AJ Bell Investcentre

AJ BELL RESPONSIBLE MANAGED PORTFOLIO SERVICE

# Adviser FAQs

Responsible investing made easy

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# So, you've launched a responsible MPS. Why?

The use of responsible investment has been growing for some time, but has increased dramatically in recent years, with the Investment Association estimating that the assets under management in the responsible sector grew by 119% between January 2019 and September 2020.

More so than ever before, investors are interested in the environmental, social and governance (ESG) credentials of the holdings in their portfolio, and want their principles and values to be considered as part of the investment process, as well as their financial situation.

In addition to investor demand, there is a strong focus on sustainability from governments and regulators around the world. To help advisers meet the challenges that these trends will bring, while continuing to deliver the most appropriate products for their clients, we have designed the AJ Bell Responsible MPS.

# Who is the Responsible MPS for?

The Responsible MPS is for customers who wish to invest for long-term growth, but want to ensure that their money is focused on companies that are committed to making a positive impact and sustainability. The portfolios are passively implemented, and there are six different risk profiles, from the most cautious, MPS 1, to the most adventurous, MPS 6. This ensures that there will be a portfolio that is appropriate for the vast majority of your clients' attitudes to risk.

# How will the MPS invest responsibly?

We invest where possible in securities tracking an MSCI SRI index, which gives a robust range of values-based exclusions and ensures that we target companies with high ESG rankings to invest in.

Firstly, a series of exclusions removes companies from controversial industries such as tobacco and armaments. Then, a 'best-in-class' ranking system means that, of the remaining companies, only those that score more highly on ESG credentials are included.

# What exclusions are used?

There is a wide variety of exclusion criteria. A non-exhaustive list is shown in the table below.

| Business | Exclusion criteria |
|---|---|
| Controversial weapons | 0% tolerance |
| Civilian firearms | 0% tolerance for producers;<br>5% for distributors |
| Nuclear weapons | 0% tolerance for manufacturers and related manufacturers |
| Tobacco | 0% tolerance for producers;<br>5% for distributors |
| Adult entertainment | 5% tolerance for producers;<br>15% for distributors |
| Alcohol | 5% tolerance for producers;<br>15% for distributors |
| Conventional weapons | 5% tolerance for producers;<br>15% for distributors |
| Genetically-modified organisms | 5% tolerance for any activity |
| Nuclear power | 15% tolerance based on revenues;<br>5% of total output or capacity |
| Fossil fuel reserves ownership | 0% tolerance based on proven and probable coal, oil and natural gas reserves used for energy purposes |
| Fossil fuel extraction | 0% tolerance for companies deriving any revenue from thermal coal mining or oil and gas extraction |
| Thermal coal power | 5% tolerance |

!

For further details of the MSCI SRI methodology, including how companies are ranked for ESG scoring, see the MSCI website on: **msci.com/msci-sri-indexes**. Please note that the exclusions listed above are correct at the time of writing, but they are subject to change.

# Do these exclusions mean sacrificing returns?

Traditionally, responsible investing was undertaken using a simple process of screening out certain companies if they didn't meet an investor's values. This could mean sacrificing returns.

More sophisticated, modern approaches to responsible investment – such as the one we have taken within our Responsible MPS – focus not just on exclusions, but also on positively selecting companies with solid ESG credentials. Academic research demonstrates that this process may actually aid long-term returns, and therefore does not mean foregoing performance. You can read some of this research here: **msci.com/what-is-esg**.

# How do the exclusions make a 'responsible' impact?

An analysis of the holdings within the portfolios allows us to make a comparison of various metrics with a 'standard' portfolio, and this shows the following, versus a suite of standard MPS portfolios:

- The estimated carbon intensity of the Responsible MPS decreases by an average of 65%
- The average ESG score is uplifted by 21%
- The ESG score ranking amongst all listed funds increases by 31 percentiles on average
- 7% of companies in the Standard MPS are removed due to SRI screens, and the average exposure to SRI 'offenders', where we have data, is 0.6%
- The average exposure to UN Compact violators is 0.2%, which is a 2.4% decrease compared to the standard MPS
- The average exposure to companies with severe controversies is 0.3%, which is a decrease of 2.8% compared to the standard MPS

*Source: AJ Bell*

# How do you monitor the responsible aspect of the portfolios on an ongoing basis?

When choosing ETF and fund providers to invest in, we undertake due diligence on the provider to ensure it is taking its responsibility towards responsible investment, stewardship and voting seriously.

