The Australian Investor's Podcast Episode Transcript

Episode: Ethical investing deep dive with Australian Ethical Head of Ethics Research, Dr Stuart Palmer
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Speakers: Owen Rask & Dr Stuart Palmer
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Episode transcript:

Owen:
Welcome to part one of our three-part Australian Investors Podcast mini-series on ethical investing in Australia, sponsored by Australian Ethical, a leader in ethical managed funds and superannuation. I believe that ethical investing is not a transient trend or thematic. It should be talked about in the same vein as your risk tolerance or return expectations. ESG, which stands for environmental, social, and governance, is rapidly emerging as one of the most important considerations for any investor. The amount of money invested in ESG-aware strategies is now over $10 trillion globally and rising rapidly.

Owen:
As I discovered when I was creating the Rask Ethical Investing Course in 2021, according to our paper by Wynes & Nicolas, 2017, choosing a high impact sustainable investment option over a standard index fund would result in a reduction of your annual carbon emissions, totaling seven tonnes. To put that in perspective, it's the equivalent of more than five families switching to a hybrid car or seven people becoming vegan. Even with a more conservative ESG investing strategy, it can result in a CO_2 reduction of two tonnes, equivalent to a return flight from New York.

Owen:
Here at Rask's Australian Investors Podcast, we're all about finding businesses that can scale fast with lower incremental costs, bigger returns, less effort. So let me break this down. Switching to a proper sustainable investing option is by far the highest impact per unit of your effort, you will find anywhere. As I hope, we're both going to discover, ethical ESG responsible or sustainable investing, however you want to frame it, does not mean sacrificing returns. There are no hard and fast rules. So don't be perturbed by people who say something like, "That's an unethical investment."

Here's how I draw a distinction between ethical and sustainable investing. In my opinion, ethical investing is about your personal values, while sustainable investing can be objectively measured by carbon footprints, social impact measures, incentives, and things like corporate governance ratings.

Owen:
In part one of this mini-series, ethical investing in Australia, you're going to hear from Australian Ethical's Dr. Stuart Palmer. Stuart walks us through the evolution of ethical investing, the Australian Ethical Charter, the core tenets of Australian Ethical's investing process, and how the ethical filter creates a universe of investible companies. Finally, I ask for Stuart's response to owning Westpac Banking Corp and Facebook/Meta Systems. Then I run five ASX companies past him and his ethical filter. These companies are Guzman y Gomez, the private company involved in Mexican fast food, National Storage REIT, a self-storage REIT which offers a stable dividend, Tyro Payments, the card terminals payments business, ARB, the 4x4 accessories company, and Aussie Broadband, a low-cost NBN provider with good customer service.

Owen:
In part two and part three of this series, I'm joined by Australian Ethical's head of Australian Equities, Mike Murray, who walks us through the investing pillar of Australian Ethical's investment process, and then offers us three ethical investing ideas from the Australian Shares High Conviction ETF, which trades in the CBOE under the ticket symbol AEAE. I hope you enjoy part one, of my conversation with Dr. Stuart Palmer of Australian Ethical.

Owen:
Stuart, thank you for taking some time to join me on the podcast today.

Dr. Stuart Palmer:
Yeah, thank you Owen.

Owen:
It's always an interesting chat when we get to talk investing, but it's also, I would say, more interesting when we get to talk about the ethics of investing as well, because this is an area of investing, generally speaking, where people are growing aware of, if they're not already aware of, and they're seriously considering how their ethics play out in their portfolio. One of the great, I guess, investing wisdoms that I heard from the Motley Fool co-founder David Gardner was,

make your portfolio represent the best version of the future. And he basically talks about this idea of what does your portfolio say about you and your values as an investor? And I think that's a great way to frame, not just the way we think about ethics in investing, but just investing generally speaking.

Owen:
Today, we're going to talk about how you and the team in Australian Ethical basically construct a universe of companies that may be more ethical or improving in some way and focus on the Australian Ethical Charter and what that means and how that plays out in practice. We'll follow on with two episodes and two conversations with Mike about the portfolio construction and using some examples from the ASX. But to keep things off and to introduce you to the Australian Investors Podcast audience, can you tell us Stuart, how did you get to be in the position that you are at Australian Ethical?

Dr. Stuart Palmer:
Well, it wasn't necessarily a straightforward journey for 15 more years. I had very mainstream roles in law and finance, legal background, mainly across into structured finance. I guess I had slightly less mainstream interests around philosophy and carried on some sort of part-time academic, starting in that area over the years. And I guess it was that academic interest that led me to probably a little bit over 10 years going to the Ethics Centre. It was the St. James Ethics Centre at that time, and was working there with companies, not-for-profits, with government around ethical controversies, crises, and generally just how they could support cultures, practises, for better decision making, good decision making.

Dr. Stuart Palmer:
And it was there I came across Australian Ethical and that was a further step I took in 2014. So looking back, a fair bit of luck involved and interesting, despite my interest around philosophical ethics of involvement and interest in finance, I really hadn't come across either the Ethics Centre or Australian Ethical until shortly before I ended up joining them. So I think that maybe is an indication of going back a decade, the lower level of awareness of ethical investing and something that's come on in leaps and downs since then.

Owen:
So what drove you to join Australian Ethical then?

