



SUSTAINABLE
INVESTING:
A FORCE FOR
POSITIVE
CHANGE

Introduction

Sustainable investing is a force for positive change. While terminology may differ, sustainable investing is an approach that incorporates **environmental, social, and corporate governance (ESG)** issues when building an investment portfolio, while encouraging companies to improve their ESG risk-management practices. Interest in sustainable investing continues to grow, which can be measured by the remarkable growth in total assets under management (AUM) of more than \$30.7 trillion (1). In the process, sustainable investing has changed the investment industry, improved companies, and helped communities. These extraordinary outcomes are aligned with the basic intention of sustainable investing: to build wealth responsibly without sacrificing investment principles.

1: Global Sustainable Investment Alliance, "2018 Global Sustainable Investment Review (2018)."
<http://www.gsi-alliance.org/trends0report-2018/>

Changing the Investment Industry

Sustainable investing has improved the investment industry by challenging and then adapting the traditional investment decision-making process. This effort evolved slowly at first, starting when the Pax World fund, which excluded manufacturers of weaponry from its portfolio, launched in 1971 and became the first sustainable investing mutual fund.

Other large investors began to follow Pax, and instances of divestiture grew, as manufacturers of tobacco and companies with operations in Apartheid-era South Africa were removed from investment portfolios. **Divestiture, or excluding securities from an investment universe on the basis of standards and norms, is the oldest sustainable investing method.**

By the late 1980s, two small companies emerged to carry the transition beyond just divestiture. Both companies began gathering data that allowed investors to build an investment universe on the basis of a company's ESG data and then compare this data relative to peers, which ultimately merged "value-driven investors" with "values-driven investors."

Value(s)-driven investors. In 1985, Innovest Strategic Value Advisors, Inc. (Innovest) began using proprietary analytics to uncover hidden risks and value potential in companies that conventional investment analysis could not detect, a focus commonly desired by value-driven investors.



In 1988 Kinder, Lydenberg, Domini & Co. (KLD) was founded with a mission to remove barriers to socially responsible investing and influence corporate behavior. In 2010, MSCI purchased both Innovest and KLD, forming MSCI ESG Research, which has become the world's largest ESG-rating data source. It currently provides ratings on 7,500 companies and more than 650,000 equity and fixed income securities (2).

While Innovest, KLD, and other similar companies were collecting ESG data, actual use of the “ESG” term didn't appear until a 2004 United Nations Global Compact report titled, “Who Cares Wins: Connecting Financial Markets to a Changing World.” The report sought to “develop guidelines and recommendations on how to better integrate environmental, social and corporate governance issues

in asset management, securities brokerage services, and associated research functions (3). In 2005, the United Nations Environmental Program's Financial Initiative's (UNEP-FI) “Freshfields Report” discussed the financial relevance of ESG data and the concern of fiduciary duty in the use of ESG data in the investment decision-making process (4). This concept was later updated to state that “the fiduciary duties of investors require them to incorporate ESG issues into investment analysis and decision-making processes, consistent with their investment time horizons” (5).



2: <https://www.msci.com/esg-ratings>

3: https://www.unglobalcompact.org/docs/issues_doc/Financial_markets/who_cares_who_wins.pdf

4: Freshfields Bruckhaus Deringer and United Nations Environment Programme Finance Initiative, “A Legal Framework for the Integration of Environmental, Social, and Governance Issues into Institutional Investment” (2005).

http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

5: United Nations Global Compact, UNEP Finance Initiative, PRI. “Fiduciary Duty in the 21st Century.” 2019.

These two reports became foundational pieces of the UN-backed “Principles of Responsible Investment (PRI),” which was launched in 2006. The initial group of 18 signatories (6) has evolved into a thriving global initiative with more than 2,400 members representing over \$86 trillion in AUM.

The UN-backed PRI’s role is to advance the integration of ESG issues into the investment decision-making process, following a set of six investment principles listed on the following page.



