ESG 2020:
THE DECADE OF SUSTAINABILITY

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The decade started with a new evolution in ESG investing

PAST

PRESENT

FUTURE

One Dimensional Investment Process

- Negative screens
- Exclusionary portfolios
- Targeted or thematic investing (i.e. – renewable energy or board diversity)

Two Dimensional Investment Process

- Negative screens
- Exclusionary portfolios
- Targeted or thematic investing (i.e. – renewable energy or board diversity)
- **Best/worst performer by sector**
- **Risk adjusted or ESG factor investing**
- **Informed by 3rd party ESG and sustainability analytics**

Three Dimensional Investment Process

- Negative screens
- Exclusionary portfolios
- Targeted or thematic investing (i.e. – renewable energy or board diversity)
- Risk adjusted or ESG factor investing
- Informed by 3rd party ESG and sustainable analytics
- **Robust data driven analyses**
- **Multifactor analysis across environmental, social and governance factors across time**
- **Incorporating the "new balance sheet" alongside financial factors in investment analysis**
- **Multiple data sets inform theses**

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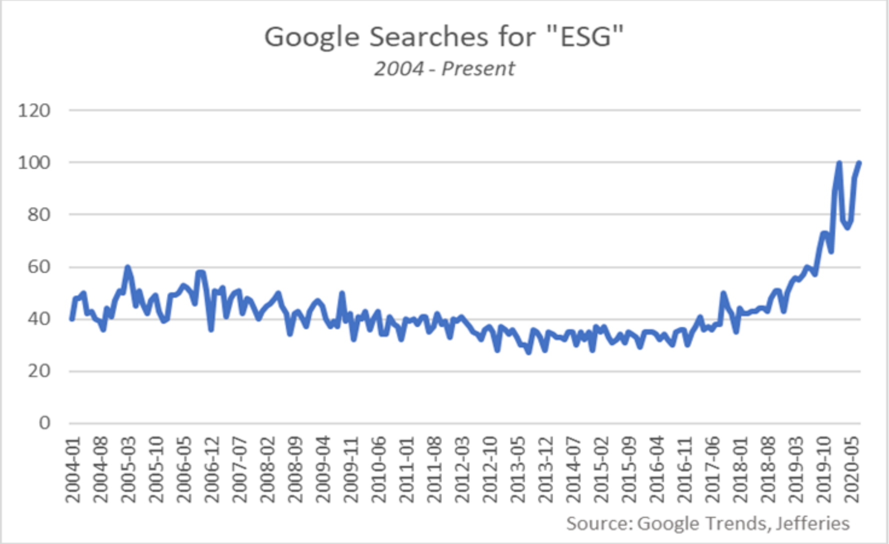
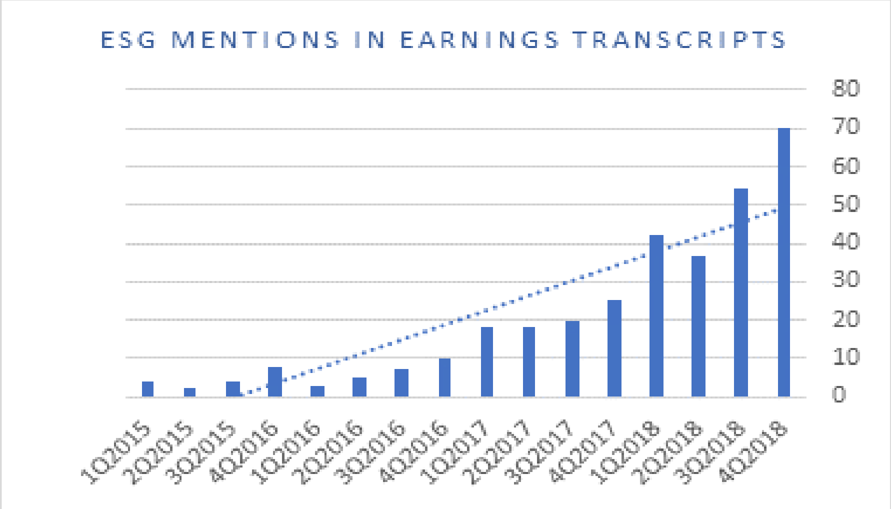
The interest is there…



