TRAILS ethical

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The world is changing

The Coronavirus pandemic from early 2020 has had a considerable impact on us all, on the high street, the economy, the stock market, our NHS, and on our environment.

Rather than dwell on the negative outcomes of COVID-19, let us focus on some of the positives. It has changed our routines, the way we live and work, but more importantly, there has been a significant and positive impact on the environment. The drop in pollution and carbon emissions has been sizeable since the lockdown began.

It would be great if the trend continued and if this was in fact a turning point in how we all lived and how our lives impacted the health of the planet?

Less travel + reduced use of fossil fuels

=

less pollution + reduced carbon footprint.

We all need to start thinking about our impact on the environment, individually and as a society. We must encourage companies (and governments) to be more thoughtful, more responsible, and to operate in a more sustainable way to achieve positive change. You can contribute to this through the way you invest some or all of your money.

A rising trend:

The world's population is growing at a rate of 1.05% per annum, equivalent to 81 million people per year with a current total of over £7.926 billion.[1] Media attention has been on climate change and plastic pollution for years now. It is impossible to ignore the impact we are having on our planet. If you are someone who wants to make a positive difference, you can play your small part by investing some or all of your monies in a sustainable way via our TRAILS™ Ethical model portfolios.

What is ethical investing?

Ethical investing refers to the practice of using one's ethical and moral principles as the primary filter for the selection of securities. In essence it means supporting companies (via the funds in which you invest) that benefit the community, the environment and society and avoiding those whose products and services (or business practices) many find morally objectionable, such as tobacco, animal testing, gambling, etc. It also refers to a method of investing whereby the underlying mandate of the investment firm might be to reduce greenhouse gas emissions (e.g. Dimensional) or to engage with the main companies within the fund, on material ESG issues in the belief that they can impact long-term value creation (Vanguard).

Ethical investing has many other terms and acronyms:

- SRI - Socially Responsible Investing
- Sustainable Investing
- Socially Conscious Investing
- ESG - Environmental, Social and Governance Investing
- Social Impact Investing
- Eco-Investing or Green Investing

Although these terms are often used interchangeably, some have slightly different definitions.

Ethical investing is more traditionally known as ***'SRI' (Socially Responsible Investing).*** In general, SRI investors encourage corporate practices that are morally grounded and promote environmental stewardship, consumer protection, social justice, human rights, and racial or gender diversity. They also seek out companies that invest in alternative energy/clean technology efforts.

Sustainable investing directs investment capital to companies that seek to combat climate change, environmental destruction, while promoting corporate responsibility.

'***ESG' (Environmental, Social and Governance)*** investing is the integration of environmental, social and governance factors into the fundamental investment process. It refers to the principles that sustainable investing funds look to comply with. ESG is a recognised way of measuring the sustainability of companies from not just one ethical perspective, but three: environmental, social and governance.

1. https://www.worldometers.info/world-population/

Impact Investing is a subset of SRI, devoted to the conscious creation of social impact through investment. Managers will actively select companies whose positive impact on the world can be measured. This can be anything from generating a specific amount of recycling, to saving a certain amount of water.

ECO-Investing/ Green Investing: is a form of socially responsible investing where investments are made in companies that support or provide environmentally friendly products. Green investing focuses on companies or projects committed to the conservation of natural resources, the production and discovery of alternative energy sources, the implementation of clean air and water projects. These companies encourage (and often profit from) new technologies that support the transition from carbon dependence to more sustainable alternatives. Green investments may fit under the umbrella of SRI, but they are fundamentally much more specific.

ESG Ratings:

ESG Ratings or scoring, include various factors that a fund manager will assess when determining whether to invest in a certain company. ESG scoring can work out how big a part environmental, social and governance principles will play in a company's long-term performance.

ESG investing doesn't mean you have to sacrifice your financial returns. It can literally pay to have principles! You could say it is helping to future-proof your investment.

So what issues are included in ESG and are they the things that matter to you? To the left is an example of some of the things that are considered.

Negative and Positive Screening:

Many ethical fund managers employ either negative screening, positive screening or both, when selecting securities (e.g. stocks, bonds or options) to invest in within their fund. Each mutual fund, (OEIC or Unit Trust), tends to create its own inclusion or exclusion criteria concerning a whole list of considerations.

Negative screening means excluding the types of businesses or industries that do not comply with specific pre-set social or environmental criteria, companies that are morally unsuitable. This could include arms manufacturers, alcohol and tobacco companies and known environmental polluters. It could also include a company with known poor working practices and substandard corporate governance.

