Impact Investing: how to be sure?

Bedford Row Capital discusses.

Impact investing: "…investments made with the intention of generating a positive, measurable social and environmental impact, alongside a financial return."

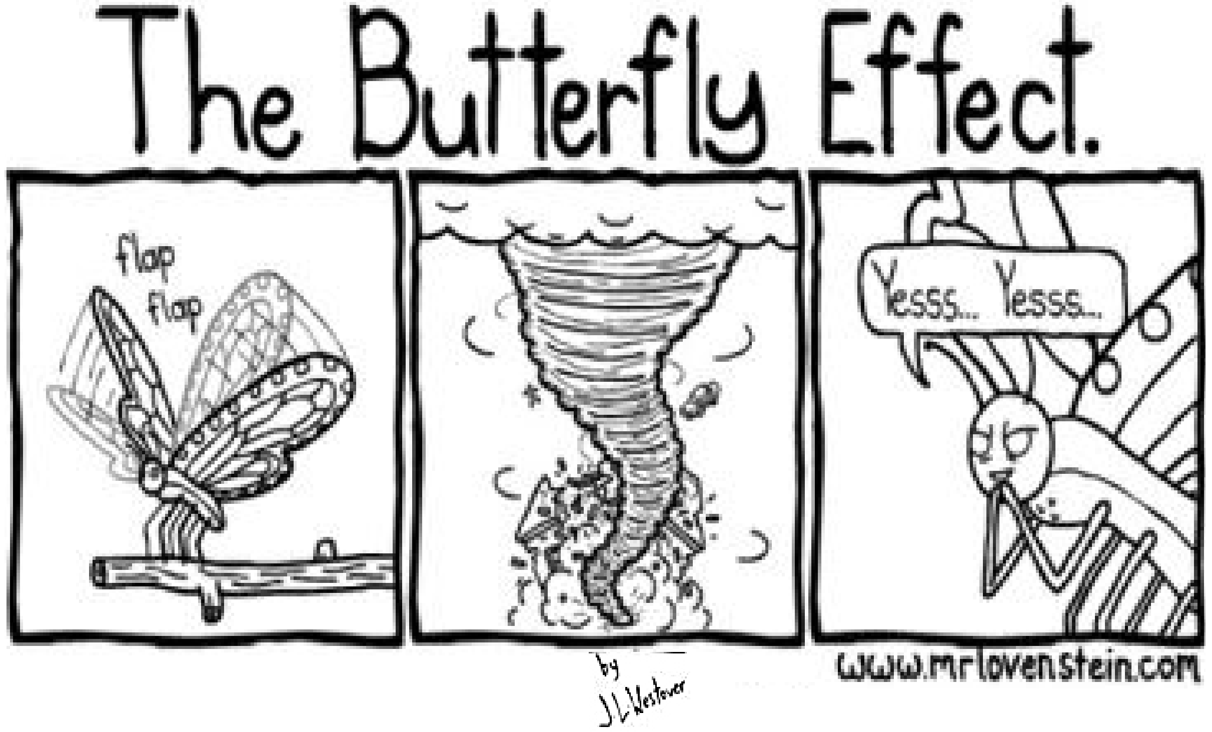
There is much and growing interest in impact investing. Talking about impact investing is, of course, quite hollow unless one can measure and demonstrate the said impact. Measuring and demonstrating impact can be difficult; companies spend millions on advertising how they hope to make a difference but how can you better understand what a company will do with investors' money? Is it measurable or can it be monitored? As a simple guide, there are three key stages to measuring and demonstrating the impact of your investments.

1 – What change/impact?

It is absolutely necessary that a company is clear and specific as to what precisely the intention is when a company looks for investments. What impact, exactly, will be made? The change or impact should be described in terms of specific outcomes. If it is not articulated clearly then how can the company demonstrate its green, social, ethical, or sustainable credentials?

2 – Thesis for change

What is the thesis for the change? In other words, there should be a clear idea of how an investment will bring about the desired impact/outcome(s). Hit and hope is not good enough. There must be a demonstrable link between investment, activity, and pre-defined outcome(s). Noting, of course, that cause and effect are in a complex relationship with one another and that achieving change may take time. Clarity in assumptions and specificity of outcomes defines the best impact investing propositions.



