SAFAA MONTHLY

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Stockbrokers and Financial Advisers Association

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BY JASON TODD, Head of Investment Strategy, Macquarie Wealth Management

AN INTRODUCTION TO ESG investing

ESG investing is in an explosive growth phase. Investors are focused on investment options that incorporate ESG principles, investment managers are integrating ESG criteria into selection processes and businesses are increasingly focused on being better corporate citizens.

We see this as a very positive development. Better corporate citizens should, in time, be rewarded with a lower cost of capital and higher valuations. At the same time, more socially and environmentally aware behaviour has obvious positive implications for the wellbeing of the planet. The rapid pace at which ESG investing is becoming mainstream means investors increasingly need an understanding of the subject area, what they should be focused on and how it might impact their portfolios.

We know the ESG backdrop is complex and changing rapidly. In addition, what might present as an investment challenge now, may end up be widely available in the not-too-distant future. When all is said and done, investors should understand that there is no silver bullet for sustainable investing. Every individual has a different sustainability compass, how sustainable practices are implemented by investment managers may/will differ by manager and asset class and ultimately what an individual is prepared to give up in pursuit of their sustainable goals may also vary.

When all is said and done, investors should understand that there is no silver bullet for sustainable investing. Every individual has a different sustainability compass, how sustainable practices are implemented by investment managers may/will differ by manager and asset class and ultimately what an individual is prepared to give up in pursuit of their sustainable goals may also vary.

What is ESG investing?

ESG investing is an investment process which incorporates environmental, social and governance (ESG) criteria either alongside traditional financial analysis or on its own.

Environmental factors consider how a company performs as a steward of nature. Social factors examine how an organisation manages relationships with employees, suppliers, customers, and the communities where it operates. Governance deals with such things as a company's leadership, executive pay, audits, internal controls, and shareholder rights.

ESG investing, sustainable investing, responsible investing and ethical investing are all terms that describe investing strategies that consider how a social or environmental good can bring about a positive social change according to investor values.

ESG investment has grown to include a variety of approaches that are intended to enhance returns and better manage risks by including the pursuit of environmental and social change.

Why is ESG growing in importance?

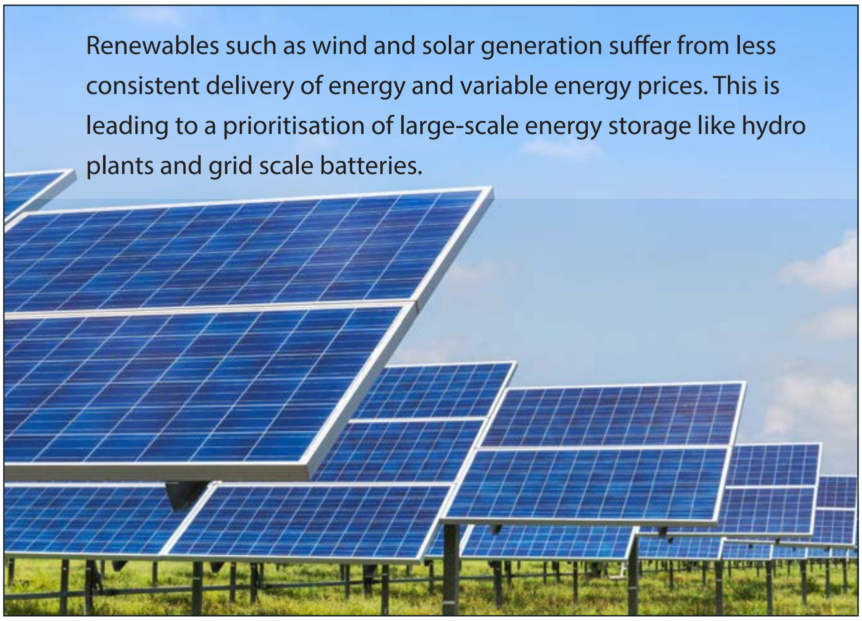
ESG investing began with socially responsible investors looking to exclude stocks or industries or even countries that they believed did not satisfy their social ideals. Over time, investors, fund managers and corporates have come to appreciate the benefits of incorporating ESG factors into their investment process rather than just excluding "sin" sectors.

