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How Does ESG or Impact Investing Affect My Investment Return

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2. One challenge when it comes to implementing a shift towards ESG investing is how to measure what companies are really doing.

There is a growing trend among investment managers and advisors towards offering portfolios that reflect investors' values as they relate to the environment and social issues. These offerings are in direct response to a growing request among clients for the ability to use their investment dollars to positively influence the world around them. The push seems to be led primarily by younger investors who are interested in aligning their portfolios with their values.

Today's investors have a broad range of issues they may wish to influence. We hear from clients that they are concerned about the environment, for example, and that they would like their portfolios to reflect their values around environmental priorities. This may be as simple as selling certain stocks an investor currently holds like tobacco stocks or it may be as complex as funding private clean water investments in emerging market countries. The former situation is sometimes referred to as "negative screening" or taking out parts of an existing portfolio that the investor may find to be offensive or harmful. The latter is more proactive and is often called "social impact investing," a more positive spin on how to deploy assets to advance the investor's values.

Large endowments and foundations often lead the way with investment trends and the move towards Environmental, Social & Governance ("ESG") investing is no different. Many institutional investors are now examining their pension and endowment funds through the lens of social good. This practice has trickled down to a broader universe of individual investors in recent years as standards are developed to evaluate the impact companies are having.

One central question in all of this is "how does ESG or impact investing affect my investment returns"? Several studies have shown that investing for "good" can also be good for portfolio performance. One reason is that well-run companies—ones that value diversity, ethics and have a high regard for employees—are likely to do better financially over the long term. As with all investments, each investor needs to consider a host of factors including desire for income and liquidity, risk tolerance for market value fluctuations, and overall portfolio size and diversification, to name just a few.

One challenge when it comes to implementing a shift towards ESG investing is how to measure what companies are really doing. There are a number of services that attempt to monitor and categorize publicly traded companies into various groups based on ESG criteria. Perhaps a company has recently announced they will no longer source materials from a country known to use child labor. Such a company may score well on an ESG screen due to this action. However, investors must be watchful for "greenwashing," a term used to denote a company masking "bad" policies and actions by highlighting "good" ones. The truth is that most large, publicly traded companies in the U.S. engage in some activities an ESG investor would find admirable at the same time pursuing business practices that one might not like as much. Weighing these factors against the criteria that meets the investor's needs can be difficult.

Challenges notwithstanding, using investment portfolios to reflect an investor's values is a trend that is with us to stay. It is important for anyone pursuing such a strategy to stay informed and be aware of the potential conflicts. Keeping a long-term view and having a sense of perspective is always healthy in investing and ESG investing is no different.

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