



Guide to 3D Investing

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A Personal Introduction

In September 1987 I entered the financial industry. It was a momentous time, with the financial world being rocked by 'Black Wednesday', when markets across the globe fell like a stone. Stocks became valued at 30% less than they had been just days earlier. How could this be I asked myself? After all the outlook for the companies hadn't changed that much. And of course, they hadn't; but how they were valued had. I had received my first investment lesson - that perceptions of the world do matter and have a profound impact on how we value things.



Two years later and my view had changed too. Increasingly I had come to recognise the incongruence of my personal life and my professional career in finance. In my evenings I was campaigning for world justice, whilst in the day I was oiling the wheels of finance that perpetuated the very injustices that I was campaigning against. It was time to change – and change I did. In 1991 I stopped shuffling paper and started to advise people on ethically screened investments, something that I did for the next 13 years. Over this time the popularity of ethical funds just grew and grew and with it my business, but I had become increasingly dissatisfied with the funds that I was promoting. Yes, ethical funds had grown in number and popularity, but (with notable exceptions) failed to inspire me, since a quick glance at the top ten holdings revealed them to be not that very different from the conventional portfolios that they replaced in my panel of recommended investments. Furthermore, the reliance of ethical funds on the share markets was cruelly exposed in the dotcom crash of 2000 when ethical investors began to realise what 'investments can go down as well as up' really means. Indeed it felt for a while as if it would be better to say that investments can go up as well as down. Something had to change – not to do so would compromise my clients and me. If I didn't believe in the products, what hope was there for my clients?

“I chose to develop an investment service in which I could believe”

So I chose to develop an investment service in which I could believe – where the values of the client are truly reflected in their investments; where exposure to the whims of the stockmarket is limited; and most importantly, where the underlying investments inspire me and the investors who place their trust in me. After a further five years, I think that I'm slowly getting there, but the journey continues. This guide is intended to take you through that journey; a journey that reflects the morphology of socially responsible investment itself. Bon voyage!

Why 3D Investing?

Most people tend to think about two things when investing money – risk and return. This is a pretty 'flat' view of money, since all of us have values beyond pure financial considerations. When we make decisions in life – may be to have a family, change career, relocate or follow a dream – finance is only part of the picture. So why do we commonly ignore other factors when we make decisions about how our money is invested? A three dimensional or 3D view of money takes a more rounded view, incorporating non-financial values into the investment planning process.



Your bank account says more about you than almost anything else – its a written record of your priorities

If you care for any person or any thing; if you appreciate beauty; if you have a faith, you'll know what it means to have a value set that's not just about money. In fact these things are far more important than money and that's the point. Money is just a value tool. It says more about you than almost anything else. So what are your investments saying about you? Do they paint a picture of how you view the world, or are they divorced from your world view? 3D investing is all about re-connecting with your money, knowing how returns are achieved and how these satisfy your life goals. Its about using money productively, not just in the sense of making more money, but also in using it to effect social and environmental change. The benefits of such an approach are manifold:

- There is a congruence between your money and the rest of your life
- You regain a sense of ownership
- You can share the financial benefits from investing in solutions to social and environmental challenges
- Your money helps to shape corporate practice for the better
- You gain greater confidence in your investment planning

What is 3D Investing?

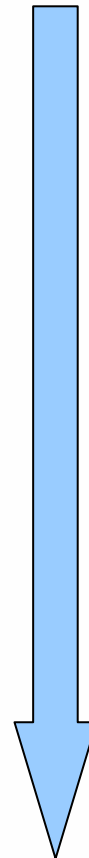
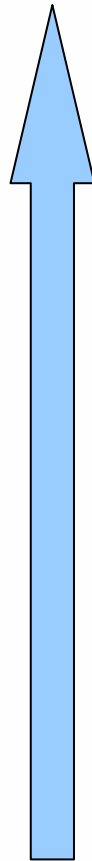
3D investing takes many forms, but all are different ways of reflecting whole-life values in your investment planning and stretch across a continuum from pure philanthropy at one extreme to investments that may be highly financially attractive at the other.

