

australian**ethical**

AIM HIGH

Winter 2010

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climate ADVOCACYfund

Engaging for change

The Australian investment landscape has changed with Australian Ethical's ground-breaking Climate Advocacy Fund officially launched in June.

- ❑ Change corporate behaviour
- ❑ Sharemarket return
- ❑ Low fees

The Climate Advocacy Fund is an exciting new way to influence corporate behaviour in Australia while achieving index returns. Australian Ethical will endeavour to improve the climate change performance of some of Australia's largest companies by proposing and supporting resolutions at annual general meetings (AGMs).

This modus operandi turns current practice on its head. Rather than picking the best of the best, as is Australian Ethical's current investment practice, this innovative approach focuses on under-achievers – aiming to encourage all companies to improve their practices.

The fund is the first of its kind in Australia. While governance issues such as director remuneration have been relatively well covered by shareholders and fund managers, there have been no environmental or social resolutions proposed at Australian company AGMs in the last five years. This resolution activity is most prominent in the United States and is gaining traction around the world.

The Climate Advocacy Fund will have, as the name suggests, a climate change focus. Climate change is the most important issue to face present and future generations. The scope and potential impact of climate change – environmental, humanitarian, health and political – make it an overarching issue to rival the consequences of war in magnitude.

Greenhouse gas emissions attributable to the top 200 companies amount to about half of Australia's national emissions. Currently many companies don't even disclose detailed emissions data. Today less than half of the ASX200 companies produce sustainability reports and many of these are not produced in a standardised, comparable form.

How does the fund work?

In Australia, there are two ways resolutions can be put to a company AGM. A resolution can be proposed by those holding 5% of the company's shares (a very big ask for many large companies), or else 100 shareholders are required to propose a resolution for it to be voted on at a company AGM.

However, even if a fund manager or super fund has 1000 members, they will usually only be regarded as a single shareholder. Arrangements have been made with 100 Australians deeply concerned about corporate responsibility who are prepared to use a shareholding in support of the aims of the Climate Advocacy Fund. In addition, the Climate Advocacy Fund will endeavour to garner broader support amongst the shareholding community in support of its aims.



The Climate Advocacy Fund will invest in the largest companies on the Australian Securities Exchange based on their economic footprint. The fund will not actively engage in stock-picking.

How will the fund engage with companies?

The advocacy process is a persistent, methodical and intellectually informed process. The fund's corporate researchers use databases developed over many years to identify and monitor sustainability issues relevant to the companies included in the S&P/ASX 200.

In the first instance, issues may be raised with companies through letters and meetings, the results of which are often made public. Following on from this, the advocacy process aims to have resolutions seeking to improve corporate behaviour supported at company AGMs.

Today, companies are placing increasing importance on the value of responding positively to such engagement and the resulting public goodwill. Research shows that companies which perform well on sustainability measures also tend to perform well financially.

What sort of issues will the fund pursue?

All issues raised by the Climate Advocacy Fund will reflect the aims set out in the Australian Ethical Charter. In this way the fund

will have a similar aim to Australian Ethical's other funds, but goes about the process in a very different way.

The initial focus of the Climate Advocacy Fund will be the full range of issues relating to climate change, including greenhouse gas emission abatement, sustainable property development, population, health, energy supply, bio-diversity and transport.

Raising these issues directly with company management can lead to improved performance by:

- improving knowledge of the issues involved
- raising the profile and priority of the issues within the company
- empowering individuals within the company who are personally motivated on these issues
- raising awareness within the company of stakeholder views and concerns on these issues, and flagging potential areas of reputational risk for the company.

An imperative of the fund will be to improve company disclosure of their greenhouse gas emissions, and then to seek improved performance in containing emissions.

A number of organisations provide reporting frameworks for companies to disclose their greenhouse gas emission 'footprint'. The Carbon Disclosure Project and the UN Global Reporting Initiatives are examples of these.

The Climate Advocacy Fund might engage with companies that have not responded to reporting frameworks, asking them about their non-participation and encouraging them to respond in future. The intent is that this communication would also provide a positive message, providing the company with relevant details to help them in preparing future responses.

Engagement might be in terms of greenhouse gas emissions from the company's products and operations, greenhouse gas emissions per unit of production or adoption of policies for renewable energy research.

For example, in the United States at the Exxon Mobil 2009 AGM a resolution was put that Exxon Mobil 'adopt a policy for renewable energy, research, development and sourcing, reporting on its progress to investors in 2010.'

