Dilemmas of being ethical

Duncan Hughes

Ethical investing is likely to offer comparable moral dividends to financial, as the average Australian ethical fund is broadly similar over three to five years before expenses, according to analysis from Morningstar.

But "ethical" portfolios specialising in Australian stocks that have avoided mining companies and focused on the big banks have been among the best performers of the past 12 months, the analysis reveals. The word "ethical" is so loaded with cultural assumptions, tainted by competing morals and rent by conflicting goals that it is conceivably possible to attack the same stock for being a saint or a sinner.

For example, one fund manager might exclude uranium stocks because of the environmental dangers, while another might invest in them on the grounds that they help reduce carbon pollution.

Levels of tolerance for "unethical" behaviour can also vary between fund managers depending on the criteria they choose to cull stocks and the screening of corporate behaviour. The ethical high ground from placing pink insulation bats in ceilings to reduce carbon emissions begins to sink if the companies installing are involved in shonky practices resulting in deaths and house fires.

Investing is also a process that leads to the production of a good or service, so where does an investor draw the ethical line between the production of steel and the manufacturing of armaments?

The manager for responsible investment and sustainability for fund manager Perpetual, Pablo Berrutti, warns the complexity of issues and variety of funds places a heavy onus on the diligent investor to do some homework. Perpetual's Wholesale Ethical SRI Fund, which has about $337 million under management, aims to provide long-term capital growth and income through investment in quality shares and "other securities of socially responsible companies".

It uses a range of ethical filters to exclude stocks that have more than 5 per cent of their earnings coming from "sin" activities that range from booze to bombs after an initial screening to ensure the underlying companies are well-managed, have recurring earnings, and conservative debt. It typically holds about 40 stocks.

The fund has returned more than 3 per cent over the past 12 months, outperforming the benchmark by about 2 per cent. Since inception in 2002, it has returned 11.3 per cent, outperforming the benchmark by 2.6 per cent. The fund's largest underweight positions include mining giants BHP Billiton and Rio Tinto and retailer Wesfarmers because they do not pass the fund's ethical and socially responsible investing criteria.

During the year, engineering group Downer EDI was excluded from the fund because of an environmental breach, while chemical provider Incitec Pivot was added after ceasing to provide explosives for armaments.

According to Morningstar, returns from ethical and non-ethical funds have been broadly similar over three to five years. During the three years to March 2011, the average return from ethical funds was about 0.7 per cent, compared with about 0.6 per cent from mainstream offerings. Over five years, the returns were 2.5 per cent and 2.3 per cent respectively.

But buffing your conscience can cost bigger bucks, which detracts from performance. The average ongoing fee for ethical funds is about 1.7 per cent, compared with 1.5 per cent for their mainstream rivals.

A dilemma for fund managers attempting to build an ethical portfolio of Australian stocks is the small number of companies available compared with their peers in the United States or Europe. That leads to the crossover in stocks evident between ethical portfolios and their mainstream rivals, even though the concentration in various categories may vary between them.

AustralianSuper last year announced it was removing an ethical exclusion from its sustainable investment fund because the range of listed companies fitting the criteria was too narrow.

"An investor considering investing in an ethical share fund should carefully read the product disclosure statement, especially the section on how the fund manager chooses stocks and their specific ethical/sustainable investment policy," says Morningstar editorial manager Phillip Gray.

Financial advisers warn investors considering ethical investing as an option to ensure they have a diversified portfolio and to avoid concentrating too heavily on single-issue funds that are emerging to cover specific sectors, such as clean air or water.

The bulk of specialist ethical investments are concentrated in a handful of funds, with the seven largest accounting for about 85 per cent of the $2 billion invested. Sector heavyweights include the AMP Sustainable Share and BT Wholesale Ethical Share funds.

