CLEARPOINT

clearstead

APRIL 2021

ANDRES ARSUAGA, CFA, DIRECTOR, PORTFOLIO MANAGEMENT

SUSTAINABLE INVESTING HAS ARRIVED

BY ANDRES ARSUAGA, CFA, DIRECTOR, PORTFOLIO MANAGEMENT

The last year has been marked by health and economic crises, renewed calls to confront social inequalities, and a politically charged presidential election. As difficult as these issues are, they have provided a spark to sustainable investing. In 2021 there were record inflows to these strategies as investors emphasized investments and companies that are tackling these difficult issues. While progress has been made to better define sustainable investing and utilize consistent data, it is still in its infancy.

WHAT IS SUSTAINABLE INVESTING?

Sustainable investing is an investment approach that seeks to incorporate economic, social, and governance ("ESG") factors into asset allocation and risk decisions to generate sustainable, long-term financial returns[1].

Many investors associate sustainable investing with environmental issues, but it encompasses much more. Below are examples of the types of criteria included in sustainable investing:

- Environmental: Natural resource use, carbon emissions, energy efficiency
- Social: Workforce, human rights, diversity, supply chain
- Governance: Board independence, board diversity, shareholder rights, and corporate ethics

DEPARTMENT OF LABOR ANNOUNCEMENT

NO ENFORCEMENT OF ESG AND PROXY VOTING RULES IN RETIREMENT PLANS

On March 10, 2021, the U.S. Department of Labor ("DOL") issued a temporary, non-enforcement policy for the "Financial Factors in Selecting Plan Investments" rule, published on November 13, 2020, and the "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" regulation, published on December 16, 2020. The rules related primarily to environmental, social, and governance ("ESG") investing and stated that fiduciaries should limit the influence of ESG factors in investment selection and proxy voting. The DOL noted it will not enforce either final rule until it provides further guidance. It intends to revisit the rules, though no specific timeline was provided.

For further information on how this may effect retirement plans, contact Sarah Parker, Senior Managing Director:

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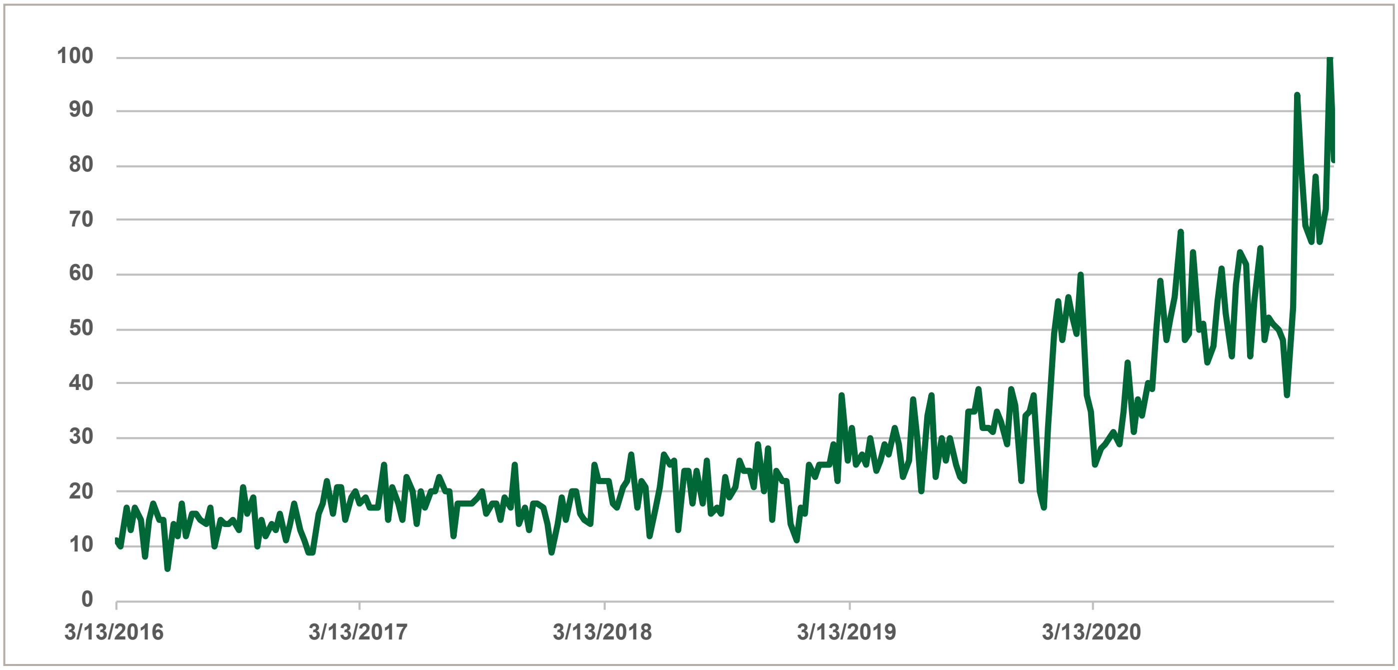
DRIVERS OF GROWTH

