HARGREAVES LANSDOWN

GUIDE TO RESPONSIBLE INVESTMENT

Put your principles into practice.

IMPORTANT INFORMATION

This guide is not personal advice. All investments fall as well as rise in value, so you could get back less than you invest. Past performance is not a guide to the future. If you are unsure of the suitability of an investment for your circumstances, please seek advice.

Investing in individual companies isn't right for everyone. Shares are for people who understand the increased risk of investing in individual shares. If the company fails you risk losing your whole investment.

You should make sure you understand the companies you're invested in, their specific risks and make sure any shares you own are held as part of a diversified portfolio.

When buying shares please be aware that on rare occasions shares can be delisted from the stock market, without warning. If this happens it may be difficult and costly, or even impossible, to sell your shares.

This is issued by Hargreaves Lansdown Asset Management. **www.hl.co.uk**

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INTRODUCTION

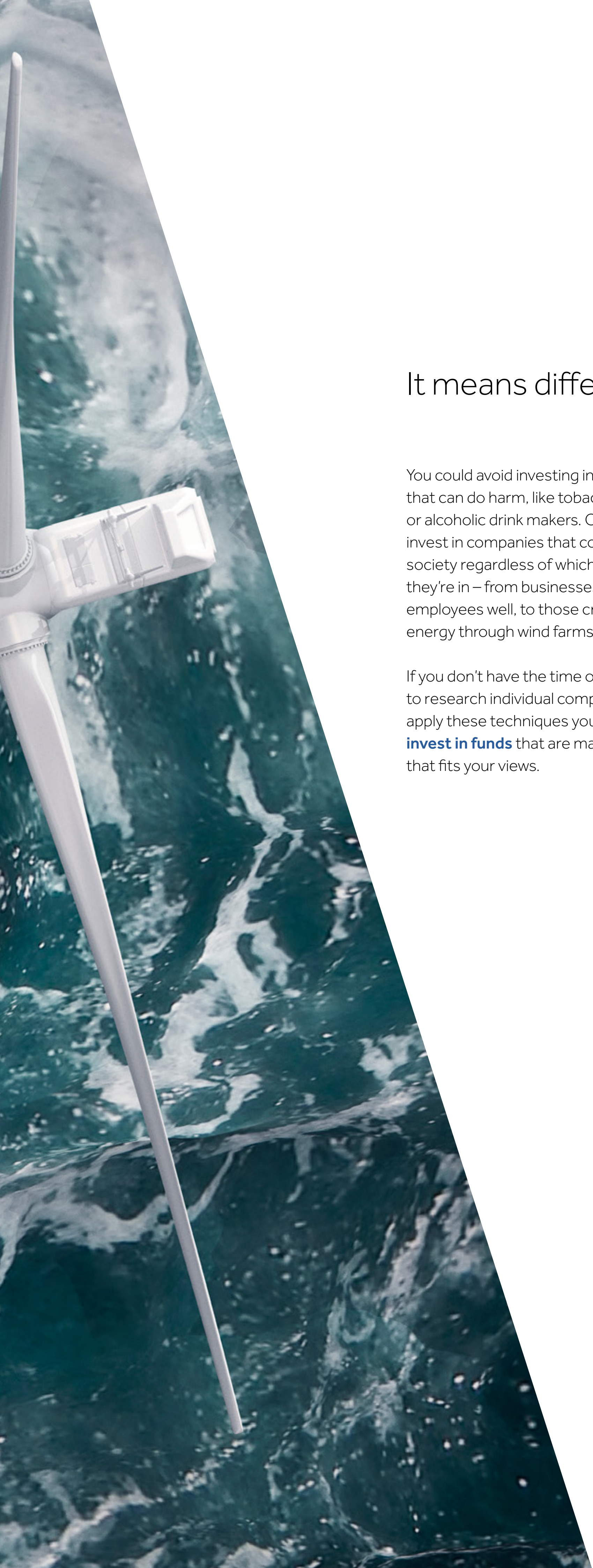
The case for investing is simple. To grow your money over time.

DOMINIC ROWLES
Investment Analyst

But investing can be about so much more than just trying to make money. You can use your investments to benefit the environment and society, as well as yourself. And there are lots of ways to go about it.

