PLANNING ESSENTIALS

Sustainable Investing

Align your investments to your principles

The concept of aligning investments to a person's values is by no means a new idea. From the earliest days of the stock market, individuals and groups have looked for ways to exclude various 'sin' stocks, such as gambling enterprises, alcohol and tobacco producers, and gun manufacturers, from their investment portfolios.

In recent years, however, there has been a radical departure from this approach. Rather than punishing companies that are deemed morally or ethically undesirable, many of today's more savvy investors are instead seeking to incentivize and reward forward-thinking companies that commit to exhibiting positive environment, social, and governance (ESG) behaviors.

This approach has resulted in an explosion in the number of mutual funds and Exchange Traded Funds (ETFs) focused on ESG and values-based investing—with a multitude of new approaches offering unique areas of focus and emphasis.

Popularity of ESG Investing

- Global ESG assets recorded 16.0 billion—the highest inflows of the year.[1]
- Here in the U.S., the number of ESG funds reached 4.3 billion at the end of Q4.[1]
- As a whole, U.S. sustainable funds rose by 6.3% from the end of 2023.[1]

A survey conducted in the first half of last year found that 61% of asset owners in North America said that ESG has become more material in the past five years.[1]

Carrots rather than sticks

Several factors impact an investment's ESG score, including the company's greenhouse gas emissions, resource depletion, working conditions, workforce diversity, philanthropy, board diversity, and transparency as well as overall perceived corporate ethics. While not precise measures like sales or earnings, these factors help to gauge a particular company's long-term economic sustainability relative to their peers.

When assessing potential investments, however, it's important to realize that companies will rarely fit neatly into either a 'responsible' or 'irresponsible' ESG box. For example, an extremely eco-conscious, environmentally-friendly (high 'E' score) business might have a relatively poor history of workforce diversity (low 'S' score). Conversely, a company with an excessive carbon footprint (low 'E' score) could be leading the way in giving back to their community (high 'S' score).

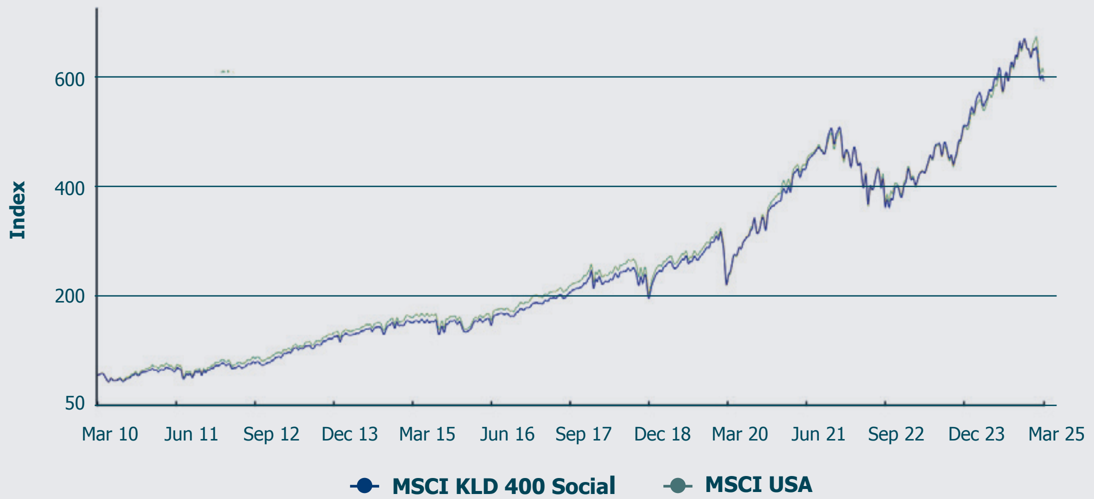
Therefore, you'll need to prioritize exactly which ESG factors are most important to your personal definition of social responsibility before you can select investments that best align with your social values.

You don't have to sacrifice performance

When it comes to socially-responsible investing, there's a common misconception that when pursuing a sustainable ESG strategy, investors have to be willing to accept significantly reduced returns. It's a perception, however, that's based on outdated approaches where screening out undesirable stocks served to significantly reduce the universe of potential investments.

More recent studies, on the other hand, show that there may be a **positive** correlation between a company's performance on ESG metrics and its overall financial performance. As depicted in the chart below, a 20-year comparison of the MSCI KLD 400 Social Index (a capitalization weighted index of 400 U.S. stocks with outstanding ESG ratings) and the MSCI USA Investable Markets Index (a broad measure of the large, mid and small cap segments of the US market) shows a steady level of outperformance for those companies with high ESG scores.

Cumulative Index Performance - Gross Returns (MAR 2010 - MAR 2025)[2]



Past performance is no guarantee of future results. An investor cannot invest directly in an index.