Source: Google Trends



Source: AlphaSense

- ESG investing has been around for decades in various forms
- But now for the first time, various secular trends are converging – **creating an explosion of interest from investors, companies *and* consumers**
- At the broadest level, there has been a step change in Google searches for ESG investing globally
- Even more compelling?
  - Companies *themselves* are addressing these topics in their earnings calls. Through the end of 2018, there was growth **across the board and across sectors**
- Half way through 2020, we **continue to see an acceleration of companies discussing ESG, but particularly through the lens and language of 'sustainability'**
  - A recent NYU Stern study reveals: "The most recent earnings season has been different, driven, at least in part, by the impacts of the Covid-19 crisis…**As a result, ESG content has been a feature of more [earnings] calls**…This increase in ESG content in earnings calls amidst the Covid-19 crisis extends and accelerates recent trends in ESG disclosure. **More ESG information is appearing with greater frequency in proxy statements, 10-Ks, and across a variety of other disclosure formats like investor day presentation.**"[1]
- A recent CFA Institute survey reveals **52% of respondents believe ESG *and sustainability* disclosures should be mandatory for companies**[2]
- But is this all talk….or typing, as in the case of the Google searches?

1. ESG and the Earnings Call: Communicating Sustainable Value Creation Quarter by Quarter. Kevin Eckerle, Brian Tomlinson and Tensie Whelan. NYU Stern and the CEO Investor Forum. May 2020. Available at: https://cecp.co/wp-content/uploads/2020/05/CECP_ESG-and-the-Earnings-Call_FINAL.pdf

2. The Case for Quarterly and Environmental, Social and Governance Reporting. Mohini Singh, ACA and Sandra Peters, CFA, CPA. CFA Institute. 2019. Available at: https://www.cfainstitute.org/-/media/documents/survey/financial-reporting-quarterly-and-esg-2019.ashx

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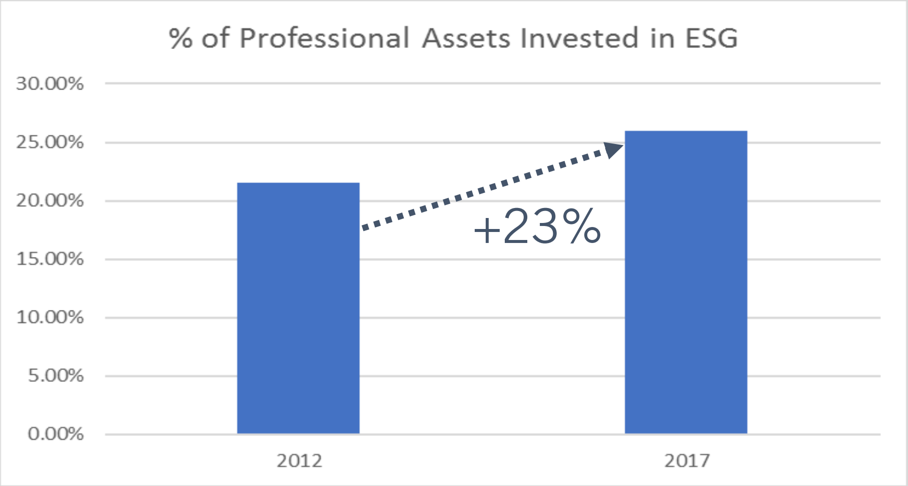
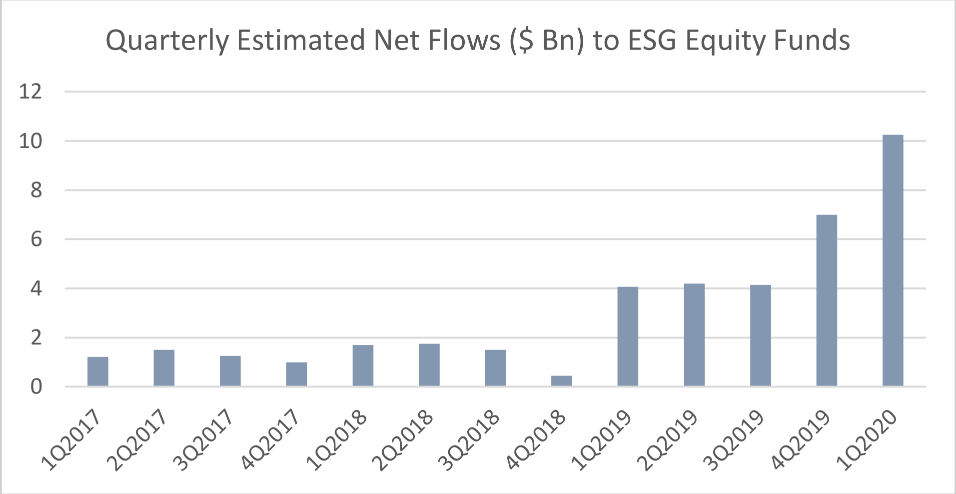
And assets have followed – across asset classes



