

## Q&amp;A

## Ethical investing



**The Adviser**  
Alexander Heywood,  
Independent Financial Adviser



**The DFM**  
Harry Thompson, Portfolio Manager,  
King & Shaxson Asset Management

Alexander started in financial services in 1983 as a Lloyd's of London Insurance Broker, enjoying such concepts as *Dictum Meum Pactum* (my word is my bond) and *Uberrima Fides* (utmost good faith). He started as an Independent Financial Adviser in 1996. He has a desire to change the world to be a better place, believing passionately that it can be done through the allocation of savings and investments. He has a strong commitment to working with clients to achieve this.

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 How have you set up your investment proposition to cater to clients with a desire to invest 'for good'?**

**A** I began with the Funds Eco Market website, which gave me a good understanding of what a robust proposition would look like. I had been monitoring King & Shaxson for over four years and then they gave a presentation at an event which I found very good and encouraging.

Through a third-party service, I have access to an investment process solution. They have updated their negative and positive filters for ESG features and variables which a client might want. I am a strong believer in negative filters to start with, and then evidence that a company is engaging with their investments or going one further and investing for impact.

I have set up a "Core plus Satellite" approach as an investment philosophy. The core, rules-based part, tends to be 60% of a client's investments and is a portfolio designed by Discretionary Fund Managers.

This takes the hubris out of my fund selection and, significantly, it enables a wider range of research, engagement and fund selection in the final portfolio. This has the advantage that the asset allocation is more diverse, and I can obtain a better feel of what is happening in the various markets.

The Satellite funds are four which I select. At times they can be more volatile versus the DFM solutions I use, but will form around 40% of the portfolio, providing added diversification to the underlying funds in the Core allocation. Having a small number of funds in the Satellite allocation of the portfolio makes it much easier for me individually to monitor, but I enjoy the dialogue and discourse of monitoring the Core holdings too.

**Q Having set up your ESG central investment proposition, what do you see as the challenges?**

**A** ESG and Impact investing is the current flavour of the month. Its proponents want to address climate change, the preservation of nature that mankind needs to do, and issues of justice and fairness. It is a complex piece that requires

significant discussion and engagement with clients as emotions are stirred to keep people on board and to understand what is possible and why.

Avoiding greenwash and seeing accountability in the portfolio really matters. What is measured is valued and not an externality. The turf wars over "taxonomies" and what should or should not be included means that many issues are measured in different ways by different vested interests. Just as we wished for COP26 to be a "Conference of the Partners", as there is only one planet and the issues are so large. However, attempting to get different bodies working together and not trying to put each other down is difficult. Until recently, green and ethical investing was the outsider in the financial industry. Now, it is rapidly becoming mainstream and with the introduction of regulations and the expansion of targets, such as Net Zero, it will become increasingly prominent.

What is fantastic is that with its growth there is a much wider investment universe. This healthy alignment of the stars has translated into one-, three- and five-year figures of above average performance. Although this

may not continue, I see in many areas of finance the halo effect continuing.

To my mind, if we are to save the planet, and address the wide range of social issues that exist within it, the responsibility falls to private investors, as sovereign nations have so much debt that they are unable to step up to the plate.

**Q At a time when investment costs are falling, how do you justify using a discretionary fund manager like King & Shaxson?**

**A** King & Shaxson provide risk-adjusted models which invest solely in collective investments, but also models that include direct equity holdings. Their engagement with fund houses and other participants, whether that's ongoing, or for fund launches, gives them very good market intelligence.

From a financial perspective, I would not wish to set up a portfolio whereby the majority of the funds run were decided in terms of market calls only by me. This could lead to financial behavioural biases, which is not good practice. But also, on top of the investment process, they have a thorough screening process in place, which obviously takes time, being an ongoing process. Outsourcing this allows me to spend greater time with my clients.

Finally, when it comes to sustainable and impact investment, capital placement is an important part in order to channel flows to worthwhile investments. While smaller, the specialist and boutique nature of a DFM like King & Shaxson allows access to smaller companies and funds in the early stages of their journey, something that is not always possible with behemoth asset managers. As a result, they are able to monitor and select from a much larger pool of funds.

## Asking the DFM

**Q The latest pledges to come out of COP26, if met, would still see a global temperature rise of 1.8 degrees. How important is it to front load investments to speed up the transition?**

**A** Ahead of the COP26 climate summit, held in Scotland in November 2021, it was reported by the International Energy Agency, that despite emission pledges from governments, we would still fall short of limiting global temperature rises to 2°C compared to pre-industrial levels.