Importance of Financial Return

Importance of Social Return

LOW

HIGH



Philanthropy



Social Enterprise



Transformational Investing



Solutions-based Investing



Values Aware Investing

HIGH

LOW

3D investing is radically different from conventional investing since it embraces the concept of social return as well as financial return and risk, and it considers the impact of your money beyond yourself. Traditionally this meant consideration of *how* financial returns were generated, but latterly, 3D investing has moved beyond *values-aware* investing to *values-driven* investing.

Traditionally, ethical investment asked only one fundamental question – what are the social and environmental consequences of my investments and are these acceptable to me? This is values-aware investing and generally means investing in global stock and bond markets where extra-financial values are incorporated into the management of funds.

In recent years, however, a second question has been raised – how can I deliver on social and environmental goals through my investments? This can be termed values-driven investing where the social or environmental impact of the investment is of paramount importance.



Investing in your future – and theirs'

Values-aware

What are the social and environmental consequences of my investments?

Values-Driven:

How can I deliver on social and environmental goals through my investments?

Values-Aware Investing

Values-aware investing may take many forms, but if you asked someone what it meant to them, especially if you used the words 'ethical investment', you'd probably get an answer along the lines of avoiding companies on the basis of their ethical transgressions. After all, this is where ethical investment started back in the late 1960s. Times have moved on since then, however, and there is a multiplicity of approaches that might be grouped under the banner of values-aware investing and these include:

- ◆ Exclusion
- ◆ Engagement
- ◆ Best of Sector Investing



Ethical issues are rarely straightforward, so its important to weigh up an investment according to your values.

Exclusion

For many people, this is still a valid approach, as many investors still wish to ensure that they are not associated with ethical 'nasties' like tobacco, armaments or gambling.

In practice, the fund or the investor specifies the level of exclusion that they wish to employ and a screening company applies that screen to the investment universe to ensure that the specified criteria are followed.

Tip - Its important not to be too restrictive or you could end up with very little in which to invest. Just avoid the type of companies in which you couldn't countenance any investment regardless of the financial consequences.

TYPICAL EXCLUSION CRITERIA

Alcohol	X
Animal Testing	X
Armaments	X
Gambling	X
Genetic Modification	X
Human Rights	X
Intensive Farming	X
Nuclear Power	X
Pollution	X
Tobacco	X

Engagement

Engagement is an investment approach that seeks to bring about change by influencing the companies in which investment is made. Rather than avoiding companies because of the nature of their activities, fund managers seek to engage with the companies in which investment is made, using their influence as major shareholders. This normally takes place by way of dialogue with senior company management, but it can also take the form of shareholder resolutions and as a last resort, disinvestment.

Tip – Many fund managers claim to exert some form of influence on the companies in which they invest. Only a few commit the resources necessary to engage systematically with companies on social and environmental issues, and you can only judge how well an engagement policy is implemented if this is reflected in a public report on engagement activity.

ENGAGEMENT IN PRACTICE

Dialogue - Regular discussions with board directors and other executives of the company

Voting - Shareholdings are voted on behalf of clients in line with the provisions of the investment mandate.

Policy research - Bespoke research may be commissioned on a range of governance and corporate responsibility policy issues.

Public statements - Publishing papers on important issues of corporate governance and responsibility.

Sponsoring debate - Sponsoring discussion between interested parties in order to better identify good practice.

Working with others - Institutional investor collaboration.

Best of Sector Investing

Best of sector or class investment generally means expressing a *preference* for investments that demonstrate social or environmental leadership in their industry. This allows fund managers to invest without excluding whole industries, and also facilitates investment in larger companies which may be excluded by a more restrictive approach.

Tip – Check the actual underlying investments and the methodology for selecting investments. Is 'best of sector' being used to justify investments when the primary reason is financial? Have the fund managers addressed all of the key issues in justifying 'best of sector' status?

