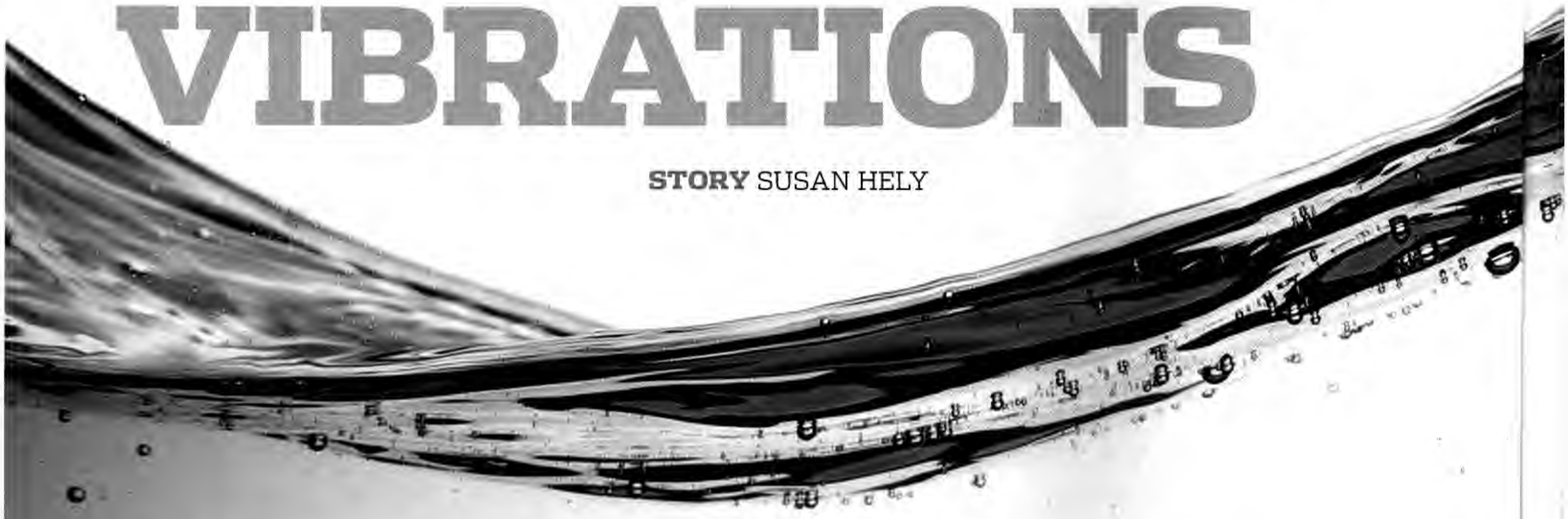
GOOD VIBRATIONS

Investors want to make a difference as well as money but products are scarce



STORY SUSAN HELY

WHEN 35 OF THE largest Australian superannuation funds sold $1.8 billion worth of shares in global tobacco companies, it was an example of "responsible" or "ethical" investing. Divesting tobacco businesses, along with controversial weapon dealers, is fairly standard practice for those that care about more than just the returns. Some funds go further and exclude investments that are linked to animal cruelty, gambling and human rights abuses. Several invest along environmental lines and avoid areas such as coal, coal seam gas, oil and old-growth logging, as well as companies with extreme executive remuneration, bad boards, poor labour relations and doubtful governance practices.

Responsible investing can reduce the risk of putting money in companies with bad practices. Environmental, social and governance disasters that have cost investors dearly include: BHP Billiton's Brazilian dam collapse, which will cost the company billions of dollars in fines; bribery and corruption allegations against CIMIC (formerly Leighton); and the Volkswagen emissions fraud, which will cost the car maker billions in compensation.

"The people who are paying for the fines are the super funds and their members," points out Bill Hartnett, head of sustainability at *Money's* top-performing "green" super fund, Local Government Super (LGS). He says bad practices destroy value for investors. "We are looking after the long-term retirement savings of members," says Hartnett. All of LGS's $9 billion in funds under management is invested responsibly and $700 million is invested "positively" in low-carbon assets.

More Australian investors want to use their money to do the right thing. "All of a sudden we are seeing strong views from investors and super fund members on what they are investing their money in," says Simon O'Connor, chief executive of the Responsible Investment Association Australasia (RIAA).

