Investing Ethically with BetaShares

BetaShares
Exchange Traded Funds

NOVEMBER 2017

The case for investing ethically using the BetaShares Sustainability Leaders ETFs (ASX Codes: ETHI and FAIR)

Introduction

Ethical investing is on the rise. Both institutional and individual investors are flocking to align their investments with their values. This is a result of three trends that have emerged in recent years:

1. Investors are increasingly realising the connection between the companies they invest in and the social and environmental challenges facing our planet;
2. Investors are responding to the inherent risks associated with companies who demonstrate poor environmental, social or governance outcomes; and
3. Investors are responding to consumer trends that have seen the rapid growth of companies involved in positive industry segments such as healthy eating, sustainable consumption, energy efficiency and clean energy generation,

To meet the growing demand for ethical investing the financial services industry has created a raft of new "ethical" investment funds.

But what constitutes an "ethical" fund?

As yet, there is no generally agreed industry definition. The result is that some funds touted as "ethical" still invest in industries that many investors would prefer to avoid such as fossil fuel generation, armaments, gambling, tobacco, junk food and alcohol.

What's more, many ethical funds still place a high priority on active management – using their discretion to pick stocks with a view to beating investment benchmarks. This can result in high management fees, poor sector diversification and an overweight allocation to smaller companies, unnecessarily increasing the risk and volatility of an investor's portfolio.

BetaShares has taken a different approach with the introduction of both the BetaShares Global Sustainability Leaders ETF (ASX Code: ETHI) and the BetaShares Australian Sustainability Leaders ETF (ASX Code: FAIR). First and foremost, our funds employ some of the most stringent sets of environmental, social and governance (ESG) screens in the industry. This ensures investors get a "true to label" ethical investment fund that does not include companies many might still find objectionable.

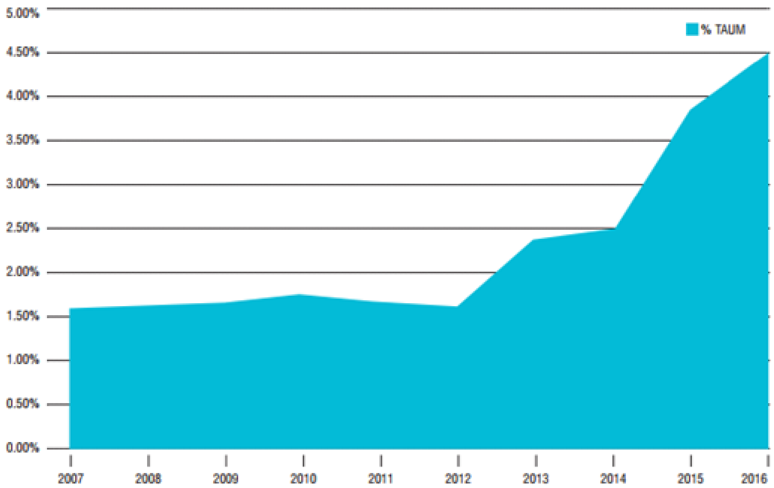
As a result of our sophisticated, rules-based methodology, investors in our funds benefit from investing in a product that is cost-effective, transparent and diversified. And thanks to growing market support for companies with strong environmental and social credentials, the performance in recent years of the benchmarks our funds aim to track has been positive as well.

Last, but not least, as with all BetaShares' funds, these funds are also conveniently offered through the ASX as exchange traded funds (ETFs), meaning investors can buy them just as easily as a company share.

It's little wonder ethical investing is on the rise

Australian investment in responsible and ethical investment portfolios has grown at a rapid pace in recent years. At the end of 2016, around $65 billion was being invested within "core responsible investment" managed funds, representing 26% growth over the year[1]. These funds now account for around 4.5% of total assets under management in Australia, which is up significantly from approximately 1.5% of total industry funds earlier last decade.

CORE RESPONSIBLE INVESTMENTS AS A PERCENTAGE OF TOTAL INDUSTRY AUM SINCE 2006



Source: Responsible Investment Association of Australia 2016 Benchmarking Report

Consumer demand is the key driver for the increase in responsible investments. Given the environmental and social pressures facing our planet, many more investors are seeking out investment funds that only invest in companies consistent with their values. The last few years have seen high profile public campaigns against companies – and the fund managers that invest in them – engaged in a range of sensitive activities such as fossil fuels, tobacco, and the detention of asylum seekers.