Responsible investment means different things to different people. In this guide, we break down the jargon and look at some of the main ways you can align your principles with your investments.

WHAT IS RESPONSIBLE INVESTMENT?



It means different things to different people.

You could avoid investing in companies that can do harm, like tobacco producers or alcoholic drink makers. Or you could invest in companies that contribute to society regardless of which industry they're in – from businesses treating their employees well, to those creating clean energy through wind farms or solar panels.

If you don't have the time or knowledge to research individual companies and apply these techniques yourself, you could **invest in funds** that are managed in a way that fits your views.

Funds can be a great way to invest in lots of businesses of different sizes, in different industries across the globe. One of the big benefits is that fund managers can talk to companies they invest in to encourage them to become more ethical or socially responsible.

There are more options than ever for investors who care about where their money is going. We look at the main ones in this guide. But remember, the following categories aren't mutually exclusive, meaning several could apply to a particular fund.

STEWARDSHIP

Working with companies to drive improvement.

Fund managers practicing good stewardship normally see themselves as part-owners of the businesses they invest in and want to make sure they're run in a way that benefits all shareholders.

Managers focused on stewardship normally engage with company management to make sure their voices are heard on issues that are important to investors, either by using their votes at annual general meetings (AGMs) or contacting company managers directly.

Lots of fund managers use their bargaining power to push positive change. That might include cost-cutting measures, or changes to a company's senior management. But some go a step further.

Some lobby company managers on environmental, social and governance issues. That could range from setting targets to reduce waste and carbon emissions to making sure companies treat their suppliers, customers and employees well.

Most mainstream fund management companies practice stewardship in one form or another. To find out more about how stewardship is integrated in a given fund, you'll need to check its prospectus.

How could this affect performance?
A focus on stewardship has the potential to boost returns. If shareholders work with company management to bring about positive change, such as greater efficiency or productivity, this could boost performance in the long run.

Attentive shareholders can also provide an additional layer of scrutiny for company managers, helping to ensure that investors' interests are at the centre of corporate decision-making.

Who might be interested in stewardship funds?

- Investors who want to make sure their money is invested in a responsible way
- Those who want their fund managers to encourage companies to change for the better

ESG INTEGRATED FUNDS

A flexible way to invest with principles.

Investing in a fund that looks at ESG (environmental, social and governance) factors in its investment process is one of the least restrictive ways to incorporate your values into your investments. That said, some will still avoid investing in certain areas, like mining and tobacco, even though they technically could invest here.

When analysing a company, a manager of an ESG integrated fund will consider environmental, social and governance factors as part of their wider research.

Their main goal is to invest in companies with the strongest prospects, but they think ESG factors play an important part in the long term performance of a company. Managers of ESG integrated funds will often also engage with companies to encourage changes where necessary (see "Stewardship" on page 6).

Taking ESG factors into account can help fund managers avoid potential issues. For example, a mining company might be less likely to face bad press if they have robust environmental and safety policies in place. And it'll be less likely to face industrial action if it treats its workers fairly.

We look at a selection of ESG funds in more detail in the Responsible Investment and ESG section of our **website** but each manager will work ESG factors into their investment process in a different way.

For more information on how ESG is integrated into a fund, you'll need to read its prospectus.

How do we expect them to perform?
ESG integrated funds can invest in any part of the stock market, as long as a company meets their criteria. This means they have the potential to perform just as well as funds that don't place specific importance on ESG factors.

Who might be interested in ESG integrated funds?

- Those who want to invest responsibly without imposing specific restrictions on their investment
- Those who think companies with a focus on environmental, social and governance issues could perform well over the long run
- Those who want to make sure the diversification of their investment is not impacted by their desire to invest responsibly

EXCLUSIONS

Avoid investing in areas that don't line up with your principles.

Exclusions-based funds, also known as 'ethical' or 'negatively-screened' funds, won't invest in companies, industries or countries that don't meet their moral criteria. Companies that damage the environment, like those in the mining and oil & gas industries, are often excluded, as are weapons manufacturers, and tobacco companies.

The exact restrictions will vary from fund to fund, so it's important to check the details. We look at the exclusion criteria of a selection of funds in the Responsible Investment section of our **website**. But you'll find a more detailed description of each fund's criteria in its prospectus.

