MILWAUKEE
BUSINESS JOURNAL

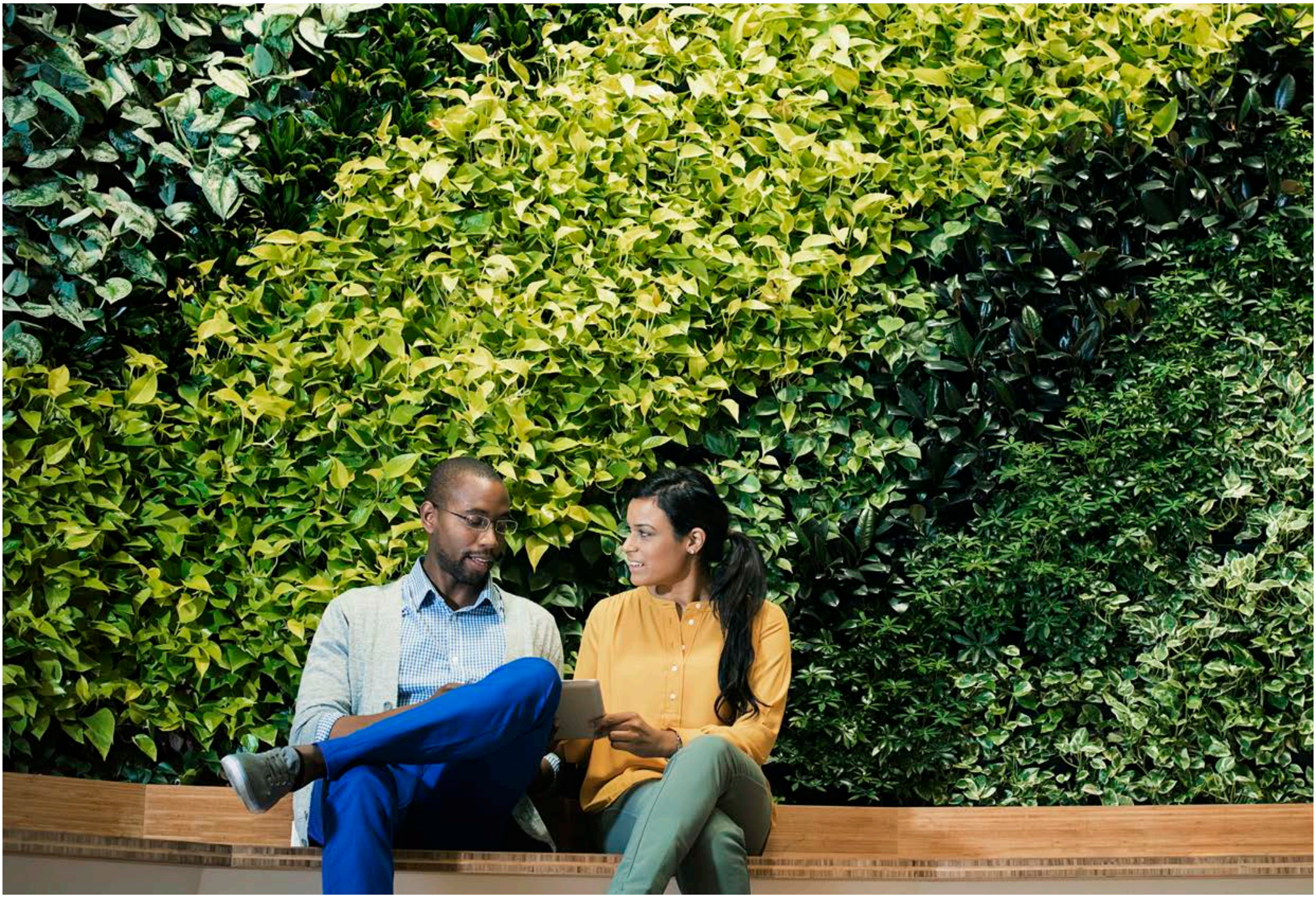
MAY 2018

Investment strategies and financial advice from local experts

2018 GUIDE TO WEALTH MANAGEMENT

INVESTING WITH ENVIRONMENTAL & SOCIAL IMPACT

ADVERTISING SUPPLEMENT



A NEW BOTTOM LINE

More investors focusing on a corporate social and environmental impact

MORE AND MORE INVESTORS ARE LOOKING BEYOND THE BOTTOM LINE WHEN IT COMES TO INVESTING. THEY'RE SEEKING OUT COMPANIES THAT HAVE DIVERSE LEADERSHIP TEAMS AND ARE SOCIALLY AND ENVIRONMENTALLY RESPONSIBLE AS WELL. IT'S NOT JUST A MORALITY PLAY ON THEIR PART. STUDIES INCREASINGLY SHOW THESE COMPANIES CAN OUTPERFORM THEIR PEERS.

"The average annual return of the MSCI KLD 400 Social Index, which tracks public companies with outstanding environmental, social and governance ratings, has been 10.87 percent since 1990," says Adam Peck, founder and CIO of Riverwater Partners LLC, a Milwaukee-based independent investment advisory firm that provides specialized asset management to individuals and institutions. "The average S&P return for the same time period was 10.49 percent. That adds up over the long term."

This type of investing can also protect a portfolio by mitigating risk. That's accomplished by steering investors clear of companies like BP, which had a poor safety record even before the Deepwater Horizon oil rig disaster in the Gulf of Mexico tanked its stock.