Dr. Stuart Palmer:
It's a unique sort of organisation in many ways. It certainly was at that time. And I mean, becoming less unique, which I think is great, is partly a product of its success in that, at its foundation, it has an Ethical Charter, which sets its purpose, how it's going to invest to pursue positive change for people, animals and the environment and avoid unnecessary harm. And there was this crazy role there where you stepped in and you were able to sort of... Well, you inherited, I inherited a whole wealth of information and practices sitting under that charter, which I know we're going to talk about, but to then take that forward and help the organisation navigate, how do we think about these different parts of the economy and society as the world

changes? So when I became aware of what they were doing and there was the opportunity, I chased it very vigorously.

Owen:
And by accounts, it seems to be a very good move for you professionally and for the business, because things have really taken off at Australian Ethical because the company's publicly listed. A lot of investors are familiar with not only the managed funds and the superannuation side of Australian Ethical, but also as a company and what it stands for, the foundation and those types of things. Can you tell us... You mentioned there briefly in your discussion, how I guess the awareness of environmental, social and governance interests has really dawned on the investment community, principally in the last 10 years, but if we go back a few decades to the late '80s, when Australian Ethical forged the charter, can you describe some of the important shifts that have happened as an industry, as we talk about ethical investing, sustainable investing, et cetera, or even responsible investing, however you want to frame this, can you fill us in on the important milestones over recent decades that have led us to where we are today?

Dr. Stuart Palmer:
Sure. And as you say, late '80s, that was when Australian Ethical was founded and the Ethical Charter was written. And listen, there's been a lot of positive change since then, but I should say one thing that probably hasn't changed is some of the big challenges that were identified then by the company, like climate change, we've been slow to act on. So it's been a slow process. We were a niche organisation at that time. And maybe still in many people's minds, ethical investing was viewed often as just a narrow set of exclusions around sin stocks. We won't invest in gambling, pornography, alcohol. So Australian Ethical took a much broader approach. We care about people, animals, and the environment, invest in a positive as well as avoid negative.

Dr. Stuart Palmer:
So around that time, I don't think there were many people doing what we were doing, but over the next decade there were other players and through the good works of many, but including Australian Ethical, the Responsible Investment Association was established in Australia in 2000, originally called Ethical Investing Australia, and Australian Ethical was a founding member there. Globally, we saw the UN principles for responsible investment established in 2006. And really interesting to look back at the history there. There were a couple of Australians who were key drivers in setting that up. And indeed our current chair was on the steering committee, which helped develop those principles. I think more recently, I think a significant factor in the growth of the sector has been civil society, activist organisations have obviously been around forever looking to change the world for the better, hold business, hold governments to account.

Dr. Stuart Palmer:
But I think a growing focus on how they can apply a little bit of pressure to our sector, the investment sector, the finance sector. So locally we've had market forces, the Australian Centre for Corporate Responsibility, who I think their presence has been a significant factor in the growth of the sector. And some of those stats, I don't know if they're worth mentioning, but I think now in Australia specifically, if we look back since 2014, there's been about 35% per

annum compound growth in the size of ethical or responsible investing. Globally, I think the total market share... And listen, these numbers change a bit depending on how you're going to define responsible investing, sustainable investing, ESG investing and so on. But of the 100 trillion U.S. audit of assets under management globally, there's anything from people depending on how they classified from 35% to 60% of that managed under some form of sustainable or responsible investment strategy.

Owen:
Wow. That's a lot bigger than I thought, to be honest. I've seen some reports from Bloomberg in the tens of trillions, so that's a huge number.

Dr. Stuart Palmer:
Yeah. So the global... What do they call? The Global Sustainable Investment Alliance is a coalition of responsible investment organisations around the world. They come out every few years with the reports. So the report they brought out last year had that 35% number. So that was over 100 trillion, which was their definition of their understanding of sustainable investing.

Owen:
Yeah. Fantastic. I thought maybe, could you mention... You brought more of a few terms there, Stuart, that I might just get you just to clear up for us like a definition moment.

Dr. Stuart Palmer:
I'll do my best.

Owen:
You mentioned that investing for positive change, not just the negative. And I think it's important maybe just to define as we go through the conversation, how do you define something like negative screening versus positive screening and what's the importance of those two, I guess, tools or techniques?

Dr. Stuart Palmer:
Screening carries some of those connotations about, let's exclude some sin stocks and so on, but I mean, in a sense, that's what investors do, whether they're responsible investors or not, you're screening according to some criteria, I guess, unless you're a passive investor investing right across the market, you're screening in some way. But negative screening, I guess, as a term is focused on, well, what are those harmful products, activities, which we'd be better off without? Tobacco, for example. Positive screening is saying, "Well, okay, we can limit the harm we cause, but where can we put capital into activities, businesses, which if they grow, will promote the wellbeing of people, animals, and the environment?" So how do we target capital to more renewables, energy efficiency, healthcare, which is reaching vulnerable populations who maybe aren't getting adequate healthcare?

Owen:
Okay. And I think that frames it really well for what we're about to talk to next, which is just basically, what does the day look like for you as head of ethics research at Australian Ethical? I guess people that we've had on the podcast in the past, I've had dozens and dozens of portfolio managers, chief investment officers, et cetera. I think you're the first head of ethics that I've had on the show. And I guess that's a shame, but it's also maybe a sign of things to come. What does a typical day look like for you? And then maybe beyond that, we'll dive into the investment process, the universe, and how we get down to a list of investible securities.

