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KODA

Responsible Investment: - using your capital for profit and purpose.

The purpose of this paper is to introduce the concept of responsible investment and highlight how this style of investing can help you successfully align your capital and your values.

It is a reference point for individuals, families, non-profit organisations and charitable foundations who are curious about responsible investment, its evolution and how it can be implemented.

Introduction

Responsible investment is an approach to allocating capital that continues to grow in relevance and popularity. Investors across the globe are embracing investment opportunities that deliver attractive financial returns without harming people or the environment. In increasing numbers, progressive investors are also seeking out opportunities that see them rewarded financially for making investments that bring about positive environmental and social change.

In Australia, more than 60% of institutionally managed assets already incorporate responsible investment practices. This number is growing at a rapid pace, as community expectations evolve and more and more responsible investment opportunities emerge.

It is an inescapable truth that whenever you make an investment, the capital you allocate to that investment has an impact in the world, whether you intend it to, or not. It is also true that you do not have to sacrifice financial returns when investing responsibly.

It is because these truths are becoming more widely understood that weighing up positive and negative impacts is now an essential aspect of mainstream investment analysis. Recent years have seen investors and the businesses they invest in become more aware of the need to allocate capital on a responsible and sustainable basis and more informed about the risks of doing otherwise.

Businesses are increasingly judged by the role they play in society and the impact they have on the environment, as well as the profit they generate. This change in focus reflects rising community expectations in relation to issues like governance, climate change, human rights and equality.

> "*Sometimes I hear claims that impact cuts the financial returns. This is not true. On the contrary, impact is ideal for strengthening companies and their prospects.*"
>
> **Sir Ronald Cohen**

How you approach responsible investment will depend on your values as well as your financial position. Koda's investment process is designed to help you establish both and then successfully integrate your social, environmental and financial goals into a bespoke investment strategy that results in a portfolio tailored to your individual circumstances.

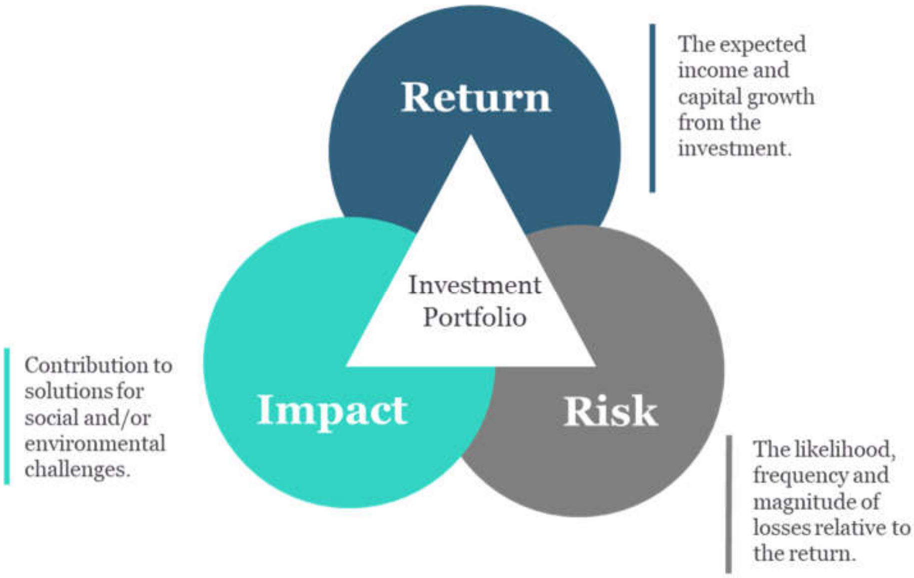
This paper is designed to help you prepare for your own responsible investing journey. It will help you understand this style of investing, how the responsible investment landscape is evolving and how you can incorporate responsible investing principles into your own portfolio.

Part I – What is responsible investment?

All investments will have an impact in the real world – either positive or negative or a combination of the two. Responsible investment looks to reduce negative impacts and focus on positive impacts. It provides investors with an opportunity to align the financial objectives of their capital with a goal of contributing to a healthy and sustainable society, environment and economy.

