ESG Investing

What is ESG?

Key Points

ESG is an investment method that has gained noticeable momentum and popularity in recent years.

• ESG investing is often used synonymously with sustainable investing, socially responsible investing, and mission-related investing.

• It involves the consideration of environmental, social, and governance factors, alongside financial factors in the investment decision-making process.

• There are three common investor objectives that align with an ESG-investing strategy: integration, values, and impact.

A few approaches involve ESG integration, exclusionary or negative screening, and thematic investing.

• ESG encompasses a wide range of initiatives and focuses, meaning it can materialize in a variety of ways for different people and investors.

What does ESG Stand For?

ESG stands for environmental, social, and governance, and these three principles comprise a set of standards that socially conscious investors can leverage to evaluate potential investments. ESG criteria have blossomed in popularity in recent years, as people have begun to express a strong interest in thoroughly knowing and understanding the companies they are investing in, with a desire to put their money where their values are.

What is ESG Evaluation?

ESG evaluation is used to enhance traditional financial analysis, and although social awareness is a forefront goal for ESG investing, the main objective remains financial performance. The concept behind ESG investing is that investments with strong ESG scores have the potential to drive positive returns, while investments with weak ESG scores could signal poor returns in the future. By evaluating corporations based on ESG factors, investors can weed out companies that may be assuming greater financial risk – in the form of supply chain issues and overall performance, for example – because of their lack of focus on environmental issues, while also discovering investment opportunities that they have a genuine care for. Some of the environmental factors that play into ESG evaluation include: energy usage, waste production, climate change, animal welfare, and natural resource preservation.

A few of the social aspects that are examined in ESG investing involve employee and stakeholder relations, human rights, health and safety, and community interactions. Lastly, a sample of the governance elements involved in ESG evaluation encompass shareholder rights, quality of management, disclosure and transparency, and board independence. Due to the influx in popularity of ESG-sound investments, many brokerage firms, mutual funds, and robo-advisors now offer specific investment vehicles that adhere to ESG guidelines. Exchange-traded funds (ETFs) are a common way to incorporate ESG-sound investments into a portfolio. ESG-focused ETFs select stocks based on companies' ESG practices and traditional financial factors with the initiative of investing for social good. These ETFs enable investors to implement healthy diversification among a variety of carefully screened companies with sound ESG scorecards, as an alternative to investing in a single environmentally conscious company.

ESG vs. SRI vs. Impact Investing

As a growing number of investors want to see their money go towards companies that are not only profitable, but also reflective of their values, new criteria for evaluating corporations have been put into practice. Three investment styles have led the way include: ESG investing, socially responsible investing (SRI), and impact investing. Although ESG investing is often used synonymously with socially responsible investing (SRI) and impact investing, these methods have a few differences that impact how your portfolio should be structured and which investments are most suitable for meeting your ethical-investment goals.

As stated above, ESG investing involves evaluating a company's environmental, social, and governance principles - as its name entails - in addition to traditional financial assessments. In contrast to ESG investing criteria, socially responsible investing (SRI) involves actively selecting and removing investments according to specific ethical guidelines, and impact investing aims to help businesses fund a certain project or initiative that seeks to positively benefit society. The underlying motives of SRI could be anything from religion and political beliefs to personal values, and the goal is to generate positive returns without sacrificing one's social conscience. SRI essentially takes ESG a step further by adding an additional layer of screening to investments that involves one's personal beliefs and sentiments. With impact investing, positive outcomes are at the forefront of importance, and this style of investing really looks towards helping businesses that have specific goals aimed to benefit society and the environment, regardless of success.

