

# Promoting Positive Change Through Investments

## The Impact of COVID-19 on Sustainable Investing

The past couple of months have been challenging as the world struggles to adapt to the spread of the COVID-19 virus. The health crisis has directly impacted millions, and mitigation efforts to slow the spread have led to an aggressive slowdown in economic activity due to significantly lower consumption and other economic disruptions.

Within this setting, clients who have demanded greater transparency about how and where their money is invested have seen their investments perform better than conventional approaches while at the same time knowing their investments are promoting positive change. For many of today's investors, the way they invest matters, and sustainable investing offers the opportunity to build wealth responsibly without sacrificing investment principles.

In the midst of the COVID-19 global pandemic, sustainable investing

continues to be a force for positive change—changing the investment industry, improving companies, and helping communities.

### Investment Industry

Sustainable investing has helped change the investment industry by challenging, and then adapting, traditional approaches in the investment decision-making process, while creating greater transparency and adding investment options in the process. Formalized in 2006 under the United Nations-backed Principles of Responsible Investment (PRI), which seeks to advance the integration of

environment, governance, and social (ESG) issues into investment decision-making, this type of investing has attracted over \$30 trillion in assets under management.<sup>1</sup>

During the first quarter of 2020, sustainable investing equity funds held up better than their conventional peers. Seven out of 10 sustainable equity funds finished in the top halves of their Morningstar Categories, and 24 of 26 ESG-tilted index funds outperformed their closest conventional counterparts.<sup>2</sup>

Contributors to outperformance included a higher allocation to high-



<sup>1</sup> Global Sustainable Investment Alliance, 2018

<sup>2</sup> "Sustainable Funds Weather the First Quarter Better Than Conventional Funds," Morningstar, April 3, 2020

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quality companies (as measured by strong financial statement metrics such as low debt and higher return on equity), and a lower allocation to energy. A primary feature of sustainable investing strategies is what is referred to as ESG incorporation, or incorporating ESG issues when building investment portfolios. This process leads to an emphasis on companies that exhibit better ESG ratings relative to their peers. These companies typically have fewer hidden risks (referred to by investors as off-balance sheet liabilities) and are more resilient to unexpected events (referred to by investors as black swans).

The fact that sustainable funds have been holding up well in this market makes sense considering those funds with better ESG ratings relative to their peers have given thought to and developed policies

around environmental concerns, such as resource depletion; social concerns, such as employee relations; and governance concerns, such as board diversity and structure. Having transparency and policies around these concerns exemplifies long-term planning and preparation for all different types of contingencies.

While the depth and breadth of outperformance during the first quarter was impressive, it may be surprising that it is consistent with longer-term performance as well. The MSCI KLD 400 Social Index—an index of 400 US securities that provides exposure to companies with strong relative ESG ratings and excludes companies whose products have negative social or environmental impacts—has outperformed the S&P 500 Index since its inception May 1, 1990.

If an investor had placed \$10,000 in the MSCI KLD 400 Social Index on May 1, 1990, it would have grown to \$175,430, compared with \$156,480 if invested in the S&P 500 Index over that same time period. This is equivalent to an annualized return of 10% for the MSCI KLD 400 Social Index versus 9.6% for the S&P 500 Index.

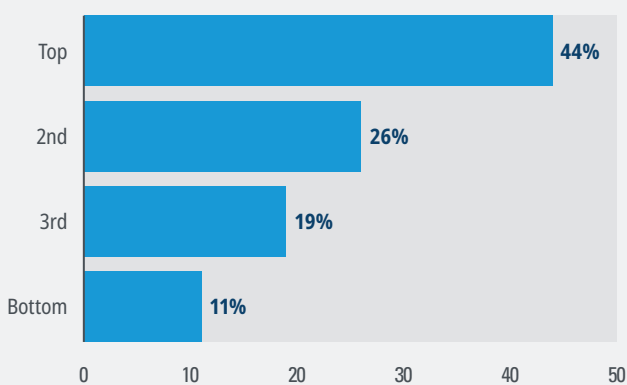
In addition to holding up better than conventional funds during the first quarter of 2020, flows into sustainable investing funds set a record, eclipsing the previous record set in the fourth quarter of 2019.<sup>3</sup>

