



JOSEPH D. BOUSHELLE, CFA, CAIA, MANAGING DIRECTOR, RESEARCH

## IMPACT INVESTING: DRIVING CHANGE AND PORTFOLIO RETURNS

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We are seeing an increased desire from institutions and families to find investments that align with their long-term values or drive social or economic change. As we have discussed in previous articles, sustainable, responsible, and impact investing (SRI) continues to see strong growth in the United States. According to The Forum on Sustainable and Responsible Investment (US SIF), environmental, social and governance (ESG) issues are an element of the decision-making process for portfolios totaling \$11.6T, with \$8.6T managed on behalf of institutions, and \$3T on behalf of individual investors. This is a 44% increase from 2016 when the group conducted its previous study.<sup>1</sup>

Last year we analyzed the role of ESG in clients' liquid portfolios and looked at the ability of ESG screens to lead to alpha generation (the excess return of investment relative to a benchmark) and lower volatility returns. The article can be found [HERE](#). A large part of ESG screens is excluding "bad apples" or companies that have strategies, governance, or practices that don't align with long-term values. Outside of shareholder advocacy, ESG funds seem to have little direct impact on driving desired changes. However, investors are increasingly looking at their investment portfolio to drive their desired social or environmental changes in a more direct manner. Investments in ESG alternative investment vehicles, such as

## CLEARSTEAD HOSTS ESG ROUNDTABLE

On Tuesday, February 26 Clearstead will host a Roundtable Discussion on Environmental, Social, and Governance investing.

The Roundtable is entitled *The Cost of Conscience: Charting ESG Roadmaps for Institutional Portfolios*. It will be led by Mr. Robert Stein, Managing Director, John Carroll University Boler College Responsible Leadership Initiative. Mr. Stein will lead a panel of eight experts in ESG – foundation executives, money managers, attorneys, and not-for-profit trustees – in discussing the trade-offs of ESG principles and fiduciary responsibilities. Clearstead will write a summary of the Roundtable that will be available on our website.

The ESG Roundtable is the second subject-matter discussion Clearstead has hosted. The first was held in October, 2018 and explored discretionary management of institutional portfolios. It was entitled *Discretionary Management: Finding an Appropriate Balance*, was led by Mr. Brad Whitehead, President, Fund for Our Economic Future, and included eight subject matter experts. The summary of this Roundtable can be found on the Clearstead website, [www.Clearstead.com](http://www.Clearstead.com).

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private equity, private real estate, and venture capital, has tripled since 2016 to \$588B across 780 alternative investment vehicles.<sup>2</sup> As the number of managers and options in the space grows, we are finding an increasing number of funds and strategies that could help our clients meet their long-term investment return objectives while taking an active role in driving change.

Impact investing is still in its early stages and there is still debate around terminology and implementation. We would define impact investing as investments that are made to drive societal or environmental changes while delivering market-based returns. In this article, we will look at the different strategies that could be used in impact investing as well as the challenges and issues with implementation.

## IMPACT INVESTING: ALIGNING RETURNS WITH A MISSION

In 2016, the United Nations created a set of 17 Sustainable Development Goals (SDGs) with an overall aim of eradicating poverty, eliminating hunger, addressing climate change, reducing economic inequality, sustaining clean water and sanitation, supporting affordable and clean energy, and eliminating unsustainable production and consumption. The UN hopes these goals, shown in their entirety below, will be achieved by 2030.

### United Nations Sustainable Development Goals



Source: <https://www.un.org/sustainabledevelopment/>

While these goals create a framework for investors and investment managers, where an investor decides to focus his or her impact investing will depend on his or her mission and values. It might not be possible to achieve some of these goals without the risks of sacrificing returns. However, an investor can work to achieve a number of these goals while still generating market rate returns, which in turn can be used to fund other impact investments or socially impactful investments that generate below-market returns (such as community grants). These areas include:

We are planning a third Roundtable on Next Generation investing in September, 2019.

If you would like more information on these Roundtables, please contact Ms. Monica Fletcher, [mfletcher@clearstead.com](mailto:mfletcher@clearstead.com).

### New Professionals

We are pleased that several high-quality professionals have joined our firm in the past month.

Jennifer Coleman, Senior Program Officer of the Arts for The George Gund Foundation has joined our Management Committee. Jennifer oversees the arts grantmaking of the Gund Foundation, which invests in primarily local arts-focused organizations that directly impact the City of Cleveland. Her career has included both for-profit and not-for-profit assignments and she will bring valuable perspective to Clearstead.

In addition, the following individuals have joined our team:

- Larry Carone, Managing Director, Institutional Client Group
- Corwin Sorley, Client Planning Associate, Private Client Group
- Konstantin Goldberg, Performance Analyst, Client Services Group
- Rashauna Johnson, Administrative Assistant, Private Client Group
- Jon Watts, Director, Client Services Group
- Kathleen Thompson, Controller, Operations Group
- Luz Caraballo, Administrative Assistant, Institutional Client Group
- Kiana Woodgett, Client Planning Associate, Private Client Group