Dr. Stuart Palmer:
So stepping back just to sketch, I guess, our overarching investment process, because we're an investment management firm. Our approach is to recognise the two important things that we need to take care of, independently important pillars in our process. That assessment is an investment suitable to enter our sustainable, our ethical, our responsible investment universe. Do we think it's part of a better future for people, animals, and the environment? So that's the ethical pillar. And then the other pillar is the more mainstream traditional one existing in any investment house, which is applying, implementing an investment strategy within that universe. So looking at risk return, pursuing optimal balance of those things.

Dr. Stuart Palmer:
So my world is the ethics research side of things, that first pillar, understanding what the impacts of different industry sectors, product services are and then individual companies to try and make that assessment. Are we going to allow this investment opportunity into the universe? And got a team of four people on the ethics research team applying our criteria, our charter, Ethical Charter on the frameworks and policies that sit under it, but then drawing on enormous amount of external information, as you'd expect any investment process to draw on external expert analysis, scientific research, I've already mentioned NGO, civil society, they're doing some great research around human rights impacts and climate impacts, which we draw on in our process.

Dr. Stuart Palmer:
So it's a dream job for someone who's interested in the world's challenges and opportunities to play a bit of a role in creating that better future and just thinking deeply about some of those challenges, recognising the complexity, their complexity, and therefore the complexity of some of the solutions that we need to be working on.

Owen:
We're going to talk more about... We're going to use some examples towards the end of this conversation, just so that it can frame it really nicely for people and put a ribbon on it. So my interpretation of what you've just said there, Stuart, is basically there are two independent pillars, obviously there's the Ethical Charter, which is your specialty. And then there's the investment process. It's all part of the investment process generally, because that's what the company does, but there are two pillars, the investing, what happens in the typical analyst day-to-day role. And then there's you and your team on the other side. To help us understand how Australian Ethical and how you and the team go about building, I guess, or stepping

through that process, can you walk us through the Ethical Charter? You don't necessarily have to do it line by line, but however you see fit in terms of framing the conversation for what you look for and why or what you are trying to get out of the process and why. I think that will be really, really helpful for us.

Dr. Stuart Palmer:
Anyone who's interested, I'd recommend jumping on our website and having a look at the charter, because people do respond to it in different ways. It's 23 principles. So there's 12 areas that we're going to look to invest, to advance, to promote, to support. And then 11 areas of potential harm we are going to look to avoid in our investing. And some examples, it's what we call principles based. It's not saying, "Here you can't invest in this sector. You must invest in that sector." It's saying things like, "Okay, look for opportunities to invest, to support general things like human and animal happiness and wellbeing and dignity, invest, look for opportunities around sustainable buildings, sustainable land use, sustainable food production, avoid unnecessary waste, exploitation of finite resources in an unnecessary way, practises which impact, infringe human rights, misleading advertising, promotion of unwanted products and services."

Dr. Stuart Palmer:
So it's principles-based broadly. The people who put it together, I think were just thinking quite carefully about, okay, better future for people, animals, and the environment. What are some of the guiding principles that are going to help us navigate that? But sitting under that, then we need to apply those principles to where are we going to target our capital, for example, in the energy sector? We want to support renewables. We want to see those fossil fuel sources of energy shrink as rapidly as they can, as the renewable production grows. In the food sector, thinking about health impacts, again, climate impacts, the emissions impacts of different sources of protein, the animal welfare impacts, hugely important in the agricultural sector.

Dr. Stuart Palmer:
So we then develop specific criteria for the food sector, for the property sector, for the retailing sector to basically, obviously important in any investment process to clear criteria, a consistent rigorous process that you can replicate. And that's the work that those frameworks do, whilst that charter, those principles haven't changed, those frameworks do over time as the world changes, scientific understanding of ourselves and the challenges we face develops, technologies change.

Owen:
I imagine having that kind of principles-based focus is actually really important because it is what basically allowed that charter to survive decades, right? Because if it was so specific to that time, the late '80s, the concerns of that time may have been a bit political and through the goodness of time, we've had things change and the issues change and the context changes too. So being principles-focused, it might cause a few kind of hairs on some people's backs when they think, why is this in the portfolio? Why is that not in the portfolio? But it will get to how you deal with the more polarising debates in just a moment. One of the things that I find when I look

at say like some of the passive ESG, will go air quotes, ESG or ethical investing ETFs here in Australia in particular.

Owen:
And the there's what people would associate as an index fund, but with an ethical overlay. I find that they can be quite blunt in the sense that it's a very binary outcome for some companies. Like you said, they're basically on the negative screens. So I'm interested to hear your thoughts on, can those types of vehicles, those ethical ETFs, not all of them, by the way, but some of those ethical ETFs, can they provide decent exposure for investors who are looking for a low-cost way to play this idea of investing for a better future?

Dr. Stuart Palmer:
Yeah. I think they do face some challenges. Some of those challenges are shared with active ethical strategies like our own. And unfortunately, it's not always easy for investors to choose. I guess it becomes a cliche, but it's for a reason. Transparency is so important really in investing generally, but specifically, particularly around ethical and sustainable investing. So it's really important that strategies are clear about how they're making decisions about what's screened in and out, what their criteria are. So we've got to spend a lot of energy, both just in our public reporting, but also on our website, what's our position on how do we think about the energy sector, the food sector? What tends to be in, what tends to be out the property sector? What do we think about companies that may be involved in the infringement of human rights and how do we address that hugely complex challenge?

