

Transcript

The Ideas Exchange

Episode 15: ESG Investing - Investments that reflect your values

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[00:00:04] **Voiceover** Welcome to the monthly Ideas Exchange podcast brought to you by ASX, the heart of Australia's financial markets. Each month we'll connect you to a range of leading industry experts who'll give you a look into the finance industry and deliver valuable insights, hear about important market events, industry research, tips for your own market research, as well as innovative products to help you diversify your investment portfolio.

[00:00:33] **Rory Cunningham** Hi, everyone. I'm your host, Rory Cunningham, Senior Manager of Investment Products at ASX. In this episode, I had the pleasure of talking with our investment expert, Jessica Leung. Jessica is a portfolio manager at one of Australia's largest ETF fund managers, BetaShares. During our discussion, I asked Jess to explain what ESG investing is, talk about how BetaShares measures the impact their funds are having on ESG related goals, and I asked Jess to reflect on industries and companies that are benefiting from the ESG movement. So for those of you that are looking to learn more about ESG investing, let's get started

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[00:01:37] **Rory Cunningham** Jess, thank you for joining us on ASX's Ideas Exchange podcast.

[00:01:42] **Jessica Leung** Thank you for having me. I'm very excited to be here.

[00:01:44] **Rory Cunningham** Yeah, great. So we're going to be talking today about the topic of ESG. Obviously a very popular topic at the moment and a very important topic, actually, as I'm sure we'll talk about during this episode. But before we get into the detail, just for our audience, do you want to talk about what you do at BetaShares and how you got into the role, actually, that you're currently in?

[00:02:05] **Jessica Leung** I'm an equity portfolio manager at BetaShares. I look after our ESG suite of funds, so that includes ETHI, FAIR, ERTH, our ethical diversified ETFs, along with some other international ETFs as well. So my role as a portfolio manager is to oversee and manage underlying assets that the fund actually holds. In my case, because I look after equity funds, it'll be the underlying stocks, as well as the cash levels. And alongside my day to day as a portfolio manager, a big part of my role is also product development. So coming up with new ideas and building new products to bring out to the market for our investors. A bit into how I got into the role, so before

BetaShares, I was at Macquarie Systematic Investments team, doing a similar type of role, also managing index funds as well.

[00:02:50] **Rory Cunningham** Yeah, great. Very busy and with the product development side, quite busy at BetaShares as well. I think you now have well over 60 products.

[00:02:57] **Jessica Leung** Yes. We recently just crossed the 70 product mark line.

[00:03:01] **Rory Cunningham** There you go. It's going from strength to strength. OK, so for this discussion, we've broken it into three parts. First, we'll start by defining and providing an overview of ESG. Then we'll take a look under the hood of the BetaShares methodology and discuss some of the industries, companies and outcomes that are being achieved by that ESG investment methodology. And then we'll finish by providing some useful tips for investors on how they can start to learn more about ESG investing. So, Jess, I think it's fair to say that ESG investing goes by many names. It has been referred to by umbrella terms such as responsible investing, sustainable investing or ethical investing. Or it may be referred to by a specific focus such as climate change. And even during our chat, I have absolutely no doubt that we'll interchange all of these terms as we're having a discussion. But just so we can get a baseline understanding of what we're talking about, could you please define ESG investing and give some examples of methodologies investors such as yourselves use when building an ESG portfolio?

[00:04:05] **Jessica Leung** So, ESG is another three letter acronym that starts with E that's become very popular, and one of my favorites, along with ETF recently. So ESG stands for environmental, social and governance. So the E for environment. That's where we deal with issues such as climate change, pollution, deforestation. Social, that's where we deal with issues like child labor, human rights and employee relations. And lastly, government, where we deal with board make up, executive pay, bribery and corruption. So like you said, there are many different interpretations and many different methodologies used when building an ESG portfolio, but some of the main ones, we'll just go with high level ones, are used quite broadly, exclusions. So an exclusion most typically can be used based on a business activity. So, for example, you might be screening out or choosing not to have tobacco or gambling in your portfolio. So that's one end on the spectrum. On another end of the spectrum, you can choose to include, so where we actively seek out names or include the best in class as well. And then you can also have something known as positive scoring, where a certain stock might be favoured a bit more depending on certain ESG scores or aspects which you choose. So ESG considerations are slowly and will become the norm. And what's more important is ESG integration, that's using research and data to inform our investment decisions and manage the ESG risk within the portfolio. And that's what we've done in our funds, and we can go through them in a bit more detail later on.