Some 6 million Australians describe themselves as "highly ethically active" and 70% believe that ethical investments will give them a better return, according to research by the ASX-listed Australian Ethical.

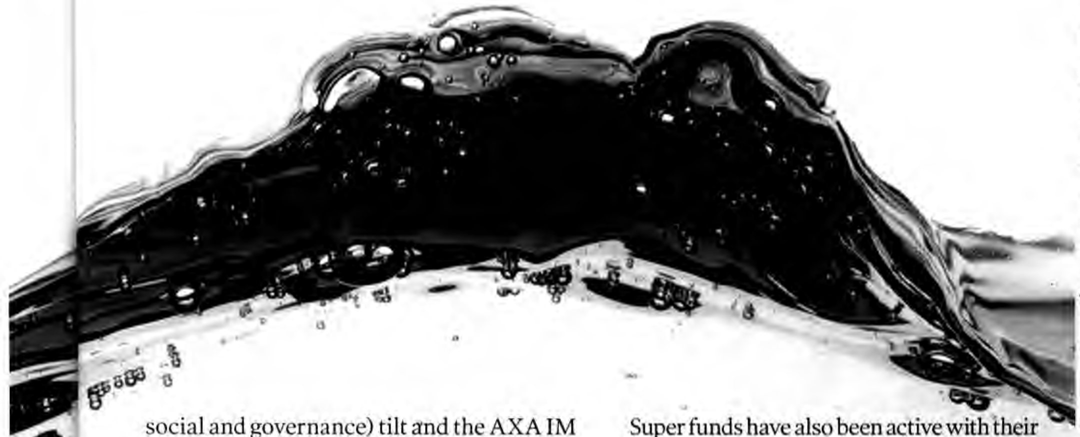
Dinah Koehler, equity strategist at UBS Asset Management in its sustainable equities team, says there is no risk-free investment because every product is a trade-off. She says the big change is that investors used to say "I want to make money and I don't care how I do it" but now they do care. She says responsible investing is part of good investment practice.

Avoiding companies doing the wrong thing should give responsible investments a performance edge. The RIAA's benchmark index shows that responsibly invested Australian equities funds outperformed both the S&P/ASX 300 and large-cap Australian equities funds over one, three, five and 10 years (see chart). It also found that core responsible international equities did well, outperforming the average large-cap international equities fund over one, three and five years. Responsible multi-sector growth funds or balanced funds also outperformed their equivalent mainstream equivalents over one, three, five and 10 years

"There is enormous demand out there," says Steve Greatrex, financial planner and principal of Wealth On Track. More and more of his clients want to build a balanced portfolio of responsible investments because of their religious, environmental or personal beliefs. The number of planners who have joined the RIAA has jumped by 25% in the past eight months.

But Greatrex says responsible retail managed funds are thin on the ground with only 29 on Morningstar's database; 21 have less than $10 million under management. Greatrex uses a platform to manage his clients' investments but it includes very few responsible funds. There is a lack of different responsible asset classes, with few bond funds. "The mainstream providers aren't giving consumers what they really want," he says.

Recent new responsible funds include six ethical exchange traded funds (ETFs) from UBS, Russell's Australian Responsible Investment ETF, Altius Asset Management's Altius Sustainable Bond Fund, AXA's smart beta fund with an ESG (environmental,



social and governance) tilt and the AXA IM SmartBeta Equity fund.

More cash products with an ethical overlay are being rolled out, such as the one from UCA Funds, a social enterprise run by the Uniting Church.

A long-standing responsible investor, established 30 years ago, is Australian Ethical Investments, which offers seven funds that avoid a long list of what it classifies as harmful industries. It is the only super fund that aims to move to a zero-emissions investment portfolio by 2050 and to decarbonise its portfolio across all sectors, says managing director Phil Vernon. It also backs companies that do good things, investing in clean energy (First Solar and Vestas), sustainable products (Tasmanian salmon producer Tassal), transport (bike parts manufacturer Shimano and Brambles) and recycling and waste management (Toxfree and Sims Metal).

Australian Ethical's Australian share fund ranked first out of 51 mainstream Australian share funds for performance over 10 years, returning 10.1%. Its other six funds typically rank in the first-quartile of performance tables.

