

## Private clients' growing interest in the moral impact of their money

By Yuri Bender



The Russian invasion of Ukraine gave added impetus to banks' attempts to avoid links with autocratic regimes. Image: Getty Images

Investors want to be sure they are not supporting illiberal and autocratic regimes and avoid certain sectors of the economy.

Since the onset of Russia's latest phase of [military aggression against Ukraine in early 2022](#), wealth managers are starting to systematically assess family portfolios for exposure to authoritarian regimes.

Investing along socially and morally acceptable lines has been a growing trend during the last 25 years. But the new development means banks with large clienteles of wealthy families are increasingly trying to avoid links with illiberal countries in their investment strategies.

"This is driven by families taking greater care when looking at their investments: where are we invested, in which segment and which sector?" says Belinda Aspinall, London-based head of global family and private investment offices services for Europe, the Middle East and Africa at \$350bn US wealth manager Northern Trust.

"There is often a moral side, with a family view that they don't want to be supporting certain regimes or certain activities. I think we will see a lot more of that."

Wealth and investment managers are being pressured, by threat of litigation from clients, to improve reporting, she adds. "We've seen this notion of legal responsibility, of big investment managers getting sued by investors, saying, 'we didn't realise our investments had been going into these sectors or regimes, and we're going to take you to task about it'. Family members are seeking a much higher level of reporting, to understand where their investments are being made."

Most portfolio managers have [failed to anticipate or react to geopolitical events](#), says Amin Rajan, founder of the Create-Research consultancy and strategic adviser to asset and wealth management groups.

"They will say: 'Russia's going to invade Ukraine so let's look at those equities which will be most directly affected.' They forget about the supply chain and are unable to see the bigger picture, because they haven't really engaged," he says. Few wealth managers have learned lessons from the global financial crisis of 2008, the Greek crisis of 2009 or the Crimean crisis of 2014, when Russia first invaded Ukraine.

"The invasion occurs, there is mass selling and a stampede, which leads to the next downward spiral through a self-fulfilling prophecy," says Mr Rajan. "Strategic thinking has never really been a forte of portfolio managers."

### Boutique strategies

But some smaller, specialist investment firms are starting to listen to investors' needs around geopolitical and moral demands. One of these is TOBAM, a French investment boutique, overseeing \$7bn in assets. Its founder, Yves Chouefaty, has studied stockmarket impact of dictators including Germany's Adolf Hitler, Libya's Muammar Gaddafi, Iraq's Saddam Hussein and Syria's Bashar Al-Assad, incorporating his findings into investment strategy.

His mission has been to identify regimes detrimental to human rights and business freedoms and minimise investors' exposure to these autocracies. "It doesn't make sense to continue to invest without looking at this dimension," suggests Mr Chouefaty, a mathematician and former chief executive of Credit Lyonnais Asset Management in Paris, who has combined these variables into a "[tyranny risk factor](#)" (TRF).

He believes TOBAM can double managed assets with the new lens offered by his Civil & Democratic Rights Strategy, adding that in most portfolios, exposure to autocracies, including 12 countries with the highest TRFs – China, Egypt, Hong Kong, Kuwait, Mexico, Pakistan, Qatar, Russia, Saudi Arabia, Thailand, Turkey and UAE – tends to be indirect.



McDonalds was one business hit hard by its exposure to Russia. Image: Getty Images

Citing research from Yale University, Mr Chouefaty calls for greater awareness of losses from closing businesses in Russia, with [Shell taking a \\$4.1bn charge in 2022](#) and [McDonald's confirming a hit of up to \\$1.4bn](#). "More than 1000 companies listed outside Russia had to shut their businesses in Russia, resulting in close to \$240bn of losses," he states. "This is much more than what the Western world owns in Russian stocks."

Through limiting this exposure, TOBAM claims superior returns over the Bloomberg Emerging Markets Large and Mid Cap Index during times of geopolitical turmoil, for example outperforming the benchmark by 5.3 per cent in July 2021, after the crackdown by Chinese authorities on education technology companies. China is a particular market where, he says, both pension funds and family offices are reducing exposure due to ethical issues.

While TOBAM focuses on reducing geopolitical risk in equity portfolios, Boston, US-based fixed income manager GMO offers a strategy for investors building emerging market sovereign debt portfolios "that prioritises freedom and democracy while preserving the key investment characteristics of the asset class".

