ESG Investment Capabilities

Investors, like many individuals, are becoming more aware of creative ways to help the world. They increasingly seek to use business and capital markets to effect social change. In addition to charitable giving, more and more investors are choosing to invest in what they value to change the world.

Over the past few decades, a focal area of investing has emerged where investors limit their investments to companies that meet certain societally beneficial screens. These screens are pre-determined by the investor based on their values – health, environmental stewardship, social justice, etc. For example, an investor with an environmental screen may choose to limit their investments to companies with good environmental records.

Socially Responsible Investors tend to negatively screen investment options. They may choose, for example, to exclude a company from their portfolio that has caused environmental damage, such as Exxon (based on the Exxon Valdez spill of 1989) or BP Oil (based on the Deepwater Horizon leak of 2010). Or they may choose an exclusion based on product impact such as tobacco or firearms.

Sustainable Investors tend to apply screens to actively choose or include investment options in their portfolio such as green energy companies or electric transportation companies. Investing in SunPower Corporation or Telsa is an example of sustainable investing.

In general, either method of applying screens is termed ESG investing or Environmental-Social-Governance investing. Screens in these three categories encompass the main areas for impact investing. Environmental screens typically relate to natural resources, climate change, pollution and waste, and environmental opportunities. Some example screens in this category include carbon footprint, scale of manufacturing waste, and clean energy.[1]

Social screens, the "S" in ESG, typically relate to human capital, product liability, stakeholder opposition, and social opportunities. Some example screens in this area include safe work environments, family leave policies, supply chain labor standards, product safety and quality, privacy and data security, and access to healthcare.[1]

Governance screens, the "G" in ESG, relate to corporate governance and corporate behavior. Example screens in this area include board diversity, executive pay and pay equity, accounting, business ethics, and competitive practices.[1]

The following chart shares the general classification of ESG categories by MSCI, a leader in global indexing. This chart shows the dimensions along which ESG screens are applied and ESG funds are scored.

MSCI ESG Ratings Methodology 2018[1]

3 Pillars	10 Themes	37 ESG Key Issues	
Environment	Climate Change	**Carbon Emissions***	Financing Environmental Impact
		Product Carbon Footprint	Climate Change Vulnerability
	Natural Resources	**Water Stress***	Raw Material Sourcing
		Biodiversity & Land Use	
	Pollution & Waste	**Toxic Emissions & Waste***	Electronic Waste
		Packaging Material & Waste	
	Environmental Opportunities	Opportunities in Clean Tech	Opp's in Renewable Energy
		Opportunities in Green Building	
Social	Human Capital	**Labor Management***	Human Capital Development
		Health & Safety*	Supply Chain Labor Standards
	Product Liability	Product Safety & Quality	Privacy & Data Security
		Chemical Safety	Responsible Investment
		Financial Product Safety	Health & Demographic Risk
	Stakeholder Opposition	Controversial Sourcing	
	Social Opportunities	Access to Communications	Access to Health Care
		Access to Finance	Opp's in Nutrition & Health
Governance	Corporate Governance*	**Board****	**Ownership****
		Pay**	**Accounting****
	Corporate Behavior	**Business Ethics***	Corruption & Instability
		Anti-Competitive Practices*	Financial System Instability
		Tax Transparency*	

** indicates "universal" issues assessed for all companies in the MSCI World Index*

*** Board, Pay, Ownership, and Accounting carry weight in the ESG Rating model for all companies. Currently, they contribute to the Corporate Governance score directly and 0-10 sub-scores are not available.*

The trend toward ESG investing has grown significantly as investors intend to create positive impact alongside financial return. In fact, from 1995 to 2018, investments with ESG considerations grew from $639 billion to $11.6 trillion (see chart on following page). Assets managed with ESG strategies now account for more than one out of every four dollars under professional management in the United States.[1] This type of investment mandate and strategy has been dominated by institutional investors and large investment funds such as CalPERS.

The following graph shows the growth in impact investing from the beginning for 1995 to the start of 2018. It includes independent ESG strategies, shareholder directives and overlapping strategies.

For individual investors, an ESG strategy had been challenging to execute as reporting information was limited, fewer options existed, and fund options were expensive and difficult to judge based on mission effectiveness.

Today, more ESG financial products are available at a reasonable cost. And in response to the growing interest of our own clients, Sharper Granite has developed a process to maintain intelligent portfolio diversification as ESG strategies are incorporated. With this process, we can objectively score companies and funds along each of the three Environmental, Social or Governance categories to evaluate them for impact/values-based investing.

Our methodology allows us to build ESG solutions for clients. These solutions utilize our same stock targets for various risk levels and portfolio sizes but can substantially improve ESG scoring. The solutions may be used for partial or total portfolios of any size and risk level. We can also customize for a client's personal values along the three ESG categories.

For existing portfolios, your advisor can conduct a comprehensive ESG review to provide you with an ESG score. We can then compare this portfolio to a similar portfolio containing an appropriate ESG strategy. Investing trade-offs, such as cost differences (ESG funds tend to have higher expenses), may then be reviewed as part of the decision process.

Isolating ESG categories by client preference takes significant work and may require substantial input regarding trade-off decisions. Thus, it is important to discuss the implications with your advisor. Adding an ESG strategy to your portfolio may be attractive, especially if you are looking for another way to support causes you care about.

Notes and Acknowledgements:

1. MSCI ESG 101 and MSCI ESG Ratings Methodology, December, 2018
2. U.S. SIF Foundation report on Sustainable, Responsible and Impact Investing Trends, November 14, 2018

All forms of securities investing involve risk of loss for which clients should be prepared. There are no guarantees or insurances of principal preservation and market fluctuations of any level may occur and impact portfolio value. Past performance is not a good predictor of future performance. [Winter 2019]