SERIOUS ABOUT SUSTAINABILITY

Investor demand means more companies focus on profitability, sustainability and accountability

You need look no further than your newsfeed for yet another example of corporate misdeeds. Better reporting, round the clock news coverage and social media have added transparency and enhanced scrutiny to a company's behavior, which can lead to lost profitability. What's an investor to do?

Enter ESG – the environmental, social and governance factors that may help you evaluate company behavior and investment potential beforehand. Investors aren't looking to ESG purely out of a strong personal connection to a particular cause or an idealistic view of the world; they're realizing that long-term performance will be impacted by companies' attention – or lack thereof – to possible regulatory and reputational risks. In fact, 35% of pension fund investors cited the latter as a top reason to incorporate ESG factors into their process, according to a 2019 survey by State Street Global Advisors. It's not all emotions – it's financial too.

By requiring transparency into ESG factors material to each company they own, shareholders are holding businesses to a higher standard as corporate citizens of the world, demanding responsibility and accountability in addition to strong financials. As consumers, we've been doing something similar for decades, spending money to support companies we believe in, and redirecting dollars from those who lose our trust.

Investors have long been able to apply exclusionary filters to weed out companies that sold tobacco or supported apartheid, for example. But today's approach to sustainable investing involves deeper analysis that can both reward and penalize companies for their actions, taking into account issues such as women in leadership, carbon reduction targets, and HR policies that encourage ethical behavior. Some investors even look to reward "ESG momentum" – the efforts of firms to regularly boost their sustainability, despite being ranked behind peers.

As of yet, there are no U.S.-mandated standards for analyzing material ESG factors, but many companies voluntarily support those outlined by the Sustainability Accounting Standards Board and the United Nations, which created Principles for Responsible Investment and Sustainable Development Goals (in collaboration with global corporations) as a "blueprint to achieve a better and more sustainable future" by 2030 across the globe. While the need for transparency and standardization of ESG data is apparent, investors aren't waiting for regulators to take action. Institutional investors are engaging directly with companies to get the answers they seek.

Sustainable investing provides a pathway for all investors – big and small – to align their portfolios with not just their financial goals, but their values, too. And now, with the recent expansion of opportunities in this space, chances are pretty good that you can find a cause that resonates with you and an investment to match. Your approach to sustainable investing can be as customized as you like, whether through assigning weights of material factors or incorporating values you hold dear, there is little doubt that you and your advisor will find the investment mix that feels right to you.

Thousands of starfish washed ashore. A little girl began throwing them back in the water. "Don't bother," her mom said, "it won't make a difference." The girl stopped for a moment and looked at the starfish in her hand. "It will for this one."

Misconception No. 1

SUSTAINABLE INVESTING IS JUST ABOUT SAVING THE ENVIRONMENT

Investing responsibly takes many forms, but for most, it is about driving meaningful change across any number of factors (a handful of which are listed below) that have a material impact on a company's success. The top factors cited by investors are actually related to governance to ensure the right people are at the top and are thinking appropriately about long-term business viability and risks.

While some sustainable investors align with a certain theme, such as water conservation or gender equality, more commonly, they look to drive change by focusing on metrics most crucial to a particular company's long-term performance. Not all ESG factors are created equal – for example, a professional services company likely has a smaller environmental footprint than a chemicals manufacturer, but a potentially larger threat of data breaches.

ENVIRONMENTAL

- Climate change, carbon emission
- Air and water pollution
- Energy efficiency
- Green products, technologies and infrastructure
- Biodiversity

SOCIAL

- Employee engagement, pay and development
- Labor standards
- Diversity & inclusion
- Human rights
- Data protection and privacy
- Community relations

GOVERNANCE

- Executive compensation
- Board composition
- Audit committee structure
- Bribery and corruption
- Whistleblower schemes

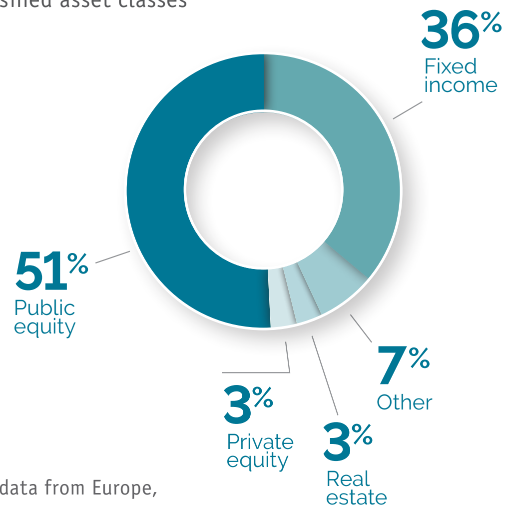
Misconception No. 2

SUSTAINABLE INVESTING IS TOO NICHE

Sustainable investing, by broad definition, is up 38% since 2016 – to the tune of $20 trillion, according to The Forum for Sustainable and Responsible Investment. And more than half those surveyed for the 2018 Global Sustainable Investment Review cited a desire to use ESG screens to minimize risk, fulfill fiduciary duties and improve financial performance over time.