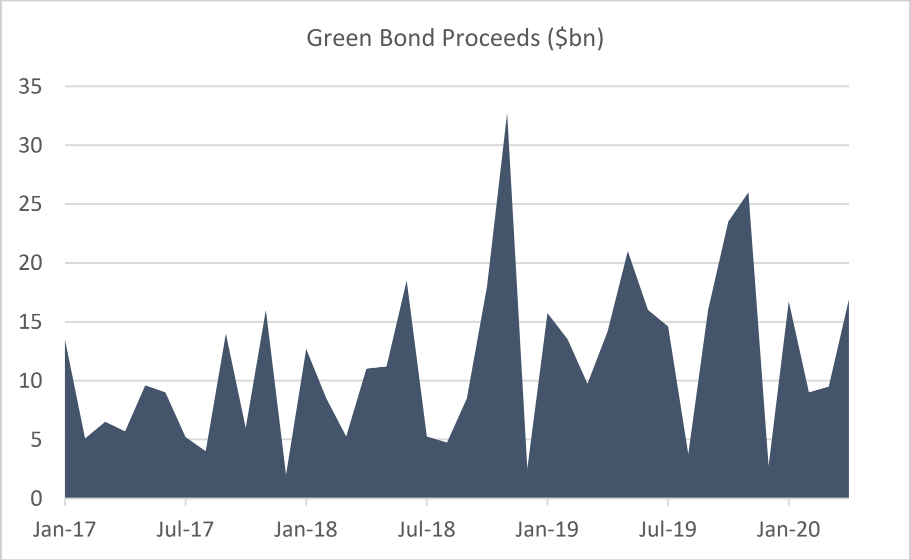
Source: SRI

OVERALL



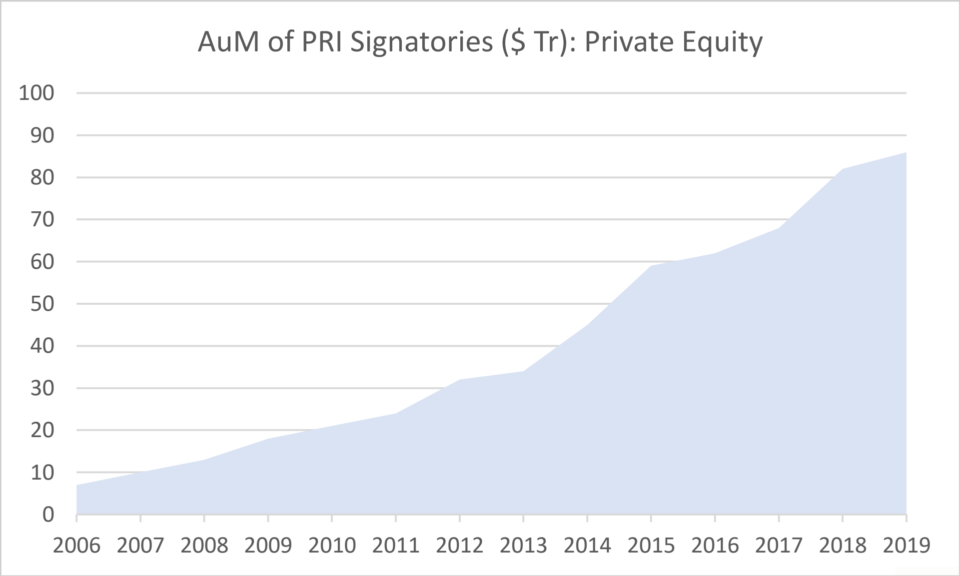
Source: Morningstar

EQUITIES



Source: Refinitiv

FIXED INCOME



Source: Bain

ALTS/
PRIVATE EQUITY

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Why does this matter

- For the first time in decades, there's material growth across the board and asset classes around sustainable vehicles. So we are seeing interest translate into assets – **across diverse asset classes.**
- Top level – in the 5 years between 2012 and year end 2017 - there was a more than 20% growth in terms of total global assets managed, and **some estimates today report almost a third of global assets are in some form of sustainable products**.
- Equities have been the biggest beneficiary to date – ESG/sustainable assets were accelerating before 2020 and Morningstar reports this year, demand has kept pace. For the first time **more than $10 billion flowed into ESG/sustainable equity vehicles in a single quarter in the U.S. and a multiple of this in other regions.**
- Fixed income – also on the upswing but a little less further along than Equities. Growth has been in Green or Climate related ETFs and Green Bonds or Green Bond Funds
- And then alternatives, which has been even slower mover is starting to grow materially.
- For the first time, we are witnessing ESG/sustainability focused hedged and PE funds launching on a quarterly basis.
- The numbers are still small, but are in partial response to LP requests and interest.
- The critical point about this is the diversity of products, themes and vehicles trying to address appetite for sustainable options.
- ESG has been around for decades, what finally translated interest into considerable interest, and finally asset flows?

