By:

Nancy T. Bell
CFP®, CDFA™, CSRIC™
Wealth Advisor
nbell@tcwealthpartners.com
630-545-3653

ESG by the Letter

3 KEYS TO VALUES BASED INVESTING

They seem simple enough, but financial acronyms such as GDP, FDIC, FOMC, and IRA can be confusing. While remembering a few letters can be easier than remembering what they stand for, keeping them all straight and understanding why they matter can be a challenge.

What is true for the broad and varied world of finance is also true when considering how to invest your money in alignment with your personal values and priorities. In the sphere of values-based investing, the term SRI is often used to describe: Socially Responsible Investing, Sustainable Responsible Investing, and Sustainable Responsible Impact investing.

They all sound similar and yet can have different meanings depending on whom you ask. This lack of clarity in terminology can make it challenging to build a solid foundation of knowledge around intentional investing (another often used phrase).

THE EVOLUTION OF VALUES-BASED INVESTING

Adopting a moral or ethical approach to investing is an ancient concept. Some sources say impact investing dates back to Biblical times when ethical investing was mandated by Jewish law to promote justice and equality in their communities.

Socially responsible investing is thought to have started in the 1700s when the Methodists discouraged investment in anything having to do with liquor, tobacco, or gambling. It wasn't until the 1970s that SRI – or socially responsible investing – became a buzz word.

In today's context, **SRI** often refers to **Sustainable, Responsible, Impact investing**. Under this umbrella you invest in what you like, exclude what you don't like, and hold companies accountable for their business practices, their labor force, and the impact their products and services have on the environment.

Significantly more data surrounding SRI has become available in recent years, and an influx of new SRI strategies has been created to support this style of investing. With so many options available and with more people taking an interest, it is not surprising that the terminology has become muddled and confusing.

THE 3 MOST IMPORTANT LETTERS: ESG

While SRI is certainly the foundation for intentional investing, you only need to focus on the three most important letters in the SRI conversation today: E, S, and G. **ESG** stands for **Environmental, Social and Governance**. These represent the key data categories that allow investors to identify, measure, and then monitor company products, services, and overall business practices according to specific category standards.

ESG data is collected and summarily applied to companies all over the world by a scoring system designed to sort out the "good" companies from the "bad." Having a high ESG score does not promise a high return, but it has been shown to be an important factor in managing business risk and the financial bottom line. Therefore, a company's ESG score is certainly an important consideration for investors.

ESG data helps determine if a company (or the basket of companies in mutual funds and exchange traded funds) aligns with the investor's personal values, ethics and morals. More specifically, it shines a light on how the company operates in relation to the environment, social factors, and governance. A company can be evaluated by one, two or all three data points depending on the investor's objective.

ENVIRONMENTAL IMPACT:

For example, an investor might be very concerned about the environment and wants to invest in companies that are working hard to shrink their carbon footprint. One example, and not to be construed as an investment recommendation, is Hilton Hotels and Resorts, which has an **Environment** score of 100 out of 100 according to Sustainalytics. They have carefully aligned their 2030 corporate responsibility goals with the applicable United Nations Sustainable Development Goals, and have a plan to double their social impact investment and cut their environmental footprint in half. On the flip side, a company that seeks to profit regardless of how its business practices affect the environment would have a low environmental score. By gathering this data, the investor can ferret out the companies that are "bad" and identify companies like Hilton that have intentionally aligned their business goals toward making a positive impact on the environment.

SOCIAL IMPACT:

The **Social** data category looks at how a company manages its relationships with its workforce from the societal and political environment in which it operates. For example, a company that is willing to sacrifice the safety of its workforce over profit would have a low social score due to its "bad" employment practices.

GOVERNANCE IMPACT:

The Governance data category assesses the policy risks the organization's leadership is willing to take to grow their profits. S&P Global research assesses companies by four factors: structure and oversight, code and values, transparency and reporting, and cyber risk and systems. Companies that rank well below average on these factors are particularly prone to mismanagement, and a mismanaged company may impose unnecessary risk to their profits and their stock price.

PUTTING IT ALL TOGETHER:

An investor can choose to invest in one company or a whole portfolio of companies deemed to be sustainable and responsible. An example, also not to be construed as an investment recommendation, would be Parnassus Core Equity Fund, which only invests in companies with sustainable competitive advantages, increasingly relevant products or services, exemplary management and ethical practices.

Like any investment decision, accurate and timely data is paramount and is still the most important aspect of investing successfully. However, ESG data will help you to better identify, evaluate, and monitor companies you own individually or in your mutual funds to ensure they measure up against what matters most to you.

Note: The content of this article is for guidance and information purposes only and is not intended to be construed as advice. Information provided is not intended to provide investment, tax, or legal advice.