Dr. Stuart Palmer:
And I think where some of the simpler narrower ETFs fall down is that they have a couple of narrow exclusions, but they've got a long way to go. It's not really meeting the needs of most people when they're thinking about responsible and sustainable investing, to just exclude ammunitions and tobacco, for example, limited exclusions of some ETFs. I think the challenge they also face and we face it too, is that data challenge, but in a passive fund. So on the financial side, you're benchmarking yourself to a market index, ASX200, let's say, straightforward for an investor, a customer to look at the performance of the strategy against the index, make that informed choice.

Dr. Stuart Palmer:
The concept of an ethical index or a sustainable index is a little stranger, because there's not that straightforward sort of score or benchmark for ethical business, ethical investments. So it's not very meaningful for a customer to be told, for example, "Well, all the companies we invested have a sustainability score of at least seven." I mean, what does that mean? And sustainability is hugely multidimensional. It's not like return, it's a percentage.

Owen:
Like the price earnings ratio or something.

Dr. Stuart Palmer:

It's a single figure. That's right. So listen, I think what we've struggled with is doing this in a robust, we think, doing it right, to deliver what customers need is complicated. And that can make it complicated to explain and communicate sometimes. But we sort of wear that and we just try and put information in as clear a fashion as we can on our website. We respond, we are really proactive in responding to customer inquiries. We have a lot of interaction with our customers, "Would you invest in this? Why are you in that?" And so I think that's really important of what responsible investment needs to deliver to its customers, is that transparency.

Owen:
I think there are two things in there that I might just draw on, Stuart. The first is that the younger generation loves transparency. And so when I go onto social media, the number of followers that Australian Ethical has through its social media channels is multiples of anything else, remotely the size in terms of even I can't even think of peers that would have any type of engagement with the community like Australian Ethical has. And so I think that emphasises that point, that the transparency is important. The communication is so important when it comes to ethics and values and those types of things.

Owen:
The other thing is when people look at particularly, I want to draw out the passive ethical ETFs here in Australia, because what we find is that it's like close enough is good enough. And that still doesn't sit well with a lot of people. But if there was some sort of communication around, here's why this is in the portfolio and this isn't, I think people would be a lot more drawn to those types of vehicles, but they're not, because they just don't have that ability to say, "Here's why we've come up with this" because they don't have their own Ethical Charter. They don't formulate principles like that, like you do. So I think that's where Australian Ethical brand and teams, it's kind of head and shoulders above it. Most other, if not everyone else in the market right now.

Owen:
There is one thing that I'm going to draw out from one of the letters that were on the website, and I might just read it verbatim if that's okay. It says, "The carbon intensity of our portfolio continues to decline, while so investment in renewable power generation powers on. Since 2000, we have donated more than $6 million to our foundation, driving positive outcomes for the planet, people, and animals." I'm interested, one, in how you and the team monitor existing positions within the portfolios to determine, okay, this is no longer an ethical investment in our eyes or however you define that. And if you have any examples of companies that then have been subsequently removed from the portfolios on that account, I'd love to know. And if you could just maybe walk us through one of those, if you have one available.

Dr. Stuart Palmer:
No, that'd be good because I'm conscious sometimes. This doesn't come to life until we talk about particular companies, and people can engage a little bit more in the reality of it. Can I just divert just for a second? Because I'm conscious and it's at the core of what we do, but we have focused on where we are targeting capital, what we will, what we won't invest in. Responsible

investment has a couple of other pillars, which is a crucial part of my day to day, should have ventured it earlier. And it goes hand in hand with it. It's that investor engagement advocacy. So using your influence as an investor. The companies that we end up investing in, so we are limiting our universe typically to 50% or less of most mainstream indices. So it's not a light touch, positive-negative screening approach.

Dr. Stuart Palmer:
But that by no means leaves us with perfect companies. So having that invest have always taking that long-term view and having constructive conversations with companies is a hugely important part that responsible investors need to play. And we devote a lot of energy to that, what we call ethical stewardship of the companies we do invest in. And it gives us a deeper understanding of the companies as well from an investment point of view. And I guess alongside that, you've mentioned the foundation. So as an organisation, we have a foundation where we're granting 10% of our profits each year to the not-for-profit. The civil society is where that's targeted. So we recognise the crucial role that has to play alongside private markets, alongside government.

Dr. Stuart Palmer:
Government is an area where we use our voice to try and encourage better public policy, because that's going to make markets and civil society work so much more efficiently and effectively in tackling climate change and so on. So all that's part of what we do. And so is the measurement piece. You mentioned the lower carbon intensity that we had, the higher renewable energy that we had. I mean, customers, yes, we need to find our position, but they also want to know, okay, here's my portfolio. How does it look compared to a mainstream benchmark? Is it less carbon intensive? Oh, yes it is. And here's by how much, 75%, looking at our share investments across our strategies and so on. So that's just to say, there's a lot that Australian Ethical does as part of that, what it takes to be key pillars of responsible investment.