ESG/sustainability benefitting from three secular trends

1 — INVESTOR APPETITE

- Rising demand for sustainable vehicles
- Across asset classes, sectors and regions
- Driven in part by regulatory change (particularly the SFDR in Europe)

2 — DATA AVAILABILITY

- Companies starting to report waste, water and carbon metrics themselves
- Enhanced ability to harness and analyze third party data (i.e. EPA, local news stories, etc.)
- Harmonization of long standing third parties (SASB/GRI)

3 — PRODUCT DIVERSIFICATION

- Asset managers, private equity funds and hedge funds all looking to meet demand
- In exploration and education phase
- Better analytics tools available for portfolio and performance attribution

ESG Funds Setting a Record Pace for Launches in 2020

Here's a look at some intriguing new sustainable funds so far this year.

SASB, GRI to help users understand similarities, differences of standards

MARKETS

Sustainable investing is set to surge in the wake of the coronavirus pandemic

July 02, 2020 01:25 PM

Global ESG-data driven assets hit $40.5 trillion

Source: Morningstar, Pensions & Investments, CNBC and Pensions & Investments, respectively

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Why does this matter?

WHAT

- Growth in ESG/sustainability interest AND assets

WHY

- Rising interest by investors, companies, & consumers is building a new decade of demand for sustainable products

CONTEXT

- Growing regulation (esp. from the EU)
- Increasing calls for transparency and reporting
- Harmonization of sustainability standards

OUTCOME

Acceleration of sustainability focus across asset classes, much like passive experienced last decade

