ADVISOR INSIGHTS

Socially Responsible Investing

Helping clients align their investments with their beliefs, values, and morals

Socially responsible investing (SRI)—also referred to as sustainable investing, impact investing, or ESG (environmental, social, and governance) investing—has become increasingly popular as more consumers seek to achieve their financial goals while having a positive impact on people and the planet.

However, misconceptions about SRI have caused some advisors to avoid presenting it as a strategy to their clients—an unfortunate reality, since offering products that resonate with clients on a personal level is a great way to differentiate and grow your advisory business, and SRI is one of the fast-growing trends in the investment industry. Institutions such as pension funds, foundations, universities, and nonprofit and religious organizations all practice socially responsible investing.

First, the SRI tent is bigger than many advisors may think—it's not just about renewable energy stocks and organic pet food. Socially oriented investors may seek out investments they believe will provide societal and environmental benefits (or at least do no harm in these areas), but they're also interested in those that promote positive employee and customer relationships, as well as those that embrace "enlightened" executive compensation plans and shareholder rights.

More than one out of every three dollars under professional management in the U.S. is invested according to socially responsible investing strategies.

– 2020 Report on U.S. Sustainable, Responsible and Impact Investing Trends.[1]

Second, like anyone else, socially responsible investors seek strong financial performance and competitive returns, and they range from average retail investors to high-net-worth individuals and family offices. And their numbers are growing.

Rapid growth in SRI

The SRI industry has experienced rapid growth in recent years. According to the Forum for Sustainable and Responsible Investment Foundation (US SIF), total U.S.-domiciled assets under management (AUM) held within investments that use SRI strategies grew by 42%—from $12 trillion to $17.1 trillion—between 2018 to 2020, and at the end of 2020 more than one out of every three dollars under professional management in the U.S. was invested according to SRI strategies.[1]

As impressive as this sounds, the change from a generation ago is even more dramatic. Assets held in SRI investments have increased 25-fold since 1995, when they were just $639 billion[2]—that's a compound annual growth rate of 14%.

The major screens for SRI money managers include climate change/carbon emissions, tobacco, conflict risk (terrorism or repressive regimes), human rights, transparency and anti-corruption, pollution/toxins, military/weapons, and alcohol.[3] As measured by the number of shareholder proposals filed, the top five considerations between 2018 and 2020 were:

1. Climate change /carbon
2. Anti-corruption
3. Board issues
4. Sustainable natural resources/ agriculture
5. Executive pay

What's holding advisors back?

Some advisors have been reticent to offer SRI as a strategy to their clients for two primary reasons. First, they may perceive a lack of client interest, and second, they may have concerns about the performance of SRI investments.

For example, some advisors say that it's difficult to bring up the topic of SRI with their clients, or decide which clients may be interested. But this roadblock, ironically, appears to stem from myths and stereotypes surrounding SRI investors that have led some advisors to conclude that SRI is not relevant for their clients.

However, research suggests interest in SRI is more widespread than many industry professionals assume. For example, Morningstar created a tool that asked investors to choose between the following investment profiles:

1. **Returns-driven (0-19):** Investor has a low interest in sustainability.
2. **Returns-minded (20-39):** Investor has a medium-to-low interest in sustainability.
3. **Balanced (40-59):** Investor has a balanced interest between sustainability and returns.
4. **Sustainability-minded (60-79):** Investor has a medium-to-high interest in sustainability.
5. **Sustainability-driven (80-100):** Investor has a high interest in sustainability.

What about gender and generational differences?

One common misconception about socially responsible investing is that its main demographic is women and younger investors. However, research disproves both theories.