As a result, ESG investing has evolved from a narrowly applied set of criteria to a process that is now helping address some of the major issues facing society. For instance:

- According to the World Economic Forum's 2018 Global Risk Report, Environmental dangers (E), inequality (S) and cyber vulnerabilities (G) are three leading trends creating both risk and opportunities for investors.
- Significant decarbonisation on a global scale is required to meet the Paris Agreement challenge of containing global warming to 2 degrees Celsius above pre-industrial levels.
- Rising inequality within nations is an important issue, driven in part by adverse consequences of technological advances and high structural underemployment.
- Cybersecurity is a growing issue linked to the increased digitisation of society. With cybercrime growing quickly it is also creating opportunities for those businesses combating it.
- Rules and regulations: The investment landscape is increasingly changing due to greater regulation. For example, ESG investing is helping to address the risks of government restrictions on developing trends such as sugar levels in foods, greater checks on supply chains, the use of child labour, and legally enforceable exclusions on controversial weapons such as cluster bombs;
- Sustainable Development Goals (SDG): The UN's 17 SDGs are a global initiative to create a better world while also earning a return on investment. The Goals tackle issues ranging from eradicating hunger to improving education for girls.

UN's 17 Sustainable Development Goals

Source: United Nations



What is coming for ESG investment?

The COVID-19 pandemic proved to be a catalyst for innovation. Renewables such as wind and solar generation suffer from less consistent delivery of energy and variable energy prices. This is leading to a prioritisation of large-scale energy storage like hydro plants and grid scale batteries. In January 2021, Macquarie Bank was involved in the creation of a financial instrument by which energy storage can be traded, helping mitigate some of the risks of renewable energy.

The investment industry is also responding to the rapid changes through the increase of sustainable offerings as inflows into global sustainable funds accelerates in 2021.

Progress also continues to be made on addressing ESG issues that are often nuanced and dependant on investor philosophy. For example, a greater acceptance of companies in "transition" is enabling carbon emitting companies to gain funding for renewables investment. Investors are also increasingly accepting that small or emerging market companies lack the resources of large developed market companies and that they must be assessed in this context.

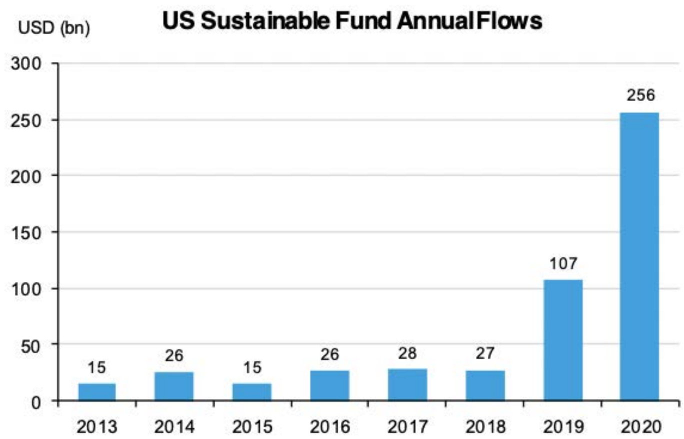
We believe the next decade will be driven by the following themes:

1. Decarbonisation (climate change) + investment options
2. Resource efficiency (using less while producing more) + investment options
3. Circular economy (better resource efficiency and wasting less) + investment options
4. Green(er) transport (moving away from fossil fuels) + investment options

When all is said and done, investors should understand that there is no silver bullet for sustainable investing. Every individual has a different sustainability compass, how sustainable practices are implemented by investment managers differs by manager and asset class and ultimately what an individual is prepared to give up in pursuit of their sustainable goals will also vary.

