



GRANT GUYURON, CFA, SENIOR MANAGING DIRECTOR

RESPONSIBLE INVESTING – PRACTICAL IMPLEMENTATION

BY GRANT GUYURON, CFA, SENIOR MANAGING DIRECTOR

INTRODUCTION

Responsible investing has garnered a lot of attention. You have undoubtedly heard the terms ESG, Socially Responsible Investing or Impact Investing that are part of this category. There have been many products created and capabilities developed to cater to investors who demand them, and there is an ongoing debate regarding whether these types of investments can or should provide similar or superior returns to more traditional strategies. This article is not intended to solve this debate or convince anyone of the merits of responsible strategies. The purpose is to illustrate how an investor should consider implementing such an approach if they so choose. The approach should be to develop a responsible investment policy, then identify investments, monitor the strategy for compliance, and finally, measure impact.

DEVELOPING A RESPONSIBLE INVESTMENT POLICY

Investors who are interested in pursuing responsible investments can vary meaningfully in objectives, areas of focus, and risk tolerance. Some investors may focus on screening out companies that operate in ways incongruent with the organizational mission or individual values (e.g., a healthcare organization removing tobacco exposure). Other investors may want to use their assets to

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Institutional Consulting, Research and Investment Management, and Private Client teams with Matt Kolenich, Sydney VanScoy, Mike Fedeli, Doug Wiedeman, and Christine Trunk, respectively.

Matthew Kolenich, CPFA, AIF® joined Clearstead's Institutional Consulting team as a Managing Director and Defined Contribution consultant. He has over 20 years of experience serving as a dedicated fiduciary advisor to organizations, supporting their retirement plans and participants. His skills will bolster the firm's retirement plan services, including fiduciary oversight, plan design, investment due diligence, provider oversight, and participant services and success metrics. Matt has a BSBA with a specialization in Finance from Bowling Green State University.

Sydney VanScoy has joined Clearstead as an Associate Portfolio Manager. Sydney recently graduated from Ohio University with a Bachelor's degree in Finance.

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influence corporate behavior in a positive way or to make a more direct impact on an important cause (e.g., climate change, clean water, promotion of diverse managers, etc.). Regardless of the tactic or focus, developing a responsible investment policy is a critical first step.

The responsible investment policy may be part of the investor's investment policy statement, or it may be an entirely separate document. What is important is that the policy captures the mission, objectives, and constraints associated with the responsible investment program and that there is sufficient detail so that investment directives are clear. The key items of the policy are as follows (as applicable):

- Objectives of the policy, which should refer to the investor's beliefs or mission
- Identification of investment restrictions, with specific directions regarding tolerance for impermissible investments
- Explanation of responsible investment themes and impact goals
- Process for measuring compliance with the policy and impact

For institutional clients and families, developing a policy can take time and several conversations because views on critical issues may vary among stakeholders. We believe clients need to fully understand the investment implications of their decisions, so your advisor should have input in the process and provide leadership—ultimately, this policy can and will affect investment choices, and it is critical that everyone involved understands these potential effects.

IDENTIFYING COMPLIANT INVESTMENTS

Once policy is established, the next step is to create an aligned portfolio. For investors screening out securities in public market portfolios, this is a straightforward process, but changes to the portfolio will be dictated by the stringency of the restrictions. For example, a zero-tolerance policy for tobacco or gambling may necessitate changing investment vehicles. Marriott generates less than 5% of its revenue from gambling,¹ but a zero-tolerance policy would mean eliminating this holding in a separate account or replacing a commingled vehicle (e.g., mutual fund) that holds the stock. This level of control is best achieved through customized separately managed accounts.

For policies with more leniency, the use of commingled strategies to invest in public securities may be the better route. The industry has created numerous responsible investing products that vary by asset class, restrictions, utilization of environmental, social and governance factors, and broad themes. For example, there are strategies designed specifically for Catholic investors that seek to abide by the United States Council for Catholic Bishops (USCCB) guidelines and other strategies designed to support climate change, among other important causes. Morningstar notes that the number of sustainable open-end and exchange-traded funds available to U.S. investors increased to 534 in 2021, up 36% from 2020.²

Mike Fedeli has also joined Clearstead as an Associate Portfolio Manager. Mike graduated in May from John Carroll University with a Bachelor's degree in Finance.