Sustainable mutual funds during 2020 saw inflows amounting to $51.1 billion which is double 2019 flows and nearly ten times 2018 flows[2]. Of all the net flows into stock and bond funds in 2020, sustainable investing mutual funds accounted for approximately a quarter of all flows[2]. There were multiple drivers that likely caused such a large increase, including the pandemic, changing views towards climate change, social movements, and a new president and administration. Fund flows are not projected to slow any time soon, and according to Deloitte, it is estimated that by 2025, in the US alone, half of all managed assets will have some type of ESG mandate. As seen in the chart below, according to Google trends, interest in "ESG" searches steadily increased in 2020 relative to prior years.

Google Trends "ESG" Search



Source: Google Trends, weekly interest observations over time (3/13/2016-3/7/2021).

Numbers represent search interest relative to the highest point on the chart for the given region and time. A value of 100 is the peak popularity for the term. A value of 50 means that the term is half as popular. A score of 0 means there was not enough data for this term.

Institutional investors also contributed to the acceleration of sustainable investing, a shift that has received wide publicity; even more than the shift among retail investors. According to the US Sustainable Investing Foundation's (US SIF) 2020 report on US Sustainable and Impact Investing Trends, institutional assets account for 70% of sustainable investing assets. Institutions have been vocal about these changes, which include Norway's sovereign wealth fund announcing the sale of all fossil fuel assets representing $13 billion of their $1 trillion fund, and the $500 billion New York State pension fund announcing that, over four years, they will divest oil and gas holdings. This momentum among institutional investors is unlikely to slow as trustees, shareholders and boards of directors ask more questions about what companies are doing to address sustainable investing issues.

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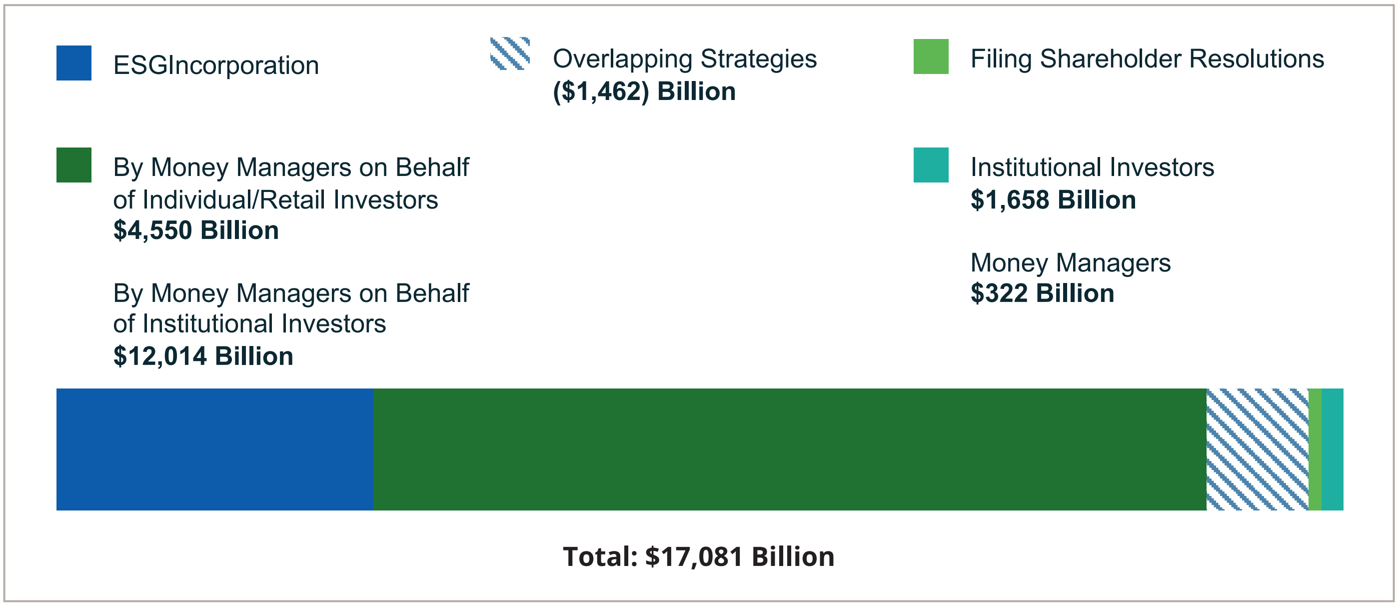
Sustainable Investing Assets 2020