3 – Evaluate the impact

It is, of course, absolutely essential to evaluate, measure and demonstrate the impact of investments with specific data points and tangible results. Unless such results can be demonstrated, how does an investor know whether the intentions and objectives have been achieved? This evaluation should be consistent with objectives, ESG/SDG considerations (i.e. don't ignore the uncomfortable) and, ideally, have a degree of independence. There are many companies which perform "second party opinion" and monitor performance just like rating agencies monitor credit risks (like Sustainalytics, Vigeo, CICERO and GRI). In many ways, this is no difference than selecting fund managers. Reporting, measuring and monitoring style drift are important for advisers. Change is rarely linear, it is often complex and sometimes contradictory but advisers should understand and be able to evaluate clear communications from "greenwashing".

Where to turn?

In the investment spectrum, green bonds have received the most attention and should deliver the best clarity for impact monitoring. The key to understanding bonds and their affinity with outcomes and impact is found in their basic structure of operation. A standard corporate bond (even for a company which purports to be a green business) is fundamentally for "general corporate purposes". This phrase you will see in bond documentation and may be highlighted in the "Use of Proceeds" section (or similar). Green bonds (unlike corporate bonds) have specific outcomes stated in their documentation and are therefore much more reliable (or accountable) when it comes to determining credible options for impact investing.

This leads to an interesting problem with the growing number of impact, sustainable, esg or green funds. If they are predominantly equity funds then they are just as likely to be greenwashing their own strategies (as the invested companies have no direct accountability). Funds which invest in green bonds are much harder to find but are worth the effort. The specific outcome requirements of a certified green bond mean that the managers will be able to look deeper in to impact and outcomes knowing the use of the funds in advance. The role of an adviser has never been more important than to avoid hollow statements and allowing clients to sleep well at night knowing their funds are hard at work at changing the world.

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The curse of knowledge

TAM Asset Management explains some ESG conundrums.

ESG, SRI and Impact Investing are terms we have recently become accustomed to hearing. But whilst we may now be familiarised with them, what do they actually mean? These three subsets are arguably enveloped within the same spectrum of "ethical investing".

In 1990, Elizabeth Newton earned a PhD in Psychology at Stanford by studying a simple game in which she assigned people to one of two roles: "Tappers" or "listeners." Tappers received a list of twenty-five well-known songs, such as "Happy Birthday to You" and "The Star-Spangled Banner." Each tapper was asked to pick a song and tap out the rhythm to a listener by knocking on a table. The listener's job was to guess the song, based on the rhythm being tapped.

Over the course of Newton's experiment, 120 songs were tapped out. Listeners guessed only 2.5 percent of the songs: 3 out of 120.

Newton asked the tappers to predict the odds that the listeners would guess correctly. They predicted that the odds were 50 percent. The tappers got their message across 1 time in 40, but they thought they were getting their message across 1 time in 2. Why?

When a tapper taps, she is hearing the song in her head. Meanwhile, the listeners can't hear that tune — all they can hear is a bunch of disconnected taps, like a kind of bizarre Morse Code.

It's hard to be a tapper. The problem is that tappers have been given knowledge (the song title) that makes it impossible for them to imagine what it's like to lack that knowledge. When they're tapping, they can't imagine what it's like for the listeners to hear isolated taps rather than a song. This is the Curse of Knowledge. Once we know something, we find it hard to imagine what it was like not to know it. Our knowledge has "cursed" us, and it becomes difficult for us to share our knowledge with others because we can't readily re-create our listeners' state of mind.

Much like Elizabeth's experiment, it is hard to convey what is ethical investing and what is not, and it boils down to opinions made on the knowledge of each person. One person may have a distant relative or friend that was adversely impacted by the Fukushima Daiichi nuclear disaster, another may have a PhD in nuclear science and researched the positive effects that nuclear power has saved lives by preventing the burning of fossil fuels. Which person is right, which one is wrong?

How green is green?

As we know, financial services is full of industry jargon that most of you reading this will be familiar with, but how many of you can go home and use those same words with a friend or family member? Would those same individuals be happy with an "ESG" portfolio that invests in the company that spends most in the world on renewable energy research? Probably… until perhaps they found out it was BP, then would the only image in their head be of the birds covered in oil off the Gulf of Mexico?

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Combining investment opportunities with peace of mind? It's possible!

OneLife explains solutions for optimising and securing your external fund portfolio inside an insurance policy.

The Luxembourg insurance policy is a legal and fiscal envelope presenting many advantages, including access to a very wide choice of investments. These investment vehicles will be selected with the advice of an insurance intermediary, depending on the client's investor profile and risk appetite. But once invested, **how can we avoid stress linked to the high volatility of the markets?**

A solution is available for investors who opted for an *external fund solution with UCITs funds as underlying investment*! It is indeed possible to protect your portfolio or even to optimise its management by implementing **investment options**.