Doug Wiedemann has joined Clearstead as a Senior Client Planning Associate, Financial Planning. Doug has a Bachelor's degree in Accounting and Business Administration from Heidelberg University and holds CPA and CFP licenses. Prior to joining Clearstead, Doug was a Senior Associate on the Financial Planning Team at MAI Capital Management.

Christine Trunk has joined Clearstead as a Client Planning Associate, Tax. Christine has a Bachelor's degree from Excelsior College, majoring in Accounting. Christine previously worked as a Staff Accountant at Rea & Associates.

These changes underscore the firm's commitment to building its investment consulting practice, promoting the next generation of leadership, and maintaining a rigorous investment process.

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Private markets may also be an attractive area of investment for those with a responsible investment policy. For investors restricting exposures, there are sector or industry-focused strategies which should, by their nature, avoid undesirable areas. For those seeking to make direct impact, there are numerous themes that can be expressed in the private markets that may not be as readily available or as easy to measure in the public markets, such as:

- Affordable housing
- Renewable energy
- Regionally focused economic development
- Access to healthcare, education, and clean water

In some cases, private strategies may work best depending on an investors' specific objectives.

Diversity, equity and inclusion is another important area of focus for many organizations. Objectives and restrictions vary, while availability of data is limited and inconsistent. Clearstead queries its high conviction managers through surveys in an effort to solve this issue. Additionally, Clearstead has a list of approved minority- or women-owned business strategies for interested clients.

ONGOING COMPLIANCE MONITORING AND IMPACT MEASUREMENT

Once the portfolio is created, ongoing compliance becomes an important procedure. In the public markets, there are data providers that enable investors to evaluate exposures to restricted areas at the company and fund level. This can then be aggregated across the portfolio to help the investor understand how well aligned the portfolio is with the policy. Below is a simple example of such an output:

	Gambling ¹	Tobacco ²	Total
Total Portfolio	0.57%*	0.86%	1.43%

*Includes full weighting of companies that have any exposure to these areas—that revenue may be a small percentage of the companies' total revenues.

There may be cases in which holdings are flagged and require additional research. There may be cases in which a manager holds a restricted security in their fund to engage with that company and influence behavior.

There is no uniform practice for measuring impact in either public or private markets. In such cases, investors are generally reliant on "impact reports" produced by their managers, which has grown in popularity. These reports typically detail the fund's impact or ESG-related objectives and what has been accomplished in relation to those goals. As an example, the report may provide information about protection of clean water, jobs created, volunteer hours of employees, or reduction in carbon emissions. Summarizing these accomplishments in a consistent and digestible format is currently a challenge given the inconsistency of the data and the labor-intensive nature of the project; as such, investors should consider creating such a report, at most, on annual basis.

CONCLUSION

We work with many investors who seek to align their investments with beliefs or organizational missions. While the output requires customization, the process can be the same regardless of one's areas of focus. Development of a responsible investment policy ensures that the mission, objectives, and constraints are well-documented. The investor's implementation plan will then depend on policy, but there are options available to build a diversified portfolio given the proliferation of products and services that have been created. Monitoring compliance and impact requires data and customized work. While we do not claim that alignment is easy, we know that it can be done assuming the right process is followed.

Sources:

- (1) Morningstar.
- (2) Morningstar.

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

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MARKET BENCHMARK RETURNS

June 30, 2022		1M	3M	12M	YTD
US Large Cap	S&P 500	-8.3%	-16.1%	-10.6%	-20.0%
US Small Cap	Russell 2000	-8.2%	-17.2%	-25.2%	-23.4%
Developed Intl	MSCI EAFE	-9.3%	-14.5%	-17.8%	-19.6%
Emerging Intl	MSCI Em Mkt	-6.6%	-11.4%	-25.3%	-17.6%
Real Estate	NAREIT	-7.3%	-14.8%	-6.9%	-19.3%
Core Fixed	BarCap Agg	-1.6%	-4.7%	-10.3%	-10.3%
Short Fixed	BarCap 1-3Yr	-0.7%	-0.6%	-3.6%	-3.1%
Long Fixed	BarCap LT G/C	-3.0%	-12.3%	-20.1%	-21.9%
Corp Debt	BarCap Corp	-2.6%	-6.9%	-13.6%	-13.8%

Source: Bloomberg

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