Positive screening finds good reasons to invest. There are businesses out there that do some good in the world, such as creating renewable energy, helping to look after our health, adopting sustainable environmental principles or just being exemplary employers. Companies meeting any of a range of positive criteria might be selected for investment.

TRAILS ethical Funds and Model Portfolios:

We have put together 7 risk-rated model portfolios that comprise a maximum of 10 'ethical' funds. These models all conform to the traditional TRAILS portfolio principles - adopting the same asset allocations, global diversification as per the market cap, the same expected risk: reward principles, and offer tilts to small cap and value stocks, but instead the models have been predominantly configured out of high quality (largely low-cost) funds that adopt SRI measures.

Methodology:

The first stage of the portfolio construction process involved a manual search of FE Analytics' fund universe, both domestically and foreign domiciled. This was to identify funds of an ethical/ sustainable/ green nature using key words related to sustainability etc. This process resulted in a short list of c. 300 funds.

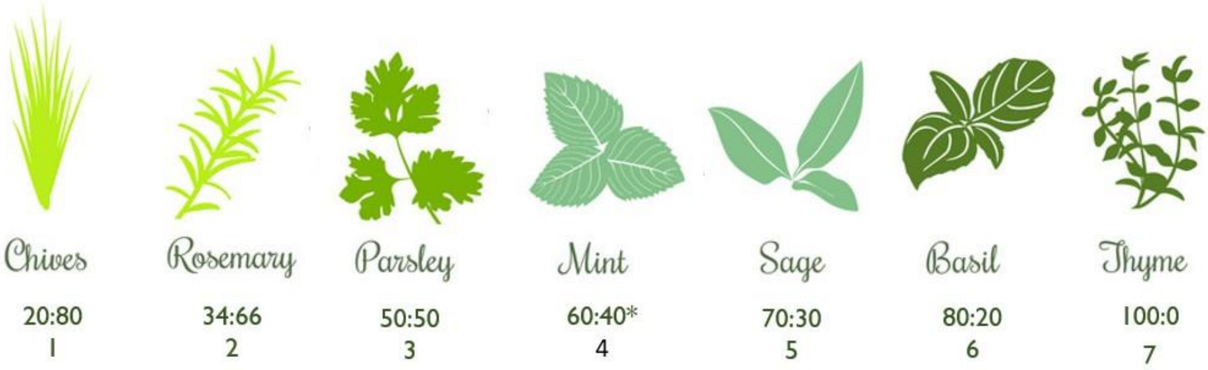
The shortlist was then ranked on a number of quantitative performance-based metrics: return relative to other funds with a similar risk profile within the sample, a maximum loss/ drawdown metric relative to other funds with a similar risk profile within the sample and on cost.

The highest-ranking funds were then judged based on their SRI policies and active screening of equity and fixed income securities based on corporates' adherence to certain SRI standards. Funds that did not actively screen for and/or exclude inappropriate corporates were excluded from our selection process.

Seven New Ethical Model Portfolios:

There are 7 risk-rated TRAILS™ Ethical model portfolios, numbered 1 to 7. They each include a risk profile name from 20:80 (Equities:Bonds) to 100:0 (Equities:Bonds).