Do resolutions need to pass to be successful?

Resolutions do not necessarily have to be passed to have an impact. Even resolutions that are not passed can inform other shareholders about a company's poor record or highlight the level of interest in addressing specific issues.

In the United States, sponsors of responsible investment resolutions often consider it a victory if they can withdraw their resolution because that means they have reached a voluntary agreement with the company that the issue will be addressed.

How will the fund perform financially?

The Climate Advocacy Fund is an index fund. It will invest in the largest companies on the Australian sharemarket based on 'economic footprint' weighting.

An economic footprint weighting is determined using measures such as sales, cashflow, book value and dividends. This approach is designed to avoid limitations of a traditional index fund which is based solely on share price, leading to funds holding excessively large proportions of over-priced shares and smaller proportions of better value shares.

Historically, portfolios constructed using the economic footprint model have tended to out-perform the broad share market index in the vicinity of 2–3% per annum.

The fund will be a low fee investment option. It is available to both managed fund investors and to super members.

How do I find out more?

You can find out more about the Climate Advocacy Fund by contacting Australian Ethical and receiving a copy of the Product Disclosure Statement, or by visiting the fund's website at www.climateadvocacyfund.com.au.



www.climateadvocacyfund.com.au

1800 021 227

Why is my sustainable fund investing in cluster bombs?

The growth of 'best of sector' **australianethical** had its birth in the late 1980s when ethical investment was viewed among the financial mainstream as a novel idea.

In the two decades since **australianethical** has grown to manage almost \$650 million on behalf of 18,000 investors.

Ethical investment has now worked its way into the mainstream. Australia's big investment companies and super funds have taken notice and many are offering their own ethical investment options. In the process the big investment and super players have muddied the waters about what ethical investment actually is.

In the first instance, a range of vague terms were coined to describe an investment style which took account of environmental, social and governance considerations – responsible investment, sustainable investment, socially responsible investment, green investment.

More often than not, these large fund managers with an ethical or sustainable option choose to use an investment process known as best of sector.

australianethical uses a negative screen which avoids companies with undesirable activities and a positive screen which actively seeks out companies with strong environmental and social credentials. A best of sector fund will invest in the best companies across all sectors and industries.

australianethical does not use a best of sector approach because we believe there are some industries, such as tobacco and uranium, which are not sustainable or socially positive, and companies may be identified as sustainable or ethical based on token practices.

In other words, some of the companies you could be investing in may be the best of a bad lot.

According to Choice, 'many of the top shareholdings in these funds end up being very similar to the shares held

by their 'ordinary' investment options'. The end result is that people who have chosen their fund manager's ethical option might not have their expectations met.

The Responsible Investment Association of Australasia website shows that 20 out of the 24 super funds with an ethical or sustainable option use a best of sector investment style.

The latest super fund to join this group was the largest Australian super fund, which in January 2010 dropped the ethical exclusions from its sustainable investment option and introduced a best of sector approach.

Previously, this super fund had excluded companies which received a significant proportion of their revenue from alcohol, tobacco, gambling, uranium extraction or

the manufacture of weapons or armaments. These automatic ethical exclusions no longer take place.

According to Nicholas Taylor of independent research consultancy Outcrop, the move by the fund is significant 'not just because of its size, but because it had arguably gone further by offering its members an ethical option, only to then slip into the murkier waters of 'sustainability'.

australianethical believes that a key aspect of ethical investment is knowing what your money is doing. Ethical investors should seek a full portfolio listing from their fund manager to ensure their investments meet their expectations.

australianethical's portfolios can be viewed at our website – www.australianethical.com.au.



Global smart energy

australian**ethical** has repositioned the International Equities Trust to focus on Global Smart Energy.

The International Equities Trust now targets investment in companies involved in global sustainable energy supply and demand. This dual focus on both the supply and demand side of energy use will allow the Fund to benefit from the opportunities presented in combating and managing the impact of climate change.

The Fund will provide specialist exposure to renewable energy supply through sources such as wind, solar and geothermal, as well as exposure to efficient and adaptive technologies in areas such as transport, recycling, metering and smart grid systems.