"The strategy focuses on trying to identify and avoid companies that are more likely to have bad events," says Greg Wait, president of Falcons Rock Investment Counsel, a Germantown investment consulting firm for institutional and high net-worth investors; and Prophecy Impact Investments, which provides investment advisory services with positive social and economic impact for smaller investors.

This approach to investing has several names, each with its own twist. The most popular are SRI, which has traditionally stood for Socially Responsible Investing; and ESG, which focuses on Environmental, Social and Governance factors. Wait says those two approaches are merging into a new definition of SRI - Sustainable, Responsible Impact investing.

By whatever name, the concept resonates especially well with millennials and women, which Peck believes will drive the growth of this strategy. "Millennials are going to see the greatest wealth transfer in the history of the country and women are going to manage 67 percent of wealth by 2030," he says.

Wait agrees. "The majority of new clients coming to us talk about ESG," he says. "Some of our older clients have also become very interested." They are joining the ranks of institutional investors who have established their own social and environmental criteria and are increasingly using their proxy power to leverage change. That's because there's a growing consensus that this approach will create value for the company. In 2015, the Department of Labor ruling determined that environmental, social and governance criteria can have a direct impact on the economic and financial value of an investment, giving pension funds the green light to consider the criteria without being in violation of their fiduciary duties. Wait notes that in Europe, you can actually be in violation of your fiduciary standard if you do not consider social, environmental and governance criteria.

Socially responsible capitalism is not new.

"In the 18th Century, the Quakers and Methodists laid out clear guidelines for the types of companies that their members could run," Peck says. In the 20th century, religious organizations began prohibiting investments in companies that provided products or services that violated their beliefs, including alcohol, tobacco, abortifacients, gaming and pornography. In the 1980s, the focus expanded to take on social issues, including discrimination and racism.

"Many people credit fund managers for their decision to stop investing in South African companies as one of the factors that helped end apartheid there," Peck says.

Social, environmental and governance issues, however, continued to play a relatively small role in investing until the financial crisis of 2008. Since then, the dollar amount of investments selected using sustainable, responsible and impact investing has grown significantly – from $2.5 trillion to $8.7 trillion in 2016. "We think that was driven in part by how millennials grew up during the crisis," Peck says.

ON ESG (ENVIRONMENTAL, SOCIAL AND GOVERNANCE)

"THE MAJORITY OF NEW CLIENTS COMING TO US TALK ABOUT ESG."

—Greg Wait, *president of Falcons Rock Investment Counsel*

The strategy has also shifted its focus.

"Socially responsible investing started out as an exclusionary approach," says Wait. "It was about avoiding so-called sin stocks. Now it is more about establishing appropriate criteria for including stocks. It is about looking for companies that perform well both financially and in terms of social environment and governance factors."

Investors can choose between SRI/ESG mutual funds or work with money managers that apply their own criteria. "A number of money managers are automatically incorporating ESG criteria into their funds so people are buying them without necessarily knowing," Wait says.

Choosing socially responsible companies is not as simple as it may seem.

"My definition of what is socially responsible can be different from yours," Peck says. Riverwater uses both traditional SRI and ESG criteria when selecting companies. "We don't invest in alcohol, tobacco or firearms, and we work off the 'Catholic mandate' for defense companies, which means we don't invest in manufacturers of unconventional weapons – nuclear, chemical, cluster bombs or landmines that are likely to kill more innocent people than military combatants."

Riverwater also looks at a company's impact on the environment and the make-up of its senior leadership and board. Companies still have to perform well financially. "One of the companies we invest in is Interface, which makes carpet tiles," Peck says. "We thought they were attractively valued from a financial standpoint, but what we really liked was that their goal was to have no net negative impact on the environment by 2020."

No company is perfect. And no ESG/SRI strategy is the same. Some managers may stay away from companies that don't meet their criteria, while others may play a proactive role and use their proxy voting power to direct the company.

ON ESG (ENVIRONMENTAL, SOCIAL AND GOVERNANCE)

"EIGHTY-TWO PERCENT OF ALL S&P 500 COMPANIES PUBLISH SUSTAIN-ABILITY REPORTS."

—Adam Peck, founder and CIO of Riverwater Partners LLC

Getting the data to make appropriate decisions can be challenging. There are no set standards like there are for financial disclosures. There are organizations that gather data, like MSCI and Bloomberg, while others, like Sustainalytics, will provide an aggregate rating for a fee.

Many money managers do their own research, combing through annual reports, safety records, other company documents and, increasingly, sustainability reports.

"Eighty-two percent of all S&P 500 companies publish sustainability reports," Peck says. "They explain what they are doing to lower their water or electricity usage, or their greenhouse gas output." The numbers are not audited, but Peck says a sustainability accounting standards board is moving forward to put together an auditing process to make sure that companies are not greenwashing.

Leadership diversity has become a primary concern among governance issues. State Street Global Advisors has notified companies that it will use its proxy voting power to vote against the heads of governance or nominating committees if they fail to increase the number of women members on their boards. And BlackRock, the world's largest asset manager, said it plans to stop investing in companies that have fewer than two female board members.

"There are 400 public companies in the United States that have no women on their boards," Peck says. "It's improving. Last year, 36 percent of the 397 S&P 500 board seats that came open were filled by women, but we still lag well behind Europe."

That's a concern, because studies have shown that companies with gender-diverse teams drive more innovation and better financial results.

"A Credit Suisse study found that companies where the top management is at least half female post returns on equity that are 19 percent higher than average returns," Peck says.