Crystal Wealth Partners Guide to Responsible Investing

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Background to Responsible Investing

All businesses, and therefore all investments, have an impact on people and the planet.

Responsible investing seeks to minimise the negative effects generated by business and promote positive impacts, ultimately delivering a healthier economy, society and environment – and, of course, a robust investment outcome.

There has been increasing desire across the investment world for incorporating the concept of responsible investing into standard investment processes to avoid investing in companies that engage in environmentally and socially irresponsible practices or display poor corporate behaviour.

Initially, such action was called ‘sustainable’, ‘socially responsible’, ‘impact’ or ‘ethical’ investing. Previously, this would have been achieved through simply excluding certain types of industries from portfolios altogether – for example, gambling, alcohol, tobacco, thermal coal and firearms.

Crystal Wealth Partners believes that you should be able to invest in a way that is closely aligned with your personal values, and we can now incorporate a Responsible Investing framework alongside our fundamental investment analysis to improve the management of investment risk and potential returns.

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The impact of Responsible Investing

ASX-listed companies, fund managers and investment research companies have begun to identify the significance, and measure the impact, of environment, social and governance (ESG) matters on their activities.

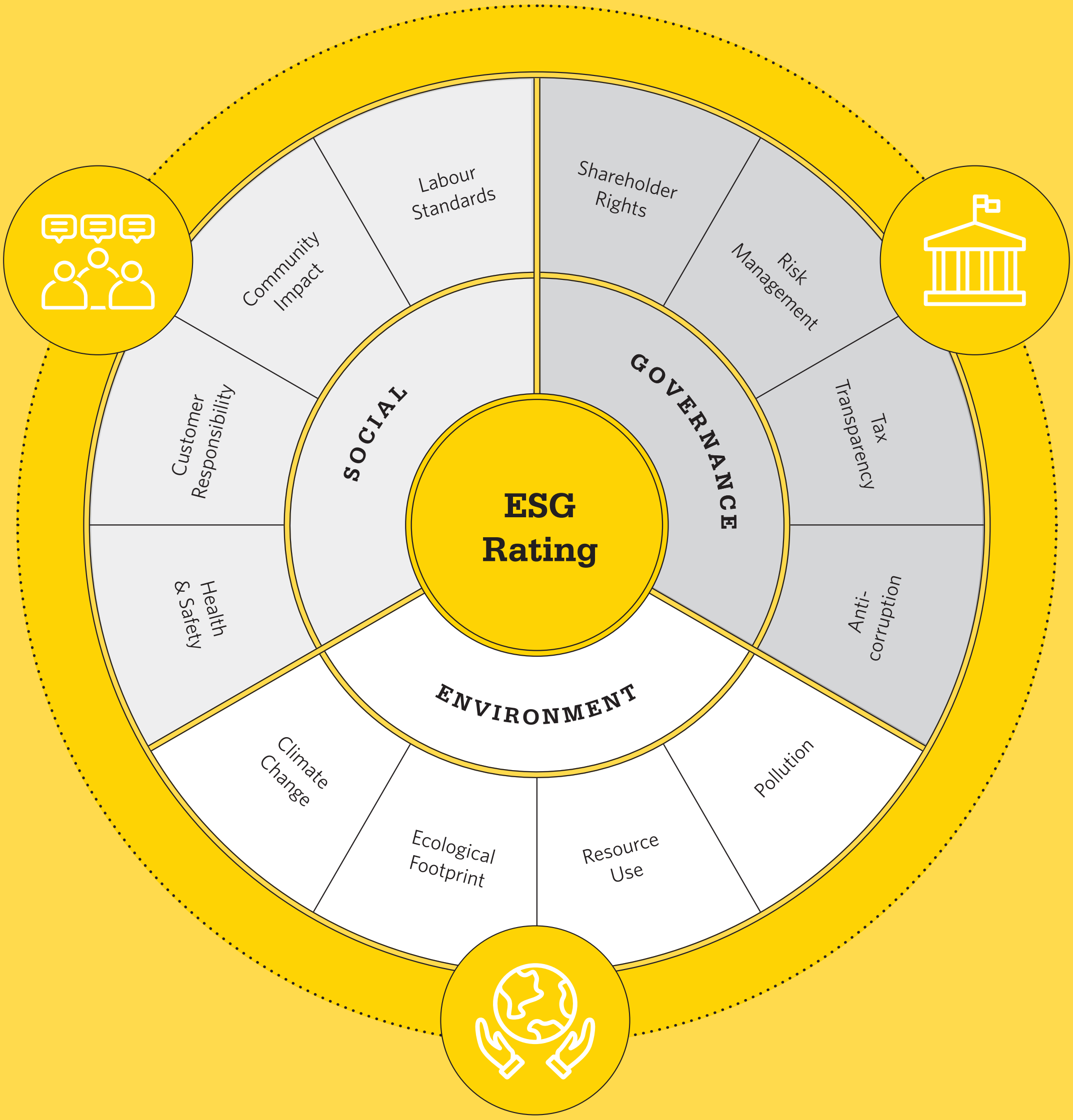
Regulators, companies, fund managers and investors are being encouraged to recognise the relevance of incorporating ESG factors to enhance corporate transparency and performance, and the measurement of risk. The availability of increasing amounts of ESG data is allowing investors to incorporate these strategies into portfolio construction.

