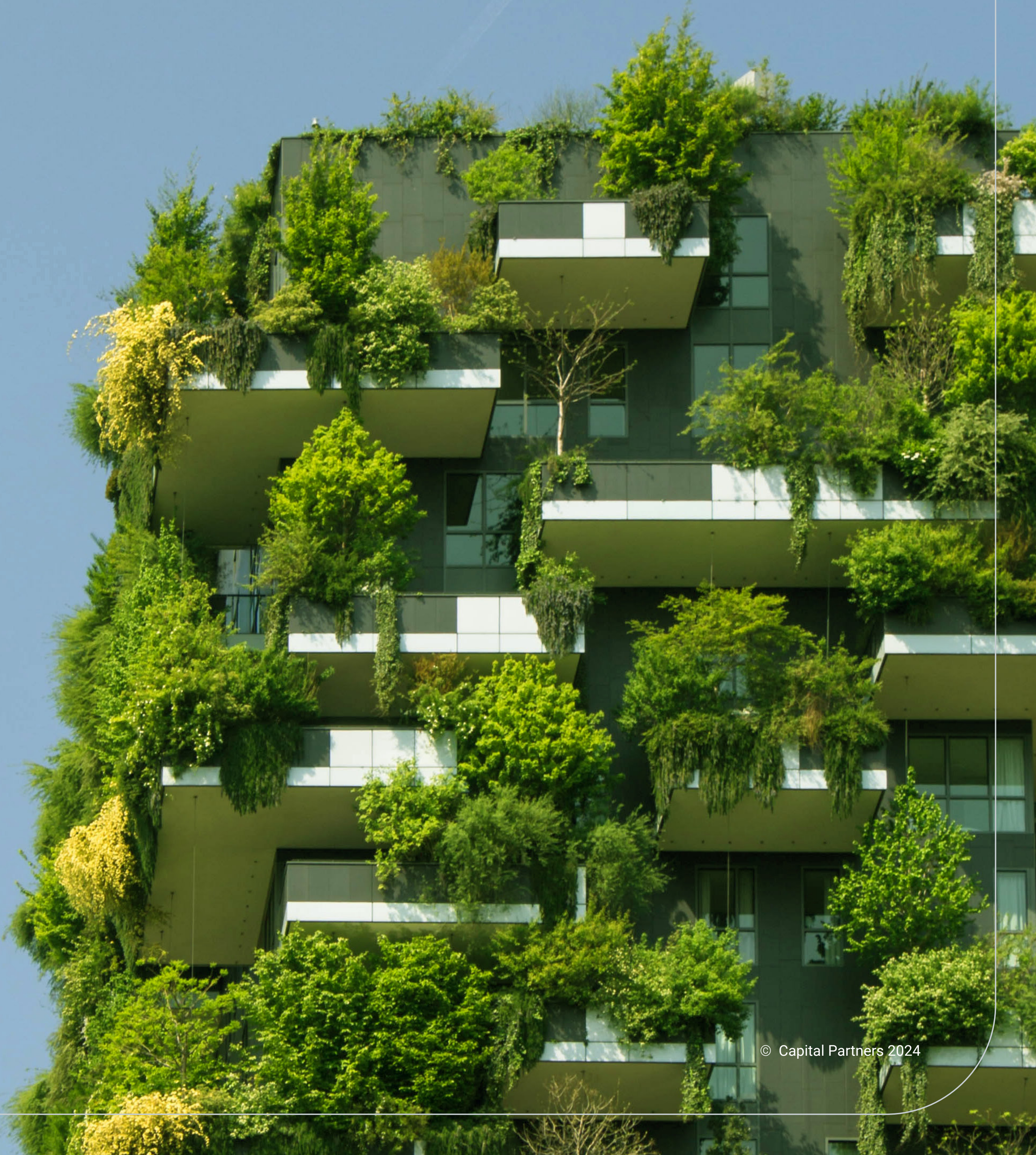
Capital Partners

PRIVATE WEALTH ADVISERS

Sustainable Investing | Do well by doing good



© Capital Partners 2024

Disclaimer: The information in this document is of a general nature only and may not be relevant to your particular circumstances. The circumstances of each investor are different, and you should seek advice from a professional financial adviser who can consider if these strategies are right for you.

