defaqto

ESG Review

Psigma Investment Management

SRI MPS Cautious

August 2020

Psigma
Investment Management

Contents

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Danny Luggah, CFA

Key facts

- Part of a range of four multi-asset portfolios with varying risk levels and a socially responsible investment (SRI) overlay.
- A focus on positive inclusions as opposed to negative exclusions. This strategy results in low exposures to traditional controversial areas whilst investing in positive contributors.
- Sustainability focus is gained from a diversified range of sources including Emerging Markets, Asset Back Securities and Alternatives.
- Believe in strong engagement with underlying fund managers and a good understanding of their processes.

Portfolio information

Launch Date	31 July 2019
Portfolio Manager	Mike Myers & Inv Team
Domicile	GBR
Assets	Active
Approach	Return Focused
Type	MPS

UN PRI signatory*	No
UK Stewardship Code signatory	No
IA Sector	n/a
Morningstar Category	n/a
Defaqto Diamond Rating Type	-
Diamond Rating	-

*UN Principles for Responsible Investment (PRI)

ESG policy and alignment

Number of exceptions: 0

The Psigma SRI MPS range consists of four portfolios with varying risk levels (Cautious, Balanced, Growth and Aggressive Growth). They are an extension of Psigma's existing multi-asset range, but with an added socially responsible investment (SRI) overlay.

Asset allocations will match the core MPS range, however, underlying fund investments may differ as this range has more of a focus on SRI/ESG funds.

For funds with an SRI-focus, the investment framework is based on four-pillars: ESG integration, sustainable investing, impact investing and engagement. As this is a multi-asset range, the team have a focus on diversification and may include some funds for risk management purposes such as an exposure to gold and government bonds.

The range's philosophy is based on positive inclusion as opposed to negative exclusions. However, there is a formal exclusion policy that prohibits the range investing in funds that have more than 5% exposure to gambling, adult entertainment, tobacco and armaments. We found none of the underlying funds to be in violation of these restrictions.

Levels of ESG integration

Exclusions	100%	Sustainability focus	36%	Impact investing	1%

For full details, please refer to p5

Sustainable Development Goals (SDG) focus

ESG factors

Environmental

Less than 1%	Between 1% and 10%	More than 10%

Environmental Exposures	Product
Fossil Fuel	1.01%
GMO	<1%
Nuclear	<1%
Oil Sands Extraction	<1%
Palm Oil	-
Pesticides	<1%
Thermal Coal	<1%

Source: Based on availability of Morningstar ESG data as at 31 May 2020

Although the range does not have specific environmental exclusions, as can be seen in the table on the left, its focus on positive inclusion has resulted in minimal exposures to most of these areas.

Fossil fuel is the only exposure of significance. For the Cautious portfolio, we found one fund that has greater than 10% exposure to this area: the Robeco Sustainable Emerging Stars Equities Fund. However, in this case, the fund has a set target of environmental footprint reduction compared to its benchmark and invests heavily in the transition to a low carbon economy. An example of one of its holdings is ENN Energy, which is one of the largest clean energy distributors in China.

Social

Social Exposures	Product Involvement
Adult Entertainment	-
Alcohol	<1%
Animal Testing (Pharmaceutical)	5.38%
Animal Testing (Other)	-
Controversial Weapons	-
Fur and Specialty Leather	-
Gambling	<1%
Military Contracting	<1%
Small Arms	-
Tobacco	-

Source: Based on availability of Morningstar ESG data as at 31 May 2020

The portfolio has some exposure to animal testing, although this is a common feature among ESG funds given their often higher exposure to the healthcare industry and the legal requirement for pharmaceutical companies to test new drugs on animals.

The alcohol and military contracting exposure predominantly come from one fund: ASI UK Ethical Equity. It is something that the team are aware of and monitor to ensure the exposure is kept to a minimum.

There is also a very small exposure to gambling which comes from the Neuberger Berman Short Duration Emerging Market Debt Fund. The team have queried this with the fund manager who mentioned it is from the fund's exposure to hospitality, tourism and leisure in the Emerging Markets. Again, this exposure is very small and only accounts for approximately 0.05% of the overall SRI MPS Cautious.

Governance

The team's belief is that governance is highly correlated to share price performance. As such, they expect underlying fund managers to illustrate good/improving governance practices across their holdings

As part of the research process, the external fund management team are sent a proprietary due diligence questionnaire which includes details of their process, engagement with companies, voting records and SRI credentials. This is used to form a picture of how the fund is managed as well as its focus on governance. During our meeting with Psigma, an example provided was of the portfolio's holding in Sparx Sustainable Japan Fund, one of the reasons this fund was chosen was because of the fund manager's commitment to improve the governance policies of its underlying holdings.

In terms of ongoing fund monitoring, the team use Morningstar to formally analyse the revenue exposure of its fund holdings on a monthly basis to ensure they are aligned with the policy. If a position is held that is not consistent with Psigma's SRI framework, the first step is to begin a dialogue with the fund manager to understand the rationale for holding the position. This rationale is then evaluated and if the position contravenes the SRI framework, the fund is removed.

