Enquiring stewards... researching the issues others may fail to consider

Julia Dreblow | Director of sriServices and Founder of FundEcoMarket

The last time I contributed to Connections, in late 2014, I talked about fears of a 'carbon bubble' and the Governor of the Bank of England's first pubic reference to the risk of 'stranded assets'.

Much has changed since then. In particular; COP21, the Paris climate change conference where 195 countries signed an agreement to limit temperature rises to below 2°C - and the divest campaign. Both look set to shape the way people think about energy and climate over the coming years.

The fact that that coal, oil and gas reserves cannot all be burned - if we are to avoid catastrophic climate change - poses significant questions for investors large and small, 'ethical' or 'otherwise'.

However fossil fuels are not the only high profile issues that investors may wish to consider.

Military action in Syria, heartbreaking images of refugees, tempers fraying over gay marriage within the Anglican Church, loss of biodiversity and a diesel fuelled corporate disaster – all are high profile issues people may want to reflect in their investment decision making.

Investment managers label such issues with rather unwelcoming terminology like 'avoidance of strategic armaments', 'human rights', 'equal opportunities', 'resource management' and 'corporate governance' ... but they are none the less relevant.

The industry is however moving towards better management of such issues. The FRC Stewardship Code, for example, encourages longer term thinking and greater engagement.

'Mainstream' fund management responses can be broadly split into two, albeit overlapping, groups; research intended to inform buy/sell decisions - and ongoing 'activity' with investee companies.

The former, 'ESG integration' (Environmental, Social and Governance), is increasingly used to improve risk management. It typically involves researching areas that would otherwise be overlooked – and voting shares accordingly. Activity with existing investee companies meanwhile can take many forms take many forms - variously referred to as 'responsible ownership, stewardship and/or engagement'. This involves investors thinking of themselves as 'stewards' or 'part owners' - and typically involves encouraging better management of material ESG issues through dialogue, voting and sometimes shareholder resolutions.

Alliance Trust, Jupiter, Pictet, Sarasin & Partners, BMO (F&C) and Aviva are good examples of investors who are active in these ways. The Sarasin 'House Report' , for example, weaves easily between ESG and financial issues. Their work in this year's 'Aiming for A' shareholder coalition is likely to be high profile as they and others are asking Anglo American, Glencore and Rio Tinto to show that they are working to lessen the impact of climate change on their businesses - ahead of this year's AGM. This follows last year's program, led by CCLA, which resulted in 98% of shareholders backing a similar resolution at Shell and BP. So this will be one to watch.

In these changing times there can be no downside to understanding clients' aims better. Indeed you are likely to find that as stewards of your clients' financial plans this is an increasingly essential skill set.

This train of thought is taken even further by some funds of course.

Many chose to put 'sustainability' and other 'ethical' issues front of house. Approaches vary greatly with some focusing more on 'finding companies with winning longer term strategies - given the way the world is changing - while others focus more on finding attractive 'ethically appropriate' holdings.

To help advisers make sense of this diversity and match it to clients' aims we have come up with the 'SRI Styles' segmentation system – as used in Fund EcoMarket and by RSMR in their 'Rated SRI fund' service.

In brief - the recently reviewed segments are:

- **ESG Integration** - conventional funds that also research material 'Environmental, Social and Governance' risks.
- **Responsible Ownership & Engagement** - conventional funds that actively encourage better ESG management through 'responsible ownership' - for the benefit of investors.
- **Sustainability Themed** funds focus on companies' responses to sustainability issues to help identify investment opportunities. These regularly include ethical criteria also. See options from Alliance Trust SF range, Quilter Cheviot, Triodos, Impax and WHEB.
- **Environmental Themed** funds focus on environmental issues to help identify opportunities. These may include ethical criteria also. See options from Jupiter, Pictet and Scottish Widows.
- **Social Themed** funds focus on social (people) issues when selecting investments. May include ethical criteria. eg Columbia Threadneedle Social Bond.
- **Ethically Balanced** funds combine positive and negative ethical screening criteria. May use 'best in sector' strategies and allow diverse investment. See options from Rathbones, EdenTree, Henderson, Standard Life, BMO/F&C, Friends Life.
- **Negative Ethical** funds employ strict 'negative' values based 'ethical' criteria – which may mean they exclude a number of sectors. See options from Kames, Alliance Trust Ethical (ex NU) and OMW Ethical.
- **Faith Based** funds avoid companies in line with religious principles (eg Shariah Law). (Note: many ethical funds also have 'faith friendly' policies).

