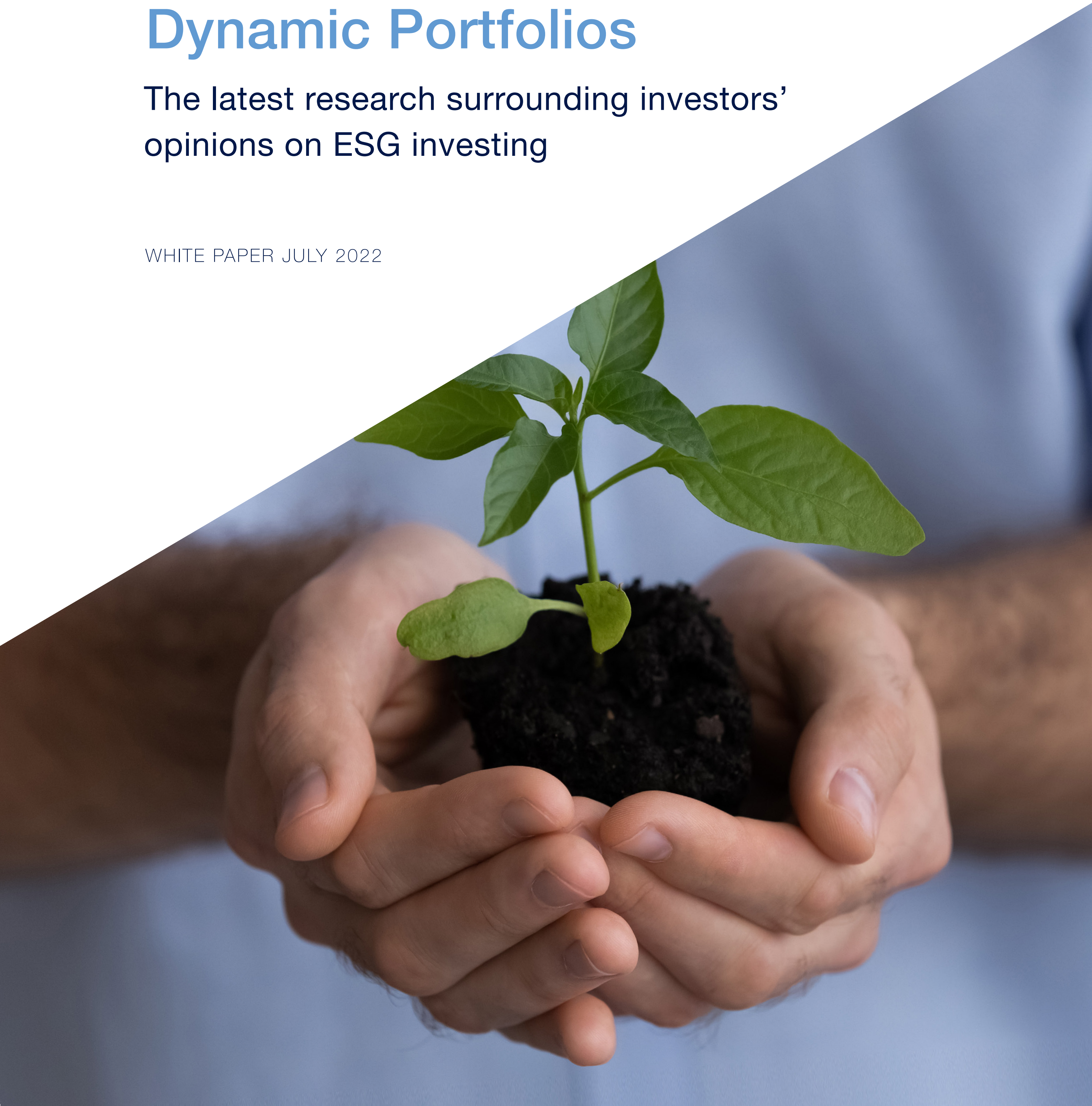
FosterDenovo

Investing with the Dynamic Portfolios

The latest research surrounding investors' opinions on ESG investing

WHITE PAPER JULY 2022



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Methodology

An online survey was conducted by Atomik Research among 1,001 respondents from the UK, all of whom had investments. The research fieldwork took place on 24th March – 28th March 2022. Atomik Research is an independent creative market research agency that employs MRS-certified researchers and abides to MRS code.

