**Investing for the Greater Good: Theory vs. Practice**

It wasn't very long ago that socially responsible investing (SRI) was met with some hesitation as investors, with the chief goal of maximizing portfolio returns, questioned whether the additional focus might compromise the likelihood of attaining return expectations. Only a handful of years ago acronyms like SRI and ESG (Environmental, Social, and Governance) were essentially unknown on Wall Street and to the broader investment community. Though responsible investing dates back as far as the 18th century, when guidelines based on religious affiliations were put in place, it was not until the 1960s and later when social issues took center stage (e.g. the civil rights movement, apartheid in South Africa), that the concept become more formalized among certain investors. That said, despite its long history, for much of the 1990s and 2000s, responsible investing was embraced principally by wealthy investors interested in making a difference, specific organizations with investment mandates written into their policies and endowments pressured to make investment decisions based on demands from their community (e.g. university endowments responding to student appeal). The idea behind this paper is to help explain a bit more about socially responsible investing today and to communicate to our clients how this type of investing can not only add value on the social scale, but has the ability to generate financial returns as strong as, or in some cases in excess of, those investment options that are less focused on such issues.

To begin, it is important to recognize that being a socially responsible investor means different things to different people and that there are many motivating factors behind the selection of a particular practice. Ultimately, though, irrespective of the approach, the general motivation behind the effort links the fact that companies we invest in are connected to the environment and society in which we operate. As for the methods, the most straight forward and least invasive strategy is an approach that relies on "exclusionary" or "avoidance" screening of those considered to be controversial businesses, otherwise known as SRI. SRI based strategies have established screens that eliminate groups of stocks, frequently called "sin stocks", such as those within the tobacco, alcohol and firearms industries. Often, investors embrace the SRI approach to manage risk and fulfill fiduciary duties such as a religious organization's requirement of avoiding companies related to alcohol. While SRI is based on "exclusionary" rules, ESG investing tends to follow an "inclusionary" process. (See Chart 1 below depicting the landscape for ESG investing through 2016). An ESG portfolio manager will invest in companies that are expected to deliver a net benefit to society, through their products, job creation and general social behaviors. The idea is to hold companies that employ management focused on their financial as well as non-financial goals and responsibilities. Portfolio managers will take an active role in determining which companies are correctly addressing issues related to the environment, gender equity, governance, human and labor rights to name a few (see Chart 2 for a comprehensive list of popular ESG factors). Many portfolio managers will work with company management to help them push through positive change and improve their ESG standing. Ultimately, ESG or sustainable investing should be related to a company's long-term performance and return on investment.

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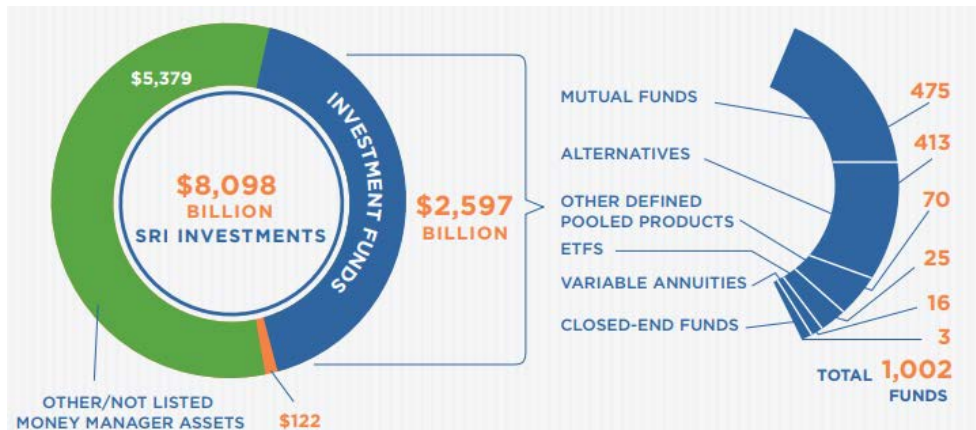
Chart 1

