

### Can multi asset investors invest ethically?

There is no industry standard definition of what it means to invest ethically and there are a number of different approaches under the umbrella of ethical or sustainable investing. At a very high level, however, you can broadly split them into two: negative screening and positive discrimination. The traditional negative screening focusses on excluding those industries that are explicitly seen as harmful to society: Tobacco, Alcohol, Gambling, Adult Entertainment and Armaments.

To invest in a positive manner one can either take the targeted approach, investing directly in companies/instruments that generate Environmental, Social or Governance (ESG) impact, or a positive overlay approach that discriminates in favour of companies that score well on ESG factors. Finally, one can take the integrated approach that seeks to incorporate both positive and negative aspects of ethical screening.

### What does the investment universe look like?

For many years the investable universe was very limited in nature, typically only offering options within equities. However, we have seen over recent years an impressive growth in demand for ethical investments, and this in turn has led to a growth in the number of ethical options available (Bloomberg estimate around 80% growth over five years). This growth has been broad in nature: active; passive; across multiple asset classes. While the active equity space is well established, a growing number of new active funds operating within fixed income and other asset classes have provided increased optionality to investors. In addition, the growing number of passive ETFs operating within this space has allowed investors to obtain liquid exposure to equity regions and fixed income markets at a low cost.

The 'positive impact' part of the market has also experienced healthy growth, partly as a result of environmental issues coming to the fore of political debate (i.e. last year's Paris Treaty) but also a more general acceptance that action needs to be taken to tackle issues such as climate change. Both developments have made impact investing more commercially attractive. Overall, the palette available to an ethical investor has expanded immensely providing increased optionality and opportunity to diversify.

### Are returns sacrificed?

This remains an area of debate and has historically been one of the key factors holding back investors from choosing to invest ethically. Recent history, however, suggests that investing in a way that both seeks to avoid controversial sectors as well as focus on areas of the market that score well on ESG factors can actually be beneficial to performance. MSCI, the world's largest data provider, has been running regional socially responsible (SRI) equity indices, which combine negative screening with a positive scoring system, for a number of years. Since inception of each SRI index, of the seven indices (World, US, EMU, Japan, UK, Pacific, EM) only the US has underperformed its comparator non-SRI index (ie. MSCI US vs MSCI US SRI) in terms of total return (note inception dates vary for each index).

The same is true when you look at it on a risk adjusted basis using the Sharpe ratio (unit of return per unit of volatility/risk). This counters another common critique that excluding certain sectors from a portfolio can increase concentration and potentially the overall risk of a portfolio.



## Contact

To find out more about the Heartwood strategies, visit our website or contact your local representative.

### What does this mean for those looking for a multi asset solution?

It is our belief that multi asset investing offers the best potential for long term risk adjusted returns and that investors who want ethical solutions should not have to compromise. This is supported by research we have carried out with professional intermediaries (IFA's), which revealed 81% would prefer to invest in a globally-diversified ethical portfolio for their clients (when given an ethical mandate). Taken together, these points suggest that ethical multi asset investment solutions will likely experience significant development over the years to come.

**Benjamin Matthews**  
Investment Associate

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