In any instance where information is based on historical performance, we would advise that this is not a reliable indicator of future performance. You should not rely solely on this material to make investment decisions and should seek professional advice.

© 2024 Capital Partners Consulting Pty Ltd AFSL 227148 trading as Capital Partners Private Wealth Advisers ABN 27 086 670 788.

Contents

Introduction

Do you really care what the companies you're invested in are doing and how they're behaving? And wouldn't you feel more comfortable knowing your money supported practices and products that sit well with your values?

Putting your money where your values are

Like many Australians, you're probably well aware of dubious practices among large companies – like Volkswagen's emissions scandal or child labour concerns in Nestle's chocolate supply chains. Closer to home, in 2020, Westpac was ordered to pay a $1.3 billion fine resulting from their anti-money laundering offences and possible links to child exploitation. As a result, you may want reassurance that the companies you're invested in take their social responsibilities seriously.

You may also be concerned about the impact of climate change and loss of biodiversity on your children and grandchildren's future. You may want to avoid investing in fossil fuel companies and the companies that finance them, and instead put your money into clean sources of energy, like wind or solar.

Balancing personal values and financial needs

We all need to balance these concerns against the need to secure our own financial futures. As an aging population puts upward pressure on the cost of health care, the Government's shrinking tax base makes it more difficult to support people in retirement. It makes sense to aim for financial self-sufficiency later in life.

That's what this paper is all about. It examines how you can invest in line with your values – without compromising your financial security. By combining sound, evidence-based investment principles with sustainable screening methods, you'll see it's possible to do well, by doing good.

> **You may also be concerned about the impact of climate change and loss of biodiversity on your children and grandchildren's future.**

About Capital Partners

From our inception in 1999, Capital Partners Private Wealth Advisers has always taken an evidence-based, fiduciary approach to providing financial advice. Our model has always been fee-based, with no investment commissions – which means there are no conflicts or compromises in putting your interests first.

Capital Partners' approach to advice is based on our unique wealth-with-purpose philosophy. Creating wealth is important, but unless it's built and managed with purpose, all the money in the world won't lead to a richer happier life. That's what sets us apart from other wealth management firms. Instead of simply focusing on the numbers, we focus on you, your family, your values, your goals – your best life.

A privately-owned business, our intergenerational practice is a proud member of the Global Association of Independent Advisors™– an international network of like-minded advisory firms that sets the fiduciary excellence benchmark. We were also the first company in Australia to earn the CEFEX mark, the highest quality standard for investment fiduciaries globally.

You may want to avoid investing in fossil fuel companies and the companies that finance them, and instead put your money into clean sources of energy, like wind or solar.

Section 1

What is sustainable investing?

Simply put, sustainable investing considers an investment's impact on the environment and society – as well as its ability to generate competitive returns.

Sustainable investing explained

Within the sustainability sector, there are a range of approaches employed by investment managers. But generally, they consider a company's environmental, social and governance (ESG) credentials when researching, analysing, selecting and monitoring investments.

Sustainable investing is sometimes known as responsible, green or impact investing. You may also see the terms ethical investing, SRI and ESG used interchangeably.

Positive and negative screening

As part of the investment research, analysis and selection process, investment managers will screen each investment for its positive or negative attributes – or both.

Negative screening	Positive screening
Means excluding companies or sectors that don't meet the investors' values. This could include: • businesses that are environmentally harmful, such as coal mines, companies that produce toxic waste or have poor land and water management practices • businesses that cause social harm, such as tobacco companies, weapons producers or companies that use slave labour in their supply chains • companies with corrupt governance records or poor diversity outcomes.	**Means actively seeking companies with strong social, environmental or governance records.** This could include businesses that: • produce renewable energy or manufacture products to create renewables, like solar panels or wind turbines • provide social benefits, like medical products or education • have strong governance, such as companies with good diversity outcomes, who actively engage the communities they work in.

Investment managers will screen each investment for its positive or negative attributes – or both.

Figure 1: **The growth in sustainable investments**

2013	2018	2022
$AU178 billion The value of sustainable assets under management (AUM)[1]	**$AU980 billion** The value of sustainable assets under management (AUM)[2]	**$AU1.293 billion** The value of sustainable assets under management (AUM)[3]

A brief history of sustainable investing

While sustainable investing is increasing in popularity, it's not a new concept.
From the 18th century onwards, many investors have been keen to align their wealth with their values.

