ESG

What is it?

betafolio
by timeline

Put simply ESG investing means taking Environmental, Social and Governance factors into account when making investment decisions.

This approach has seen rapid popularity growth in recent years as regulators focus on sustainability and consumers demand responsible behaviour from corporations.

Global ESG assets are on track to exceed $53 trillion by 2025, representing more than a third of total assets under management, according to McKinsey and the Global Sustainable Investment Alliance.

So what are the factors?

The considerations widely accepted by financial services are laid out by the CFA Institute as:

Environmental

Conservation of the natural world

- Climate change and carbon emissions
- Air and water pollution
- Biodiversity
- Deforestation
- Energy efficiency
- Waste management
- Water scarcity

Social

Consideration of people & relationships

- Customer satisfaction
- Data protection and privacy
- Gender and diversity
- Employee engagement
- Community relations
- Human rights
- Labour standards

Governance

Standards for running a company

- Board composition
- Audit committee structure
- Bribery and corruption
- Executive compensation
- Lobbying
- Political contributions
- Whistleblower schemes

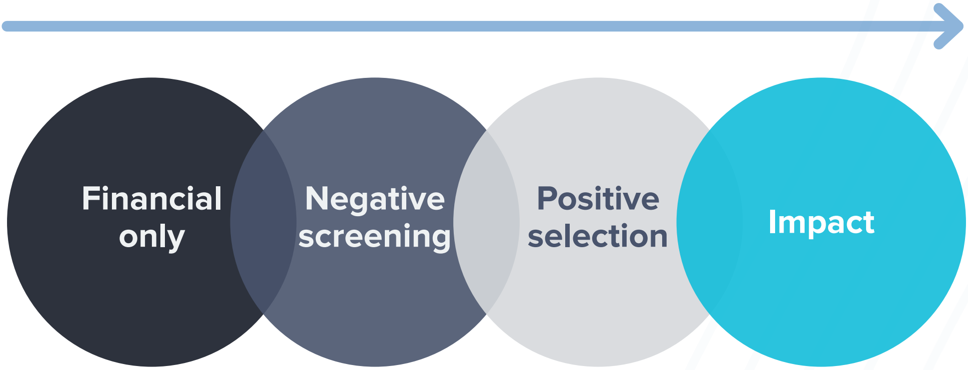
Source: https://www.cfainstitute.org/en/research/esg-investing

But this is far from a list of rules to abide by, there is a huge amount of subjectivity in defining what qualifies as an ESG investment, and what satisfies one investor will not quell the conscience of the next.

BP is an oft quoted example, long-standing fossil fuel company, but spending an estimated $60b in renewables over the next decade – ESG stock or not? You decide.

In reality, approaches to ESG investing present a continuum, rather than a clear cut “in or out” process.

We see it like this...



Financial only	Negative screening	Positive selection	Impact
No consideration given to ESG factors when selecting investments. But note, that with this “whole of market” approach, many holdings are likely to be those that would otherwise qualify as ESG. There is a valid argument, that when investing in the whole market, the “winners” are those embracing sustainability.	Companies which breach pre-determined ESG standards are removed from the opportunity set and will not be considered for investment.	Companies which show sustainability initiatives are favoured and held at higher weightings.	Only companies whose activities have proven positive impact on social, environmental or governance areas qualify for investment. There may be little, no, or negative potential financial return.

There are investment strategies available to UK investors at each point along this spectrum, but there are clearly other consequences that financial planners must take into account when assessing the right approach for individual clients.

Cost is, as ever, among the most important. Our market survey found the average AMC for an ESG Model Portfolio Service came in at 0.4%, with underlying fund charges (OCF) of 0.7%.

When a market portfolio can be achieved for around 0.25% all in, that creates a difference of £13k on a starting value of £100k over 10 years in a 50:50 equity: bond portfolio, median return scenario*.

Might an investor feel they could make more impact by using the market strategy and donating £13k to the charities of their choice?