When investors begin this journey, it could be on a small scale encompassing single investments or it might be across an entire portfolio which is now a very realistic outcome. Sustainable investing does not need to be complicated or daunting because every individual determines their own outcome and we have provided a simple three step process for an advisor-client conversation to begin. ■

Sustainable fund flows strong despite market turmoil



Source: Morningstar, MWM Research, March 2021

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Value: why this is a long-term play *Wednesday 13 October | 1.00 to 2.00pm*

Vanguard expect value to outperform growth in the next five to ten years. Join three Vanguard representatives who will discuss what has really driven the long-runing underperformance of value stocks and how to incorporate the value factor into portfolios to help your clients thrive.

FASEA CPD: 1.00 hour Technical competence | RG146: 1.00 Specialist knowledge – Securities


Beatrice Yeo


Ian Boater


Matthew Cho

Anti-hawking provisions: what are the impacts? *Wednesday 20 October | 1.00 to 2.00pm*

With the 5 October introduction date fast approaching, join Michelle Levy and Simun Soljo from Allens who will explain how the new provisions will impact stockbrokers and investment advisers, clarify the grey areas and run through ASIC's updated regulatory guide.

FASEA CPD: : 0.5 hour Regulatory compliance and consumer protection, 0.5 hour Client care and practice | RG146: 1.00 Generic knowledge

Cybersecurity: managing threats and risks *Wednesday 27 October | 1.00 to 2.00pm*

Cyber-crime is big business and attacks are 24/7/365, with vulnerabilities being easily exploited. Shane Bell, a cybersecurity and digital forensic specialist, will outline how organisations can set themselves up for cyber resilience and data security.

FASEA CPD: 1.00 hour Regulatory compliance and consumer protection | RG146: 1.00 Generic knowledge


Shane Bell

Yield, alpha, ESG: you can have your cake and eat it too *Wednesday 10 November | 1.00 to 2.00pm*

The investment process for the Pengana International Equities LIC eschews companies engaging in unsustainable business practices or pursuing short-term profits at the expense of long-term growth and stability. Hear from the team behind Australia's largest international ethical LIC.

FASEA CPD: : 0.5 hour Technical competence | RG146: 1.00 Generic knowledge


William Deer


Conor O'Daly

Gold in the decade ahead *Wednesday 24 November | 1.00 to 2.00pm*

Gold rallied strongly in 2020, with the USD gold price rising by 25% as pandemic threats reignited safe haven demand. The precious metal has corrected, even as inflation rates rise around the world. Jordan Eliseo will discuss what the key drivers of demand, and the future outlook, are likely to be.

FASEA CPD: 1.00 hour Technical competence | RG146: 1.00 Generic knowledge


Jordan Eliseo

Practitioner & Organisation Members: FREE
Non-Members: $55.00

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Building a sustainable portfolio

The investment strategists at iShares work with a variety of ETF investors to help them address a wide range of portfolio construction issues. These challenges run the gamut of portfolio construction questions: How do I create a diversified portfolio that can help target my goals? What are the risks that I should be aware of and how do I mitigate them? What trade-offs should I consider when making portfolio decisions? In recent years, ETF investors are increasingly asking: how can I build a portfolio that is aligned with my clients' additional goals and aspirations in sustainability?

Understanding your current portfolio's sustainability

Once an investor has decided to pursue a more sustainable portfolio, the next question is one of how to go about it and how much improvement can the portfolio achieve from a sustainability perspective?

For many investors, their existing portfolio already consists of some level of sustainable exposures; however, those investors who do not target sustainability explicitly are likely to also be holding exposures that are much less sustainable. Even if the investor has not given a moment's thought to environmental, sustainable and governance (ESG) ratings, they are holding stocks and bonds of companies and countries that are, for instance, going to adapt their business practices in response to climate change, or not; companies that are adapting their business practices to increase boardroom diversity and hire and retain talent, or not; companies that are managing governance issues, or not.

Therefore, when setting out to build a sustainable portfolio, a key first step is to understand the ESG profile of your current holdings. Consider the following illustrative example: an investor owns a diversified portfolio with a 60/40 growth/defensive mix, which includes a blend of domestic, developed market and emerging market equities exposures alongside a blend of domestic and international bonds. Using indices as proxies for each asset category, that portfolio could look like Portfolio 1 (below).

