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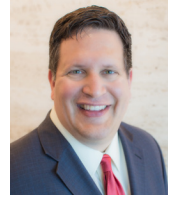
# Socially Responsible Investing "SRI"

Environmental Social and Governance "ESG" Investing, Sustainable Investing, and Impact Investing: From Fringe Fad to Mainstream Movement.



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## Definition of sustainable investing

While traditional investing ignores environmental, social, and governance issues or “ESG” principles, socially responsible investing or “SRI” focuses on investing in the stocks or bonds of the most sustainable companies that operate with values and principles that have the most favorable or positive impact upon society. Environmental concerns of ESG asset managers could include clean water and water conservation, global warming, and carbon emissions. Social concerns could include excluding sin stocks such as alcohol, tobacco, firearms, and gaming. Social issues could include promoting diversity and gender equity, human rights, and ethical corporate behavior. Finally governance issues could include responsible management of capital, development of effective and accountable boards of directors, adequate disclosure of environmental and social risks, and transparency in addressing adverse events. SRI and ESG investing allow Institutions and affluent investors alike the opportunity to reconcile their investments with their values.

## Popularity of sustainable investing

Today \$1 of every \$4 of professional assets under management in the U.S. is now invested in ESG-focused investments. (Connaker, A, Madsbjerg, S. January 17, 2019)<sup>1</sup> Sustainable investing has grown exponentially in recent years from \$3.8 trillion globally and \$2 trillion in the United States in 2006 to \$22.9 trillion globally and \$8 trillion in the United States in 2017. (Hale, J. 2017)<sup>2</sup>. It’s not surprising that over 1200 asset managers, who manage over \$60 trillion in AUM, have all adopted the United Nations’ Principles for Responsible Investment (PRI), which requires them to factor ESG issues into their methods of security selection. (Hale, J. 2017)<sup>2</sup>. Most recently sustainable asset management strategies have grown from \$8.7 trillion in the U.S. in 2016 to \$12 trillion in the beginning of 2018. (Bankrate Staff April 3, 2019)<sup>3</sup>. Worldwide, SRI, or socially responsible investing now has reached over \$30 trillion in assets. (InvestmentNews April 1, 2019)<sup>4</sup>.

## SRI and ESG investing has not always been in vogue.

“We still recall meeting with a minister who was looking to invest, approximately 20 years ago, and we asked him if he had any socially conscious objections and he said “ tobacco” and then quickly backtracked and stated, ‘Well, if it’s making money, I’m ok with it!’ ” (Sarver Vrooman Wealth Management)

## Performance of SRI and ESG investing

Investors do not need to sacrifice their performance in order to align their investments with their values. For example, since 1990, the MSCI KLD 400 Social Index<sup>8</sup> has had similar returns as the S&P 500 stock market index, with a slightly higher average return, 11.2% vs. 10.7%. (Haeefe, M. September 17, 2018)<sup>5</sup>. Proponents of ESG investing argue that neutral to positive performance is expected because good governance and advocacy for social and environmental concerns lead to less risk with regulators, less mistakes, and less likelihood of developing a rift with public opinion or “negative” brand equity. Over the past 40 years, 90% of the studies of ESG-focused investment performance has established a neutral to positive result, demonstrating that socially responsible investing has not historically hurt performance. (Haeefe, M. September 17, 2018)<sup>5</sup>. According to Morningstar research, SRI mutual funds have slightly outperformed non-SRI mutual funds on a 3-year, 5-year, and 10-year basis, 5.5% vs. 4.7%, 3.7% vs. 3.4%, and 8.9% vs. 8.5% respectively. (Iachini, M. February 1, 2019)<sup>6</sup>

## How can investors determine whether a mutual fund, stock, bond, or portfolio is highly ranked for ESG criteria?

Often advisors and investors alike would like to invest in SRI and ESG mutual funds, stocks, bonds and total portfolio, yet they do not know what tools to use to evaluate the investment’s compliance with ESG criteria. Institutional investors often use third-party research firms, such as Sustainalytics and MSCI ESG Research to establish ESG ratings relative to their sector or peer group. (Hale, J. November/December 2017)<sup>2</sup>. Morningstar has established the Morningstar Sustainability Rating or MSR which evaluates funds for their adherence to ESG principles, using Sustainalytics to evaluate each security and providing a portfolio-weighted rating. (Hale, J. November/December 2017)<sup>2</sup>. The Morningstar sustainability rating or MSR system goes from a 5-globe rating which is high — only

10% receive it — to a 4-globe rating which is above-average — 22.5% receive it — to a 3-globe, 2-globe, and finally 1-globe rating which is low — the lowest 10% receive it. (Hale, J. November/December 2017)<sup>2</sup>.