It's certainly crucial to make sure additional costs incurred to serve ESG preferences are justified to meet the investor's goals.

**Timeline*

Betafolio's pragmatic approach to ESG

Our investment process is guided by a hundred years of empirical data, decades of academic research by renowned economists and the practices of leading institutional investors.

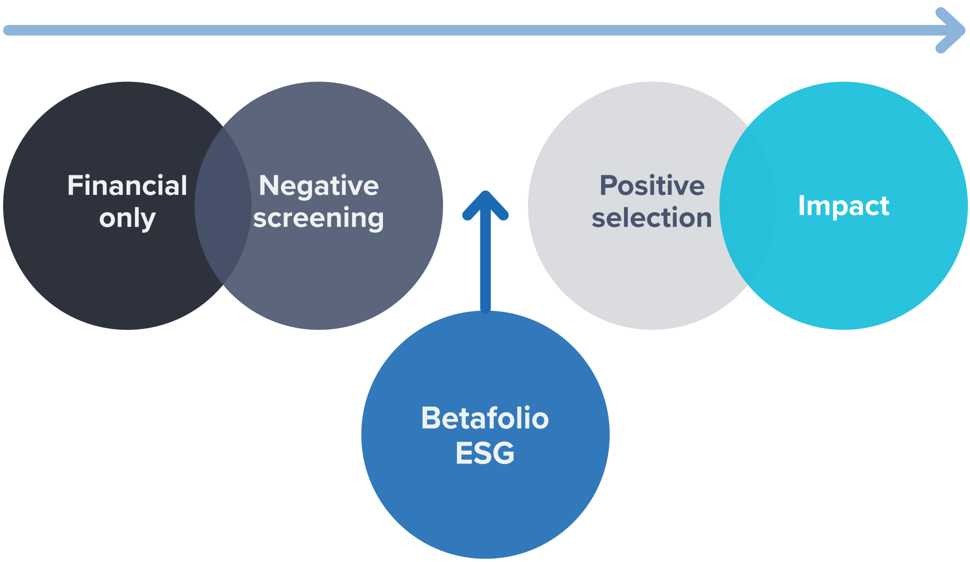
The Betafolio ESG Model range adheres to our core investing principles, which are:

- **Diversification is essential**
- **Asset allocation and portfolio structure drive returns**
- **Costs matter**
- **Capital markets work**
- **Risk and return are related**
- **Consistent outperformance is rare**
- **Investor behaviour is a key determinant of long-term outcomes**

Betafolio ESG strategies place greater emphasis on companies that are adhering to higher sustainability standards while maintaining our low cost, buy-and-hold and globally diversified approach, that has been demonstrated to serve investors well over the long term.

Betafolio ESG aims to allocate more to companies that adhere to ESG principles and less to those that don't. We don't necessarily exclude these companies completely.

Our portfolio range includes a number of ESG funds that satisfy our requirement for rigorous investment processes achieving ESG credentials, reasonable costs and strong diversification, both across the same fixed income and equity portfolios.



Is ESG a factor?
How does it link itself with other factors?

Considering ESG as a factor on its own, could be debatable. But stating that the sustainability profile of a company has an impact on its returns is reasonable.

The sustainability profile could be a measure of better governance or less carbon impact. The lower carbon footprint could in turn be linked to reduced carbon taxation and then a positive impact on profits.

To put it in meaningful terms let's consider a company's value. A company's valuation is a function of the profitability it will generate in the future.

Increasing sustainability, could prove more expensive leading to reduced profitability in the short term.