Dr. Stuart Palmer:
The question though, companies changing, also just even before change, the listed companies were investing in a big complex organisation, so things in them that we'd like, things in them that we don't like. And so we need the frameworks do the work of dealing with that. We invest in a company called Contact Energy. 80% of its revenue comes from renewables, hydro, and geothermal. It's still using around 20% of gas as backup. And there's not enough rain to fill the dams, but the sort of company that we want to be investing in because it's continuing to invest in geothermal, continuing to invest to reduce that reliance on gas. So we do get to that 100% renewable objective. So things aren't black and white, there's that complexity. And then of course, companies change, they make mistakes.

Dr. Stuart Palmer:
So when there is a significant business change and acquisition or divestment, change of strategic direction, or when there's a significant controversy, if we look at that and say, "Oh, that might change our ethical assessment," then that's something we get up to, and we revisit its place in our ethical universe. Independently of that, periodically we are coming back every two

years at least to do a complete review of the company and say, "Where is it at? Are we still satisfied that it's aligned with our Ethical Charter?" In terms of examples, I guess the finance sector, the Royal Commission, I guess, is still fresh in our minds for many of us anyway, certainly someone who screens companies in the finance sector like mine, it's hard to forget, but we got out of AMP, we got out of IOOF in the context of the Royal Commission and the findings of the Royal Commission, and we still look at the findings of that Royal Commission as really helpful guidance in determining where we will and won't invest in that sector. And we're a selective investor in the banking sector.

Dr. Stuart Palmer:
We have companies make mistakes and they can even be hugely positive companies. I mean, internationally, we invest in Siemens Gamesa Renewable Energy, which is a big wind turbine company. So we like wind energy, but obviously it needs to... We are looking at what a company does, but also how it does it. So is it for example, managing its environmental impacts and its development of wind farms? Is it safeguarding human rights in the areas that it operates in? So there was a company, we are actually growing its operations in occupied territories in North Africa, in the Western Sahara. And actually contracting with the Moroccan government, which was occupying that area and not honouring a transition to free and fair elections.

Dr. Stuart Palmer:
So we engaged with that company. And that's generally, if we see an opportunity where we might be able to influence a change in approach, that will be our first response to what we see as a misstep by a company, let's try and understand what's going on. And are there plans to rectify that? But if we can't get comfort, if there's not change or if there's not sufficient change, then we'll jump out. And then there are the other examples, the other way where we have concerns about a company like Boral, in building material sector, tough area for us to invest in with high emissions that are really obviously a crucial sector for... I've mentioned sustainable buildings is a particular area caught out under our charter. There aren't those obvious low emissions alternatives at the moment for concrete, for steel.

Dr. Stuart Palmer:
So we engaged with Boral before we actually got to the point of investment around the work they were doing around low carbon concretes and transitioning. And we did ultimately invest in them. We continue to engage with them as part of the Climate Action 100+, which is a big global collaborative climate engagement involving lots of responsible investment houses. And we're one of the lead investors with Boral, and we've seen that company continue to set higher targets to align its business strategy with the Paris Climate Agreement.

Owen:
So you mentioned earlier that you meet with the companies or you review the companies at least once every two years. When you do these reviews or when you seek out companies that could be added to the universe, do you go and speak with management teams? Do you go do site visits, those types of things? And I guess following on from that, do you participate in the discussions that, we'll call it the analyst team have, when they're talking about company-specific

things when they're doing their valuations and those types of things, do you participate in those as well? Or is it you do, this is your wheelhouses over here and theirs is over there?

Dr. Stuart Palmer:
Yeah. So it's a great question. And it does depend a little on the type of company and the issue. I mean, in the lucky position, I think over the past decade, a lot of the information that is relevant to our ethical assessment is now much more readily available in public reporting than it used to be. Climate reporting is now become pretty standard. So when we are looking at that issue and how is the company aligning its direction with a transition to net zero. There's a lot of public information which will often get us where we need to go in terms of completing our ethical assessment on that issue, for example. There's now modern slavery, compulsory modern slavery reporting for larger companies in Australia. So we get more public information about how they're managing human rights impacts. But there will be areas where we need more detail, where it's a less standard for companies to report. Animal welfare is a big issue, a huge issue for us, often there's not a lot of public reporting of that by healthcare companies, for example, who may be using animals in their healthcare research.

Dr. Stuart Palmer:
So there are areas where we are going backwards and forwards with the companies, and often we will be doing that in conjunction with the investment team who has the relationship with management, with the head of clinical research or whatever head of research at these biotechs, for example. But there's an element of divide and conquer. I mean, we will engage direct lines of engagement and debate on issues that are really crucial to our ethical assessment, the investment team will be in parallel or with different companies on different areas of focus, working on more business, short, near-term business issues and so on. So it really does depend what's the most efficient way that we can allocate our resources.

Owen:
I can only imagine, Stuart, when a CEO is on the other end of an email that says, "Our analyst would like to speak to you." And that email comes from Australian Ethical versus as say another fund manager, because they're probably prepping themselves for a different conversation when they receive that email. If I may ask a question, you may not have it off the top of your head, but what are some examples of questions that you would ask a management team? Is there a checklist or a series of questions on one, what's your favourite question that you ask when it comes to like an ethical thing? Or even if there's an example that comes to mind on where you've asked a CEO or some type of manager a question, and you've got a response that you've thought, this is interesting. If you have anything like that, I'd be fascinated.

