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REPORT Nº: 10
Published for CMC Markets

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Social responsibility pays off

Outsized returns for socially responsible funds are proving that investing in sustainable businesses is no longer only the right thing to do, but it may also be the smart thing to do

- SolarEdge Technologies [SEDG]
- Eversource Energy [ES]
- Progressive Corporation [PGR]
- Mastercard [MA]
- Visa [V]
- Apple [AAPL]
- Alphabet [GOOGL]
- Microsoft [MSFT]
- Unilever [UVLR]
- Procter & Gamble [PG]

Summer 2020

Environmental, social and governance (ESG) funds are offering up some of the biggest returns yet. As sustainable investing becomes increasingly important in a world plagued by the impact of climate change, corporate instability and, more recently, a global pandemic, ESG funds are outpacing traditional rivals

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Once seen as merely a fringe movement, investors have been piling into these funds over the past year as sustainable stocks prove that they are not just good for society, but can be profitable too.

Sustainable mutual funds and exchange traded funds (ETFs) raked in $20.6bn in assets in 2019, almost four times that of 2018. And, what's more, these funds are outperforming the market.

Bloomberg's fourth annual ranking of the largest ESG funds shows that nine out of 75 of the biggest funds in the US outperformed the S&P 500 in 2019 (see chart below).

Top performers, such as the $878m Ave Maria Growth Fund [AVEGX] and the $3.8bn Calvert Equity Fund [CSIEX], posted gains of more than 35% by the end of 2019, outpacing the S&P 500's 31.5%.

Common stocks among these funds include Mastercard [MA] and Microsoft [MSFT], which both gained 60% in 2019, as well as Visa [V], which saw a 44% rise.

Even as the coronavirus spurred on the biggest market sell-off since the 2008 global financial crisis in the first half of 2020, ESG funds fared better than conventional ones.

Bloomberg analysis has shown that the average ESG fund fell by 12% this year, just half the decrease seen by the S&P 500 index over the same period of time.

"What has happened is that it has become more profitable to be part of the solution than to be part of the problem," says Alessandra Sollberger, founder of Top Tier Impact — a network of sustainability-focused investors and entrepreneurs.

Sollberger tells *Opto* that she has seen impact investing hit the mainstream retail market in recent times, as more investors weave ESG values into their daily work and also demand among consumers grows.

"I've seen the shift," she explains. "The last six to nine months have been incredible."

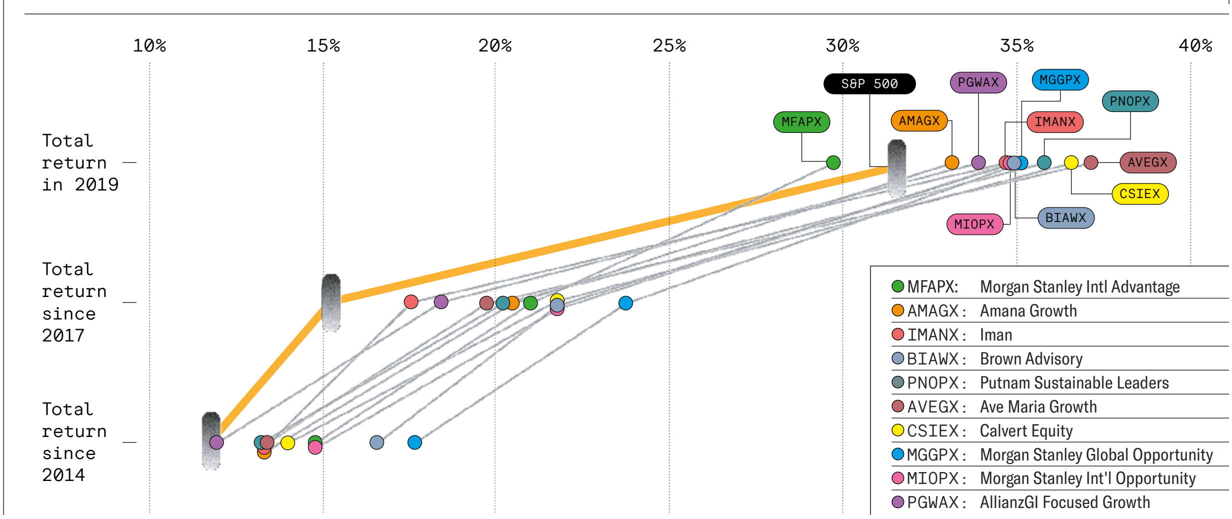
COVID-19: the ESG acid test

This year's market downturn has emphasised that ESG stocks and funds are well equipped to handle market volatility, but will their outperformance continue throughout 2020?

