INVESTMENT INSIGHTS

Analysis, Insights and a Different Perspective | September 2022

SUSTAINABLE & RESPONSIBLE INVESTING (SRI)

Sustainable and Responsible Investing (SRI) is an investment discipline that incorporates ethical and sustainable factors to positively impact society. Research suggests that these strategies may impact investment returns and positively impact society. This issue of Investment Insights looks at SRI, one of the most popular segments in the investment industry.

BACKGROUND

While SRI recently gained popularity, its origins date back centuries to when various cultures attempted to set guidelines for investment types.[1] SRI strategies continued to evolve from the 1960s until the 2000s. In 2006 the United Nations created formal Principals for Responsible Investing (PRI). The PRI signatories, typically financial institutions, voluntarily incorporate socially responsible investing into their investment practices.

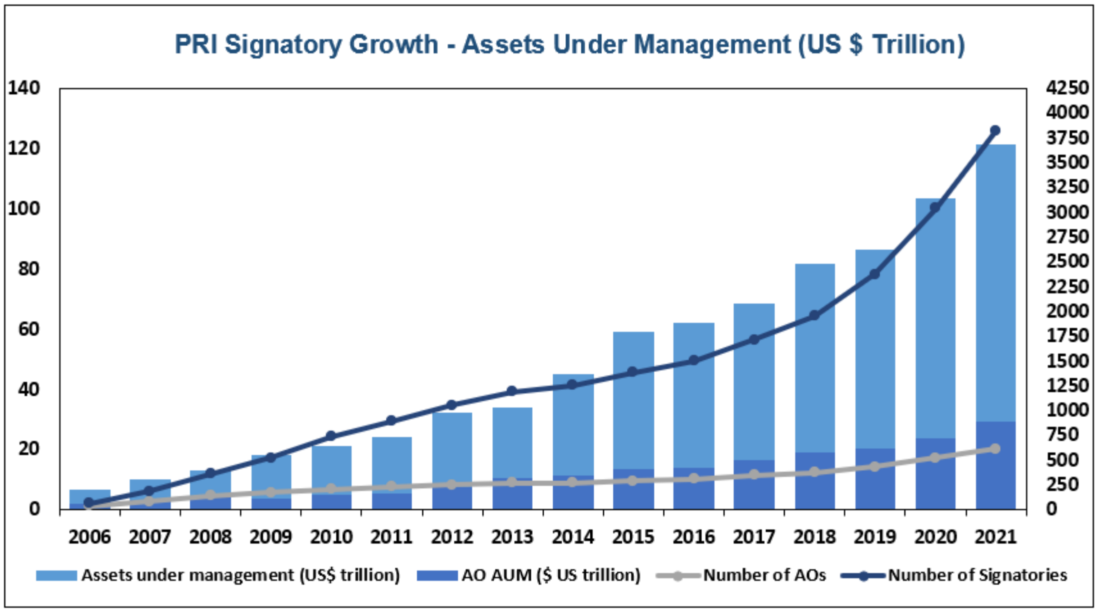
1 "The History of Socially Responsible Investing." CNote, 15 Nov. 2019.

KEY POINTS

- Sustainable and Responsible Investment (SRI) is an investment discipline that aims to generate competitive investment returns and incorporates ethical and sustainable factors into investment decisions.
- Previously known as Socially Responsible Investing, today, SRI encompasses a broader focus beyond social issues.
- SRI strategies are gaining popularity among investors. They account for 1 in 3 dollars invested in the U.S.
- Research has found a strong link between SRI and financial performance. The link between SRI and investment performance, however, is not conclusive.

Cornerstone
WEALTH MANAGEMENT LLC
A Registered Investment Advisor

As you can see below, the number of PRI signatories has increased from less than 100 in 2006 to more than 3,800 as of March 2021. This represents more than $120 trillion in assets under management worldwide.[2] In the United States, the assets managed under a socially responsible mandate have increased 25-fold from 1995 to 2020 at an annual growth rate of 14%. In 2020 one out of every three dollars was invested using SRI strategies in the U.S.[3] Despite this rapid growth, the U.S. lags behind other developing regions in the proportion of SRI investments.[4] In 2020, sustainable investing accounted for 33.2% in the U.S., 37.9% in Australia, 41.6% in Europe, and 61.8% in Canada.[5]



Source: PRI Association.

TERMINOLOGY

One problem with SRI investing is the confusing terminology. Sustainable and Responsible Investment (SRI) is an umbrella term for a wide range of investment strategies that focus on social or environmental factors in addition to risk and return. They include community investing, ethical investing, ESG (environmental, social, and corporate governance), and impact investing. The original umbrella term that described these strategies was known as Socially Responsible Investing. The updated terminology reflects that these investment strategies have a broader focus than just social issues. Socially Responsible Investing is still used synonymously as an umbrella term, leading an unfamiliar individual to conclude that they are focused only on social issues. The table below clarifies this common confusion. SRI is composed of 3 broad categories: ethical investing, impact investing, and sustainable investing.