Reflecting these heightened concerns, many fund managers and financial institutions are now engaged in an active fossil fuel divestment program. By the end of 2016, global commitments from investors to divest from fossil fuels had reached 688 institutions across 76 countries, representing almost $A7 trillion[2].

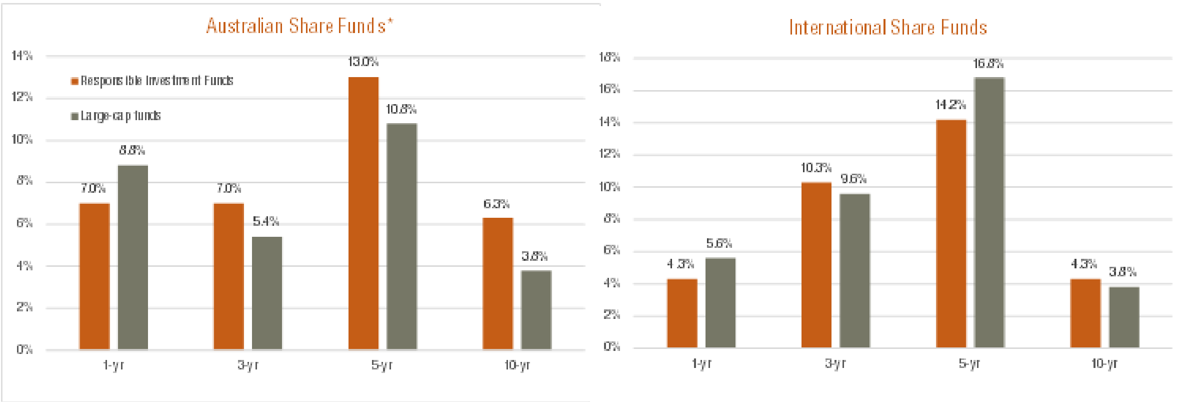
Ethical investing can make good financial sense

Responsible investing is increasingly not just a matter of conscience – it can make good financial sense in its own right. After all, along with their investment dollars, households are also shifting their consumer spending toward companies that are considered greener and more socially responsible. On the cost side, technological innovation in the energy sector is also favouring companies less reliant on producing or using fossil fuels.

[1] Responsible Investment Association of Australia (RIAA) Benchmarking Report, 2017.
[2] Arabella Advisors

It's therefore perhaps no surprise that according to the Responsible Investment Association of Australia's 2017 Responsible Investment Benchmarking Report, the average return performance by both Australian and international "responsible" investment funds has generally tended to exceed that of the funds management industry average over the medium to long term.

PERFORMANCE OF RESPONSIBLE INVESTMENT FUNDS V LARGE CAP AUSTRALIAN SHARES FUNDS & INTERNATIONAL SHARE FUNDS AS AT DECEMBER 2016



Source: Responsible Investment Association of Australia 2017 Benchmarking Report. Past performance is not an indicator of future performance. Average performance among funds as surveyed by Morningstar.

As seen in the chart below, that's also consistent with other evidence suggesting that, out of the universe of our 6000 global stocks, relatively more carbon efficient companies (or "climate leaders") have tended to produce better financial performance.

AVERAGE TOTAL RETURN PERFORMANCE OF 'CLIMATE LEADERS' V 'CLIMATE LAGGARDS' AS AT END 2015

Source: Etho Capital, Trucost. Past performance is not an indicator of future performance.

Notably, the outperformance of "climate leaders" over "climate laggards" has been consistent across many sectors, including materials, industrials, and financials.

