InSight

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Responsible asset selection

Supporting responsible practices and contributing to a sustainable future

Environmental, Social and Governance (ESG) investing is a strategy that focuses on companies that prioritise environmental, social and governance factors in their operations. Investing in these businesses aims to support responsible practices and contribute to a sustainable future.

By focusing on companies with high ESG scores, investors can support sustainable and ethical businesses while enjoying the potential for superior financial performance.

HERE'S A BREAKDOWN OF THE THREE ESG CRITERIA:

Environmental: This criterion evaluates a company's impact on the environment. Factors such as energy use, sustainability policies, carbon emissions and resource conservation are considered when assessing a company's environmental performance. Companies with strong environmental practices often have lower environmental risks and demonstrate a commitment to reducing their ecological footprint.

Social: The social aspect of ESG investing examines how a company treats its employees and interacts with the communities in which it operates. Businesses prioritising employee welfare, workplace safety and community engagement are more likely to have a positive social impact and maintain a good reputation. Supporting companies with strong social values can promote fair labour practices and foster a more inclusive society.

Governance: Governance factors relate to a company's leadership, management and overall corporate structure. Key considerations include executive compensation, audit processes, internal controls, board independence, shareholder rights and transparency. Companies with robust governance structures are more likely to be accountable, trustworthy and better prepared to manage potential risks.

By considering ESG factors in investment decisions, investors can support companies that demonstrate a commitment to sustainability, ethical practices and strong governance. This approach aligns investments with personal values and can lead to long-term financial benefits, as ESG-focused companies are often better equipped to navigate evolving regulations, mitigate risks and capitalise on emerging opportunities.

FOCUSED ON SUSTAINABILITY, ETHICAL PRACTICES AND STRONG GOVERNANCE

ESG factors are increasingly essential for investors when evaluating companies and making investment decisions. Investing in high-scoring ESG companies allows for responsible and ethical investments without sacrificing returns. Numerous studies have shown that companies with strong ESG performance tend to outperform their counterparts with lower ESG standards.

High ESG scores indicate that a company is focused on sustainability, ethical practices and strong governance, which can lead to long-term success and reduced risk exposure. These companies are more likely to be resilient in market fluctuations and other challenges.

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On the other hand, businesses with low ESG standards have often faced consequences like declining share prices and reputational damage. Examples of such companies include those causing significant environmental harm, engaging in unethical practices or attempting to cheat regulatory systems. These events can lead to financial losses for investors who hold shares in these companies.

CHALLENGES OF ESG INVESTING: GREENWASHING AND SUBJECTIVITY

ESG investing has gained significant traction recently as investors increasingly seek to align their portfolios with ethical values. However, the varying interpretations of ESG categories and the rise of 'greenwashing' can make it challenging for investors with specific ethical requirements to navigate this space.

SUBJECTIVE NATURE OF ESG

One of the main challenges of ESG investing is the subjectivity in evaluating companies based on their environmental, social and governance policies. What is considered a responsible investment for one person could be viewed as unethical by another. For instance, a sugary drinks manufacturer may have an excellent recycling policy, earning them high marks in the 'E' category. However, some investors might argue that sugary drinks are detrimental to society, making the company an unsuitable investment choice.

This subjectivity makes it difficult for investors to find a universally agreed-upon standard for determining whether a company or fund meets their ethical criteria.

THREAT OF GREENWASHING

Another challenge facing ESG investors is the phenomenon of 'greenwashing,' where companies or funds market themselves as environmentally friendly or socially responsible when, in reality, they do not meet these standards. This deceptive practice can lead to investors unwittingly supporting businesses that do not align with their values.

To combat greenwashing, investors must conduct thorough due diligence on the companies and funds they are considering. This may involve reviewing third-party ESG ratings, examining a company's sustainability reports and scrutinising the portfolio holdings of ESG-focused funds.

NAVIGATING ESG INVESTING CHALLENGES

Despite the challenges posed by subjectivity and greenwashing, ESG investing remains an essential tool for those who wish to align their financial goals with their ethical values.

TO SUCCESSFULLY NAVIGATE THESE OBSTACLES, INVESTORS SHOULD:

- Clearly define their values and priorities when it comes to ESG issues.
- Conduct thorough research on companies and funds, utilising third-party ESG ratings and other available resources.
- Be cautious of companies or funds that make bold sustainability claims without providing concrete evidence to back them up.
- Diversify their investments across ESG-focused companies and funds to mitigate the risk of inadvertently supporting unethical businesses.

By taking these steps, investors can better ensure that their investment choices align with their ethical values and contribute to a more sustainable and socially responsible future. ■

TIME TO BUILD A MORE ETHICAL PORTFOLIO?

As awareness and interest in ESG factors continue to grow, the trend towards responsible investing will only strengthen. Starting a portfolio and filling it with environmentally, socially and governance-minded investments doesn't need to be difficult. To find out more, speak to us today.