



# Dispelling the Five Common Myths



A GUIDE TO SUSTAINABLE INVESTING



INVESTMENTS

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# Overcoming misconceptions of sustainable investing

*In 2018, over \$12 trillion in assets were managed using a sustainable process in the U.S. alone, compared to \$639 billion in 1995.<sup>1</sup>*

In recent years, “sustainable investing”—meaning investment strategies that incorporate non-financial environmental, social, and governance (ESG) factors alongside traditional financial analysis — has grown considerably in attention and assets under management (AUM). According to a 2018 study, more than \$12 trillion in assets in the U.S. alone were managed in a sustainable process, compared to \$639 billion in 1995.<sup>1</sup>

Despite this exponential growth, financial advisors and individual investors have remained largely on the sidelines, even as institutional investors have embraced sustainable investing. Of the \$12 trillion in sustainable strategies, an estimated 74% were managed on behalf of institutional investors, while the remainder was managed on behalf of individual investors.<sup>1</sup>

Another 2018 study showed that only one-fourth of financial advisors currently employ ESG strategies in their clients’ portfolios.<sup>2</sup> And, in a 2019 study performed here at New York Life Investments, we found that only 20% of investors surveyed had a financial advisor who recommended using an ESG-based strategy — while 38% of those same respondents stated they have an extremely high interest in discussing these types of strategies with their financial advisor in the future.<sup>3</sup>

So, what are the reasons advisors and individual investors are holding back? Well, the industry’s fondness for jargon certainly hasn’t helped matters. A confusing range of acronyms — ESG, SRI, SDG, PRI and so on — may be one barrier. In addition, there are persistent misconceptions about sustainable investing. Many of these myths have some basis in reality, which may be why they continue to persist so stubbornly. In this piece, we address some of those key myths and shine a light on the realities of sustainable investing.

1. Source: The Forum for Sustainable and Responsible Investment (US SIF), “Trends Report 2018.”

2. Source: Ginger Szala, “Why Are Advisors Reluctant to Hop on the ESG Train?” ThinkAdvisor, 12/4/18.

3. Source: New York Life Investments and RTi Research, September 2019. Results based on survey questions asked of 594 investors, both men and women, with investable assets over \$250k, ranging in age from 25-39; 40-54; and 55+.

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# Five myths of sustainable investing

*Empirical evidence supports the notion that sustainable strategies can, and often do, outperform conventional strategies.*

## **Myth 1:** Sustainable strategies underperform conventional strategies

### **Reality: Sustainable strategies tend to perform in line or better than conventional strategies**

The so-called “performance trade-off” myth is probably the most entrenched misconception surrounding sustainable investing. Despite evidence to the contrary, many investors still think they need to sacrifice returns in order to invest following ESG principles.

In 2015, academics analyzed more than 2,000 studies to investigate how companies with strong ESG profiles compared with those with lower ESG profiles. The paper determined that individual companies with strong ESG profiles tend to outperform their non-ESG counterparts. The authors suggested that sustainable strategies that focus on companies with good ESG practices were investing in “better” companies. The article concluded that “the business case for ESG investing is empirically well-founded” and the authors state, “We clearly find evidence for the business case for ESG investing. This finding contrasts with the common perception among investors.”<sup>4</sup> The fact that the authors acknowledged that their findings depart from the consensus shows just how entrenched this myth has become over time.

Along with academic research, industry studies also debunk the idea that ESG strategies necessarily underperform conventional approaches. In February of 2019, Morningstar published a study that showed that 63% of sustainable funds finished 2018 in the top half of their respective categories. In looking specifically at sustainable equity funds, Morningstar found that this category performed better than their conventional equity counterparts in a volatile and negative market for stocks in 2018.<sup>5</sup> While ESG strategies are varied and will not always outperform, both academic research and real returns suggest that investing in sustainable investments doesn’t mean compromising performance.

4. Source: Gunnar Friede, Timo Busch, and Alexander Bassen (2015), “ESG and financial performance: aggregated evidence from more than 2000 empirical studies,” *Journal of Sustainable Finance & Investment*, 5:4, 210-233.