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Executive Summary

In recent years, there has been a significant increase in the number of people who want to align their investments with their moral and personal beliefs. As a result, sustainable investing is becoming more popular. Options include environmental, social and governance (ESG) investing, ethical investing, impact investing, socially responsible investing and more.

However, while this new focus on sustainable investing is a welcome change, there are some potential issues. These include a lack of common terminology, a perception that sustainable investing means lower returns, as well as key regulatory issues. With so much uncertainty, we believe it's important to get to the bottom of how investors feel about sustainable investing, why people aren't investing sustainably and how we can support individuals and organisations to make better informed decisions with their money.

Our research highlighted some key findings:

51% said they feel either very strongly or strongly about the impact that climate change could have on their savings and investments.

60% were not aware of ESG (environmental, social, governance) investing.

44% said that they thought sustainable and ESG investing might mean lower investment returns.

83% said they would risk performance for a more sustainable investment.

70% of respondents without any ESG investments said that they hadn't had this discussion with their financial adviser about sustainable investing.

Top 3 justifications for people not investing using ESG factors included perceived lower returns, not enough evidence to back it up and potentially more costly.

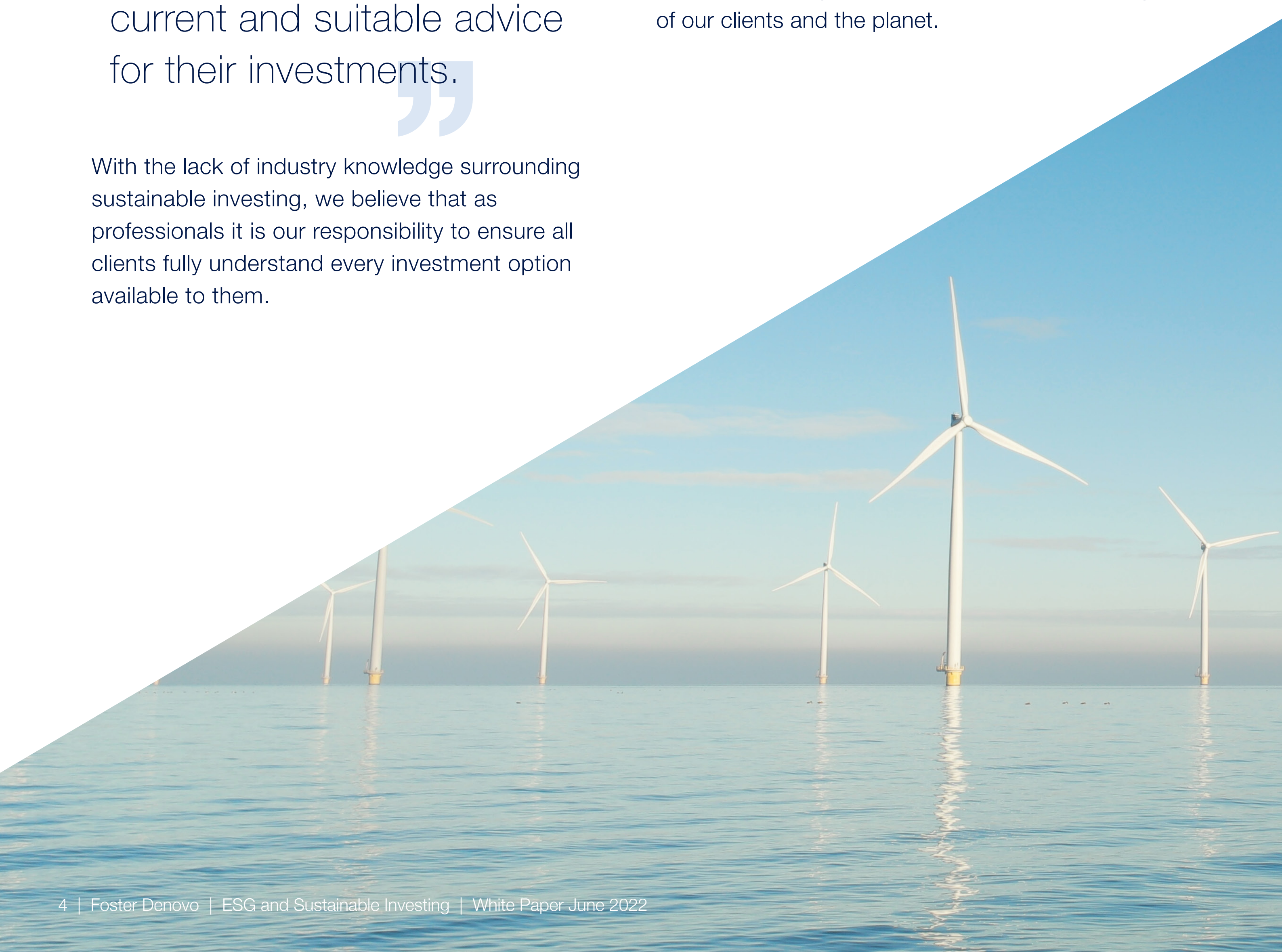
The research brought to light that many individuals do not understand what sustainable investing is or how it could impact them. It also highlighted that financial advisers still have a lot of work to do when it comes to providing guidance around sustainable investing. But it is clear to see from the results, people are looking to make change to better the world we live in today, whether through making everyday changes or through their finances. It appears that investors are ready, but the industry may not be.