Hamish Chamberlayne, head of the global sustainable and responsible investment team at Janus Henderson, believes so.

"We are living in a period of such exceptional change, characterised by the low-carbon energy transition, the fourth industrial revolution and the digitisation of everything. We do not have an environment of broad based

ESG fund growth compared to the S&P 500 over the last five years



Source: Bloomberg 2019 ranking of the largest ESG funds 29.01.20

Past performance is not a reliable indicator of future results.

growth lifting all boats. There will be big winners and big losers," he tells *Opto*. Chamberlayne notes that resilient growth companies are well placed to deliver attractive returns.

Among the early winners are stocks like BlackRock [BLK] and Apple [AAPL], which both rank fairly high in ESG scoring. Both stocks dropped less than 10% in the month up to 30 March, the month that saw the biggest sell-off as a result of the coronavirus outbreak.

By comparison, companies with a low ESG score saw much steeper losses. EasyJet [EZJ] for example, saw a loss of near 50% in the same period, while Wells Fargo [WFC] — which has a low score due to high CEO compensation — saw a drop of nearly 27%.

There are a couple of reasons for the success of ESG funds during this period. For one, ESG funds tend to limit their exposure to companies reliant on oil and gas, like airlines, which means they benefited as oil-reliant stocks tanked around the world in the first quarter of 2020.

As oil prices collapsed in March due to an aggressive price war between Saudi Arabia and Russia, many ESG funds found themselves at the top of performance tables.

In the month leading up to 12 March, the returns of 66% of sustainable equity funds ranked in the top halves of Morningstar's respective sustainability categories.

The firm has various categories to

help it determine how to classify companies. More than a third (39%) ranked in their category's best quartile.

Secondly, the transparency that comes from being ESG compliant means that they are more vigorously tested against crisis situations and therefore tend to be more prepared for such unexpected incidents.

Gabriel Thoumi, director of financial markets at Planet Tracker — a non-profit working on developing sustainable financial markets — recently told thought leadership agency Grist that ESG funds are more likely to include companies that are

BELOW: Protesters demonstrate in Grünheide, Germany against the planned Tesla Gigafactory, which they say will endanger wildfire and contaminate the water supplies.

Images: Bloomberg via Getty Images; Michele Tantussi/Getty Images

How to spot greenwashing

ESG ratings are neither uniform nor regulated, which means that a wide umbrella of stocks can be considered ESG compliant depending on what they excel at — whether that is green policies or corporate transparency — and which organisation is rating it.

This has led some stocks to crop up in funds that are not expected to be there. Tesla [TSLA] for example, is rated highly by MSCI, but FTSE rates it poorly based on its lack of disclosure about the environmental impact of its manufacturing.

The lack of uniformity has prompted criticism. Many accuse certain companies and funds of greenwashing, which is when these companies and funds give a false impression of providing products that are socially responsible. Some ESG funds even include stocks in their portfolio from the oil and gas sector or tobacco and manufacturing industries.

Many believe it's a long road ahead before there is any unified concept of the terms. There are a growing number of ratings providers, each with their own methodologies to judge if a company is ESG compliant, according to the *Financial Times*.

For example, Sustainalytics, one of the most prominent ESG ratings providers, has 138 sub-industry groups and designates exposure scores for each factor within each sector. While elsewhere, one of the world's oldest ESG rating agencies, Paris-based Vigeo Eiris, identifies 38 sustainability drivers and sets out a weighting for each, across 40 different industries.

Steps are being taken to amend this. For example, in the UK The Investment Association recently unveiled its responsible investment framework, which it hopes the industry will adopt to create a common language that offers investors greater transparency on what they are investing in.

transparent about their supply chain.

When companies do this, it means investment firms can do a better job in identifying risks that may affect a company's core business. Therefore, some portfolio managers designing ESG funds would have screened out companies more vulnerable to a market shock.

"ESG factors within investment processes enable investors to better understand the risks faced, which leads to better-informed investment decisions," Sheila ter Laag, head of ESG Specialists at BNP Paribas Asset Management, a firm that has been involved in sustainable investment for two decades, tells *Opto*.

