Parallel
Investment Management

Socially Responsible Investing (SRI)

Background

We believe that there is an increasing number of investors who wish to invest ethically.

Our research has determined that at present there is no industry standard definition of Socially Responsible Investing. Although most definitions employ the word 'ethical' they embrace a number of different approaches which can be broadly divided into either positive impact or negative screening, or indeed a combination of the two.

Investing in a positive manner involves investing in companies (or collective investment schemes that invest in companies) which score well for their impact based on Environmental, Social or Governance (ESG) factors. Negative screening focuses on excluding those industries and companies whose activities are generally seen as being harmful to society, such as alcohol, tobacco, armaments, pornography, gambling etc. We are aware that a number of investors have a particular area or areas of concern or interest, but from an investment perspective this can only be perfectly addressed through the design and build of a bespoke investment portfolio which is likely to be expensive as well as potentially a high risk strategy.

Solution

Our experience shows that the majority of investors are satisfied that a broader strategy will fulfil their objectives, and so our SRI investment solutions adopt an integrated approach of both positive and negative aspects of ethical screening. At present we offer two SRI portfolios to cater for investors with different tolerances to risk; these are:

Model Portfolio	Description	Performance Benchmark
SRI Cautious Growth	For investors with a moderate tolerance of risk	CPI + 3% pa over a rolling 3yr period
SRI Balanced Growth	For investors with a higher tolerance of risk	CPI+ 4% pa over a rolling 3yr period

Each portfolio benefits from the same methodology and approach as our existing multi-asset strategies but contain a carefully blended range of 'ethically' screened investments to ensure that investors' values are aligned with their needs.

Our portfolios are suitable for investors who are prepared to invest for at the least the medium term of 5 years plus (although our portfolios can usually be liquidated within 10 days), but are unsuitable for those seeking short term gains, or who have income requirements, or are unable or unwilling to take any downside risk.

Parallel Investment Management Ltd.
Alexander House, James Street West, Bath BA1 2BT
Telephone 0345 128 6699 **www.parallel-im.co.uk**

Our screening process

We have applied a number of positive and negative screening criteria within our research process to provide consistency across our portfolios with the objective of enhancing returns.

Positive impact:

- **E**nvironmental (including climate change)
  - dealing with the challenges of sustainability including cleaner energy, energy conservation, sustainable transport, water resources, waste management, pollution control, etc.
- **S**ocial
  - supporting positive outcomes for individuals, communities or society as a whole in areas such as housing, employment, education, transport, health care, safety, etc.
- **G**overnance
  - a focus on business ethics including executive pay, bribery and corruption, board diversity and structure, treatment of employees, political lobbying and donations, tax strategy, etc.

Negative screening (exclusion criteria):

We seek investments that avoid investing in companies that derive a proportion of their earnings or have any involvement in the following areas:

- Alcohol
- Animal testing – for the cosmetics industry (NB. allowed for medical purposes)
- Armaments
- Gambling
- Pornography
- Tobacco

We believe that these sectors represent the most common areas of investor concern but we accept that this list will not meet the ethical requirements of each and every client.

Each of the investment funds and Exchange Traded Funds (ETFs) included within our portfolios has been identified through our analysis, which includes screening undertaken by Vigeo EiRiS (Ethical Investment Research Service), one of the largest independent SRI research organisations worldwide to ensure compliance with our exclusion criteria.
Please note that periodically we may include funds within the 'thematic' element of our portfolios that have not been screened by EiRiS, and these will typically target companies that make a positive impact on the environment or promote sustainability.

When deemed appropriate, and for tactical reasons, we may also hold a cash weighting within our portfolios and normally we purchase a cash fund to achieve this. Currently, there are no cash funds available which meets our full screening criteria but we will always seek to select a money market fund which provides the closest match.

Where ETFs are included within a portfolio we make use of the screening provided by MSCI's ESG methodology. However, investors should be aware that this screening process does not exclude companies that participate in the testing of cosmetic products on animals. We anticipate that ETF's will be sparingly used within our portfolios and when a 'better performing' active fund cannot be found, and subject to availability.

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Investment universe

There is a commonly held view that the investable universe for SRI investing is very limited and only provides for anyone prepared to invest in equities. For many years this has been largely true, but the increasing demand for ethical investments has resulted in the creation of a wider collection of investable options across a broader range asset classes. In addition, the growth of the passive ETFs market which allows investors to gain exposure to both the equity and fixed interest markets has blossomed, such that there now exists a number of SRI-screened ETFs.

Whereas negative screening has been the primary driver within the SRI investing world there is little doubt that positive impact investing is having an increasing influence, and to a wider audience as issues such as climate change, economic uncertainty and social upheaval dominate the headlines.

Consequently, we believe that the traditional approach of 'accumulating wealth at any cost' is increasingly unlikely to insulate an investor from the significant global challenges that we all have to face.

Performance benchmark

Another commonly held view is that an investor who chooses to invest in an ethical portfolio has to sacrifice returns. Although this remains an area of debate, recent history suggests that SRI investing can be beneficial to performance.

The MSCI ESG Ratings help investors to identify environmental, social and governance (ESG) risks and opportunities within a portfolio, and it is interesting to note that in 8 of the last 9 years the MSCI ESG ACWI (All Countries World Index) has out-performed the MSCI ACWI (Gross returns in US$ - Source: msci.com).

Each of the funds selected for inclusion within our SRI portfolios has been subject to the same rigorous research process used by Parallel for our multi-asset portfolios. Part of this process is to measure individual fund performance against a relevant market index that we would use for a non-SRI holding. As an internal measure we construct a composite benchmark made up of the indices used for individual fund performance comparison weighted in line with our portfolio asset allocation.

However, we believe that for investors a CPI+ % benchmark provides a more meaningful measure by which they can determine if the performance of the portfolio is meeting their investment needs and objectives, whilst being aligned to their social goals.

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