> At Foster Denovo, we believe in being completely transparent with our clients by providing them with clear, current and suitable advice for their investments.

With the lack of industry knowledge surrounding sustainable investing, we believe that as professionals it is our responsibility to ensure all clients fully understand every investment option available to them.

> We have chosen the word 'Sustainable' to represent our portfolios as they provide investment solutions that incorporate ESG factors into investment decisions to better manage risk and potentially enhance long-term returns.

However, we are aware that there are still common misconceptions within the industry and that's why we will continue to do everything we can to highlight the facts surrounding sustainable investment for the good of our clients and the planet.



Introduction

The world as we know it today is constantly changing. From climate change issues and use of fossil fuels, to increased calls for better working conditions and equality and diversity rights. These have all been well publicised in the media and there are many supporters calling for urgent change, including celebrities, public figures and even the royals.

The Prince of Wales has used his unique position to champion action for a sustainable future for over four decades now. There are also many celebrities fighting for better equality and diversity including actors, musicians and sporting figures. By now, most of us will be aware that change in all these areas is needed for a better planet. And this goes for investors too.

The way in which investors are seeking to invest their money is also changing. Many are looking for investment styles which avoid investing in companies that do harm, and support those that benefit society in some respect, causing an increased demand for ESG investment options.

Although ESG and sustainable investing is growing in popularity, it is still a lesser known investment option. That's why we recently conducted research to find out people's investment focuses, how investors perceive the need for ESG and sustainable investing, as well as what might be stopping investors from investing in this way. We also take a closer look at what ESG investing is and how this style of investing is perceived within society.

What is ESG investing?

ESG considers three factors - environmental, social and governance. These factors are used, alongside traditional criteria, to evaluate potential investments. ESG is not only about what a company manufactures or sells, but also how it goes about it. Key ESG factors are:

Environmental

This takes into consideration the impact companies are having upon the planet today and in the future including:

- Pollution, waste and emissions
- Renewable energy and efficiency
- Recycling

Social

Takes into consideration the social impact companies are having upon people in the world including:

- Human rights
- Workers' conditions and rights
- Relationships with suppliers and customers

Governance

This takes into consideration the interests of all stakeholders affected by the company's activities including:

- Avoidance of bribery and corruption
- Equality and diversity
- Health and safety, compliance with regulations

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The Results

Do investors truly understand ESG and sustainable investing?

The subject of investing in general can be daunting as the industry is often filled with jargon, complex messaging, and countless investment options. So, it's not surprising that when something such as ESG starts growing in popularity, many people may not have heard of it or do not know enough about it to understand what it is.