Figure 2: **Timeline of sustainable investing**

1703-1791

John Wesley, the founder of Methodism, encouraged believers to avoid businesses that profit at others' expense, including through tobacco, weapons, alcohol and gambling.

1758

The Religious Society of Friends (Quakers) ban members from investing in the slave trade.

1898

The Quakers Fiduciary corporation is founded with a no weapons, alcohol or tobacco investment policy.

1960s

Vietnam War protestors demand university funds stop investing in defence contractors. Shariah-compliant investment funds emerge in Malaysia to provide faith-based investments for Muslim investors.

1970s

Investment philosophy develops to avoid investments in slave trade, war and apartheid – and supporting initiatives like fair trade.

1980s-90s

Divestment from South Africa emerges as a response to apartheid. Small ethical investment funds begin to appear in Australia.

Early 2000s

The United Nations Principles for Responsible Investment (UN PRI) is released. Larger conventional fund managers began to set up ethical and responsible investment products in Australia.

1. https://www.afr.com/companies/financial-services/ethical-investments-soar-to-nearly-1-trillion-20190702-p5239b
2. https://responsibleinvestment.org/wp-content/uploads/2019/07/RIAA-RI-Benchmark-Report-Australia-2019-2.pdf
3. https://responsibleinvestment.org/wp-content/uploads/2023/11/RIAA_benchmark_report_australia_2023_v09.pdf

Principles of sustainable investing and ESG

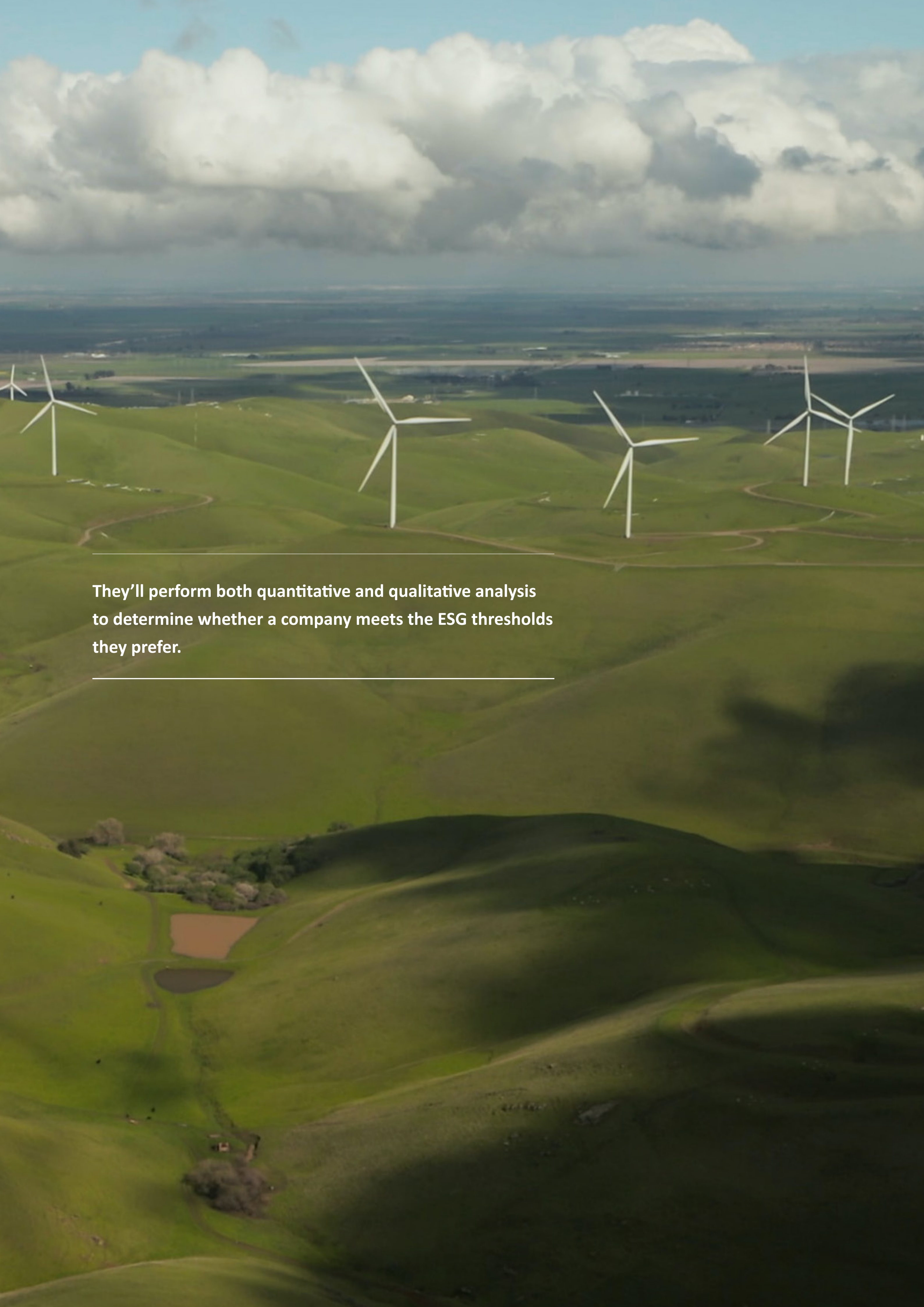
When developing a sustainable portfolio, investment managers will assess investments against specific environmental, social and governance principles. To do this they'll perform both quantitative and qualitative analysis to determine whether a company meets the ESG thresholds they prefer.

