Brown ADVISORY
Thoughtful Investing.

The Advisory

INVESTMENT OUTLOOK FOR PRIVATE CLIENTS

SPECIAL EDITION

Constructing a Sustainable Portfolio

Amid the steady flow of new ideas for sustainable investing, Brown Advisory has created a framework to help clients focus on their goals for sustainability and construct a detailed portfolio strategy. As always, we concentrate on listening to our clients while providing the highest level of performance, advice and service.

From the CEO:
Our Framework for Client-Driven Sustainable Investing

Following up on last year's commitment to help clients cut through the noise in the sustainable investing marketplace, Mike Hankin, Brown Advisory President and CEO, offers an update on the firm's progress and lays out a simple and accessible framework we use with clients to review and choose an approach that makes sense for them.

BY MICHAEL D. HANKIN
President and Chief Executive Officer

Last year, we published our first special edition of *The Advisory* focused on sustainable investing. At the time I wrote that our firm was fully committed to helping clients sort through an array of choices in sustainable investing, and to developing a tailored approach for each client—one that best fits their long-term goals. I also reflected on the confusing nature of this area with constantly changing word definitions, potentially conflicting investment goals and emotionally charged concerns often colliding with unintended results.

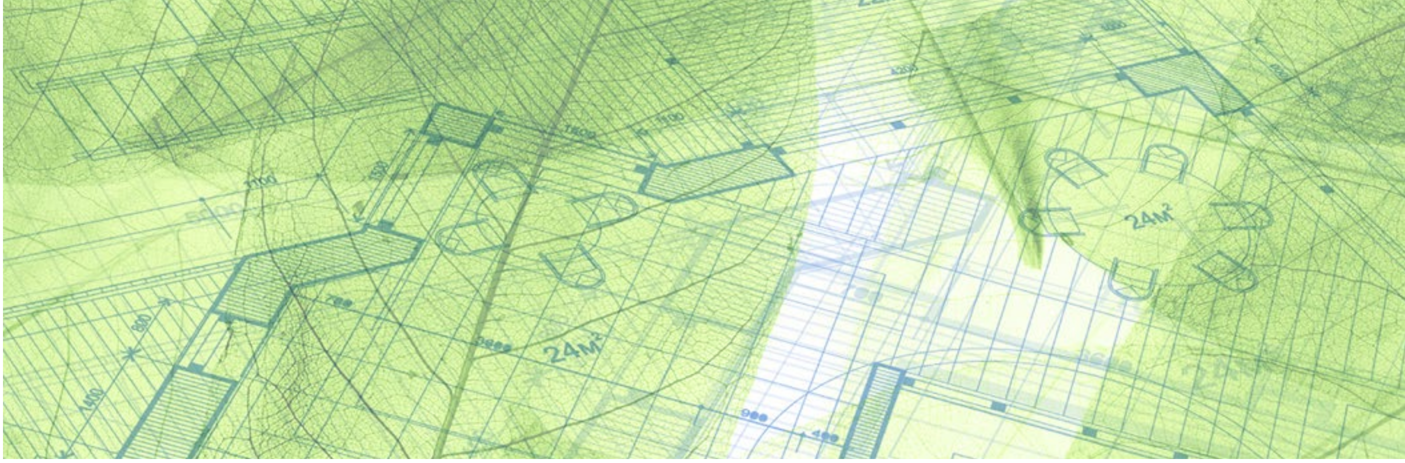
We have been working hard to fulfill this commitment over the past 15 months, enhancing our offerings in a number of areas. We are excited about the progress we have made, but as we move down this road as a firm, I consider it a top priority to maintain focus on our very specific initial mission: To help you, our clients, discover just how powerful a client-driven approach to sustainable investing can be. All of our work is in service to that goal. If we listen well, we believe we can provide each of you a sustainable investment solution that meets your performance targets, aligns with your values and delivers the impact you desire.

With that as backdrop, we want to use this special edition of *The Advisory* to share with you the framework we are using to help clients hone their thinking about sustainable investing into an actionable investment strategy. This framework seeks to deliver the same performance, advice and service outcomes that guide all of our work with you.

- **We begin with advice**—an in-depth engagement and discovery process to learn exactly how you view the intersection of your values with your portfolio.
- **Then, we focus on performance**, which we seek via **sustainable alpha**, **screening** and **impact** solutions. The goals you express during our discovery process dictate the types of solutions used in your portfolio. Many of the articles in this special edition will dive deeper into the challenges investors face in implementing these solutions and how we try to help.
- **Finally, we seek to ensure the highest level of service**, through compliance with your investment criteria, specialized reporting and regular discussions with you to ensure that we keep pace with any changes in your views and beliefs over time.