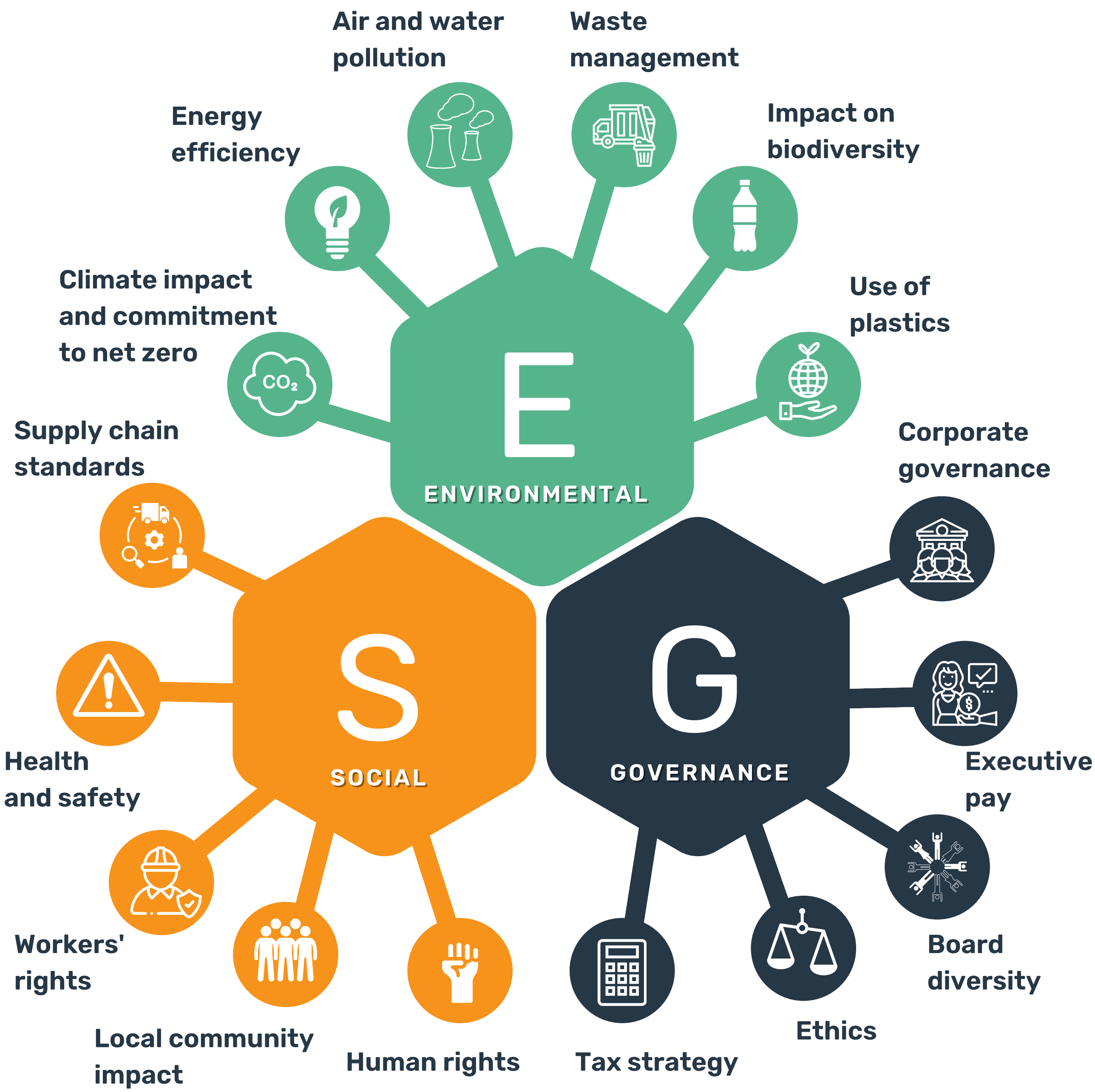
What is sustainable investing?

- Sustainable investing means looking at all the factors – not only financial – that can have an impact on a company's ability to operate today, or in the longer term.
- Sustainable investing considerations are often grouped into three categories: environmental, social and governance (ESG).

	ENVIRONMENTAL	SOCIAL	GOVERNANCE
	Factors related to the quality and functioning of the natural environment and natural systems.	Factors related to the rights, wellbeing and interests of people and communities.	Factors related to the way companies are managed and overseen.
EXAMPLES	Carbon emissions, waste management, water stress	Cybersecurity, employee diversity, product safety	Executive pay, board composition, ownership structure
ILLUSTRATION	BP's Deepwater Horizon oil spill is perhaps the highest-profile ESG transgression in recent history, and illustrates the impact that environmental mismanagement can have on company performance. A decade on, BP's share price has still not recovered.	As well as the short-term share price effect, a high-profile data privacy breach can have significant long-term consequences for a company, damaging customer trust, attracting regulatory scrutiny and driving up costs.	When executive pay is based on short-term achievements, companies can develop a culture of excessive risk taking that damages long-term performance. Remuneration packages should be aligned with the company's long-term goals.

Environmental, Social and Governance (ESG) Examples

ESG investing is about understanding the impact of potential companies we might invest in across three broad areas:



Source: The Ink Group
https://theinkgroup.co.uk/news-insights/esg-investing-what-it-is-and-why-its-important Date: 2021

Different approaches to building an ESG portfolio

Negative Screening	Typically avoid "sin" related businesses (gambling, tobacco, pornography, alcohol), weapons manufacturing or potentially environmentally harmful industries (nuclear power, oil and natural gas)
Faith-based Investing	A similar approach to Negative Screening, but with filters determined according to a specific religion's beliefs (eg abortion providers or non-kosher food processors)
Positive Screening	As the flip-side of Negative Screening, this strategy actively seeks to include environmentally friendly industries (solar energy, electric vehicles, clean water) or socially beneficial focuses such as housing, education or healthcare. Note: Positive Screening is also sometimes referred to as "impact investing."
Integrated ESG Analysis	Blends traditional fundamentals research with ESG (Environmental, Social and Governance) factor analysis to assess long-term risks and opportunities. However, specific approaches to ESG Integration can vary widely among asset managers depending on their different research models and assessment of corporate ESG practices.
Community Investing	Investing directly in an organization or institution instead of purchasing stock. For example, loans to a community development financial institution (CDFI) who in turn provides credit or financial services to underserved populations or targeted community projects.
Shareholder Engagement	Engagement strategies include attempts by shareholders to positively influence corporate behavior, typically through proxy votes directed with management. For example, an asset manager might present evidence to a company they've invested in showing the correlation between gender diverse boards of directors and financial performance.

Source: Calvert Funds "Tools of Change" brochure Site: https://www.calvert.com/calvert-documents.php Date: April 2021