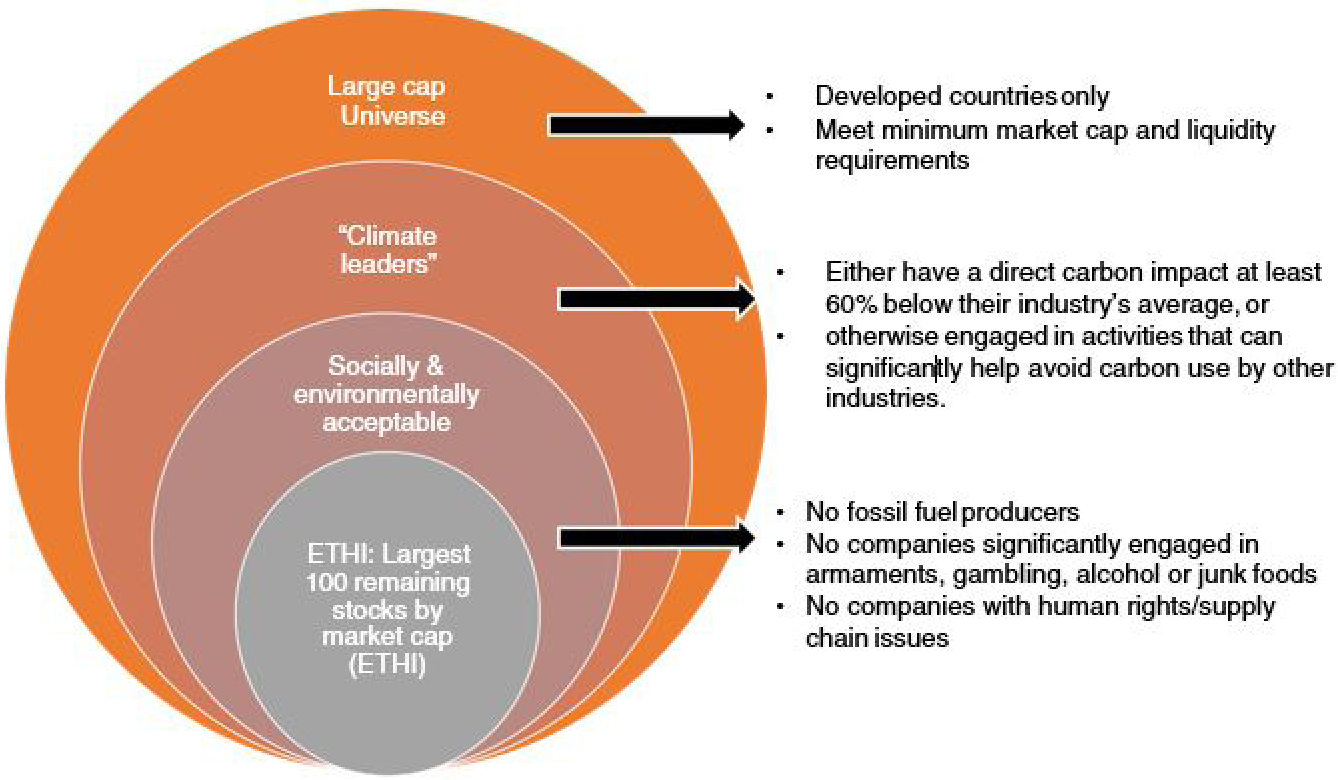
What's special about the Betashares' Sustainability Leaders ETFs?

As noted above, there is no generally agreed definition of what constitutes an "ethical" or "responsible" investment fund. Using their own discretionary criteria, some funds surprisingly manage to include fossil fuel producers, while others can include companies engaged in a range of other activities such as gambling or tobacco.

In order to offer funds that are "true to label", BetaShares and our partners decided to develop a comprehensive ESG screening methodology. To ensure the process was objective and cost-effective for investors a largely rules-based screening methodology was devised, using well established industry benchmarks where available.

ETHI

In the case of ETHI, an overview of this methodology is provided in the diagram below:



As evident, the first screen limits the portfolio to global large-cap companies objectively rated as 'climate leaders' in their respective industries. To be a climate leader, a company must have greenhouse-emissions-per-dollar-of-market capitalisation at least 60% lower than its industry average, or otherwise be involved in potentially significant greenhouse gas reducing activities (e.g., renewable energy, sustainable agriculture and land use, and carbon sequestration).

Those companies that pass these tests are then subjected to a range of negative screens to exclude those significantly engaged in a range of activities that are deemed inconsistent with "responsible investing." These activities include the following (known as 'Negative Screens'):

- Production or financing of fossil fuel activities
- Uranium or nuclear energy
- Gambling
- Junk foods
- Tobacco
- Pornography
- Alcohol
- Mandatory detention of asylum seekers
- Armaments
- Human rights and supply chain concerns
- Animal cruelty
- Recent significant fines or convictions
- Chemicals of concern
- Destruction of valuable environments

Having found companies that pass these stringent screens, ETHI invests in the largest 100 global companies remaining, weighted by their market capitalisation.

FAIR

The FAIR product utilises the same Negative Screen used above, with addition of a gender diversity screen that removes from our investment universe companies that have all-male boards[3].

As there is less reliable data on carbon emissions at the Australian company level, the selection of "climate" or "sustainability" leaders uses other criteria such as whether companies earn a minimum level of revenue from a range of sustainable business activities. These activities include renewable energy, energy efficiency, recycling, waste remediation, and public transport. Other activities prioritised in the fund include education, healthcare, community and regional banking, social services and social infrastructure such as child care.

