AJBell Investcentre

Fundamentals with Russ Mould

February 2017

Hello, I'm Russ Mould, AJ Bell's Investment Director, and welcome to Fundamentals, where I'm going to look at one of most popular Exchange-Traded Funds on the AJ Bell Investcentre platform right now, namely UBS MSCI USA Socially Responsible ETF.

[CAPTION - UBS MSCI USA Socially Responsible UCITS ETF (USD) A-dis (GBP) EPIC code - UC46 SEDOL – B6YRHS5]

An ETF is designed to track the performance of the underlying assets and deliver that performance, minus any running costs. In this case the product is designed to track an MSCI index, called MSCI USA Socially Responsible, which uses rigorous checks to determine whether US-listed firms are suitable for inclusion or not.

What's different about the index, and therefore the tracker, is the tests used to select those stocks. Normally 'negative' screening is used, whereby certain industries are automatically excluded – gambling, tobacco, alcohol, adult entertainment, weapons manufacturing, for example.

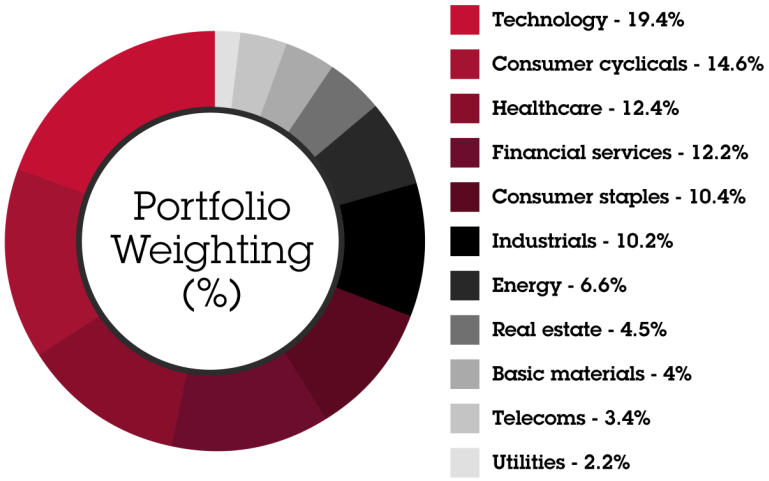
But this index used 'positive' screening, which integrates environmental, social and governance (ESG) considerations into other factor analysis of a company. Each firm is given a score based on two factors:

- First, an intangible value assessment (IVA) ranks a firm from AAA (the highest) to CCC (the lowest)
- And second an impact monitor or (ESG) rating that lies between 0 (the lowest) and 10 (the highest).

Only the highest combined scores are included and the result is an index of around 150 firms, where no one stock can be greater than 5% of the total portfolio.

Once all of that analysis is complete, UBS MSCI USA Socially Responsible uses physical – or direct – replication to provide performance, so it owns the underlying securities. In this case, the five largest holdings are Microsoft, Procter & Gamble, Intel, Walt Disney and Cisco.

By way of sectors, technology, consumer discretionary and healthcare are the three biggest exposures while utilities, basic materials – mining – and telecoms have a much lower profile within the MSCI index and therefore the tracker.



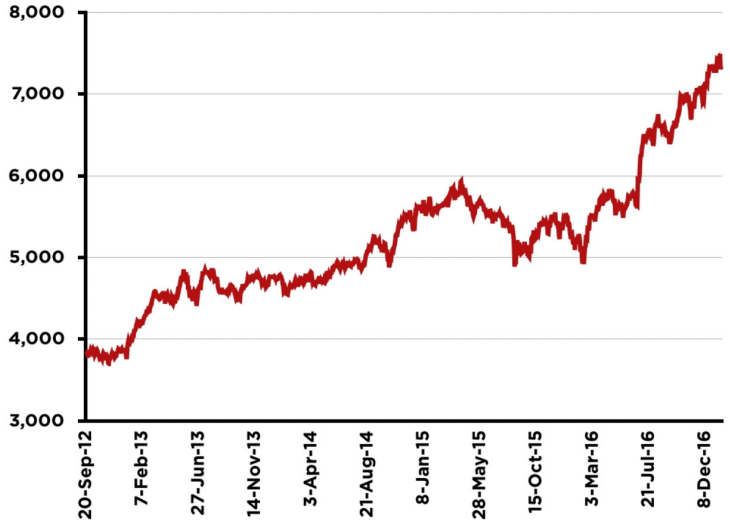
Source: UBS factsheet, Morningstar

The tracker comes with an annual ongoing charge figure of 0.33% and has around £285 million in assets under administration. Established in 2011, the product comes with a two-star Morningstar rating, for those who put store in such things.

So those are the mechanics. The question to address next is why would clients and advisers be so interested in this product right now?

I would suggest there are three possible reasons:

- First, some advisers and clients may be seeking exposure to US – and dollar-denominated assets in the wake of the so-called Trump trade, in the hope the American economy, stock market and currency all get a lift from the new President's planned tax reform, deregulation and infrastructure spending programme.
- Second, the Socially Responsible element. Most advisers and clients put capital at risk because they want a return that satisfies their personal needs and requirements. Some may do so because they want to make a difference and do good. Many more will be keen that their investments do not do harm and make a difference in a negative way, and the twin screen tests will clearly help here.
- Third, it is possible that socially responsible investing can actually help investment returns. In 2012 Deutsche Bank published a research report which asserted that companies with high ratings for corporate social responsibility and ESG factors enjoyed a lower cost of capital in terms of debt and equity. That implies markets viewed such firms as lower risk and that by implications, companies with weak governance or who pay less attention to their social responsibilities were seen as higher risk. The performance of the ETF since inception suggests advisers and clients are not sacrificing performance for their principles at the least, as we can see from this chart here:



Source: UBS factsheet, Morningstar

There are clear risks, as a firm that passes the MSCI screen tests could still make a mistake and then be excluded from the index, but only after its misdemeanours have come to light. In addition, the Trump trade could disappoint and a potentially expensive-looking US stock market could start to flag and lose momentum.

Advisers and clients will therefore need to ensure the ETF does fit with their overall strategy, target returns, appetite for risk and time horizon before they put any capital to work.

Thank you for watching and I look forward to seeing you next time.

AJBIC/RM/T/20170208