Responsible Investing: An Overview of Strategies and Institutional Considerations

Summit Strategies Group

Michael C. Lauer
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Responsible investing includes a variety of strategies that attempt to align investment portfolios with the beliefs and values that hold importance to investors. These strategies include: Socially Responsible Investing; Environmental, Social, and Governance (ESG) Investing; and Impact Investing. Investors that allocate capital to these strategies desire benefits that are beyond monetary: the alignment of the organization's values with investment portfolio holdings. We have seen an increase in the number and variety of strategies available as more and more institutional investors become involved, and we do not expect to see this trend slowing any time soon.

Section 1

Overview of Responsible Investing Strategies

Responsible investing encompasses various types of investment strategies such as: Socially Responsible Investing (SRI); Environmental, Social, and Governance (ESG); and Impact Investing. These strategies continue to gain traction as investors integrate their organizational mission, vision, and values with investment decisions. Additionally, many asset owners are seeing external pressure from beneficiaries and activist groups to be more responsible stewards of capital.

Socially Responsible Investing (SRI) primarily involves screening out or avoiding industries or specific companies that derive revenue from goods or services which (either directly or by method of production) contradict predetermined social or environmental values. Typical SRI screens may seek to avoid companies that profit from: tobacco, fossil fuels, adult entertainment, contraceptives, defense and weapons, discrimination, predatory lending, or stem cell research. The extent to which these screens are utilized varies and can be customized. Measuring a manager's compliance with this restriction should be transparent: comparing the predetermined list of excluded companies with the manager's holdings.

Environmental, Social, and Governance (ESG) Investing is a framework developed to analyze investments beyond the typical financial or fundamental criteria. To-date, there is no uniform list of ESG factors used by managers to assess potential investments, though there have been attempts at standardization. The table below identifies examples of key issues in each pillar (E, S, and G).

Environmental	Social	Governance
Climate Change	Community/Consumer Relations	Accountability
Energy Usage	Controversial Business	Board/Leadership Structure and Size
Raw Material Sourcing	Diversity Issues	Bribery and Corruption
Supply Chain Management	Health and Safety	Executive Compensation
Waste and Recycling	Human Rights	Shareholder Rights
Water Management	Union Relationships	Transparency

Supporters believe that ESG issues provide insight into potential company and/or industry specific long-term risks or opportunities, which can be capitalized on during the evaluation of a security. The premise is that companies who are better stewards of ESG concerns should provide better long-term, risk-adjusted returns. While SRI strategies screen out investments, ESG typically does not utilize screens to limit the investable universe so much as it applies the ESG factors as another tool to determine the best securities to purchase.

Managers can introduce these ESG factors into their investment process in a variety of ways. There are passive options, where managers utilize third-party (for example, MSCI and/or Sustainalytics) ESG ratings in their security selection process with the intent to produce similar returns to a benchmark while maintaining higher weightings to companies with better ESG profiles. Investment managers can also integrate third-party or proprietary ESG scores/ratings (quantitatively and/or qualitatively) into their security selection process. These processes can include industry and sector analysis (i.e. identifying sectors with the most and least attractive ESG profiles) and/or the identification of companies that exhibit positive ESG characteristics on a sector-relative or absolute basis.

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Oftentimes managers will even invest in a particular theme or niche that resonates and aligns with a client's more narrow or focused goals, such as clean water or green energy.

TAKE-AWAY: Responsible investing is a method of aligning investment portfolios with the beliefs and values of investors. The variability of these values and beliefs combined with a lack of standardized ESG and Impact factors makes for an incredibly large spectrum of investment options. Asset owners should understand and define their beliefs and values prior to determining appropriate investment options. They can then best assess products that conform to these values or utilize a customized solution that meets their specific criteria.

