



# Arrow

## Socially Responsible Portfolio

A Guide to Responsible Investment

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## OVERVIEW

Through a series of discussions with clients and prominent members of the wealth management industry, Arrow has identified a change in the mindset of investors. Clients are increasingly wanting and expecting to have their savings invested in line with their beliefs and morals. Ideally this involves an investment portfolio that causes no harm to the community and leaves the world a better place.

A socially responsible approach to investing drives positive environmental, social and corporate responsibility outcomes alongside financial results.

“Creating strong businesses and building a better world are not conflicting goals – they are both essential ingredients for long term success”.

*Bill Ford*



# RESPONSIBLE INVESTMENT

Responsible and Ethical Investment has grown rapidly within the investment landscape both globally and within Australia. The RIAA (Responsible Investment Association Australasia) suggests that as much as 12% of investible assets within Australia are now invested responsibly, as not only socially conscious individuals but professional investors identify the benefits of responsible investment.



Responsible investment is a broad term used to describe a wide range of investment ideologies that consider other factors in addition to financial performance.

Terms commonly used are ethical investing, impact investing, sustainable investing and socially responsible investing (SRI). While these terms will mean something slightly different to each investor and specialist asset manager, the core underlying framework is often very similar.

Within the investment universe an increasing number of responsible funds are becoming available to the retail investor. Arrow believes it is now possible to create a diversified investment portfolio that is not only socially responsible but is also aligned to our broader investment philosophy. In addition to a growing investment universe, it is now possible to invest thematically allowing access to portfolios that specifically target sustainable themes that are expected to be the backbone of our future global economy e.g. clean energy, sustainable farming.

In addition to the social benefits responsible investing can provide to investment portfolios, there is a large amount of research being completed delving into the performance advantages of responsible investing when compared to non responsible investing.

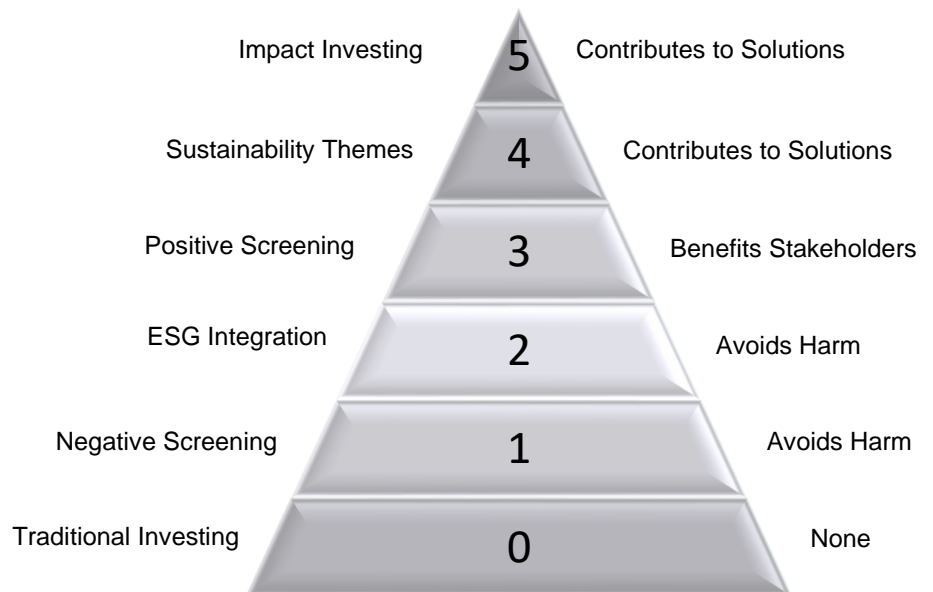


## RESPONSIBLE INVESTMENT

# FRAMEWORK

At Arrow we break the Responsible Investment Framework down to five levels: Negative Screening, ESG Integration, Positive or Best-In-Class Screening, Sustainability Themed Investment and Impact Investing. There is no one specific approach that is superior to others and we view it as critical to collect a diverse range of approaches from various specialist asset managers to align with a range of client beliefs and moral values.

# Impact Intention



## Negative Screening

A screening policy that systematically excludes industries, sectors, companies, regions, practices from a portfolio that are misaligned with the responsible investment goals. This approach is also referred to by some specialist asset managers as ethical screening.



## ESG Integration

This approach relies on the belief that a company's environmental, social and governance (ESG) policies can be a driver of investment value and risk. Therefore, a manager who wishes to integrate ESG into their portfolio will review a company's ESG policies in addition to traditional financial analysis.



## Positive/Best in Class Screening

Involves screening or ranking companies within a sector based upon their positive ESG or sustainability policies. This allows a specialist asset manager to identify companies that may have superior ESG performance.



### Sustainability Themed Investment

Involves investing in companies or assets that are within a sustainability theme. Typically, this involves investing in funds who pursue themes such as green technology, water technology, or clean energy and sustainable agriculture. Many of these themes in the future are predicted to become the backbone of our economy and investment in them contributes to solutions globally.



### Impact Investing

These are targeted investments that have the intention of addressing a specific environmental or social issue whilst also having the potential to create positive financial returns. Although difficult, specialist asset managers invest into companies, organisations and funds with the intention to generate social and environmental impact alongside financial return.



# WHY INVEST RESPONSIBLY?

Increasingly the feedback we hear most from investors is that they are wanting a portfolio for their savings or superannuation that is aligned with their personal, moral or organisational values. While this is no doubt vital in meeting objectives, there are many other benefits from responsible investing that can flow to investors.

