

# Combining ESG and shariah principles in a fund

BY TAN ZHAI YUN

Sustainable investing is increasing in popularity globally as more investors and companies prioritise the need to act responsibly in order to create a positive lasting impact on the community and the environment. Shariah-compliant investing, which is also rising in prominence, shares many similarities and goals as sustainable investing.

“We believe that sustainable investing is becoming the ‘new normal’. Companies and investors are increasingly aligning their values and leveraging their investments for the good of the world and society. This contributes to the demand for various institutions to make ESG [environmental, social and governance] performance and sustainable investments part of their long-term strategy in the coming years,” says Ahmad Najib Nazlan, CEO of Maybank Asset Management Sdn Bhd (MAM).

Governments, institutions and the younger generation are more concerned about environmental issues such as climate change. As such, they demand more independent governance structures and want corporations to fulfil social responsibilities like ensuring workforce diversification, he explains.

“It is important to know that fund managers can also play a pivotal role in educating [the public] and to a certain extent, influence investors and companies that we are investing in to be more ESG-centric. Various data has also shown that sustainable investments do provide a slight advantage in risk-adjusted returns,” Ahmad Najib says.

Observing these trends, MAM recently launched the Maybank Global Sustainable Equity-i Fund on Aug 25, its first actively managed shariah-compliant ESG fund that invests in both shariah-compliant and sustainable companies in the global markets. Schroders Investment Management (Singapore) Ltd is the fund’s investment adviser.

While the fund is not the first in Malaysia that combines the elements of ESG and shariah-compliant investing, it is one of the few actively-managed funds that focus on these two areas.

There are not many such funds available for Malaysian retail investors in the market currently. Of the over 600 unit trusts registered (as at June) in Malaysia, only eight are Sustainable and Responsible Investment (SRI) funds, according to Securities Commission Malaysia criteria. Among these, five are retail funds. Shariah or ESG funds that meet the requirements can qualify as an SRI fund.

“We at MAM do agree that there are not many true-blue ESG funds for retail investors in Malaysia. We believe this is because there isn’t a lot of demand out there, and are of the opinion that the level of awareness is still low. Hence, there is a lot of potential to be explored by fund managers,” says Ahmad Najib.

Much work still needs to be done in Malaysia to educate the public about sustainable investing, he adds.

“The government and regulators in Malaysia are becoming more ESG-centric and have crafted the SRI Roadmap by having policies and framework that promote it.”

## ESG AND SHARIAH-COMPLIANT INVESTING

The fund will not just use negative screens — which exclude certain companies and sectors — to determine the companies’ ESG performance and shariah compliance. Schroders will also use its tools to appraise the impact the company has on a broad set of stakeholders, such as the environment, employees and communities.

Will excluding companies and sectors that do not meet ESG and shariah standards limit the investment universe? Gavin Marriott, product manager for global and international equities at Schroders, says it will not.

“The impact of incorporating these filters also highlights companies that are genuinely managed for the long term, with stakeholders at the heart of the corporate strategy. Arguably, it is this inclusionary aspect that has the largest potential impact on financial returns and should, over time, lead to improved risk-adjusted returns,” he adds.

“Even with the exclusions, there remains a rich source of opportunity within the investible universe, with more than 2,000 stocks to choose from.”

Another challenge investors may face is the prevalence of “greenwashing”. In this case, they will have to look beyond companies’ corporate social responsibility disclosures to find out if they are truly implementing what they say on paper.

Marriott says Schroders overcomes this by developing a number of proprietary tools to appraise a company’s relationship with its stakeholders and the sustainability of its business model.

“CONTEXT, our flagship ESG research tool, comprises over 260 metrics for over 13,000 companies and is designed to support investors’ understanding of the

sustainability of companies’ business models and profitability.

“Our SustainEx tool enables analysts to quantify the positive contributions and negative impacts companies have on society. Viewing those costs and benefits through a hard economic lens provides an objective measure of companies’ credit or deficit with society, which will become more important as they crystallise into financial costs or benefits,” he says.

## INVESTING IN VARIOUS ASSET CLASSES

The fund is suitable for long-term investors who are looking to achieve income and capital growth by investing primarily in a portfolio of equities that are shariah compliant and have good ESG performance, according to its master prospectus. The minimum initial investment amount is RM1,000 for the ringgit share class and US\$1,000 for the US dollar share class.

A minimum of 80% of the fund will be in shariah-compliant equities and shariah-compliant related securities. The rest of the fund will be invested in Islamic liquid assets. According to Ahmad Najib, the fund aims to generate a total target return of 8% to 10% per annum, inclusive of a potential annual dividend income of 3%.

“Our investment approach is driven from the bottom up. This means that any company that is eligible for this fund is competing for a place in the portfolio against all others, irrespective of sector or country of listing,” says Marriott.

The Schroders team highlights stocks with an improving cash flow and earnings fundamentals, he adds. One of the stocks currently held in the portfolio is TransAlta Renewables, a Canadian-listed company that owns a portfolio of renewable and natural gas generation facilities. “As a leading green energy infrastructure company, it is a key facilitator of the decarbonisation of North American power generation and distribution. As a result of its power purchase agreements, it benefits from highly predictable cash flow streams alongside attractive growth prospects as North America transitions to a low-carbon economy,” says Marriott.

It is also invested in Swiss-listed Nestlé. “The company is a key enabler in improving access to nutritional food. A growing global awareness of the bene-

fits of healthy nutrition will drive structural growth for Nestlé’s stable of iconic brands. The brand’s halo effect supports high levels of profitability, which alongside low capital requirements, allow for significant levels of cash generation,” he says.

Guangdong Investment, a Hong Kong-listed water supply and irrigation systems manufacturer, is also among the fund’s holdings. It is involved in wastewater treatment and reuse. Growing urbanisation in the country will drive the long-term growth of the company, Marriott observes.

The fund can invest up to 20% of its net asset value in Islamic real estate investment trusts (REITs). One that the fund is currently invested in is Hong Kong-listed Link REIT, which benefits from some of the highest rental rates globally, says Marriott.

“As a key global financial hub and iconic tourist destination, Hong Kong will remain a high populated and visited destination for decades to come. Land is a scarce asset [in Hong Kong] and as a result, [introducing] significant new developments is fraught with difficulty. This underpins both the growth potential and resilience of the stock,” he says.

The market will remain challenging in the short term, observes Marriott, and volatility should be expected. Financial stress due to the Covid-19 pandemic will be seen in a number of countries, and the US-China political tensions will also remain as a headwind, he adds.

“As gloomy as the short-term economic picture is, we are keen not to lose sight of the fact that Covid-19 will eventually pass, and that business and consumer confidence will eventually recover, bolstered by unprecedented levels of monetary and fiscal support,” says Marriott.

“Economic recovery may be slow and gradual, but markets are likely to discount the recovery much sooner. In areas that have been particularly hard hit, there may well be a significant rebound in investor sentiment quite quickly as lockdowns start to be lifted. This could include parts of the consumer space or in the industrial sector.”

Ahmad Najib believes that well-governed, sustainable and socially responsible companies can outperform their broader market peers in the long run. Meanwhile, the shariah screening process will highlight companies that have lesser debt, for instance.

“We believe that these companies will weather the current market weakness better and will outperform their peers over the long term,” he says. ■



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