Responsible investing focuses on risk management and better decision making. By focusing on ESG factors and data we can identify companies that are leading or lagging in their industry or sector, and can pinpoint significant risks relevant to the company or industry.

ESG Factor	Positive Impact	Negative Impact
Environment factors	Positive outcomes might include avoiding or minimising environmental liabilities, lowering costs and increasing profitability through achieving energy and other efficiencies, reducing regulatory, legislation or reputational risk.	Negative impact would include polluting or degrading the environment, adding to atmospheric carbon levels, threatening a region's biodiversity or cultural heritage or risks associated with climate change, reduced air quality and/or water scarcity.
Social factors	Social positive outcomes could include increasing employee productivity and morale, reducing staff turnover and absenteeism and improving brand loyalty.	Negative issues might include sub-standard conditions for production employees in third world countries, aiding human conflict, facilitating crime or corruption, poor product integrity, inadequate health and safety policies for employees customers or suppliers, harming the local community, or risks associated with large-scale pandemics or shortages of food, water or shelter.
Governance factors	Positive outcomes would include aligning the mutual interests of shareholders and management, improving timely disclosures, and the avoidance of unpleasant surprises.	Negative connotations such as the way companies are run, lack of board independence and diversity, weak corporate risk management, poor corporate culture, excessive executive remuneration, and inadequate product/market diversification.

There is no definitive list of ESG issues that an investor could consider when making investment decisions and each factor has differing implications that can materially influence a company's investment performance.

The diagram below illustrates some of the commonly used ESG considerations:



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Why invest responsibly?

/ Investment returns

There is substantial academic evidence and research in Australia, New Zealand and internationally to support the argument that responsible investing performs on a par with, if not better than, the broader investment market over the long term.

A 2023 study by the Responsible Investment Association Australasia (RIAA), found that the RIAA certified products outperformed conventional benchmarks over the long term, for the period to 31 December 2022.

Managed Growth Funds	1 year	3 years	5 years	10 years
Responsibly Invested Fund*	-10.55%	4.25%	8.72%	16.28%
Conventional funds^	-8.19%	3.08%	5.32%	10.28%
International Shares Funds				
Responsibly Invested Fund*	-17.22%	3.73%	7.52%	13.07%
Conventional funds^	-13.17%	3.19%	6.15%	15.47%
Australian Share Funds				
Responsibly Invested Fund*	-8.99%	5.95%	7.12%	4.16%
Conventional funds^	-5.82%	4.64%	6.05%	11.05%

*RIAA certified Funds

^Benchmarks undertaken by Plan for Life Actuaries & Researchers

Please note that RI strategies aren't always going to outperform. There will be diversions from market returns for various reasons, as seen in the 1 year data, particularly due to the concentrated nature of the resource heavy Australian share market.

While this research supports the argument for responsible investing over the medium to long term there can be no guarantees that this level of relative performance outcome will occur in the future.

/ Contribute to preserving our environment

By selecting managed funds with low carbon designations and individual companies with minimal exposure to fossil fuels, your investments can help mitigate the impact of climate change as economies transition to low-carbon consumption. There will be more opportunities for companies to innovate and adapt to a greener world.

/ Growth in the sector

The market for responsible investment is growing rapidly, and is now estimated to represent 44% of professionally managed funds, up from 13% the previous year (2019), according to the Australian Bureau of Statistics (ABS). This is a sharp increase from earlier years and illustrates the need for ESG integrated decision making. This growth in the market can facilitate social changes as business alter their practices to attract your investment.

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Responsible Investment strategies

There are a number of strategies that fall under the responsible investing universe. Here are some of the most common that can be used in isolation or combination:

Negative screening

Negative screening involves excluding investments in assets, companies or sectors from your investment universe.

Recently there was a large scale movement to avoid tobacco with 45 Australian Superannuation Funds signing the UN-led Tobacco Free Finance Pledge, a movement to stop the financing and support of tobacco products.

ESG Integration

ESG integration* is the systematic and explicit inclusion of environmental, social and governance issues in investment analysis and investment decisions.

*As defined by Responsible Investment Association Australia (RIAA), which is the peak body representing responsible, ethical and impact investors across Australia and New Zealand.

Sustainability themed investing

Investment in themes, sectors or assets that specifically relate to sustainability. It involves making investments in assets, companies or sectors that specifically relate to sustainability, i.e. a preference towards carbon footprint, renewable energy, waste management, fair trade, social housing etc.

Impact investing

Impact Investing uses the power of capital for 'good'. It is typically achieved through investing in companies, businesses or projects that actively seek to generate a positive, measurable and sustainable impact on society or the environment.

One key element with this style of investing is that the impact should be measurable. Often impact fund managers will provide an annual impact report that details the positive impact of your investment. For example, litres of water treated, tonnes of waste recycled, megawatts of renewable energy generated.