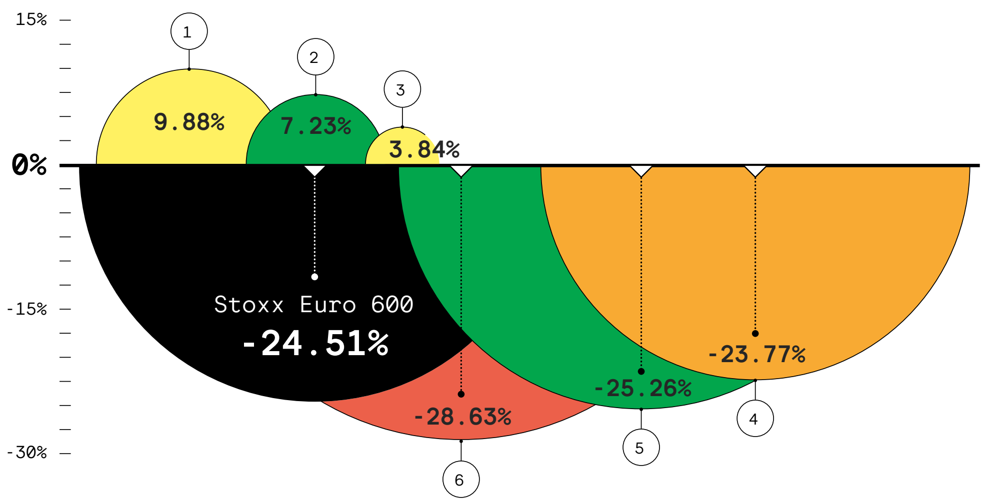
But research conducted even before the current economic crisis highlighted that ESG funds do better than conventional ones during market volatility.

In 2019, a BlackRock whitepaper showed that ESG funds were more resilient during downturns than those that performed poorly in this space.

"Strong ESG performers may be better at managing legal, reputational and financial risks," the firm states in the whitepaper.

"These findings are consistent with external research. An example: AQR finds that stocks with the worst ESG scores are 10% to 15% more volatile than those with the best scores — and that poor ESG performance points to future risks not captured in standard risk models," BlackRock notes.

ESG funds YTD growth compared to the Stoxx Europe 600



Despite the market sell-off in March, the top three performing ESG funds in Europe were able to outpace the Stoxx 600. The worst performing fund, meanwhile, was just 4.1% worse off against the benchmark.

		Morningstar Sustainability Rating	YTD TOTAL RETURN TO 28 APRIL
The top three performing ESG funds domiciled in Europe	1 Handelsbanken USA Index Criteria	Above Average	+9.88%
	2 Fidelity Funds - Sustainable Global Equity Fund	High	+7.23%
	3 DNB Global Lavkarbon	Above Average	+5.80%
The bottom three performing ESG funds domiciled in Europe	4 JSS Sustainable Equity - Europe	Average	-23.77%
	5 BNP Paribas Funds Europe Multi-Factor Equity	High	-25.26%
	6 Long Term Investment Fund SRI	Low	-28.63%

Source: Morningstar 28.04.20

Past performance is not a reliable indicator of future results.

Surviving the sell-off

There are a range of products available to retail traders looking to play ESG stocks. Two of the most popular trading methods include participating in the market via ETFs or stock picking.

The past two years have seen a steep increase in passive funds such as ETFs. These funds surpassed the value of stock pickers for the first time last summer, accumulating $4.27trn in assets. In this space, there is a wide range of ETFs focused on grouping ESG stocks.

Top performers include iShares MSCI USA ESG Select ETF [SUSA] — a fund that has climbed by 116% since its inception in 2005 to the start of April.

The fund, which includes US companies screened for high ESG ratings, has $1.12bn in net assets under management and 118 holdings, including Apple and Ecolab [ECL]. Companies on the fund are weighted based on their ESG rankings with less weight given to those scoring lower on ESG criteria.

Elsewhere, since its inception in 2016 the SPDR S&P 500 Fossil Fuel Reserves Free ETF [SPYX] has grown by 30% to the start of April 2020.

The fund, which tracks the holdings and returns of the S&P 500 Fossil Fuel Free Index, has $418m in assets under management and has holdings in companies such as Microsoft and Amazon [AMZN].

