Influence Change with Greater Impact

A GUIDE TO ESG INVESTING

NEW YORK LIFE INVESTMENTS

Growth and evolution of ESG investing

Impact investing is the most proactive ESG investment approach in that investors explicitly use capital to attempt to influence the world in a positive way.

In recent years, “ESG investing”—meaning investment strategies that incorporate environmental, social, and governance (“ESG”) factors alongside traditional financial analysis—has grown considerably in attention and assets under management (AUM). In 2020, more than $40 trillion in assets around the globe were managed using an ESG-related process to drive investment decisions,[1] with $17 trillion of that in the United States.[2] As a subset of that $40 trillion global total, “impact investing” accounted for $715 billion in 2020.[3]

What is impact investing, and how does it fit into the broader ESG investing universe? First off, impact investments are made with the intention to deliver measurable social and/or environmental impact along with financial returns. Compared with other ESG investing approaches, impact investing is the most proactive because investors explicitly use capital to attempt to influence the world in a positive way. That said, impact investments are still investments. Unlike purely philanthropic approaches, impact investments seek a financial return alongside their positive impact.

Impact investing's place along the ESG investment spectrum

Before diving further into impact investing, it may be helpful to outline where this approach fits into the broader ESG investment universe. The table on the next page summarizes the various approaches to ESG investing. As a reminder, all ESG investment approaches include the belief that ESG factors play a key role in the investment process. On one end of the spectrum stands ESG integration, which considers or integrates ESG factors into the investment approach alongside other material factors used to assess the risk/reward profile of securities. Moving further along the spectrum, under the umbrella of sustainable investing, we find approaches such as "exclusionary" and "inclusionary" investing. An "exclusionary" approach—also referred to as "negative selection"—excludes controversial companies or sectors that do not meet certain sustainability criteria. This approach aims to ensure that an organization's investments align with its broader mission.

An "inclusionary" approach—also referred to as "positive selection"—seeks positive ESG outcomes by selecting companies based upon their ESG profiles within their sector. Investors following this approach generally seek to purchase stocks or bonds of "best-in-class" ESG companies and avoid the "worst" ESG companies with poor or problematic ESG profiles. In short, they believe companies with strong ESG profiles will outperform. There's evidence to support that belief. After analyzing more than 2,000 studies, a 2015 academic report determined that companies with good ESG ratings have indeed outperformed over time.[4] While inclusionary investing's primary goal is to generate positive investment performance and mitigate risk, this approach does not directly intend to effect social or environmental change.

Approaches to ESG investing

ESG Integration

This approach, also referred to as ESG consideration, is defined as investing that considers or integrates ESG factors into the investment approach, alongside traditional financial factors.

Sustainable Investing

This approach makes ESG analysis a significant aspect of a strategy's investment thesis in order to respond to investors' values while seeking financial returns. Within sustainable investing, there are three common nonexclusive approaches:

Exclusionary Investing

Also called negative selection or negative screening, is an investing approach that excludes companies or sectors that do not meet certain sustainability criteria. **This approach is commonly used for investors who want to ensure their investments don't support companies that act against their values.**

Inclusionary Investing

Also called positive selection or positive screening, is an investing approach that seeks positive ESG outcomes by selecting companies based upon their ESG profiles. **This approach is commonly used for investors who want to evaluate ESG risks and opportunities when selecting a company or issuer to invest in.**

Impact Investing

Is an investing approach that attempts to deliver measurable social and/or environmental impact. **This approach is commonly used for investors who want to invest in companies and issuers that are creating a positive change.**

Stewardship Activities

ESG incorporation generally functions alongside—or in combination with—stewardship or active ownership. Stewardship includes proxy voting and engagement with companies in dialogue and can be conducted across all portfolios. Stewardship is defined as the use of influence by investors and can be implemented through a use of tools including, but not limited to, engagement with issuers, voting at shareholder meetings, and direct roles on investee boards and board committees supporting stewardship goals.

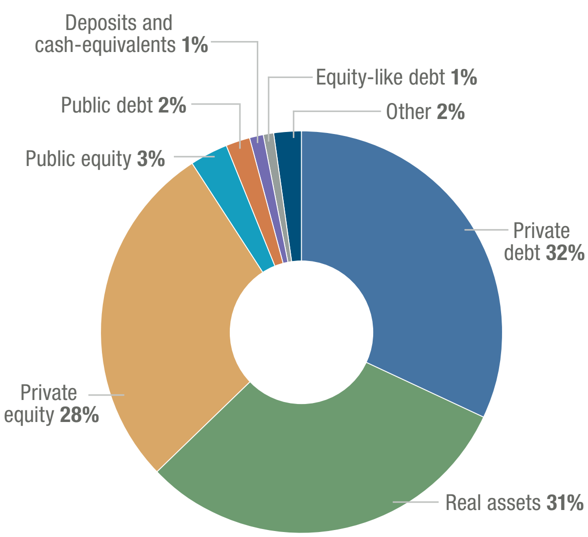
Going a step further: Explicitly aiming to do good

Impact investing takes “inclusionary” ESG investing a step further: Investors explicitly seek to use capital to effect positive change in the world. Impact investments can be made in developed, emerging, or frontier markets and use capital to address areas such as sustainable agriculture, renewable energy, and other environmental goals. Impact investments can also help underserved populations gain access to affordable and essential services, such as housing, health care, and education.