For example, they may analyse companies and industries against the following themes and issues, to evaluate their relative positive and negative social impacts. They can then include, exclude, underweight or overweight these investments in a portfolio, based on their ESG scores.

Figure 3: ESG considers a range of social issues[4]

Three pillars	10 themes	36 key ESG issues	
Environmental	Climate change	Carbon emissions Product carbon footprint	Financing environmental impact Climate change vulnerability
	Natural resources	Water stress Biodiversity and land use	Raw material sourcing
	Water and waste	Toxic emissions and waste Electronic waster	Packaging material and waste
	Environmental opportunities	Clean tech Green building	Renewable energy
Social	Human capital	Labour management Health and safety	Human capital development Supply chain labour standards
	Product liability	Product safety and quality Chemical safety Financial product safety	Privacy data and security Responsible investment Health and demographic risk
	Stakeholder opposition	Controversial sourcing	
	Social opportunities	Access to communications and finance	Access to health care Opportunities in nutrition and health
Governance	Corporate governance	Board Pay	Ownership Accounting
	Corporate behaviour	Business ethics Anti-competitive practices Tax transparency	Corruption and instability Financial system instability

4. MSCI SRI Ratings Methodology, April 2018.



They'll perform both quantitative and qualitative analysis to determine whether a company meets the ESG thresholds they prefer.

Section 2

How it works

There are three main sustainable investment strategies: passive, integration and active. This section explains how the different approaches work.

Just as everyone's values differ, so too do the way investment managers approach sustainable investing. Investment managers can use one of the following three strategies to guide their investment choices: a passive, integration or active approach.

Figure 4: The sustainable investment continuum: from doing less harm, to doing more good

Passive approach	Integration approach	Impact approach
Use shareholder power to affect positive change	Choose companies with higher ratings and reweight portfolio	Put sustainable investing impact above financial returns
< Doing less harm		**Doing more good >**

1: Passive approach

A passive approach considers how a company's sustainable investment performance affects the company's value, risk profile and financial returns. Investment managers take sustainable investing into account, but only as a secondary factor.

Institutional investors, like super funds or large fund managers, may also use their shareholder power to prompt positive changes in a company – for example, to divest from fossil fuels, commit to improving workers' conditions, or disclose the risks that climate change has on their business.

While this action can help improve a company's social, environmental or governance profile, it's main aim is to improve its financial returns, or to reduce risks that could impact its share price.

A passive approach usually has minimal impacts – either positive or negative – on a portfolio's returns. However, it's also relatively ineffective in creating significant social or environmental change.

2: Integration approach

The integration approach treats a company's sustainable profile and its potential for financial returns as equally important. The investment manager uses data from third-party research entities, like US financial company MSCI, to help inform their investment decision-making process.

Here's how it works: MSCI uses a rating system to measure companies, against their peers, based on how well they manage their exposure to ESG risks. The investment manager can then use these ratings to select investments, and then rebalance their portfolio, so it is weighted toward companies with higher sustainable investment scores.