How do we expect them to perform?
Exclusions-based funds have the potential to perform well over the long term but their performance will differ from that of more conventional funds. If areas they can't invest in do well, they could underperform compared to unrestricted funds. But exclusions-based funds could do well if these areas suffer a setback.

Lots of the areas where exclusions-based funds can't invest, like tobacco and some healthcare businesses, tend to be the ones that make money whatever shape the economy is in. It means they tend to invest more in cyclical businesses, like those in the technology or financial sectors, whose share performance tends to mirror the health of the economy. Profits and dividends rise during the good times, but suffer during slumps.

Exclusions-based funds also tend to invest more in small and medium-sized businesses than other funds. That's because lots of large businesses operate in areas these funds can't invest in, like oil and gas. Smaller companies have excellent long-term growth potential but they can be more volatile than larger ones, which makes them higher-risk.

Who might be interested in exclusions-based funds?

- Those who want to avoid certain industries for ethical, religious or values-based reasons
- Those prepared to accept that exclusions-based funds will perform differently from unconstrained funds

SUSTAINABILITY FOCUS AND IMPACT INVESTING

Make a difference with your money.

Sustainability-focused funds try to make money by investing in companies that are more sustainable than their competitors or that are likely to benefit from the growing need for more sustainable goods and services. No area is specifically off limits but companies must usually fulfil certain sustainability-related criteria or deliver a specific, measurable sustainability outcome.

Funds may apply a variety of approaches including 'best in class' (focusing on sector-leading companies) and 'positive tilt' (investing more in companies that score highly on sustainability measures). Importantly, these approaches may mean having exposure to companies some may not consider to be 'sustainable'. For example, an oil company that is in the process of moving to renewable energy, but is nonetheless still an oil company today.

Impact funds go one step further. They must measure and report back on the impact they set out to make on the environment and society. They might invest in companies that save a quantifiable amount of water, or avoid producing a certain amount of carbon dioxide. That means they're often more restricted on where they can invest than sustainable funds, but each investment has a direct, measurable impact.

For example WHEB is a fund management company that use an impact approach. £10,000 invested into the fund throughout 2020 helped:

- Generate 2 MWh of renewable energy
- Avoid 3 tons of carbon dioxide emissions
- Treat 27,000 litres of waste water for reuse
- Recycle or recover 1 ton of waste material
- Provide 3 days of tertiary education
- Five people receive healthcare treatment, and saved £270 of costs through more efficient healthcare systems

This is an example, not a recommendation to invest.

HOW DO WE EXPECT THEM TO PERFORM?

The global population is expected to grow significantly in the coming decades. That means we'll need to make major developments in areas like clean water, sanitation, energy generation and healthcare. Funds investing with sustainability at the heart of their approach have the potential to benefit from these trends.

But spotting long-term trends is the easy part. Identifying companies that can benefit most from them is harder. There are lots of factors that will affect a company's performance over the long term which is why it's also important to invest with a talented fund manager. Please remember that all investments fall as well as rise in value, so you could get back less than you invest.

We look at a selection of sustainability-focused and impact funds in the Responsible Investment and ESG section of our **website**.

WHO MIGHT BE INTERESTED IN SUSTAINABILITY-FOCUSED AND IMPACT FUNDS?

- Those who want to know their money is doing something good
- Those who want exposure to potential long term growth themes