BEST OF SECTOR – FINANCIAL SERVICES

Almost everyone in the UK uses financial services in one form or another, yet for an industry which relies on trust, it is sadly mistrusted. Companies have responded with an avalanche of corporate responsibility statements to prove their worth in community endeavours, but at the heart of what financial services companies do, is how they use our money.

Banks – commercial lenders

'Best of sector' refers to banks that demonstrate leadership in environmental management, lending policies, putting the customer first, community investment, micro-credit and social banking.

Insurance & investment

'Best of sector' might require that companies lead on socially responsible investment, in the management of their internal environmental impact, social reporting, treatment of customers or response to global warming.

Values-Driven Investing

Values-driven investing takes a wholly different approach. Rather than focussing on the *how* companies operate, it enables you to invest in social and environmental change and to be inspired by what you can achieve with your money. When was the last time you were inspired by an investment? Values-driven investing is all about such investments – investments that leave a lasting legacy when the money is long gone.

At the one extreme this may translate to the gift of income or capital (philanthropy), whilst at the other, it might even result in spectacular financial returns from private equity investment. The choice really depends on the level of financial and social return desired, with four broad categories:

- ◆ Philanthropy
- ◆ Social enterprise
- ◆ Solutions-based investing
- ◆ Transformational investing



Inspiring? When was the last time you were inspired by your investments

Philanthropy

If you've been fortunate enough to be blessed with significant wealth, you may have more than you need. So what do you do then? Do you accumulate more, or could you achieve a greater return by making your money work hard in social rather than financial terms? Philanthropy is concerned with the latter. It seeks to maximise social return at the expense of financial performance – indeed, the return on capital is -100% where you gift capital away, but the social returns can be life-changing!

Great philanthropists of the past such as Rockefeller and Joseph Rowntree continue to make a major impact on society today through their charitable foundations, as do the more modern philanthropists whether they be incredibly rich businessmen like Bill Gates, or individuals with more modest wealth.

Tip - Today, there are more ways than ever to give your money, but the key principle is one of *involvement*. The more involved you are, the more you are likely to give and the greater your confidence in the social impact of your gift.

WAYS OF GIVING

A Charity Account is like a bank account for your giving. You make a regular or one-off gift into your account and a tax rebate is added into the plan. You are then free to make donations to charities from your account. www.cafonline.org.

A Charitable Trust is like having your own foundation. The trust can hold investments, with any income being distributed or re-invested, and with the option of making capital withdrawals at any time. Investment managers or financial advisers with a philanthropy department offer trust facilities as do the Charities Aid Foundation.

The Funding Network arranges funding events at which individuals hear from the organisations seeking funding at first hand, with commitments being made on the day. www.thefundingnetwork.org.uk.

The Network For Social Change has similar objectives, but has a minimum gifting requirement of £3000 per annum from each member and is less focussed on funding events, with decisions on funding being made collectively. www.thenetworkforsocialchange.org.uk

Social Enterprise

Investing in social enterprise blends philanthropy with investment for financial returns, with social returns being paramount and financial returns secondary. However, there is an expectation of a financial return, albeit a sub-optimal one, since the surpluses of a social enterprise are principally reinvested for its social purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners.

Social enterprises take many forms as do the investment vehicles in them. Investments are often only open for fixed periods. Tax reliefs may be available in certain instances, notably Community Interest Tax Relief which goes some way to compensate for the financial return foregone. Examples of social enterprise investments include the Ethical Property Company, Café Direct and community development trusts.

Tip – It may not be possible to sell an investment when you want to, take care as to how much capital you commit to such investments.



Café Direct works in partnership with over a quarter of a million coffee, tea and cocoa producers through 33 organisations in 11 countries, ensuring that producers get paid a fair price for what they do. The capital raised from their share issue has helped to fund the further development of fair trade into the mainstream.

Solutions-based Investing

Social and environmental challenges abound – climate change, resource depletion, population pressures and so on – but challenges create opportunities and the bigger the challenge, the greater the opportunity. Solutions-based investing focuses on investing in companies whose core product or service provides a partial or total solution to these key global challenges. Typical solutions might include clean energy, resource management, energy efficiency, healthcare, public transport, sustainable forestry, eco-housing and the provision of clean water.

