What you spend is at least as important to your future as what you save; and, argues Morten Strange, curbing spending can have a more positive environmental impact than any number of ESG investments

The ethical escape to financial freedom

What do country singer Tammy Wynette, actor Burt Reynolds and tennis star Boris Becker have in common? The answer is they all filed for bankruptcy, like so many other celebrities who made millions and yet ended up broke. The point is that it is not (just) about the money you make, it is how you manage it that is most important, if you want to ensure your financial success.

It sounds trivial, but it is important to keep in mind that maintaining your expenditures under control is as important to your financial well-being as a decent income and return on capital.

There is a simple formula you would do well to pay attention to: $F = (I + r) - e$.

Your financial freedom (F) is your income (I) plus return on your investments (r) minus your expenditures (e).

And how much do you need to consider yourself financially free, salary independent, ready to work just because you want to, not because you have to? That number can be expressed in a simple ratio as well: $S = Y/r$ (or $Y = S \times r$), where S is the savings you require for financial independence, Y is your yearly income from savings and r is your return on capital.

Say you want a monthly income of £3,000, then Y = £36,000 and if you think you can generate 6% pa on your portfolio S = £36,000/0.06 = £600,000.

To reach that number, it is important that you keep e from the first formula in check.

As investors, we spend a lot of time and effort sourcing and analysing the best capital allocation opportunities. But it is equally important that we watch our spending as well and keep it in check.

So the sooner you curb your spending, the sooner you will reach financial independence; but there are many other benefits to this strategy.

Many people have found that they are happier with less stuff and material clutter in their lives. There is a whole school of thought that draws on this: the FIRE movement (Financial Independence, Retire Early).

Millennials with good jobs and extra income from gigs and online work have found that if you save 50% of what you make, you only have to work ½ your lifetime! Less than that in fact, if you become financially literate and manage to invest wisely.

Environmental aspects

If you are concerned about the state of our natural environment, it would also be important to note that spending less is one of the best things you can do.

The topic of global warming has put the spotlight on environmental issues in a way we have never seen before. But quite honestly, the problems are not new; and furthermore – we have had plenty of warnings about all this.

I do not think I have to list all the alarming surveys and statistics that are published on an almost daily basis now, and I can even understand if some people are getting a bit fed up with the whole thing – it is almost too much to grasp and somewhat depressing to deal with in the first place.

To reduce our ecological footprint and save the planet, we are regularly being told to replace our light bulbs with more energy-efficient ones, take shorter showers, hang-dry our clothes, bring our own shopping bags to the supermarket, recycle our plastic, switch to a hybrid car...

All this is well and good, but these actions are unlikely to have a material impact.

However, curbing your consumption will.

A detailed study published in *IOP Science* in 2017 concluded that four major lifestyle changes would result in by far the largest savings of personal CO_2 emissions (in order of importance): (1) having one less child; (2) living car-free; (3) avoiding airline travel; and (4) eating a plant-based diet.

Worth keeping in mind, especially since all these adjustments would also save you a boat-load of money.

Reduce, reuse and recycle

Recycling has more or less been a flop; much of the plastic that households carefully put in separate containers for recycling is in fact never recycled. Most end up being sent at great expense to China or (most recently) Malaysia, where it is often just burnt in the open or, worse still, chucked in a river

Reuse? By all means try to buy second hand stuff and swap items with others in the new sharing economy; but if you really want to save the planet, the best way is to reduce your consumption at source: buy less and consume less.

The problem with ethics

Then there is the matter of how you best invest the hard-earned savings you generate this way. If you have an ethical mindset you might want to apply some of those values to your investment strategies.

In my own personal experience, ethical investing is not that much different from any other investment strategy. You invest in the companies and the financial instruments that you feel comfortable with, and which you hope will provide you with a good risk-adjusted return over the long run.

Ethics is a very personal matter. In fact, I would brave the statement that no two people's ethics are exactly the same, which is why there is no one-size-fits-all in the world of ethical investing.

Most people start by applying a negative screening policy to their choices of financial products. I know some people who would screen out weapons manufacturers and avoid their shares as well as corporate debt; others might not like to finance companies involved in gambling, tobacco, coal, fossil fuels in general and even perceived human rights violations.

Institutional investors are increasingly applying ethical criteria to their selection of investment vehicles.

The Government Pension Fund of Norway, which with over US$1trn in assets is the largest sovereign wealth fund in the world, has long been guided by an Ethical Council and has a long list of excluded companies.

Given the origins of the cash that the fund invests it is unsurprising it does not exclude oil and gas companies – in fact, in Norway it is popularly called The Oil Fund – other institutional investors, however, are doing just that, including many university endowment funds, pension funds and also in 2018 the €9bn Ireland Strategic Investment fund.

A survey in 2019 by consulting firm PwC found that out of 162 finance companies in 35 countries, 91% had or were in the process of adopting ethical investment policies, up from 80% in 2013. Of respondents, 83% were concerned about global warming, 76% about human rights, 67% considered the UN Sustainable Developments Goals in their decision making and 35% of firms had in-house teams in place to ensure that their investments were responsible and sustainable.

Constructing a portfolio

The fiasco of green jobs and green investing after the 2008 financial crash gave SRI (Sustainable, Responsible Investing) a bad name among retail investors for a while.

However, while investing solely in solar panel start-ups over the past 10 years may have not been a good idea, there are many indicators that applying some element of ESG (Environmental, Social Governance) criteria to your investment decision will work well going forward.

Since 2009, the MSCI World SRI Index has out-performed the MSCI World Index, and indications are that this trend is likely to continue.

Constructing your own ethical portfolio may be a daunting task, and there is the additional issue of complex conglomerates to consider; some large corporations produce wind turbines as well as coal-fired power plants, so is this OK with you?

To avoid the detailed research required, as well as the additional risk of picking individual stocks, you can invest in ethical ETFs and mutual funds; each and every fund provider now-a-days would have one or more of those.

Just make sure you check online and go through their holdings carefully before you commit your cash, to make sure you are comfortable with that particular selection of companies.

> **"If you really want to save the planet, the best way is to reduce your consumption at source: buy less and consume less"**
> Morten Strange, author and financial analyst

In spite of the data available, there is a school of thought in the investing community that ethical investing is a hoax. How can you do well if you exclude certain companies? Surely profitability is all that counts? No one wants to lose his money just to be nice, right?

Fine, if that is your view; you can still help save the Earth. Just work and invest in the extractive industries for as long as it takes to get rich... but no longer than that. Then retire early and use your skills and resources to make the world a better place. It is a strategy has worked for many.

Morten Strange is an independent Singapore-based financial analyst and the author of Be Financially Free: How to Become Salary Independent in Today's Economy.