Traditionally, investors have focused on two dimensions of investing: risk and return. As responsible investment has become mainstream, investors are consciously factoring in the third dimension of investing: impact.

All investments have three dimensions



Evolution of responsible investment

Not until Markowitz introduced modern portfolio theory in the 1950s did we have an investment dimension beyond return. Risk (or volatility) began to be measured as an important component in portfolios. There developed an acknowledgement that not every investor could tolerate large changes in the price/value of their investment, regardless of the long-term prospects of a big return, and that risk could be managed through diversification.

Measurement of this risk focused on velocity, frequency and magnitude of the change in price. Modern portfolio theory confirmed that diversification could reduce volatility yet did not address the sources of risk that drove prices. Over the following decades many investment managers attempted to bring into valuations a range of factors to identify and mitigate risk in their portfolios. This included strategies focusing on quality, value, growth and more recently Environmental, Social and Governance (ESG) criteria.

> *"To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."*
>
> **Larry Fink, Chairman & CEO, Blackrock, 2020 Annual Letter to CEOs**

ESG based investment analysis is a systematic and explicit inclusion of environmental, social and governance characteristics into traditional financial analysis and investment decision-making by investment managers. ESG investors want to understand not only what a business does, but how it does it, and holds the belief that these factors are drivers of investment value and risk. Ignoring ESG characteristics has both an ethical aspect and potential financial consequences, such as poor employee engagement, loss of brand strength, resource misuse, litigation and legal penalties.

"Investors are holding companies accountable... The importance of strong alignment between corporates and investors is reinforced by the central and decisive role that ESG plays in investment decisions: 91% of investors surveyed say that non-financial performance has played a pivotal role in their investment decision-making over the past 12 months."

Mathew Nelson, EY Global Climate Change and Sustainability Services

In parallel, another movement had begun where investors sought to exclude from their portfolios investments, sectors and industries that did not align with their values – ethical investment. This saw broad based campaigns to end investment in armaments (particularly landmines) and tobacco, as well as other controversial sectors such as gambling/gaming, vice and alcohol. More recently, fossil fuels, deforestation and biodiversity, predatory lending, modern slavery and supply chain management have become widely debated as reasons to exclude (divestment) or engage to improve (stakeholder activism).

As ethical investment and ESG (or responsible) investment collided, more people started to turn their mind to the power of capital to create a better world. As a result, over the last two decades the concept of impact investment took flight.

Now accounting for an estimated $715bn in investment assets worldwide, impact investment focusses on intentional and measurable impact alongside financial returns. It is becoming recognised as a tool to achieve strong outcomes at the intersection of investing, business and public policy.

Impact investment has the power to mobilise the capital required to achieve the 17 United Nations Sustainable Development Goals. There are a range of investment opportunities that can help investors tackle these issues whilst achieving strong financial returns for their portfolios. It is no longer necessary to consider impact as sitting solely within your philanthropic strategy.

There is also a shift to exercising shareholder stewardship practices to encourage and influence companies to improve their performance around a range of topical areas. With this comes greater expectations on companies about their reporting and transparency in relation to these topics.

The United Nations Sustainable Development Goals (UN SDGs)

Source: https://sdgs.un.org/goals

The performance myth

Research shows responsible investment does not compromise long-term financial returns. Many studies also indicate that applying a responsible investment lens is beneficial to both performance and managing risk. The Responsible Investment Benchmark Report 2020 Australia found that "*Australian and multi-sector responsible investment funds outperformed mainstream funds over every time horizon [1, 3, 5 and 10 years].*"

The rise of impact investment

Climate change, the Global Financial Crisis and, more recently, the COVID-19 pandemic have brought into sharper focus the potential impact of capital allocation – our investments – on exacerbating (negative impact) and solving (positive impact) environmental and social challenges. These events have heightened the urgency to uncover approaches that can create a more resilient and viable future, resulting in the rise of impact investment.

We see consumers becoming more conscious of aligning their purchases with their values, shareholders demanding climate action plans from corporates and grassroots social movements putting equality front and centre. The social license for a company to operate is being challenged. The public expectation of business is moving from corporate social responsibility to becoming an active participant in resolving social and environmental problems.

