Baker Avenue
Wealth Management

See Why Impact Investing Is Trending Among All Generations

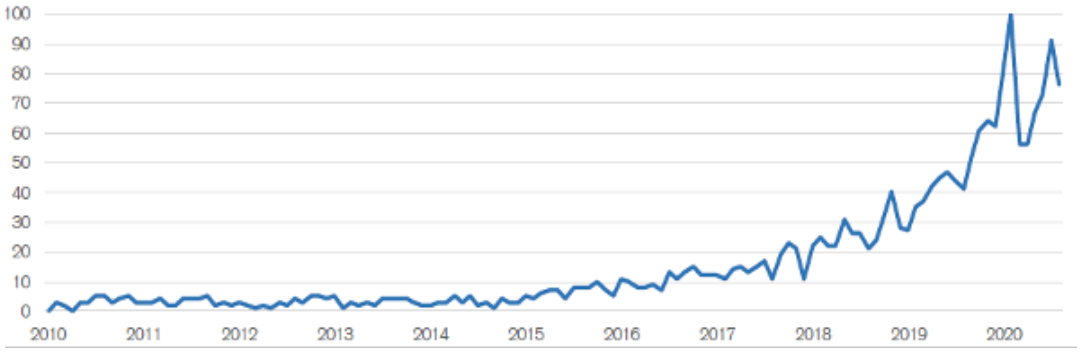
By Doug Couden, CFA, Chief Investment Officer

Investors are allocating where they see their values

During the past 20 years, there has been an evolution in impact investing, with a steadily increasing interest among all different types of investors. 10 years ago, even five years ago, conversations about socially responsible investing would not start with financial advisors asking clients, "Is this something you'd like to do?"

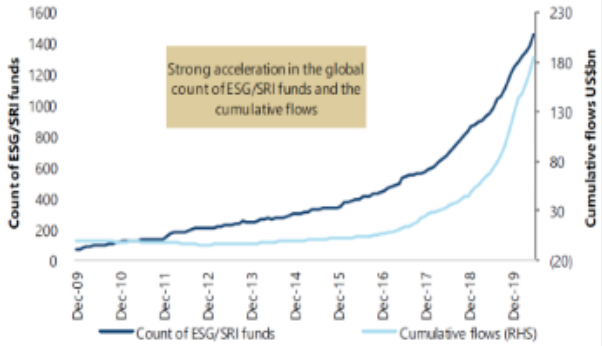
Today, the tables are turned. Google searches illustrate the tremendous increase in interest in the last few years of this investment approach. Clients are proactively asking how they can back companies that are committed to best practices for environmental impact, social responsibility, and corporate governance issues.

Google Search for ESG Investing



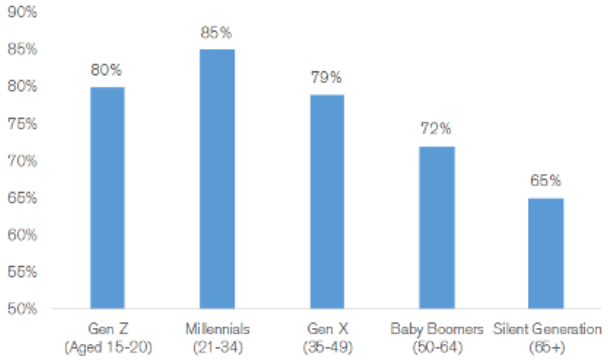
Source: 2010-2020 Popularity of "ESG Investing" search term on Google Trends. Representing search interest related to the highest point on the chart for a given region and time. A value of 100 is peak popularity for the term. A value of 50 means the term is half popular. A score of 0 means there was not enough data on the term.

The dark blue line on the left is the number of accounts of Environmental, Social and Governance (ESG) funds or Socially Responsible Investing (SRI) funds.



The light blue line looks at all equity funds and the cumulative flows (money) coming in or out of them. If you look at ESG or SRI funds since 2018, you see that the growth has been exponential. Mainstream investors, pension funds, and retail investors have their share of impact investing because of societal shifts. People are looking for meaning and purpose in their money as a way to express meaning and purpose in their lives. And they want to understand the impact that their funds can have.

Over the next two decades, there will be a tremendous transfer of wealth from Baby Boomers and the preceding Silent Generation down to Generation X and Millennials.



According to a 2019 Credit Suisse study, impact investing is on the rise with 79% of affluent Gen Xers and 85% of affluent Millennials reporting having made an impact investment.

Their choices can drive markets and support companies that are really aligned with their values. Advisors who help clients make impact investments now should have a good tailwind for the space in the next 15 to 20 years.