Money Manager Assets Incorporating ESG Criteria (Billions) 2016




Source: Forum for Sustainable and Responsible Investment

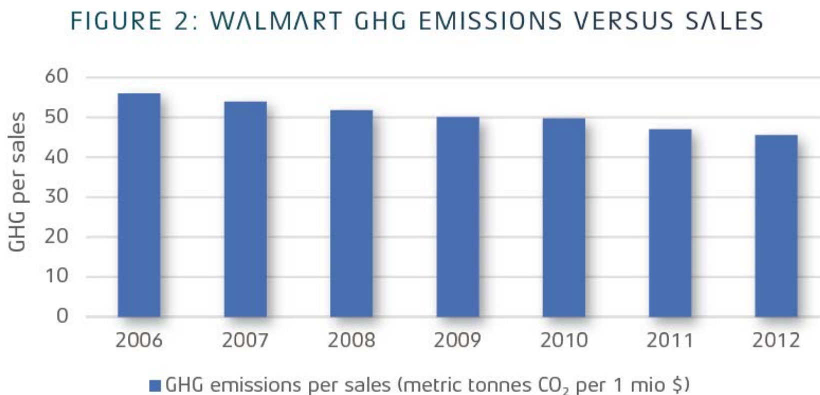
Chart 2

| ENVIRONMENTAL ("E") | SOCIAL ("S") | GOVERNANCE ("G") |
|---|---|---|
| Biodiversity/land use | Community relations | Accountability |
| Carbon emissions | Controversial business | Anti-takeover measures |
| Climate change risks | Customer relations/product | Board structure/size |
| Energy usage | Diversity issues | Bribery and corruption |
| Raw material sourcing | Employee relations | CEO duality |
| Regulatory/legal risks | Health and safety | Executive compensation schemes |
| Supply chain management | Human capital management | Ownership structure |
| Waste and recycling | Human rights | Shareholder rights |
| Water management | Responsible marketing and R&D | Transparency |
| Weather events | Union relationships | Voting procedures |

Source: University of Oxford & Arabesque Partners Study

The next question we will address is if ESG investing has compromised financial returns over time and taking it a step further, whether those managers that integrate ESG metrics into their valuation process actually have an edge over those that do not. It is commonly believed that sustainable investing sacrifices returns and that the strategy doesn't yield as much money as investing in fossil fuel assets, high carbon companies or weapon manufacturers. Critics have claimed that the strategy limits the investment universe, but in practice, sustainable investing at its core is about identifying well managed companies that have a long term view and where sustainability aspects are a part of their business model. In fact, in 2013, Accenture, the consulting company, surveyed 1,000 CEOs in 103 countries and 27 industries and found that 80% of them viewed sustainability as a way to gain a competitive advantage. They also discovered that 81% of these CEOs believe their stakeholders (communities, suppliers, customers, employees) felt the practice was important as well. Where the disconnect has resided for years has been in the CEOs need to respond to short-term financial market pressures. According to an Oxford University and Arabesque Partners[i] study, there is actually a positive correlation between sustainability and financial performance of stock prices for 80% of the time, and that efforts made towards developing solid sustainability standards tend to lower a company's cost of capital. As you can see from Chart 3 and 4 below, Walmart saved over $200M by incorporating recycling and efficient waste management into their model, while performance from companies that focus on specific types of environmental efficiencies have performed better than the FTSE Global All-Cap benchmark. While we would argue that one competitive study from 2012-2017 is insufficient for a robust analysis, it might provide a glimpse into the investment potential of such companies over longer periods of time and across multiple market benchmarks.

Chart 3




Source: chart and data from Oxford/Arabesque Study

Chart 4

To conclude, we hope this paper has provided our clients with some basic information about sustainable investing and has dispelled, if there were any lingering feelings, the idea that investing in SRI/ESG related products is only for those who consider themselves "do-gooders" and "tree-huggers". We would also like to remind the reader that not all products are alike and it is important to find a manager with the resources and knowledge to decipher between the different ESG factors and to then correctly apply these factors in an effort to uncover those companies with both a well thought out social and financial platforms. It is our feeling that over time, SRI/ESG trends will continue to mature and gain momentum as millennials reach their peak earning years and are better able to communicate their views through their investment portfolios. Even shorter-term though, there exists the feeling that where policymakers globally lead, companies and investors will have to follow.

Date: May 2018

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[i] "From the Stockholder to the Stakeholder"