[00:05:29] **Rory Cunningham** Yeah, brilliant, I'm particularly interested in that area of ESG integration and how that's going to play out over the next 5 to 10 years, and we'll dive a bit deeper into that during our discussion. The focus and popularity of ESG investing strategies is growing rapidly in Australia, but also around the world. So according to the latest research by the Responsible Investing Association of Australia, there's now over 1.2 trillion dollars in Australia that's invested responsibly. Given that there's just over 3.1 Trillion dollars in total managed funds in Australia, this means that about 40 percent of the assets in Australia are managed responsibly. That's up from 31 per cent 12 months prior. Similar research from the Global Sustainability Investment Alliance shows that across the United States, Europe, Canada, Japan and Australasia,

sustainable investment in these markets has reached 35.5 Trillion U.S. dollars in assets under management. This equates to about 36 percent of all professionally managed assets across those particular regions. And finally, on ASX, we have seen an increase in the last number of years in a number of strategies that are focused on ESG. So now there's well over 20 ESG focused products across exchange traded funds, listed investment companies and also mFund. So with all this growth in funds under management and the number of products, Jess, I'm just wondering, do you have views on why is the interest in ESG investing on the rise globally, but also in Australia? What's driving that demand?

[00:07:03] **Jessica Leung** Yes, I think it really all boils down to that investors are definitely caring more about their exposures and looking into more detail into what exactly they hold. So they want to combine the ability to meet your investment goals along with their ethical values. So more and more investors are realizing that, you know, these two are not mutually exclusive goals, you can do good with your money while also achieving the financial returns that you're after. So, we also have some stats, following on from yours. According to the BetaShares Investor Trends survey, so investor alignment with ESG principles continues to grow, with 46 percent of people reporting that investment decisions were based on ESG factors, and that's up from 40 percent in 2020. So like we mentioned, all ESG components, the E, S, and the G, appear to be gaining traction, but environmental issues are now often the main area of focus for investors. And this doesn't apply just to your big institutional investors, but also to your everyday retail investor as well. So we can't exactly comment on the global, but because BetaShares, we know the Aussie market the best, and our data shows that when it comes to buying investment products, 27 percent of all investors bought for environmental reasons, and that's compared to 11 percent in 2020.

[00:08:14] **Rory Cunningham** Do you think there's any particular investor demographic that is leading the ESG charge? And also has there been anything in the last couple of years that's really helped create that step change in focus on ESG investing?

[00:08:27] **Jessica Leung** Yes, I think a big driver of the demographic is just a younger cohort of investors. So due to COVID, more and more younger investors are entering the market for the first time, and that's just combining the data that we have of ETF and especially our ESG ETFs and with the majority of our ESG ETF, they're still seeing inflows to this day.

[00:08:49] **Rory Cunningham** Yeah, I think the ETF trend, in particular, the fact that ETFs are so accessible and as we'll discuss, you can wrap an ESG strategy into an ETF as well, and it's fully transparent, appeals to that younger investor demographic.

[00:09:04] **Jessica Leung** Yes, I think you hit the nail on the head. Definitely about the transparency factor, and they really care about what they're holding and they want to see exactly what they're holding and understand the product a bit more and not just have it very vague per se.

[00:09:16] **Rory Cunningham** Yeah. OK, so let's turn our focus to the BetaShares ESG investment methodology. So some would argue that the responsible investment industry, if I could call it that, is continuing to evolve and develop in terms of the standards of practice and increasingly their expectations that sustainable investment is defined not just by the strategies that are involved, but by the short and long term impacts that investors are having from their sustainable investment approach. Or said another way, investors are increasingly wanting to look under the hood to understand and analyze what a fund does, how it does it, and then the outcomes that fund is

achieving. So maybe if we could just start at that kind of first level, what's the methodology that the BetaShares ESG investment funds apply and whether you want to pick a specific fund or you're able to talk broadly, I'll leave that in your hands.