An integration approach doesn't just screen out companies with poor ESG scores. It's also possible to use positive screens to identify companies making gains in the right direction. The best performers in a polluting industry may be those leading the transition to a greener future.

Screening examples: environmental, social

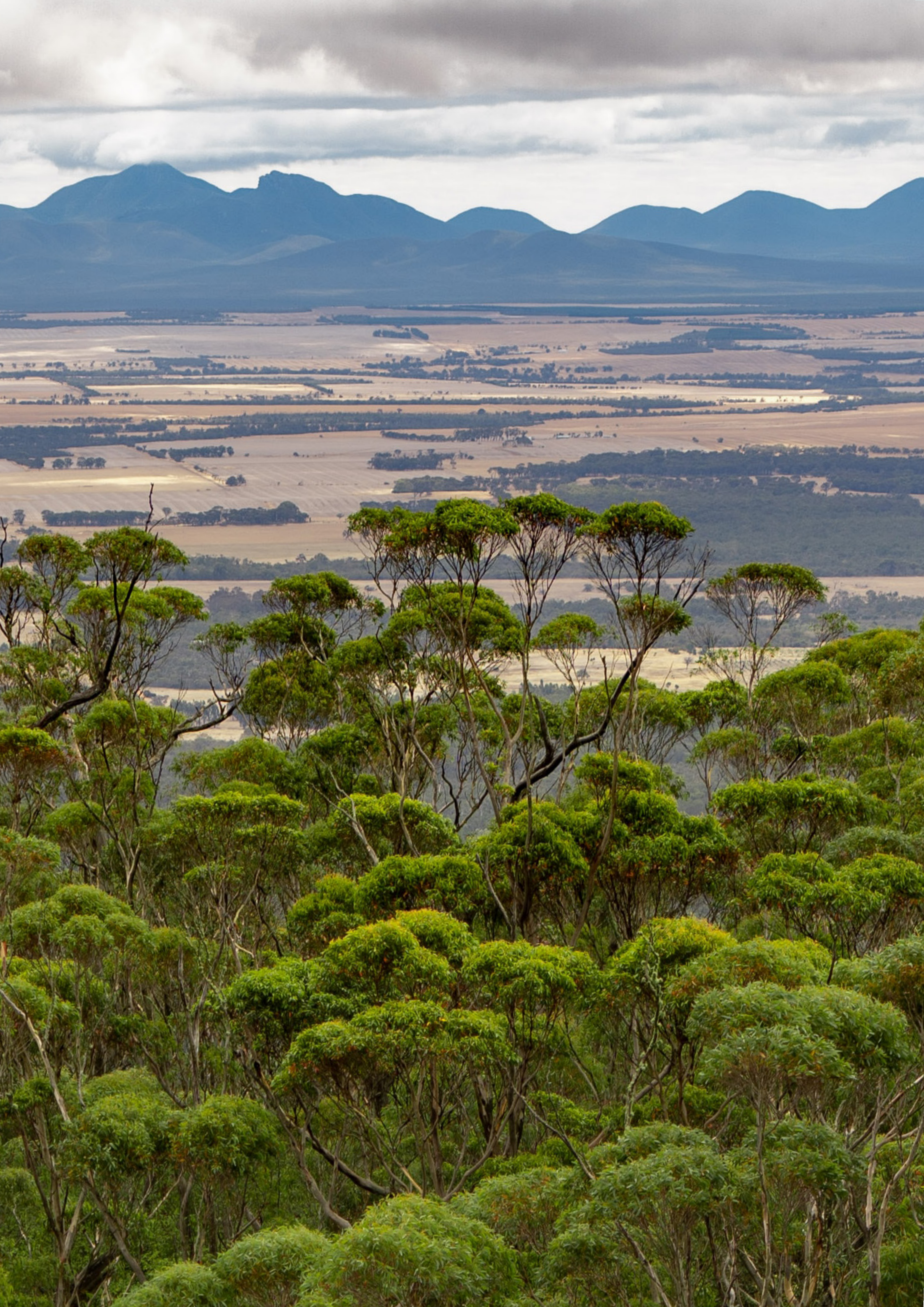
	Examples of excluded companies from the Dimensional Australian Sustainability Trust (ASUT)	Examples of excluded companies from the Dimensional Global Sustainability Trust (GSUT)
Environmental Fossil fuel emissions	BHP Group Limited, Woodside petroleum	Exxon Mobil Corporation, BP PLC, Chevron Group
Fossil fuel reserves/ coal reserves	BHP Group Limited, South32 Limited	Berkshire Hathaway Inc, American Electric Power, BHP Group Plc
Social Child labour/ controversial sourcing	n/a	Nestle SA, Philip Morris International, British American Tobacco
Weapons	n/a	Vista Outdoor Inc