(The 'triangle' image shown illustrates a rough 'allowable universe' for investment).

This system is intended as a guide that helps highlight core strategies. Within each style strategies vary - and there are areas of crossover. Many 'Themed' options, for instance, list ethical avoidance criteria although these may have little impact on stock selection (as themes drive where they will invest).

In addition, things change. Only a short time ago the term 'fossil free' was almost unknown to investors, diesel was in favour and there was no Social Investment sector.

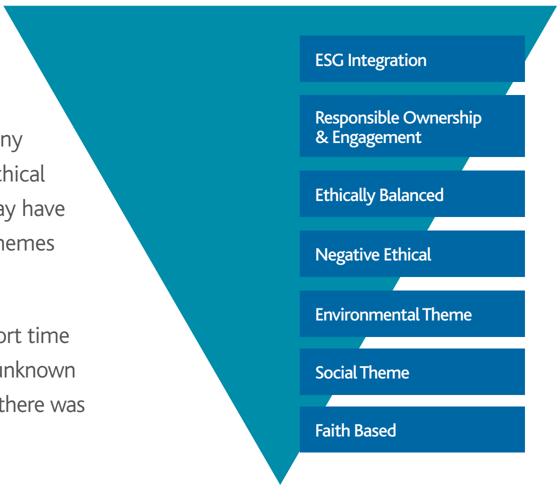
For advisers, the winning formula can only be to focus on what clients' want - by asking them.

Identifying priorities with the help of a supplementary fact find is an easy way to do this. Our online 'SRI StyleFinder' fact find is free to use and as a Synaptic user you will also have access to their updated 'issues based' questionnaire.

These methods are quite different, but both are supported by tools, links and reporting functions. In these changing times there can be no downside to understanding clients' aims better. Indeed you are likely to find that as stewards of your clients' financial plans this is an increasingly essential skill set.

Notes

i http://newsroom.unfccc.int/unfccc-newsroom/finale-cop21/
ii https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx
iii See Sarasin entry on www.FundEcoMarket.co.uk for report link



SRI Investing
how to choose funds

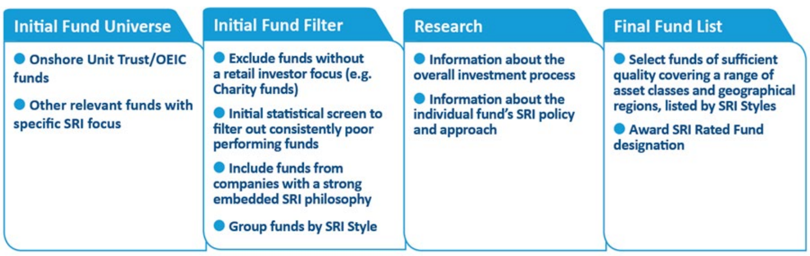
Stewart Smith | Investment Manager | RSMR

The market for SRI funds is clearly diverse, both in terms of client requirements and in terms of the funds available. It is also dynamic with new ideas and themes emerging on an ongoing basis. Most advisers now accept that consideration of SRI investments should form part of their normal advice process, regardless of whether or not they specialise in this area, but many are not clear on how to approach their fund selection.

We work closely with sriServices, who categorise these funds into SRI styles. This is a very useful starting point, enabling you to find funds which fit with your clients' requirements. Once this is done, you then need to narrow down your choice to a specific fund, which is where our SRI fund rating comes in.

Our SRI fund rating is our 'badge of quality' for SRI funds, and uses a similar and equally robust methodology to that used for mainstream funds, modified slightly to take account of the range of SRI funds and their specific characteristics.