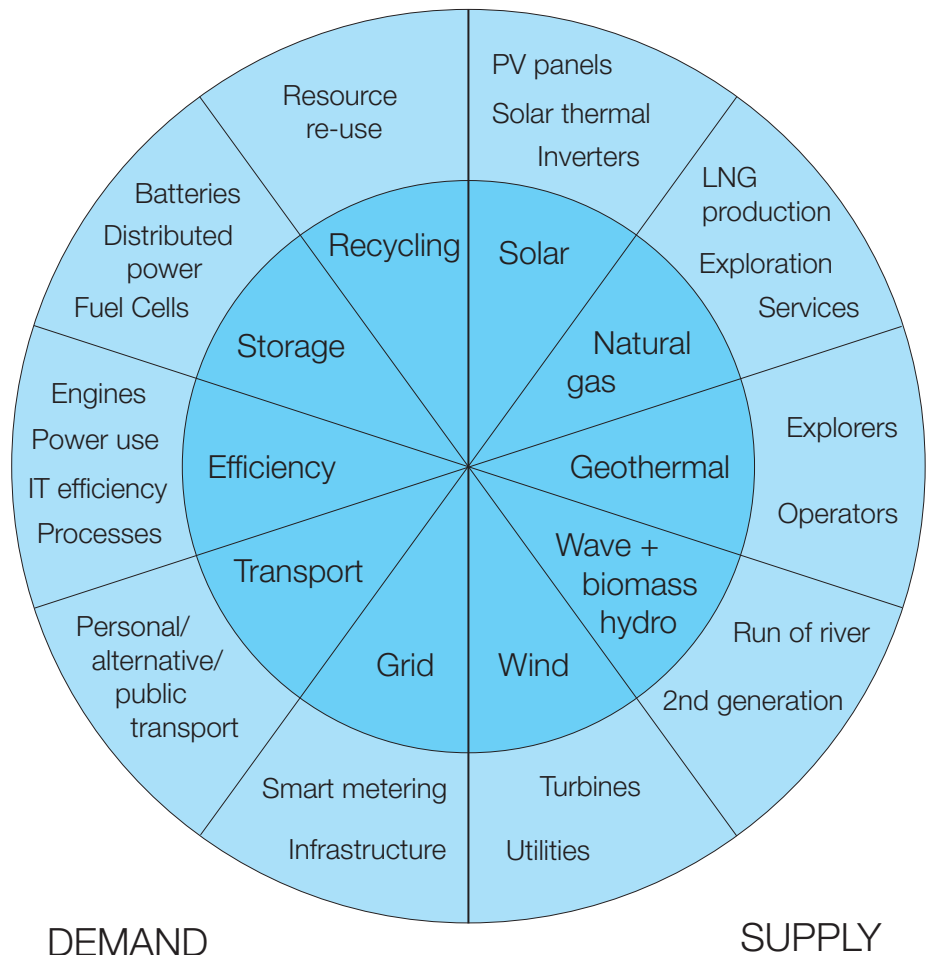
The focus on both the supply and demand sides of sustainable energy use is what sets this Fund apart in the investment marketplace. Other thematic funds may only invest in the supply side of clean energy.

australian**ethical** believes that whilst renewable energy supply is growing and will become a significant contributor to lower emissions over time, large reductions in emissions can be achieved now through innovation, adaptation and consumer preference for less energy intensive products and services.

This includes companies such as VMWare and Citrix Systems who reduce emissions from IT use through videoconferencing and virtualisation; bicycle component manufacturer Shimano and public transport company Stage Coach Group; precious metal recycler Asahi Holdings as well as TOMRA Systems with their reverse vending machine technology; and water and energy metering company ITRON.

Recent additions to the Fund in the renewable energy space include American Superconductor Corporation, Centrotherm Photovoltaics and First Solar. Further details on these companies are on the back page of this newsletter.

globalsmartenergy concept



The change to a global smart energy theme hasn't resulted in wholesale changes to the International Equities Trust. The Fund has always invested in renewable energy, recycling, efficient transport and other smart energy companies, but this will now be the focus.

The portfolio manager for the International Equities Trust, Ursula Tonkin, believes all-round exposure to the critical themes of climate change and energy security presents compelling potential for long-term growth and investment outperformance. Ursula believes the next few years will represent a turning point in the shift toward renewable generation, alternative fuels and transport, energy saving and recycling.



Portfolio manager Ursula Tonkin

Investor profile: Jerry Coleby-Williams



I'm not a celebrity; I'm a good, practical gardener who happens to teach in the media. I'm an import and some of the baggage I brought with me included professional training as a curator by the Royal Botanic Gardens, Kew, and four generations of traditional organic farming and gardening knowledge acquired from my family.