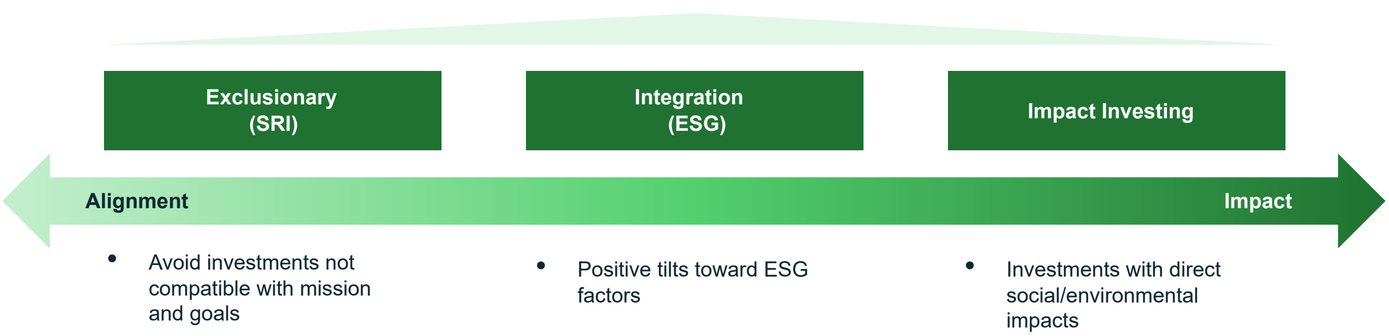
Source: US SIF Foundation.

Climate change is a cornerstone to Biden administration policies, both from economic and environmental perspectives, and President Biden created a specific Climate Change position in his cabinet to address this issue. In January 2021, President Biden issued an executive order establishing climate considerations as an essential element of US foreign policy and national security; mandates that the US government use its buying power to enact positive changes; and plans to rebuild US infrastructure for a sustainable economy. In addition, the US Department of Labor is making it easier for 401k plans to invest in sustainable investing funds. These initiatives, focused on climate change, should be a tailwind to sustainable investing.

CLEARSTEAD'S APPROACH

Our own experience with Sustainable Investing may help illustrate how ESG principles are being incorporated into investment programs. We categorize ESG considerations into three main investing strategies:

Clearstead's Solutions



This continuum ranges from exclusionary screens, which ensure investments are not made in unacceptable activities; to ESG integration, which uses sustainable factors to proactively move a portfolio toward desirable attributes; to impact investing, which makes direct investments in assets that generate acceptable financial returns and positive social or environmental effects.

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Clearstead's involvement began in the early 2000s, when several faith-based clients asked us to screen portfolios to minimize investments in tobacco, defense, pornography, and gambling, among others. For example, several of our clients used an exclusionary approach (SRI) to comply with the United States Conference of Catholic Bishops (USCCB) Socially Responsible Investment Guidelines, while others were more ESG-focused and implemented programs focused on environmental and social issues.