The range of available investments include direct investments in shares and bonds, which may be listed on recognised stock exchanges or might be privately held, and there is an increasing range of funds specialising in environmental and social solutions.

Tip – Be careful to diversify your holdings. As with any technology, it's very hard to identify the long-term winners from the losers, and even if the company is a long-term winner, that may be more than reflected in the share price.

SOLVING PROBLEMS - CLEANING UP CHINA

China has fast become one of world's economic powerhouses. The consequent demand for energy, water and other resources is creating huge environmental problems, but companies in the region have stepped forward to provide solutions to these problems. They are responding to the demand for clean air, water and energy, with technologically advanced alternatives to the old polluting way of doing things.



Transformational Investing

Transformational investing takes solutions-based investing one step further. By harnessing the capital markets it seeks to transform whole areas and the lives of people within them, and in doing so generate attractive financial returns at the same time. These are amongst the most inspiring of investments which touch people's lives in a profound way, often lifting them out of abject poverty to a better life. Surely there can be no more compelling reason to invest than this!

The risks associated with such investments may be high, but often they show little correlation with mainstream stockmarkets, property and fixed interest securities, and it could therefore be argued, that as part of a portfolio, they can actually reduce overall risk. Given that investments may be in private equity, financial returns can be high, but the prime reason for investing is likely to be socially motivated.

Tip – Transformational investments are somewhat thin on the ground for the typical retail investor, but it may be possible to access them through a discretionary fund manager or specialist fund.

Africa Invest – Investing in The Poor



The problems of Africa are well rehearsed: disease, famine, corruption. Sometimes it seems like the continent is doomed to perpetual poverty. In this unpromising climate, Africa Invest is a shining beacon that aims to impact on 1.3 million poor people through investment in commercial farming in Malawi. Not only this, but Africa Invest aims to change the terms of trade that keep so many poor farmers in poverty and to set an example of how business can

solve the seemingly insoluble problems that rack the continent. It also aims to offer financial returns (not guaranteed!) that make it an attractive financial investment in its own right.

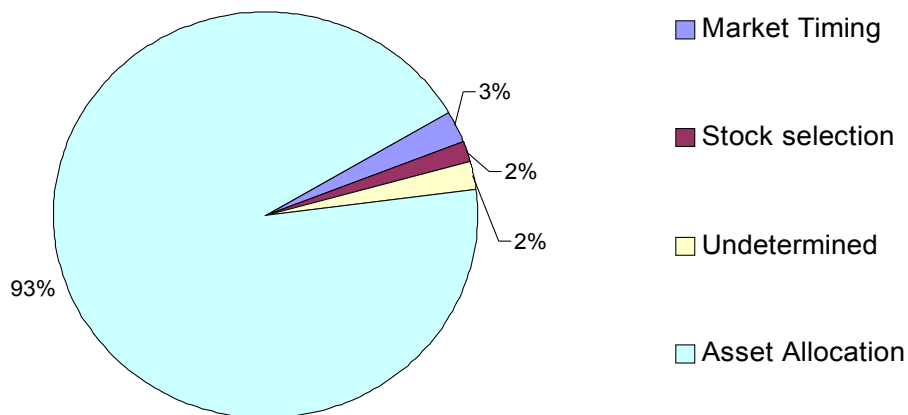
Performance

A long enduring myth of investing for a social as well as a financial return, is that financial returns are compromised. How true is this? Well, it depends on what we mean by 'performance'. Is it risk adjusted, relative or absolute, benchmarked or unconstrained?

Risk

Firstly, the prime concern of many investors is not to lose money. There is no evidence that adopting non-financial criteria is inherently more risky, although it is true that many equity funds applying such criteria have a bias toward smaller companies which are more volatile than their larger counterparts. Furthermore, funds that apply exclusion criteria may rule out parts of the market and may therefore be unable to invest in these areas when they would otherwise do so.