The firm, which manages \$61bn, says Russia's 2022 invasion of Ukraine and the ensuing war have prompted "new and difficult questions for sovereign debt investors", including "how best to approach illiberal and autocratic countries, like Russia, within the asset class".

In their paper, [stressing the importance of backing democracies within investment choices](#), portfolio strategists Eamon Aghdasi and Mina Tomovska write: "We believe such an approach may help investors reduce exposure to certain costly political events akin to the ones witnessed in 2022. At the very least, it should help sustainability-conscious investors to establish emerging debt portfolios that are freer, more democratic, and better aligned with their own values."

To define which countries are "free, open and democratic", GMO works with the World Bank's Voice & Accountability (V&A) metric. Their research shows that over periods of five, 10, 15 and 20 years, constructing a "constrained portfolio" by excluding fixed income investments in illiberal countries ends up with broadly similar returns to the index. This reassures investors that they can "help to promote freedom and democracy without significant sacrifices in returns".

### ESG challenges

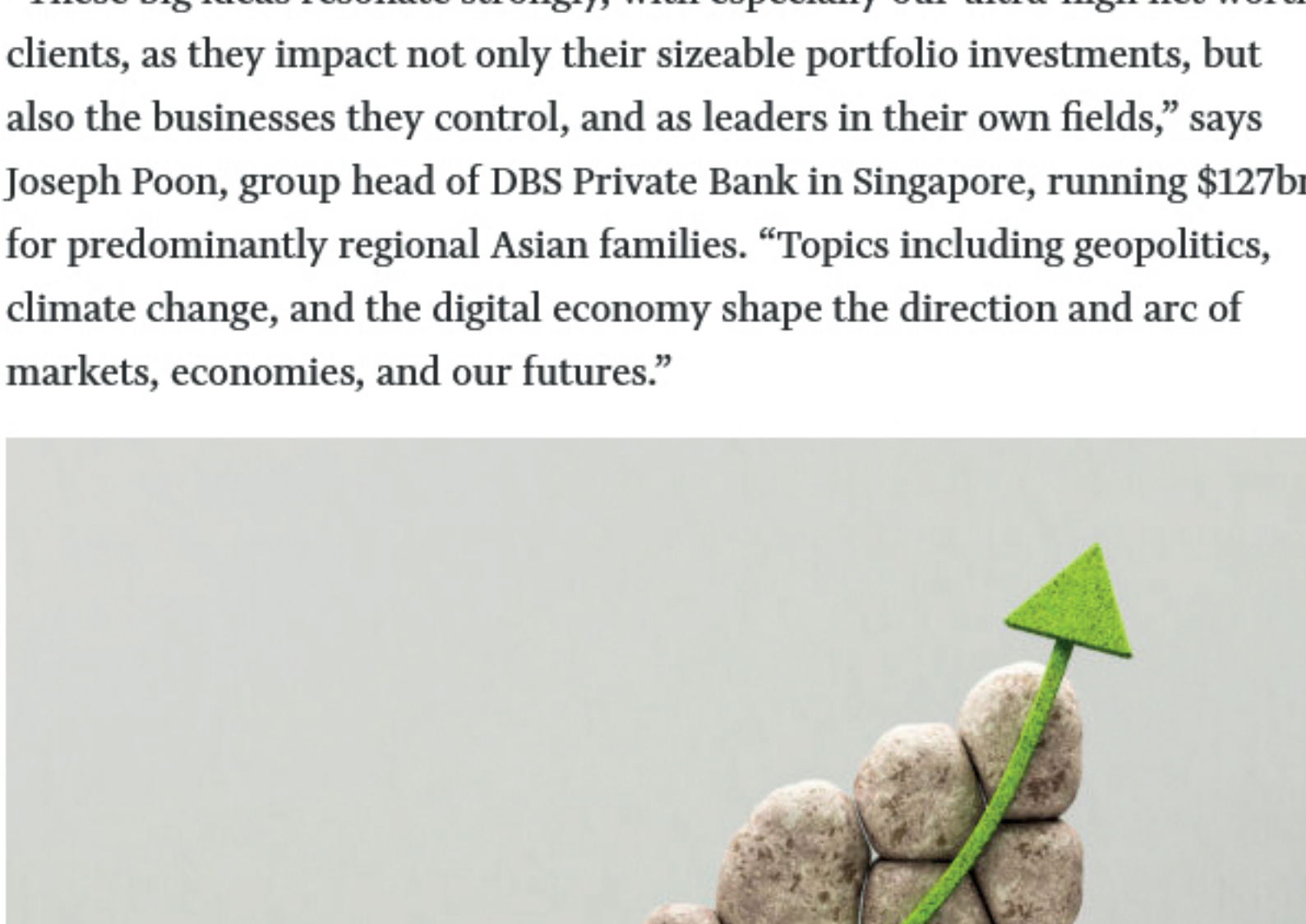
But investors must also learn to think in a more nuanced fashion, to better understand motives of illiberal actors, according to Amati Global Investors, a boutique firm based in Edinburgh, UK, managing close to £1bn (\$1.2bn).