Growing inflows from an increasingly diverse mix of institutional investors

Extreme proliferation of ESG and ESG-adjacent products

Increasingly nuanced thought processes behind ESG investing strategies

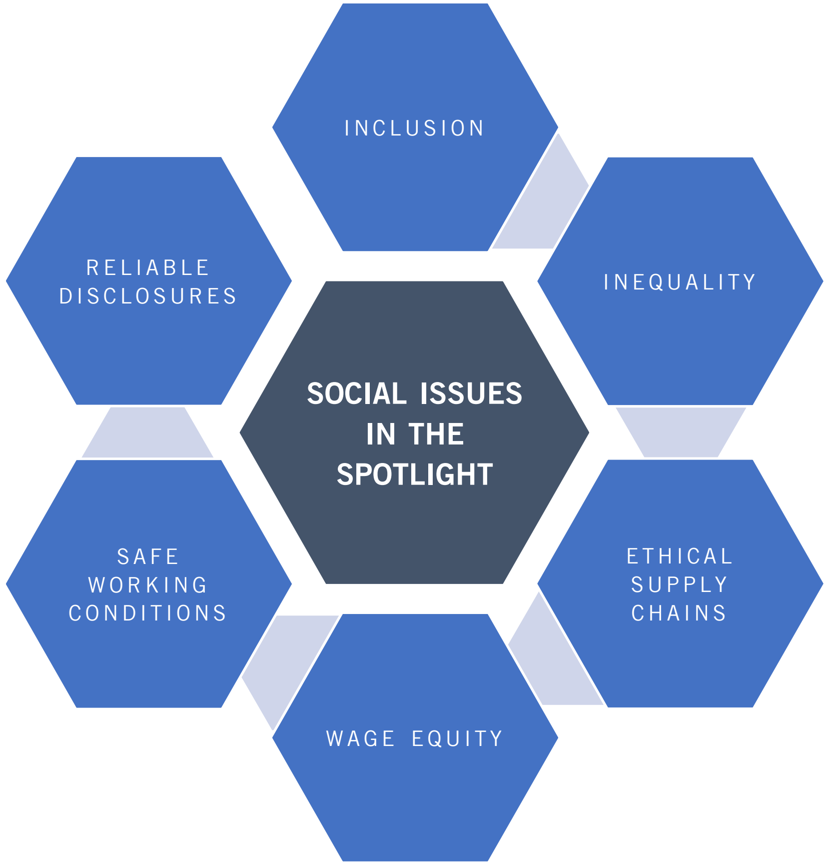
IMPACT

Managers will need to clearly and compellingly define their specific strategy in what is a very broad topic

Increasing onus on issuers to measure, collect, and provide data around various E, S, and G metrics

Impact of Covid-19

- As with most things in 2020, it's too early to be definitive on lasting trends – given the unprecedented nature of this year's events
- But looking at the data **we do have**, what is apparent is that **ESG/sustainable investing have not been penalized halfway through 2020**
  - Asset inflows have largely **persisted, and in some cases, have accelerated**
  - And **diverse products and vehicles continue to come to market**
  - **Investor appetite continues to grow**, with about 15% of investors currently exploring sustainable vehicles in the alternative investment space
- By most measures of industry health: asset growth, asset retention, and product diversification – it is apparent that ESG/sustainable investing is not only on investors' radars, but in many cases are growing as potential avenues for asset allocation
- **But perhaps the most material shift from Covid-19, other than the endurance and continued growth of assets, is the elevation of social issues and themes into investment processes.** Once left as an input for risk management – we are increasingly hearing from allocators and managers alike that data around questions including worker pay and retention, diversity and inclusion and ethical supply chain management are entering investment decisions.
- **Covid is a magnified (near cartoonish) case study in how governance, workplace safety, and robust contingency planning are crucial to business success.** Especially amongst many SMID caps, **having a plan for this exogenous market shock made the difference between bankruptcy and survival**. This is the ultimate use case for ESG. While a company's financials help us understand how it'll react to fiscal/monetary shocks, **there's often more to the story**



What may lie ahead?

Improved data is going to change everything

Just as standardized balance sheets changed how companies are analyzed – the coming deluge of environmental, social and governance data will change how investors view organizations

Companies themselves are rethinking transparency and disclosures – particularly as related to TCFD, SASB and GRI.

“ESG Reports” are so last decade. Companies are considering how to best reflect accurate measures of different environmental, social and governance metrics. Glossy reports with photos of company do-gooding are already out of date.

There is a very real diversification of revenue streams happening in companies that are seen as “old line” and out of step.

Particularly in the extractives industry, many firms are exploring how to diversify their businesses away from revenue streams seen as archaic.

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