Invest in the World in Which You Want to Live

Eric Souders AWMA

Many investors are afraid to invest according to their social values out of fear of earning less. Recent research shows that is not the case and that companies with strong environmental, social, and governance policies actually perform better over the long term.

Invest in the World in Which You Want to Live.

By Eric Souders AWMA

Do you invest in a world in which we live or a world in which you want to live? Most investors perceive this question as a simple decision between making the most profit from their investment or making a sacrifice of returns to create a better world. A report recently published by MIT Sloan Management Review has presented some interesting data that gives more information to this particular decision.

The theme of the report, Findings from the 2016 Sustainability Global Executive Study and Research Project, "Investing for a Sustainable Future", is that more professional investors are "paying attention to ESG (Environmental, Social and Governance) performance, as evidence mounts that sustainability - related activities are material to the financial success of a company over time."

Assessment models are becoming available that can calculate the financial impact of a corporation's ESG factors on future performance. The assessments examine variables that are not included in financial statements and according to Sarah Teslik, former executive director of the Council of Institutional Investors, each variable "is an ESG issue that correlates with future performance." More investors are adding these tools to the evaluation process of stock selection.

The assessment criteria examine the "materiality" of a corporation as it relates to ESG issues. These are issues that are not directly associated with costs and profits, but ultimately have an effect on the bottom line. A Harvard Business School study, "Corporate Sustainability: First Evidence on Materiality", identified that a company which addresses material issues creates more value for shareholders.

These issues are certainly relevant to a corporation's operations, but found nowhere in a company's financial report. However, there have been many studies that correlate these issues to the very thing that affects our portfolios most; stock performance.

For example, a study by the Harvard Business School and Calvert Investments found that positive ESG performance correlated highly with a company's strong valuation, expected growth and low cost of capital. This was confirmed in another report by Oxford University and Arabesque Partners that examined over 200 sustainability studies and reports. Ninety percent of the reports found that strong sustainability standards lower a company's cost of capital, drive improvements in operational performance and therefore positively influence stock price.

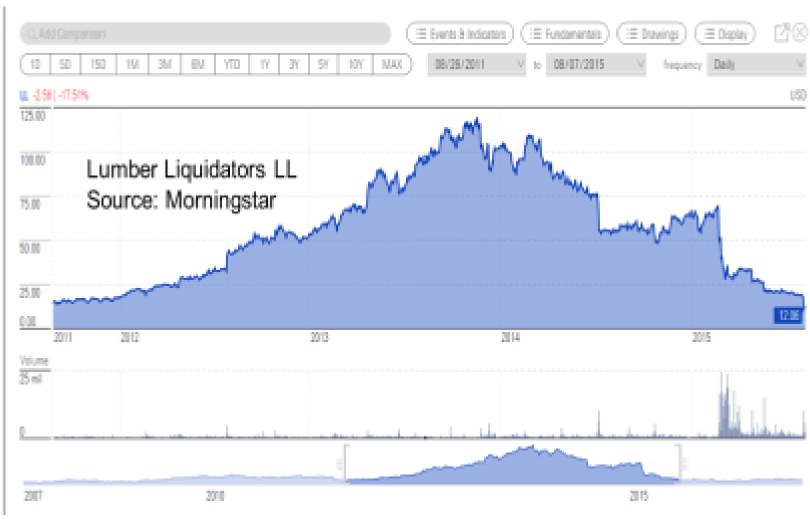
Top 10 Materiality Topics

1. **Climate Change and Energy**
2. **Human Resources**
3. **Product Excellence**
4. **Community Impact**
5. **Ethics**
6. **Supply Chains**
7. **Human Rights**
8. **Strategy and Execution**
9. **Environmental Stewardship**
10. **Labor (Health and Safety)**

Source: Materiality Tracker

A company's cost of capital, simply what it has to pay in interest on debt or deliver on share price to bring in new money, is directly linked to the company's risk level and profitability. The higher the cost of capital, the less profitable the company becomes. The more risky the behavior a company exhibits the more capital will cost. Companies with strong sustainability track records that lower capital costs are companies with effective management and therefore a better long term investment. For example, in

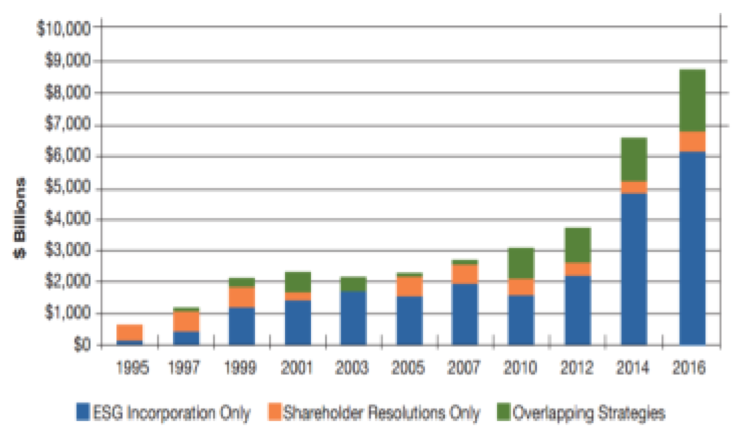
2015 Mitsubishi Corp announced a $1.1 billion investment in Olam International, and agricultural trading company with strong sustainability practices working with small farmers in remote areas of Asia and Africa. Mitsubishi was interested in Olam's ESG practices and was willing to pay a premium 29% more than its 2015 share price.



On the other hand, Lumber Liquidators was outed on *60 Minutes* for its excessive use of formaldehyde that violated US health and safety regulations and put employees and consumers at risk for respiratory irritation, asthma, and cancer. After a stock price return of over 293% from 2011 to 2013 peaking at $119/share, the airing the *60 Minutes* expose resulted in significant losses sending it down to its' current price of $12/share.

According to the Forum for Sustainable and Responsible Investment, $1 out of every $5 was invested with sustainability strategies in 2016. This is a 33% increase over 2014 and, since 1995 when it was first measured, the ESG investment universe has increased by 13.25% annually. "Across the world we are seeing a growing number of countries aligning their financial systems with the sustainability imperative", says Achim Steiner, executive director the United Nations Environment Program.

Fig. A: Sustainable, Responsible and Impact Investing in the United States 1995–2016



SOURCE: US SIF Foundation.

More investors are actively screening out companies with poor sustainability practices and including those with strong ESG policies because the research consistently indicates a positive correlation between corporate behavior and stock valuation. Companies that behave within strong environmental, social and governance guidelines can create a world that even you would want to live in. And, according to, the research, those companies are a better long term investment.

All investing and investment strategies involve risk including the possible loss of principal. Investment strategies cannot ensure a profit or protect against loss in a declining market.