To inform our judgement, we engage actively with the managers of the investment vehicles within our portfolios. It is our expectation that, as a minimum, they will be an FRC Stewardship Code signatory or, if not, that they will be able to demonstrate substantially similar investment stewardship principles. This, however, is a minimum standard and we will obtain much more information from managers in order for us to establish their credentials, provide adequate oversight of their arrangements and ensure that they are aligned with our principles.

Through our initial and ongoing due diligence with managers, we seek to obtain voting and stewardship policies and also cover more specific areas, such as signatory status for the UN PRI initiative; stewardship philosophy; engagement approach; historic voting record; and details behind any votes which may have been deemed controversial (for example, opposition to mergers and acquisitions or appointment of board members).

We will not use providers that do not meet our expectations.

# How will you keep clients informed?

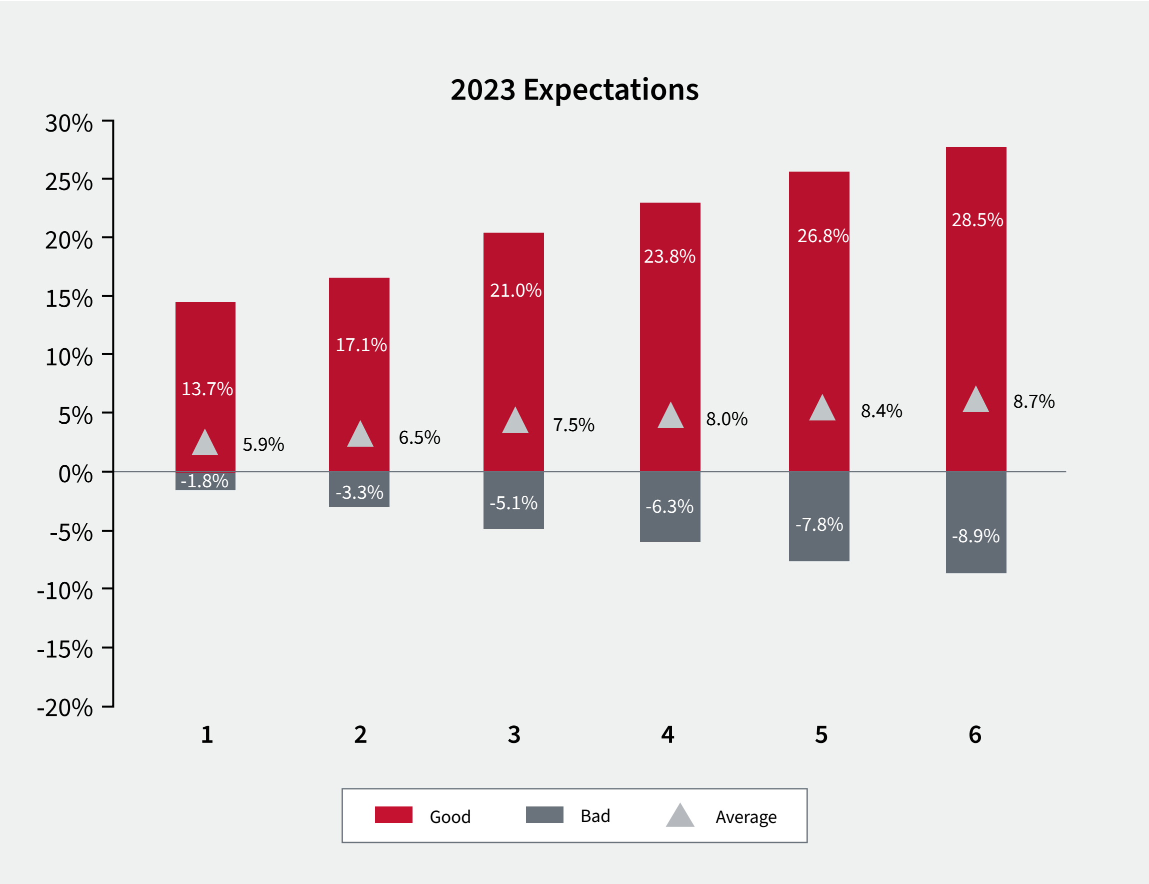
At AJ Bell, we are committed to clear, transparent communication. We will provide factsheets and regular commentary on where, how and why your clients' money is being invested, to help you help your clients meet their investment objectives and understand how their capital is being used in a manner that makes a positive impact.

