Ashburn

Wealth Management Limited

Can good financial returns and positive impact go together?

"I don't pay good wages because I have a lot of money, I have a lot of money because I pay good wages". So, said German industrialist Robert Bosch.

He had tapped into a virtuous circle, where a socially positive use of his money contributed to a financially positive return for him.

We have been asking ourselves the question, "Is it possible for individuals to invest money, with a significant positive, social or environmental impact, whilst at the same time receiving a competitive return on their savings?" And, "If so, can we find a robust cost-effective way to help them do so?"

Perhaps our most fundamental needs are security and the wellbeing of our family and loved ones. However, we also have higher level needs, such as fulfilling our goals and expressing our values.

Society is changing and individuals are becoming increasingly cognoscente of the effect our actions have on the world. Whether it is how we shop, recycle, use plastics, or fuel our house and cars, there are consequences to how we live our lives. Similarly, many are considering the impact of their investments.

From a purely financial perspective, a tried and tested way to meet our fundamental needs is to invest around the world in widely diversified assets and spread risk. Restricting the companies in which one invests to a narrow subset deemed to be "good", by either a financial or a moral benchmark, may increase risk and result in less reliable financial returns. But for some it is more important to line up their investments with their values and worldview, and they are prepared to accept higher risks to do so.

A helpful schematic that takes account of both financial goals and the impact of investments is the "Spectrum of Capital" below. This flows from broad based "Traditional" investment at one end, to "Philanthropic" at the other.

The Spectrum of Capital

<table>
<tr><td>Investment Approach</td><td>Traditional</td><td>Responsible</td><td>Sustainable</td><td colspan="2">Impact Driven</td><td colspan="2">Philanthropic</td></tr>
<tr><td>Financial Goals</td><td>Highest Risk Adjusted Returns</td><td colspan="2">Competitive Risk Adjusted Returns</td><td>Accept Higher Risk for Positive Return</td><td>Tolerate Below Market Returns</td><td>Partial Capital Preservation</td><td>Accept Full Loss of Capital</td></tr>
<tr><td rowspan="5">Impact Goals</td><td rowspan="5">No specific ESG factors considered. Accepts positive and negative effects of global enterprise.</td><td colspan="6">Avoid harm and mitigate Environmental, Social and Governance Risks</td></tr>
<tr><td rowspan="4">Avoid Harm. Aim to prevent significant negative effects of investment on people and the planet.</td><td colspan="5">Benefit All stakeholders</td></tr>
<tr><td rowspan="3">Benefit. Investments slanted toward generating postive outcomes for people and the planet.</td><td colspan="4">Contribute to Solutions</td></tr>
<tr><td rowspan="2">Positive Measurable Impact. Seeking solutions to global social and environmental problems.</td><td colspan="3">High Impact Solutions</td></tr>
<tr><td colspan="3">Focused. Often targeted at specific areas of concern to the individual investor or donor.</td></tr>
</table>

Traditional Diversified Approach
In our view, this approach works well for many clients, including many of those with strong social and environment values.

The rationale is that the world is complicated and the world of investment more so. We can find things we approve of, or disapprove of, in almost every nation, regime, tax system, financial institution, employer, or company we might invest in.

We pay taxes but may not condone everything the government does with "our money". We may work for an organisation, which has poor employment practices or environmental credentials, but it pays our wages and so clothes us, feeds our family, and allows us the luxury of saving.

We accept we cannot live in a pure bubble, our own utopian micro-economy, unsullied by the commercial world. Rather, when it comes to investment, as with the rest of our life, we accept the flawed system and work within it.

Based on our understanding of how investment markets work, we subscribe to the view that the "Traditional" investor is likely to see a higher financial return, relative to the risk he or she is taking, than someone who tries to navigate their way along the value spectrum. Their portfolio is more diversified and has lower costs, so the financial outcomes are likely to be more reliable. (This is considered below, and in our guide "Intelligent Investment", which is also available on our website.)

As a result, this investor may well have greater financial security and ability to support charities targeting areas they care about, or to invest in micro projects, where they can see the direct impact of their involvement.

Investing at the left-hand end of the spectrum and, if funds permit, making a difference at the right-hand end, is an ideal solution for many, and especially those whose financial security is paramount.

Moving along the Capital Spectrum – Adding Impact
However, others want their investments to produce positive outcomes and be able to assess their Social and Environmental Impact. They may or may not accept the rationale above, but regardless, they want to move along the Spectrum if practical and prudent.

Until recently we had not found a solution, which was evidence based and sufficiently robust. However, social and environmental investment has developed quickly in recent years, and now objective research and measures of expected impact are increasingly available.

Based on this research, we have revisited the problem and now feel we can offer a practical solution for those who wish to shift their portfolios along the Spectrum.