60%

of respondents were not aware of ESG (environmental, social, governance) investing.

Our research showed that when it comes to ESG investing, 60% of investors are not aware of ESG investing, whilst only 32% are aware and 8% weren't sure. To help, all respondents were given an explanation of what ESG investing is and just under half said they still only somewhat understood what it was whilst 7% still said they did not understand at all. This proves that even with reasonable explanation, investors need more clarity and support to truly understand investment types, including less well-known options such as ESG.

The impact on our planet

In recent decades, our planet has been severely affected by climate change. This is partly because of human activity, including:

- an increase in carbon emissions;
- use of single use plastics;
- deforestation;
- increased burning of fossil fuels; and
- much more.

Although there are some natural causes which can impact our climate over time, it's clear that the choices humans have made in previous years have impacted our planet greatly.

With the recent climate change and fuel protests, news coverage, and the latest COP26 conference, it's no surprise that many more people are becoming aware that change must happen fast, and our research supports this view.

63%

said that in the last 3 years, they had changed their opinion, to some degree, regarding the importance they put on the environment and long-term sustainability of the planet.

On top of this, 89% of respondents said they were either very or somewhat concerned about the impact corporate practices and some large companies are having on the environment.

Our research indicates that whilst many are concerned about how this damage could affect our world, not only today, but for future generations to come, there is also an element of worry about how this might impact peoples' finances too.

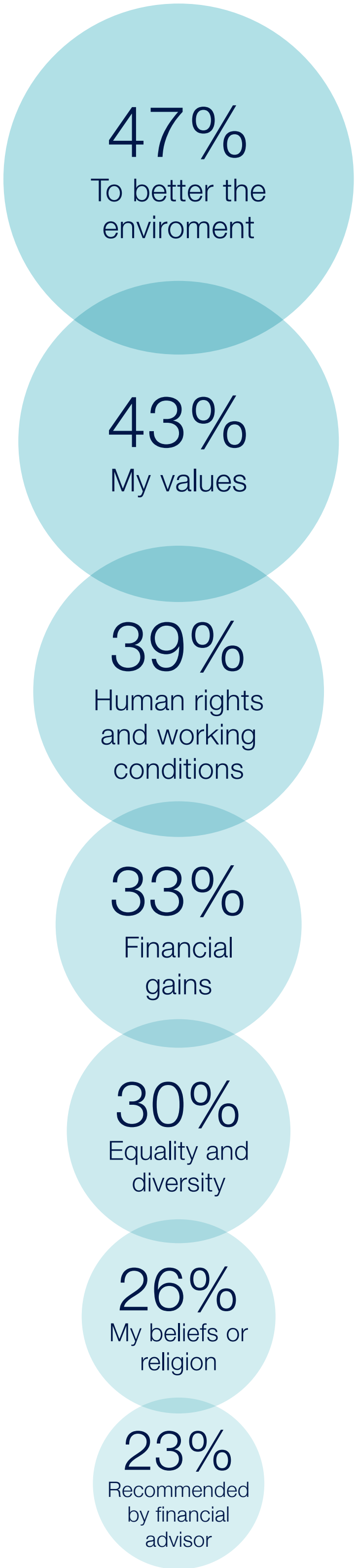
51%

of investors said they felt either very strongly or strongly about the impact climate change could have on their savings and investments.

Although many of us are trying to do our bit to help protect our planet, it's clear that there is much more work to be done, and the responsibility shouldn't just stop with our government and world leaders, but with us as individuals as well.

Why are people investing in ESG?

Our research states that many people do not fully understand ESG investing, but it is encouraging to see that some individuals are deciding to make changes to their portfolios to include it. 25% of those surveyed said that one or more of their investments were invested using ESG factors. Amongst these 25%, the top reasons for investing using ESG are:



It's clear to see that for most people, their focus on improving the planet and standing by their values comes before any want for financial gain. ESG investing is typically focused to help people achieve their financial goals, whilst considering the impact to environmental, social and governance factors.

People's passion to do good, was highlighted again when 79% of respondents with ESG investments stated they would avoid investing in companies who were not taking sufficient action on ESG issues.