# Why are you using a 25% allocation to the Responsible Growth Fund?

Using the Responsible Growth Fund allows us a great deal of flexibility, and keeps costs low. The advantages to this approach include the ability to make investment decisions within the fund wrapper, rather than needing a full, formal rebalance of the entire model. This increases speed of implementation and reduces Capital Gains Tax exposure for GIA clients if assets need to be sold. It also allows us to broaden the investible universe, by accommodating securities whose unit price would otherwise be prohibitive for smaller portfolio sizes.

# What can I expect?

The red and grey bars represent a typical year (representing an 80 out of 100 outcome). In a good year, clients might see a return above the red bar range. In a bad year, losses would be likely to be below, in the grey range. In a very bad year, such as a repeat of the credit crisis, the loss could be significant.




As the output is based on statistical forecasts, the actual outcome and performance could differ from the scenarios above.

! The value of investments can go down as well as up and your client may not get back their original investment.

# What about the risks?

Since your clients ought to be prepared to witness bad market conditions at some point on their investment journey, we show the range of outcomes that they should allow for.

But the longer your clients invest, the more predictable their returns become. That's because, over time, the good and the bad years tend to cancel each other out. Using our back-testing data, based on testing the strategic asset allocations for the portfolios over the last five years, had your clients invested in our Responsible MPS, they would have made the gains shown in the table below.

| **Responsible MPS** | MPS 1 | MPS 2 | MPS 3 | MPS 4 | MPS 5 | MPS 6 |
|---|---|---|---|---|---|---|
| 5 year back tested performance [1] | 1.7% | 2.9% | 3.8% | 4.4% | 5.1% | 4.0% |
| Expected returns | 5.9% | 6.5% | 7.5% | 8.0% | 8.4% | 8.7% |
| Expected volatility | 4.2% - 6.3% | 6.3% - 8.4% | 8.4% - 10.5% | 10.5% - 12.6% | 12.6% - 14.7% | 14.7% - 16.8% |

All returns are gross of underlying product OCF, transaction and platform charges. These figures are forward-looking, and are based on returns over a complete economic cycle, which would typically be around five years or more.

*[1] 5 year Back Tested performance is the annualised return based on current portfolio allocations as at 31 January 2023. Returns are simulated using fixed weights. Where the holding has not existed for 5 years a proxy security or index is used where appropriate prior to its launch.*

! Past performance is not a guide to future performance and some investments may need to be held for the long term.

**Target yields are not guaranteed and can fluctuate.**

# What about the costs and charges?

We firmly believe that high charges are one of the biggest threats to investment returns, and that's why we have worked so hard to keep charges for our range of MPS portfolios as low as possible. We do this by ensuring that the underlying investments in the Responsible MPS are selected using low-cost, index-tracking strategies, and keeping running costs as streamlined as we can. Our investment management charge of 0.15% p.a. is lower than many of our competitors offer.

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This document provides general information about the Managed Portfolio Service. It should not be read or construed as investment advice. It is your responsibility to assess you client's circumstances and make a personal recommendation that is suitable for their needs.