Dr. Stuart Palmer:
Yeah. A good question, which I haven't really thought much about before. I mean, one of the things that we do do is, and the work that these ethical frameworks for individual sectors, they do as well. What are the most material, environmental, social, animal impacts of a given sector? So to that extent, what we're talking with a property company about is going to be different from a retailer, is going to be different from an energy company. In terms of general approach, the

key question is, so the most productive way is saying, "Hey, there's this challenge we see in your sector or globally. How are you thinking about that?" And then let them talk to you about, do they recognise it as an issue? And if they do, what are they doing about it?

Dr. Stuart Palmer:
So that's just part of the avoiding the leading questions because sometimes you can... It's that balancing between a whole lot of tick the box type questions, which can be efficient because you're saying, "We are really interested in these things," but you're not necessarily getting an unvarnished picture of where the company's at on a particular issue. And in terms of your specific question, what's the general question, I mean, the thing you want to know is... I don't necessarily think the word's the best word, but is this a company of integrity? Does it have a clear understanding of what it's trying to achieve, its purpose, its values? How it is going to achieve its business objectives, and is that understanding itself shared throughout the organisation? Are they transparent about the things they're doing, which are helping achieve that purpose, where they've actually got more work to do?

Dr. Stuart Palmer:
Do they have a culture, that open transparent culture internally, but also then externally when they're dealing with stakeholders like our shareholders? I think if you're looking for an area which crosses sectors, that culture governance type area of inquiry is the one which is shared. At the same time, it's I think probably the most difficult one to gauge from outside an organisation, but in a big organisation, it's equally hard for directors and executives to get a handle on their own culture a lot of the time.

Owen:
It is indeed. And I find the questions that we ask as analysts to be quite fascinating because there are distinct ways that analysts or portfolio managers interview perspective investments. And some people prefer to lead them down the garden path, so to speak. And some people prefer to open-ended questions. Some prefer closed-ended, some prefer the gotcha questions. And it's always interesting to hear that. And then from the ethical perspective, to just really step back and ask yourself, "Does this company have integrity?" I think is a really interesting way to frame it. I might just ask another question, which maybe is a bit close-ended of me, which is just that over your time with Australian Ethical, if you could think of one company, say the first one that comes to mind, that you think's been most polarising amongst the clients or the members that you have, which company would that be and why? Which one comes to mind first of all?

Dr. Stuart Palmer:
Listen, I'm torn. And it probably does change over time, but I guess ones which have come up consistently, well, Facebook, now Meta. So we do invest in that company, we do invest in social digital media. But then also we invest selectively in the big banks, so our investment in Westpac is always one which encourages some debates. So I'm happy to talk about either or both of those. Well, I'm not really happy to, but I’m certainly used to talking about them.

Owen:
Yeah. I guess that's your role, isn't it? To moderate that debate as well, because you've got to see it from both perspectives. So maybe if you just want to take them one at a time even, just as much as you want to give us. I guess that's really fascinating because those two examples, everyone can cling to and get a sense of where and how you make that decision.

Dr. Stuart Palmer:
Yeah. Okay. So, well, let's start with Westpac and big banks generally. It is an Australian sport, I think, to bash the big banks and for lots of good reasons. So why do we invest in them at all? Well, we invest in the banking sector because we think responsible finance, access to basic banking service is hugely positive to facilitate individuals and businesses in pursuing what they want to pursue. So it facilitates others to pursue positive projects. In the context of climate, hugely important that capital, that banks, large banks particularly control, is channelled towards renewables, energy efficiency, green buildings, green transport. So we're talking five trillion a year, I think was the IEA number to get us to net zero by 2050, looking at five trillion a year up to 2030. So banks had a crucial role to play in that.

Dr. Stuart Palmer:
So responsible finance is important. Then the challenge is determining what's responsible, what's not. And on the climate front, we are in the midst of a massive debate in Australia about... I think the debate is moved on from thermal coal. I think there is acceptance finally that hey, this is not a growth. This can't be a growth area for Australia. The debate's now shifted to oil and gas. I mentioned the IEA, the International Energy Agency. They've been very clear about we can't keep expanding that sector, those sectors, if we're going to have a chance of getting to net zero by 2050, and we're in an environment where there's lots of new oil and gas projects on the drawing board in Australia.

Dr. Stuart Palmer:
So that's where we are engaging heavily with banks and asking them questions, not only in private, but also at their annual general meetings. We're at the Westpac annual general meetings in December, supporting the shareholder resolutions there and asking questions about culture, asking questions about climate. So I don't want to sound like a defender of the banks, but I mean, historically we have felt that Westpac domestically and indeed in some regards globally, has been a leader in having really clear criteria around its climate lending. Our expectations of that have grown, so we're still wanting them to do more, but that's been one of the reasons why we've liked them, they've actually approached their climate criteria in a detailed, in a science-based way.

Dr. Stuart Palmer:
Culture, far tougher. We did think that they were doing okay on that front, but recent years, recent events have really... Well, listen, maybe that's why I said assessing culture is the hardest, because we obviously got that wrong because they continue... I mean, all the banks have that issues. They recognise them and it's a challenge to fix them, but Westpac has had more than its fair share in recent times. So that's banking.

