Are You an ESG Investor but Don't Know It?

- **Responsible Investing (RI) continues to trend globally as investors gain confidence that there isn't a necessary 'give up' in returns by investing with an eye toward environmental, social, and governance (ESG) issues.**
- **Most RI investors have a high degree of intentionality and seek to invest some or all of their portfolios in a responsible way. Conversely, some investors claim that the ultimate goal of maximizing gain is at odds with investing responsibly.**
- **Given the overlap between traditional financial analysis, 'quality' investing and ESG-factors analysis, a mainstream investor might have investments which garner high ESG marks without even realizing it.**
- **Responsible Investing is a trend, not a theme and is likely best implemented as a philosophy, not a product.**

Evolution: from Values to Value

What's known as "Responsible Investing" today has its roots in values-based investing ("ethical investing," which gave way to "socially-responsible investing" in the 1970s.) Values-based investors typically embrace negative screening as a way to exclude investments that are inconsistent with their social or religious beliefs.

Today, the industry has moved well past values-base negative screening toward overall value creation, seeking risk mitigation and alpha generation. (See the chart below of commonly-identified RI investing approaches.)

Current Trends[1]

Globally, RI assets make up 26% of all professionally managed assets. More than half of all managed assets in Europe have an RI bias; in the United States, that number is about 22%, an increase over 18% from 2014-2016. While negative screening is still the largest sustainable investment strategy globally, the fastest-growing strategies were impact/community investing and sustainability-themed investing.

Mainstream Funds with high ESG/RI scores

Although some ESG factors are intangible and qualitative, they can have a material financial impact on the underlying value of an investment. Companies such as MSCI and Morningstar (via Sustainalytics) provide ratings on individual securities and funds based on 1,000+ RI-related data points.

A 2016 Barron's article, *The Top 200 Sustainable Mutual Funds*, ranked high-RI-scoring US Large Cap Equity Funds based on one-year performance. The surprising results: many of the funds that dominated the list were not billed as ESG/RI funds. Of the top 10 listed funds, only one had an expressed sustainable mandate: Parnassus Endeavor. The other top 10 funds were from well-known (and otherwise mainstream) fund families: Transamerica, American Century, Loomis Sayles, and Franklin.

ACG's research suggests that many non-ESG-branded managers engage in processes that have considerable overlap with those of highly-intentioned ESG managers, e.g. managers are aware of underlying asset valuation in light of potential stranded asset issues; many engage companies to encourage enhancement of health and safety practices; and managers show a preference towards companies with strong governance. This increased awareness and incorporation of environmental, social, and governance factors naturally trickles down into portfolio constituents which in aggregate leads to a more sustainable portfolio.

Portfolio Positioning

Is there a way to invest being mindful of RI principles without a complete overhaul of the portfolio or process? Absolutely. As a start, one could be mindful of the ESG/RI ratings of portfolio holdings, where available (fund ratings are not available for all strategies or across all asset classes). One could target a certain ESG score for the portion of the portfolio which can be measured. At a minimum, investors can devote some time to understanding the key issues and trends to ensure they are making informed decisions.

Commonly-Identified Responsible Investing Approaches

Increase in focus, intentionality; move from investor focus to outcomes focus

Negative / Exclusionary Screening	Positive / Best-In-Class Screening	ESG Integration	Sustainability-Themed	Impact / Community	Engagement / Shareholder Action
Exclusion of certain sectors, companies or practices from a fund or portfolio based on specific ESG criteria.	Investment in sectors, companies, or projects selected for positive ESG performance relative to industry peers.	Explicit incorporation of ESG factors alongside traditional financial analysis; seeks both risk mitigation and opportunities for alpha.	Investment in themes or assets specifically related to sustainability (clean energy, green technology, water, low-carbon, sustainable agriculture.	Targeted investments – typically within the private markets – seeking both social/ environmental **AND** financial return.	Use of shareholder power to influence corporate behavior on ESG matters such as executive compensation, shareholder rights, diversity and climate-risk disclosures.

[1] Source: 2016 Global Sustainable Investment Review, bi-annual report