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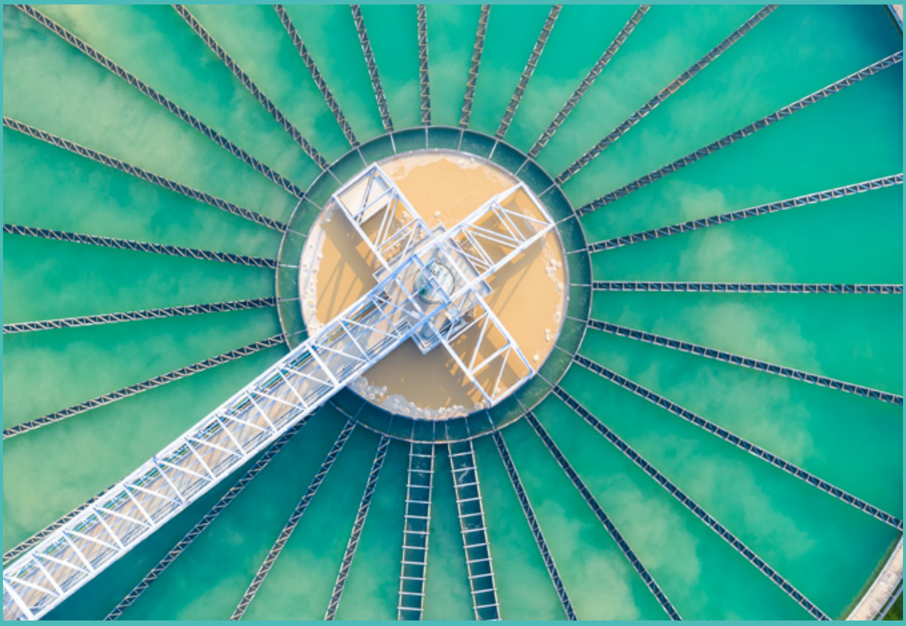

TRACKER FUNDS

A simple way to invest with your morals in mind.

WHAT ARE THEY?
There are many different types of responsible tracker.

Some use an exclusions-based approach and won't invest in industries like tobacco, munitions and coal. They could do this either by tracking a screened index, like the FTSE4 Good, or tracking an index that hasn't been screened, like the FTSE All-Share, and investing in all of the companies in that index that meet their criteria.

Other trackers invest in all of the companies in a given index, but adjust the size of their investments depending on how well each company scores against a set of environmental and social criteria.

Key Investor Information Documents (KIIDs) will have more information how a fund tracks its index, and what index it aims to track, along with the underlying risks of the fund.

Tracker funds can be a great way to invest in lots of different companies at low cost. Our beginners guide to funds gives you more detail on the **differences between active and passive funds**.

How do we expect them to perform?
The performance of funds that make their own exclusions, or those with the flexibility to increase or reduce the size of their investments, will be different to the broader region or sector being tracked. How much it differs will depend on how restrictive the fund's criteria is.

Since the exclusions are likely to take out some big companies from the index, tracker funds might be more concentrated towards companies at the smaller-end of the index, which can be higher-risk, as well as cyclical businesses.

Tracker funds that aim to track a pre-screened index, like the FTSE4Good, should see performance that's close to that index.

Who might be interested in tracker funds?

- Those who want to invest in a simple and easy to understand fund
- Those who want to invest at a low cost

SHARES

Have more control over where you invest.

If you have specific criteria or beliefs that you want to be fully reflected in your investments, it might be hard for you to find a fund that completely suits your needs. Choosing individual companies to invest in might be the best way to align your principles with your investments.

WHY SHARES?
Investing directly in shares will give you extra control over where your money's invested.

Control is important because responsible means different things to different people. For example, you might have concerns over investing in pharmaceuticals, but not every responsible fund manager will screen these stocks out.

Picking shares yourself gives you the maximum possible control. But you won't get the expertise of a professional fund manager, and remember, individual share prices can fluctuate more than a diversified investment like a fund. That means there are extra risks attached. So investing in shares isn't for everyone.

HOW TO CHOOSE?
When choosing shares, you can use a responsible approach, just like a fund manager would. But how do you choose?

Over recent years, more companies have started thinking about their position on corporate, social and environmental responsibility. And companies release more information about it than ever before.

Although this is great for visibility, it also means when investing responsibly there's no substitute for research.

We think that's fair enough. As choices of responsible investments are based on your personal perspective and objectives, it's important to take some time to make sure your investments are right for you.

A good place to start could be a company's annual reports. When doing so, you might want to think about whether their business activities have environmental and social impacts, and also who their customers and suppliers are. We offer **research on a large number of shares**. To access this research, just check the factsheet of the share you are interested in, and click the HL Research tab.

Regardless of whether you invest responsibly or not, when you pick shares you should always think about the long-term potential of the company. Buying shares in a company doomed to failure isn't a good idea, however responsible it might be.

As we explore in our **guide to picking shares**, profitability, growth and dividend-paying potential are all things to consider.

READ THE GUIDE NOW →

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