The team have also established non-disclosure agreements (NDAs) for all of the funds in their SRI strategies to ensure they have access to the most up-to-date holdings list.

Due diligence questionnaires are also reviewed on an annual basis.

Levels of ESG integration

Within this section, we look at how ESG has been integrated across the portfolio. Using the IA responsible investment framework, there are three fund-level components: exclusions, sustainability focus and impact investing.

Exclusions 100%

There is a formal exclusion policy that prohibits the range investing in funds that have more than 5% exposure to gambling, adult entertainment, tobacco and armaments. The team also monitor exposures to other industry sectors, although there are no set maximum levels. For example, when there is revenue linked to fossil fuels, the underlying securities contributing to this exposure must have positive SRI attributes that warrants their inclusion.

Psigma also believe a more pragmatic approach is needed, such as in the case of Emerging Markets, due to the fact that in many cases their processes are not as well-established. Therefore, rather than a restrictive negative exclusion policy there is a focus on positive inclusion, which naturally limits unwanted exposures.

Sustainability focus 36%

Sustainability focus funds invest in assets with specific sustainability goals and/or themes. According to information provided by Psigma, this makes up 36% of the SRI MPS Cautious.

A highlight of the Psigma range is that they target a sustainability focus from a variety of source. Examples include: the TwentyFour Asset Backed Income fund, which integrates ESG and sustainability into asset backed securities; the Osmosis MoRE World Sustainable Market Neutral fund, which is a market neutral fund that chooses investments based on their resource efficiency; and the Robeco Sustainable EM Equities fund, which targets sustainable Emerging Market companies.

Impact investing 1%

Impact funds invest with the intention of achieving a positive, measurable environmental or social impact. This makes up 1% of the SRI MPS Cautious.

Impact investing makes up one of the four pillars of the Psigma SRI framework. A key differentiator from the 'sustainable investing' pillar is that the team expect impact funds to measure and report the social or environmental performance of the underlying investments.

Given the cautious nature of this portfolio, there is understandably a lower allocation to impact funds as they often involve longer investment horizons and less predictable returns. For the SRI MPS Cautious, there is exposure to only one impact fund: the Impax Environmental Markets fund, which invests in companies involved in energy efficiency, water treatment and pollution control, and waste technology and resource management.

Top 10 holdings

Name	Sector	Country	% of assets
Fidelity Global Inflation Linked	Index Linked Bonds	Global	13.5
L&G Global Inflation Linked Bond	Index Linked Bonds	Global	10.0
Allianz Gilt Yield	Sovereign Debt	United Kingdom	8.0
Liontrust Sustainable Monthly Income Bond	Investment Grade	Global	7.0
TwentyFour Core Corporate Bond	Investment Grade	Global	7.0
TwentyFour Asset Backed Income	High Yield	Global	5.0
TwentyFour Focus Bond	Investment Grade	Global	5.0
Osmosis MoRE World Sustainable Market Neutral	Alternatives	Global	4.0
Royal London Sustainable Leaders	Equities	United Kingdom	3.5
Neuberger Berman Short Duration EM Debt	Sovereign Debt	Emerging Markets	3.5

Source: Psigma Investment Management, July 2020

Sustainable Development Goal (SDG) focus

Source: Psigma Investment Management, July 2020

Engagement with corporates and/or funds

Each potential fund is sent a due diligence questionnaire that covers their ESG/sustainability policy, investment process and personnel. This is reviewed annually to ensure any significant changes are captured.

Prior to investing in a fund, the investment selection team will meet with every fund management team and write-up an initial recommendation, which is circulated to Psigma's investment managers. Follow-up meetings may then be arranged with product specialists to ensure it is aligned with Psigma's SRI framework.

Post investment, the team believe in maintaining close relationships with fund managers and aim to have a formal meeting with each one every 6-12 months and an informal meeting more regularly.

The team regularly review underlying fund holdings and if one is found to be inconsistent with Psigma's SRI framework, they will engage with the fund manager. The next step is to get a written answer and check for an appropriate response.

Resources

Psigma have 33 investment professionals, including six members within the Investment team.

The Head of SRI is Mike Myers, who oversees the central SRI investment list. Two members within the team have also gained the CFA ESG Investing certificate.

The team use Morningstar to monitor the revenue exposures of the funds on their recommended list each month and have established non-disclosure agreements (NDAs) with all of the funds in their SRI strategies to ensure they have access to the most up-to-date holdings list.

For specialist funds, such as the TwentyFour Asset Backed Income fund, Morningstar does not currently have the ability to assess Asset Backed Securities (ABS) from an ESG point-of-view. In this case, the team have gained an understanding of TwentyFour's internal tool, Observatory, which the fund manager uses to integrate ESG factors into ABS.

Psigma's ESG policy

At present, there is no formal, firm-wide ESG policy. However, there is an SRI policy that governs all of Psigma's SRI services (as discussed within the Exclusions section on P5).

Furthermore, part of the firm's due diligence questionnaire, which is sent out to all underlying funds, queries whether they consider ESG factors in their investment process. At the time of review, a large majority of funds within the non-SRI service integrate some form of ESG into their decision-making process.

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