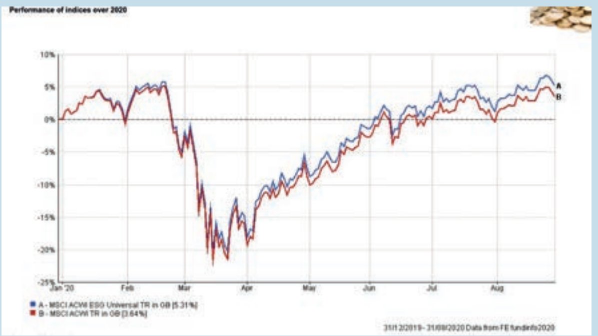
BEYOND ESG: THE SPECTRUM OF CAPITAL

The Spectrum of Capital is used in investing circles to explain the different approaches to investing when other issues such as ethics and sustainability are considered on top of the financial analysis. IFA Magazine spoke to **Wayne Bishop CEO of King and Shaxson** marking the 10 year anniversary of its MPS.

King and Shaxson (KASL) have been managing ethical portfolios since 2002, and with the flagship Model Portfolio Service (MPS) celebrating its tenth anniversary in 2020, now seemed the opportune moment to talk about topicality and transparency in the ESG sector.

A key point raised out the outset by Wayne Bishop, KASL's Chief Executive Officer, is that ethical investing isn't a new concept. He reminds us that the first ethical screen arose back in 1758, although exclusions at that time by the Quakers, were driven in terms of their faith. The market has certainly come a long way since then and over the past decade the universe of available assets has grown dramatically.

When MPS first launched, the availability of ethical investible assets was limited; for every fund that passed KASL's screen many, many more did not. Now the market has changed. Over the last 5 years we have seen ESG outperform and in the opening eight months of 2020 saw environmental, social & governance (ESG) funds outpace their conventional rivals by as much as 20 percentage points, according to research by Trustnet.



According to Bishop, over the last decade 'the myth that ESG investment meant sacrificing returns has been debunked.' The phrase 'Ethical Investing' can sometimes make people think of avoidance, but there is a strong focus on the positive as well. KASL does maintain a rigorous negative screen to avoid various 'sin' stocks, however the eco-system of available ethical opportunities has flourished since MPS started in 2002.

ESG investing has not only outperformed, but has done so with lower volatility. A key factor behind this, according to Bishop, are the oil and gas, mining and financial sectors, which are dominant in many indices but either lower or fully absent in ESG investments. Exposure to commodity prices has made mainstream indices more volatile sectors, and at the same time these three sectors have lagged the markets for a number of years. This accounts for a large part of the outperformance of ESG. Over time we will see the weighting and influence of these traditional sectors decline and we expect the gap in performance to narrow.

Whilst demand for ESG has often grabbed the headlines, as well as the rapid increase in the number and range of funds, one other key fact has been overlooked; the maturing of many of the favoured ESG sectors. At the turn of the century, wind energy was marginal and uneconomic without subsidies and investing in wind turbine companies such as Vestas Wind Systems was considered risky and optimistic while the concept of investing in solar farms in the UK would have been considered lunacy. Today, wind is a mature sector and Vestas is considered a more mature investment. In addition to the turbine developers and manufacturers, yield based investments in wind and solar farm operators (including those based in the UK) are available, and have proved to be resilient investments over the COVID crisis.

As Bishop explains further, "for years we were frustrated as investors, that one of the leading offshore wind farm

Conventional investing is just that; the client aims to invest for returns only, and all stocks are investible. Socially Responsible and Sustainable Investing differs. A screen is added before investors allocate their capital. A company's business practices must not to be considered detrimental to society, or the environment, and exhibit good governance. The research undertaken is known as Ethical, Social, and Governance (ESG) analysis, and the universe of stocks available for selection are reduced.

Thematic Investing looks at companies whose products or services are of direct social or environmental benefit concerning a particular theme. Themes emerge over time as pressing issues gain greater weight. Most recently we have seen this with climate change.

Impact Investing focuses on investing in companies that finance solutions to the social and environmental issues we face, where the outcome is identifiable and measurable. An obvious investment is renewable energy companies, where the impact can be measured in terms of CO2 emissions saved.