83%

said they would risk performance for a more sustainable investment

Although this might be of slight surprise to some, with ESG investing you may see greater returns over the longer term. This can mean that not only will your money be more resistant to longer term market volatility and reflect your morals and personal beliefs, but it could also grow more effectively.

According to a study published by FTAdviser, European portfolios that were invested to a high degree of ESG principles persistently outperformed their benchmark. This is the case even after factor and sector adjustment.

The report notes that that the European high-ESG (top 10% of MSCI scored companies) equity portfolio consistently outperformed by around 12% a year. This shows that you don't have to necessarily choose between investing in a sustainable way or seeing strong risk adjusted returns on your portfolio. There is of course no guarantee that this outperformance will be present in the future although it powerfully illustrates real market conditions and actual returns.

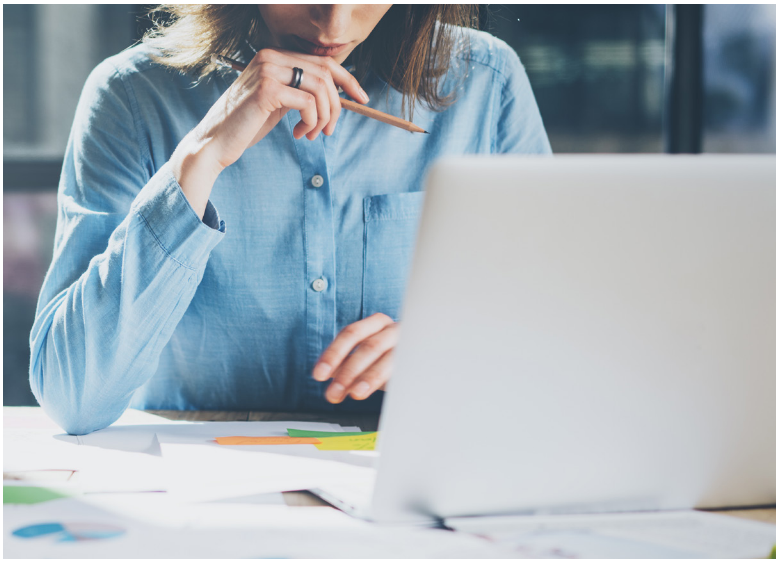
Why are investors choosing to avoid ESG?

For those who are already onboard with ESG investing, it appears they are keen to do their bit to make the word a better place. But many people are not familiar with this type of investing and are, therefore, excluding it as a form of investment choice or simply not even realising it is one.

Of those who don't have investments with any ESG factors, more than half said they would consider investing their savings and investments if it led to a more sustainable and positive impact on the world:

- **16% said yes**, and were interested in the field;
- **52% said potentially**, but would need to know more about it; and
- **20% were unsure** or had no clear opinion.

Whilst 68% of respondents would consider investing with ESG factors, our research indicates there are some key concerns as to why people may avoid ESG investing, including:



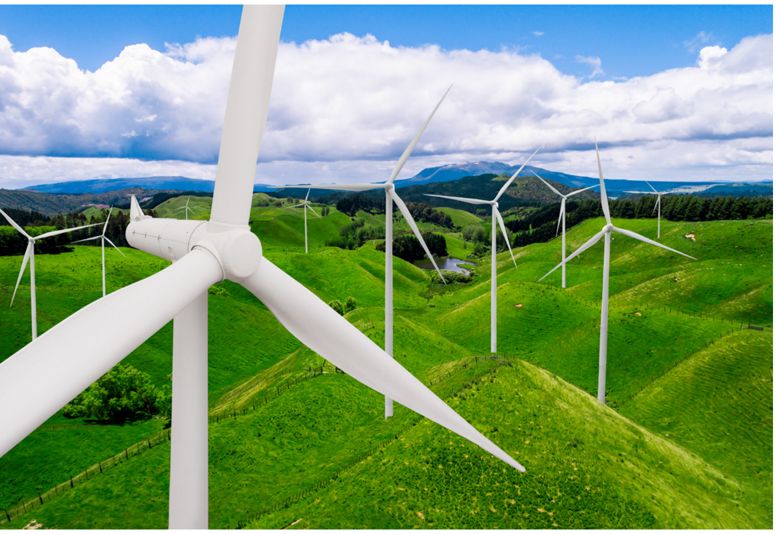
50% Perceived lower returns

45% Not enough evidence to back it up

40% Potentially more costly

37% Perceived higher risk

14% Not part of my values or beliefs



Quite surprisingly, it appears more than half of investors who are not currently invested in ESG, would be willing to invest a significant proportion of their investments this way. 53% of respondents said they would invest up to 25% in ESG and sustainable investments, whilst 32% said they would invest up to 50%.