## What is the spectrum of types of sustainable funds?

The major types of ESG funds include:

- 1) ESG consideration funds,
- 2) ESG integration funds,
- 3) Impact funds, and
- 4) Sustainable sector funds.

*ESG consideration funds* are the most weakly correlated with ESG principles. ESG consideration funds may use ESG criteria to make investment decisions, but they are not required to, nor is ESG the central focus of their investment thesis. (Hale, J. February 2019)<sup>7</sup>. *ESG integration funds* are mutual funds that primarily use ESG criteria for the central thesis of their investment process. (Hale, J. February 2019)<sup>7</sup>. A third type is *impact funds*. They are created to create an impact on the environment or society, in addition to creating investment returns. (Hale, J. February 2019)<sup>7</sup>. The European Investment Bank, the World Bank, and the Seychelles government have all issued “green bonds” for the purpose of protecting the environment. (Connaker, A. and Madsbjerg, S. January 17, 2019). Finally, *sustainable sector funds* typically focus on the environment and are “green funds,” including water infrastructure, green real estate, renewable energy, and environmental services. (Hale, J. February 2019)<sup>7</sup>.

The opportunity to invest sustainably and the popularity of socially responsible investing has never been greater. Fears of inferior performance have not been substantiated and now more than ever, institutional investors and affluent investors alike can assess the extent to which a security or portfolio is aligned with ESG principles and also decide which type of sustainable fund or strategy is appropriate.

<sup>1</sup> Connaker, A. and Madsbjerg, S. (2019). Harvard Business Review. “The state of socially responsible investing.” Retrieved from: <https://hbr.org/product/the-state-of-socially-responsible-investing/H04QYP-PDF-ENG>

<sup>2</sup> Hale, J. (2017). Investments & Wealth Monitor. “Helping investors evaluate the sustainability of portfolios.” Retrieved from: [http://www.iwmonitor-digital.com/iwmonitor/november\\_december\\_2017/MobilePagedArticle.action?articleId=1258966#articleId1258966](http://www.iwmonitor-digital.com/iwmonitor/november_december_2017/MobilePagedArticle.action?articleId=1258966#articleId1258966)

<sup>3</sup> Bankrate Staff. (2019). Bankrate. “Socially responsible investing: How to make a difference.” Retrieved from: <https://www.bankrate.com/investing/guide-to-socially-responsible-investing/>

<sup>4</sup> Bloomberg News. (2019). InvestmentNews. “Socially responsible investments reach 30.7 trillion.” Retrieved from: <https://www.investmentnews.com/article/20190401/FREE/190409995/socially-responsible-investments-reach-30-7-trillion>

<sup>5</sup> Haeefe, M. (2018). The Financial Times. “Sustainable investing can propel long-term returns.” Retrieved from: <https://www.ft.com/content/292eca7-294c-3a4b-bde6-a7a744cb85a9>

<sup>6</sup> Iachini, M. (2019). Charles Schwab & Co., Inc. “Socially responsible investing comes of age. Can SRI funds hold their own?,” retrieved from: <https://www.schwab.com/resource-center/insights/content/socially-responsible-investing-comes-age>

<sup>7</sup> Hale, J. (2019). Morningstar. “Sustainable funds U.S. landscape report more funds, more flows, and strong performance in 2018,” retrieved from: <https://www.morningstar.com/lp/sustainable-funds-landscape-report>

<sup>8</sup> The MSCI KLD 400 Social Index is a capitalization weighted index of 400 US securities that provides exposure to companies with outstanding Environmental, Social and Governance (ESG) ratings and excludes companies whose products have negative social or environmental impacts.

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