However, as with all investment decisions, the key factor is one of asset allocation – that is, how you divide a portfolio between different sorts of investment.



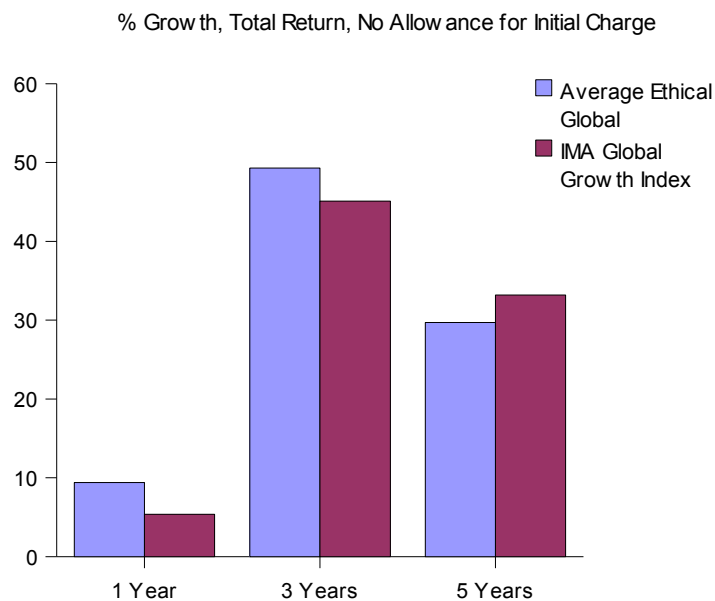
Source: Financial Analysts Journal July-Aug 1986

Furthermore, it can be argued that employing a 3D approach to investing can actually reduce investment risk by including non-correlated assets (investments that don't tend to rise and fall in tandem) that might not otherwise be included. These investments have characteristics that make them worthy of inclusion from an investment perspective, regardless of any social or environmental considerations. For instance, there are now micro-credit funds with competitive target yields and underlying repayment rates that would make them the envy of most mainstream banks. Similarly, there are forestry funds that have

very little correlation with equity, bond and property markets since they represent investments in the physical trees which have predictable growth rates and can be harvested at times chosen to maximise returns.

Relative Performance

“Ethical investments don't perform” is the old chestnut of 3D investing, but how true is it? The evidence is that applying non-financial criteria doesn't necessarily impact on investment performance when compared with conventional funds.



Source: Trustnet, 1 Feb 2008

Rather the evidence is that some 'ethical' funds outperform and some under-perform. Choice of type of asset and fund are clearly more important than the ethical screen itself, the impact of which is to be found in the divergence from conventional benchmarks. These benchmarks are often the headline indices such as the FTSE 100 Index, which are composed without reference to social considerations. Many 3D investments would exclude whole sections of these indices such as mining, resources and tobacco. When these sectors perform well, 3D investment funds that exclude them will perform relatively poorly, and when these sectors under-perform, 3D investments will fare relatively well. Likewise, a focus on emergent sectors like renewable energy will skew performance toward that of those industries.

The other notable impact on performance is to be found in the tendency of ethical funds to be more heavily weighted toward smaller companies. This means that the performance of the funds will be directly influenced by that of smaller companies as a whole.

In summary, there is no evidence that employing extra-financial criteria necessarily leads to under or over performance over the long term, but rather, ethical investment funds have inherent financial characteristics that skew performance in the shorter term.

Absolute Return

In any case, the primary concern of many investors is simply to generate a return in excess of inflation without taking on too much risk. Applying non-financial criteria is less important in this respect than asset allocation. The evidence is that ethical funds do not necessarily perform any worse, but many are equity based and will broadly reflect the underlying stock-markets in which they are invested. If you are primarily concerned with beating inflation or another fixed benchmark, you should diversify your investments appropriately.

Tip – Focus on how your money is distributed in terms of type of investment and sectors of the economy rather than individual stock picking. Seek out long-term economic drivers and invest in those areas.