During the coronavirus panic in the first quarter, the top-performing US fund was the IQ Candriam ESG US Equity ETF [IQSU], which lost 15.97% during the period. The more conventional iShares Core S&P 500 ETF lost 19.55% in the same period, according to *Yahoo Finance*. A close second in this race was the iShares MSCI USA ESG Select ETF, which lost 17.72% (see chart from previous page, for the top and worst performing ESG funds in Europe so far this year).

The standout ESG stocks to watch

Among these funds there are numerous high-performing ESG stocks to watch that are both ESG compliant and market beating.

Whether you're looking to avoid stocks that pull sources of energy from the ground or tech companies that use copious amounts of electricity to run data centres, there are some standout names to consider.

Solar stocks still shining

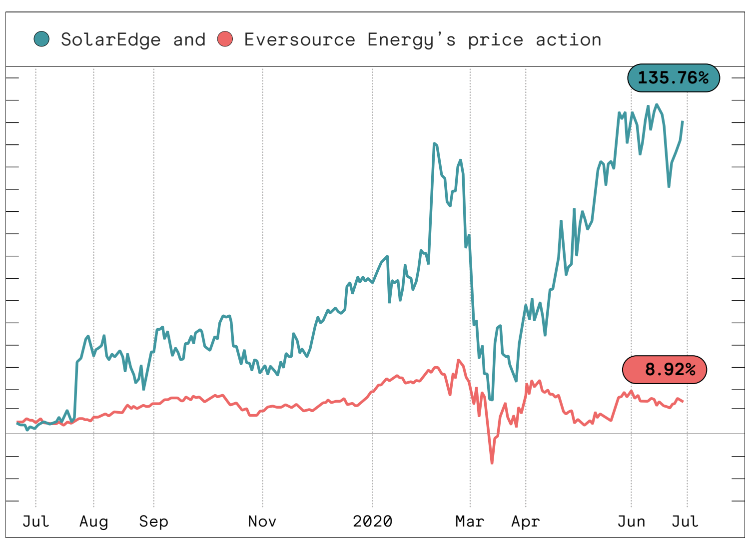
In the renewables sector, SolarEdge Technologies [SEDG] — a provider of solar products — was one of the fastest growing ESG stocks of 2019, gaining nearly 170.9% throughout the year. Even factoring in the market sell-off in the first quarter of 2020, the stock has gained 36.21% this year (through 26 June). As of 29 June, SolarEdge's PE ratio stands at 39.12, significantly higher than its top rival Enphase Energy's [ENPH] 27.16, according to *Yahoo Finance* data.

Growing demand for sustainability leaders

As ESG standards become a priority for a growing group of companies, the value of individuals who can navigate this sector has shot up.

"We have witnessed a consistent rise in the number of newly created sustainability focused leadership roles in banks and investment managers over the last three years, which has been matched by an increase in compensation levels," says Ian Povey-Hall, a principal consultant at sustainability-focused recruitment and talent development firm Acre.

"Previously a total remuneration of £250,000 to £350,000 would have resulted in the pick of top talent, whereas now we are seeing packages of well over £500,000 for the increasingly scarce individuals who can navigate the plethora of sustainability driven risks and opportunities that investors are now faced with."



Source: TradingView 24.06.20

Images: Bloomberg via Getty Images; Steve Proehl/Getty

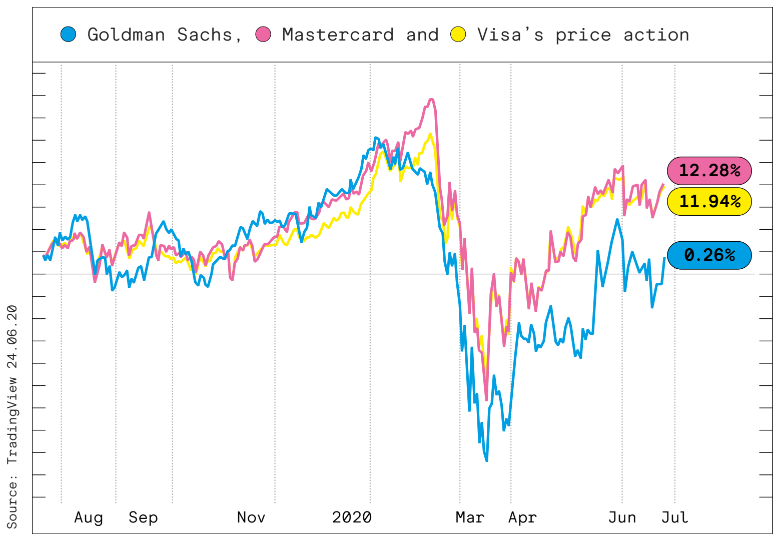
Eversource Energy [ES] also has a high ESG rating among the energy sector. Based on MSCI ESG Research, the utility company has held an AA ESG rating since November 2016, making it a leader in the space.