Sustainable and Responsible Investment (SRI)			
Broad Category	Ethical Investing	Sustainable Investing	Impact Investing
Examples	socially responsible investing, best-in-class investment, and values-based investing	ESG, carbon footprint, and green investing	community investing, thematic, impact-first, and venture philanthropy

2 "About the PRI." PRI, 1 Mar. 2020, www.unpri.org/pri/about-the-pri.

3 Source: US SIF Foundation.

4 With Japan's proportion of SRI investments relative to total managed assets being the lowest amount among the developed regions measured by Global Sustainable Investment Alliance at 24.4% in 2020.

5 Global Sustainable Investment Alliance.

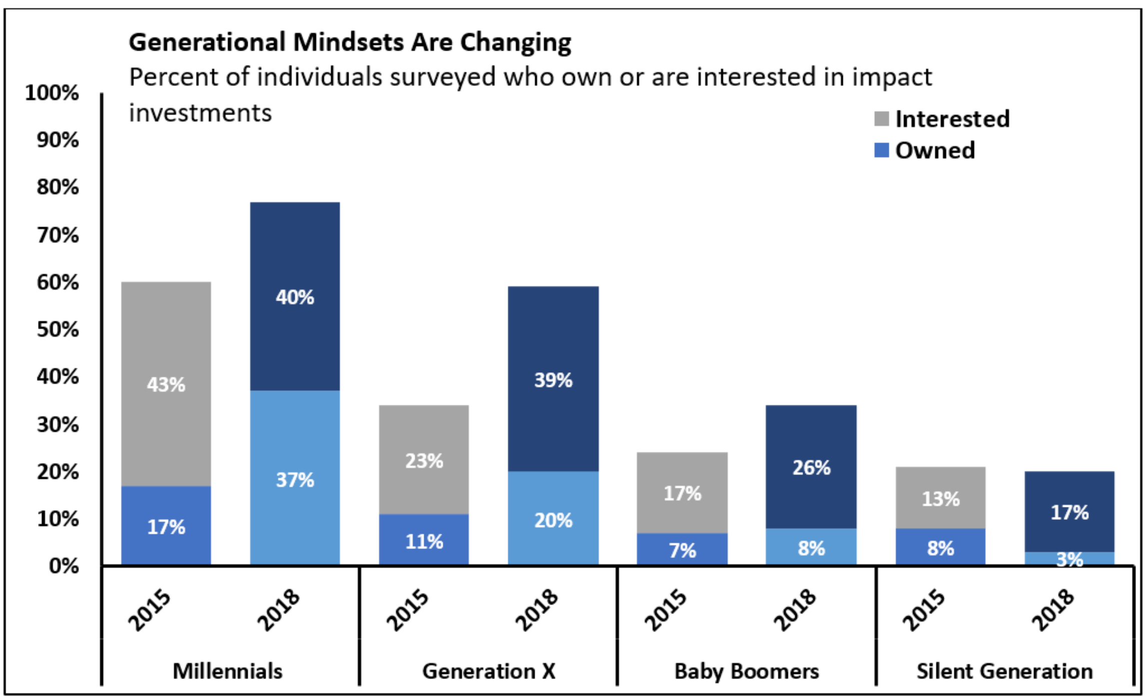
Ethical investing uses guidelines based on an investor's values (social, moral, or religious) to exclude investments that derive their revenues from harmful things. Ethical guidelines vary greatly by investors. Industries like weapons manufacturing, tobacco, gambling, and stem cell research are some common examples of issues that investors aim to exclude under this approach.

While ethical investing aims to minimize harm overall, sustainable investing uses a broad set of long-term sustainability factors to include in investments. Some examples of these factors include good corporate governance, labor rights, human rights, and pollution control.

Finally, impact investing aims to facilitate a positive change in a targeted manner. These strategies intend to allocate capital directly to things like renewable energy, affordable housing, microfinance, and sustainable agriculture.

TRENDS

While the adoption of SRI strategies in the U.S. appears to be slow on a relative basis, they continue to gain traction among U.S. investors. These trends are largely driven by demographics, with younger individuals taking more interest in these strategies. These demographic tailwinds are apparent in the graph below.