While a study by Morningstar found that women have a slightly stronger preference for SRI than men, the difference is small, and it disappears when sociodemographic variables such as income, age, risk tolerance, and financial literacy are factored into the equation.[9]

In addition, the research also found that Millennials and members of Generation X have roughly the same level of interest in SRI. And while Millennials have a slightly stronger preference for SRI than Baby Boomers, the statistical significance between them again disappears when sociodemographic variables are included.[10]

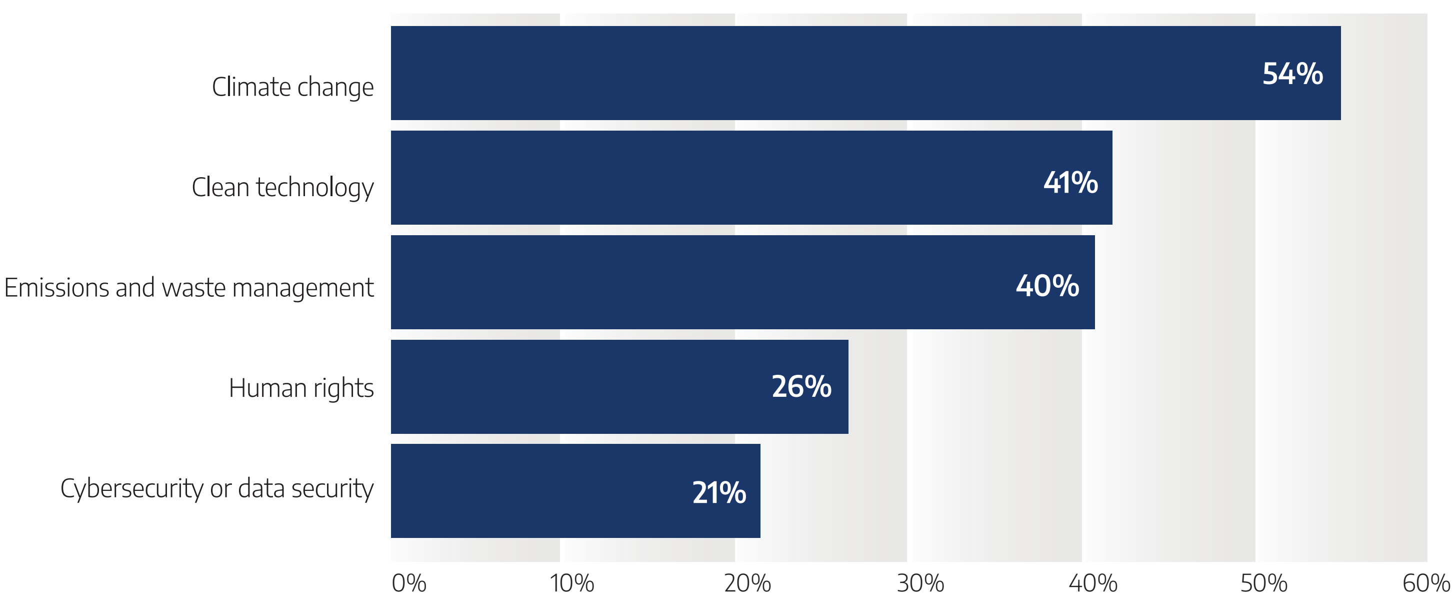
The results showed that 81% investors have a balanced, sustainability-minded or sustainability-driven attitude toward investing.[4] Another way to look at these results: Eight out of ten investors are at least moderately interested in SRI and potentially receptive to incorporating it in their investing strategy.

Is there a performance trade-off for SRI investors?

Another concern about SRI involves the perceived trade-off between social benefits and investment performance. Advisors (like many investors), may assume SRI returns are below average, and may question whether a client is really willing to sacrifice performance to achieve SRI goals. However, several studies indicate a performance trade-off, if there ever was one, may no longer exist:

- A report produced by Nuveen TIAA Investments found no statistical difference in the long-term returns of leading SRI equity indexes compared to broad market benchmarks.[5] Also, the report noted that incorporating SRI criteria into security selection doesn't incur additional risk because SRI indexes have similar risk profiles to broad market benchmarks.[6]

What are the most common SRI criteria brought up by your clients?