I act as a bridge between science and gardening, and between conservation and management. I use my expertise and my sustainable home to encourage as many 'travelers' as possible to cross over from where society is now to a more democratic place where human, animal and environmental rights come first.

That 'place' involves becoming equipped to deal with the coming peaks of oil, phosphorous, food production and population, while we adjust to the inescapable physical and political effects of global warming.

While running the 'tree, shrub and grass department' that comprises the Royal Botanic Gardens, Sydney, I fell in with the gardening mob in ABC television, radio and their Organic Gardener magazine. I also work with the Seed Saver's Network, Queensland Conservation, and Australia's Open Garden Scheme.

Being poor helps budgeting. It keeps things simple. Getting a mortgage was a huge step. I worried I'd become less young at heart and less willing to take risks, but it allowed me to establish a pioneering sustainable home where I practice what I preach.

I'm not commercial and being hopeless at investing means you have to trust others. Since this gardener/bridge wants a place where new agriculture, new energy generation, new industry, new housing and new education are mainstream, shoving my superannuation into ethical investment was the easiest and laziest thing I've ever done. Quietly and effectively this mob are equipping new Australia, leaving me to cultivate my own plot in Brisbane.

You can view Jerry's blog at:

www.bellis.info

Phillip Vernon joins **australianethical** as CEO



I joined **australianethical** as chief executive officer in December 2009 after a long career with one of Australia's leading fund managers.

My interest in the environment was inspired by the activities of my sister and her family who are very active in the movement in Tasmania. What

started with them being concerned about the logging of the area around their home led to them, with others, being instrumental in having the Tarkine rainforest recognised. The dedication of the entire family is an inspiration and demonstrated to me the power of grassroots activism.

My interest in responsible investment has evolved over a number of years where I witnessed many examples of both good and bad corporate behaviour. I saw the power and influence that investment and capital markets have to shape that behaviour and formed strong views about their responsibility to use that influence in a positive way. This is illustrated no more strongly in relation to climate change where there is a significant opportunity for investment markets to step into the void left by the failure of the political process.

I am very pleased to be joining a company with the pedigree and reputation of **australianethical** who are pioneers in socially responsible investment in Australia. We have a commitment and conviction not just in our investment style but in our entire corporate ethos that is unmatched here and possibly the world. We have a strong investment and management team that has delivered consistent investment performance and has a proven capacity for innovation.

I am married and have two teenage boys. My personal interests include being a keen Sydney Swans supporter. I'm also passionate about music and in my spare time play guitar (badly) in a rock cover band.

Forestry, carbon offsets and climate change

The use of trees, forest sinks and plantations have become increasingly popular ways for companies to mitigate their climate risks, demonstrate leadership by offsetting their emissions, or profit from carbon reduction measures.

Carbon offsets

Carbon offsets are financial instruments which can be purchased to achieve net reductions in greenhouse gas emissions. Carbon offsets operate in the Global Carbon Market, which can be further divided into the compliance market and the voluntary market. In the compliance market, carbon offsets are purchased to comply with caps on the total amount of carbon dioxide the company or entity is allowed to emit from their operations. In the voluntary market, carbon offsets are purchased to voluntarily mitigate a company or individual's own greenhouse gas emissions.

Carbon offsets have been identified as an important tool for reducing greenhouse gas emissions while maintaining stable economies. Carbon offsets can be generated by a number of diverse activities belonging to any of the following broad categories; renewable energy, methane abatement, energy efficiency, fuel switching and reforestation.

Carbon offsets by themselves are not a sufficient solution to climate change because they are unlikely to produce the deep emission reductions required to avert dangerous climate change. Nevertheless, purchasing offsets can be an effective interim strategy that can be implemented immediately.

Reforestation

While the provision of carbon offsets is a positive step, offsets generated by reforestation have been criticised by green groups. Concerns have been raised regarding leakage, permanence, quantification and certification.

Leakage

Leakage occurs when natural forests are cleared to compensate for the loss of arable land that was caused by a reforestation project. If this happens, a reforestation project may only result in a negligible increase in total forest coverage.

Permanence

Reforestation projects reduce carbon levels because atmospheric carbon is absorbed and sequestered in trees. However when a tree is cut down or otherwise dies, the carbon stored in it will again be released into the atmosphere. Hence reforestation projects only temporarily store carbon.