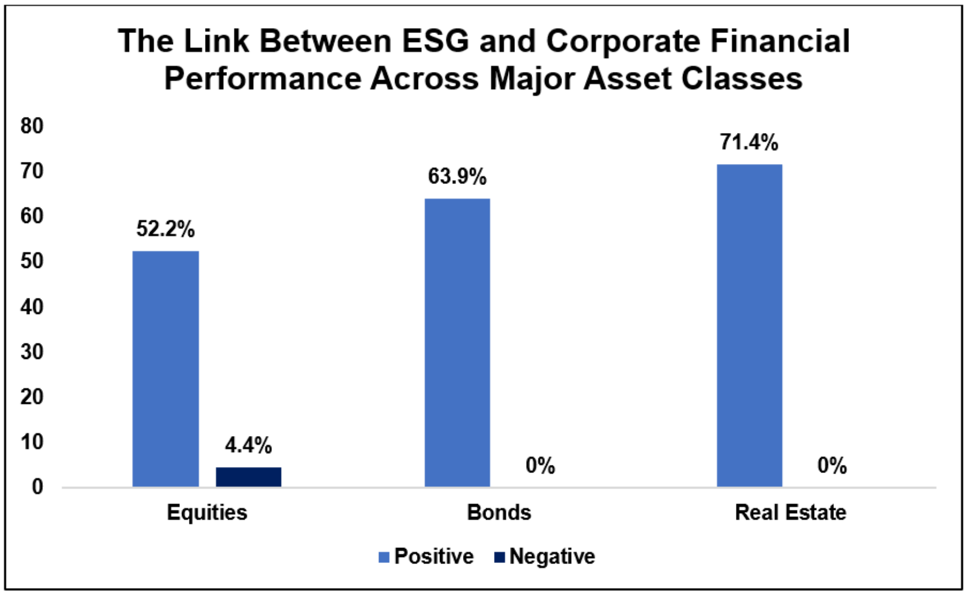
Source: 2018 and 2017 U.S. Trust Insights on Wealth and Worth.

According to a survey of investors, the majority of Generation X (age 37-52) owned or were interested in owning SRI strategies in 2018 (the latest survey available). Generation X has experienced a 73% increase in SRI interest or ownership in 3 years from 2015 to 2018. Among millennials, the preference for SRI strategies is even stronger. More than 75% of millennials already owned or had an interest in SRI strategies as of 2018. Given the increase in investor demand, the number of investment managers that focus on SRI strategies has grown substantially over recent years. In the early days of SRI investing, only a small number of investment managers specialized in SRI strategies. According to the U.S. SIF Foundation's report on Sustainable, Responsible, and Impact Investing Trends in the U.S., there were more than 384 SRI money managers and 1,204 community investment institutions in the U.S. as of 2020.

PERFORMANCE

With a continued rising investor demand and a need for more SRI strategies to meet the demand, it appears SRI is here to stay for the long term. Like all other investors, SRI investors look for competitive returns. Many SRI investors feel it is unnecessary to forgo competitive investment returns when investing responsibly.

In 2015 Deutsche Asset & Wealth Management and Hamburg University completed one of the largest studies on SRI performance.[6] This meta-study (a combination of multiple studies) examined more than 2,000 empirical studies since the 1970s, making it one of the most comprehensive academic reports on this topic. The study found that since the 1970s, most research has rarely found a negative relationship between a company's SRI and corporate financial performance. The graph below shows the findings across three different major asset classes.[7]



Source: Friede, Busch, Bassen (December 2015).

Since 2015, a number of other prominent studies have found mixed results across asset classes.[8] A meta-study that examined all research published between 2015-2020 found a negative relationship between a company's SRI and corporate financial performance at 13% for equities and 25% for Bonds.[9] Despite relatively small evidence of a negative impact on financial performance, it is also unclear if SRI improves risk-adjusted investment performance.[10] Thus, while some evidence suggests that SRI strategies may have a relatively small impact on investment performance, the evidence is not conclusive on whether it improves investment performance. For investors who value SRI as much as investment returns, SRI strategies can allow them to "do well by doing good."[11]

If you have any questions about SRI or would like to know more about SRI, please contact your financial advisor today.

6 Friede, Gunnar, et al. "ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies." SSRN, 19 Dec. 2015.
7 Ibid.
8 Desclée, Albert, et al. Sustainable Investing and Bond Returns - Research Study into the Impact of ESG on Credit Portfolio Performance. BARCLAYS, 2016; Matthews, Jessica, et al. "The Financial Performance of Real Assets Impact Investments." The GIIN, Cambridge Associates; Global Impact Investing Network, 2017; and, O'Brien, Amy, et al. Responsible Investing - Delivering competitive performance. TIAA. 2017.
9 ESG AND FINANCIAL PERFORMANCE: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published between 2015 – 2020.
10 Giese, Guido, and Linda-Eling Lee . "WEIGHING THE EVIDENCE: ESG AND EQUITY RETURNS." MSCI, Apr. 2019.
11 This quote is often attributed to Benjamin Franklin.