The risk premium is rising for companies with unsustainable practices – this is the focus of ESG and responsible investment. Impact investors focus on businesses and investments that are harnessing both financial capital and the drive of changing public attitudes to contribute to solutions for complex environmental and social problems.

The Australian Government has measures in place to support the development of the market with several state governments recognising the role that investor capital can play in fostering innovation in the social sector. The Responsible Investment Benchmark Report 2020 confirms that the total value of impact investment products widely available to Australian investors as at 31 December 2019 has risen 249% to $19.9 billion in two years. The report expects potential demand to increase to $100 billion over the next five years.

As awareness continues to grow, we are seeing the supply of quality impact investment opportunities continuing to build.

> *"To my mind it is just an evolution of capitalism. Why wouldn't you take the best of what capitalism tries to do, efficiently allocate resources, and just nudge it in the direction of allocating these resources to things that makes the world a better place?"*
>
> **Kerry Series, Eight Investment Partners**

Part II - Why are investors shifting to responsible investment practices?

Investors who are implementing responsible investment practices are influencing the way corporates behave and are reshaping the way we think about creating a better world for future generations.

There are a number of reasons investors are attracted to responsible investment, including:

1. **It makes financial sense**

   Emerging evidence suggests that responsible investments may be more resilient to broad share market and economic downturns, as the investment thesis is often based on meeting a growing sustainability or social trend rather than solely economic growth. Impact investments typically have low correlation to traditional debt (bond) and equity markets. For this reason, they can provide an important source of diversification to traditional portfolios, helping to reduce risk (volatility).

2. **They can lead by example**

   Philanthropic and for-purpose organisations with long timeframes can invest in a way that complements their organisation's mission and objectives. For private investors and family offices, responsible and impact investment is a means to engage future generations in the power of capital for good. Helping to create a better world for them and their children.

3. **They can reduce the long-term risk to their wealth**

   Left unresolved, many of the challenges mentioned have the potential to have a long-term impact on people's wealth and prosperity. Putting capital to work to reduce negative impact, favour positive impact and contribute to solutions benefits the future. A healthy society and environment create stability that is more conducive to doing good business and building and maintaining wealth.

4. **They get enormous satisfaction from it**

   Responsible investment can be incredibly satisfying. Not only are you getting the enjoyment of knowing you are making a difference, you can simultaneously learn about social and environmental innovations around the globe and be a part of a rapidly growing community of like-minded investors.

   Different types of investor – from individuals, family office, foundations and not-for profit organisations – will have different motivations and a different journey towards responsible investment. Some seek to align investments to their personal values or organisational mission, while others wish to amplify the impact of their capital. Many institutions now understand that to meet their long-term fiduciary duties they must address long term social and environmental challenges.

Part III – How to align your portfolio and your values

Responsible investment has grown into a sophisticated investment and risk management approach that complements traditional risk and return analysis. Academic research shows that analysing investments through a responsible and impact lens may enhance investment selection and lower overall portfolio volatility.

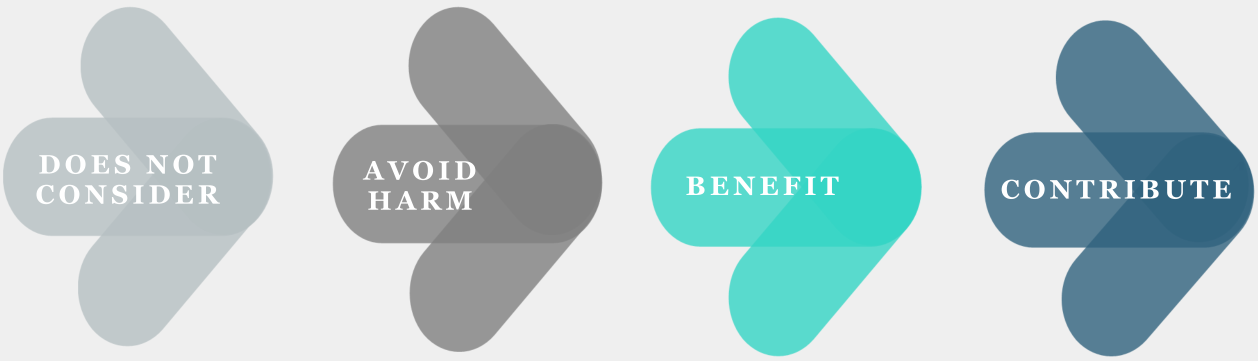
With the right framework, you can build a diversified portfolio across all asset classes, designed to meet your financial objectives.