The fact that carbon offsets from forest sequestration will not be permanent in the same way that offsets generated from renewable energy projects will be permanent (as they prevent the carbon being released in the first place), means they are a less attractive tool for combating climate change.



Quantification

There are uncertainties associated with how to calculate offsets from forest sequestration. This is a particular weakness when compared to offsets generated from emission reduction through renewable energy projects.

Certification

The Australian Forestry Standard (AFS) has been repeatedly criticised by a number of green groups as not being an adequate standard for sustainable forestry. The driving force behind the AFS was the Tasmanian Government and the Australian forestry industry itself.

In contrast, the Forest Stewardship Council (FSC) was established by a collaboration of NGOs and global forest industry leaders as a specific attempt to identify sustainable forestry practice in advance of base-line certifications such as Australia's AFS.

The AFS differs to the FSC in the following key areas:

- It allows native forests to be removed and replaced with plantations;
- It does not prohibit the use of genetically modified organisms;
- It does not require a minimising of biological control agents, and does not prohibit the use of any particular chemical; and
- It has less stringent requirements in regards to stakeholder consultation.

Australian **ethical** considers climate risk a key driver of future company value and gives strong consideration to measures which legitimately reduce a company's carbon risk. Australian Ethical also recognises and seeks out opportunities available in genuine carbon reduction.

Returns to 31 May 2010

Trust	6 month return (%)	1 year return (%)	3 year return (% pa)	5 year return (% pa)	10 year return (% pa)	Inception year
Balanced	0.1	6.0	-3.9	1.8	5.9	1989
Smaller Companies	-2.6	12.5	-1.5	8.0	7.7	1994
Larger Companies	-1.3	10.2	-8.2	1.8	5.5	1997
International Equities	1.2	1.9	-	-	-	2007
Income	2.2	5.5	4.5	4.7	4.8	1997
Property	3.0	-5.9	-	-	-	2009
Super						
Balanced	-0.5	4.8	-3.6	1.6	5.3	1998
Equities	-4.0	10.6	-1.6	7.1	7.2	1998
Larger Companies	-2.1	8.4	-7.4	1.8	5.3	1998
World	-1.7	-0.1	-	-	-	2007
Income	1.7	4.4	3.6	3.8	3.8	1998

New company profiles – Global Smart Energy

American Superconductor Corporation
 American Superconductor Corporation offers an array of proprietary technologies and solutions spanning the electric power infrastructure – from generation to delivery to end use. The company develops wind turbine hardware as well as highly efficient superconducting motors, generators, power converters and transmission lines. American Superconductor has supply agreements with the biggest Asian wind turbine manufacturers. This investment provides greater exposure to Asian renewable energy. Last year China became the largest wind power market in the world.



American Superconductor Corporation

Centrotherm Photovoltaics AG

Founded in 1976, Centrotherm Photovoltaics provides technology and engineering services for solar module manufacturers. The company has over 1,000 employees, located across Europe, Asia and the USA. One of the company's subsidiaries manufactures specialty products for the treatment of hazardous material produced as a by-product of solar cell and semiconductor manufacturing.

First Solar

First Solar manufactures solar cells, solar modules and develops large scale solar installations. The company's proprietary cadmium telluride solar cells have the lowest 'cost per watt' ratio in the industry and produce the lowest life cycle emissions. The company recently signed an agreement to build what will be one of the world largest solar power plants in China.

Past performance is not a reliable indicator of future performance. Total returns are calculated using exit prices. Total returns take into account ongoing management fees and trust or super fund expenses. For the super fund, total returns are based on an investment of \$10,000 at the inception of each strategy. Performance figures for each strategy assume an investment in that strategy only. For the trusts, total returns are calculated as if distributions of income have been reinvested. They do not take into account tax that may be payable on the distribution of income. For the super fund, total returns are calculated taking into account taxation on super fund earnings and capital gains. Neither the return of capital nor the performance of a trust or the super fund is guaranteed. Figures showing a period of less than one year have not been adjusted to show an annual total return. The latest available performance figures can be obtained from our website or by calling 1800 021 227. Units in the trusts are offered and issued by Australian Ethical Investment Ltd ('AEI') ABN 47 003 188 930, AFSL 229949. Interests in the super fund are offered by AEI and issued by the trustee of the fund, Australian Ethical Superannuation Pty Ltd ABN 43 079 259 733, RSEL L0001441. The PDS should be read before making an investment decision.

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