Selecting funds for our Positive Impact Portfolios

The introduction of our Positive Impact Portfolios in April 2019 was driven by the recognition that clients were increasingly wanting their portfolios to be invested in a manner that caused less environmental harm and more societal good, with a focus on delivering positive change.

We believe that our Positive Impact Portfolios will:

- **Influence change for the better of the planet and its inhabitants, do less harm to our environment, to other people and to our society at large.**
- **That the socially responsible companies in which the funds invest are far less likely to be hurt by adverse regulation, changing societal preferences, controversy and investor backlash and that there are significant, structural reasons why sustainable companies will offer the best investment opportunities in the years ahead.**

Constructing impact portfolios is less straightforward than it sounds given the subjectivity of the topic and different interpretations by fund groups on what represents an acceptable environmental, social and governance (ESG) standard to warrant investment. Debate continues as to how much is currently reported as 'green' genuinely addresses the problems at hand or instead is more a box ticking exercise. Whilst there will be cases at the edges, it would be a mistake to underestimate the fundamental shift that is now underway at the corporate, asset management and individual client portfolio levels.

In building our Positive Impact Portfolios, we are subject to those same subjectivity failings, so this note seeks to explain how we see the marketplace, how we rate our funds and how we go about building portfolios that we feel will meet the majority of our clients' needs and concerns.

The Universe: The styles of fund we research

Simple Screening Negative & Positive	Responsible & Sustainable Screening & Engagement	Impact Companies delivering solutions & positive change

We see our investment universe as evolving and developing and one that will take time for best practices on ESG reporting to be fully developed and understood. In time, we hope all our fund selections to be 'Impact-style' funds, but this is still a relatively nascent part of our market. In the meantime, fund managers will continue to take different approaches to assessing ESG risks, but by carrying out our own analysis and scoring methodology, we can assess each within their own relevant peer group and select the best in class.

The Fund Universe: How we assess the varying methodologies of our fund managers

Fund managers methodologies vary greatly and, in many circumstance, there is a tendency to take comfort in data that assesses the underlying holdings on factors such as source of revenues, C02 emissions, diversity scores, raw material use, and so on. There is merit in using the data led approach, however in doing so you may end up investing in a portfolio of companies that are sector concentrated and generate marginal or nil net benefit. This is why active managers who can do individual company ESG analysis and employ specialists to carry out proactive company engagement hold sway in our Positive Impact Portfolios for now.

The conclusion of our market assessment on ESG methodologies is that a common-sense approach works best. Instead of solely focusing on the data or becoming beholden to third party research, we decided that combining these whilst engaging with fund management teams is optimal. What is often exemplary on paper, falls down in practice and vice versa. Only by speaking with management teams, can we test this.

We sought to identify a number of factors that we could measure ourselves

Our objective in choosing funds and constructing a portfolio is two-fold:

- Deliver the financial returns that enable you to meet your financial planning objectives
- Choose funds that make a social and environmental impact and help to solve global challenges

Using the fund's literature in conjunction with our own and third-party research, we analyse the strength of each fund's ESG process, through their screening methodologies, their engagement practices and how they measure these. Our assessment starts with identifying the criteria that the fund utilises; be this be a simple negative screen or a much more focused approach seeking only impact companies.

We look at several areas, in particular:

- **Controversial Sectors.** (including weapons, tobacco, alcohol, unnecessary animal testing, gambling, oil and gas, GMO/genetic testing, coal and gas extraction and production, deforestation, and predatory lending).
- **Screening Criteria Strength.** How strong is a fund's exclusion policy, e.g. what percentage of overall revenues from a controversial sector leads to exclusion? Conversely, what is the evidence of positive impact and sustainability benefits of the companies in the portfolio.
- **MSCI ESG Scores.** This is a widely used, industry standard third-party screening criteria with seven categories broadly broken down into laggards, average and leaders.

- **Transparency.** Does the fund have a detailed ethical approach and methodology, make its holding list publicly available, produce regular sustainability & engagement reporting as well as disclose its voting records?
- **Impact.** Some funds will naturally avoid controversial sectors, so measuring their impact and identifying whether they are investing in companies providing solutions to sustainability challenges is important.

We then score the fund in each area and so long as the fund meets our minimum requirements, the fund undergoes our standard due diligence.

We are not looking for the funds to be 'squeaky clean', but we will exclude funds that include too many controversial sectors. For the remaining factors we are checking that the mandate of the fund is strictly adhered to. ESG investing is not straightforward and we are not looking to make moral judgements on individual company holdings. Rather we look to identify funds with a robust ESG standard and process that apply these processes with rigour and have a high level of consistency in approach, whilst providing transparency and measurability in a way that is consistent with our Positive Impact Portfolio's aims.

To conclude, our approach is top-down and seeks to identify and understand the 'green' ambitions a fund sets for itself, analyse its strengths and weaknesses and measures it on an ongoing basis, where we seek to ensure the criteria they put in place is fulfilled. When we have taken our view on whether the fund meets the criteria relative to its peers, we discuss what role and what size the fund should take in a portfolio, in light of our macro views and our strategic and tactical asset allocations.

For more information on our Positive Impact Portfolios contact your HFMC Wealth Consultant or call on 01932 870 000