[00:10:10] **Jessica Leung** Yeah, we can go through ETHI as an example. So that's the ticker ETHI. That is our BetaShares global sustainability leaders ETF. So that is one of our most popular products, and it's currently sitting over \$2 billion in funds under management. So this product was really a trailblazer in both ESG and the ETF space. It was first inception in 2017, and it was one of the first to combine both positive and negative screens into the methodology. So a lot of the success of the ETF was a result of constructing a true to label portfolio, and this has really resonated well with investors. And that is investors that are experienced, but also ones that are just starting on wanting to get into the ESG space. So ETHI will give you an exposure toward a diversified portfolio of sustainable international names that are considered climate leaders in this space. So how we do that is we select the top one third of performers in terms of carbon efficiency for the industry or are engaged in activities that can help reduce carbon use by other industries. So ETHI also has the most comprehensive set of screens in the market. All the names are rigorously screened for fossil fuel, human labor rights and gender diversity, and we're also very transparent about our holdings, and the fund is also industry certified by the Responsible Investment Association Australasia or RIAA.

[00:11:28] **Rory Cunningham** So when you're getting that data to enable yourself to first screen out a universe of stock and then also apply a positive lens to the portfolio. How do you go about collecting that information?

[00:11:42] **Jessica Leung** Yes, so the data collection process is quite rigorous and strenuous in itself. So we go through the broad universe of all the stocks that are investable. And then we get the ones that have carbon data and then we go from there.

[00:11:54] **Rory Cunningham** Yeah. So quite an undertaking. So say I'm invested in ETHI, let's continue with that as an example. How do you actually measure the impact my money is having? So, for example, for every dollar that I invest in ETHI, is it helping to achieve the UN sustainability goals or some other type of impact?

[00:12:13] **Jessica Leung** Yeah, so this area is actually very exciting because prior to a few years ago, we couldn't exactly quantify the impact that your investment had. So you could just say that you avoided fossil fuel companies or that you knew that you were doing good with your money, but it was very broad in general, and you couldn't exactly pinpoint the impact that your investment had specifically. So with the advancement of ESG data collecting and reporting we can really quantify reliably, compare across different funds and show the impact that your investment has. So we'll just switch it up a bit, we've been talking about ETHI for a while, so let's talk about FAIR. So, that's our Australian version of the Sustainability Leaders ETF. So for example, if you invest \$1 in FAIR, that will result in 85.4 percent lower carbon emissions than \$1 invested in the S&P/ASX 300 index. So you mention U.N. sustainability goals. So just as a quick recap, that's a set of 17 interlinked global calls by the U.N. or the United Nations, designed to be a blueprint to achieve a more sustainable future. So some of the goals include ending poverty, affordable and clean energy and gender equality. So to answer your question, 78 percent of FAIR's portfolio contributes towards these U.N. sustainability goals. And lastly, I think this one is pretty impressive, 100 percent of the power generated by the companies in FAIR come from renewable sources, as opposed to just 8 percent of the power generated by the companies in the S&P/ASX 300 index.

[00:13:38] **Rory Cunningham** Yeah, it's amazing to be able to measure the impact like that. I think that's been one of the real evolutions of the ESG industry, even in just the last couple of years, and I know it's something that ASX is paying a lot of attention to in terms of how we can help improve that disclosure from listed companies about various ESG related metrics. Jess, a question for you around industries. So are you able to share a story of an industry that's benefiting from the ESG movement that's held within any of your portfolios?

