Sustainable Investing

A PROVEN GROWTH STRATEGY FOR INVESTORS

The idea of "doing good" while building wealth is something that dates back to the 18th century in the United States, and in recent years has become increasingly important among both baby boomer and millennial investors alike. The political climate over the last four years was linked to an increase in investment dollars toward strategies that seek to have a positive impact on environmental, social and governance (ESG) matters. Additionally, experts are predicting a further interest in ESG among investors due to President Biden's *Build Back Better* policy.

Whether you are already fully committed to aligning your values with your investments or are unsure how to get started, it's important to draw the distinction that this type of investment strategy is no longer a niche, nor will it have negative financial outcomes. In fact, it has become mainstream. Sustainable investing, or impact investing, is a consideration your advisor likely has thought about — and in most cases — implemented into their strategies already.

A movement in the making

Even though there is much historical evidence of socially responsible investing, as with many movements in this country, the importance of ESG wasn't a priority up until recently. Each generation tends to focus on different social causes, Laurie Kamhi, partner and CIO of New York City-based LCK Wealth, explains. "With every generation, there are new groups that want to bring change or impact change. An important factor to recognize is that even though the baby boomers were marching for equal rights and against the Vietnam War, the technology could only get us so far back then," Laurie says. "The disruption of computers, technology and data analytics in just the past decade has made everyone hyper-aware of the impact their individual actions are having on society and the environment. Data analysis and collection is expected from both a profitability standpoint and other sustainable or social or governance criteria to measure success from both the shareholder and consumer."

Richard Flahive, private wealth advisor and director of research and planning at Harrison, New York-based Hightower Westchester, and Paul Rand, managing director and partner at Newport Beach, California-based The Rand Group, both share similar sentiments.

Richard and Paul — who have been in the industry for 10 years and 20 years, respectively — explained even in the early aughts, they worked with clients who had various restrictions on their accounts such as firearms, fossil fuels, alcohol and tobacco, but the focus wasn't really there back then.

"I considered myself ahead of the curve doing sophisticated financial planning, but it wasn't until one day when a client emailed me to make sure they weren't invested in anything to do with mountaintop removal (MTR), that I really started looking hard at this," Paul says. "After a quick Google search, I was deep into MTR, why it's used, its detrimental environmental impact, and eventually, which companies were involved in both application and financing. This then led to more discussions about different companies' environmental impacts, and ultimately, developing portfolios designed to reduce my clients' carbon impact. The more I learned, the more I wanted to share with those clients who had an interest."

Richard explains he definitely started to see a shift five to seven years ago with the onset of new technologies, echoing Laurie's point. "I think it was due to a combination of factors including more research, data and transparency," he says. "My clients also started asking me more about it. Once this started happening more frequently, I said I need to find out more. I went to a conference in New York that was set at a meditation center — we all sat on beanbags — there were about 75 people there. The next event I went to less than a year later had almost 1,000 people there. To me, that was so telling. I knew socially responsible investing was here to stay."

Additionally, Hightower advisors are all fiduciaries, so taking a close look at ESG just made sense, Richard adds. "The impact side of ESG is the most meaningful to me because there's obviously a clear, defined benefit to society or a positive outcome to making the investment," he says. "In a world where seven out of 10 global risks are associated with ESG factors, I feel it is a fiduciary responsibility to take a look at this."

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The numbers don't lie

A clear movement had begun, but there were still many skeptics when it came to the true financial return on socially responsible investing. Brooke Levey, CFP, planning advisor and client relationship manager at New York City-based LCK Wealth Management, has been integrating sustainable investments into her planning for years.

"As a millennial, I primarily work in financial planning and help clients with everything from cash management needs to buying their first home. And I get this question all the time: How can I be a force of good? How can I incorporate sustainable investing into my portfolio, because I keep hearing that I can't do that without sacrificing my returns," Brooke says. "So, our job [as advisors] is to really educate our clients on the mounting evidence that shows sustainable investing will not negatively affect their return," Brooke says.

The Forum for Sustainable and Responsible Investing (US SIF) published in their 2020 report on U.S. sustainable and impact investing trends that total U.S.-domiciled assets under management (AUM) using environment, social and governance (ESG) strategies grew to $17 trillion out of $51 trillion invested in the in just the past 10 years. This represents one in three dollars of the total U.S. assets under professional management.

More than ever, a large body of academic research has shown that ESG investments perform as well as, or better than, traditional investments. See details on a few of the studies below.

In 2017, **Nuveen TIAA Investments** released *Responsible Investing: Delivering Competitive Performance*. After assessing the leading SRI equity indexes over the long term, the firm "found no statistical difference in returns compared to broad market benchmarks, suggesting the absence of any systematic performance penalty. Moreover, incorporating environmental, social and governance criteria in security selection did not entail additional risk." It added that SRI indexes had similar risk profiles to their broad market counterparts, based on Sharpe ratios and standard deviation measures.

