

a clear conscience and good returns

July 2010

Audrey Ryan explains her approach to making investment decisions based on strict 'dark green' ethical principles.



Investor interest in ethical investing or socially responsible investment (SRI) remains high. Such funds are often categorised by various shades of green depending on the strictness of the ethical criteria applied to investment decisions.

'Dark green' or negatively-screened funds avoid specific unethical activities, and companies or industries associated with moral concerns; the investable universe is typically narrower for funds of this type because they exclude more companies.

'Light green' or positively screened funds (typically referred to as SRI funds) try to invest in companies that the fund manager believes demonstrate the best environmental, social and governance performance, as well as financial performance. Positive screening is a less visible approach to selecting securities than negative screening and investors must ensure they understand the metrics against which 'best-in-class' are being measured.

strict ethical screening

In managing our ethical funds, we use highly selective investment criteria. The ethical screening process evaluates the effects that a company's activities, products and services may have on the environment and society. Our separate in-house ethical research team undertakes ethical fund screening at arms length from our fund managers. The team utilises the services of

the Ethical Investment Research Service (EIRIS), a recognised industry leader in ethical screening, and also undertake their own research on select issues. The ethical funds cannot invest in companies that fall under any of the set exclusion criteria. These criteria include traditional avoidance areas like alcohol, gambling, tobacco and military as well as environmental concerns, oppressive regimes etc.

In effect, of the 628 companies in the FTSE All-Share index, approximately 300 are available for investment after ethical screening, with another 70 or so companies listed on the alternative investment market (AIM) also eligible. In market capitalisation terms, the screens take out over two thirds of the index, including large sectors like banks and pharmaceuticals, which are effectively no-go areas. This means the investable universe is typically skewed towards small and mid cap stocks relative to the FTSE benchmark. Nonetheless, the funds can still invest in 48 of the 100 large caps in the FTSE 100 index, and there is real opportunity to add value through conviction-driven stock selection in the mid and small cap market areas, including AIM. Given the ethical criteria, the fund has no

BP – rising challenges



The current difficulties faced by BP are highly topical for ethical investors. America faces its worst environmental disaster following the Macondo well explosion and the environmental and social impacts are serious and life-changing. The oil giant has lost half its market value since 20 April 2010 and agreed to suspend its dividend payments for the rest of this year.

AEGON's ethical funds do not hold BP because it does not pass our strict ethical screening criteria. Some 'light green' ethical funds do hold the stock (using best practice or similar criteria). It is still a major constituent of the FTSE4Good index, whereas the Dow Jones Sustainability index has recently removed BP as it is no longer a tenable holding for investors with environmental concerns. Ethical investors need to decide what is important to them – for many only strict or 'dark green' screening provides real peace of mind when challenging ethical, environmental or social issues occur.



sector, stock or market cap limits. Portfolio positions are scaled according to our level of conviction and our assessment of risk.

The transparency of our screening process is a key strength of our ethical funds. The no compromise screening process helps to ensure there is no ambiguity in the investor's mind over the companies chosen.

adding value

The list of acceptable companies identified by the screening process forms our investable universe. The next stage is our in-house investment research process. We add value by using the same stock selection process as our mainstream funds.

In the AEGON Ethical Equity Fund we invest in UK equities and aim to capitalise on the strength and experience of our UK equity team of 12, which includes four small cap specialists. Our investment approach is not constrained by a fixed investment style although it is governed by a disciplined, repeatable process which has demonstrated its ability to add value over time. With a consciously flexible approach, we can take advantage of investment opportunities as they occur throughout the economic and investment cycles. We analyse the fundamentals, the valuation and the technicals of a stock to arrive at an investment view. The emphasis is on identifying the changes that drive stock prices and our views will develop over time responding to, for example, company meetings, monthly strategy reviews and in-house quantitative work. We believe we can add value in stock picking, particularly in the small and mid cap area where the market is less efficient.

In terms of current positioning, the fund remains overweight in industrials, consumer services and technology, with key overweights in support services, software

and electronics. The key underweights remain in basic materials, consumer goods, healthcare and financials. The fund has no exposure to banks but within financials is overweight in life assurance and general financials. We favour stocks with high international exposure and continue to like the superior growth profile from emerging markets and the US. We remain cautious on the domestic economy given well-documented challenges. We favour corporate over consumer spend as we believe discretionary spend will continue to recover with the corporate profit recovery including areas such as recruitment, capital equipment and business-to-business media spend. We are still finding good opportunities in the small to mid cap arena, whether it's mid to late in the cycle or in structural growth opportunities where we believe growth can continue to re-rate.

ethical performance

We find most investors understand the performance issues that go with investing in ethical funds. It is generally harder for an ethical fund to outperform when defensives (for example, food retailers, aerospace, tobacco and utilities) are the markets' preferred stocks; in such a situation, we are proactive in looking for defensive earnings characteristics in areas not constrained by the ethical screening, for example healthcare and support services. Similarly, although we cannot hold banks, we can capture exposure to financials elsewhere, such as in life assurance and general financials.

In our view, investing ethically should not mean compromising on performance and we therefore measure the performance of our ethical funds against all UK funds, not just other ethical funds. ●

Audrey Ryan is Investment Manager, UK Equities at AEGON Asset Management.

*Lipper, bid to bid, net income reinvested, as at 31 May 2010. The performance of the Skandia fund will not mirror the performance of the underlying fund because of Skandia fund charges, taxation adjustments (if appropriate) and the Skandia investment process. Past performance is not a guide to future performance.

The AEGON Ethical Equity Fund is available through the Skandia Investment Solutions platform and Skandia's Life and Pensions fund ranges.

www.skandia.co.uk

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

Skandia provides you with access to its investment platform, known as Skandia Investment Solutions. Within this platform you can open an ISA and Collective Investment Account provided by Skandia MultiFUNDS Limited, a Collective Retirement Account and Collective Investment Bond provided by Skandia MultiFUNDS Assurance Limited and an Offshore Collective Investment Bond, distributed by Skandia MultiFUNDS Limited but provided by Old Mutual International (Guernsey) Limited.

Skandia Life Assurance Company Limited, Skandia MultiFUNDS Limited and Skandia MultiFUNDS Assurance Limited are registered in England & Wales under numbers 1363932, 1680071 and 4163431 respectively. Registered Office at Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom.

All companies are authorised and regulated by the Financial Services Authority with FSA register numbers 110462, 165359 and 207977. VAT number for all above companies is 386 1301 59.

Skandia Investment Group is a trading name of Skandia Investment Management Limited. Skandia Investment Management Limited is registered in England & Wales under number 4227837. Registered Office at Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom. Authorised and regulated by the Financial Services Authority with FSA register number 208543, VAT number 386 1301 59.

Old Mutual International (Guernsey) Limited is regulated by the Guernsey Financial Services Commission and is licensed to write long-term business under the Insurance Business (Bailiwick of Guernsey) Law 2002. Registered number 2424. Registered Office at The Beehive, PO Box 121, Collings Road, St Peter Port, Guernsey GY1 3HE, Channel Islands.