3: Impact approach

With an impact approach, the investment manager places a company's sustainable impact above its financial returns. The investment manager actively searches for investments that have a positive impact on the environment and society, like renewable energy or social enterprises – and screens out those with negative impacts, like tobacco or weapons.

Because this approach places less emphasis on maximising profitability and returns, portfolios based on the active approach often have a higher level of volatility. However, they generally achieve more positive social and environmental impacts.

An integration approach doesn't just screen out companies with poor ESG scores. It's also possible to use positive screens to identify companies making gains in the right direction.



Section 3
Sustainable investing risks and returns

As with all investments, it's essential to understand the risks and potential returns and make sure they match your investment goals.

What are the risks?

All investments involve risk. Economic cycles and external social, political and legal factors can impact an investment, as can a company's internal business environment.

An investment's growth and earnings may not keep up with inflation, while changing exchange rates can also impact a company's profits. Taking a specific investment approach, including a sustainable one, can also create its own set of risks.

Sustainable investing and diversification risk

Many sustainable investing investors use a negative screening method to screen out companies that don't meet their ESG standards. But by excluding or underweighting companies, they reduce the investable universe. This may eliminate some highly profitable companies from their portfolios – as well as the diversification benefits that they could provide during times of market turbulence.

However, research has also shown screening out companies with high ESG risks may provide more favourable returns over time.[5] That's because companies with poor environmental, social or governance practices face significant risks in the long-term, which can impact them financially.

For example, as the world inevitably shifts to renewable energy, a coal mining company's share price could be severely impacted if it is left with fossil fuel assets that have lost their value.

How sustainable investing can reduce risk

Investing using sustainable principles may help guard investors against a range of risks, including:

Reputational risk:	Negative practices or incidents, like child labour or an oil spill, could result in media or public action against a company. This could damage its reputation and lead to reduced sales and management issues.	**Legal risk:**	This is the risk of litigation if a company's products or services demonstrate an accidental or wilful failure in their duty of care, resulting in legal action by victims, and significant financial and reputational damage. Well-known examples include legal action against asbestos and tobacco companies.
Regulatory risk:	Changes or pending changes in regulation, such as laws to restrain coal seam gas exploration, can increase costs, reduce revenue and lead to financial loss and reputational damage if the company faces legal challenges.	**Competitor risk:**	Failing to recognise or act on changing consumer demands related to sustainable trends, such as more fuel-efficient vehicles, can result in reduced competitive advantage.

5. Robert G Eccles, Ioannis Ioannou and George Serfeim, *The Impact of a Corporate Culture of Sustainability of Corporate Behaviour and Performance*, 2011.

Sustainable investing and fees

Historically, SRI investments have been more expensive than conventional investing, as it used to require more complex operational and managerial processes to examine and screen investments. Now, due to the high demand and advancements in technology, you don't need to pay a premium to access an SRI fund. For example, Dimensional Fund Advisor's SRI offerings, although historically more expensive, now charge the same fees as their equivalent mainstream funds.

Generally, the most expensive SRI funds are those that are actively managed. These fund's costs can range between 0.588% and 1.99% per annum. Investors can gain exposure to SRI investing more cost-effectively through investing in ETFs, index funds and asset-class funds. For example, Dimensional Fund Advisors offers both mainstream and SRI funds, with the management fee for their Australian Sustainability Trust at 0.28% - a $280 fee for a $100,000 investment. This compares favourably with the management fee of the Australian Ethical's Australian share fund. At 1.1%[6] – that's $1,100 on a $100,000 investment.

Investors can gain exposure to sustainable investing more cost-effectively through investing in ETFs, index funds and asset-class funds.

6. Fee charged as at March 2024 and subject to change.

How do sustainable investments perform?