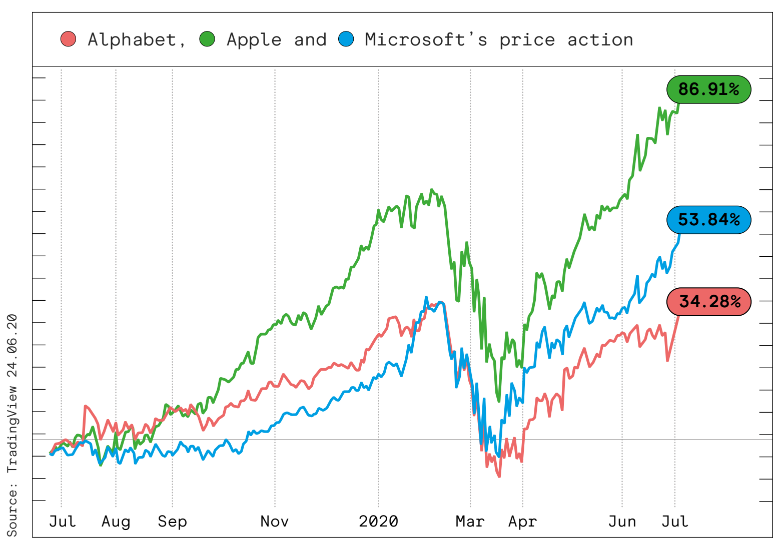
The stock is down 2.5% YTD (through 26 June), outperforming the S&P 500's 6.8% decline in the same period. It trades 3,8% below its 200-day moving average of $85.11. Positive earnings growth in the first quarter made the company a favourite among hedge fund managers. Insider Monkey data showed that the stock was in 31 hedge fund portfolios as of 19 June.

The future of sustainable finance

Another segment featuring high ESG scorers that are likely to perform well in the long-term is finance. While Goldman Sachs [GS] fell steeply during this year's market sell-off, it is expected to show a strong comeback, according to stock analysis company Trefis. In 2019, the bank's share price grew by almost 40%.

Assuming Goldman Sachs will behave as it did following the 2008 financial crisis, where its shares rose by 87% between March 2009 and January 2010, Trefis data suggests that it will recover more than 30% in the year following the coronavirus crisis.





It has recovered 41% as of 26 June since hitting a low of $134.13 on 23 March.

However, the financial services sector had been slow to integrate ESG criteria. Indeed, product specialist Tristan Camp at Legg Mason, a ClearBridge Investments affiliated firm that has held an ESG programme for more than 30 years, tells *Opto* there are two main factors that prove which firms in the space are making legitimate efforts.

The two types of companies often rated highly when it comes to sustainability are those with praise-worthy practices and those that are having a positive impact on society at large.

Camp highlights The Progressive Corporation [PGR] in the insurance space, which he says "has exemplary practices but it is not what you would intuitively think of when you're thinking about sustainability or positively impacting industry".

Both Progressive and Goldman Sachs have a BBB ESG rating according to MSCI. Shares in Progressive grew by 7.8% from the start of the year to 26 June, while others floundered during the coronavirus crash.

Meanwhile, two of the biggest payment processors in the world, Mastercard and Visa, both rank within the top 10 holdings on the MSCI World ESG Leaders Index — at ninth and fifth place respectively.

