

INVESTMENT INSIGHTS

Analysis, Insights and a Different Perspective

October 2021

SUSTAINABLE AND RESPONSIBLE INVESTMENT (SRI)

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

BACKGROUND

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



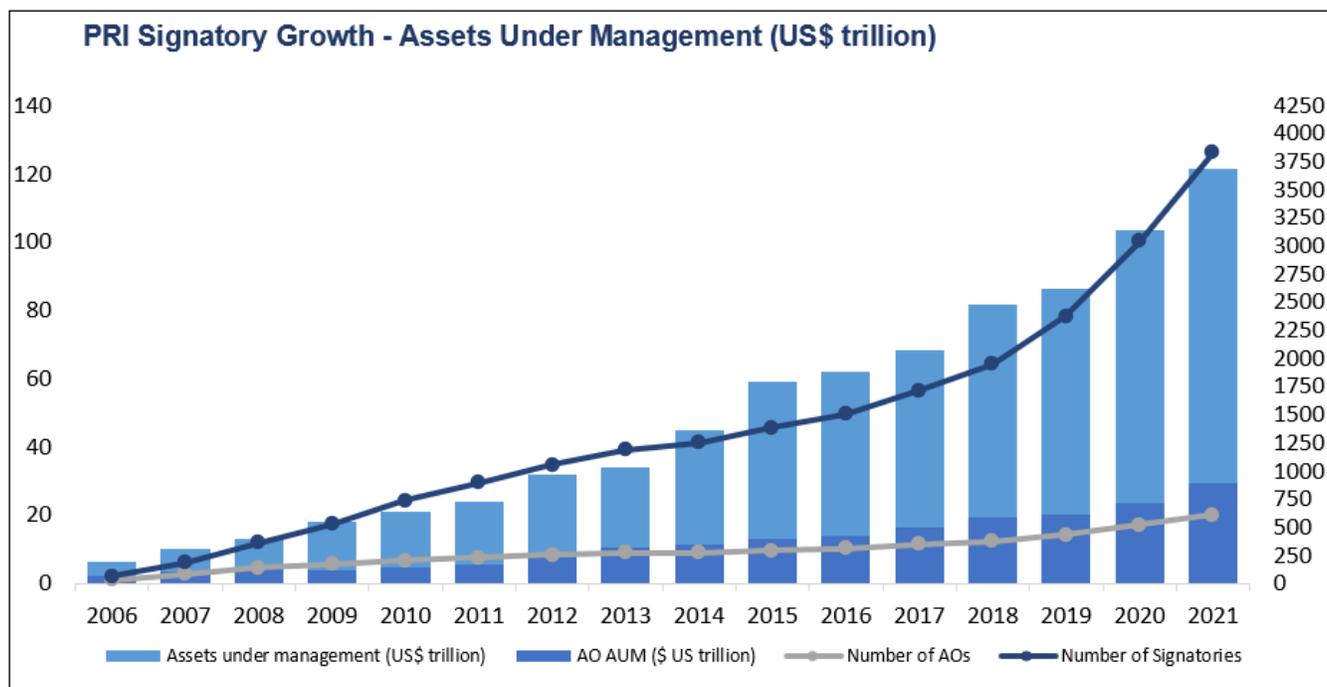
KEY POINTS

- Sustainable and Responsible Investment (SRI) is an investment discipline that not only aims to generate competitive investment returns, but also 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.

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

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 U.S., 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 United States.³ Despite this rapid growth, the U.S. lags behind other developing regions with the proportion of SRI investments.⁴ Sustainable investing accounted for 33.2% in the U.S., 37.9% in Australia, 41.6% in Europe, and 61.8% in Canada in 2020.⁵



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, among others. The original umbrella term that described these strategies was known as Socially Responsible Investing. The updated terminology reflects the fact that these investment strategies have a broader focus than just social issues. Socially Responsible Investing is still used synonymously as an umbrella term, which can lead a person who is unfamiliar with these investments to conclude that they are focused only on social issues. That is not the case. The table below clarifies this common confusion. SRI is composed of 3 broad categories: ethical investing, impact investing, and sustainable investing.

	Broad Category		
Broad Category	Ethical Investing	Sustainable Investing	Impact Investing
Examples	socially responsible investing, best-in-class investment, and values-based investment	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.