We currently rate 27 SRI funds, and the process for determining whether or not the fund deserves a rating can be summarised as follows:



The first part of the process is to determine the initial investment fund list on which to conduct further research. Our starting point for this is funds listed within the Investment Association (IA) sectors, to which we apply a filter to highlight just those with a specific SRI / ethical focus. In order to ensure we compare like with like, we then group the funds according to their SRI style (determined by sriServices) before moving on to look more closely at the funds themselves.

Our methodology for assessing SRI funds (and any other type of fund) allows us the flexibility to include funds that have not met the risk or performance criteria we set.

Having identified a workable universe of funds, we then look closely at the funds with our research being split into two key areas – quantitative research and qualitative research.

The quantitative research consists of a number of filters which are applied to the fund universe. Our fund ratings are aimed at retail investors and so we exclude funds which don't focus on this market – for example charity funds. We then apply a series of statistical screens, looking at a range of performance and risk measures. Here we are looking to exclude the funds that have performed badly and also to better understand the risks being taken and how this affects the performance of the funds. Given the range of funds considered, each is looked at in the context of its IA sector and its SRI style, thereby ensuring that we compare a fund with its appropriate peer group. More detail on the actual measures used can be found by registering on our Research Hub and accessing our SRI Guide (http://members.rsmgroup.co.uk).

The qualitative research is where we focus much of our time and resource as this is arguably the more important aspect – particularly for SRI funds. Here we look at the fund as a whole within the context of its aims and objectives with the purpose of understanding how it works in detail, and how its objectives and fund process relate to the performance and risk we have seen in our quantitative research. The qualitative assessment is based on a thorough understanding of the fund. Much of the information is obtained through a detailed questionnaire completed by the fund management group, but we also obtain information from a variety of other sources. In this part of the process we consider how the fund is run, the resources in place to manage the fund and the expertise of key individuals. We also look at how the fund management team make stock decisions and what risk measures and controls are in place. Again, more detail on this can be found on our website.

Our methodology for assessing SRI funds (and any other type of fund) allows us the flexibility to include funds that have not met the risk or performance criteria we set. This is important in many areas, but particularly SRI as a fund may be run in such a way that means it will have periods of underperformance or it may be in a sector to which it is not really comparable. Our process is to understand the fund and understand why it has performed in the way it has. Where we can see clear reasons for any underperformance, and still see reasons for using the fund, then it may still be rated. This flexibility is particularly important in the area of SRI as the funds will, by their nature, have a more limited universe of stocks to select from and may also be subject to other constraints that could affect their performance. A strong fund process and well defined stock selection criteria together with a commitment to the SRI market can override some of the other criteria.

Our SRI rated fund list comprises those funds that we feel are well run and have a robust, repeatable process that has resulted in performance in line with expectation and with the risks taken thereby providing advisers with a usable list of funds, all of which have met a minimum standard. It is important to note that there will be other funds outside this list that may be suitable depending on the risk profile of the client and their specific needs and preferences - we have taken into account a number quantitative and qualitative factors but a different set of factors may have resulted in a different set of funds.

From the list of rated SRI funds, you then need to select the most appropriate fund for your client, the sriServices SRI styles can help to narrow down your choice, and the factsheets that we provide for each of our rated funds can be used to provide the additional information you need to finalise your choice.

Join our Research Hub at http://members.rsmgroup.co.uk

Alliance Trust Investments

Sustainable Future funds deliver strong investment performance

Mike Appleby | Investment Manager | Alliance Trust Investments

The Sustainable Future funds have delivered very strong investment performance. Seven out of eight (over 87%) of these funds are either 1st or 2nd quartile versus their conventional mainstream peers over the three year and five year period to the end of December 2015.