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Bringing Responsible Investment to our clients

Crystal Wealth Partners is proud to offer five responsible investment (RI) portfolios to help enable our clients on their journey towards sustainable and ethical investing. The five responsible investment portfolios we offer are:

/ Responsibly Invested Australian Equities
/ Responsibly Invested Global Equities
/ Responsibly Invested Moderate
/ Responsibly Invested Conservative Balanced
/ Responsibly Invested Balanced

Negative Screening and ESG integration apply to the Australian shares, international shares, property and infrastructure and fixed interest asset classes, which covers around 70% of the portfolios*.

The Responsible Investment model also invests in other asset classes that are not screened. Asset classes that are not screened include private equity and debt, unlisted property and infrastructure, credit, cash and alternative assets.

* Portfolios with a higher weighting to credit will have a lower percentage of the portfolios rated.

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Step 1

Fundamental investment analysis

For direct shares, the criteria for selection includes a broad range of factors, including:

/ Interest coverage ratios;

/ A favourable outlook for the company and the sector in which it is operating;

/ The company should display a profitable history and dividend distribution record;

/ The company's shares should represent intrinsic value, using at least one of a dividend discount model, discounted cash flow model or a sum of the parts valuation;

/ Valuations – based on either a price to earnings ratio, dividend yield or free cash flow basis – should be reasonable and at least in line with peers in the same sector.

For managed funds, the criteria for selection includes many factors, some of which are:

/ The fund management company must have a long-established and consistent record of managing investments well;

/ A stable investment team for many years;

/ The senior individual investment manager responsible for a portfolio should have an established track record in managing the asset class for which they are now making decisions;

/ They should be high conviction;

/ There should be different investment styles across funds.

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Step 2

Negative screening for excluding assets

The Responsible Investment portfolio does not invest in companies or managed funds that have a material exposure to:

/ Thermal coal;

/ Alcohol;

/ Tobacco;

/ Gambling;

/ Controversial weapons;

/ Palm oil.

We understand this will not capture all preferences, particularly as what matters to one client may not be so important to another. However, our focus is on building and maintaining a robust and adequately diversified investment portfolio, and it is very difficult to exclude all controversial issues and significantly diminishes the available investment universe.

Our threshold criteria are that companies or Funds that have over 10% of their revenue related to these areas will be excluded from our investment universe. We take a hard-line view and consider revenue related to production, related products and services, and retail or distribution.

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Step 3

Investment selection process using ESG factors

We use the risk ratings provided by an independent external research house (Sustainalytics, one of the leading providers of ESG and corporate governance research) to help our investment team identify and understand the financially material ESG risks and opportunities in the asset classes and the possible impact on the long-term investment performance of portfolios.

We will use ESG factors alongside our usual financial analysis in making investment recommendations to pinpoint issues that could have a material impact on investment risk or return for client portfolios.

In this way, we can minimise investing in those companies whose ESG policies and practices expose them to unacceptable levels of risk.

The ESG risk analysis is designed to assist in the portfolio construction process by:

/ Identifying companies/funds that derive a revenue stream from, or supply to, controversial areas, enabling us to exclude/limit exposures to areas that we believe pose a higher risk;

/ Focusing on financially material issues relevant to the relevant industry/sub-industry sector and company-specific;

/ Setting our own appropriate risk rating benchmarks to determine whether the companies/funds support the fundamental analysis for inclusion in client portfolios; and

/ Actively monitoring ESG news events.

The independent risk rating process provides us with 'score' levels (in % terms) across five measures for each company:

/ A comparison for the company against it's industry peers and the global universe;

/ An assessment of exposures to ESG issues in the sub-industry in which the company operates, and the company itself, is exposed;

/ The magnitude of the ESG risk to which the company is exposed and how/ whether that risk is managed;

/ Material ESG issues are identified; and

/ An overall company risk rating (being negligible/low/medium/high/ severe) is then attached in light of the above results.

The combination of fundamental analysis and the identification of ESG related risks each investment in a portfolio is exposed to will provide us with a differentiated 'risk awareness' and deeper insight into potential investment risks, and how/whether those additional risks are being addressed by the company/fund manager.

There is also increasing evidence to suggest that the importance of this more holistic approach to measuring and understanding investment risks can reduce volatility in portfolios.

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Step 4

Use Investment Committee discretion

As these processes and filters are not perfect, we use discretion exercised by our Investment Committee to include or exclude companies or funds in portfolios. On occasions, for example, companies can have negative governance ratings, however the situation could be temporary, or the company may already have a public plan to address these issues.

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Step 5

Analyse, monitor & report the impact on investment portfolios

- / We continuously monitor and analyse ESG data for potential portfolio adjustments;
- / We provide reporting back to clients on the portfolio level exposure to controversial areas such as alcohol, gaming, tobacco and thermal coal;
- / We can measure the portfolio level ESG risk relative to a traditional or non-ESG benchmarks.

If you would like to learn more about our Responsible Investment offerings, please talk to your adviser or contact our office.

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contact@crystalwealth.com.au

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All Crystal Wealth Senior Advisers and Directors are members of RIAA (Responsible Investment Association Australasia) who are the peak body representing responsible, ethical and impact investors across Australia and New Zealand.

riaa Responsible Investment Association Australasia

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