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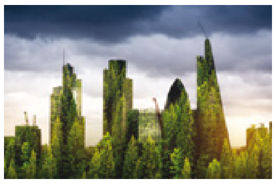

King & Shaxson: Why ESG growth is 'still in its early days'

By Lauren Mason

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The ramp-up in ESG fund launches is only set to increase exponentially over the next decade, according to King & Shaxson investment managers Craig Hart and Harry Thompson, to the point where any vehicles that do not adhere to a strict ESG screening process will be shunned by retail and institutional investors.

King & Shaxson, which this month celebrates the ten-year anniversary of its model portfolio service, is an ESG, impact, SRI and sustainable investment-only firm – a concept that may not seem unusual now, but was met with high levels of scepticism from the industry at launch.

"Ten years ago, if you were in ethical investing, you were seen as a massive outlier – a weirdo," Hart (pictured left) said. "Whereas now, this way of investing is completely mainstream.

"Around eight years ago we had £3m under management across our portfolios and now we are at £48m, but a vast majority of this has happened over the last five years. RDR was a big turning point in growth for us, as was David Attenborough's message to world leaders and the rise of Extinction Rebellion last year."

He added that this growth has not just come from first-time investors looking to manage their wealth responsibly, but from investors who have run their portfolios in the same way for decades, but have now decided to shift to ESG investing.

"I think the reasons for this shift are two-fold," Thompson (pictured right) said. "Firstly, the performance question has been knocked out of the park; we now nearly all know that ESG investing is actually more likely to enhance returns than hinder them. Secondly, there are significant long-term structural changes going on. People do not want to hold fossil fuels for instance, because they will likely become stranded assets. We still have the odd financial adviser who wants to cling onto their 4.5% dividend yield from owning Shell or BP, but people are coming round to the reality that this is not sustainable."

The key to dispelling some of the more stubborn myths behind ethical investing, according to Hart, is putting a considerable amount of time into education.

"We are very much willing to sit down with the IFA or the wealth management firm and go through our offerings. And if they do want us to sit down and speak to their clients, we can do that as well," he said.

Thompson added: "It is not always us saying to them, 'this is what we are going to invest in and it is your choice whether you choose us or not,' we can have a chat with the adviser and see what we can do for them."

Divisive themes

For instance, Thompson and Hart have decided to have no exposure to a number of controversial industries in their portfolios which, although often deemed ESG-friendly by many managers, some of their clients feel uncomfortable holding.

"One of these is animal testing in particular," Thompson continued. "If you have firms that are trying to find a cure for deadly viruses, they may test these on lab rats, rather than humans. But because our clients are divided on this, we will avoid these companies.

"Nuclear energy is another contentious issue – some people in the industry like it, but many do not. Some 95% of our mandates would not like to have exposure to it, so we do not include any funds that have nuclear energy in there."

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When it comes to selecting funds, the pair have certain fund houses they trust more than others. Janus Henderson Global Investors is a firm favourite, with its UK Responsible Income fund having been used across their portfolios since they were launched. Hart and Thompson also hold the firm's Global Sustainable Equity fund. Other fund houses that are held in high regard by the managers are Kames Capital and Standard Life Investments.

"We are also particularly keen on impact investing – we like the M&G Positive Impact fund, which had its first birthday in November last year. We have been invested in that since inception – we were even part of a consultation group for the fund before it launched," Hart said.

"There is definitely more of a focus on impact – I think it is easier to quantify the suitability of these types of funds. And in fact, performance of these types of investments has been fantastic."

While some investors may express concerns regarding stock concentration risk when favouring one particular investment style, the pair pointed out that more and more impact funds are launching, so there is a broader range of attractive investment options to choose from.

"We will look at the impact funds one by one and analyse the crossover. In fact, we are still finding company names in portfolios that we had previously never heard of. We have been doing this for ten years. This is a really good sign," said Thompson.

When it comes to an increasing number of funds launching, Thompson and Hart said this is actually constructive when it comes to minimising greenwashing in the industry, given the space is becoming increasingly competitive.

"You cannot just bring something out now and put a stamp on it like you used to because the scrutiny is there," Hart explained. "When it comes to greenwashing, we have been doing what we do for so long, it is quite easy to sniff it out."

One theme in the industry that is making ESG more challenging though, according to the managers, is the increasing amount of M&A activity among asset management firms.

"It makes our job harder because, as managers, we have a 'does it smell right' attitude to investment decisions," Thompson said.

"Are these firms just snapping up companies with ESG arms to them because they think they can get AUM into it? Or do they actually care? We need to feel genuine passion from the company.

"If the fund manager goes with the merger, that is okay because their remit is unlikely to change, but if the fund manager does not go, then you wonder whether the firm is just buying the label rather than the underlying belief. When this happens, the fund immediately goes on an amber watch list. If it is a particularly large position in the portfolio, we will chip away at it."

Looking ahead to the next decade though, Hart and Thompson are "hugely positive" that ESG investing will continue to thrive and prosper.

"We have ambitious aims regarding our AUM and we are a year ahead of our targets already. We just see nothing but growth for the next ten years," said Hart. "The way the industry has changed, there is obviously a far greater choice of investments. Again, not all of them good, but there is more money coming into our industry."

Thompson added that more money still will flow into the sector over the next decade as key investment themes mature.

"You have already seen the likes of the wind energy sector mature. Now you have themes like battery storage, which you would say is almost still in its infancy. That has a long way to go and solves a lot of the intermittent issues with renewable energy. We are very early days with the adoption of artificial intelligence and big data.

"In ten years' time we will be hitting the nail on the head in these sectors."