[00:14:09] **Jessica Leung** Yeah, so when we talk about industry, it's really hard to go past renewable energy on this topic. So within the ESG, or in particular E on the environmental and climate change really stands out the most. So investors are increasingly looking to decarbonize their portfolio. Companies are also aligning themselves with the Paris Agreement and making commitments towards net zero carbon emissions targets and according to the IPCC, the Intergovernmental Panel on Climate Change, 45 percent of the world's population is highly vulnerable to climate change right now. So this is an area that affects everyone and everything. So that's why I think so many investors care about it. And of course, you also have the current geo political events that have accelerated the deployment of green energy itself. So very recently, Germany, which is the EU's largest economy, announced that they're committing two hundred billion euros to bring forward its goal of 100 percent renewable energy by 15 years to 2035. So putting all these factors together, renewable energy companies really are the beneficiaries of a number of long term trends, so you have the increasing amount of funds being invested into this space. You have the decreasing cost of capital, as well as like you mentioned, disclosure rules such as the EU taxonomy and more recently, the SCC or the US Securities Exchange Commission unveiled a climate disclosure rule making proposal. And if that is implemented, that means that companies are required to disclose certain climate change related information ranging from greenhouse gas emissions to expected climate risk and transition plans. So all of this is making climate change very relevant and raising awareness on the need to address climate change and the like.

[00:15:46] **Rory Cunningham** Thanks for sharing those insights. It sounds like there's some great fundamental drivers for the industry that you've just shared with us there. I do love a stock story. So a question for you around what's the best company that you've seen? Hopefully, in the portfolio that's trying to solve a big challenge and demonstrate leadership and innovation in how they approach ESG. So that could be, you know, whether it's tackling climate change, human labor rights, diversity or even all of the above.

[00:16:14] **Jessica Leung** Yes, I'm actually going to give you a fund instead because I feel like the whole fund tackles the issue of climate change, and that is EARTH so ticket EARTH, or our climate change innovation ETF. So when you invest in EARTH, it gives you exposure of up to 100 leading global companies that derive at least 50 percent of their revenues from products and services that help to address climate change, including other environmental problems through the reduction or avoidance of CO2 emissions. So this one has companies like Tesla or Beyond Meat. But what I find more interesting is it also has a company such as DocuSign. So by the name, you might be able to tell that it's an electronic document signing tool. So what's really interesting that I find from this stock is that since 2003, 20 billion sheets of paper have been replaced with this digital service. That's 20 billion sheets of paper in contracts which are now converted to digital contracts and you just sign them over the web. And that's equating to the preservation of over two and a half million trees.

[00:17:12] **Rory Cunningham** That's amazing. And hasn't COVID been a real driver for that company's success as well?

[00:17:17] **Jessica Leung** Yeah. And then you also have companies like Zoom, where people can now take meetings online instead of traveling and reducing the carbon footprint on that front as well.

[00:17:26] **Rory Cunningham** What are you seeing from companies in relation to how they approach ESG and meeting investors expectations? No doubt it exists on a spectrum of some companies that are doing really good things in the ESG space, including their reporting, but also other companies that need to improve. So what are you seeing that companies are doing well and where do you think improvement is required?

[00:17:47] **Jessica Leung** Yes, so disclosure of non-financial metrics is increasingly being required of listed companies as investors seek to understand more about how they operate. So one example is how companies are increasingly looking to address questions about modern slavery in their supply chains. So in a world of global supply chains, multinational companies are being asked to have a clear understanding about their production processes and sourcing of raw materials from their investors and other stakeholders. So one example that we can quickly talk about is the production of a car. As we know a car is very complicated, there's so many different parts and along with each part, there are long supply chains that can extend beyond 20 levels deep. So we can take a stock example of Daimler, who is a parent company of a luxury car brand. So they have over 60,000 direct suppliers alone. And what they've done is that they've singled out 24 raw materials that pose the most risk and have put in motion plans to make sure that their supply chain is fully transparent by 2028. So this really goes to show that there's increasing pressure from investors and legislation forcing companies to go beyond the superficial with their supply chains and to really drill down to the bottom of it. So on these type of matters, however, there's always room for improvement. And here at BetaShares, we engage with companies on the issue and other ESG matters via our Responsible Investment Committee. So on the stewardship side, we've engaged with over 60 companies, with human rights issues being a big topic of discussion. We also hope that global efforts to improve non-financial disclosures will help investors understand how companies are addressing these important matters.

[00:19:20] **Rory Cunningham** Can you just dig a bit deeper there into what stewardship means for our listeners?