Impact Investing explicitly focuses on positively influencing social and environmental causes through investment. This is accomplished primarily through direct private and focused investments that benefit a specific (regional or local) cause (i.e. affordable housing or water preservation/purification enterprises). Some managers attempt to apply this same premise when investing in public companies, measuring the impact their holdings have on a particular theme. Investment managers can also attempt to make an impact by taking activist positions in public companies with the goal of changing how a company is managed. This is typically conducted by voting shareholder proxies in a manner consistent with the investor's moral or social beliefs. Similar to ESG investing, managers can choose to implement this in various ways as long as the impact aligns with investor goals.

Section 2: Performance Considerations

Institutional investors considering these strategies are typically seeking non-financial collateral benefits without a deterioration of risk-adjusted returns.

Risk/Return Profile

It is difficult to make broad statements when assessing the risk/return profile of these strategies given the variety and customized nature of the mandates described above as well as the short track record of most products. Academic research varies greatly on the results of the long-term performance associated with these strategies. However, we believe that placing constraints on a mandate may reduce the risk-adjusted excess return potential – with shorter-term results being dependent upon the timing of the assessment. The constraints or more narrow universe in which a manager can select stocks directly impacts SRI strategies, because constraints/exclusions are clearly defined by the manager or asset owner. ESG and Impact strategies have implied constraints, which also innately exclude various companies from selection. These managers hope to tap into additional aspects about the company that are not traditionally measured which may affect future performance; however debate remains as to whether utilizing ESG and/or Impact factors either creates or destroys value.

An example can be seen when comparing performance of the S&P 500 Energy Index (all energy names within the S&P 500), directly with performance of the S&P 500 Index. Comparing returns shows that inclusion of these names benefited the Index in 2010 and 2011 and detracted from performance in 2014 and 2015. We believe this premise can be applied fairly universally: an explicit constraint placed on a mandate (used in SRI strategies) may help during some periods and hurt during others (from a risk/return perspective). However, longer term, constrained managers do not have the opportunity to extract excess return from these stocks when valuations look compelling or divest of them when they are potentially overpriced. Therefore a broad performance-related statement may be highly biased depending on market cycle and when performance is measured.

	2008	2009	2010	2011	2012	2013	2014	2015
S&P 500 Energy	-34.9%	13.8%	20.5%	4.7%	4.6%	25.1%	-7.8%	-21.1%
S&P 500	-37.0%	26.5%	15.1%	2.1%	16.0%	32.4%	13.7%	1.4%
Excess Return	+2.1%	-12.7%	+5.4%	+2.6%	-11.4%	-7.3%	-21.5%	-22.5%

Collateral Benefits

A commonality among institutional investors that have adopted these strategies is the desire to obtain benefits other than return: qualitative non-performance related benefits. Examples might be:

- Confidence that a plan sponsor is not an equity owner of a casino company.
- Assurance that investments in the energy sector are in companies that focus on renewable energy (or at a minimum energy industry best practices).
- Mission-alignment with investments in loans that subsidize low-income housing.

As many of these strategies are relatively new with limited track records, investors should value these additional "collateral" benefits before pursuing this type of strategy.

TAKE-AWAY: From a pure performance perspective, there are contradicting views on whether responsible investing adds or detracts value. Investors should value the non-performance-related collateral benefits while understanding that performance may be impacted.

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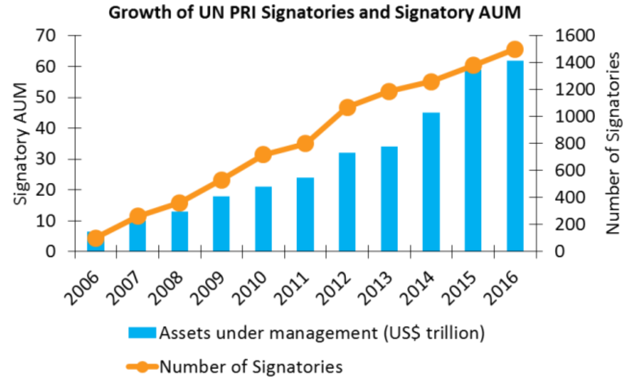
SECTION 3: ASSET OWNER INVOLVEMENT