6: Original signatories include: Amalgamated Bank, Amundi, Aviva Investors, Bank J. Safra Sarasin Ltd. BNP Paribas Asset Management, BMO Global Asset Management, British Columbia Investment Management Corporation, Calvert Research and Management, Daiwa Asset Management Co. Ltd, Domini Impact Investments, Generation Investment Management LLP, Groupama Asset Management, Hermes Investment Management, Insight Investment, Janus Henderson Investors, Mitsubishi UFJ Trust and Banking Corporation, Sumitomo Mitsui Trust Asset Management, Threadneedle Asset Management Ltd.

ESG Investment Principles

Environmental, Social, and Corporate Governance

1

Incorporate ESG issues into their investment analysis and decision-making processes

2

Be active owners and incorporate ESG issues into their ownership policies and practices

3

Seek appropriate disclosure on ESG issues by the entities in which they invest

4

Promote acceptance and implementation of the Principles within the investment industry

5

Work together to enhance their effectiveness in implementing the Principles

6

Each report on their activities and progress toward implementing the Principles.



ESG Incorporation

With more investors adopting the UN-backed PRI and increased ESG data availability, ESG issues increasingly are being considered when building an investment portfolio. This sustainable investing process, known as ESG incorporation, can be applied using a combination of three primary strategies:

Integration

Involves the explicit and systematic use of ESG issues in investment analysis.

Screening

Involves the application of filters to a list of potential investments based on investor preference and includes both negative/exclusionary and positive/best-in-class screening.

Thematic

Involves the use of traditional financial analysis coupled with an intention to contribute to a specific ESG outcome and includes sustainability-themed and impact/community investing.



Improving Companies & Communities

Sustainable investing has positively changed companies through the practice of **shareholder engagement**, which encourages **more responsible corporate practices while discouraging corporate practices that may lead to increased exposure to risk**. While the growth of shareholder engagement began in the mid-1970s, it wasn't until it was codified in the UN PRI that shareholder engagement really took root. Since then, shareholder engagement has been a driver behind some significant corporate policy changes, including increased corporate disclosures, a key element in the ESG integration process. In addition, recent research illustrates that shareholders that engage with companies on ESG issues can create value for both investors and companies by exchanging information, producing and diffusing knowledge, and building relationships (7).



Sustainable investing also has positively changed communities through community-oriented investing, which **brings capital directly to underserved communities**, such as low-income neighborhoods and rural communities, that conventional markets do not reach. It also involves delivering explicit social benefits, such as affordable housing and small business loans, using an investment product that can be managed for risk and return. Community investing can be accomplished primarily through cash, fixed income, and private equity asset classes.

7: <https://www.unpri.org/academic-research/how-esg-engagement-creates-value-for-investors-and-companies/3054.article>

Next Steps

Sustainable investing will continue to be a force for positive change in the investment industry, corporations, and our communities.

Understanding the sustainable investing impact can help you better understand where and how your money is invested.

Prior to considering investment options, you may want to consider your motivations for sustainable investing. Identify the ESG issues that most resonate with you. This process will help you learn more about the issues and help you narrow down and identify investment services that best match your investing principles.

At Golden Pond, we apply our research process and asset allocation models to ESG portfolios. Investments must meet both our traditional and ESG screening criteria to be used in a sustainable portfolio.

Although ESG investing has skyrocketed in popularity in recent years, our experience in this area dates back 25 years. If you are interested in learning more about how ESG investing might work for you and your family, please contact our office at (207)873-2200.



IMPORTANT DISCLOSURES

This material is for general information only and is not intended to provide specific advice or recommendations for any individual. There is no assurance that the views or strategies discussed are suitable for all investors or will yield positive outcomes. Investing involves risks including possible loss of principal. Any economic forecasts set forth may not develop as predicted and are subject to change.

Sustainable investing is subject to numerous risks, chief amongst them that returns may be lower than if the financial professional made decisions based only on investment considerations.

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Alternative investments may not be suitable for all investors and involve special risks such as leveraging the investment, potential adverse market forces, regulatory changes and potentially illiquidity. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

Investing in mutual funds involves risk, including possible loss of principal. Investors should consider the investment objectives, risks, charges and expenses of the investment company carefully before investing. The prospectus and, if available, the summary prospectus contain this and other important information about the investment company. You can obtain a prospectus and summary prospectus from your financial representative. Read carefully before investing.