### Companies

Sustainable investing can also be seen making improvements within companies themselves through shareholder engagement. Active engagement by shareholders can encourage more responsible corporate practices while discouraging corporate

#### 1 SUSTAINABLE EQUITY FUNDS

Q1 2020 Return Rank % by Morningstar Category Quartile (206 Funds)



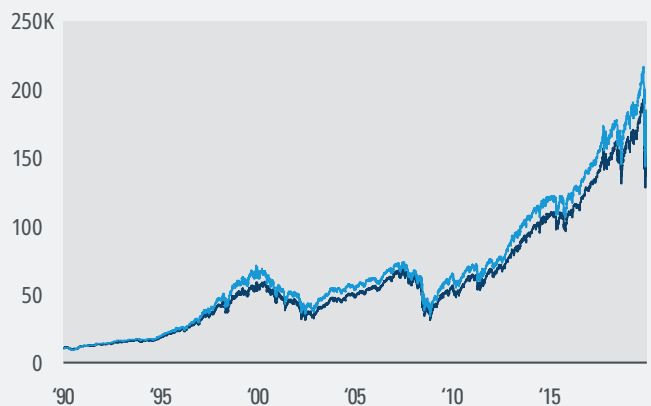
Source: Morningstar Direct 03/31/20

Oldest shareclass used for mutual funds. N=206

Past performance is no guarantee of future results.

#### 2 MSCI KLD 400 SOCIAL INDEX VS. S&P 500 INDEX

● MSCI KLD 400 Social Index ● S&P 500 Index

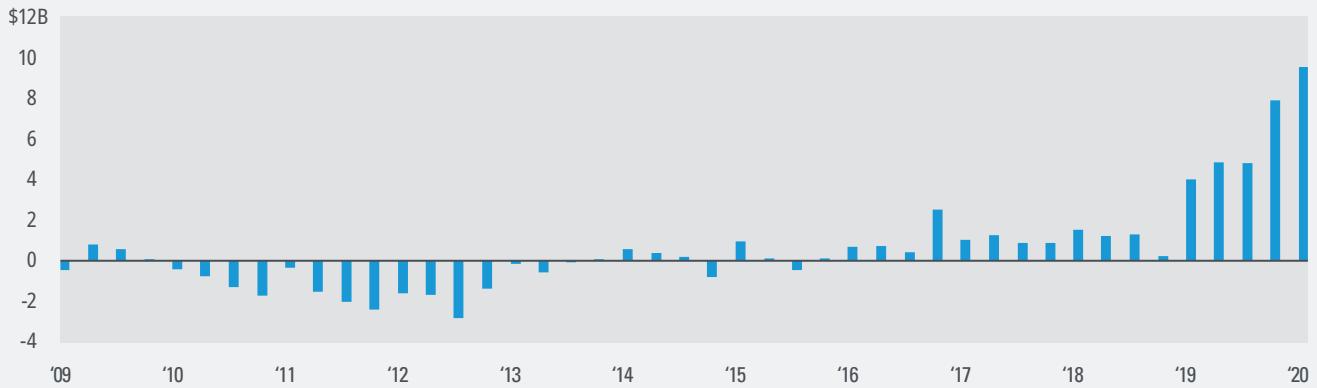


Source: Morningstar Direct 04/21/20

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

<sup>3</sup> "Despite the Downturn, U.S. Sustainable Funds Notch a Record Quarter for Flows," Morningstar, April 9, 2020

**3 U.S. SUSTAINABLE INVESTING FUNDS ESTIMATED QUARTERLY FLOWS**



Source: Morningstar Direct 03/31/20

Includes open-end and exchange-traded funds available to US investors.

practices that may lead to increased exposure to risk.

In the early stages of the COVID-19 global pandemic, sustainable investors used their relationships with company management for the benefit of the greater good. Recognizing that the long-term viability of the companies in which they invest is inextricably tied to the welfare of companies' stakeholders—including their employees, suppliers, customers, and the communities in which they operate—sustainable investors urged the business community to take specific actions.