Most funds which described themselves as "ethical" during the 1990s completely excluded defence stocks, due to perception of the industry as notoriously corrupt. But this is no longer an ethical position, believes Amati's CEO and founder, Dr Paul Jourdan. In his Environmental, Social, Governance and Human Rights Statement, he notes that "if all market participants adopted this approach, the West would become greatly weakened in a way more likely than not to provoke conflict".

Following Russia's invasion of Ukraine, "an unthinkable act just a decade ago", Dr Jourdan believes "it is both perverse and dangerous to rule out investment in the defence industry wholesale".

For many wealthy families, this discussion of geopolitics with their investment adviser – increasingly expected to act as a moral barometer – has become the number one consideration when devising portfolio strategies. The latest war in the Middle East is also highlighting this trend.

"These big ideas resonate strongly, with especially our ultra-high net worth clients, as they impact not only their sizeable portfolio investments, but also the businesses they control, and as leaders in their own fields," says Joseph Poon, group head of DBS Private Bank in Singapore, running \$127bn for predominantly regional Asian families. "Topics including geopolitics, climate change, and the digital economy shape the direction and arc of markets, economies, and our futures."



Have ESG investments provided clients with the returns they had hoped for? Image: Getty Images

But while incorporating geopolitical considerations is an important component of good advice, commentators warn against providing clients with false hope of being able to "[save the world with investments](#)" and being swept up in the out of control ESG "euphoria", which they claim is damaging private banking brands.

"At the end of the day most clients want to preserve their wealth and make it grow," says Kim Cornwall a former senior private banker with Société Générale in the Middle East, now training wealth advisers for leading banks. "Recent experience with ESG investing has left clients bitterly disappointed. I surmise that for many wealth managers and the families they serve, it is time to get back to the basics."

This dichotomy has led to a crucial debate among wealth managers, described by Alois Pirker, founder of technology consultancy Pirker Partners in Boston, US and former senior banker at UBS Wealth Management. "In times when society in many countries is bifurcated and divided on key issues such as climate change, as in the US, should wealth management firms impose a value system on its client base – i.e., tell them what's right and wrong – or should they create the opportunity to do good without forcing their hand?"

Industry voices agree that banks have some responsibility to start the conversation around the impact of investments. Successful wealth managers, believes Munich-based recruitment consultant and former UBS banker Matthias Schultess, managing partner of Schultess Zimmermann and Jauch, "will facilitate a dialogue centered around consumer preferences, helping clients understand their world views and choices in the context of investment decisions".

### Societal values

Banks have a mixed report card in engaging clients around geopolitics and questions of morality, say branding experts. Few have demonstrated any real expertise, says Anant Deboor, Hong-Kong based head of strategy with the Wunderman Thompson agency. "But increasingly, I think these are themes that are playing out in real decisions around investments and where the clients feel their wealth should go," he says.

Only a handful of leading players – including Investec, Lombard Odier and Julius Baer – take this [sense of social and moral purpose seriously](#), believes Helen Westropp, principal of the Delphi Marques consultancy in London, with "traditional old school money" still placed according to relationships and performance.

This will change with the handover of assets and responsibilities to the next generation, she adds. In order to reflect the changing mood of society, banks and family offices can take advantage of the opportunity to create a new proposition, to appeal to a more defined audience, says Ms Westropp.

"Younger people are definitely looking for organisations that have a clear sense of purpose. They need a wealth manager that matches their own societal values."