The summit, which was widely anticipated to be the turning point in our fight against climate change, brought about additional pledges, including those on methane and biodiversity, which, if met, will supposedly limit the rise of global temperatures by 1.8 °C. While this news must be cheered, it still

falls drastically short of the 1.5°C scenario where scientists believe anything above will cause major climate-related disasters.

These major climate-related disasters are already playing out. You only have to look to the Mekong Delta, where half of Vietnam's rice is grown, to see more frequent droughts and floods causing substantial damage and loss of life. If this volatility in weather continues, millions of livelihoods will be lost as the agricultural land becomes unusable.

According to Bloomberg New Energy Finance, investment in low carbon energy rose 27% last year. However, this is still well short of the investment required and highlights the need for greater urgency and ambition from policy makers. Despite the warnings, Europe's largest lenders provided \$55 billion of funding to companies to expand their oil & gas operations last year. Something that very much needs to be addressed should we succeed in meeting our climate targets.

While critics have highlighted the shortfalls in renewables during the recent energy crisis, it has only cemented our view that front loading investments in clean technology, including battery storage, is vital for our transition.

**Q While climate action is pressing, what other investment themes are you targeting and how is this represented in your portfolios?**

**A** Climate action is incredibly important, and is entwined with a host of investment themes, such as alternative energy and energy efficiency. Here the need is pressing and the market is more mature, and because of this our portfolios have greater exposure.

For us, investment in clean mobility is not just about carbon reduction, but also about reducing toxic emissions, which remain a killer, particularly in developing cities such as New Delhi in India. In the UK, a 2020 court ruling attributed the death of a nine-year-old girl in 2013 to air pollution, a world's first, underscoring the fact that it's not just about carbon counting.

As a global economy, we rely heavily on the natural world. It is far too often taken for granted, despite providing natural capital for roughly \$44 trillion worth of goods and services each year (or roughly half of global GDP). However, biodiversity loss, which has implications for a vast number of issues such as climate change, food security, wellbeing and health, has significantly accelerated. As David Attenborough chillingly writes in *A Life on Our Planet*, "humans have moved from being a part of nature, to being apart from nature".

There has been a transformation in public and political awareness of biodiversity issues. Frameworks such as 30x30 and

COP15 (convention on biological Diversity) will assist in moving the dial further to focus on protecting species and habitats. Investment managers will also have a vital role to play.

As mentioned, social themes are just as important to us. Our healthcare exposure tends to be high impact and disruptive. Holdings here include funding for global immunisation in the developing world, online access to healthcare resources (including mental health counselling) and artificial intelligence for disease detection.

When it comes to property, not only do we want buildings to be efficient and environmentally friendly, the social mission has to be strong. We therefore have exposure to affordable, medical and social property. Elsewhere, social finance ensures access to financial resources not only in the developed world but also in the developing world. Our microfinance exposure is predominantly lending to women in developing nations, which plays a significant role in empowering women, in turn addressing gender equality.

**Q While longer-term performance has been supportive, can you discuss the recent volatility and decline in genuine ESG/Impact investments?**

**A** The accelerated hawkish rhetoric and eventuality of higher rates has been one of the main drivers of declines in equities and bonds so far this year. Alongside this, there has been mounting geopolitical uncertainty surrounding Ukraine.

While the broader market has dragged, we have again seen an intensified sell-off in higher-growth investments whose valuations are impacted by a rise in the discount rate. The recent reversal in relative performance for both ESG and Impact has provided a window for a number of critical comments.

Over the years, we have cautioned about the outperformance in ESG and Impact, as a large part of this is due to the underperformance of oil and gas, commodities, and large banks. While the reflation trade has seen this pullback, we call the longer-term nature of this into question. We believe high energy prices will lead to an acceleration in renewable take-up, especially into technologies such as battery storage. We also see disruptive technologies eroding some of the older industries such as autos or finance.

While the past few months has seen volatility jump and performance lag, the longer-term trends associated with genuine ESG and impact (i.e. investing for good, not just to control risk) remain intact. We see these trends accelerating alongside the need to transition to more sustainable growth. We see the recent declines as a good entry point in a number of investments, although we do see volatility remaining elevated throughout the year.