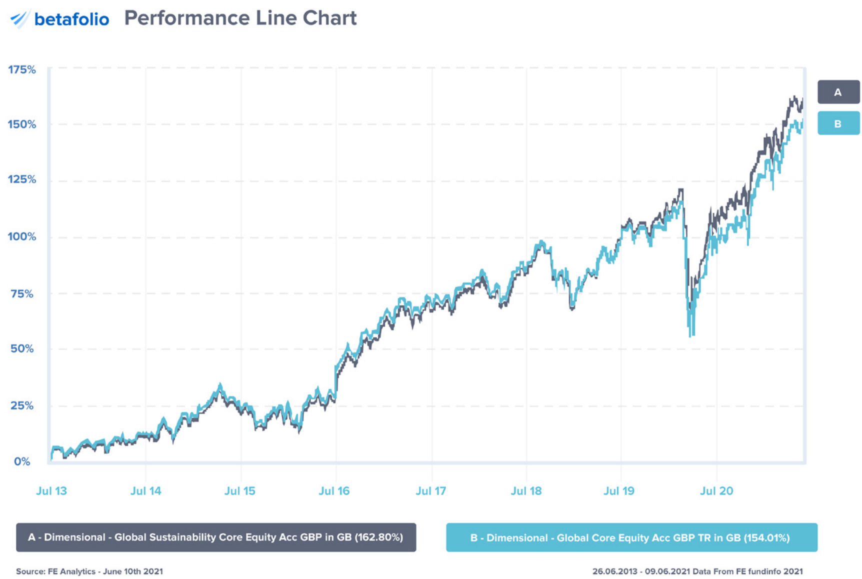
But when we consider the prolonged period the company is going to sustain; the cumulative profits outweigh that of a not so sustainable company.

Considering this, investors should be willing to hold the company longer and pay more for ownership. So, the ESG "factor" is intertwined with the value of the company and its profitability.

Outcome with and without ESG inclusion in factor investing

Experimental and research work along these lines has confirmed the same. Going with the ethos of our investing, keeping a tilt towards the value, size, and profitability factors, the returns with and without the inclusion of ESG were measured.

This performance chart shows these returns are nearly the same.



And in this case in fact, over the long run the Global Sustainability Core Equity fund started to outperform. So as ethical investors this is good news!

In a quest to incorporate sustainability factors the fundamental of maximising risk adjusted returns associated with value, relative size and profitability premium were not compromised.

Model stats

MODEL*	Betafolio ESG 0	Betafolio ESG 30	Betafolio ESG 50	Betafolio ESG 70	Betafolio ESG 100
Number of securities	16,000+	27,000+	27,000+	27,000+	10,000+
MPS charge	0.09%	0.09%	0.09%	0.09%	0.09%
OCF	0.20%	0.21%	0.21%	0.22%	0.23%
Transaction Cost	0.08%	0.08%	0.09%	0.09%	0.09%
Morningstar ESG rating					

Source: Betafolio (2021)

**Model allocations with 10%, 20%, 40%, 60%, 80% and 90% equity also available.*

5 Globes *(High)* | ***4 Globes*** *(Above Average)* | ***3 Globes*** *(Average)* | ***2 Globes*** *(Below Average)* | ***1 Globe*** *(Low)*

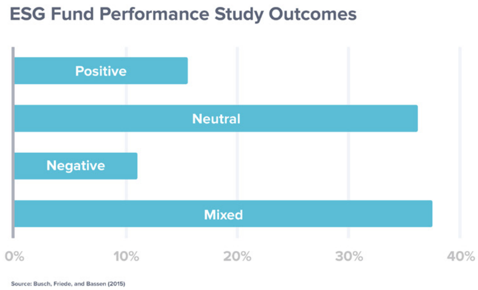
Morningstar Sustainability Rating - *Morningstar assigns Sustainability Ratings by ranking all scored funds within a Morningstar Global Category by their Historical Sustainability Scores. The ranked funds are then divided into five groups, based on a normal distribution, and each receives a rating from "High" to "Low." Although a higher rating is better than a lower one, please note that due to the risk component of the scores, lower scores are better (and lead to higher ratings) than higher scores and indicate that a fund is, on average, invested in fewer companies with a high ESG risk under Sustainalytics' ESG Risk methodology, and therefore exposed to less risk driven by E, S or G factors. When ranked by percentile rankings, the top 10% ranked investments have a rating of "High", which can also be depicted as 5 globes. The next 22.5% have a rating of "Above Average"and can be depicted as 4 globes. The subsequent 35% ranked investment have an "Average" rating, depicted as 3 globes, followed by the next 22.5% having a "Below Average" rating, depicted as 2 globes. The lowest ten percent ranked investments have a "Low" rating, and can also be depicted as 1 globe.*