The final selection of companies to be included in FAIR's Index includes a process that ensures an adequate level of diversification across sectors.

By adopting a rules-based stock selection strategy, both ETHI and FAIR are cost effective, with management costs of no more than 0.59% p.a. and 0.49% p.a. respectively[4].

Finally, ETHI and FAIR are easy-to-access and invest in. Each can be bought or sold like any share on the ASX. As a result, there is no minimum investment amount required by BetaShares and, as long as you are set up to buy shares, you can buy either ETHI or FAIR without any further paperwork.

[3] Although not part of the current screening methodology for ETHI, gender diversity is being considered for future inclusion. FAIR also includes a screen against companies engage in "payday" lending.

[4] Management costs comprise ongoing costs associated with operating the fund, such as management fee and recoverable expenses, but exclude transaction costs.

ETHI's Index – exposure to global leaders in a cleaner and greener world

The global portfolio of stocks contained within ETHI's Index provides a mix of well-known and established large companies across diversified sectors and geographies. These include Apple, Home Depot and Roche, along with exposure to companies which are directly involved in the transition to a sustainable energy future, such as Tesla and Shin-Etsu, which manufactures silicon for solar cells.

Below are some examples of companies that are included within ETHI's portfolio. As you can see, they are large organisations that are making profits for shareholders while still caring for the social and environmental well-being of the planet.

Apple

Apple is one of the World's largest companies, best known for its computers and mobile devices. Apple has shown leadership on best practice supply chain with the *Baptist World Aid's Behind the Barcode* report giving Apple the equal highest score for an electronics company. The company has also led on other environmental initiatives, including elimination of mercury, lead, brominated flame retardants, arsenic, and phthalates in all products in advance of any regulatory requirements, as well as the near elimination of PVC.

First Solar Inc

First Solar manufactures solar panels and provides supporting services for photovoltaic power plants including financing, construction, maintenance, and panel recycling. To date, the company has sold over 13.5 gigawatts of solar generated electricity and financed and facilitated projects worth more than $11bn.

Industria De Diseno Textil SA

Industria De Diseno Textil is a Spanish company better known as Inditex. It is the World's largest fashion group with over 5000 stores with its most well known brand being Zara. The company has scored an A grade in *Baptist World Aid's Behind the Barcode Fashion Report in 2016*. Inditex has made commitments to be fur free, angora free, and to have zero discharge of hazardous chemicals.

FAIR's Index – no major banks or resource companies

Like ETHI's Index, FAIR's Index includes a broad range of companies displaying best-practice with regard to environmental, social and corporate governance issues.

What's more, given the top-heavy nature of the Australian equity market, another feature of FAIR's Index is that it provides good diversification away from the major banks and resource companies that dominate the market. As seen in the table below, compared to the benchmark S&P/ASX 200 Index, FAIR's Index excludes the Big-4 Australian banks (as they have provided finance to fossil fuel producers) and the fossil-fuel producing major mining companies such as BHP-Billiton.

COMPARISON OF TOP HOLDINGS: FAIR'S INDEX V S&P/ASX 200 AS AT 31 OCTOBER 2017

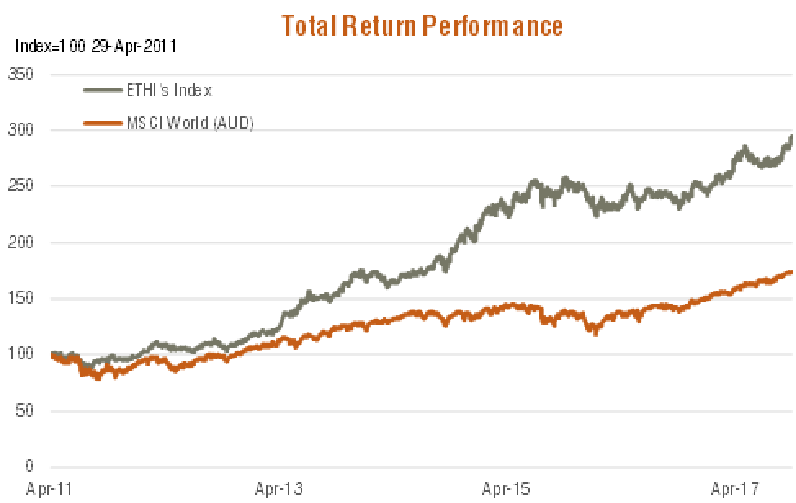
S&P/ASX 200 Name	Weight	FAIR's Index Name	Weight
Commonwealth Bank of Australia	9.02	CSL Limited	4.00
Westpac Banking Corp	7.21	Telstra Corporation Limited	4.00
Australia & New Zealand Banking Group Lt	5.81	Suncorp Group Limited	4.00
National Australia Bank Ltd	5.47	Brambles Limited	4.00
BHP Billiton Ltd	5.37	Insurance Australia Group Limited	4.00
CSL Ltd	3.85	Resmed Inc	4.00
Wesfarmers Ltd	3.16	Stockland	3.97
Telstra Corp Ltd	3.06	ASX Limited	3.82
Woolworths Ltd	2.31	Dexus	3.67
Macquarie Group Ltd	1.96	Ramsay Health Care Limited	3.66