This highlights that with better education surrounding ESG investing, many investors are willing to make the necessary changes to their portfolios to benefit the planet and all of us on it.

Dispelling the myths

Our research has highlighted a lack of knowledge surrounding ESG investing. Amongst everyone surveyed, 44% of people said that they thought sustainable and ESG investing might mean lower investment returns, 38% were unsure and only 18% of people said they didn't think this to be true.

This, coupled with 50% of non ESG investors who said lower returns were stopping them from investing in ESG, clearly states that there is a big misconception about the performance of sustainable and ESG investing. However, the Covid-19 pandemic has shown this not necessarily the case.

> "Research has been conducted by multiple academic and investment industry bodies over many years which suggest that ESG and sustainable investing over the long term does not result in lower performance. Indeed, it can actually potentially contribute to better risk adjusted returns for investors."

Declan McAndrew,
Head of Investment Research at Foster Denovo

The impact of the coronavirus pandemic and subsequent lockdowns had a significant effect on the UK economy in 2020, and stock markets fell accordingly. Figures from the Guardian highlighted that the FTSE 100 index fell by 14.3% in 2020, its worst year since the 2008 financial crisis.

However, while the value of many funds plummeted, in contrast funds with sustainable and ESG principles performed relatively well.

Morningstar research also found that three-quarters of ESG-screened indexes outperformed their broad market equivalents in 2020. Furthermore, almost nine-tenths of such funds outperformed for the five years through to the end of 2020.

One explanation for this is that while the strategy of sustainable and ESG investing may avoid some profitable but unsustainable sectors, its focus on long-term sustainability and profitability gave it an edge during the period of economic disruption.

Do demographics affect individuals investing with ESG?

Whilst there are many factors which might affect someone's decision on where and how to invest their money, demographics can also play a role.

The age gap

Our research has highlighted that there is a clear divide between generations when it comes to ESG and sustainable investing.

Younger respondents appear more likely to feel very strongly about what climate change could do to their investments and savings – 38% of the under 20s-30s and 35% of those aged 31-40s said this. However, just 12% of those aged 51-60 and 8% of those aged 61+ said the same. This major difference in feelings towards climate change and investments could be due to those over 50 being closer to retirement and therefore feeling the impact to their finances will be minimal compared to younger investors who have time for their investments to grow.

But, it could also be down to the younger generation being more aware of sustainable investment options like ESG, with our research highlighting that those aged 51-60 and 61+ were the two least likely groups to know what ESG is. And, those aged under 20s-30s and 31-40 are most likely to already have an investment(s) using ESG factors compared to those older age groups.

The gender divide

Although our research didn't highlight any major differences between gender and ESG investing, there were some results which could prove there is a gender gap.

When it comes to the planet in general, 20% of female respondents said they had always had an awareness of environmental issues compared to 15% of male respondents. However, 57% of these males said they felt strongly about the impact climate change could have on their savings and investments compared with 47% of females saying the same. And whilst it may appear that females are slightly more conscious about the environment in general, many did not know what ESG investing was. 70% of women said they were unaware of ESG investing vs 52% of males saying the same. This was reflected amongst those who said they had investments in ESG when 32% of males said that at least one of their investments had ESG factors, compared with just 16% of females saying the same.

Pensions

Many of us will have a pension - whether it's a personal one, a workplace pension or a mixture of both. And although a pension is a common type of investment, a lot of people do not pay it the same level of attention as other investment types. How a pension is invested is down to us, but many individuals do not realise that they can change their pension funds or default funds to align with ESG goals.