[00:19:24] **Jessica Leung** So stewardship means taking an active role in making better outcomes in terms of ESG for your investments.

[00:19:31] **Rory Cunningham** So an example of that would be investing into a company that might meet your investment criteria, but then also working with the board and management to improve how they go about their ESG credentials?

[00:19:43] **Jessica Leung** Yes, that's correct. So one side that you've mentioned is engagement with the companies and another that we participate is by proxy interest or voting, as well.

[00:19:53] **Rory Cunningham** You mentioned earlier that we're potentially moving to a world of ESG integration. So my question is, what does ESG investing look like in 10

years? Will all companies be following ESG principles? Will we still need ESG focused funds? Or will that just naturally be part of the investment mandate of any fund?

[00:20:14] **Jessica Leung** Yeah, so like you mentioned earlier in the episode, a significant portion of funds are already invested in ESG. But even with the amount of money, I would say that this space is still in its early stages and it's still going through a lot of change. So investors are the one demanding and essentially driving the changes, and companies can no longer ignore ESG issues. And then also on the reporting side have things like the TFC or the Task Force on climate related financial disclosures and things like COP26 or the United Nations Climate Change Conference that really brought together leaders from all countries who agree on how to set up action and solve the climate crisis. Now, I would say that ESG is just increasingly becoming the new normal and will be over the next 10 years.

[00:20:56] **Rory Cunningham** Yeah. So for investors wanting to get started in ESG or improve how they think about ESG investing strategies, what's your guidance for them in terms of, first of all, what should they consider when choosing an energy fund?

[00:21:09] **Jessica Leung** Yes, I think what's really important here is do your research or like the name of this segment, look under the hood, and just really have a think about what their personal objectives are. So what are they after when they're looking to invest in an ESG or ethical fund. So, they might value certain screens more or decide to not have certain stocks such as tobacco or gambling. So, after you've considered what your personal objectives are when investing in this space, you should then do your homework to really try to find a fund that best aligns with your values, as not all funds are created equal. So one of the main benefits of ETFs is transparency, so you can have a look at the underlying holdings, make sure that they're aligned with what you're after.

[00:21:48] **Rory Cunningham** Where do you recommend they go for education?

[00:21:51] **Jessica Leung** So for more education, you can go to our website [BetaShares.com.au](https://beta.com.au), that has lots of resources and education pieces. You can also find us on YouTube, where we upload a lot of videos and our webinar sessions.

[00:22:03] **Rory Cunningham** Yeah, that's great. I think for anyone getting started, I would recommend the Money Smart website by ASIC as well. They have some fantastic resources for any investor, whether you're a beginner, intermediate or even advanced investor. Of course, the ASX website and naturally, there's a lot of podcast content out there where you can find specific content related to ESG. One final question for you Jess before we wrap up, what's your favorite book on ESG or a particular theme such as climate change?

[00:22:34] **Jessica Leung** So one book that I read quite recently, which I find very interesting is called 'Reset Map to make Australia a renewable energy superpower' by Ross Garnaut. So it's written by the economist Ross Garnaut, and he develops the idea of a renewable superpower and lays out how the pandemic offers Australia the opportunity to reset its economy and why old approaches or old ways of thinking won't work.

[00:22:57] **Rory Cunningham** Fantastic. Thanks, Jess, and thanks to all our audience for listening today.

[00:23:02] **Jessica Leung** Thanks for having me. It's been great fun.

[00:23:05] **Rory Cunningham** That's a wrap with Jess. The key takeaways for me are that there is significant growth in investor demand for funds, they factor ESG into their investment decision making and over time we may see ESG become fully integrated into the traditional investment approach. It's also really important for investors to do their research and look under the hood before selecting an ESG product to ensure that the fund aligns with your values, goals and objectives. Increasingly, funds are getting better access to information to help investors with their research and to inform them about the impacts their investment dollars are having. I hope you found this conversation valuable, and we'll see you next month.

[00:23:43] **Voiceover** Visit the ASX website asx.com.au, and register for the next investor day, our premier education event, providing timely market insights and ideas from a range of industry experts.