You can count on ESG's proven staying power

Since ESG investing's humble beginnings about 20 years ago, the demand for socially conscious investing has grown substantially, making ESG investments a staple in many portfolios.

Global initiatives, like the UN Global Compact, the Paris Climate Accord and the UN Sustainable Development Goals, gave ESG initiatives a global platform that continues to influence investors.

Interest in ESG is growing exponentially as investors become more conscious of the impact climate change, poverty, and inequity have on organizations, communities, and society. Climate change serves as a primary motivator for investors seeking to make a positive impact.

"As the planet warms, and as younger consumers and investors make sustainability a priority, ESG has never been more financially relevant."[3] Consequently, growth in ESG investments outpaced its traditional counterparts in 2023.[3]

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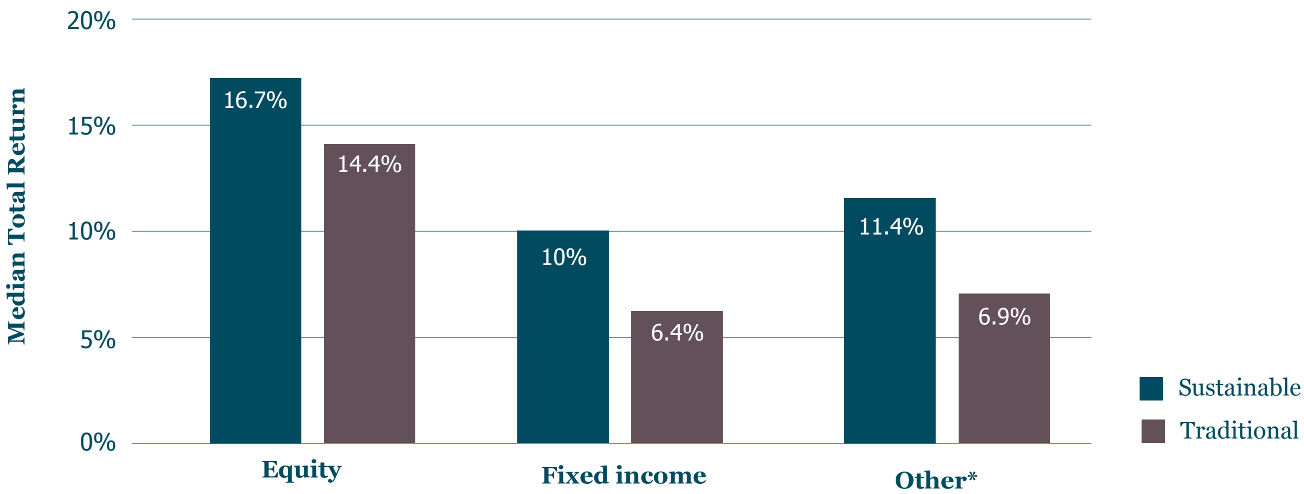
Sustainable Funds Outperformed Across Asset Class 2023[4]



Even the occasional studies that still suggest there's a small sacrifice in return potential associated with sustainable investing are generally inclined to acknowledge the relative insignificance of that performance gap when weighed against the opportunity to measurably improve the well-being of our planet and positively impact the lives of countless individuals and communities.

ESG strategies may rely on certain values-based criteria to eliminate exposures found in similar strategies or broad market benchmarks, which could result in relative investment performance deviating. There is no assurance ESG strategies will result in more favorable investment performance.

Looking ahead

ESG investing is by no means a trend of the moment—rather, it is a strategy that is here to stay. For most of the 61% of assets owners in North America that think ESG has become more material in the past 5 years also feel that ESG aligns with fulfilling their fiduciary duty. Also, as assets continue to flow into ESG-focused ETFs and mutual funds, what used to be a simple either/or choice (invest for profit or invest to make a difference) is increasingly encompassing a wide range of new and innovative opportunities.

[1] Noemi Pucci. "Global ESG Fund Flows Increase in Q4." Morningstar. https://www.morningstar.com/sustainable-investing/global-esg-fund-flows-increase-q4.

[2] MSCI. MSCI KLD 400 Social Index (USD) Fact Sheet. February 2025. https://www.msci.com/documents/10199/904492e6-527e-4d64-9904-c710bf1533c6.

[3] Leah P. Norton and Charity Blue. ESG Turns 20: A Brief History, and Why It's Not Going Away, June 2024. June 21, 2024. https://www.morningstar.com/sustainable-investing/esg-turns-20-brief-history-why-its-not-going-away.

[4] Morgan Stanley Institute for Sustainable Investing's analysis of Morningstar data as of February 9, 2024, and as reflected in the full report, Sustainable Reality: Sustainable Funds Show Continued Outperformance and Positive Flows in 2023 Despite a Slower Second Half. https://www.morganstanley.com/ideas/sustainable-funds-performance-2023-full-year. Other includes multi-asset, property, commodities and alternative fund types.

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