5. Source: Morningstar, “Sustainable Funds U.S. Landscape Report,” February 2019.



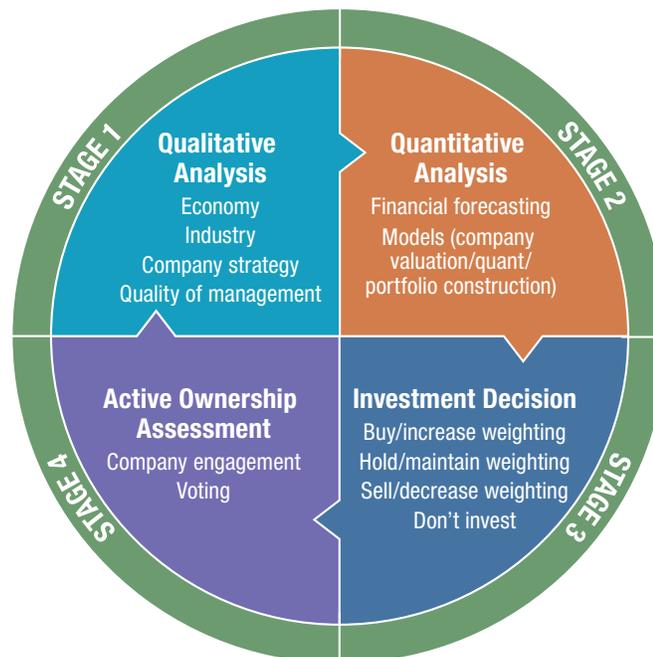
## Myth 2: Sustainable investing only involves screening out “sin” stocks

**Reality: Positive, inclusive approaches that follow “ESG integration” are gaining rapidly**

The myth that sustainable strategies are purely exclusionary has some basis in history. Many of the original socially responsible investing (SRI) strategies — thought to have had its roots with the Quakers and Methodists in the 1700s — followed an exclusionary approach that allowed religious and other organizations to avoid investments that violated their worldview.<sup>6</sup> In modern investing, exclusionary or “screens-based” approaches tend to avoid stocks or bonds of companies that manufacture or distribute alcohol, tobacco, or firearms, as well as those that operate casinos. For instance, the \$345 billion California Public Employees’ Retirement System (CalPERS) divested from tobacco stocks in its internally managed portfolio in 2001 and removed an additional \$500 million in tobacco stocks managed by its outside investment managers in 2016.<sup>7</sup>

In contrast to negative screens, investment managers are increasingly viewing ESG in a positive approach by integrating sustainability factors throughout the investment process. To encourage this approach, the United Nations sponsored Principles for Responsible Investing (PRI) has set forth guidelines for investment managers to formally integrate ESG analysis, as shown in **Figure 1**.<sup>8</sup> In its 2018 annual report, PRI signatories — both asset managers and asset owners — represented close to \$90 trillion of global assets. All signatories must incorporate ESG integration into their investment processes. PRI believes that encouraging investment in companies with strong ESG profiles will benefit the world, and investment managers increasingly view ESG as an alpha source to benefit their clients. While negative screens will continue to exist, ESG integration appears to be the future of sustainable investing.

**Figure 1: PRI Guidelines for Investment Managers to Formally Integrate ESG Analysis<sup>8</sup>**



6. Source: Frank A.J. Wagemans, C.S.A. (Kris van Koppen, and Arthur P.J. Mol (2013), “The effectiveness of socially responsible investment: a review,” *Journal of Integrative Environmental Sciences*, 10:3-4, 235-252.