In 2017 we wrote a paper entitled *Responsible Investing*. This was followed by papers in 2019 entitled *The Female Factor and Impact Investing: Driving Change and Portfolio Returns*. In 2018 we sponsored a Roundtable for clients and friends of the firm entitled *The Cost of Conscience: Charting ESG Roadmaps for Institutional Portfolios*. Our Roundtable brought together industry experts on responsible investing. In 2021, we produced a podcast entitled *A Meaningful Combination: Private Equity and ESG*. We regularly speak at industry conferences on Responsible Investing.

Clearstead follows six "P"s in its investment philosophy and manager research process, and in 2020 we formally integrated ESG factors by adding "Principles" which encompasses Responsible Investing factors. Each manager goes through a rigorous selection process and receives a Responsible Investing rating based on our assessments.

We often are asked by clients to help them navigate toward sustainable investing approaches for their portfolios. This can be a complicated process that must consider investment objectives as well as organizational and financial priorities. We help our clients by executing a five-step process, including a questionnaire to guide them through these decisions. The table below describes our approach:

TOPIC	CONSIDERATIONS
Education	Responsible investing and incorporating it in an investment program
Investment Objectives	Core mission, values, and investment areas to emphasize
Approach	Exclusionary, Integration, or Impact
Portfolio Construction	Manager selection, active or passive
Reporting and Risk Management	Annual responsible investing audit and evaluation, on-going risk monitoring

Sustainable investing is not a fad and is something we believe is going to grow. However, it is in its infancy and can be difficult to put into action. According to US SIF there are 836 registered investment mutual funds and ETFs with sustainable mandates. There also are numerous private strategies that incorporate ESG factors. Deciding which strategies best align with our client's values can be daunting. Our experience and commitment to sustainable investing can help clients integrate values and goals into portfolios.

CLEARSTEAD'S FIRM APPROACH

Our commitment to sustainable investing extends further than the advice we provide clients, and we believe our own practices provide us with an enhanced understanding of sustainable investing. In 2015, we launched EmpowHER, which seeks to drive female success across the firm. This initiative has helped double the number of female shareholders and increased women in senior leadership positions. We also created a formal Diversity & Inclusion Council in 2018 that focuses on identifying opportunities for inclusion, educating employees on diversity awareness, and overseeing corporate policy including vendor, manager, and philanthropic relations. As part of our Diversity & Inclusion efforts, we established the Clearstead Foundation, and started a Clearstead Scholarship to support students of color at Ohio colleges and universities.

Please call us if you would like more information on ESG investing, Clearstead's approach, or specifics of the Clearstead Scholarship.

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Sources:

(1) Cochran, P. and R. Wood (1984), "Corporate Social Responsibility and Financial Performance", *Academy of Management Journal*, Vol. 27/1, pp. 42-56, http://dx.doi.org/10.2307/255956.

(2) Hale, Jon (2021), A Broken Record: Flows for U.S. Sustainable Funds Again Reach New Heights", *Morningstar*.

MARKET BENCHMARK RETURNS

March 31, 2021		1M	3M	12M	YTD
US Large Cap	S&P 500	4.4%	6.2%	56.4%	6.2%
US Small Cap	Russell 2000	1.0%	12.7%	94.8%	12.7%
Developed Intl	MSCI EAFE	2.3%	3.5%	44.6%	3.5%
Emerging Intl	MSCI Em Mkt	-1.5%	2.3%	58.4%	2.3%
Real Estate	NAREIT	5.4%	8.5%	36.9%	8.5%
Core Fixed	BarCap Agg	-1.2%	-3.4%	0.7%	-3.4%
Short Fixed	BarCap 1-3Yr	0.0%	0.0%	1.6%	0.0%
Long Fixed	BarCap LT G/C	-3.6%	-10.4%	-2.1%	-10.4%
Corp Debt	BarCap Corp	-1.6%	-4.5%	7.9%	-4.5%

Source: Bloomberg

The performance data shown represents past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.