One group, led by Domini Impact Investments, Interfaith Center for Corporate Responsibility, and the Office of the New York City Comptroller—which included 195 investors representing nearly \$5 trillion—provided a benchmark for the business community on topics such as paid leave, health and safety of workers, supplier/customer relationships, and financial prudence.<sup>4</sup>

**Communities**

Sustainable investing has also been at work positively changing communities through community-oriented investing. This type of investing brings capital directly to underserved communities that conventional markets do not reach, such as low-income neighborhoods and rural communities.

One approach is to invest in government-backed securities that target low- and moderate-income communities, which offers both the potential for social benefits to underserved communities and economic advantages to investors. A pioneer in the field, Ron Homer at Access Capital Strategies (now RBC Global Asset Management), created customized mortgage pools backed by Fannie Mae to help provide capital to underserved communities. In order to meet various reporting requirements, Ron's granular approach has been able to identify specific benefits from this investment

method, including providing more than 14,000 mortgages for low- and moderate-income home buyers, more than 55,000 affordable rental units, and more than 6,000 nursing home facility beds.<sup>5</sup>

While the economic impact of COVID-19 on communities as a whole will be substantial, those who were financially vulnerable prior to the pandemic will be disproportionately affected. Without a paycheck, low- and moderate-income workers are unlikely to be able to pay their housing costs, will fall behind on basic bills, and may not even be able to put food on the table for their families. Ron's strategy has a significant allocation to agency mortgage-backed securities (MBS) where the underlying loans are made to homeowners making less than 80% of area median income. As part of the stimulus package, mortgage giants Freddie Mac and Fannie Mae have instructed lenders to be more flexible with borrowers, allowing forbearance or modified payment plans. This

<sup>4</sup> "Investor Statement on Coronavirus." Domini. March 26, 2020

<sup>5</sup> RBC Global Asset Management, as of September 30, 2019.

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provides much-needed relief to the same individuals this strategy seeks to support. At the same time, the agency backing of the underlying loans provides investors with assurance that regardless of divergence from standard payment schedules, they will continue to receive the expected principal and interest each month.<sup>6</sup>

As a result, the strategy's holdings of primarily AAA-rated agency-backed securities have held up much better during the recent market volatility, while many other areas of the bond markets, such as corporate and high-yield bonds, declined.

<sup>6</sup> RBC Access Capital Strategy Update. RBC Global Asset Management. April 1, 2020.

### Bottom Line

The past couple of months have been challenging as the world has struggled to adapt to the spread of the COVID-19 virus. Within this setting, clients who have demanded greater transparency about how and where their money is invested

have seen their investments perform better than conventional approaches while knowing their investments are promoting positive change. In the midst of the COVID-19 global pandemic, sustainable investing continues to change the investment industry, improve companies, and help communities.



### IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for any individual. There is no assurance that the products or strategies discussed are suitable for all investors or will yield positive outcomes. Investing involves risks including possible loss of principal. Any economic forecasts set forth may not develop as predicted and are subject to change.

Sustainable investing is subject to numerous risks, chief amongst them that returns may be lower than if the advisor made decisions based only on investment considerations.

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In an effort to distinguish funds by what they own, as well as by their prospectus objectives and styles, Morningstar developed the Morningstar Categories. While the prospectus objective identifies a fund's investment goals based on the wording in the fund prospectus, the Morningstar Category identifies funds based on their actual investment styles as measured by their underlying portfolio holdings (portfolio and other statistics over the past three years). See Morningstar Category for Funds Definitions (April 2020) for further details.

### INDEX DESCRIPTIONS

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

MSCI KLD 400 Social Index is a capitalization weighted index of 400 U.S. securities that provides exposure to companies with outstanding environmental, social, and governance (ESG) ratings and excludes companies whose products have negative social or environmental impacts. The parent index is MSCI USA IMI, an equity index of large, mid and small cap companies. The Index is designed for investors seeking a diversified benchmark composed of companies with strong sustainability profiles while avoiding companies incompatible with values screens.

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