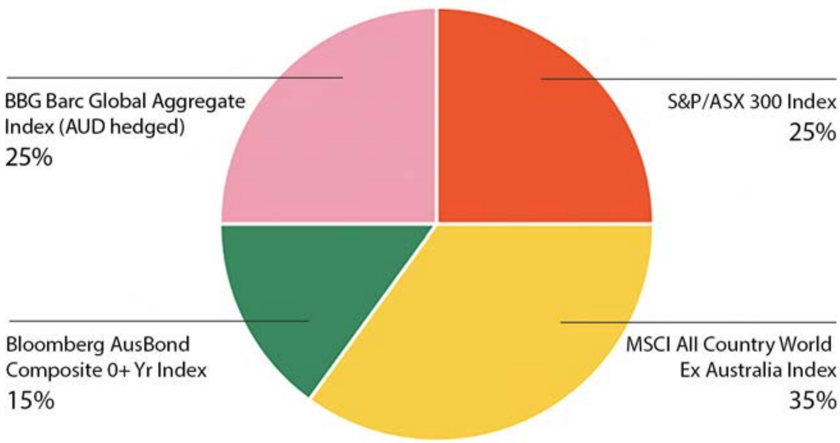
We calculate that that Portfolio 1 has an MSCI ESG Quality Score of 5.6 and an MSCI Weighted Average Carbon Intensity of 182 tonnes CO2 emissions/$m sales.[1]

Seeking greater portfolio sustainability

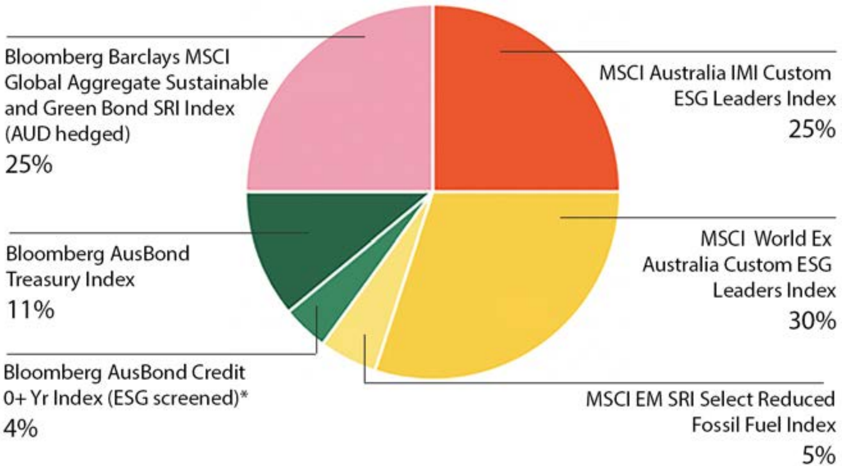
Now, consider a comparable portfolio with a sustainability focus (see Portfolio 2 overpage).

This new, more sustainable portfolio achieves an MSCI ESG Quality Score of 8.0 and an MSCI Weighted Average Carbon Intensity of 121 tonnes CO2 emissions/$m sales, which provides

PORTFOLIO 1: HYPOTHETICAL ORIGINAL PORTFOLIO



PORTFOLIO 2: SUSTAINABLE PORTFOLIO EXAMPLE



the investor with an uplift in exposure to entities with positive ESG business practices while lowering exposure to carbon intensive entities. To help put the carbon emissions reduction into perspective, every 61 tonnes of CO_2 emissions saved is equivalent to over 7.4 million smartphone charges!

All the while, the new portfolio maintains an asset allocation and characteristics that are not unlike the original portfolio. Correlation and tracking error are measures often used to demonstrate the similarity or difference in two exposures, and in this instance, the sustainable portfolio has a relatively high correlation (0.99) and low expected tracking error (1.2%) to the original portfolio.[2]

Such an approach can be created by using the iShares ESG suite of funds, which seeks to balance the pursuit of a similar risk and return to the relevant broad market with a more sustainable outcome.