As we've seen, there are conflicting theories about the impact that sustainable investment principles have on a portfolio's expected returns. However, a comparison of sustainable investments with mainstream investments reveals that both approaches generally follow the same market trend over time.

Figure 6 compares the performances of sustainable investments and traditional Australian Equity, International Equities and Managed Growth Funds over one, three and five year periods as of 31 December 2022.[7]

Figure 6: Performance of sustainable investments against mainstream funds as at 31 December 2022.

Managed growth funds	**1 Year**	**3 Years**	**5 Years**
Average SRI fund: Managed Growth	-10.55%	4.25%	8.72%
Average managed growth fund	-8.19%	3.08%	5.32%

International share funds	**1 Year**	**3 Years**	**5 Years**
Average SRI fund: Overseas Equity	-17.22%	3.73%	7.52%
Average international share fund	-13.17%	3.19%	6.15%

Australian share funds	**1 Year**	**3 Years**	**5 Years**
Average SRI fund: Domestic Equity	-8.99%	5.95%	7.12%
Average Australian share fund	-5.82%	4.64%	6.05%

7. RIAA, Responsible Investment Benchmark Report 2023 Australia.

Capital Partners favours an integration approach to sustainable investing that allows us to combine our proven investment philosophy with ESG principles. This offers investors a broader range of investment opportunities – and is more cost-effective when compared with the active approach.

Section 4

Capital Partners' sustainable investing approach

At Capital Partners, we actively participate in the sustainable investing conversation.

That's because sustainability aligns with our core principles – acting in our client's best interests, investing to a fiduciary standard, and taking a long-term, sustainable approach to investing. We see no conflict between promoting investment practices that impact positively on the future of our community, country and planet and a sound investment philosophy.

We support our clients who choose to invest in a way that aligns with their social and environmental values. Our experience tells us that investors don't need to sacrifice their values for good returns.

Our philosophy

We base all our investment decisions on an evidence-based philosophy that shows:

- markets are an efficient way to allocate capital
- taking a broadly diversified approach is a better approach than picking sectors, stocks and funds in the hope of outperforming the market
- certain share market dimensions – company profitability, company size and relative price – can be systematically exploited to provide the investor with a higher expected return.

We then overlay this philosophy with an assessment of each investment's performance in common ESG dimensions. These could include:

- environmental considerations such as a company's carbon footprint, impact on biodiversity, water and land use and opportunities in renewable energy, green building and clean tech
- social considerations like labour management and health and safety record, product quality and safety, or opportunities in health, nutrition education and housing
- governance issues including corporate governance, board composition and remuneration, accounting standards, and any record of corruption or anti-competitive tactics.

We take an integration approach to sustainable investing

Capital Partners favours an integration approach to sustainable investing that allows us to combine our proven investment philosophy with ESG principles. This offers investors a broader range of investment opportunities – and is more cost-effective when compared with the active approach.

Capital Partners has chosen to partner with global leaders in sustainable investing whose investment beliefs align closely with our own. Our approach avoids a black and white approach where companies are either included or excluded – it's important to encourage companies to be part of the solution. This ensures better diversification, and the potential to invest in asset classes that traditionally offer higher than expected returns – like smaller companies and value investments.

Section 5

Deciding if sustainable investments are right for you

We believe every investor should be able to invest in a way that sits right with them. For many, this means investing in companies that practice social and corporate responsibility – contributing to the well-being of the society in which they operate, and on which they depend.