A framework within which to consider impact

Investors can choose the level to which they consider impact in their investment strategy. Some simply choose to avoid doing harm, whilst others seek to actively contribute to solutions, many choose a combination of approaches to build a responsible investment portfolio aligned to their values and balancing risk, return, impact, cash flow and liquidity.

At Koda we help investors to build portfolios across the full spectrum of responsible investment.

The level of investment impact



Traditional investment practice with limited or no application of environmental, social and governance (ESG) factors in analysis.

Inclusion of ESG factors in investment decision making and exclusion of sectors or industries based on values.

Behave responsibly and mitigate risk.

Target superior ESG performance within industries to manage risk and investments with sustainability themes to pursue opportunities.

Seeks positive effect on society.

Deliver market rate financial returns alongside positive, intentional and measurable social and environmental impacts. This includes impact investments.

Solving problems.

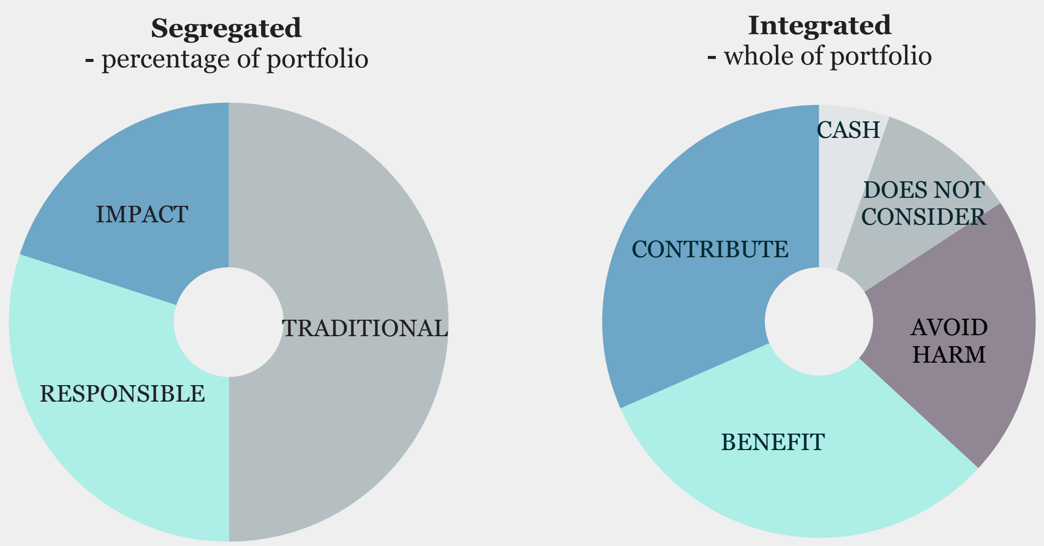
Adapted from: **Impact Management Project.** https://impactmanagementproject.com/

Incorporating responsible investments into your portfolio

Responsible investments come in all shapes and sizes and there are quality investment opportunities available across all asset classes, allowing you to construct a well-diversified portfolio tailored to your objectives. Every investor's journey to responsible investment is unique and therefore a variety of approaches can be adopted to build an approach that they feel best fits their circumstances, priorities and values.

When constructing a portfolio, investors can consider a segregated or integrated approach. A segregated approach allocates a percentage of a portfolio to responsible and impact investments whereas an integrated approach seeks to incorporate and monitor the impact of the total portfolio, often with a view to increasing impact over time.

Portfolio construction approaches



Investments in all asset classes and across the impact categories of 'avoid harm', 'benefit people and planet' and 'contribute to solutions' can be included in both approaches.

What are some of the pitfalls to beware of?