Dr. Stuart Palmer:
And I should say, people say, "Well, why don't you just invest in small banks?" So just to say, well, we do, but I guess a couple of limitations that one, they don't score any better on metrics like complaints to the Financial Complaints Authority. So they have exactly the same customer issues, mis-selling issues that the big banks have. And indeed typically will score worse than the big banks. And then on the climate front, they don't lend to fossil fuels, but equally, they're not lending to large scale infrastructure. So they're just not in that business. So it's sort of de facto, they're not in that sector. Shall I bump on to social media?

Owen:
That's fascinating about Westpac. And I know it's one that has brought up a lot of debate amongst the Australian Ethical broader community as well as commentators. And I guess as we record this, it's very timely to talk about Facebook aka Meta. Not just for recent events, but also for legacy events, I guess, going back quite a few years. So I'm fascinated to hear what you have to say about this.

Dr. Stuart Palmer:
Yeah. So listen, and it's been a focus, so I think we invested maybe four or five years ago at a time. I think that was around the time, maybe a little bit before Cambridge Analytica, but it's been a consistent stream of issues and concerns, harm to users, particularly younger users, the spread of disinformation, it's effect on the quality of our democracies, hugely complex for us to judge these platforms, we find. I mean, one thing to say is they are pervasive. They're like the banking system and they're part of the plumbing, so much a part of the way that we live our lives. We run businesses, but sometimes we do overlook the benefit that they bring and just focus on the downsides. And we think there are wide ranging benefits that social media and other digital information sharing platforms deliver. Whilst we see them being used to mislead people, they're used to reveal truth as well, to hold powerful individuals, businesses, governments, to accounts, and lots of great examples of that, where people have been exposed for the great harm that they've caused to their employees or customers and so on.

Dr. Stuart Palmer:
And they do give us access to information in a way that I could only dream of when I was at school and university. They help people stay connected. So during pandemics, for example, obviously have a hugely positive role, but they can be misused. They are misused. They're used to spread disinformation. They can make people feel more isolated. We know that particularly for young people. So it's a question on how we use them, how we regulate them. And currently where we sit on balance, we think there's a positive role for social media in our society, in our economy, but we need to see better regulation. And we're seeing some progress on that. And we need to see more proactive measures from the companies to promote the positive uses, limit the negative uses. But I think to recognise that those fixes are not simple. There's some great minds including locally in the ACCC working on some of these issues and we're seeing progress, but I guess new technologies, it will take us a little while, unfortunately, to work out how to use them to maximise their benefits.

Owen:
Can I ask you, how do members of Australian Ethical, how do they voice concerns with you? Is there an open medium for them to communicate? Is it through social media? How do they get in contact with you?

Dr. Stuart Palmer:
Yeah, so we're active on social media. So absolutely social media messaging is one conduit. Email, call centre, the occasional letter. But yes, through those sorts of mechanism, superannuation, these days, we have annual member meetings. So our last year member meeting in October, November, I think it was, was a great platform for lots of discussion about banks, social media, food, energy.

Owen:
Yeah. Imagine you get to handle all the good questions.

Dr. Stuart Palmer:
Yeah. And luckily, the team. We're blessed with a really strong ethics research team who are specialists in lots of areas that I'm not. So we all jump in and field those questions and we're responding, but we're also listening and learning. That interaction really does inform our process. Ultimately, it's our responsibility, our expertise and experience we need to bring to bear, these are such complex issues. The input we get from our customer base and others is huge.

Owen:
For sure. Stuart, I've got one final question, which is like a five-parter because there's five example companies here that I hope illustrate the Australian Ethical process. Well, basically they're all Australian companies and these are taken from the Australian Ethical 2021 sustainability report. So if anyone's listening to this and they're thinking, I'd like some more context on this, I'd like to understand Australian Ethical a bit better from a sustainability perspective, and look at that charter and how it plays out. I'll put links in the show notes. And of course, if you are listening to this on your podcast player, you can just jump down into your phone and have a look and click the link there to go to the Australian Ethical landing page for this.

Owen:
So I thought I'd just maybe go through these five companies. And just as briefly as you'd like, tell us why and why not, they made it through into the universe. So the first one is, I believe it's still a private company, which is Guzman y Gomez, which is GYG, as it's known, it's a Mexican fast food. I know there's one stop at the road here for me in Melbourne. Why, why not, did that make it through the filter?

Dr. Stuart Palmer:

So we looked at them when they were considering listing on the ASX and that didn't proceed. Although I think there's talk about it maybe coming back. So their menu relies heavily on ingredients which don't meet our food sector criteria, is I guess the short answer. So when we are looking at food, we pay a lot of attention to the climate impacts, health impacts, animal welfare impacts of animal based protein. So by and large, it's got a much higher emissions footprint and indeed other environmental footprint than say, plant-based nutrition and protein. So our focus is on that, those plant-based alternatives because of their lower carbon and environmental and animal footprint. And that's an example where there's some vegetarian options on the Guzman menu, very tasty food across their menu, I have to say, but it's again, an area where we look at the mix, we look at revenue breakdowns, estimate the breakdown there and they didn't make it.