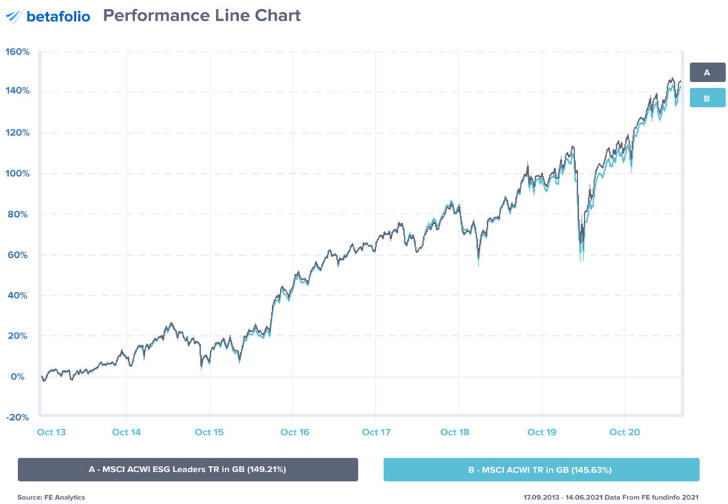
FAQs

Do ESG preferences reduce investment returns?

Academic research shows that investing responsibly does not negatively impact returns. Busch, Friede, and Bassen's (2015) meta-analysis of over 2,200 empirical studies examined the link between ESG investing and financial performance.

It found that in approximately 90% of the studies, investing for ESG criteria did not negatively impact results.





A simple performance comparison of the MSCI ACWI* and MSCI ACWI ESG Leaders* indices shows that performance is mirrored despite, in this instance, the meaningful reduction in the number of stocks included.

**MSCI ACWI is a global equity index including developed and emerging market companies at market capitalisation weights. The MSCI ACWI ESG Leaders index takes the same universe, excluding companies that do not meet MSCI's ESG criteria.*

As a broad principle, how do you expect ESG strategies to perform?

We design portfolios that capture capital market returns based on decades of empirical data and research by Nobel-Prize winning economists. We don't chase fads, engage in market-timing and other behaviours that damage returns.

The capital market itself is a natural ESG filter to a point, as institutions that are unethical don't tend to survive in the long run. This has been compounded in recent times with companies seeing their processes deeply scrutinised and firms are no longer capable of hiding bad practice. Evidence suggests the ESG range is set to perform at least in line with capital market expectations.

Does ESG investing mean less diversification?

Not for Betafolio ESG. Our models hold a minimum of 10,000 individual securities (the equity only model) and on average around 25,000 for multi-asset portfolios.