Concluding remarks

Sustainable investing is like any other type of investing. The first step is always to determine the goal one is investing towards, and how much risk one is willing to take to get there. Investment decisions often involve balancing different trade-offs. For instance, a drawback of eliminating exposures to certain companies is that one could be reducing the diversification of their portfolio. This perspective needs to be weighed against the positives, such as the potential for higher quality attributes of companies earning high ESG scores, and the opportunities presented by the transition to a green economy. Moreover, incorporating an ESG lens into the investment decision-making process can help bolster portfolio management and governance, by taking a more holistic view of risks and opportunities facing a company, beyond the scope of traditional financial analysis.

There are also implementation considerations when one is looking to transition to a more sustainable portfolio. For investors deploying cash to invest into a sustainable portfolio, implementation is relatively straightforward. For those with existing investments, there may be tax implications and other matters to consider. The investor would need to consider the various trade-offs, but it is important to reiterate: the average portfolio is already impacted by sustainable trends. The question is whether, when constructing a portfolio, the investor maximises the opportunities and manages the risks to adapt to a changing world.

Portfolio characteristics: Before & after

	Portfolios side-by-side	
	Original Portfolio	**Sustainable Portfolio**
Expected Risk (%)	7.7	7.5
ESG Quality Rating	BBB (average)	AA (leader)
ESG Quality Score	5.6	8.0
ESG Coverage (%)	79	95
Carbon Emissions Intensity (tonnes CO_2/$m sales)	182	121

Source: MSCI, Aladdin, risk and holdings as at 30 July 2021, ESG data as at 11 August 2021

Portfolio differences

Correlation	0.99
Tracking Error (%)	1.2
ESG Improvement	44% improved
Carbon Improvement	34% improved
Carbon Emissions Differential (tonnes CO_2/$m sales)	61

Source: MSCI, Aladdin, risk and holdings as at 30 July 2021, ESG data as at 11 August 2021.

[1] Source: MSCI, constituents as at 30 July 2021, ESG data as at 11 August 2021.
[2] Source: Aladdin, as at 30 July 2021.

BY TONY KAYE, Senior Personal Finance Writer, Vanguard Australia

How investors are using ETFs for global exposure

The response to the COVID-19 pandemic has been the key driver for one of the biggest surges in global investment flows ever seen, with more and more investors tapping into booming share markets.

Those inflows have spurred many share markets around the world, including ours, to record highs.

The boom conditions on markets reflect rising investor confidence as global economic and business conditions continue to improve.

This has largely been the result of massive government stimulus programs, record low interest rates, and the rapid rollout of COVID vaccines.

If the same pace of global investor inflows continues over the rest of this year, equity funds alone are expected take in record amounts of investment money in 2021.

More investors are thinking globally

Beyond their direct holdings into specific stocks listed on the Australian Securities Exchange, an increasing number of Australian investors are also adding equity exchange traded funds (ETFs) to their portfolio to gain international exposure and diversification.

This trend is likely to increase over time as investors lift their global exposures to different types of asset classes.

A reliable indicator of the international inflows from Australia is the monthly data from the ASX showing investments into globally focused ETFs.

If the same pace of global investor inflows continues over the rest of this year, equity funds alone are expected to take in record amounts of investment money in 2021.

The ASX's data shows that in August this year alone there were more than $2.5 billion of funds inflows into global (non-Australian) equity ETFs.

Investors now have almost double the amount of funds invested in global equity ETFs on our market than they do in Australian equity ETFs.

At the end of August globally focused ASX-listed equity ETF products accounted for more than $63 billion in funds under management versus around $32 billion for Australian equity products.

The global equity total is more than double the $27 billion in global equity funds under management at the end of June 2020.

The ASX splits global funds into the categories of Equity Global (broad-based products), Equity Asia, Equity Emerging Markets, Equity Global Sectors, and Equity Global Strategy.

Equity Global, which has around $26 billion in funds under management, accounted for $718 million of net ETF inflows in August. These are broad products that invest across countries, continents and in several cases the entire world.