Owen:
That's fair enough. Okay. So the National Storage REIT, trades in the ASX under the ticket code NSR, it's self-storage real estate investment trust. This is a really interesting one because we think, I guess this is sustainable buildings, we're going to go with this, but you wouldn't think that a REIT is quite a polarising one, but maybe I'll throw it over to you for the National Storage REIT.

Dr. Stuart Palmer:
Yeah. And there's property, sustainable buildings, land use, is a positive under the charter. So the question is what do we consider to be sustainable? So we are looking for good environmental credentials and transparency. So have you got neighbours' ratings or other equivalent environmental sustainability ratings for your buildings? And there's lots of managers, particularly in areas like commercial office property who are doing some amazing things around the operational emissions of their buildings, carbon neutral buildings being built today from an operational point of view. And also looking at the built emissions. So lowering the intensity of the building materials they're using including sustainable timber, for example, in some smaller scale commercial buildings.

Dr. Stuart Palmer:
But interesting that the storage part of that property sector, there's not the same level of transparency and measurement. We engaged with NSR, National Storage REIT, and they were receptive to that. It was good and I think we saw, and we expect to continue to see improvements in the approach they're taking. So maybe we can look at them again, but at that time, we couldn't be satisfied that they were meeting that environmental hurdle, just because there wasn't enough information. And in that particular case, when we're looking at property, the burden of proof, if you like, lies with the REITs to tell us what you're doing on this.

Owen:
For sure. This third one is interesting for me, I believe I own shares in this company. So it's Tyro Payments, which is the card... It does the payment terminals, which you'll see around Australia. Sometimes they're grey and you can tap your card and go and what have you. Typically found in

like cafes and medical practises. Did Tyro Payments pass the filter? If not, why not? I'd be fascinated to know.

Dr. Stuart Palmer:
Yeah, no, it certainly did. I mean, just technologies which contribute to the efficiency with which individuals, businesses can pursue their objectives will generally get through if they're managing their footprint reasonably, they're not focused on negative sectors. So that payments functionality we view as positive. I don't think it was a necessary part of them getting in, but the fact they're an alternative to the banks, I think as a general rule, competition we would view as a good thing under the charter. So they got in there as a facilitator of financial transactions.

Owen:
Good to know. Number four is another company which many of our listeners will be familiar with, which is ARB Corp, trades on the ticket symbol ARB, it's on the ASX. A family-run company, does 4x4 accessories, so offroad, many of the people that listen to this would be familiar with seeing that logo around. Did the ARB Corp make it through?

Dr. Stuart Palmer:
So they didn't, and don't have anything in particular against four-wheel drives, beyond the general point that like the rest of the transport sector, they do need to transition to net zero. So when we are looking at how do we invest positively in that sector? We're focusing on public transport, we're focusing on electric vehicles and the motor vehicle accessory technology companies that we do invest in, are where we see they're making a significant contribution to the growth of the EV sector, for example. And we just couldn't see that with ARB, that focus on accessories for high footprint petrol, diesel four-wheel drives. We just didn't find that positive under our Ethical Charter and under our transport framework.

Owen:
Fascinating. Okay. Last one, which is not the internet connection I'm coming through to you with today. But if I was at home, I would be, which is the company known as Aussie Broadband, trades on the ASX under the ticket symbol ABB. And this provides low-cost NBN connections, and I can vouch for it, pretty good customer service. So this is a company that's only new to the ASX, but I'm wondering if Aussie Broadband made it through.

Dr. Stuart Palmer:
So yes, it did. And interesting you mentioned customer service because I'll come back to that. So again, the sort of company that's part of the plumbing, communication services, helping us pursue our day to day as individuals, as businesses more efficiently, more safely, often access to mobile information, we think is positive. When we are looking companies in that sector often we are faced with high levels of consumer dissatisfaction and complaints. So we take that into account. We're not ruling out lots of companies on that basis. Unfortunately, it does seem to be an industry challenge generally. And great to hear, I must say that Aussie Broadband has good customer service.

Owen:
Yeah, it does. I think I've referred maybe four or five of my friends who have then gone and referred a few of their friends. So I think it's a fantastic business when you can call them and they'll answer and you hear that a familiar voice and it's just a really good customer service, that's just blew me away.

Owen:
So Dr. Stuart Palmer, I really want to say thank you for taking the time to join me on the show today. I know there are a lot of resources available to people in the Australian Ethical website. So if you want to learn more, if you want to get access to that transparency that Stuart was talking about with regards to seeing what's in the portfolio. Australian Ethical have also launched a high-conviction fund in an ETF wrapper. So you can invest in that on an exchange. There'll be full details of that in the show notes. And you can head to the landing page that's available in your podcast player.

Owen:
Just to recap, we've covered a lot about a lot of your history, how the pillars of the Australian Ethical investment process are like twofold. There's the pillar for the ethics research. And then there's the one for the traditional investment research and how they marry together is really interesting. And they create a universe. I think one of the things that was really interesting to me is, basically you're saying that you can refine that universe in Australia at least by up to half, which is fascinating. And then we went through some examples, Facebook being one of the most polarised in companies that you've come across alongside of Westpac.

Owen:
So Stuart, I just want to say thanks again for joining me on the Australian Investors Podcast, and all the best with more of those polarising debates and the next member meeting that you have. I'm sure there'll be more good questions for you then. So thanks again for joining me.

Dr. Stuart Palmer:
Owen, thank you very much, really enjoyed that.