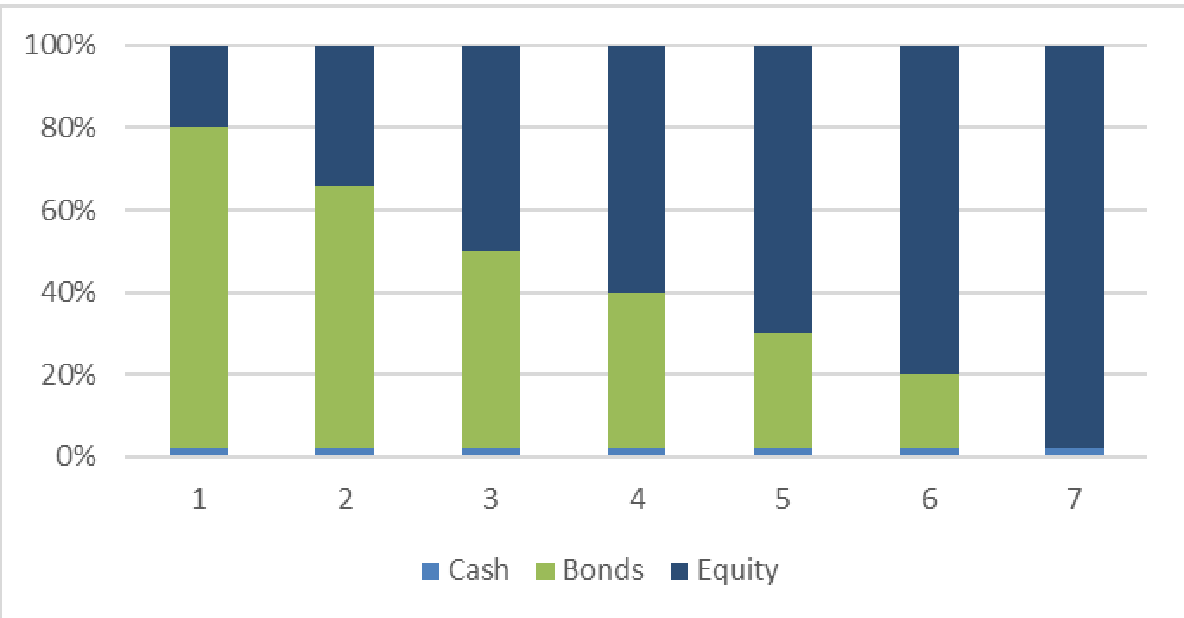
Each risk-rated model portfolio is named after a herb and they all happen to be 'green!'



*Equity: Bond ratio

Asset allocation:

All portfolios comprise a core asset allocation of Cash, Bonds, Equities and Property as per the table below. All funds chosen at the point of writing, are open-ended collectives (Unit Trusts or OEICs). There is a wide spread of investment houses within each portfolio. There are between 4 and 7 funds in each model portfolio and in turn, this totals between 10,626 and 16,800 stock and bond holdings.



Key Criteria for fund inclusion within TRAILS™ Ethical

a. Must be available on Transact, Fidelity and Nucleus in GIA, ISA, Pension and Bond (onshore and offshore)
b. Must be an Open-Ended Collective (Unit Trust or OIEC). No ETFs due to issues with regular premiums.
c. Must be relatively low cost (or rather cost-efficient). No initial fees or exit fees and competitive OCF (Ongoing Charges Figure).
d. Must be in GBPs and ideally Accumulation version of the fund.
e. Must tick the box for a type of ethical fund: SRI, ESG, Sustainable, Green etc.
f. The fund should have some history to it. No funds that are newer than 2 years old in general. We could overturn this with exception if nothing else is available.
g. Morningstar Sustainability Score[1] should be above 50% (if rated).

Who are TRAILS™ Ethical Models suitable for?

The aim of the TRAILS™ Ethical investment model portfolios is to generate growth over the longer term, while aiming to avoid investments in harmful activities, such as alcohol, tobacco, oil, gambling, weapons and other such industries that one might find morally questionable.

TRAILS™ Ethical gives you the opportunity to invest some or all of your money into a well-diversified portfolio of funds that adhere to higher social and moral values, whilst still giving you the opportunity for long term growth.

Costs/ Charges

The majority of ethical funds available have until recently, been actively managed. However, there are now numerous index and passive or non-predictive funds that fulfil our criteria as set out above. Most ethical funds are very specialised and employ specific criteria to select securities for the fund. Some are prohibitively expensive; however, we have managed to reduce those costs considerably by utilising certain index and passive funds within our models. For more information on fund and portfolio costs, speak to your adviser at Tandem Financial Ltd.

Risk to investing in an Ethical Portfolio:

In offering an 'ethical Fund', the fund managers must actively 'screen' the stocks that they include or exclude. This can narrow the number of viable securities the manager has available to them compared to a mainstream fund or to an index fund. Therefore, overall diversification may be more limited globally and this can affect performance. Ethical funds can be more volatile as a result.

[1] https://www.morningstar.co.uk/uk/news/148119/the-morningstar-sustainability-rating.aspx

Disclaimer:

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If you have any questions related to your investments or the suitability or appropriateness for you of anything described in this document, please contact your adviser at Tandem Financial Ltd.

Past performance is not necessarily a guide to future performance. Changes in exchange rates may also cause an investment to fluctuate in value. Levels of taxations depend on an investor's individual circumstances and the value of any applicable tax reliefs.

The value of investments and the income arising from them, can go down as well as up, and are not guaranteed, which means that an investor may get back less than they invested.

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