Quartile Rankings to 31/12/2015	Peer Groups	1 year	3 years	5 years
Sustainable Future UK Growth	IA UK All Cos	1	1	2
UK Ethical	IA UK All Cos	1	1	1
Luxcellence - Alliance Trust Sustainable Future Pan-European	Pan European Equity Funds	1	1	1
Sustainable Future Cautious Managed	IA Mixed 40% - 85% Equities	1	-	-
Sustainable Future Defensive Managed	IA Mixed 20% - 60% Equities	1	-	-
Sustainable Future Managed	IA Mixed 40% - 85% Equities	1	1	1
Sustainable Future Global Growth	IA Global	2	1	1
Sustainable Future Absolute Growth	IA Flexible	1	1	1
Sustainable Future Corporate Bond	IA £ Corporate Bond	2	2	2
Sustainable Future European ex UK	IA Europe ex UK	2	3	3

Source: Financial Express, as at 31/12/2015. Past performance is not a guide to future performance.

There is increasing demand for sustainable and ethical funds; and there are advisors who have chosen to differentiate themselves and grow, by specialising in offering these types of funds. Yet, some advisors still feel reluctant to recommend these funds, due to long-held misconceptions about poor investment performance, as well as being confused about this style of investment. It is time to get up to date and get rid of these misconceptions.

The objective of the Sustainable Future funds, which are run by Alliance Trust Investments, is to generate investment returns that are competitive to conventional funds, by looking for good businesses set to benefit from long-term trends we see happening in the economy. Many of these trends relate to improving quality of life by reducing the negative externalities and promoting positive consequences of business – this is essentially what we mean by sustainability. We are interested in understanding this because it can have a meaningful effect on the value of companies. We look for well run businesses which benefit from these trends and invest where we believe they are undervalued.

We are stewards of our client's capital and encourage proactive management of the business for the benefit of long-term shareholder returns.

As for what these funds mean by sustainability or ethics: we clearly state our position on issues of concern to clients, disclose all fund holdings and are happy to respond to client queries on them. In addition, we publish information about trends we see happening in the market and what stocks to watch; which gives investors plenty of information to understand where their money is invested.

These funds could make a lot of sense for many of your clients.

Important information

For investment professionals only.

The value of investments and the income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

References

[1] Analysis on the Sustainable Future Equity Funds by MSCI Research (12-Aug-2015) http://www.alliancetrustinvestments.com/sri-hub/posts/2015/September/investments-to-be-fossil-fuel-free

Focus on the manager

At Alliance Trust Investments (ATI) we have some of the top talent in the industry to manage our investment portfolio. Our team of 17 specialists are led by Peter Michaelis and have over 225 years industry experience between them. They have significant experience in managing the Sustainable Future funds and deep expertise in integrating sustainability into investment selection. We offer a diverse range of funds from corporate bond, through mixed asset funds and a selection of equity funds. We believe that our investment philosophy is robust and has been used in the running of our Sustainable Future funds for over ten years.

Rathbone Ethical Bond Fund

Bryn Jones | Fund Manager | Head of Fixed Income

The fund

Our objective is to provide a regular, above average income through investing in a range of bonds and bond market instruments that meet strict criteria ethically and financially.

We run this benchmark-agnostic fund with a strongly defined view that accounts for economic and political trends, company analysis, and thematic ideas. The investment grade fund targets a high yield with a strong ethical overlay. Once investment themes have been developed, the team carry out credit analysis to find the assets that work best within the thematic framework. Cash flow and strong balance sheets are key in determining bond selection, with the team applying the 'Four Cs Plus' principles: character, capacity, collateral and covenants. The 'Plus' is conviction – that to achieve above-average long-term performance, the team feel they must think differently to the market. After that, an ethical overlay is applied - a negative screening to exclude any corporate bond issuers in breach of any of the exclusion criteria.

The fund shall exclude bonds issued by companies wholly or predominately involved in the manufacture of alcoholic beverages; animal testing; the manufacture or sale of strategic weapon systems, ordnance or combat vehicles; environmentally unsustainable or high-impact activities; gambling; nuclear power; pornography or the manufacture of tobacco or tobacco products.