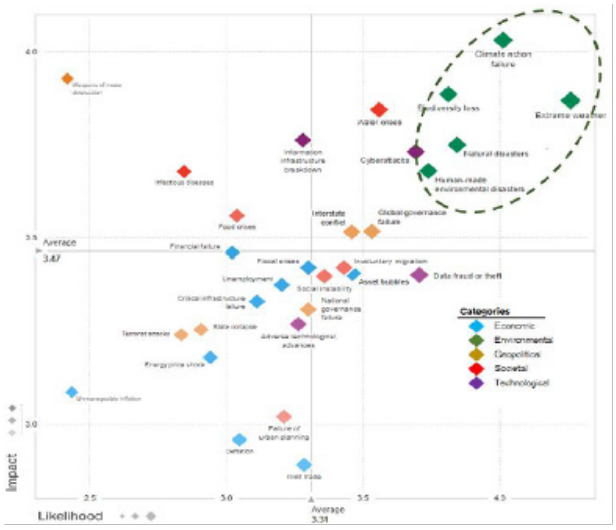
The institutional perspective

There is also an enormous institutional acceptance and push, a lot of which was spearheaded by the liability and financial aspect of climate change. Close to 70% of institutional investors have implemented some ESG or SRI strategies, which taken altogether are over a trillion dollars. The personal acceptance of aligning money with values, combined with institutional acceptance, has led to an enormous reallocation of capital.

2019 BlackRock study of 2,800 global stocks

A 2019 BlackRock study showed that ESG portfolios can also be more resilient during downturns. Climate change is often viewed as a risk factor in a company's daily activities, and top executives are recognizing the likelihood of the risk and its impact. It's another reason that good governance, resilient supply chains, and environmentally sustainable practices should be integrated into companies -- and into investment portfolios.

World Economic Forum's global risk perception study



A World Economic Forum study indicates risks tend to be more environmentally based. Companies need to analyze what climate action failure or natural disasters caused by extreme weather can mean to their businesses. This corporate recognition that's been institutionalized, or is in the process of being institutionalized, further adds credence to the impact category.

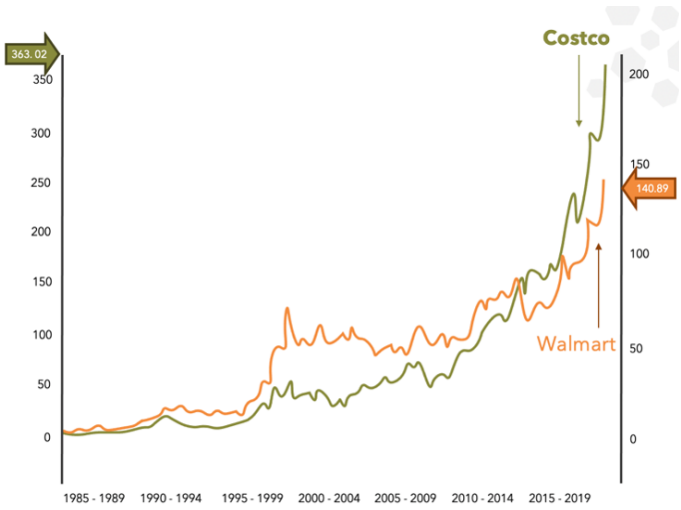
Previously, an analysis of a company included a laser-like focus on the income statement, balance sheet, and earnings. Now, the assessment of ESG type of factors is important to the investment and the risk-return profile, which is an incredibly powerful recognition at the institutional level.

Source: World Economic Forum's 2020 Global Risks Report

Equity returns may be linked to employee satisfaction

Companies consider intangible assets along with other factors such as: brand value, intellectual capital, human capital, customer relation and employee satisfaction, that can lead to increased valuation.

For example, the Costco and Walmart comparison illustrates significantly better performance when they have satisfied employees, and there are number of things businesses can do to increase employee satisfaction.



Based on this analysis, we see that higher wages and more benefits can give businesses something for those costs. If employees are happy, that leads to significantly less employee turnover, one of the major expenses of being a retailer. Two quantifiable outlays are (1) training and other costs that go into hiring someone new, and (2) employee theft.

