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Good vs Evil

Good vs Evil - who's your money on?

Ethical investments could for once have a chance of outperforming cigarettes and alcohol in the latest economic crisis. In recessions, vices like tobacco and alcohol tend to gain ground among those daring enough to buy shares. But if Barack Obama's plans to invest in clean energy and tighten regulation set a trend, growth plays in worthier sectors may also offer rewards.

This mix of slowdown and conscientious investment suggests that while a sprinkling of traditional defensive vice may help in the short term, some ethical stocks could benefit too. Received wisdom among fund managers is that the next generation of fund products will be designed to be 'back to basics', easy to understand. Among classic defensive plays, companies focusing on human habits fit that bill squarely. "People will not stop smoking in recession. They might even smoke more because they are nervous," said professor Andrew Clare, chair in asset management at London Cass Business School. "Whatever happens people need cigarettes and do not tend to cut back on alcohol." Amid the fracas of recent months, many investments in classic defensive sectors - of the type offered by a US-based fund that uses the idea of 'vice' as its promotional gimmick - have fallen less sharply than the market as a whole. UK firm Imperial Tobacco on November 25 reported an annual adjusted earnings increase of 15 per cent, despite smoking bans enforced in Britain and other Western countries. Its stock, just like that of British American Tobacco and drinks producer Diageo, fared significantly better than the FTSE's 35.8 per cent fall in the year to November 30. More ethical, or socially responsible, funds have to date shown a marked underperformance, but the changing tune coming from the US could give some a lift. "My view is that the clean energy sector will be one of the first to come out of the recession," forecast Nick Robins, senior analyst on socially responsible investing at HSBC and author of a book called 'Sustainable Investing'. Meanwhile, investors prepared to look beyond the obviously addictive products such as alcohol and cigarettes to invest in gambling and weapons manufacturers in the aerospace industry could explore the 'Vice Fund', which covers just these four sectors. Data on its web site shows the fund was hit by the market downturn but outperformed its benchmark of reference, the S&P 500, in the year to March 31, when it yielded a positive 4.44 per cent return against a 5.08 per cent fall for the index.

“We focus on four sectors that have the potential for long-term gains in a variety of different market and economic conditions,” said Charles Norton of GNI Capital, which is involved with the fund’s management. “They also are often overlooked and underfollowed, which means our target sectors tend to offer more inefficiencies and opportunities.” But if some plain vanilla defensive investments - whether focused on escapist sins or basic necessities - offer shelter in times of trouble, they also tend to lag a market recovery. Karina Litvack, head of governance and socially responsible investment at UK-based asset manager F&C, argues investors would be better off preparing for a recovery that demands stricter corporate governance and higher accountability. With the launch of its Stewardship Growth Fund to exclude alcohol, tobacco and gambling stocks in 1984, F&C was one of the first to join the broad church of investment products known as ethical or **socially responsible investments (SRI)**. On a year-to-date basis, the fund yielded minus 38.7 per cent versus the FTSE’s minus 31.2 per cent but Litvack said the (mostly retail) investors had remained loyal due to their long-term view. Clare warned against reading too much into funds’ simplistic tags, noting that subtleties of definition could disappoint some investors, and queried the financial advantage in the ethical route: “The academic data that I have seen suggests that the differences in the performance of an SRI fund and an ordinary [one] are very limited,” he said. But Robins disagreed - he claimed investments in companies incorporating ethical social and corporate governance principles outperformed the MSCI World index in the five years to 2007.