What exactly are these?

Investment options are **automatic switches** which allow you to secure capital gains, limit losses, or even enter or gradually return to markets in order to optimise the management of your external fund portfolio and minimise risks.

Save Gains – This option allows you to benefit from the rise in the financial markets and to secure your gains. The capital gain realised by an investment fund may be redirected to one or more other investment funds which are often safer.

Stop Loss – With this option, you can guarantee peace of mind and protect your savings against downturns in financial

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Winning the loser's game

Haymarket Capital looks at using big data and machine learning to drive excess returns.

Ledbury SICAV has launched a new fund where stock selection is driven by artificial intelligence. Patrick Armstrong and Eugen Fostiak, who work for the fund's sub-investment manager, discuss the use of AI in stock selection.

Active management has always been about uncovering opportunities before they are priced in by the broader market, and we believe that processing information more swiftly, robustly, and objectively than our peers with the help of Artificial Intelligence, allows us to do this in a consistent and repeatable manner.

Our process utilises a large set of company-specific data from financial statements, as well as market data including prices, returns, volatility, and broker estimates of various financial statement items, investment recommendations and target prices.

Machines do not sleep, and do not take holidays. In our process their only reason to exist is to identify stocks that have the characteristics that lead to outperformance. Our approach allows us to process incredible amounts of data, and to uncover connections that are not as obvious to other investors, or at least not yet obvious. We have found our machines often identify companies in emerging trends before they become mainstream knowledge.

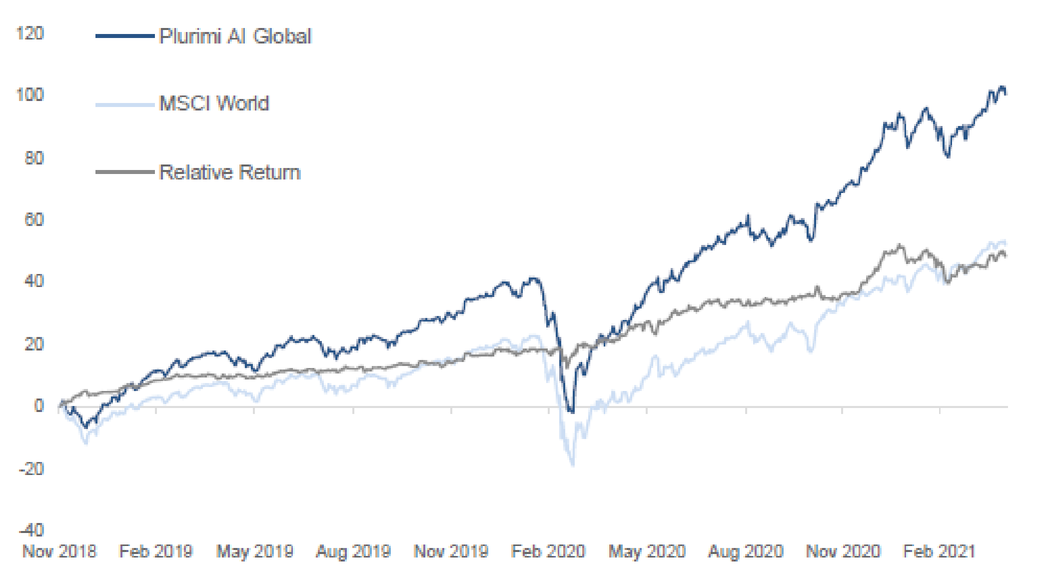
A good example of this was in February and March of 2020. Our system started to highlight video game companies as the most attractive stocks in the coverage universe, using this information we bought Activision, Tencent and Nexon. As we do not utilise non-financial data, our machines did not know about a pandemic. They did not know about lockdowns that would increase demand, but they did have visibility of analysts upgrading the earnings estimates and increasing target prices in this sector. They also saw companies trading at near market multiples but offering considerably higher growth. During the same months, the machines supplied data ensuring that we did not have any traditional oil companies, despite highlighting very attractive company valuations. The machines identified that downgrades in cyclical estimates across industries would lead to poor performance from these stocks despite the attractive value scores.