Do the right thing

Ethical, sustainable or socially responsible Australian equity managed funds

	Ongoing fee (% pa)	Net assets ($m)	Return (% pa) 1yr	3yr	5yr
Alphinity Socially Responsible	2.10	5.87	0.13	-2.32	-2.38
Alphinity Wholesale Socially Responsible	1.10	21.29	0.93	-1.43	-1.48
AMP Capital Responsible Inv Ldrs Aust	0.87	20.39	0.37	0.13	2.77
AMP Capital Sustainable	0.72	423.53	-0.99	-0.60	1.84
AMP Capital Sustainable A	0.97	18.52	-1.24	-0.87	1.55
AMP FLI-AMP Sustainable Future Aust	1.45	7.11	-2.40	-1.99	0.40
AMP FLI-Responsible Inv Ldrs Aust	2.25	2.45	-1.03	-1.27	1.32
ANZ OA IP AMP Resp Inv Ldrs Aust EF/Slct	2.31	1.34	-1.06	-1.70	—
ANZ OA IP ING Sus Inv Aust- EF/Sel	1.72	1.10	1.32	0.69	3.78
ANZ OA IP ING Sus Inv Aust - NE	2.57	2.74	—	—	—
Australian Ethical Climate Advocacy	1.07	4.45	3.60	—	—
Australian Ethical Larger Coys	2.09	117.79	-1.85	-0.97	-1.58
Australian Ethical Smaller Coys	2.08	229.61	8.65	9.21	6.44
Aviva Investors Prof Sustainable Inv	0.85	17.56	1.35	3.45	4.11
BT Classic Investment - Ethical	2.46	1.48	-0.36	-1.68	1.93
BT Institutional - Aust Sustainability	0.85	139.98	1.47	0.57	2.69
BT Inv Choice - Westpac Sust Aust NEF	2.50	0.64	-0.19	-1.10	0.96
BT Wholesale - Ethical	0.95	168.26	1.23	-0.20	3.32
Hunter Hall Australian Value	2.17	101.32	12.61	9.24	6.88
Maple-Brown Abbott Ethical Aust	0.90	20.14	-0.33	—	—
Perennial Socially Responsive	0.98	58.89	-0.86	-0.03	2.03
Perpetual WFIA Perpetual Ethical SRI	2.25	3.32	2.90	—	—
Perpetual WFIF Perpetual Ethical SRI	2.25	10.49	2.07	5.40	5.35
Perpetual Wholesale Ethical SRI	1.18	356.05	3.19	6.55	6.54
Vanguard Sustainability Leaders Aust	0.50	255.85	0.54	0.95	2.93
Westpac Sustainability Aust (Retail)	2.19	3.81	0.07	-0.81	1.33
Avg for retail/wholesale ethical	**1.67**	**47.58**	**0.86**	**0.70**	**2.46**
Avg for retail/wholesale non-ethical	**1.53**	**138.61**	**1.58**	**0.56**	**2.30**

Performance data to March 31, 2011 SOURCE: MORNINGSTAR

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SELF-MANAGED SUPER FUNDS SLOW

Assets in do-it-yourself superannuation funds increased by 44 per cent, to $420.6 billion, in the past two years as the sector consolidated its position as the largest in the retirement savings industry.

However, the rate of growth in new funds has slowed by 3 per cent since the global financial crisis.

New figures from the Australian Taxation Office show 5904 DIY funds were established in the December quarter of 2010 compared to 6112 in the December quarter of 2008.

The number of funds wound up fell by a significant 90 per cent over the two-year period. Funds are typically wound up at divorce,or retirement age, and when one spouse dies and the surviving partner is too old to manage the fund.

Overall the total number of DIY funds in the December quarter rose to 439,397, which is 11 per cent higher than the two years before.

The industry body representing financial planners who advise self-managed funds said the results reflected consistent growth, driven by a desire among people to have more control over their retirement savings.

"It's not a simply a defection from pooled funds," said Andrea Slattery chief of the Self-Managed Super Funds Professionals Association of Australia.

The Tax Office figures show that shares were the preferred investment among DIY investors.

Shares accounted for 31 per cent, or $131 billion, of total DIY assets at December 31 last year, up from 26 per cent two years before. Cash holdings accounted for 27 per cent of total assets, or $112 billion at the end of last year.

Anecdotal evidence of an increase in property investment is not yet evident in the official figures, with residential real estate accounting for only 4 per cent of the sector's total holdings at the end of last year, and non-residential property only 11 per cent.

"Asset allocations are tracking as per normal with balanced funds," said Ms Slattery.

Membership in the sector has grown by 11 per cent in the past two years from 743,783 in 2008 to 839,510 investors in 2010.

Women remained the more active investors in the under 55 age group.

Bianca Hartge-Hazelman