Brown ADVISORY
Thoughtful Investing.

SUSTAINABLE INVESTING

Starting Points

Many investors have deeply held beliefs and values that shape their life choices, including where they invest, yet many are reluctant to raise the topic with their advisors. Here are some ways we begin the conversation with our clients.

DUNE THORNE
Head of Boston Office and Head of Client Experience

ALICE PAIK
Head of Strategic Advisory

Many investors have deeply held beliefs and values that shape their life choices, including where they invest. The numbers tell a clear story: Assets in investments aligned to environmental, social or governance factors increased nearly fivefold between 2012 and 2016, according to US SIF Foundation.

Still, nearly three out of four investors wait for their advisors to raise the topic of sustainability in relation to their portfolios, according to a 2013 survey by Calvert Investments. Meanwhile, four out of five financial advisors wait for investors to begin the conversation, Calvert says.

That can be a mistake. We have found that clients who clarify their values and reflect them in their portfolios view that process as a cornerstone of their investment plan, and they tend to successfully stick to that plan for the long term. To help you figure out your family's or institution's approach to sustainability, we have identified five starting points in creating your distinct plan:

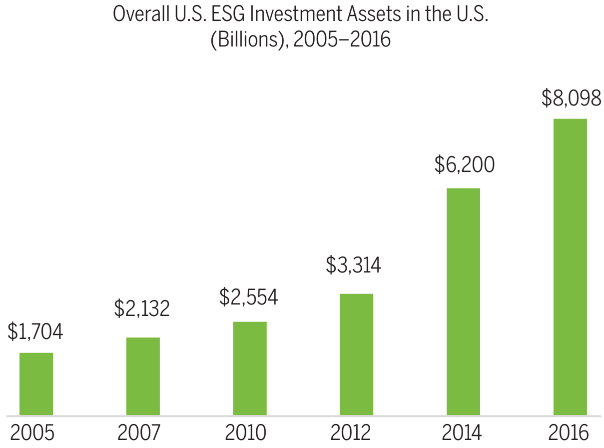
1. Identify which values are the highest priorities. Many institutions and families share broad values, such as environmental stewardship, good governance or social justice. The specific causes they see as priorities, though, can vary dramatically. One family we advise wants to support local businesses with a regionally focused portfolio. Another family is focused on supporting women by only selecting female portfolio managers, while a foundation we advise wants to avoid investing in companies related to fossil fuels. Identifying a clear goal or priority can help investors to narrow their focus from a wide range of values and views, and begin to make progress and move forward.

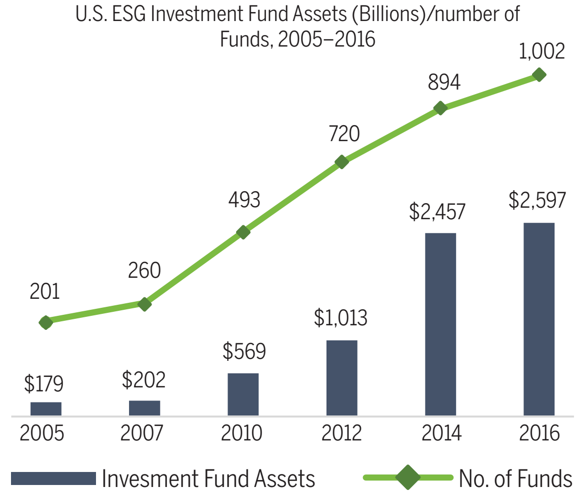
2. Use sustainability to bridge generations instead of divide them. Clarifying an approach to sustainability can give institutions and families an opportunity to unify older and younger generations around shared interests and values. One client we advise skipped a generation when selecting a successor for his family foundation, choosing his granddaughter as executive director to bring fresh leadership to the organization. Working alongside her grandfather over many years, the executive director gradually took on more responsibility, first for grant-making and then for the investment portfolio. During board discussions, she raised the importance of aligning the foundation's portfolio with its values. The foundation is taking incremental steps, first choosing a sustainability large-cap equity manager while reviewing sustainable investing opportunities in fixed income. The family believes that the sustainability approach has helped bring the next generation into the investment and decision-making processes.