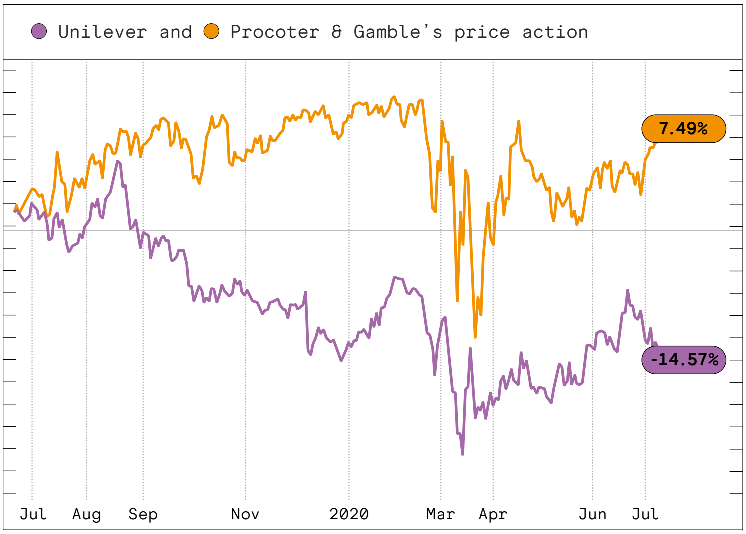
Aside from their plastic credit cards, both companies otherwise have low manufacturing footprints. Visa's share price is up 1.04% YTD (through 25 June), while Mastercard's is down 2.81% in the same period.

Technology dominates ESG funds

ESG purists would certainly turn up their noses at the tech sector, especially considering the ongoing anti-trust investigations surrounding a number of Silicon Valley giants.

Corporate governance issues aside, there are some tech companies leading the way when it comes to reducing their carbon footprints.

Stocks like Apple and Alphabet [GOOGL] — the operations of which



Source: TradingView 24.06.20

> *"Technology is employed almost everywhere to achieve greater efficiency, be it in manufacturing, waste reduction, or the development of more cost effective solutions … the list goes on"*

run on 100% renewable energy — saw a lift of more than 90% and 32% respectively across 2019. Year to date, these stocks are up 21% and 1.7%, respectively, through 26 June, despite the market downturn.

Chamberlayne believes technology has a huge role to play in a sustainable future. Janus Henderson' Global Sustainable Equity Fund, of which he is the portfolio manager of, has recently seen a significant uptick in demand.

The fund, which has a high sustainability rating on Morningstar, has holdings in companies like Microsoft, Adobe [ADBE] and Nintendo [7974]. The former has been rated AAA by MSCI, while Adobe and Nintendo are rated AA.

"Technology is employed almost everywhere to achieve greater efficiency, be it in manufacturing, waste reduction, or the development of more cost effective solutions … the list goes on," Chamberlayne explains.

After all, sustainability is more than just investing in renewable energy, Craig Bonthron, investment manager of Kames Capital Global Sustainable Equity Fund, tells *Opto*. The recent outperformance of his fund is 80% due to stock picking and 20% via its exposure to more growth-orientated areas of the market, he says.

However, Bonthron does consider that in the short-term "many companies in these areas are in structural decline and are being disrupted by those who are positioned for a sustainable future".

Longer term, Bonthron believes that "quality companies that incorporate sustainability into their operational and strategic thinking will have a better chance of building competitive advantages".

The consumer staples aligning themselves with a greener planter

The efforts of two giants of the consumer staples space, Unilever [ULVR] and Procter & Gamble [PG], to be more ESG compliant has been reflected in their product and supply chain transformation.

Both companies have reviewed the environmental impact of their product manufacturing in recent years, making changes to reduce water, waste, plastic usage and carbon output.

Unilever, rated A by MSCI, is down 0.1% for the year to 26 June. Shares in Procter & Gamble, rated AA by MSCI, are down 6.57%.

In April, Erin Lash, analyst at Morningstar, suggested that Procter & Gamble, aside from tailwinds due to pandemic-induced "pantry loading" has also benefitted from a "revamped strategic playbook". The company, she explains, takes a more "holistic approach to brand investing, encompassing how a product performs, the packaging, brand messaging, execution in stores and online".

RIGHT: Amy Hood, CFO at Microsoft, and Brad Smith, president at the company, unveil plans to invest $1bn in businesses working on technologies to remove carbon from the earth's atmosphere.

Images: Bloomberg via Getty Images

Making sustainability profitable

AMY DOMINI AND CAROLE LAIBLE,
Domini Impact Investments

Sustainable investing — a practice that goes by many names — is not a passing trend, but a movement that dates back decades. What started in the 1970s as a means to combine investment returns with a person's values has evolved to a place where environmental, social and governance (ESG) investing is now a crucial factor in a company's reputation.

Many institutions have contributed to and furthered this progress, but one firm stands out against the rest: Domini Impact Investments.

Its founder Amy Domini is one of the key figureheads in the push to take sustainable investing mainstream. Her curiosity in the area began when she was working as an investment advisor at a time when not many knew what ethical investing was.