Since auto enrolment, many employees have been set up with their workplace pensions and enrolled into a default fund. However, many do not realise that they can move all or some of it to a more sustainable fund. According to our research, 43% of those with a workplace pension said they were not aware of their workplace pension offering access to ESG funds, with only 23% aware these funds exist.

Additionally, almost half of respondents, 42%, said that they would be happy if they were automatically enrolled into a sustainable pension default fund. As highlighted earlier in our research, respondents stated that financial gains came second to preserving the planet in other investment types, and it appears cost is not a barrier for pensions either, as 54% of people said they would be happy to pay more for a default fund in ESG. These results demonstrate that people have a positive attitude to change and are willing to adjust their pension funds to better the world we live in. It also highlights the importance of regular pension reviews, and the responsibility employers have to educate their employees about their pension fund options.

89%

said that they had had a discussion with their adviser regarding sustainable investing

Are financial advisers doing enough?

Financial advisers play an important role when it comes to financial planning. Whilst some like to manage their money themselves, others prefer to let an expert do the work. And, when it comes to investing specifically, many find that working with an adviser can remove some of the stress. But whilst advisers play a major role in managing financial returns, could they be doing more to educate their clients about sustainable investment options?

People who have sought advice are more knowledgeable about ESG investing, with 72% of people with one or more of their investments invested using ESG factors having worked with a financial adviser, and 89% said that they have had a discussion with their adviser regarding ESG/ sustainable investing. Interestingly however, 82% of respondents said that it was them who instigated the discussion with their adviser on sustainable investing.

One reason for this could be down to financial advisers assuming their clients are aware of sustainable investment options and therefore not instigating the conversation with them. It could also be that many financial advisers within the industry are not fully aware themselves of ESG and sustainable investing, or are not willing to get to grips with these newer investment styles. However, this could all be set to change as from August 2022, recent changes to regulations come into play which means advisers will need to be much more proactive with clients when it comes to discussing ESG investment options.

Our research clearly highlights that these new changes can't come soon enough to make sure everyone has the opportunity to decide whether ESG and sustainable investing is right for them.

What next?

The responsibility of improving our planet, whether it's the environment, places we work or how we treat people, falls on all our shoulders. And it's clear from our research that people are willing to change their investment habits to make sure they are doing their bit.

It's important that investors are more curious about where their money is being invested to make sure it's aligned with their financial and personal goals.

However, it is also vital that advisers start to initiate more conversations surrounding ESG and sustainable investment options. And although ESG may not be a priority for all investors, everyone should have the right to know about ESG and fully understand how it may or may not benefit them as an individual.

All financial planners and advisers should be encouraging active conversations and engagement when it comes to ESG and sustainable investing. This approach gives individuals the opportunity to invest with a conscience and help them to experience long-term financial performance.

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Foster Denovo's Sustainable Dynamic Portfolios

At Foster Denovo, we are always working on new initiatives to help our clients have access to the widest range of investment solutions.

For those investors who are looking to grow their assets whilst managing risk to environmental, social and governance factors, we introduced the FD Sustainable Dynamic Portfolios (SDPs). The SDPs are investment portfolios that have been carefully designed to balance investment risk with returns to help achieve financial goals, taking into account attitude to risk, time frame, capacity for loss and crucially environmental, social and governance (ESG) criteria.

The SDPs are distinctive because we can directly link the target investment returns of the portfolios with the annual returns investors are aiming for. We believe this gives people the best chance of achieving their financial goals in their time frames. And, for those investors who are looking for a more focused exposure to climate impact investing, we have recently introduced the Climate Impact Sustainable Dynamic Portfolio. The Climate Impact SDP is targeted at clients seeking specialised exposure to themes such as electrification, energy efficiency and alternative energy sources.

We are passionate about providing clients with sustainable investment options as well as delivering outstanding levels of service and this has been reflected in our recent award nominations and wins.

For more information about the FD Sustainable Dynamic Portfolios:

call 0330 332 7866:

email advise-me@fosterdenovo.com; or

visit fosterdenovo.com

Calls are charged at your standard landline rate.

The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

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