Impact investments remain diverse

A significant percentage of impact investments are private instruments—with private equity and debt serving as two of the largest categories. **Figure 1** shows the asset allocation of impact investments as of 2020, highlighting the prevalence of private and real assets—which accounted for 91% of the entire universe.[5]

Figure 1: Asset Allocation of Impact Investments (2020)[5]



One of the challenges the industry is facing is how to *measure* the impact of these investments because of the current lack of standardized reporting. However, the data we do have on impact strategies and both their positive impact and financial performance is promising. According to the Global Impact Investing Network, 98% of survey respondents stated that their investments had met or exceeded their impact goals, while 91% indicated that their investments had met or exceeded their financial return expectations.[6] By these measurements, impact investing has been a clear success. Respondents also report that portfolio performance overwhelmingly meets or exceeds investor expectations for both social and environmental impact and financial return in investments spanning emerging markets, developed markets, and the market as a whole.

Sustainable Development Goals (SDGs)

Impact investments often aim to address the SDGs established by the United Nations (UN) in 2015.[7] These SDGs are a collection of global goals created to address challenges around the world, including poverty, inequality, climate change, environmental degradation, peace, and justice. **Figure 2** shows these goals in a graphical format. The UN estimates it will require $5-$7 trillion annually to meet these goals by 2030. Since the funding cannot all come from governments or contributions by nonprofits, it's expected that impact investments will help fill the gap—likely leading to significant growth in the asset class over the next decade.

The Sustainable Development Goals are the blueprint for achieving a better and more sustainable future, and address the global challenges we face, so no one gets left behind.

Figure 2: The Blueprint to Achieving a Better and More Sustainable Future for All[7]

Impact investing has made meaningful progress in taxonomy and measurement over the last three years. The 17 SDGs are increasingly being used in finance as a common language and taxonomy. Many impact investors are using these SDGs to describe qualitative goals and enhance comparability. At the end of 2019, 73% of impact investors used the SDGs for at least one measurement purpose—up from 60% over just the previous twelve months.[8]

Room for growth in terms of assets and investment options

Impact investing is likely to grow significantly, driven by the trillions of dollars needed to meet the UN's sustainable development goals over the next decade and demand by investors.

Impact investing is still only a relatively small part of the ESG investing universe. At just over $715 billion in assets in 2020, impact investments represented less than 2% of the overall $40 trillion in global assets using an ESG-related process. However, this area is likely to grow significantly, driven by investor demand and the trillions of dollars needed to meet the UN's sustainable development goals over the next decade. Impact investments could be very appealing to clients seeking to make a positive environmental or social contribution, but would also like a return on their investment rather than only writing a check to a charity or other nonprofit organization.

It's still early in the story for impact investing, but the demand for strong investments and the need for solutions to large global problems such as climate change are not going away. An increasing number of mutual funds, ETFs, and SMAs are starting to invest broadly in topics aligned with the SDGs to tackle these challenges. Impact investments can address each of these goals and allow investors to feel good about making a difference in the world.

For more information on ESG investing, visit us at: newyorklifeinvestments.com

1. Source: Pensions & Investments, "Global ESG-data driven assets hit $40.5 trillion," 7/2/20.

2. Source: The Forum for Sustainable and Responsible Investment (US SIF), "Trends Report 2020."

3. Source: Barron's, "Impact-investing market expands to $715 billion, survey says," 6/11/20.

4. Source: Gunnar Friede, Timo Busch & Alexander Bassen (2015) ESG and financial performance: aggregated evidence from more than 2000 empirical studies, Journal of Sustainable Finance & Investment, 5:4, 210-233.

5. Source: Global Impact Investing Network "2020 Annual Impact Investor Survey," page 10, Figure 2, January 2021.

6. Source: Global Impact Investing Network, "GIIN Perspectives: Evidence on the Financial Performance of Impact Investments," 2017.

7. Source: United Nations, "Sustainable Development Goals," 2021.

8. Source: GIIN 2020, page 45; and GIIN 2019, page 30 (40% + 20%).

ABOUT RISK

Investing involves risk, including possible loss of principal. Asset allocation and diversification may not protect against market risk, loss of principal, or volatility of returns. There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors, and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market. No representation is being made that any account, product, or strategy will or is likely to achieve profits. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, accounting, legal or tax advice. You should consult your tax or legal advisor regarding such matters. This material is not intended to be relied upon as a forecast, research, or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy.

Impact investing and/or environmental, social, and governance (ESG) managers may take into consideration factors beyond traditional financial information to select securities, which could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market.

Further, ESG strategies may rely on certain values-based criteria to eliminate exposures found in similar strategies or broad market benchmarks, which could also result in relative investment performance deviation. Opinions expressed are current opinions as of the date appearing in this material only and are subject to change.

DEFINITIONS

Alpha is a term used in investing to describe a strategy's ability to beat the market or provide excess return.

NEW YORK LIFE INVESTMENTS

For more information

800-624-6782

newyorklifeinvestments.com