Source: Bloomberg. The Index which FAIR aims to track is the Nasdaq Future Australian Sustainability Leaders Index. You cannot invest directly in an index.

Good return potential with a good conscience

As noted above, leading global companies with good social and environmental records are increasingly being rewarded in the market place by consumers and investors alike. Accordingly, as seen in the charts below, the indices which both ETHI and FAIR aim to track have historically tended to show superior longer term performance compared to the major equity benchmarks.

ETHI'S INDEX V MSCI WORLD EX-AUSTRALIA (IN AUD): 29-APRIL-2011 TO 30-OCTOBER-2017



	ETHI's Index	MSCI World Index (AUD)
1 Year	24.5%	23.4%
3 Years (p.a.)	15.8%	8.7%
5 Years (p.a.)	22.4%	12.2%

	ETHI's Index	MSCI World Index (AUD)
2017 ytd	17.9%	18.7%
2016	0.8%	8.1%
2015	19.7%	-0.3%
2014	19.8%	5.5%
2013	54.4%	27.3%
2012	17.3%	16.5%
2011	-4.6%	-13.2%

Source: Bloomberg

Source: Bloomberg. The Index which ETHI aims to track is the Nasdaq Future Global Sustainability Leaders Index. You cannot invest directly in an index. The inception date of the index is 29 April 2011. Performance shown is of ETHI's Index, not ETHI, and does not take into account ETHI's management costs. Past performance is not an indication of future performance of the Index or the ETF.

Conclusion

Many investors today are increasingly demanding in terms of what they expect from a company. Not only should a company be able to deliver decent returns to shareholders, it should also do so whilst paying due regard to the social and environmental consequences of its actions. To help in picking companies best able to meet these dual demands, investors are also seeking out the services of professional investment managers.

To date, however, many so-called "ethical funds" suffer from often narrow and inconsistent screening approaches, along with high management fees and a focus on less globally influential and riskier smaller cap stocks.

By contrast, the Betashares Sustainability Leaders ETFs (ASX Code: ETHI and FAIR) offer transparent, true-to-label, cost-effective and easy to access ways for investors can gain exposure to a broad portfolio of companies with positive social and environmental records. Being exchange-traded, these exposures can be obtained just as easily as buying any share on the ASX.

Trading Information

BetaShares Funds can be bought or sold during the trading day on the ASX, and trade like shares.

EXCHANGE	ASX
ASX CODE	ETHI I FAIR
CURRENCY	AUD
TRADING HOURS	10:00-16:00 (AEST)
BLOOMBERG CODE	ETHI AU I FAIR AU
IRESS CODE	ETHI.AXW I FAIR.AXW

EHTI Fund Information

DISTRIBUTIONS	SEMI-ANNUAL
MANAGEMENT FEE	0.49% P.A
EXPENSES	CAPPED AT 0.10% P.A
FUND INCEPTION	5 JANUARY 2017
INDEX	NASDAQ FUTURE GLOBAL SUSTAINABILITY LEADERS INDEX

FAIR Fund Information

DISTRIBUTIONS	SEMI-ANNUAL
MANAGEMENT FEE	0.39% P.A
EXPENSES	ESTIMATED AT 0.10% P.A
FUND INCEPTION	27 NOVEMBER 2017
INDEX	NASDAQ FUTURE AUSTRALIAN SUSTAINABILITY LEADERS INDEX

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There are risks associated with an investment in the Funds, including market risk, non-traditional index methodology risk and, in the case of ETHI, international investment risk and foreign exchange risk. For more information on risks and other features of the Funds please see the Product Disclosure Statements.