Q&A Ethical investing

The Adviser
Peter Watts, Financial Adviser,
KWL Wealth Management

The DFM
Harry Thompson, Portfolio Manager,
King & Shaxson Ethical

Peter has worked in the financial services industry for 17 years, and is now a fully qualified Financial Adviser and Director of KWL Wealth Management, an Independent Financial Advice firm in the South West. KWL Wealth Management works closely with its clients to provide a highly personalised service, covering all aspects of financial planning and wealth management. Peter is passionate about proactively helping his clients to achieve both their personal and financial goals.

Harry started at King & Shaxson in 2014 after completing his business and finance degree. Now a Director of King & Shaxson Asset Management, he sits on the Investment Committee and manages both bespoke and model portfolios.

The investment team have a genuine commitment to use the power of capital to make the world a better place. Like the rest of the team, his personal investments match that of the King & Shaxson philosophy.

Asking the Adviser

Q What's one of the key drivers for your clients when they wish to invest ethically?

A A key driver, and the most common for our clients, is knowledge/peace of mind. Knowledge that their investments are placed in assets of companies and governments that are in line with their own values. Whatever the client's approach, we see a desire among them to see their investments contribute to positive changes around the world. Often this is driven by children and grandchildren, wishing to create a better world for them to inherit.

Q The spectrum of capital provides a good framework to understand the different approaches to investing, such as responsible, environmental, social, and governance (ESG), sustainable and impact. Do you feel your clients understand the various different approaches or is there some confusion?

A We have seen an improvement in clients' understanding over the last couple of years due to the coverage of climate change and environmental issues in all aspects of media.

However, while there is a greater understanding in general of ethical investments, there remains a large misunderstanding of what this landscape looks like. Our experience and the feedback we have received from our clients tell us they value the time we take as their advisers to explain the different approaches and objectives to the various investment methodologies in this space.

Q We feel clients over the last couple of years are looking to go beyond ESG and focus more on sustainable and impact? Would you agree with this?

A Yes, from recent client interactions we have seen this. The conversations and discussions we have with our clients are getting longer, deeper and more involved. There has certainly been a shift in clients' behaviour, where in the past, ESG was enough. There is now a desire from clients to know more, to understand the detail and how to advance their approach into areas beyond simply ESG considerations.

Q Do you have any concerns with the approaches highlighted in the spectrum of capital, from responsible to impact investing?

A Today – no. However, it wasn't that long ago that I would have answered yes.

When it comes to investing ethically, our today is very different to the today of past years. There was always a sense that the darker shade of green you went, the bigger the impact on your investment returns. The landscape felt concentrated, small, with limited access points. Add a lack of understanding and knowledge, and it paints a picture that to invest ethically it was pretty specialised/niche. Or it most certainly felt that way at the beginning of my career.

I am pleased to say those days have passed us. No longer is there a sense of managing a client's expectations to the potential returns they could expect from investing ethically. Today we are fortunate to sit with clients and invest in areas they wish to invest in while at the same time have an air of confidence that their money will not only contribute to positive changes in the world, but be a suitable solution to meet their financial goals.

Asking the DFM

Q Reflecting on 2020, it's been a good year for ethical investors. Will this continue in 2021 and beyond?

A If 2020 was a yearbook, you would have thrown it into the bin by now (recycling I hope!). While the year will go down in the history books for so many negative reasons, not all takeaways are such. You rightly mention the year was seen as a positive for ethically minded investors. Much of this has been discussed in length already, such as the positive impact of the negative screen, being overly exposed to companies with sustainable business models, or sectors experiencing accelerated structural growth trends.

The build back better mantra of many governments in response to the crisis has its focus on social and environmental issues, and will lay the foundation for continued growth over the years to come. The maturing of sectors such as renewable energy has allowed fiscal support to shift to technologies such as hydrogen, which will be pivotal in our shift to a low-carbon society. Meanwhile, amendments to policy will see rapid improvements in reporting requirements to allow investors to make better-informed decisions on areas such as climate risk.

Last year certainly feels like a turning point for many in realising it's possible to have a positive impact while still meeting financial objectives. There is genuine growth and cash flows supporting many of the positive impact sectors, which doesn't point to a bubble waiting to burst. Having said that, certain ESG stocks carry hefty valuations, with the good news of accelerated growth post-pandemic priced in. We have been prudent in trimming our 'ESG champions'.

Q We have seen a number of commitments from nations to reach net-zero over the next 30 to 40 years, what evidence is there to show conviction behind these announcements?

A It's reported that just over 60% of global emissions are covered by a net-zero target. While the UK was the first major economy to move on this front, many soon followed suit, with the 2016 Paris Climate Agreement firmly insight. The agreement actually established an enhanced transparency framework, meaning in 2024 countries will begin reporting on actions they have taken to mitigate climate change.

The EU's green deal, the UK's 10-point climate plan, or Biden's $2 trillion climate package are examples of how governments are seeking to get the ball rolling on their pledges. Notable actions such as banning petrol and diesel vehicles, or experimenting with hydrogen in the residential gas network, go some way in suggesting there is some conviction behind these net-zero targets. Although the UK's decision to allow a deep coal mine in Cumbria certainly raises some big questions.

Beyond this, reaching these targets won't be possible without the commitment from individual companies across the different sectors. Over the last year, thousands have committed to being net-zero too – some, such as Microsoft, have even gone beyond this and will seek to be carbon negative by 2030! However others are still slow to move, and we feel a tougher environment on polluters via stricter carbon pricing will need to be put in place for others to react.

On a side note, it's important to scrutinise any company or government pledge. An obvious example is Russia's commitment to reduce emissions by 33% by 2030 compared to 1990 levels. While the headline seems great, this would actually allow for an increase in relative emissions, as the base is set from the period of the fall of the Soviet Union, when Russia's emissions fell sharply.

Q What are some of your favoured core holdings in your model portfolios?

A It has become more evident that clients would like to shift further down the spectrum of capital and have a greater impact with their invested capital. This has seen us add exposure over the last 18 months to some of our core impact funds, including Montanaro's Better World fund and M&G's Positive Impact fund. WHEB's Sustainability fund remains one of our core holdings, and between them, they support a number of the United Nation's Sustainable Development goals.

Alternative energy is one of the largest positive themes we are exposed to, and the poster child company for this in our portfolios is the Danish company, Orsted. It is the largest offshore wind farm operator, avoiding an accumulated 54.2 million tonnes of carbon emissions since 2006! Not only this, but it has transitioned from a business model based heavily on fossil fuel revenue, highlighting to others that it's clearly possible to transition. On the social side, the Home REIT has recently been added to portfolios. The REIT invests in a diversified portfolio of homeless accommodation properties, with a focus on a number of sub-sectors including women fleeing domestic violence, ex-convicts, mental health sufferers, foster care leavers, or those suffering from drug or alcohol abuse.

Q Is there increased risk with screening out part of the universe?

A Volatility is a focus for many when it comes to portfolio risk, and data would suggest that responsibly screened portfolios have actually experienced lower volatility over the last five to six years. We would point investors to look at performance during times of market stress, and you'll find those portfolios that have screens in place, have experienced lower drawdowns than many conventional portfolios. However, if we are to stay with the textbook teachings, the darker green the screen, the greater the level of unsystematic risk, which is not necessarily reflected in volatility figures and not always articulated to clients, but it is something we take into account when constructing our portfolios. It's also important to note that some may see it as a risk in terms of losing out on financial returns, however there's clear evidence to show this is not the case.