Source: Opportunity Knocks: How Advisers Can Capitalize on Growth ESG Interest, InvestmentNews Research and Calvert Research and Management study on socially conscious investing, 2019

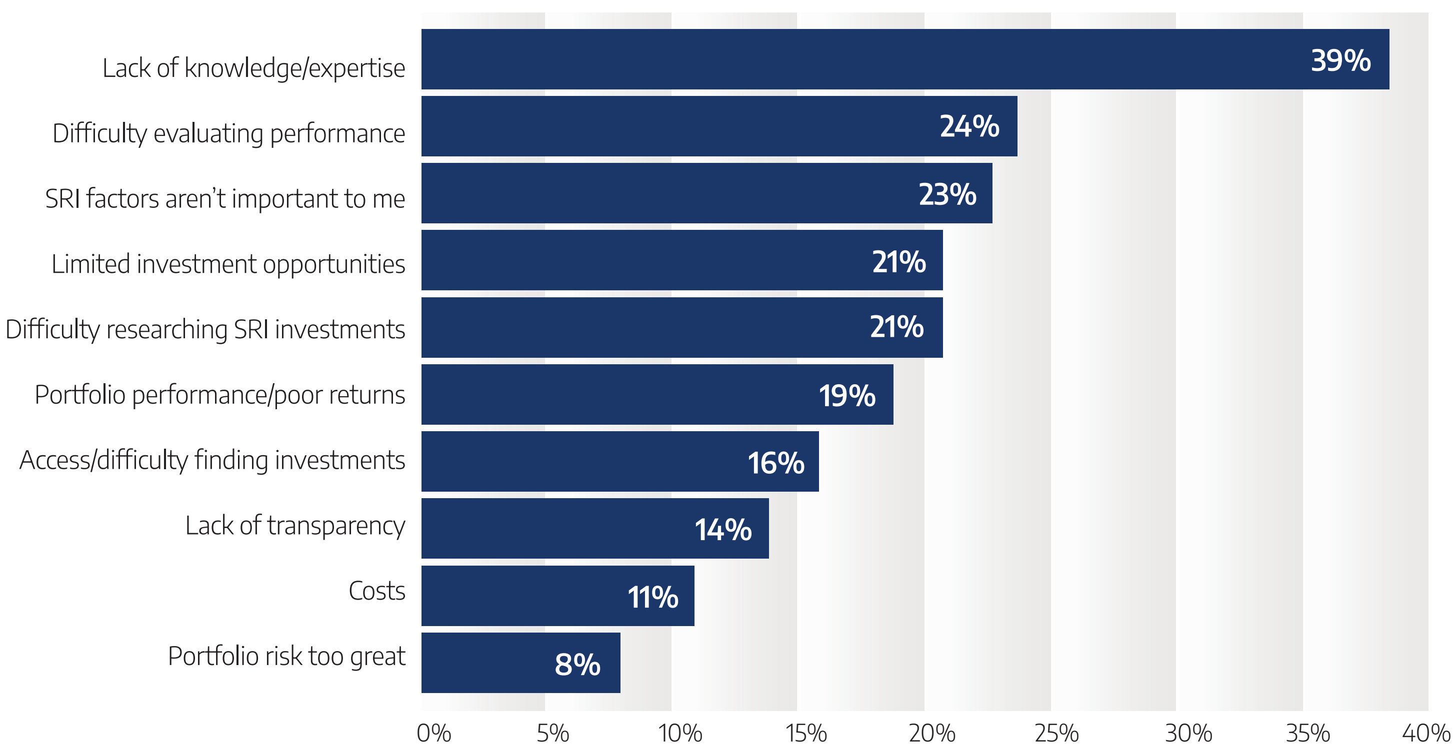
- A study co-produced by the Global Impact Investing Network (GIIN) and Cambridge Associates also concluded that risk-adjusted market rates of return are achievable with SRI.[7] More specifically, the report notes that the distribution of SRI investing fund returns mirrors the distribution of conventional real asset fund returns.
- Finally, Deutsche Asset & Wealth Management and Hamburg University conducted a meta-analysis of more than 2,000 empirical studies that represents the most comprehensive review of academic research on SRI investment performance. According to this analysis, more than 90% of studies find a non-negative correlation between SRI and corporate financial performance, and the majority of studies report positive correlations.[8] The analysis concludes the business case for ESG investing is "empirically very well-founded."