We then ensure that that issuers satisfy at least one of the fund's positive criteria requirements - progressive or well-developed practice or policies in one of the following key areas including corporate community investment; commitment to workplace diversity and equal opportunities; employee work/life balance; human rights; management of environmental impacts and the provision of products or services that offer social or environmental benefits.

The ethical research for the fund is done by specialist ethical investment unit Rathbone Greenbank Investments. The team has been at the forefront of developments in the ethical investment industry since 1992, launching one of the first bespoke ethical portfolio services.

The manager

Bryn Jones, Fund Manager,
Head of Fixed Income
Bryn.jones@rathbones.com

Bryn is the Head of Fixed Income for Rathbones, and is lead manager on the Rathbone Ethical Bond Fund and the Rathbone Strategic Bond Fund. He joined Rathbones in November 2004 from Merrill Lynch, where he managed $2 billion of fixed income assets.

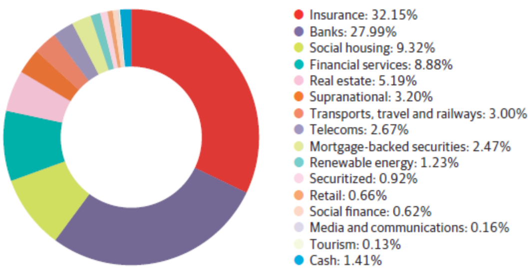
Bryn is a member of the Rathbone Strategic Asset Allocation Committee, Non-Executive Chairman of Rathbones' Fixed Income Committee, and an adviser to the Rathbone Banking Committee. Bryn appears regularly on CNBC and Bloomberg TV, and is also a co-opted Trustee for the Trust for London. He also sits on the IA Fixed Income Committee.

Bryn's Rathbone Ethical Bond Fund was awarded Best Sterling Corporate Bond Fund at the Morningstar UK Fund Awards 2014; Best SRI Bond Fund at the Money Observer 2015 Fund Awards and a 'Highly Commended' at the 2015 Moneywise Awards. His Rathbone Strategic Bond Fund was voted best Multi-Asset Fixed Income Strategy at the Investment Week Specialist Investment Awards 2015.

Peformance to 31.1.16. I-Class units

	1 year	3 years	5 years
Rathbone Ethical Bond Fund	**-1.56**	**17.83**	**42.95**
IA Sterling Corporate Bond sector	-3.37	11.52	31.05
Quartile	1	1	1

Sector asset allocation (iBoxx sector classifcations) at 31.1.16



The information contained in this note is for use by investment advisers and journalists and must not be circulated to private clients or to the general public. Source performance data, Financial Express, bid to bid, net income re-invested.

Ethical Investing

value as well as values.

Nurjanon Begum | Research Analyst | Synaptic Software

Ethical investing is driven by the growing recognition of the need for companies and investors to take a long term approach to issues ranging from climate change to resource scarcity, therefore more people are seeking out sustainable investments.

One of the key drivers for the growth in the market is that people want to actually see their money doing well, and many more would like to be offered sustainable and ethical options.

Many savers are increasingly recognising a market opportunity in building a more sustainable economy and the dangers of failing to do so. Recent incidents such as the fatal fires at textile factories in Bangladesh and the ongoing scandals in the banking sector are all blatant illustrations of serious impacts that failing to consider Environmental, Social and Governance (ESG) - factors can have on companies' profits, their share prices and therefore investor returns.

In the past, the views of investors were that they had to sacrifice financial returns in order to invest according to their beliefs. This viewpoint is slowly changing; it can be about value as much as it is about values. Now many funds focus on negative screening and reflect on sectors such as ethical and faith based investments that focus on excluding industries perceived as immoral such as tobacco, weapons, alcohol, gambling and pornography. It should no longer be just a moral issue; it should become a logical decision and a method of managing savings and planning for the future in a changing world.

Once advisers have identified clients who have social goals, they need to know what to do next. Our ethical fund data on Synaptic helps investors and advisors make those choices. We have our ethical fact find which allows investors to screen the negative and positivecriteria in order to identify SRI aims - finding out what company activities their clients want to actively support with their investment or indeed to avoid.