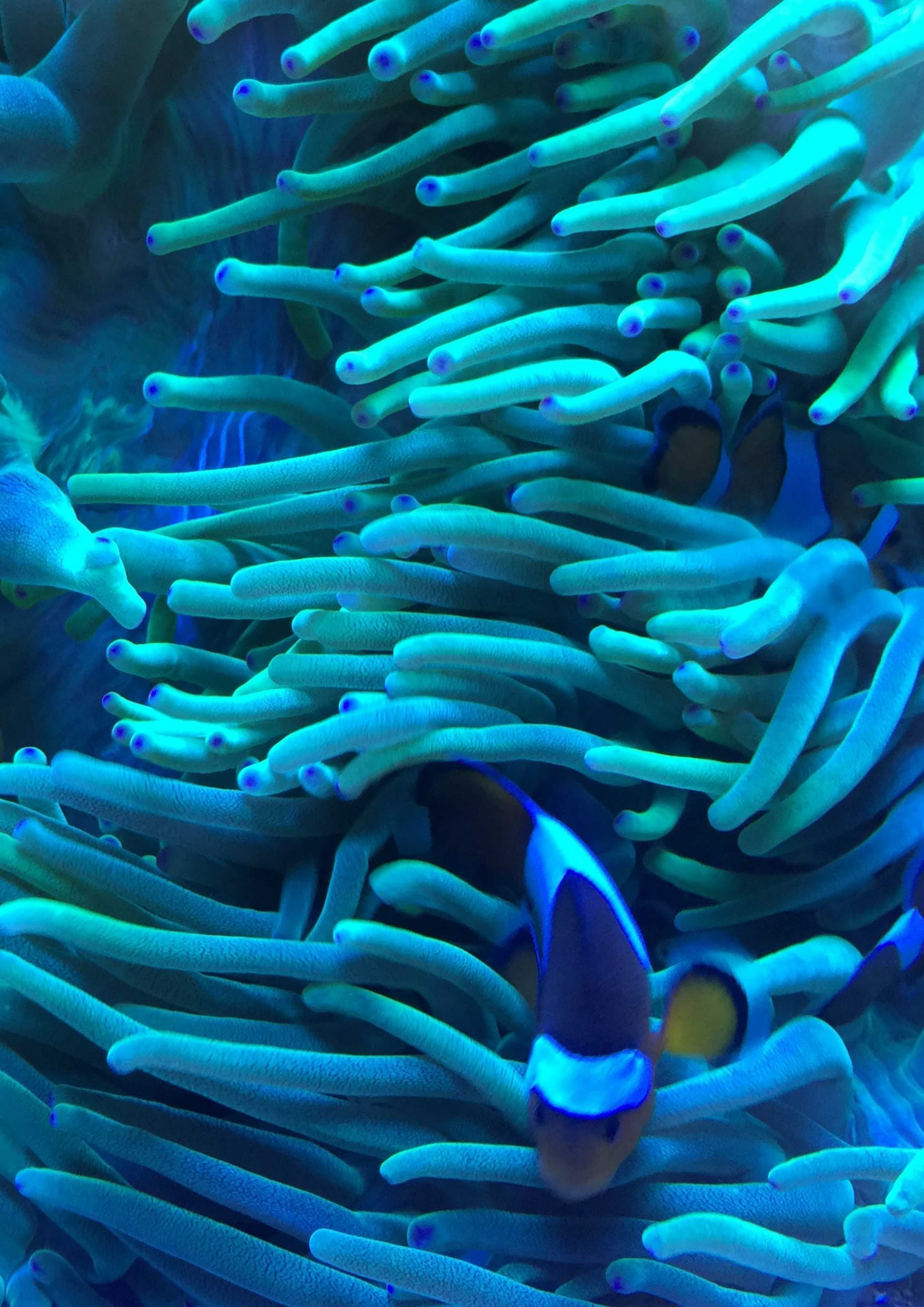
If you're interested in investing along sustainable investment principles, the key question is how to do this without compromising your desired investment outcomes. For example, how can you reduce your portfolio's carbon footprint while maintaining enough diversification to meet your investment objectives and avoid unnecessary risk?

As an evidence-based advisory firm with more than 20 years experience, we believe that an integrated approach to sustainable investing, which balances the need for investments with strong ESG performance and strong returns, is the best solution. If you're interested in a truly integrated approach, it's worth having a conversation with an experienced adviser rather than attempting to go it alone.

Talk to us

If you would like to find out more about sustainable investing, and whether it's right you, Capital Partners can help. Please get in touch on **+61 8 6163 6100**, email **communications@capital-partners.com.au** or visit our website **www.capital-partners.com.au.**

...we believe that an integrated approach to sustainable investing, which balances the need for investments with strong ESG performance and strong returns, is the best solution.



Capital
Partners

PRIVATE WEALTH
ADVISERS

22 Delhi Street
West Perth WA 6005

+61 8 6163 6100
capital-partners.com.au

© 2024 Capital Partners Consulting Pty Ltd AFSL 227148 trading as Capital Partners Private Wealth Advisers ABN 27 086 670 788.