7. Source: Randy Diamond, “CalPERS Decision to Divest from Tobacco Is Costly,” Chief Investment Officer, 12/12/18.

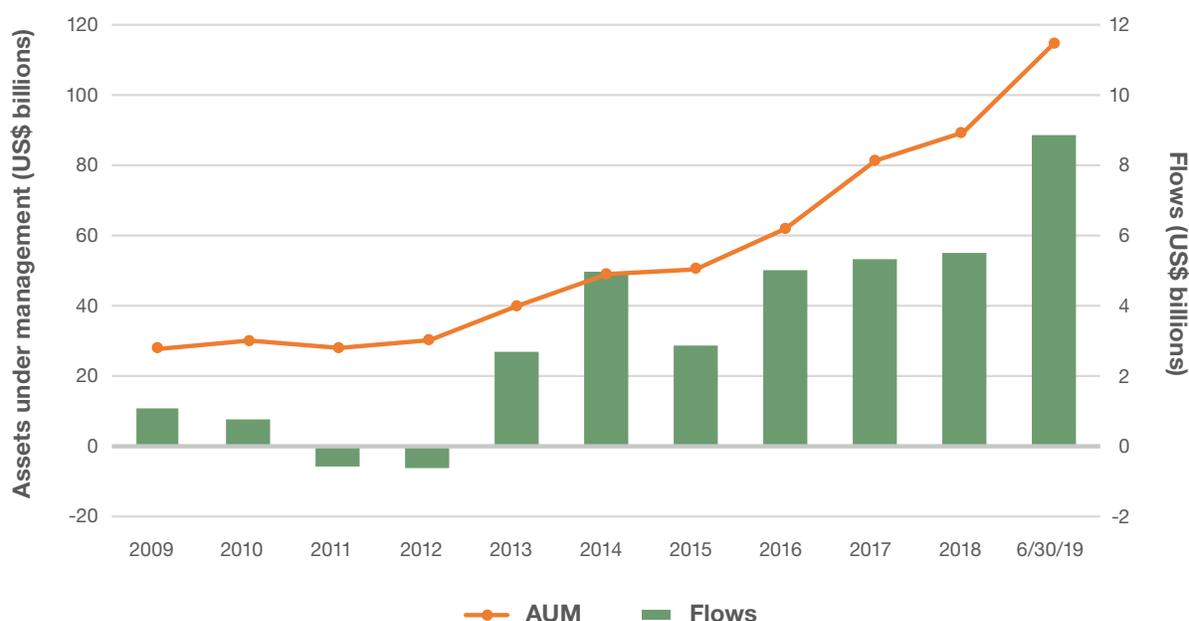
8. Source: Principles for Responsible Investing, “A Practical Guide to ESG Integration for Equity Investing,” 2016.

### Myth 3: Sustainable investing is a passing fad

#### Reality: Sustainable investing continues to grow in assets and fund offerings

Sustainable investing has been around for decades and continues to grow. As shown in **Figure 2**, sustainable strategies have shown consistent inflows and asset growth over the past decade.

**Figure 2: Sustainable Strategies Have Shown Strong Growth in AUM and Positive Asset Flows**



The number of sustainable offerings has continued to increase as well. At the end of 2018, Morningstar recognized 351 sustainable funds, a 50% increase over the 2017 total of 235.<sup>9</sup> Morningstar also noted that 2018 marked the third consecutive year of record inflows into sustainable mutual funds and exchange-traded funds. Clearly, this area is growing and will likely continue to increase in the years ahead.

*Sustainable investing has been around for decades and is not going anywhere.*

9. Source: Morningstar, "Sustainable Funds U.S. 2018 Landscape Report," February 2019.

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## **Myth 4:** Interest in sustainable investing is confined mostly to millennials and women

### **Reality: There's widespread interest in sustainable strategies, with institutional investors leading the charge**

It's a common stereotype that younger investors tend to care more about the social impact of their investments than previous generations. However, our research has backed up this claim, suggesting that millennials do indeed factor in ESG concerns more so than older investors. For instance, our study found that millennial investors are twice as likely (62%) to invest in companies or funds that target specific social or environmental outcomes compared with older investors (31%).<sup>10</sup> Additionally, another study found that 29% of investors in their 20s and 30s prefer to work with a financial advisor that offers values-based investing.<sup>11</sup>

All that said, the facts don't bear out the idea that millennials are the primary investors in ESG strategies. Contrary to popular belief, institutional investors have adopted sustainable investments more so than any other group. As noted earlier, institutional investors account for nearly three-quarters of the assets managed following an ESG approach. They've been leading the charge of sustainable investing, while individuals have been slower to adopt sustainable strategies.

That does not mean there's no market for ESG strategies for individual investors. Quite the opposite. According to a Morningstar study published in April 2019, 72% of the United States population expressed at least a moderate interest in sustainable investing.<sup>12</sup> Our research found no statistically significant difference in preferences for ESG strategies by gender, as both men and women were nearly equally open to sustainable strategies.<sup>10</sup> According to these results, there could be a large, relatively untapped market of individual investors who want to learn more about sustainable strategies.

*Contrary to popular belief, institutional investors have adopted sustainable investments more so than any other group.*

10. Source: New York Life Investments and RTI Research, September 2019. Results based on survey questions asked of 594 investors, both men and women, with investable assets over \$250k, ranging in age from 25-39; 40-54; and 55+.