Despite these filters, broad diversification is still possible. More than 350 funds are marked sustainable by Morningstar, and a growing number of tax credit funds and sustainable bonds have entered the market, surpassing $250 billion in 2018. Mainstream companies are also moving the needle. Recently, a major car company issued bonds to underwrite purchases of greener cars; a bank conglomerate launched a plan to go carbon neutral; and a major clothing retailer is investing in refugee education.

Sustainable investments are allocated across diversified asset classes



2018 data from Europe, the United States, Japan and Canada

Misconception No. 3

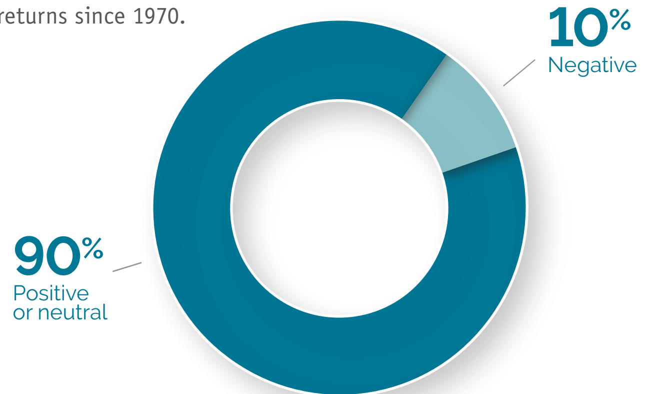
SUSTAINABLE INVESTING MEANS SACRIFICING PERFORMANCE

People commonly hear that sustainable investing is meant for doing good, but not for doing well. Turns out the two are not mutually exclusive. Study after study, including meta studies, have shown that companies with high ratings on ESG factors material to their industries tend to have lower costs of capital, higher profitability and stronger performance.

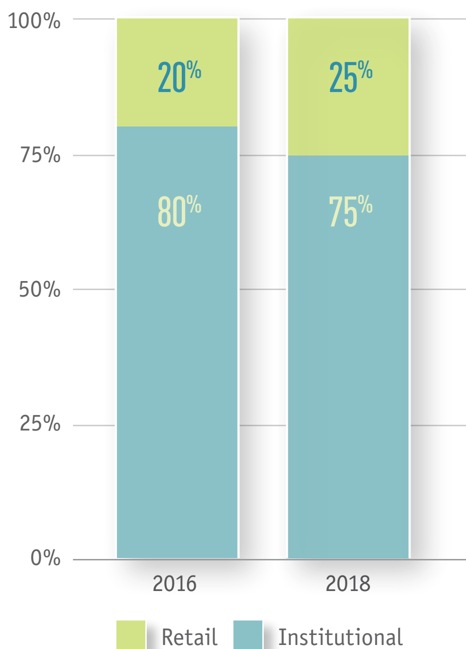
According to a study published by the *Journal of Applied Corporate Finance*, "companies with high non-financial indicators of quality seem to perform significantly better on market and accounting-based metrics." The CFA Institute also found that sustainable investments reduce volatility and exposure to future risks.

Still, due diligence is essential in order to drive returns as well as sustainable business practices, as with any good investment.

90% of more than 2,000 studies showed a neutral or positive relationship between integration of material ESG factors and financial performance, a statistically significant correlation on returns since 1970.



Global shares of institutional and retail sustainable investing assets 2016-2018



Misconception No. 4

ONLY WOMEN AND MILLENNIALS CARE ABOUT SUSTAINABLE INVESTING

More than a quarter of assets under management worldwide have some basis in sustainable strategies, driven by demand from institutional and individual investors – young and old alike, and at all wealth levels, according to The Investment Integration Project (TIIP) and the Money Management Institute (MMI).

While institutions drove growth in this space at the beginning, interest from retail investors has grown considerably. Women and millennials among them; however, men are increasingly looking at sustainable investments, and affluent individuals (mainly baby boomers) are driving the greatest retail demand.

Many foundations and endowments also apply a sustainable investment lens when looking to distribute money in a way that aligns with their philanthropic intentions (e.g., gender equality, human rights), and this ability is now available to retail investors through donor advised funds. Bonus: Investing sustainably, in conjunction with a defined philanthropic plan, could generate a larger and longer-lasting impact for the causes you care about.

Sources: Goldman Sachs Asset Management; Lazard; 2018 Report on Progress, Sustainable Stock Exchanges Initiative; Report on U.S. Sustainable, Responsible and Impact Investing Trends, 2018, US SIF; CFA Institute, ESG Issues in Investing: Investors Debunk the Myths; Putnam Investments, ESG Impact Report; Harvard Business Review; Motley Fool; Women's Philanthropy Institute at the Indiana University Lilly Family School of Philanthropy (2018); Fundamentals of Sustainable Investment; Global Sustainable Investment Alliance | There is no assurance that any investment strategy will be successful. Investing involves risks including the possible loss of capital. Past performance may not be indicative of future results. The returns mentioned do not include fees or charges which would reduce an investor's returns. Risk-adjusted return refines an investment's return by measuring how much risk is involved in producing that return, which is generally expressed as a number or rating. Environmental, Social and Governance Investing ("ESG"), also known as Sustainable Investing, may result in investment returns that may be lower or higher than if decisions were based solely on investment considerations. © 2020 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC. 20-BR3FZ-0023 TA 4/20