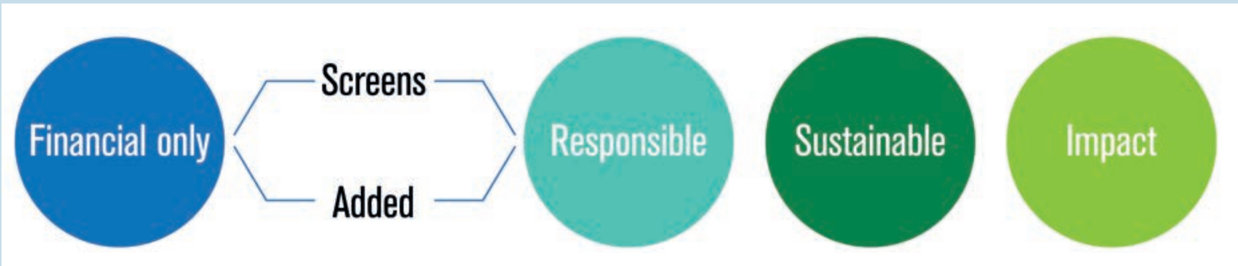
developers and owners, Danish Oil and Natural Gas (DONG) was off limits from an ethical perspective. They changed focus and rapidly began disposing of their fossil fuel interests, renaming themselves Orsted. Not only has been good from an ESG perspective, it has been very good for shareholders."

An increasing number of sectors nowadays have more viable investment options. To name but a few; social housing, better food ingredients (as well as vegan meat alternatives) and electric mobility.

KASL's Model Portfolios marry together funds across the spectrum of capital, from responsible and sustainable investing right through to Impact. Socially Responsible Investing (SRI), ESG and Impact focused investing are all included in MPS. KASL therefore aims to meet the vast majority of investors' concerns by selecting a broad range of funds that are specific in their goal. Bishop commented on this process, saying, 'ethics are personal, so it is important to educate our non-specialist clients on what KASL has to offer.'

By selecting a wide variety of funds, KASL further diversifies the risk of each portfolio, ensuring that exposure to individual companies, specific sectors or fund houses are complimentary but not repeated.

> "ESG risk adjusted returns versus various conventional benchmarks is highly commendable" Wayne Bishop, CEO, King and Shaxson



As part of their in-house due diligence process, KASL conducts an 'Under the Bonnet' screen every month. This helps to counteract 'greenwashing,' where funds that proclaim to be sustainable are avoided if they still hold stocks that are ethically questionable.

Bishop said, 'a thorough screening approach, adding qualitative analysis to external data is paramount to the integrity and longevity of our service.'

ESG investing has brought an alphabet soup of terms with it, and attempts are being made to develop a common taxonomy. Whilst this is positive move, there is a temptation to provide tick box solutions that might lead to greenwashing. It is worth remembering that there are a number of investments with good ESG scores that are still neither positive for the world nor without issues and controversies. For KASL, their experience is that investors want more; they want companies that actually behave well and are affecting truly positive changes. ESG data can provide a quantitative basis for ESG investing, but this only works if there is an equal qualitative analysis to ensure that investments meet investors' expectations.

A recent case in point is that of the company Boohoo and he comments that 'whilst it had the same ESG score as ASOS, as we dug deeper and looked to other sources outside of typical ESG screening we concluded there was an ethical difference and we favoured ASOS as an investment.'

The COVID crisis has accelerated the growth of ESG and investments in this sector have been increasingly sought after, as investors seek areas of genuine trend-based economic growth rather than just the beneficiaries of stimulus. Additionally, in Europe KASL noted a push to funnel stimulus towards greener projects, adding to the wave of interest although they share some of the concerns that there might be some short-term overheating, especially around the environmental sector.

By way of summary Bishop noted that 'as we move on with the crisis we expect to see the social and governance areas of ESG receive more interest. How companies have behaved during the crisis has become an area of focus, and issues such as executive pay and the treatment of hard-pressed customers are now all under the microscope. At times like this, greenwashing may fool some, but experienced eyes and minds will know that clients who sign up for ESG investments now more than ever, expect more.'