3. Document your sustainability objectives in your investment policy statement (IPS). An IPS is a document that articulates how a family's or organization's money is to be managed. The IPS is a perfect vehicle for recording and monitoring one's sustainable investment goals. These statements by their nature are dynamic, evolving documents, so revisiting a statement to incorporate values can help build consensus—that is exactly what the executive director mentioned above is doing with her family foundation's IPS.

Sustainability Surge

The amount of investment aligned to environmental, social or governance factors in the U.S. grew nearly fivefold from 2012 to 2016.





SOURCE: US SIF FOUNDATION. OVERALL ASSET DATA ENCOMPASSES ASSETS OF 1,520 INSTITUTIONS AND 300 MONEY MANAGERS VIEWED BY US SIF AS INCORPORATING SRI OR ESG INVESTMENT STRATEGIES.ESG INVESTMENT FUND DATA IS A SUBSET OF OVERALL ASSET DATA, AND ENCOMPASSES 1,002 FUNDS INCLUDING MUTUAL FUNDS, VARIABLE ANNUITY FUNDS, CLOSED-END FUNDS, EXCHANGE-TRADED FUNDS, ALTERNATIVE INVESTMENT FUNDS AND OTHER POOLED PRODUCTS. BOTH REGISTERED AND PRIVATE FUNDS ARE INCLUDED. ADDITIONALLY, THE DATA INCLUDES THE ASSETS OF 94 "FUNDS OF FUNDS," WHICH ARE CONTROLLED FOR DOUBLE-COUNTING EFFECTS PRIOR TO AGGREGATION.

Keep in mind that such revisions do not require an all-in decision to fully align investments with values. A change to an IPS can start with a simple commitment to discuss a values-based approach with stakeholders.

4. Take "baby steps" before a "giant leap." Values-based investing can be complex, and transitioning an entire portfolio can often involve meaningful tax and transaction expenses. Starting slowly is often wise, and it makes sense to consider "lower-friction" areas of one's portfolio first—for example, aligning a client's bond holdings with his or her values, or adding a stand-alone strategy to a broader asset allocation. Initial steps such as these can minimize disruption and help investors grow comfortable with values-based investing. Once clients find initial success with these "baby steps," they can proceed more confidently with further steps across the portfolio should they so choose. One client we work with started three years ago by investing in a sustainability-focused mutual fund and gradually has grown more comfortable with the strategy's risk and returns. Now we are working with her to build a comprehensive sustainability plan for her entire portfolio.

5. Clarify the sometimes-blurred line between philanthropy and sustainable investing. An institution or family can often most effectively make a grant through an investment structure rather than through an outright donation. This can be done in several ways, including program-related investments, which are loans or equity investments supporting a charitable activity, or B Corporations, which are for-profit entities aimed at benefiting society or furthering environmental goals. For example, we recently helped a family foundation structure a program-related loan to to help a nonprofit bridge a cash flow gap. The family received market-based interest rates while leveraging its capital to support its grant-making mission. The single transaction simultaneously achieved financial and impact goals.

Social impact bonds are also useful tools for pursuing societal aims. These bonds enable investors to lend money to an organization and receive back their capital with interest if the program meets its impact goals.

These investments are not made purely for financial return, and it is critical that investors differentiate traditional investments from these innovative structures that offer some financial incentive but primarily pursue a values-based mission. One should view the performance of these structures differently from other traditional investments in one's portfolio.

More and more of our clients are showing interest in making their values a cornerstone of their portfolios. By starting in an incremental, comfortable manner, we believe that these clients have an excellent opportunity to successfully pursue a broader set of goals.