Equity Global Strategy, which incorporates funds that have been designed around specific investment strategies, had the largest net inflows in August totalling $1.44 billion.

Vanguard currently has five ASX-listed funds in this category: Vanguard Ethically Conscious International Shares Index ETF (VESG); Vanguard Global Value Equity Active ETF (VVLU); Vanguard Global Multi-Factor Active ETF (VGMF); Vanguard MSCI International Small Companies Index ETF (VISM); and Vanguard Global Minimum Volatility Active ETF (VMIN).

In addition, Equity Global Sectors had about $214 million of net inflows in August.

Following the money

While the lion's share of all global inflows (around $1 trillion) has flowed into U.S. share markets so far in 2021, more than $600 billion has flowed into other country markets and to broader regions such as Europe and Asia.

The rising tide of investor inflows generally has lifted most developed markets, but some more so than others.

Since the start of this year the Australian market, measured by the All Ordinaries Index, is up more than 12 per cent.

By comparison, the U.S. share market, measured by the S&P 500 Index, has gained more than 22 per cent so far this year, and the FTSE All World Index has gained just over 15 per cent.

It's the returns gap between the U.S. and other regions that has been a trigger for some investors to seek out what they perceive to be undervalued markets.

Where and how Australian investors are investing globally is very diverse.

Below are Vanguard's four-largest international ETFs on the ASX, measured by their funds under management.

As evidenced by the monthly ASX data, Vanguard continues to see strong inflows into its range of international ETF products listed on the Australian market that offer low-cost access to a broadly diversified range of securities.

The overall global investment trend, reflected by the record inflows across international markets this year, is a strong sign that more Australian investors (and international investors alike) are diversifying away from their home share market biases. ■

Tony Kaye is senior personal finance writer at Vanguard Australia.

Vanguard MSCI International Shares Index ETF (VGS)

Provides exposure to more than 1,500 of the world's largest companies listed in major developed countries.

$4.18 billion in Australian funds under management at 30 August 2021.

Vanguard U.S. Total Market Shares Index ETF (VTS)

Provides exposure to around 3,900 of the largest companies listed in the U.S.

$2.94 billion in Australian funds under management at 30 August 2021.

Vanguard MSCI Index International Shares (Hedged) ETF (VGAD)

Provides exposure to around 3,900 of the largest companies listed in the U.S.

The ETF is hedged to Australian dollars so the return (income and capital appreciation) of the ETF is relatively unaffected by currency fluctuations.