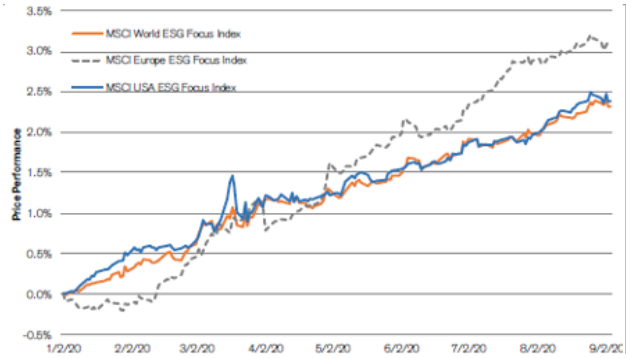
The pickup in performance in the stock price from Costco post-financial crisis is good evidence that companies don't need to give up returns by incorporating sustainable practices. When they think about more than just the single bottom line (cost), and include the double bottom line (social performance), and the triple bottom line (environmental performance), they can get better results and profits.

Sustainability impacts performance

Across the C-suite and in the investment community, there's growing acknowledgment and data that material sustainability factors directly impact a company's financial operational performance.

Brand value, balance sheets, valuation factors, intellectual factors, human factors, satisfaction, and customer relations are all measurable now. The data helps financial advisors crystallize their outlooks for investments with themes. It's been demonstrated that companies that have better ESG or SRI scores tend to receive higher valuation metrics.

Companies with Superior ESG Credentials are outperforming



This slide compares world indices and those with an ESG focus, and how they're performing relative to the overall market. The world level (orange), the US level (blue), and the Europe level (dotted line) is performance relative to a broad index. There's quite a bit of out-performance in that same chart with gold lines for one-, three-, and five-year periods as well. And that's very encouraging for investors and financial advisors.

Standardization for measuring social impact and monitoring Greenwashing

In order to avoid "greenwashing" – the practice of making statements or policies that make an investment or investment fund appear to be more serious about ESG or SRI than it actually is – there are a lot of frameworks coming together to provide consistency of which metrics are reported, and how and when they are stated:

VARIOUS FRAMEWORKS FOR SUSTAINABILITY REPORTING

In the past thirty years, a growing body of organizations and initiatives have put forth frameworks to determine how to report non-financial factors that may be material to their business footprint.

In September of 2020, a number of the major reporting frameworks issued a statement of intent to collaborate identifying, outlining, and enhancing various material metrics associated with sustainability and enterprise performance.

- SASB, the GRI, the Carbon Disclosure Project (CDP)
- Climate Disclosure Standards Board (CDSB)
- International Integrated Reporting Council (IIRC)
- Task Force on Climate Related Disclosures (TCFD)

More measurable data is now available

Previously, research for metrics of a company's impact took a lot of time and the results might not be verifiable. Today, if an advisor makes an investment based on lowering of the greenhouse gas per unit of revenue, they can find it in a couple of clicks. Different data sources provide the information and companies are disclosing that data. Then the advisor can review metrics quarterly to evaluate impact results.

Investing with purpose can also mean investing for profits and less risk

Many companies scoring highly in factors deemed important either environmentally, socially, or from a governance standpoint are showing better profitability. There was concern a while back that socially responsible investing meant giving up something. But after years of making these kinds of investments in private and public markets, in the bond market, and in stocks, we see improvement in profitability and in many instances, less risk.

As previously noted, when a business has high employee satisfaction scores, they have better retention. Better retention means less need for legal liability, accruals, etc. A robust, clean supply network means smarter changes

for environmental issues. Therefore, businesses can get a higher multiple. Over the last few years as companies have adopted standards, they are actually improving their product profiles.

Impact investing is becoming more mainstream

Indexes weighted for ESG are becoming more widespread and every asset class has the opportunity for investments, including:

- Equities (stocks)
- Fixed income (bonds)
- Cash & cash equivalents
- Real estate
- Commodities

Plus, impact investing is a sustainable, competitive approach for hedge funds and activist hedge funds, and venture capital firms.

When you are looking for meaningful investments that are important to you:

- Write it down – clearly define your values and know what makes you passionate, what you're trying to achieve with your money, and what types of things you want to support and not support.
- You can start investing on your own by buying an ETF or fund you've researched.
- For incorporating impact investments into an overall, well-diversified plan that is representative of the market, an advisor can assist you with the nuances of impact investing.

Here are two examples of how advisors can help:

1. If you had put money into just a few ESG mutual funds over the first nine months of 2020, you would have seen incredible performance – but perhaps not have known that some of the performance was attributed to heavy allocations to technology, which tend to score better on ESG frameworks.
2. For alternative options, if you are opposed to animal testing, it might not be something easily found in an ETF or mutual fund. However, an advisor can create a customized portfolio that filters out all the companies that do animal testing.

Plus, an advisor will review data points and measurability with you to see if your goals have been achieved from both an impact and financial standpoint.

If you would like more information on how to get started with impact / ESG portfolios, please contact us at bakerave.com/contact.

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