Socially responsible investment pushed beyond the fringe

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One of the paradoxes of the Crestone/CoreData 2019 State of Wealth Report is it finds little interest in ESG (environmental, social and governance)/SRI (socially responsible investment) considerations among Australian high-net-worth (HNW) and ultra-high-net-worth (UHNW) investors – with well over half of all HNW and UHNW individuals saying they do not deeply consider ESG issues in their investment decisions, and only one in six (17.6 per cent) actually holding such investments at present.

The report found HNW and UHNW investors view ESG considerations as a "nice to have" luxury, rather than a key consideration in investment decisions, but it concluded that this could change and see ESG factors move from the "nice-to-have" camp to the core of making investment decisions, with better understanding of the potential investment outcomes and associated costs.

Advisers who work with these groups do report burgeoning interest in ESG issues. "We've definitely seen increasing demand from our client base around responsible investing," says Andrew McAuley, chief investment officer at Credit Suisse Private Bank Australia.

"About one-third of our discretionary book has some form of socially responsible screening over it, but what has really accelerated in recent years is not only the demand for screening out the bad stuff – what is traditionally called SRI investing – but going further to encourage the good stuff, apply a positive screen, and further to actually invest in funds or companies or securities that can demonstrate an actual positive, proactive impact in either the E, the S or the G areas."

McAuley says ESG concern is growing surprisingly fast, and into new areas. "Obviously, climate change is a big driver, anti-fossil fuels, pro-renewable energy and plastics is the new hot area – we've had our first clients start to say, 'I don't want to invest in anyone involved in plastics'. ESG has come a long way from just screening out alcohol, tobacco and armaments."

The Crestone/CoreData 2019 State of Wealth Report found respondents were reluctant to – as they perceived – "pay more and/or sacrifice returns" for ESG/SRI investments, which were strongly seen as being "charitable causes" rather than worthwhile investment opportunities in their own right. But advisers sense this perception is changing.

Sustainability portfolios earning market returns – are you able to say that ESG principles can earn you a return premium?

"What we say, based on our comparative data at present, is that you can earn market returns by investing on ESG principles," McAuley says. "If you compare a traditional benchmark index and one that has a clear ESG overlay, you basically get returns that are very similar. Some of our research does point to the fact that in some markets, the governance factor can create a bit of outperformance – especially in emerging markets, having the focus on governance can actually add a bit extra," he adds.

"You don't surrender returns through investing on an ESG/SRI basis, you augment them," says Will Hamilton, CEO and managing partner of private wealth management firm Hamilton Wealth Management. "If you construct a portfolio on these principles, you are mitigating risk, and therefore, by mitigating risk, you should be enhancing returns.

"We believe that increasingly, a focus on ESG/SRI will be a key factor in picking up on, and minimising, financial risks to companies. That is the clear message coming out of Europe and the United States – and it is ultimately why ESG/SRI will become a mainstream investment methodology," Hamilton says. "We're probably at least five years behind in Australia – we've got a long way to go, in terms of this percolating down to the mass-affluent market – but is a mainstream consideration in Europe and the US."

In Europe, the wave of sustainable investing now measures almost $US31 trillion ($44.3 trillion) in assets, according to the Global Sustainable Investment Alliance. This includes $US17.5 trillion managed in ESG funds, an amount that has risen more than two-thirds in two years. In the US, according to the Forum for Sustainable and Responsible Investment (US SIF), since 2014, professionally managed investments in the US deployed along SRI strategies grew 30 per cent year-on-year to end-2018, to reach 25 per cent of every dollar invested – or more than $US12 trillion.

Judging from Australian clients, the driver for the ESG surge is two-fold, says McAuley: increasing awareness of ESG/SRI issues, and “generational pressure” flowing upward from children and grandchildren. “It’s a reflection of the coming of age of what used to be the younger investors, and also the younger people are influencing their parents. We think it is also on the back of increasing evidence that you don’t necessarily surrender any return by doing this.”

And in Australia, he says, post-Hayne royal commission, there is a lot more interest in the G of ESG. “With what’s happened with the royal commission, governance is very much front-of-mind. Clients are very serious about it, they aren’t just giving it lip-service anymore – they want to talk about how are you going to implement that, what stocks do you think that excludes? We find they are much more ready to get into a conversation about particular stocks, and debate whether it’s necessary to exclude them or not,” he says.