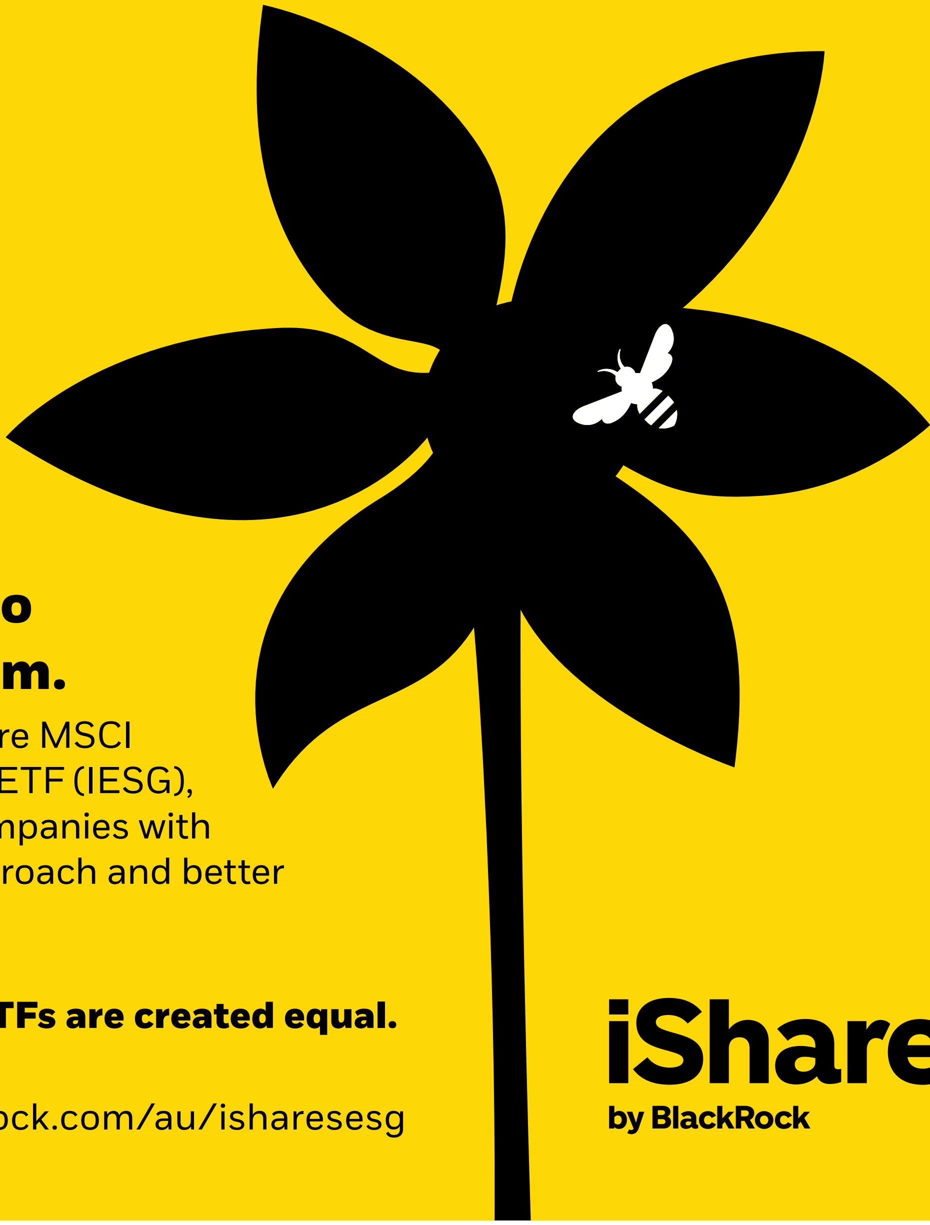
$1.76 billion in Australian funds under management at 30 August 2021.

Vanguard All-World ex U.S. Shares Index ETF (VEU)

Provides exposure to more than 3,500 of the world's largest companies listed in major developed and emerging countries outside the U.S.

$2.37 billion in Australian funds under management at 30 August 2021.

AIM TO DO GOOD BY THE PLANET AND YOUR BOTTOM LINE



Build a portfolio for the long term.

Introducing iShares Core MSCI Australia ESG Leaders ETF (IESG), providing access to companies with a more sustainable approach and better positioned to grow.

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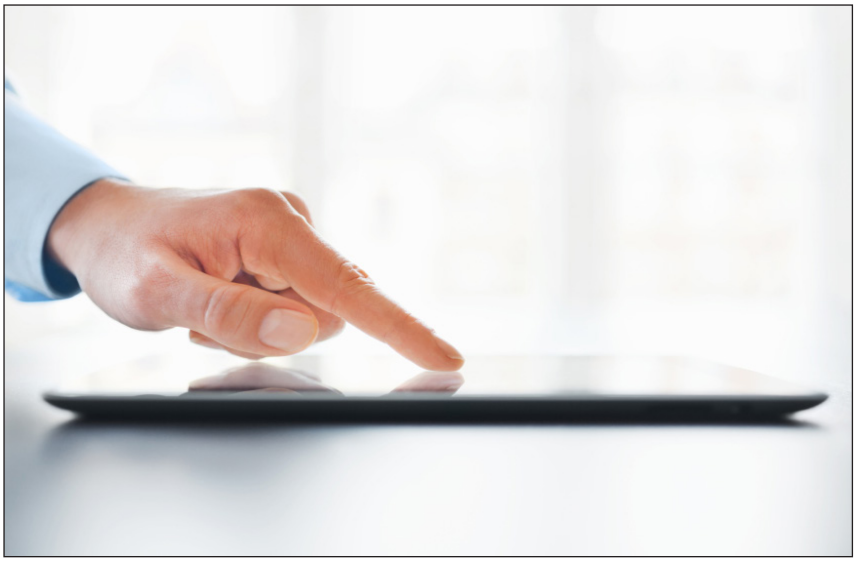
BY ASIC

Social media led pump and dump stocks

ASIC has noted a concerning trend of social media posts being used to coordinate pump and dump activity, which may amount to market manipulation in breach of the *Corporations Act 2001*.