How to discuss SRI with clients

If SRI is a strategy clients are asking about or an opportunity you would like to present, here are five tips to help you navigate these conversations:

1. Talk openly and honestly with clients early in your relationship, not only about SRI strategies, but also about their financial planning goals and risk tolerance to gain a full understanding of their overall preferences.
2. Demonstrate to clients how SRI can help them meet their financial goals while having a positive effect on people as well as on the planet.
3. Help your clients understand how SRI has evolved, the wide range of investments it encompasses, and which SRI strategies may be most likely to deliver the results they're looking for.
4. Educate clients about your firm's approach to SRI. For example, you can develop client materials explaining SRI fundamentals and whether your firm's approach is active or passive, or geared toward specific areas of SRI, and so on.
5. Embrace the unique nature of SRI and use it as an opportunity to engage with clients, add value to your relationships, and differentiate the client experience and client-advisor relationship offered by your firm.

What investors say prevents them from using socially responsible investment strategies



Source: Opportunity Knocks: How Advisers Can Capitalize on Growth ESG Interest, InvestmentNews Research and Calvert Research and Management study on socially conscious investing, 2019

Getting up to speed on SRI

If you aren't familiar enough with SRI to comfortably discuss it with your clients, there are resources available to help you build your knowledge base. One is the US SIF site at www.USSIF.org. It contains a wealth of SRI educational resources, including both online and live courses.

Socially responsible investing isn't a fad, it's an opportunity for advisors to grow their firms. If you aren't already talking to your clients about SRI, now may be a good time to learn more so you can respond to inquiries and have relevant discussions with your clients.

1 2020 Report on US Sustainable, Responsible and Impact Investing Trends [https://www.ussif.org/trends]

2 Ibid

3 Ibid

4 The True Faces of Sustainable Investing Busting Industry Myths Around ESG, Morningstar [https://www.morningstar.com/content/dam/marketing/shared/pdfs/InvestorSuccessProject/esg-investor/esg-investor.pdf?cid=EMQ_&utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=16943]

5 Responsible Investing, Delivering Competitive Performance, Nuveen TIAA Investments, July 2017 [https://www.nuveen.com/responsibleinvesting-delivering-competitive-performance]

6 Ibid

7 Understanding the World of Impact Investing, Global Impact Investing Network and Cambridge Associates, September 2016. [https://www.cambridgeassociates.com/wp-content/uploads/2016/10/Understanding-The-World-of-Impact-Investing.pdf]

8 ESG and Financial Performance: Aggregated Evidence from More Than 2,000 Empirical Studies, Deutsche Asset Management and the University of Hamburg, January 2016. [https://www.db.com/newsroom_news/2016/ghp/esg-and-financial-performance-aggregated-evidence-from-morethan-200-empirical-studies-en-11363.htm]

9 The True Faces of Sustainable Investing Busting Industry Myths Around ESG, Morningstar [https://www.morningstar.com/content/dam/marketing/shared/pdfs/InvestorSuccessProject/esg-investor/esg-investor.pdf?cid=EMQ_&utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=16943]

10 Ibid

Expand your SRI investment capabilities through Money Manager X-Change

One of the biggest benefits of working with Axos Advisor Services is the investment flexibility that our platform provides. Our technology supports your investment management needs including individual securities, mutual funds, and ETFs.

For those advisors who want to outsource some or all their money management, or are already doing so, Axos Advisor Services also provides the Money Manager X-Change (MMX) program. This resource enables you and your reps to mix and match third-party money managers and strategies according to what you think best meets your clients' investment needs. And you can efficiently manage portfolios from one easy-to-use platform, which even allows you to have multiple models managed by different money managers within a single account.

The MMX program enables you to:

- Search for managers based on strategy, investment vehicle, standard fee, minimum account size, and average trade frequency.
- Outsource all investment management or round out your own offerings with unique strategies from third-party managers that fit your clients' specific needs.
- Use multiple money manager strategies in one account to increase diversification.
- Provide clients with 24/7 online access to investment holdings, transactions, and performance reports in one place.
- Find scalable models for small accounts with managers who trade at an omnibus level.

The Axos Advisor Services platform provides you with access to powerful investment management capabilities through MMX, which can be easily and seamlessly integrated into your business.

At Axos Advisor Services, we never stop thinking of new ways to help you grow your business and deliver more value to your clients.

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