

You Can Save With a Conscience

If you want your savings to be invested well and wisely, the options for ethical investors have grown enormously over the last few years. Chris Budd considers some of the issues.

There was a time when those who wished to invest ethically had a pretty straightforward choice. Either they took a disciplined ethical stance with their investments, and ran the increased risk of poor performance and a lack of diversification within the investment portfolio, or they were forced to sacrifice their moral scruples in favour of the usual principles of investing. In other words, investing ethically came at a cost.

These days, however, it's becoming de rigueur to shop ethically, and fund management companies, are expanding their range of ethical investment products. And as the choices become greater, it becomes more feasible to construct an investment portfolio which combines traditional principles like asset allocation, along with ethical considerations.

Ethical investing is not exactly a new concept. In the early 1900s, for example, the Methodist Church began investing in the stock market, and deliberately avoided stocks in sectors such as alcohol and gambling. The current trend is partly driven by issues such as the impact of globalisation on poorer countries, and mass coverage of the issue of climate change. The market for fair-trade coffee is a case in point – its 20% market share shows ethical shopping has gone from fringe to mainstream.

Back in the investment world, one of the main changes has been the increase in the diversity of ethical products on offer. When ethical funds were first marketed in the UK (in the mid 1980s) there was one approach to ethical management, which these days would be called “negative screening”. In other words, companies involved in certain industries (the usual culprits – arms, tobacco, alcohol, animal testing, and some others) are screened out by the fund manager. Then any stocks left after that screening process can be bought and sold according to the usual principles.

Nowadays, negative screening is just one of three main approaches. The others are ‘positive screening’ and ‘engagement’. Positive screening, also known as ‘support’, involves investing in companies that have a responsible approach to business practices, products or services. For example, some funds will invest in companies which have the

best practice in their industries, while others will focus on particular themes, such as environmental technologies.

This is usually a less restrictive approach. For example, a manager using this approach could invest in an oil company if they felt that company demonstrated a better policy on developing renewable and educating consumers about energy conservation than their peers. Such a stock would normally not be available to a negatively screened fund simply because of the sector it operates in.

‘Engagement’ is the least restrictive approach of all. It is more of a general way of doing business than a process, and involves using the active influence of shareholders to encourage more responsible behaviour by businesses. Fund managers mainly use dialogue with the companies in which they invest to deal with issues of concern, and may also use their voting powers as shareholders.

Another way you might see this split described is as a continuum from light green to dark green funds, as you move from the least strict to the strictest approach to ethical investing.

The second main development in the ethical sector is that the choice has become more diverse by asset class. ‘Asset allocation’ is an investment principle which, in basic terms, describes the split of asset types within a portfolio (asset types would typically include equities, bonds, and property, with some further subdivisions). As a general rule, the more diverse your asset allocation, the lower the risk profile and the smoother your returns over the long term, as they are not so strongly linked to the performance of one asset type.

The range of ethical funds has now expanded to the point where it is possible to achieve a much more sophisticated and diversified asset allocation than it has been before. So, for example, ethical corporate bond funds are now available, allowing a strictly ethical investor to look beyond equities. And within the equity part of the portfolio, funds are available which invest in Europe and globally.

Whether or not to take an ethical stance with one’s investments is always going to be an individual choice, and it remains to be seen whether this part of the industry will become as prominent as, say, the market for organic food. By its nature, the choices are still more limited than those for an investor who does not take ethical considerations into account. That said, investing ethically is certainly not as restrictive as it once was. As demand continues to grow, and the market expands to meet it, the range available allows a much more sophisticated approach to building an ethical portfolio than has been possible in the past.

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