in companies that have anything to do with tobacco, firearms or gambling. Or you might feel strongly about climate change, so rule out any companies that contribute to deforestation or have a high carbon footprint.
- Positive screening is deliberately investing in companies that align with your ideals or certain criteria. You might choose companies that score well in ESG criteria or alternatively choose to support companies that align with your beliefs and ideals.

It’s important to know that you don’t have to choose either negative OR positive screening. You can do a bit of both. Or you can start with the recommendations of professionals and supplement these with your own research. It’s really up to you, based on what you think is important, how much time you want to devote to it and how it fits into your overall financial plan.

How do we do ESG screening at Perpetual?

Every stock (company) in our ESG portfolio must first pass our quality screen. This means it must be a high-quality company that we believe will generate the best long-term investment return for our clients. Then, we screen out (negative screen) any company that derives more than 5% of its revenue from industries including alcohol, gambling, tobacco, military etc. Finally, we do a social screen, where we look at how each company runs its business (code of ethics, environment, human rights etc).

So, if you want to grow your wealth and secure your future, while not sacrificing your morals, then consider ESG investing. It’s growing in popularity for a reason.