Artificial Intelligence guided buys and AI authority to sell

While machines are very powerful in processing information, they are not infallible, and they lack nuance at times. We have adopted a 'man + machine' process in selecting stocks to invest in, but the machines are never overruled when they signal a sell. We view buying any stock as a risk and prefer a human overlay to reaffirm any AI buy rating. On any given day, our AI identifies 150-250 stocks with the characteristics to outperform the market from a universe of more than 3000. We select stocks to buy exclusively from this list.

When AI recommends a sell, we immediately follow the recommendation. Selling a stock only creates a potential opportunity cost, rather than risk of capital loss, so we have less need for a human overlay on this part of the process.

Total return (%)



Total return in USD terms. (30 Nov 2018 - 30 Apr 2021)
Gross of all fees

Source: Bloomberg/PW

Monthly performance (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2021 PW AI	**0.5**	**1.5**	**2.5**	**5.2**									**10.0**
MSCI W	-1.0	2.6	3.4	4.7									10.0
2020 PW AI	**-0.2**	**-7.0**	**-9.7**	**9.9**	**8.9**	**4.3**	**6.7**	**4.5**	**-2.3**	**-0.9**	**10.4**	**7.6**	**34.4**
MSCI W	-0.6	-8.4	-13.2	11.0	4.9	2.7	4.8	6.7	-3.4	-3.0	12.8	4.3	16.5
2019 PW AI	**10.4**	**4.5**	**2.9**	**2.7**	**-5.2**	**7.8**	**0.7**	**-1.3**	**1.7**	**4.2**	**2.3**	**4.7**	**40.5**
MSCI W	7.8	3.1	1.4	3.6	-5.7	6.7	0.5	-2.0	2.2	2.6	2.8	3.0	28.5
2018 PW AI												**-3.6**	**-3.6**
MSCI W												-7.6	-7.6

Total return in USD terms. (30 Nov 2018 - 30 Apr 2021)
Gross of all fees

Source: Bloomberg/PW

We combine AI and our own common sense during portfolio construction and diversification

Since we launched our Global Equity Strategy in December 2018, it has delivered returns of 32.1% per annum gross of fees, which compares very favourably to the MSCI World return of 16.6% per annum. It has generated far greater returns with less volatility and drawdowns than the market. Of course, as always, we remind you that past performance is not a reliable indicator of future results, performance forecasts are not a reliable indicator of future performance and an investor may not get back the amount invested.

The age of AI and machine learning is here. Investors who embrace it, and take advantage of its dispassionate objectivity, superior ability in the processing of information and tireless approach to identifying investments that will outperform, have a sustainable edge against those who do not.

Investors who invest actively and do not have an approach with a clear information advantage will inevitably underperform and transfer value to those that do.

Our Global Equity Strategy is now available to retail clients via the AI World Equity Fund Global. Initial, CDSC and clean share classes are available.

For details, please contact **Hugh Beaumont – hugh.beaumont@jordanbuchanan.com** or tel:**+44 (0)781 594 8353**
www.aiequityfund.com

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The curse of knowledge

For the BP argument both are determinately correct in their own estimations, however, the knowledge levels of the energy sector are likely to be divergent.

The major problem with the curse of knowledge is that it can be used to one's advantage when the audience is self-confessedly naïve to the topic.

I think we can all agree that an ESG fund is not ethical merely because the name contains an ethical acronym such as ESG, SRI etc.

Curse or fashion?

So, the question is, why has there been such an increase in ESG named funds over the last 9 months? Well…

- In March of this year European fund assets hit 1.3 trillion euros in the ESG sector.
- In Q4 of 2020 over 160 new ESG funds were launched.
- In 2020 more than 700 funds were repurposed and rebranded as ESG.

Are funds therefore just a victim of the curse of knowledge, or is it an inverse move on the militant masterful inactivity?

It is plain to see that ESG has become the new fashion in retail investing which throws up a multitude of questions:

- Are funds rebranding as a fashion statement or are they genuinely making new investment decisions that positively impact environmental and social governance?
- Who decides what is considered ESG for funds?
- How much of a fund must be concentrating on ESG for it to be considered an ESG fund?
- Are one or both parties just a victim of the curse or is the rebranding a fashion statement or even worse, a hop on the bandwagon?

To conclude, choosing the right ESG fund to hold in a client's portfolio is not only a difficult task in terms of research and maintaining a global macro balance of diversification, but one must also make sure that the curse does not distort the flow of information between the fund manager and end investor.

TAM pride ourselves on a 7-year track record of doing just that – making the adviser's job less ambiguous when choosing ESG for their client, and making sure they receive exactly what they require from their investment choices.

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