This activity impacts on market integrity and can harm investors who buy a stock just before the promoters sell out and the price falls, resulting in significant losses.

ASIC expects market participants (participants) as gatekeepers to take active steps to identify and stop potential market misconduct, both through pre-trade filters and post-trade reviews of trading. Where participants have seen unexplained price movements, they should also consider if there is discussion on social media or other channels that may be suggestive of a coordinated plan to manipulate the market.



ASIC expects market participants (participants) as gatekeepers to take active steps to identify and stop potential market misconduct, both through pre-trade filters and post-trade reviews of trading.

Participants should consider the circumstances of all orders as required under the manipulative trading provisions in Rule 5.7.2 of the ASIC Market Integrity Rules (Securities Markets) 2017, and to be aware of indicators of manipulative trading including:

- coordinated trading by clients (timing, location and IP addresses) in volatile stocks
- possible misinformation, pump and dump activity or layering of the order book
- clients who aggressively cross the spread and ignite momentum
- clients wanting to trade stocks that are running on no news
- clients whose transaction activity is inconsistent with their history and profile.

Participants should be on the lookout for groups of clients who trade in the same stock, in the same direction and around the same time. They may have opened accounts at a similar time, be referred by the same person, have the same account contact details, or transfer funds between themselves.

ASIC expects participants to promptly submit suspicious activity reports where they see this type of activity.

ASIC is continually monitoring the market for this type of activity and proactively warning investors about the risks of participation. ■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SUPER SNIPPETS | by Peter Grace

Perils of ageing

Self-Managed Super Funds have been around in their current form for over 30 years. A key feature of an SMSF is that every member must be a trustee of the fund (or a director of a corporate trustee).

With an APRA regulated fund, the members are not involved in running the fund. In an SMSF, the members must take responsibility for the fund's operations. Trustees can employ the expertise of advisers, accountants, administrators, stockbrokers and auditors, but will always retain the responsibility to do the right thing. It can be a complex and time-consuming task to stay on top of the regulatory requirements.

Initially, new trustees may exhibit pride in running their fund and taking responsibility for building their own retirement funds. As they get older, they may want to reduce their involvement due to declining energy or health, particularly a reduction in mental capacity.

Many SMSFs have two trustees and often one is the key decision maker. The incapacity of this primary trustee may pose real problems for the ongoing performance and compliance of the fund.

There are five options for trustees:

Wind up the fund. Trustees can cash out their super or rollover the assets into an APRA regulated fund. Many retail and industry funds will accept in-specie transfers to avoid having to liquidate assets but real assets like direct property may be more problematic.

Invite the next generation onboard. Through succession planning, trustees can invite their children to join the fund and share the responsibilities of running the fund. This option may become more popular now an SMSF can have six members rather than the previous limit of four.

Stand aside as trustee. An individual trustee can resign their position and use an enduring power of attorney to appoint a replacement trustee. This trusted person must act in the interests of the ageing trustee when acting on their behalf.

Appoint an alternative director. Where a SMSF has a corporate trustee, an alternate director can be appointed to replace the ageing trustee. This is not allowed if a SMSF has individual trustees but may be a reason to convert the fund to corporate trusteeship.

Become a Small APRA fund (SAF). A SAF is like a SMSF but has an APRA-approved trustee. This means the members can retain their fund and control investment decisions – but are absolved of the trustee responsibilities. There would be additional costs to run a SAF and possibly limits on the investments the SAF trustee would accept.

These five options mean older trustees need comprehensive advice to ensure the choice meets their personal needs. ■

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