Assessing Impact
Our methodology draws on measurable parameters to assess the Impact of a fund, or combination of funds. Funds are assessed in 5 categories:

- 17 UN Global Goals for Sustainable Development
- Environmental, Social and Governance (ESG) criteria
- Controversies
- Transparency
- Financial Confidence

A useful way to categorise Impact is to consider how the primary activities of the companies making up a portfolio provide ***Solutions*** in line with the ***17 UN Global Goals for Sustainable Development.***

Impact Investing can help drive solutions to global problems; be they in healthcare, clean water, clean energy, education, good working practice, equality, or helping lift people from poverty through community development and economic growth. Mapping an Impact portfolio's holdings against these UN goals is a powerful measure.

The primary research we are using considers the Impact of each company within a given fund and maps their activities against these goals.

Environmental, Social and Governance Criteria (ESG) is a set of standards for a company's operations that socially conscious investors use to screen potential investments. Environmental criteria look at how a company performs as a steward of the natural environment. Social criteria examine how a company manages relationships with its employees, suppliers, customers and the communities where it operates. Governance deals with a company's leadership, executive pay, audits, internal controls and shareholder rights.

Funds are assessed to consider if there are any ***Controversies*** associated with the trade of the companies it holds. These might include issues around fossil fuels, mining, banks, animal testing and other sensitive areas of debate.

The ***Transparency*** of reporting by fund managers, as to how they are meeting their social and environmental objectives, is also considered.

Naturally no fund would be considered without a high level of ***Financial Confidence***. We need to know that: performance is solid relative to its asset class, risks are mitigated, the fund is diversified (albeit within the narrow remit of its impact constraint), the management group is strong, and the charges are reasonable.

Worthstone Impact Profiles

We have drawn heavily on the research carried out by Worthstone, an independent Social Impact investment resource, with whom we are working closely. They have produced "Impact Profiles" which assess a fund relative to the key measures above. These are an invaluable resource to adviser and investor alike.

Are there additional Risks or Costs to Impact Investing?

Before considering the relevant risks, we should clarify a few points about Impact Investing:

- It is not Philanthropy; it is investing, and you should expect a positive return.

- It need not be high-risk speculation; the companies held in a portfolio can be analysed from a financial perspective and bought only if they are sound businesses, making a profit and a positive impact.

- It is not focussed primarily on negative exclusion of "sin" stock (armaments, tobacco, etc) but rather on positive selection of a relatively small number of companies, whose endeavours improve the planet and people's lives.

However, there are four key areas of concern and risk to consider:

1. Lack of Diversification

A typical Impact fund has a honed down portfolio of perhaps 50 individual companies in which it invests. Various sectors of the economy will be excluded. Some countries, especially emerging economies may not feature. By contrast our standard portfolios invest in up to 10,000 companies across all sectors and world markets, so risk is spread. Lack of diversification increases risk.

2. Manager Risk

There is huge divergence from one manager to another. The risk of choosing the "wrong" manager (or the unlucky manager who picked the "wrong shares") adds another layer of risk on top of the lack of market diversification.

Impact funds, with concentrated portfolios, inevitably rely on the manager's skill in stock selection. We look to invest in funds with strong management, but irrespective this is an area of uncertainty and adds risk.

3. *Restriction of Sectors*

Various sectors, which are likely to give very good long-term returns, such as Emerging markets equities, tend to be excluded from the Impact arena. This could pull down expected future returns of an Impact portfolio relative to a conventional approach.

4. *Costs*

Management and trading costs on Impact funds are typically c 0.5% p.a., or more, above those of our conventional portfolios, this inevitably reduces the return to the investor.

But…
That increased risk does not necessarily mean lower returns. A concentrated portfolio of carefully chosen shares could do better than the market as a whole.

Indeed, it is likely that the companies in an Impact fund will tend to be smaller companies; and there is good evidence that, on average, smaller companies outperform larger companies over the medium to long term. (Although, that is not necessarily the case of any small subset of smaller companies)

Time will tell if following the Impact route will give better or worse returns than a conventional approach. We know costs are higher, but we cannot predict (or model) likely future returns.

Those who would like to invest in Impact solutions need to understand and accept these risks and the associated potential rewards of carrying those risks and balance them against their values and objectives.

Summary
If an individual is interested in Impact Investing, we will discuss how it might work for them, considering the pros and cons and how it relates to their financial plan. How much is invested in Impact funds will depend entirely on individual circumstances and attitudes.

For many, the traditional diversified approach we use is ideal. It gives considerable long-term security and is cost effective. That security may free the investor to do good in areas that matter to them.

For some adding Impact Investing is attractive. We believe that in isolation our Impact Portfolio might be a good solution for risk tolerant individuals particularly concerned to make a positive difference through their investments. However, the financial risks of this portfolio alone are too high for many others.

We hope that, over time, more low-cost, diversified solutions will become available in the Social and Environmental arena. Then we will be able to add more Impact investments into portfolios for those who want it, without compromising returns or adding undue risk. This is an evolving area and the more capital that is allocated to it the greater will be the cumulative effect.

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