With responsible investment growing at such a pace, it is important to recognise that there are some common pitfalls to consider and avoid when building a responsible investment portfolio. These include:

1. **Forgetting about diversification**

   Making concentrated bets is one of the most common mistakes made by investors. True diversification comes from seeking different drivers of return and risk. Each investment should be reviewed on its contribution to return, risk and diversification, as well as impact.

   Investors need to make sure they have access to an impartial and actively managed pipeline of opportunities in order to ensure they can build a truly diversified responsible portfolio. We believe that when done right, responsible investment can contribute to better diversification outcomes.

2. **Making ad hoc investments**

   With an ad-hoc approach, the risk of not meeting your risk and return objectives increases. Further, the risk of misaligning your impact objectives with that of the investment you make is also greater.

   With a clear responsible investment objective, combined with strategic asset allocation targets, each investment opportunity can be assessed on its contribution to the portfolio outcomes. It is easy to get excited by responsible investment opportunities, taking the time to make sure are aligned to your investment strategy is critical.

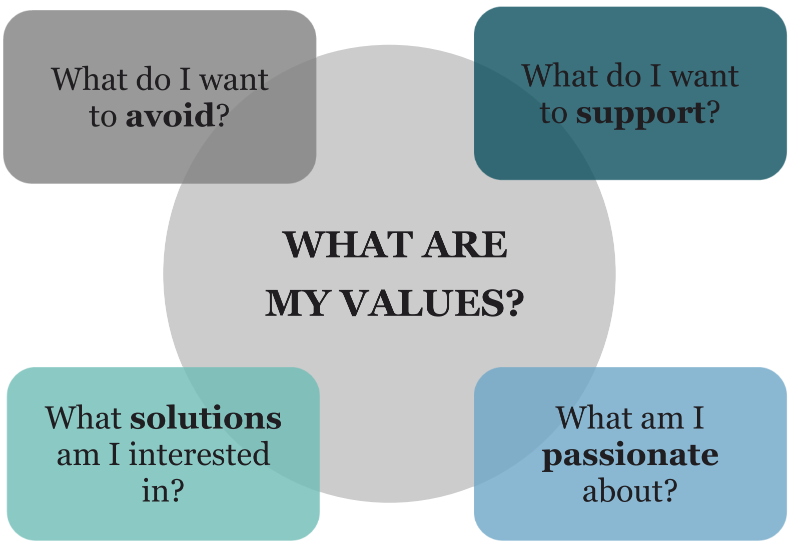
3. **Falling for 'greenwash'**

   With demand growing, product providers are coming to market with a vast range of opportunities. Not all of these opportunities display the characteristics we would expect to see in a genuinely responsible investment. A strong due diligence and research process is critical to ensuring that each opportunity is true-to-label and fit-for-purpose.

   It is very important to understand the real nature of investments marketed as responsible investments. Understanding an investment's ESG profile, its ethical exposure and the extent of the impact it expects to generate is critical, as is the level of transparency you will have in relation to the investment and how it is managed.

Starting your journey: a few key questions

Whilst there are a wide range of options to explore when considering responsible investment, a few simple questions can help you determine what really matters to you and how you should proceed.



Part IV - How does Koda advise clients on responsible investment?

Koda advises clients how to integrate responsible investments (including impact investments) into their investment strategies. Koda guides clients through the following six steps to a responsible investment portfolio tailored to each client's values:

Step 1. Education	Learn about responsible investment. Develop a knowledge base on best practice to help informed decision making. As the market grows, new products, ideas and approaches are constantly being developed. Koda will keep you, your family or your organisation informed at all times.
Step 2. Discovery	Koda guides you through this process of discovery to determine what is important to you. This involves understanding your values, your mission and impact objectives. Then, aligning these attributes with your financial objectives.
Step 3. Governance	It is important to document the discovery and decision-making process, be that through a responsible investment policy or broader investment policy statement. Koda will help develop these policy and strategy instruments that will guide your investment decisions now and into the future.
Step 4. Design	Koda will design a customised portfolio according to your specific objectives and goals for risk/return, liquidity, transparency, income and costs. Your portfolio will be tailored to your responsible investment strategy and will leverage our expertise in building values-aligned portfolios.
Step 5. Implement	Together with the depth of our networks and established pipeline, due-diligence and portfolio management processes, Koda provides access to best-in-class responsible investments, including impact investments.
Step 6. Monitor	What gets measured gets managed. Holding managers accountable to their stated objectives and relevant reporting for clients is the key to ongoing success. Koda will actively re-assess the role of each investment in the portfolio from both a financial and impact perspective.