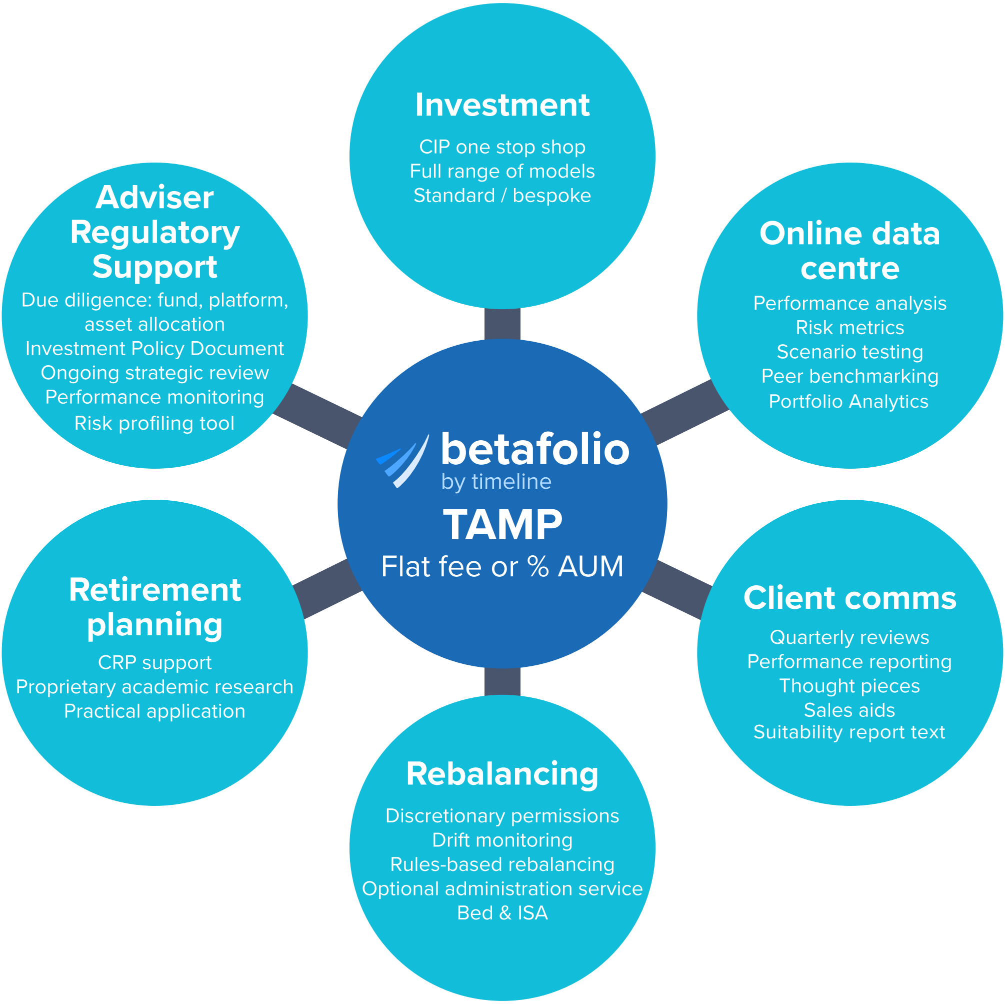
What screening process is used for ESG fund selection?

Fund screening starts with the entire market of retail investment products that have a sustainable or ethical focus, which includes OEICs/Unit trusts (onshore & offshore), Investment Trusts and ETFs.

Using FE Analytics, we apply a set of well-defined criteria to shortlist funds, this includes: investor protection, fund track record, fund charges, transparency, fund size, launch date, platform availability and investment focus. From the quantitative screen, we then take each individual fund and carry out in depth qualitative analysis.

What's the right approach to ESG?

There isn't one. Investors need to understand the trade-off between ESG criteria and other elements of investing, most notably cost.


Investment
CIP one stop shop
Full range of models
Standard / bespoke
Adviser Regulatory Support
Due diligence: fund, platform, asset allocation
Investment Policy Document
Ongoing strategic review
Performance monitoring
Risk profiling tool
Online data centre
Performance analysis
Risk metrics
Scenario testing
Peer benchmarking
Portfolio Analytics
betafolio
by timeline
TAMP
Flat fee or % AUM
Retirement planning
CRP support
Proprietary academic research
Practical application
Client comms
Quarterly reviews
Performance reporting
Thought pieces
Sales aids
Suitability report text
Rebalancing
Discretionary permissions
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Rules-based rebalancing
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Please contact support@betafolio.co.uk for further assistance.