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Part 1: What is SRI/ESG investing?

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People have long had the ability to express their personal values by choosing to do business with or invest in companies whose products or services they trust, and feel are well aligned with their interests.

Even well before stock and bond markets evolved to today's complexity, people were able to direct their money at or away from specific themes or causes. The Quakers were among initial proponents of exclusionary investing by avoiding any businesses related to the slave trade. Other investors have had various preferences for avoiding businesses tied to perceived sins. More recently, investors have chosen to not be involved with companies that did business in South Africa during apartheid or Sudan and Iran. In the past couple of years, forms of "responsible" investing have advanced at a rapid pace partly in response to the Trump Administration pulling out of the Paris climate agreement among other policy changes.

According to the U.S. Forum on Sustainable Investing 2018 Trends Report, investors now consider issues other than profit across $12 trillion of professionally managed assets. This is a 38% increase since 2016 and represents about one out of every four dollars under professional management in the United States. The U.S. is not the leader in SRI/ESG investing, however. Europeans direct more money to these strategies.

What exactly it means to invest this way is up for interpretation as there is no "one-size-fits-all" definition or application of responsible investing.

In the 1970s and 80s, when a few niche investment firms targeted an alternative way to invest, the term was Socially Responsible Investing (SRI). This still generally applies but has evolved in many cases to focus on Environmental, Social and Governance (ESG) investing.

Either way, the expectation is to apply investment selection that seeks to "maximize financial return while simultaneously advancing an idea, belief, or cause that is important to the individual investor, with the hope of changing the world for the better." This is the definition provided in the Chartered SRI Counselor™ program that I completed in March.

While much emphasis is placed on avoiding fossil fuels or sin stocks (e.g., alcohol, tobacco, pornography, gambling, weapon), the ESG landscape is broader than that. Some investors are more concerned with gender diversity among boards of directors or executive management teams. Others care more deeply about political contributions and lobbying efforts or labor rights.

The following ESG wheel covers the varied topics that investors consider when evaluating a company's contributions to the greater good and whether or not they would like to buy their stock or bonds.

Source: College for Financial Planning: CSRIC Curriculum

More individuals have taken matters into their own hands to invest in and support companies they view as making contributions to a better world. We have seen investors vote with their cash flow into these types of investments. This is especially true for millennials and women when steering their invested dollars. In a 2017 paper, Morgan Stanley noted that 71% of individual investors and 87% of millennial investors have expressed an interest in investing using SRI strategies.

One of the challenges of a financial planner and investment advisor is to determine what investments someone has conviction for and what they will trust and stick with through various market conditions rather than chase whatever the most recent performance leaders were.

With an SRI/ESG strategy, investors are expressing personal values (not just profit-seeking preferences) and it can lead to a stronger commitment to an investment approach that can be consistently applied and aligned with their goals. This can make for a better, more trusted experience between advisor and investor. And, as research has shown, this reflection of personal values in investment selection can be done without sacrificing performance. (We cover this more thoroughly in part 2).

Unlike many “advisors” who are really just product salespeople, we gladly accept a fiduciary duty to act in our clients’ best interest. There is a growing contention that this cannot be done completely without evaluating investments through an SRI/ESG lens. A report from the United Nations in September 2015 concluded that “failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty.”

Even some investment company executives have embraced the investors’ duty to hold companies accountable for their actions. Larry Fink, founder and CEO of Blackrock, the world’s largest investment firm with more than $6 trillion under management, raised awareness of these issues with this statement: “Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. … a company’s ability to manage environmental, social, and governance matters demonstrates the leadership and good guidance that is so essential to sustainable growth, which is why we are increasingly integrating these issues into our investment process.”

Whether a large investment manager or a single individual trying to decide how to invest, there are many topics to understand beyond a company’s profits, earnings growth or current stock price. To provide some framework to this pursuit of more responsible investing, the United Nations has published Sustainable Development Goals. This list of

17 aspirational achievements can be addressed in many ways through investment funds designed to reflect the preferences of a socially responsible investor.

United Nations Sustainable Development Goals (SDGs) for Investing

Goal 1: No poverty. End poverty in all its forms everywhere.
Goal 2: Zero hunger. End hunger, achieve food security and improved nutrition, and promote sustainable agriculture.
Goal 3: Good health and well-being. Ensure healthy lives and promote well-being for all at all ages.
Goal 4: Quality education. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.
Goal 5: Gender equality. Achieve gender equality and empower all women and girls.
Goal 6: Clean water and sanitation. Ensure availability and sustainable management of water and sanitation for all.
Goal 7: Affordable and clean energy. Ensure access to affordable, reliable, sustainable, and modern energy for all.
Goal 8: Decent work and economic growth. Promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all.
Goal 9: Industry innovation and infrastructure. Build resilient infrastructure, promote inclusive and sustainable industrialization, and foster innovation.
Goal 10: Reduced inequalities. Reduce inequality within and among countries.
Goal 11: Sustainable cities and communities. Make cities and human settlements inclusive, safe, resilient, and sustainable.
Goal 12: Responsible consumption and production. Ensure sustainable consumption and production patterns.
Goal 13: Climate action. Take urgent action to combat climate change and its impacts.
Goal 14: Life below water. Conserve and sustainably use the oceans, seas, and marine resources for sustainable development.
Goal 15: Life on land. Protect, restore, and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification and halt and reverse land degradation, and halt biodiversity loss.
Goal 16: Peace, justice, and strong institutions. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all, and build effective, accountable, and inclusive institutions at all levels.
Goal 17: Partnerships for the goals. Strengthen the means of implementation and revitalize the global partnership for sustainable development.