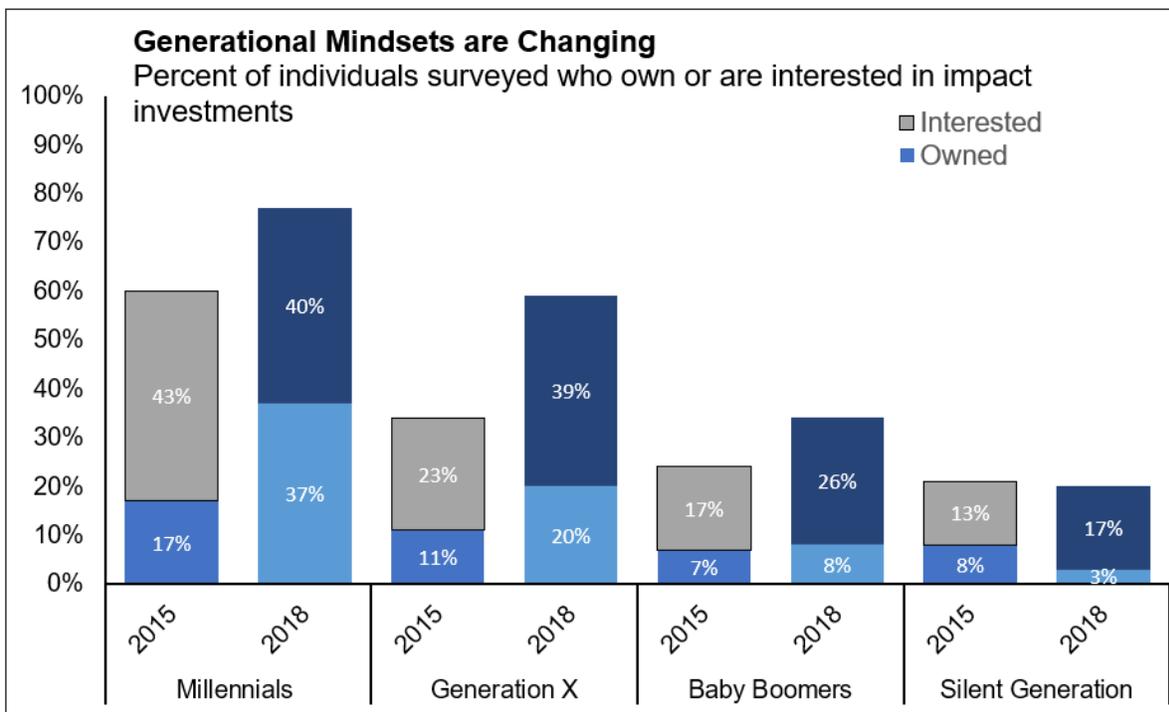
Ethical investing uses guidelines based on an investor's values (social, moral, or religious) to exclude investments that derive their revenues from harmful things. Ethical guidelines vary greatly by investors. Industries like weapons manufacturing, tobacco, gambling, and stem cell research are some common examples of issues that investors aim to exclude (screen negatively) 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 directly allocate capital to things like renewable energy, affordable housing, micro finance, and sustainable agriculture.

TRENDS

While the adoption of SRI strategies in the U.S. appears to be slow on a relative basis (compared to the rest of the developed economies), they are still gaining traction among U.S. investors. These trends are largely driven by demographics, with younger individuals taking more interest in these strategies. These demographic tailwinds can be seen in the graph below.



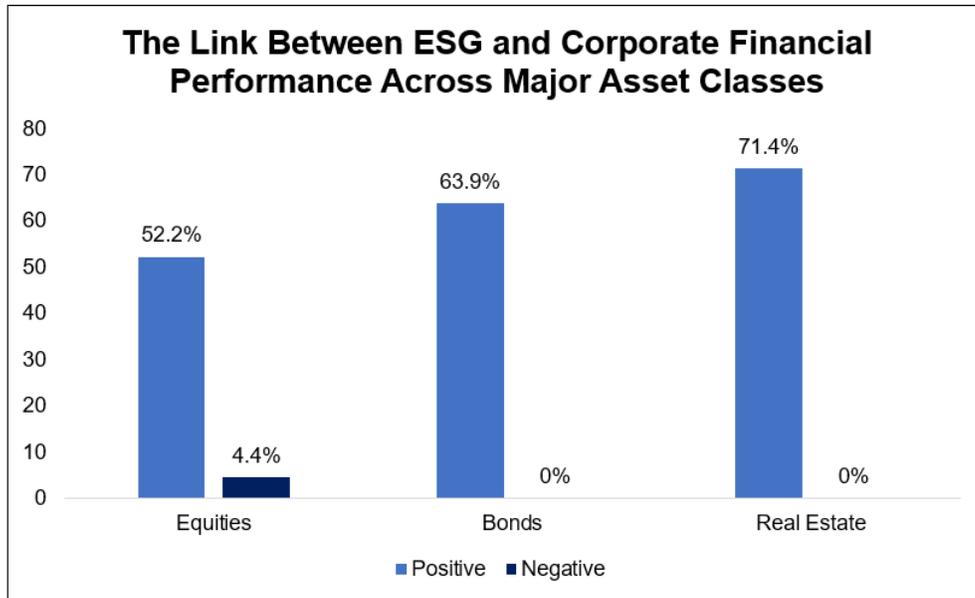
Source: Source: 2018 and 2017 U.S. Trust Insights on Wealth and Worth.

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 continued rising investor demand and more SRI strategies to meet the demand, it appears the SRI is here to stay for the long term. SRI investors, however, like all other investors, look for competitive returns. Many SRI investors feel that it is not necessary 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, the vast majority of research has rarely found a negative relationship between a company's SRI and corporate financial performance. The graph below shows the findings across 3 different major asset classes.⁷



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

Since 2015, a number of other prominent studies have found similar results across asset classes.⁸ Overall, these studies have not found evidence of the relative negative performance of SRI strategies when compared with traditional investment strategies. It is also unclear if SRI improves risk-adjusted investment performance.⁹ Thus, while some evidence suggests that SRI strategies may not hurt investment returns, 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.”¹⁰

If you have any questions about SRI or would like to know more about SRI, please contact your financial advisor today. *This report was prepared by*

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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 Giese, Guido, and Linda-Eling Lee. “WEIGHING THE EVIDENCE: ESG AND EQUITY RETURNS.” MSCI, Apr. 2019.

10 This quote is often attributed to Benjamin Franklin.

Important Disclosures: The information contained in this report is as of September 27, 2021 and was taken from sources believed to be reliable. It is intended only for personal use. To obtain additional information, contact Cornerstone Wealth Management. This report was prepared by Cornerstone Wealth Management. The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. Investing involves risk including the potential loss of principal. No strategy can assure success or protection against loss.

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