Choosing 3D Investments

Given the complex set of issues, how do you choose investments? The answer is usually to get good advice. If you have an existing adviser, they may be able to guide you, or we can also refer you to a specialist adviser or asset manager with the necessary knowledge of, and commitment to, 3D investing. However you choose to invest there are a few basic principles that you should follow:

I. Make a plan

How much do you want to leave to chance? The most important thing is to have a plan. Without one, your finances will be haphazard, whereas with one at least you will be able to judge what you need, when you need it and how you are progressing.

II. Set your financial goals

If you don't have a goal, you probably won't get there, and even if you do, you might not know it! Deciding how much is enough and when to stop saving for a rainy day, as well as when to start, is one of the most important questions that you can ask yourself. There are many other questions besides – when do you need the cash, what return can you reasonably assume, and what reserves do you need?

III. Assess your risk tolerance

It's no use just picking a number out of a hat to depict your attitude to risk. What risk tolerance really means is how much money you are prepared to lose and over what period? Think about how you would feel if you did lose part or all of your money and this will inform your answer.

IV. Decide on your non-financial priorities

Think about this in conjunction with your financial concerns. After all, the two are inseparable. For instance, you may be prepared to take more risk if you know the money is being used for socially constructive purposes. Prioritise your concerns, as financial considerations may well dictate an element of compromise. Ethical Money's questionnaire can be used to assess how your values might translate into your investment planning.

V. Choose a manager/funds according to the plan

The resulting matrix may be somewhat complex! Its therefore probably best to leave interpretation of the results to a fund manager or adviser with the professional

expertise to do so, but don't just leave it to the 'experts'. If they are worthy of your trust, take an interest in how they propose to deliver on your goals and challenge them on anything that you're not sure about.

VI. Stick to the plan

Too many people are swayed by the latest marketing campaign. If they weren't product providers wouldn't bother. Yet these are often poorly timed as far as the investor is concerned and if they don't fit in with your plan, you shouldn't be considering them.

IMPORTANT INFORMATION

Ethical Money is a trading style of Ethical Money Limited which provides independent values-based research for individual and corporate investors and their advisers. Ethical Money is NOT authorised to provide financial advice or to manage investments and investors are strongly advised to seek independent financial advice before making an investment. This guide should not be regarded as an offer to buy or sell investments or securities or enter into other transactions. While all reasonable care has been taken to ensure the accuracy of the information, Ethical Money does not accept any responsibility for any errors or omissions. Past performance is not necessarily a guide to future performance of any investment. The value of an investment may rise as well as fall, and investors may not get back all the money invested.

About Us

The Company



Ethical Money was formed to help investors, financial advisers and fund managers to adopt a values-led approach to investment. We are at the forefront of developing and promoting new and innovative investment funds which deliver '3D returns'. We work with major investment institutions and private clients, providing investment research, as well helping to develop and promote investments with a high social impact.

We aim to 'walk the talk' and to run our company in line with our principles whilst also delivering a very personal and professional service. Our commitment is borne out by being one of the first companies to be awarded the prestigious Ethics Mark.

The company is based in the English Lake District, the birth place of much social innovation such as the National Trust, the NHS and latterly, the Ethics Foundation. However, we recognise the importance of face-to-face contact and are happy to arrange meetings throughout the UK.

John Fleetwood, Managing Director

John Fleetwood founded Ethical Money and has been advising on ethical investments since 1991. He also jointly developed Ethical Analyst, the ethical analysis software for financial advisers, and helped to found the Ethical Investment Association, the industry body for ethical financial advisers.

A graduate of Edinburgh University, John is a founder of the Ethics Foundation and the author of 'The Money Test', the first UK book on Christian financial planning.



Do not squander time, for that is the stuff
that life is made of

-Benjamin Franklin 1706 – 1790

For further information please visit: www.3dinvesting.com

Postal Address:

Ethical Money
Garnett Bridge
Kendal
Cumbria
LA8 9AZ

Telephone: 0845 641 0674

Facsimile: 0870 432 4599

Email: info@3dinvesting.com

Web: www.3dinvesting.com

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