Cidel

What is Socially Responsible Investing?

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Over the past few years, there has been a massive expansion in socially responsible investing (SRI). From 2012 to 2016, the amount of money allocated to SRI-linked strategies in the United States rose 133% to $8.7 trillion due to rising demand from millennial investors, pension funds and endowments[i] . This growth has been fueled by an expanding awareness of environmental and social issues and increased support from regulatory institutions.

Despite this dramatic increase, the field is still in the early stages of development. While there is no consensus definition of socially responsible investing, its central focus is seeking positive returns while considering the long-term impact on society and the environment. Many different approaches with varying objectives exist, including *Negative Screening, Impact Investing, and ESG Integration*.

Negative (or Values-based) Screening	A strategy that eliminates specific investments which conflict with the personal values (ethical, political, religious) of the investor. For instance, an equity portfolio might exclude all companies engaged in oil production from its universe of potential investors in order to reflect concerns about carbon emissions.
Impact Investing	Seeks to place capital in companies and organizations that intend to generate measurable social and environmental benefits along with financial returns. For example, a for-profit company with an explicitly stated goal of providing affordable rental units and a supportive environment to people during times of crisis. These investments traditionally take the form of loans, bonds, or private equity. While fast growing, the supply of impact investing opportunities is very small relative to the broader industry.
Environmental, Social and Governance (ESG) Integration	An approach that considers ESG factors, in conjunction with traditional investment analysis, in security selection. Environmental factors, such as pollution output and sustainability policies, are used to assess an enterprise's actual and potential impact on the environment. Social factors, such as labour practices and safety records, help evaluate a business's contribution to society. Governance factors, such as corporate culture and executive compensation, are used to assess the quality of the company's corporate governance. At a high level, corporate governance is the system of policies, rules, and practices that an enterprise has in place to ensure its management acts in the best interest of its stakeholders (shareholders, employees, community).

Cidel's Approach

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A detailed analysis of ESG factors is an integral part of the investment decision-making process at Cidel. We believe the way in which a company deals with its labour force, community, and environment can significantly influence its competitive advantage and future earnings.

Before making any investment, our team identifies all material risks, including those related to ESG issues such as ecologically damaging activities, divisive labour relations, or poor corporate governance. Then we investigate these issues, discuss them with management, assess their potential impact on revenues and costs, and adjust our valuation accordingly For example, when analyzing a gold company with a history of clashing with the local community within which it operates, we would reduce our estimated value of the stock to reflect possible lost earnings from a production shutdown or a potential withdrawal of their mining licence. We have found that management teams who are willing to speak about the ESG threats facing their companies are generally better able to handle them. Our goal is not to completely avoid all ESG-related risks, but we need to know when we are taking a risk and be compensated for doing so with additional return.

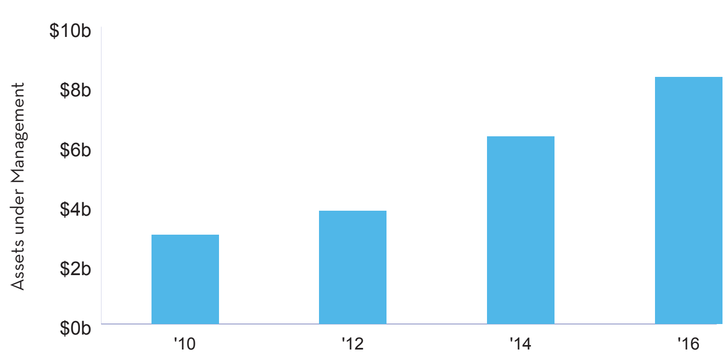
In recent years, there have been many examples of negative ESG "events" causing significant share price collapses, such as the BP oil spill in 2010 or the Volkswagen diesel emission scandal in 2014. While these episodes may have seemed to come out of nowhere, a detailed investigation would have shown elevated risk levels leading up to the incidents at both companies. For instance, even before 2010, BP had a history of environmental violations and one of the worst safety records of any major oil company operating in the United States[ii].

The potential negative consequences of ESG risks are often initially overlooked by the stock market because of its focus on short-term results. The investigation of material non-financial environmental, social, and governance data can uncover possible hidden dangers not captured by traditional financial analysis. Long-term investors, like Cidel, that take the time to accurately understand a company's ESG risks can outperform the market simply by avoiding large scale blow-ups. Evidence shows that ESG integration can lead to portfolios with slightly higher returns and lower volatility than traditional funds[iii].

Risk management is one of the core tenets of Cidel's philosophy. We believe the consideration of ESG factors helps us improve our risk management capabilities, identify well-managed companies, and deliver superior long-term risk-adjusted returns for our clients.

We will continue to explore the fast evolving field of socially responsible investing in our upcoming reports.

Socially Responsible Investing Assets in the United States



Source: US SIF Foundation

[i] US SIF: The Forum for Sustainable and Responsible Investment, "Report on US Sustainable, Responsible and Impact Investing Trends 2016" (https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf)
[ii] The New York Times, "For BP, a History of Spills and Safety Lapses" (http://www.nytimes.com/2010/05/09/business/09bp.html)
[iii] MSCI, "Can ESG Add Alpha" (https://www.msci.com/documents/10199/4a05d4d3-b424-40e5-ab01-adf68e99a169)