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- (1) **Education.** A major area of focus in education has been through the development of new education technology and services that can help drive down the cost of educational resources, provide students with access to resources that they would traditionally have been inaccessible, and help generate stronger educational outcomes. An example would be an online literacy program that gives teachers tools and content to create personalized instructional opportunities for students. We have also seen funds that have created jobs training programs for disadvantaged students in fields such as hospitality, in the case of a real estate manager.
- (2) **Community Development.** Community development can span several areas, including infrastructure, affordable housing, financing for business and community development, and bringing technology to underserved areas. Some examples include building cell towers in Africa or affordable housing in Manhattan or San Antonio.
- (3) **Healthcare.** There are many initiatives that are taking place to make healthcare more accessible, affordable, and impactful in improving and expanding life expectancy. Examples in this area include using telemedicine to improve healthcare access in rural communities, developing non-invasive technologies to test for diseases in a more cost-effective manner, or developing new drugs to combat infectious diseases.
- (4) **Food, Sustainable Agriculture, and Water.** Investing in sustainable farming is one area where we have seen investors focus. Other areas include improving infrastructure and investing in technology that can be used to farm more effectively or extract clean water from brackish or polluted water.
- (5) **Clean Energy and Renewable Energy.** Energy initiatives also fit in the category of climate change for many investors. This is more than just creating energy sources that minimize our carbon footprint, as it also includes making energy inexpensive and easily accessible for many people around the world. Some areas where we have seen a strong focus include solar energy, development of battery technology, and the development of geothermal power plants. We also see a number of real estate managers who include sustainable practices in their management of properties including building or retrofitting buildings to be LEED certified.
- (6) **Financial Empowerment.** The idea of financial empowerment is to help others who are disadvantaged, for reasons such as race, gender, or economic status, achievement economic stability or success. There are various ways investors can seek to do this. One way would be through the backing of new managers that are run by minority or women partners. It can also be through the backing of local entrepreneurs through seed or incubator investments. Another way could be through the development of technology in the financial system that seeks to reduce costs and democratizing access to financial tools and technologies, therefore providing greater access to financial resources for traditionally underserved populations. Jobs training and community development projects that are part of larger projects are other areas we have seen managers make an impact in this area.

## Promotions

In addition, we are pleased to announce the following promotions:

- Mike Moss, Senior Managing Director of Client Services
- Brad Knapp, Senior Managing Director, Private Client Group
- Terry LaCorte, Managing Director and Shareholder, Client Services Group
- Maureen Leneghan, Director of Financial Planning and Shareholder, Client Services Group
- Dave McClearn, Director of Portfolio Management and Shareholder, Client Services Group
- Ted Robbins, Director and Shareholder, Private Client Group
- Monica Fletcher, Marketing Associate, Institutional Client Group

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## IMPLEMENTING IMPACT INVESTING IN A PORTFOLIO

Once an investor decides what areas he or she would like to affect, it is important to develop an impact investing strategy. Clearstead can work closely with our clients to develop a policy that aligns with the client's impact focus while understanding the limitations and capabilities of the client. For smaller investors, or those unable to handle illiquidity, this could mean creating a policy range of investments that can be allocated to liquid strategies, most likely 40-ACT mutual funds, and sourcing those managers. Manager due diligence is important to ensure that clients are investing in quality managers who can both meet the clients' impact objectives and long-term return targets. Manager meetings and qualitative and quantitative screens go a long way in determining a manager's ability to generate strong returns while adhering to impact guidelines. Monitoring managers is crucial to ensure they are not deviating from their process or forsaking impact guidelines. MSCI has created standards to rank publicly traded companies on ESG matters and these can be monitored in a client's portfolio.

For clients looking to make a more targeted impact and can invest in illiquid strategies, we believe that these options together are often the best solution. The impact, as well as return potential, could be greater in illiquid strategies such as private equity, private real estate and infrastructure, and venture capital. However, rigorous due diligence is even more important here. Extra work is done to ensure that the manager has the appropriate systems and processes in place. Character references and confirmation of environmental and social initiatives is a key part of the process. Continuous monitoring is also crucial, and defining the impact can be made easier by following already established standards created by organizations such as the United Nations Sustainable Development Goals initiative, GIIN (the Global Impact Investing Network), PRI (Principals for Responsible Investing), and US SIF. Like traditional illiquid portfolios, these also take longer to build out, and a thorough cash flow analysis needs to be conducted on an ongoing basis to ensure appropriately sized allocations. This process is something with which Clearstead has experience helping clients.

Regardless of size, sophistication, and mission, Clearstead is here to help clients create portfolios and implement investment plans that can drive change while still generating meaningful returns.

### Sources:

- (1) US SIF, 2018 Trends Report Highlights.
- (2) US SIF, 2018 Trends Report Highlights.

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*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.*

### MARKET BENCHMARK RETURNS

| January 31, 2019 |               | 1M    | 3M    | 12M    | YTD   |
|------------------|---------------|-------|-------|--------|-------|
| US Large Cap     | S&P 500       | 8.0%  | 0.3%  | -2.3%  | 8.0%  |
| US Small Cap     | Russell 2000  | 11.2% | -0.4% | -3.5%  | 11.2% |
| Developed Intl   | MSCI EAFE     | 6.6%  | 1.3%  | -12.5% | 6.6%  |
| Emerging Intl    | MSCI Em Mkt   | 8.8%  | 10.2% | -14.2% | 8.8%  |
| Real Estate      | NAREIT        | 11.4% | 7.4%  | 10.1%  | 11.4% |
| Core Fixed       | BarCap Agg    | 1.1%  | 3.5%  | 2.3%   | 1.1%  |
| Short Fixed      | BarCap 1-3Yr  | 0.4%  | 1.5%  | 2.3%   | 0.4%  |
| Long Fixed       | BarCap LT G/C | 2.2%  | 6.6%  | -0.5%  | 2.2%  |
| Corp Debt        | BarCap Corp   | 2.2%  | 3.6%  | 0.9%   | 2.2%  |

Source: Bloomberg

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