Our approach to responsible and impact investment is centered around understanding each client's specific requirements and helping them articulate how their ethical values should be integrated into their investment policy, strategy and portfolio design. We then provide tailored advice around suitable options and can provide clients with visibility over their exposures to enable greater transparency and regular discussion about relevant issues.

Our clients hold portfolios that reflect their financial objectives, their values and their desire to invest in social and environmental problem solving. Many are now seeking to explore impact investment to ensure that their capital is not only 'not doing harm' but is invested for long term positive impact.

When it comes to impact investment, we have an active pipeline of opportunities that we recommend to clients, subject to a comprehensive and rigorous due diligence process. This is a rapidly growing and evolving area and many of our clients who have previously utilised negative ethical screens are now exploring impact investment with us to ensure that the capital is not only avoiding harm but is invested for social and/or environmental good, as well as delivering strong financial returns.

Koda leverages deep industry networks, adviser experience and expertise as well as the substantial knowledge base of specialist consultants to access opportunities, influence product design to better meet client needs and complete both financial and impact due diligence. Domestic and international opportunities across all asset classes are carefully selected.

A 'one size fits all' approach could never meet all the varied and broad financial, values-based and impact objectives of each client. We tailor responsible and impact investment strategies to each client's objectives and build customised portfolios to meet these.

We look forward to embarking on this exciting journey together and working with you, your family or organisation to build a responsible investment solution aligned to your values.

> *"I believe that responsible investment and in particular impact investment will be the next great evolution in investing. We are proud to be able to work with our clients at Koda to build responsible investment portfolios that are aligned to their values and beliefs."*
>
> **Paul Heath, Founder & CEO, Koda Capital**

To find out how we can help you make the transition to responsible investment, or to assess your current position, please contact your Koda adviser or the Philanthropy & Social Capital team at philanthropy@kodacapital.com.

KODA

Independent. Transparent. Experienced. Specialised. Client Focused.

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Victoria has worked in financial advice since the early 2000s. Working closely with non-profits and private clients to design and implement customised portfolios, Victoria knows the importance of taking the time to bring together motivations, goals and objectives into an actionable strategy. Victoria is a Certified Financial Planner and member of the Responsible Investment Association Australasia.

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Nik has over 20 years of international financial market and investment management experience and advises wealthy individuals and families, non-profit organisations and foundations on the management of their investment capital. Nik has a strong focus on governance, risk management and responsible investment. Nik is a Certified Practicing Accountant.

Farren Williams
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Farren has over 20 years of experience providing tailored financial solutions to wealthy individuals and families, non-profits and charitable foundations. She has a passion for helping clients with their wealth management needs and has extensive experience in investment policy development, governance, bespoke portfolio design, responsible & impact investing, succession planning, superannuation, estate planning and integrating philanthropy into wealth planning.

In addition to being a Partner at Koda, Farren is the Chairman of the Board of the Royal Botanic Gardens Foundation Victoria, is on the Board of the Responsible Investment Association of Australasia (RIAA) and on the RIAA Certification Assessment Panel. Farren is a Certified Financial Planner and is a Graduate of the Australian Institute of Company Directors (Order of Merit).

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David has over 30 years of experience in the private wealth industry, working with high-net-worth individuals, foundations, and charitable institutions. He chairs Koda's Non-Profit Investment Group and he is responsible for Koda's impact investing service. David currently chairs Plus One Professional Development and serves as a director of two other charities, The Sydney Community Foundation and the Foundation for National Parks & Wildlife.

Chris Wilson
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Chris has 15 years of experience in financial services, working predominantly with high-net-worth individuals, corporations, and charitable institutions. Chris has chaired non-profit organisations, sat on finance, audit and risk committees and investments committees. Chris has a strong focus on investment governance for charitable and philanthropic entities. Chris has a Masters of Commercial Law and a Bachelor of Economics.

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