The acceptance of responsible investing by plan sponsors and investment managers has grown significantly over the last few years, as many have adopted the United Nations Principles for Responsible Investment (UN PRI), which promotes research and education around these strategies. Early in 2016, there were 1,400+ signatories, including Summit Strategies Group, associated with the investment community around the globe. As can be seen on the right, the number of signatories and assets represented have grown significantly since UN PRI's inception in 2006. As more and more asset owners become involved with these strategies, investment managers will continue to develop and refine strategies that align with a variety of asset owner perspectives and values.



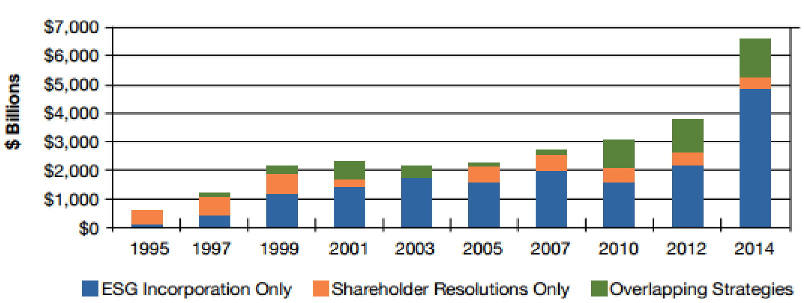
Responsible investing is a more mature segment of the market in Europe than it is within the US. As such, asset class coverage and product availability is moderately greater overseas. The composition of UN PRI asset owner signatories confirms this as six of the top ten countries represented are in Europe and account for about 45% of the total signatory count as of early 2016. An earlier 2014 study by the Global Sustainable Investment Alliance also shows that as of the same year, about 64% of assets managed responsibly were European.

Percent of Global Assets by Region Invested in Responsible Investing Strategies *(Global Sustainable Investment Alliance, 2014)*	
Europe	63.7%
United States	30.8%
Canada	4.4%
Australia/New Zealand	0.8%
Asia	0.2%

For US investors, more adoption will lend itself to more practical options. While Europe has a larger percentage of assets invested, US involvement has progressed greatly. As shown below, US investments in these strategies have grown from around $3 trillion in 2010 to just over $6 trillion in 2014 (as reported by the US Sustainable Investment Forum). These assets are held by a broadly diversified group of 1,668 US institutions. Also shown in the chart below, some have focused more on shareholder resolutions, looking to change company behavior, while others have focused solely on investing in those companies that align with an ESG ideal. As recent growth would indicate, institutional investors have clearly taken an interest in these strategies and are taking a variety of approaches to integrate responsible investing ideals into their investment programs.

This trend will likely increase as many stakeholders (asset owners, investment managers, and service providers) continue to dedicate vast resources to develop and promote these strategies. The industry is evolving rapidly as assets are pouring into responsible investing products.

Sustainable and Responsible Investment in the US 1995-2014



SOURCE: US SIF Foundation.

TAKE-AWAY: As internal beliefs and external pressures encourage investors to make a positive societal difference in their communities, state, country and/or the world, the overall growth and demand for responsible investing is likely to continue. With momentum around these strategies and increasing involvement from a variety of stakeholders, the availability of products will continue to grow, allowing asset owners greater ease of entry into the space.

ADDITIONAL CONSIDERATIONS

These strategies align with a particular type of investor who believes that the missions of these strategies align with the organization and sees value in the collateral benefits. Asset owners must consider their beneficiaries and benefactors, both from a legal fiduciary perspective and from a public relations perspective. This strategy is proving not to be just a fad or trend, and we believe it is around for the long term.

Michael is a consultant to a variety of clients, and has led recent efforts at Summit directed toward enhancing responsible investing capabilities.