Heartwood
Investment Management

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Investment Insight

Understanding socially responsible investing indices

What are socially responsible indices?

Conventional investment market indices (like the S&P 500 or FTSE 100) tend to reflect a set of companies proportionally according to their 'market capitalisation'. This means that the weighting of a company in a given index reflects the total value of that company's shares in circulation.

Socially responsible investing (SRI) indices go a step further, incorporating sustainable investment factors into their composition. This could mean only including those companies which score most highly on environmental, social and governance (ESG) issues.

Who uses them?

SRI indices have been designed to meet the needs of investors who want their money to make a positive impact – supporting and incentivising good corporate and government behaviour – whilst still gaining broad exposure to investment markets.

SRI indices can be used by both active fund managers (who use their own expertise to select specific portfolio holdings) and passive investment products (which aim to track the components and weightings of an index).

How are they made?

While there is no single methodology, the indices designed by global index provider MSCI are among the most widely used. MSCI constructs its SRI indices by:

1. Screening out sectors whose products are deemed to have a negative impact on society or the environment (for example, tobacco, alcohol, gambling, weapons and adult entertainment are all excluded).
2. Giving each company an ESG score, and removing those which fail to meet a requisite level.
3. Excluding those companies involved in serious controversies.
4. Keeping roughly the same allocations to each sector as the wider universe (so that the index roughly reflects the marketplace), then weighting the remaining companies by market capitalisation.

What do they look like?

As SRI indices necessarily exclude the shares of some companies, they are naturally more concentrated than wider market indices. Indeed the MSCI World SRI index has 392 constituents compared to the unmodified MSCI World index, which holds 1650 companies.

Despite being more concentrated, though, SRI indices remain highly diversified across sectors and companies.

How have they performed?

Over the longer term, SRI indices perform very similarly to wider market indices. They provide a comparable risk and return journey, though with some deviations over shorter time periods.

As evidenced by the chart on the next page, the last 12 years have actually seen some SRI indices outperform their unscreened counterparts – since 2007, MSCI World SRI has outperformed MSCI World, and with slightly lower volatility.

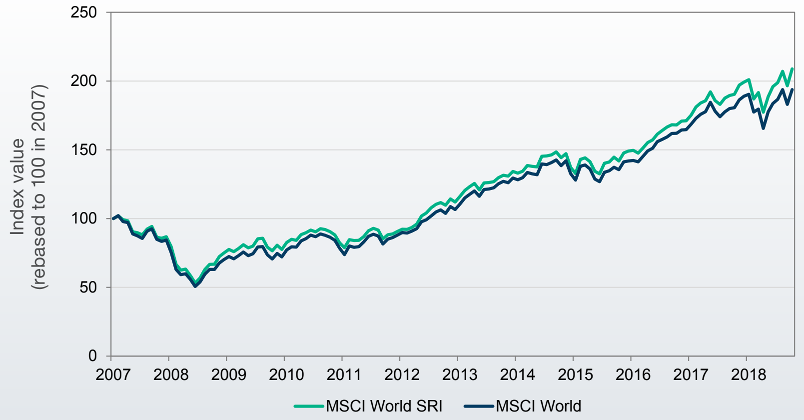
Clear Thinking

Contact

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

SRI indices offer a similar investment journey to wider market indices

MSCI World SRI index vs MSCI World index



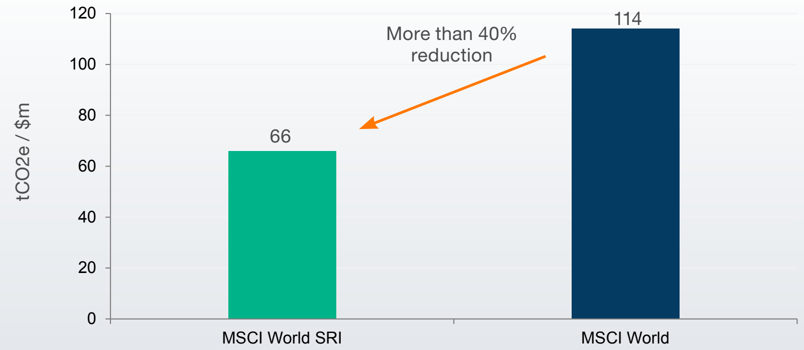
Source: MSCI

Past performance is not a reliable indicator of future results.

Besides investment returns, SRI indices have also performed well in terms of their sustainable impact. The chart below highlights the difference between the carbon footprint of underlying companies in an SRI index and the unscreened equivalent.

SRI index companies have demonstrated lower carbon dioxide emissions

Tonnes of carbon dioxide (tCO2e) emissions per million dollars invested



Source: MSCI. Covers Scope 1 and 2.

Past performance is not a reliable indicator of future results.

Why are we talking about SRI indices?

There are passive investment products (ETFs) which track SRI indices. SRI ETFs are a fantastic way of capturing returns and incentivising good corporate behaviour, and allowing us to invest in and capture the performance of SRI indices. While SRI ETFs tend to have slightly higher fees than their unscreened counterparts, they are still a very cheap means of gaining market exposure.

Consequently, SRI ETFs are used widely in the Heartwood Sustainable strategies, where we are always interested in finding cheap, broad, and sustainable exposure to key areas of the marketplace.

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Important Information

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