Globally the world is faced with a wide array of sustainability issues ranging from pollution and global warming to water scarcity. To combat sustainable issues, a range of companies and projects have pursued funding from the broader public to get them off the ground, creating a range of sustainable investment themes. Investment within these themes continues to support these companies to achieve sustainable outcomes. Over time, as the globe develops a greater reliance on these technologies, it is expected that these companies will mature and grow. Many economists refer to these opportunities as the 21<sup>st</sup> century.

There are also a wide range of views that argue that responsible investment can provide a superior performance by incorporating the responsible investment framework into the investment decision making process. To date a number of responsible funds have outperformed their peers.

Reviewing the Environment, Social and Governance (ESG) factors of a company allows specialist asset managers to identify risks that may have otherwise been unidentified. Companies who underpay staff, breach human rights, rip off customers or pollute the environment are at substantial risk of causing significant damage to their share price and to your investment.

On the other hand, identifying strong governance frameworks can assist specialist asset managers in identifying those high quality, sustainable businesses that can last the distance. Good governance would suggest that a company is planning further into the future rather than scraping through to the next reporting season.

Growth within the sector is growing rapidly as a new generation of investors align their values and recognise the favourable risk adjusted returns. The responsible investment sector has grown significantly and as more and more investment professionals turn to responsible investment, a larger amount of research will be completed, resulting in a clearer picture for the sector.





# HOW ARROW INVESTS

The Arrow Socially Responsible Portfolio is managed by the Arrow Investment and Advisory Board (AIAB) in line with its charter and ethical criteria. The portfolio takes a multi-asset investment approach across a range of asset classes. The incorporation of fixed interest and alternatives into the portfolio is unique as most ethical approaches are very equity focused.



## Ethical Criteria

Given the broad and often conflicting range of views as to what constitutes an acceptable responsible investment approach, the Arrow ethical model uses a clear and precise filtering process that results in the exclusion of three factors: tobacco, controversial weapons manufacture and distribution and gambling.

We believe the exclusion of these three factors align with the views of the majority of our investors seeking a responsible element in their portfolio.

Our filters require that companies that have over 10% of their revenue generated by activities relating to the above will be excluded from the underlying portfolios. These filters are applied across all asset classes.

## Investment Selection Process

Arrow does not prescribe a specific policy or charter to be followed by the specialist asset managers it uses to select investments. However, the specialist asset manager's responsible investment policies are reviewed alongside other attributes including ideologies, strategies and performance to determine the sustainability of a manager for the Arrow Socially Responsible Portfolio.

Each investment manager is met with directly by a representative of the AIAB to gain a deeper understanding of their policies and procedures. Additionally, the AIAB reviews third party research on each Fund and completes additional in house qualitative and quantitative research. A decision is then made to include or exclude the Fund.

# KEY MANAGER QUALITIES

There is no one best approach a manager can take to apply responsible investment across their portfolio. Arrow seeks to construct a portfolio with a range of diversified approaches and strategies from specialist asset managers that can accommodate for our broader client based objectives.



1

## Transparency

Look through of investment holdings, ESG policies and decision making. For example, the Pengana WHEB Sustainable Impact Fund provides full portfolio holdings and Investment Committee meeting minutes on a quarterly basis.

2

## Sustainability

For instance, the Nanuk New World Fund invests across nine sustainability themes including energy efficiency, clean energy, industrial efficiency, water and pollution and food and agriculture.

3

## Stewardship

We want to see specialist asset managers who take a proactive approach in engaging with companies to achieve positive outcomes for all stakeholders.

4

## ESG Integration

Ensuring sustainability and ESG are built into the investment process rather than bolted on.

5

## Accountability

Look for accountability frameworks which are used to manage social and environmental risks.

# INVESTMENT THEMES

The Arrow Socially Responsible Portfolio seeks diversification and exposure to sustainability global and sub themes and trends that will be influencing and driving global economies and markets for the next 5-25 years. All portfolio themes have significant growth potential.



**Clean Energy**



**Environmental Services**



**Resource Efficiency**



**Water Management**



**Health & Well Being**



**Safety**



**Green Technology**



**Sustainable Agriculture**





## INVESTMENT RESPONSES

The following case studies demonstrate how investment within the Arrow Socially Responsible Portfolio is applied globally



### **Pengana WHEB Sustainable Impact Fund**

WHEB's team is regarded as a pioneer in the field of sustainability-themed investment and includes five investment professionals supported by an Investment Advisory Committee of six. The fund's investments are made in companies with at least 33% of their revenue or profits generated by activities in the following nine sustainability themes: Resource Efficiency, Water Management, Sustainable Transport, Education, Well-being, Health, Safety, Cleaner Energy and Environmental Services. Pengana and WHEB believe they are investing in the sixth industrial revolution – industrial transition to a low carbon and sustainable economy. Exposure to a theme we have liked for a long time.

Pengana considers potential negative impacts associated with their products and services as well as their operations. It only invests in companies where it is clear on the overall positive impact of the business. As a result, Pengana has never invested in any company with activities substantially related to the provision of alcoholic beverages, gambling products or services, intensive farming practices, nuclear power generation, pornographic materials, tobacco products or weapons.

Example of stocks across the sustainability themes are: (1) Nautilus (NYSE) which manufactures a variety of health and fitness products for use in gyms as well as in people's homes and (2) Kingspan Group (LON) which is a leading supplier of building insulation and materials that reduce energy consumption in residential and commercial buildings.



### **Australian Ethical Emerging Companies Fund**

Australian Ethical has always gone beyond ESG with its unique combination of ethical screening. Its Ethical Charter has both positive and negative screens, which means it doesn't simply avoid companies with a negative impact but will proactively seek out companies that do good.

Companies are selected for the benefits provided by their products and services and for the responsible management of their social and environmental impact. The approach gives investors a way to create wealth and have a positive impact on the world. Top ten holdings of the portfolio include Fisher & Paykel Healthcare, 3P Learning and Healius.

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