Our software also aids ethical fund selection when carrying out product and fund research which make it easy for advisers to include these ethical policy questions into their fact find with their clients.

The Synaptic Product and Fund tool helps users find appropriate funds for their clients. The tool includes an 'ethical' area which enables advisers to filter according to dozens of criteria – including ethical screens and other responsible investment fund and fund manager attributes. The data is independent, verified continually and the quantity available is forever expanding. The aim is to give advisers the ease to include it into their fact find with their clients.

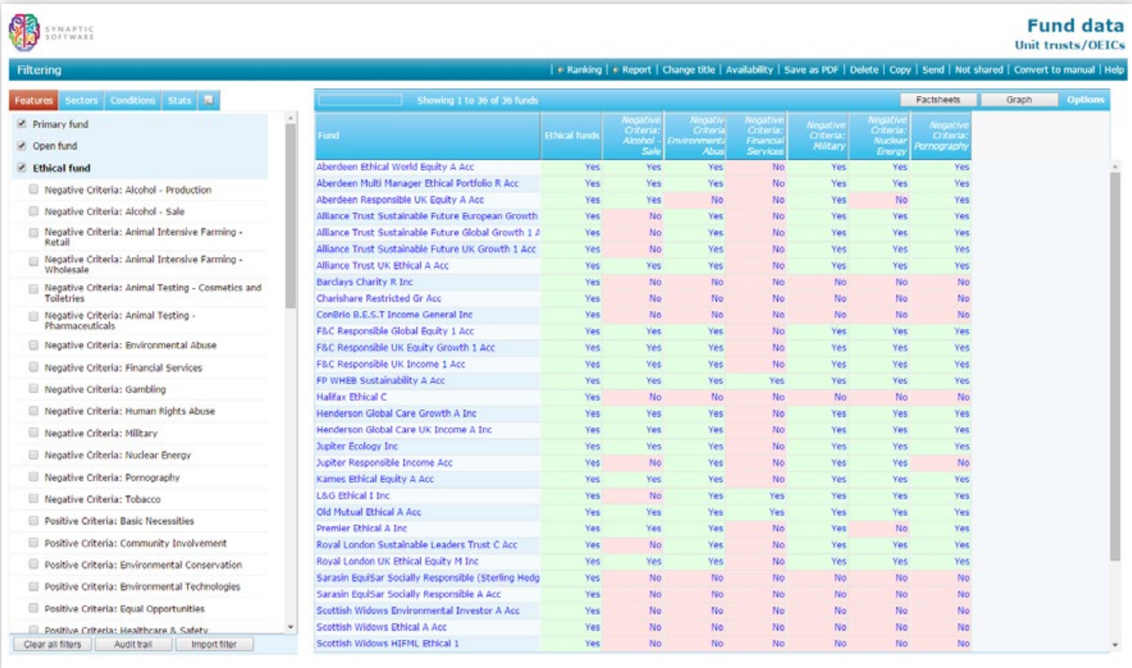
We currently maintain ethical policy data for over 730 funds and are finding on occasion that our customers are encouraging more fund managers to push this data to us as they are using our system to screen ethical funds and want specific promoters on there. It's a promising sign that investing in ethical funds is increasing.

During 2015, in excess of 5% of fund recommendations through Synaptic included some element of ethical screening. The five most commonly selected ethical policy fields (all of which represent negative fund exclusions) were avoidance of investing in: Tobacco, Military, Environmental Abuse, Human Rights Abuse and Pornography.

Source: Synaptic correct as at January 2016

The consensus is that tools such as Julia Dreblow (a Synaptic collaborator)'s EcoMarket Database Tool and Synaptic software help simplify the advice process. We just hope that it's used more frequently to change the current trend and advice process to include SRI and ethical investing in their fact finds.

The screenshot below as shows how Synaptic presents view of ethical funds in aggregate or by sector, enabling analysis by specific feature. Advisers can filter and rank options in order to present to clients.



If you would like a trial of our software, please phone us on 0800 783 4477 and quote 'Research Team'.