Super funds have also been active with their responsible investments, largely because 80% of them see it as compatible with their long-term fiduciary duties as trustees, according to a report by SuperRatings.

Also super fund members are letting their funds know about their personal investment preferences. HESTA, for example, pulled out of Broadspectrum (formerly Transfield) because of its contracting work in offshore detention centres on Nauru and Manus Island.

Some super funds are at the leading edge of the responsible investing trend and three recently were among 12 international institutions to receive the top rating for climate change risk management. The Asset Owners Disclosure Project awarded Local Government Super, AustralianSuper and First State Super AAA ratings as part of its 2016 benchmark index, the Global Climate 500.

LGS has taken the view that the No.1 ESG risk is climate change. In 2014 it sold 25 companies – such as coal and tar sands miners and coal-fired utilities – because they derive more than a third of their revenue from carbon-emitting activities. **M**

What's in a name

A big issue for responsible investing is its definition. Funds adopt a wide range of descriptions, including ethical, socially responsible, sustainable and ESG (environmental, social and governance). In this article *Money* has used the umbrella term "responsible". Also funds use different ways to invest responsibly, with super funds employing specialist researchers to screen or choose investments.

The approaches include:

- **Screening.** The most common sustainable investing strategy, making up 68% of Australian responsible investing, is negative screening, where the fund manager excludes certain investments.
- **Environmental, social and governance.** ESG factors are applied to the analysis of every investment. This makes up around 25% of all responsible funds.
- **Impact investing.** Positive screening for companies that have a good social impact, such as community or environmental infrastructure, is the strategy for a small (7%) but vibrant segment.

Increasingly funds are using their voting rights and engaging with companies on ESG issues.

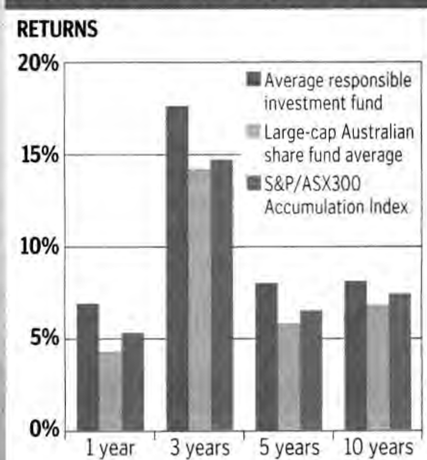
One way to differentiate between the types of screens is to use the Responsible Investment Association Australasia's free web tool, which is expected to be available in July. RIAA certifies about 80 funds and the new tool will provide full portfolio information and what the fund excludes or includes. See responsibleinvestment.org.

10 LARGEST LOCAL RESPONSIBLE INVESTING FUNDS

FUND	APIR	LAUNCH DATE	NET ASSETS	RETURNS (%PA) 1YR	3YR	10YR	FEE[1]
Australian Ethical Aust Shares	AUG0002AU	19-Sep-94	$363m	3.55%	14.53%	8.28%	1.90%
BT Ethical Shr WS	RFA0025AU	01-May-01	$222m	-8.76%	7.03%	4.57%	0.95%
Australian Ethical Aust Shares Ws	AUG0018AU	23-Jan-12	$82m	5.27%	16.31%		0.95%
Australian Ethical Advocacy	AUG0008AU	26-Feb-10	$50m	-3.68%	10.85%		2.20%
Uniting Growth	UGF0001AU	07-Jul-03	$37m	-4.50%	4.38%	4.58%	1.15%
Hunter Hall Australian Value	HHA0001AU	30-Nov-01	$36m	6.71%	5.85%	3.80%	1.00%
BT Ws Aust Sustainable Shares	WFS0285AU	30-Sep-01	$18m	-10.61%	6.07%	4.23%	0.85%
Australian Ethical Advocacy B	AUG0020AU	13-Jan-12	$16m	-2.48%	12.21%		0.95%
Alphinity Ws Socially Resp Share	HOW0121AU	30-Jun-00	$13m	-8.07%	6.31%	2.56%	1.15%
AEI Emerging Companies	AUG0027AU	01-Jul-15	$7m				1.20%

Source: Morningstar. Performance data as at 31-Mar-16. [1]Excludes any performance fee. Ws = wholesale

HOW RETURNS COMPARE



Source: Responsible Investment Ass'n Aust; as at 31-Dec-14