Purpose-Driven Investing

Investors' goals have traditionally been purely financial. More recently, many investors are simultaneously pursuing a secondary goal, directing their money to work for companies that positively impact the world. Impact investing, or Environmental-Social-Governance (ESG) investing, provides a new lever to enact improvements in many areas.

With ESG investing, funds are invested in companies that meet defined environmental, social and/or governance standards. Investing in ESG mutual funds or exchange-traded funds (ETFs) can help support responsible corporate behavior without incurring excessive fees or other market inefficiencies. As a result, inflows into ESG funds have risen over the last few years.

Below, we look at what is driving this trend, portfolio implications, and how your advisor at Sharper Granite can assist.

The Pull

According to Morningstar, 72% of U.S. investors have expressed interest in sustainable investing, sometimes called Socially Responsible Investing (SRI) or ESG Investing.[1] And in June of this year, UBS released a survey of 3,800 investors (with more than $1M in investable assets) where 90% stated they want to align their investments with their values.[2]

In our *Winter 2019 Letter on the Economy*, we discussed this growing trend and Sharper Granite ESG evaluation capabilities. Why is ESG investing gaining popularity? In the UBS survey, 79% of respondents claimed the pandemic prompted them to reassess their values.[2] Investors are increasingly interested in aligning personal values with their assets -- "doing well by doing good." And in this quest, the demand for these ESG investment vehicles is increasing.

The Push

Almost simultaneously, the United Nations has embraced the power of financial markets for creating change in the world. In 2019, the U.N. convened the NET Zero Asset Owner Alliance, where forty international institutional investors committed to transitioning investment portfolios to net-zero greenhouse gas emissions by 2050. This represents over $6.6 trillion in assets under management.[3] Further, this August a seminal U.N. Intergovernmental Panel on Climate Change (IPCC) report called on policy makers and corporations to take urgent and proactive action.

Investment firms are getting involved. BlackRock, one of the largest institutional money managers, committed to decreasing fossil fuels in many of their funds by 50% immediately and 7% each year until they reach zero.[4]

Should investors consider divesting from fossil fuel firms when they have produced dividends for decades? In any economy, drivers do change, and we appear to be witnessing one of them. University of Pennsylvania Wharton Business School Professor Jeremy Seigel recently shared this analogy:

"Fossil fuel companies such as Exxon Mobile may be like gold mines. At some point in the future the gold is gone, and the mine is worth nothing; it is just a pit. Until then it throws off a lot of gold (dividends), but the clock is ticking." [5]

Oil company valuations are low – the market is anticipating the future earning potential of this segment. However, since profitability is still high, these stocks continue to deliver high dividends. At some point, these dividends may decline. Blue chip stocks last a long time, but they do not last forever.

The Offer

Fortunately, financial firms are suppling new products (ETFs and mutual funds) to keep up with the demand for more sustainable investment options. At the end of 2020, 392 sustainable mutual funds and ETFs were available to U.S. investors, up 30% from 2019 (see chart on next page).[6] This class of funds has experienced a nearly fourfold increase over the past ten years, with growth exploding since 2015. [6]

ESG Fund Universe [6]

Assets within these funds have likewise surged. Globally, since 2016 sustainable investment assets have grown by 50% to $35.3 trillion.[7] Spurred by improving availability, sustainable fund flows now constitute nearly a quarter of overall net flows into U.S. stock and bond mutual funds.[6]

ESG assets are a hot topic in financial media as well. This August, CNBC devoted a program to understanding the role ESG ETFs can play in a portfolio and in society. Sharper Granite advisor Tina Herrera appeared on this program to discuss using a Social-Governance investment product to address gender equality in the workplace in her role as Chair of the National Board of Directors for YWCA USA. The YWCA launched an ETF (ticker: WOMN) three years ago to address gender equality.* [8]

* This is not an endorsement or recommendation of WOMN nor is it a recommendation to include ESG in your portfolio. If you are interested in discussing ESG strategies, please contact your advisor to determine if it is appropriate for you.

Assistance

As discussed in prior newsletters and in response to client interest, Sharper Granite developed a process to maintain intelligent portfolio diversification as ESG strategies are incorporated. With this process, we objectively score funds along each of the three ESG categories to evaluate them for impact and values-based investing. Our methodology then builds custom ESG solutions for clients without significant loss to their portfolio risk-return profile.

These solutions utilize our same stock and bond targets for various risk levels and portfolio size but can substantially improve ESG scores and may be used for partial or total portfolios of any size and risk level. We can also customize for a client's specific value along the three categories of Environmental, Social or Governance.

For existing portfolios, your advisor can utilize sophisticated ESG screening tools to provide an ESG score for your portfolio and its specific holdings. We can then compare this portfolio to a similar portfolio with the appropriate ESG strategy in place. Investing trade-offs, such as cost differences (ESG funds tend to have slightly higher expense ratios), may 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. If you are looking for another way to support causes you care about, consider adding an ESG strategy to your portfolio.

Notes and Acknowledgements:

1. "Are Your Clients ESG Investors?" Morningstar, Based on a nationally representative sample of 948 respondents, April 22, 2019.
2. "Wealthy Investors Seek Purpose-Driven Investments After Pandemic," Michael Fischer and Bernice Napach, *Investment Advisor,* July/August 2021.
3. United Nations Convened Net Zero Asset Owner Alliance, 2019.
4. "What if $2T moves toward net zero emission companies every year?" BlackRock, August 4, 2021.
5. Professor Jeremy J. Siegel, Wharton School of Business at Penn University, Wisdom Tree, August 2021.
6. Sustainable Funds U.S. Landscape Report, Morningstar, February 10, 2021.
7. "Fund Managers Feel the Heat in SEC Crackdown on Overblown ESG Labels," Benjamin Bain and Saigel Kishan, Bloomberg, September 3, 2021.
8. "Women's Equality Day: How one ETF up nearly 20% this year promotes female empowerment," CNBC, ETF Edge, August 26, 2021.