During Domini's career, she became sympathetic towards clients who didn't want to be unethical. This sparked an interest in the area, leading her to become more empathetically involved.

By 1984, Domini had pioneered the concept in a book she co-wrote called *Ethical Investing*. "It was the first book of its kind and it is largely responsible for having made the field known," she tells *Opto*.

ESG returns prove resilient

However, at the time the wider investment community wasn't convinced that ethical investing could be profitable, giving Domini motivation to launch the very first sustainable investing index in 1990 — the Domini 400 Social Index (now known as MSCI KLD 400 Social Index [DSI]).

In the five years leading up to the start of 2020, the fund climbed more than 70%, outpacing the 56% rise in the S&P 500 over the same period of time. That outperformance has only continued, with the DSI beating the market benchmark by around 2% in the first four months of the year.

"The DSI 400 attempted to track the behaviour of 400 companies that represented the universe of what the person operating within an ethical framework might purchase," Domini explains. "For the first 15 years or so it beat more conventional benchmarks, thereby opening up the question: how can a fiduciary justify doing anything else?"

The index's success led to increased credibility and as large European pension funds got interested, so did Wall Street. "The United Nations eventually began integrating standards for asset managers, calling them the 'Principles for Responsible Investment'," and from there awareness in the space snowballed.

Today there is "an understanding among investors and traders that the moral character, so to speak, of a company is a component of its success". While this shift is phenomenal, Domini's work isn't done yet.

"My end goal and my purpose is to create an investor class that is large enough to affect outcomes — to make things better for people and the planet," she determines.

A new green wave

An integral part of Domini Impact Investments' growth over the years was the hiring of Carole Laible. She joined the firm at the inception of the SEC registered investment advisor in 1997 as director of financial compliance.

Over the years she rose through the ranks, taking on the position of chief operating officer and then president until eventually being appointed CEO in 2016. Before Domini Impact Investments, Laible had been working in public accounting and specialised in mutual funds.

"I got to a point in my career where I was really searching for what difference all of these labour-intensive hours would result in for people on the planet," Laible tells *Opto*. "It was about that time that Domini's prospectus came across my desk. That was really my first experience with a mutual fund that cared about criteria, beyond simply the numbers."

With her interest piqued, Laible threw herself into the role, spearheading the firm's pioneering work in educating investors about the impact of their investment decisions.

People, planet, profit

As CEO, she is responsible for the firm's investment strategy, which aims to do more than just buy stock in companies that meet their criteria. She is also an advocate for more change through shareholder proxies by using a "triple bottom-line approach of people, planet and profit," Laible notes.

Finding ways to ensure transparency in this process is important to Domini. One way the firm does this is by making its investment standards public. These are published in a 40-page document that details how ESG research is at the forefront of how it builds an investment portfolio.

"We've built each of those social and environmental standards around two goals that can be separate and distinct, but are also often intricately linked. Those goals are universal human dignity and ecological sustainability," Laible explains. "From there, we take an approach that first focuses on what the core business of a company is and how closely aligned is that with those two twin goals." The firm has built more than 100 of what it refers to as "proprietary sub industry reports", which it uses as a lens to evaluate a company.

Laible has played an instrumental role in building out the firm's products, which include two equity funds — one domestic and one international — a bond fund and the Domini Sustainable Solutions fund. This uses a high-conviction buy-and-hold strategy.

"Sustainable Solutions is focused on a concentrated portfolio of investing in companies that are meeting specific thematic needs, such as renewable energy, clean water, healthy food, access to finance and technology and healthy communities," Laible says.

The Domini Impact Equity Fund [DSEFX], which has top holdings in Microsoft [MSFT] and Apple [AAPL], has net assets of $660m as of 31 March. The fund returned 31.66% in 2019, just in line with the S&P 500's 31.49% but has so far beat the US-blue chip index in the first quarter of 2020 by 4.14%. Both the international and domestic funds are weighted with large-cap equities, targeting a blend of value and growth.

The fund's recent success further proves that sustainable investing is "on a great path." Laible highlights: "We're seeing both the demand at the retail investor level but also from the institutional market." She adds: "That's really promising because impact investing is not something we want to keep as a boutique. It is the way we'd like to see all investing done."

Leveraged ETFs are complex financial instruments that carry significant risks. Certain leveraged ETFs are only considered appropriate for experienced traders.