The **Global Impact Investing Network (GIIN) and Cambridge Associates** co-produced a report in 2017, *The Financial Performance of Real Assets Impact Investments.* After analyzing 55 real assets, including timber, real estate and infrastructure, the authors concluded that "risk adjusted market rates of return are achievable in impact investing, as evidenced by the fact that the distribution of impact investing fund returns mirrors the distribution of conventional real asset fund returns..." The report explains the importance of fund selection because of the wide variation in individual fund returns.

Sustainable Investing and Bond Returns is a 2016 report by **Barclays Research**. To study the link between ESG incorporation and corporate bond performance, the team constructed broadly diversified portfolios tracking the Bloomberg Barclays U.S. Investment-Grade Corporate Bond Index. They matched the index's key characteristics but applied either a positive or negative tilt to different ESG factors. Barclays Research found that "...a positive ESG tilt resulted in a small but steady performance advantage..." They did not find evidence of negative performance.

"ESG investing is a fundamental shift in the attitude of people who will soon be controlling the majority of our countries," Brooke adds. "There's a massive wealth transfer from the baby boomers to the millennials and next-gen, and it's mounting to over $68 trillion. We know that the younger generation not only wants to see their investments grow, but grow as a result of supporting businesses that will further a sustainable environment for their children and beyond."

The pressure is certainly on for companies of all sizes. News plays a huge role, Paul adds. "News, particularly bad news, spreads at such an incredible speed these days that companies are being forced to try to get ahead of specific issues before a headline makes their stock price plummet. If doing the right thing long-term hasn't been the driving factor in making decisions, a catastrophic headline will quickly teach companies that valuable lesson."

One example of this was back in 2017 when Under Armour Inc.'s CEO commented that former President Trump was a "real asset" to the country. The comment drew rebukes from the company's own celebrity endorsers, and Susquehanna's Sam Poser downgraded the stock to negative from neutral, according to Bloomberg.

On the flip side, when public perception is positive following a company taking a stance on a social issue, they can reap the rewards. Brooke shares the story of when Colin Kaepernick was hired by Nike to be featured in their 2018 ad campaign. She goes on to explain that it was seen as very controversial at the time because he was being ousted by the NFL for kneeling in protest during the national anthem to take a stand against systemic racism. However, after Nike made the decision to feature Kaepernick, their stock actually soared over 30% that year.

Future of ESG in the US

As Laurie, Paul and Richard all shared, with the amount of data and reporting being done around socially responsible investing, it is easier for investors to find out if a company they are investing in aligns with their personal values. However, it's important to point out that the United States isn't as far along as many other countries when it comes to sustainability goals. "The U.S. is behind. In Europe, things aren't even labeled "ESG" anymore. There's a checklist and it's automatic," Laurie says.

Though the U.S. was one of the last countries to adopt the United Nations' Sustainable Development Goals (SDG), Brooke is optimistic that it can catch up. The SDGs were adopted by all United Nations Member States in 2015 as a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030.

There is more pressure than ever on private and public companies alike in the past four years to step up to the plate in terms of being socially responsible.

"It is interesting to note the increase in ESG interest we've seen during the Trump administration because of its rolling back the Paris Climate Accord and various other social stances," Brooke says. "CEOs of major corporations are stepping up and saying, 'We know it's not really our job to step in and comment on public policy, but we feel we have to speak up at this point.' And that, I think really kind of got the ball moving in this direction."

A question still left, though, is how long will this all take? What does the rate of adoption look like in a country like the United States, already behind on sustainability initiatives?

"I think there are still some people who look at ESG as some sort of black box, or worse, a fad. ESG is really just another lens for looking at how to evaluate investments," says Paul. "Companies will continue to be pressured to publish more data on their board diversity, environmental impact, HR practices, shareholder rights, supply chains, etc., and then data collected on the decisions made around best practices will become even easier to obtain and measure. Those companies who fail to make the best decisions will lose. If you treat the environment poorly, you're not sustainable. If you treat humans poorly, you're not sustainable. If you run a company that tries to suppress what your shareholders are demanding you do, you're not sustainable."

"Who knows what the future will look like under a Biden administration and administrations beyond, but this is not just a trend. This is here to stay for the long run," Brooke adds.

Though many Hightower advisors work at different firms, we are all supported by Hightower's Positive Impact Committee, which educates that strategic impact investing and attractive long-term financial returns are not mutually exclusive.

So, you can feel confident that we are already looking at sustainable investing and how it can be the most beneficial to clients, so if you're interested, please don't hesitate to reach out.