11. Source: Ernst & Young, "Sustainable investing: the millennial investor," 2017.

12. Source: Morningstar, "The True Faces of Sustainable Investing: Busting Industry Myths Around ESG," April 2019.

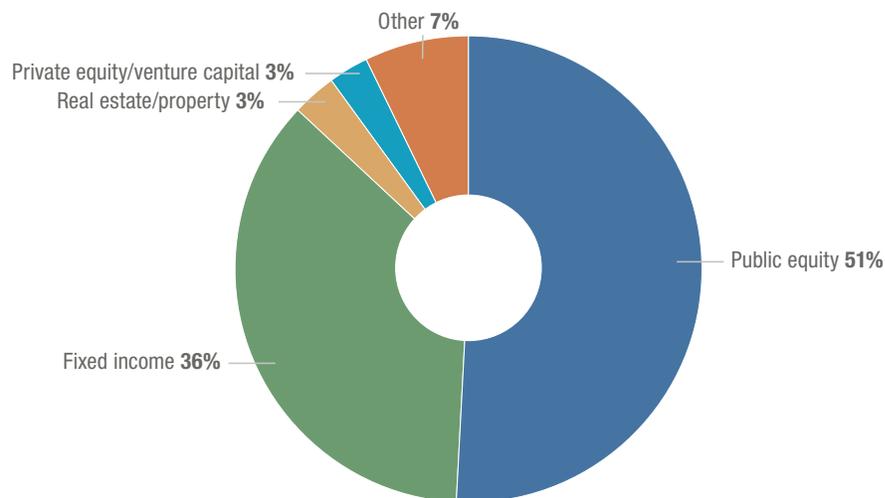
## Myth 5: Sustainable investing only works for equities

### Reality: Sustainable strategies are available across asset classes

Again, this myth has basis in history, but in reality, other asset classes are increasingly incorporating ESG analysis into the investment process. As shown in **Figure 3**, more than half of global sustainable assets were in publicly listed equities, and as of 2018, fixed-income assets represented more than a third of these assets. Alternative assets, including real estate, private equity, venture capital, and hedge funds, among others, represent more than 10% of sustainably managed assets.<sup>13</sup>

According to the PRI, the number of sustainable equity investments remained unchanged from 2017 to 2018, while fixed-income and alternative assets showed significant growth over this period.<sup>14</sup> This higher growth rate indicates that these other asset classes are likely to continue increasing their share of assets invested in a sustainable fashion.

**Figure 3: Integration of Global Sustainable Investments Across Asset Classes (as of 2018)**<sup>13</sup>



Source: Global Sustainable Investment Alliance, "2018 Investment Review." NOTE: "Other" includes hedge funds, cash, commodities, infrastructure, and unclassified assets. It does not include asset breakdown for Australia and New Zealand.

Due to the vast size of the overall market, fixed income offers the largest growth area for sustainable investing. While fixed-income assets managed following ESG guidelines still lag their equity counterparts, the recent growth of so-called "green bonds" suggests this area has room to grow. Green bonds finance new or existing projects that are intended to have beneficial

environmental effects and/or help fight climate change. According to Bloomberg, \$580 billion in green bonds were sold through 2018, with another \$170–\$180 billion likely to be sold in 2019.<sup>15</sup> While these totals represent a fraction of the vast fixed-income universe, there is significant room for growth ahead.

13. Source: Global Sustainable Investment Alliance, "2018 Investment Review."

14. Source: United Nations Sponsored Principles for Responsible Investing, "Annual Report 2018."

15. Sources: Lyubov Pronina, "What Are Green Bonds and How 'Green' Is Green?" and Bloomberg, 3/24/19.

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## Know the facts

*Myths and misconceptions about sustainable investing are likely to persist. Our goal is to arm you with facts to help navigate the expanding ecosystem of sustainable investing. We believe there's potentially strong demand for sustainable strategies, but education will clearly play a key role in moving the conversation forward.*

### ABOUT RISK

All investments are subject to market risk, including possible loss of principal. Diversification cannot assure a profit or protect against a loss in a declining market.

### DEFINITIONS

**Alternative investments** are speculative, not suitable for all clients, and intended for experienced and sophisticated investors who are willing to bear the high economic risks of the investment.

**Commodities** markets are subject to greater volatility than investments in traditional securities, such as stocks and bonds. **Fixed-income securities** are subject to credit risk—the possibility that the issuer of a security will be unable to make interest payments and/or repay the principal on its debt—and interest rate risk—changes in the value of a fixed-income security resulting from changes in interest rates. **Bonds** are subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner. **Alpha** is a term used in investing to describe a strategy's ability to beat the market or provide excess return.



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