We are finding this framework extremely helpful as a starting point in conversations with clients who are deciding how they want to tackle sustainability in their portfolios. In the end, we want to provide some order to a universe that seems to offer new ideas and new solutions every week, any one of which may or may not deliver the outcomes that you specifically seek. Clients seek to incorporate sustainability in different ways; using this framework helps us to build the portfolio that most directly addresses the things you care about most.

As I mentioned above, we have been busy over the past year, building out our capabilities so that we can be more effective on your behalf. Our Large-Cap Sustainable Growth strategy



continues to perform extremely well—in fact, as of June 30, 2016, its investment returns were ranked in the top 1% among strategies in its large-cap growth peer group since its inception on Dec. 31, 2009, proving that attractive investment returns can be achieved by focusing on companies that manifest Environmental Business Advantage™. We also launched two sustainable fixed income strategies—a core portfolio and a tax-exempt portfolio—during the past year. For clients seeking a balanced portfolio that incorporates sustainable thinking across asset classes, we now confidently recommend a select group of external managers that meet our standards for fundamental excellence. We are deeply engaged with leading sustainable-investment organizations like CERES, the Intentional Endowments Network, USSIF, the Principles for Responsible Investment and the Green Bond Principles. And we have formed a Sustainable Investing Advisory Board of leading researchers, policy experts and practitioners to advise and guide us as we develop our sustainable investing solutions over time. Daniel Esty, James Gifford, Martin Kaplan and Mamie Parker all bring extremely valuable and diverse viewpoints to this board, and they have quickly become an invaluable source of insight and ideas.

Most importantly, we have been able to use these new capabilities for the benefit of a number of new client relationships centered on sustainable investing, and to introduce new solutions to a growing number of our long-term clients.

This special edition is largely focused on ways that we help clients achieve various sustainable outcomes. First, Emily Dwyer and Chad Larson will discuss the concept of screening portfolios to better understand which investments may match or conflict with a client's goals. For something that sounds straightforward, screening can be very challenging. Emily and Chad will discuss how screening works and how we help clients do it in a thoughtful manner.

Second, Karina Funk and Amy Hauter will cover sustainable alpha, a term we use to refer to the pursuit of better investment decisions and higher returns by enhancing existing research processes with sustainability information. Karina and David Powell have had great success using this approach in the equity markets, while our fixed income team is finding similar success with our new sustainable bond strategies. Karina and Amy will describe how our teams dig in with primary research to find the real sustainable investment stories driving the stocks and bonds we ultimately select for our strategies.

Finally, Ethan Berkwits and Brigid Peterson will cover impact solutions that pursue outcomes beyond financial returns, in the form of measurable progress toward targeted social and environmental goals. There are a wide variety of ways to achieve this impact, from publicly available equity and fixed income strategies, to innovative private investments that often straddle the line between investing and philanthropy such as microfinance, social impact bonds, and direct loans and investments. One can also achieve impact through proxy voting and shareholder engagement. Dune Thorne, Erika Pagel and other portfolio managers at our firm are well-versed in helping clients consider possible paths for impact investing. Ethan and Brigid will discuss these options and also caution readers to closely scrutinize these investments, as they often offer different risk/reward profiles than more traditional investments.

We are pleased to offer you this update on our progress and our thinking with regard to sustainable investing, and we welcome the opportunity to discuss these topics with you.

Sincerely,

Know What You Own

Investors gain greater confidence in their investment plans by screening companies to ensure whether their portfolios align with their values.

SCREENING

Some Wal-Mart stores sell rifles, some Starbucks coffee shops sell alcohol and GE builds engines for jet fighters and bombers. While generating just a small part of their revenues from these products, these companies pose a dilemma to investors who want to purge their portfolios of connections with guns, alcohol or the military. Should they set a ban on involvement or merely a low-level limit?

The dilemma underscores how investors building a sustainable portfolio need to clarify the precise objectives of any effort to screen out industries that they deem to be undesirable. Before even beginning to vet companies, investors need to recognize the limitations and weaknesses of the screens available. This may mean screening out some methods of screening.

A selective approach to filtering helps investors avoid supporting companies that they believe have an impact on society or the environment that is not aligned with their values. Screening can also help investors to better know what they own, or gain a richer understanding of the components in their portfolio. Indeed, many fiduciaries and charities feel a duty to use screening to identify and track any potentially controversial companies.

However, screening can exact a cost, so we help clarify for clients the potential impact on risk and return. The California Public Employees' Retirement System (CalPERS) said in April that it missed out on as much as $3 billion in gains between 2001, when it started to sell its tobacco stocks, until the end of 2014, when it completed the divestment. CalPERS is the largest defined-benefit pension plan in the U.S., with more than $291 billion in assets.

"Negative screening" is the most commonly used method among the many approaches to building a sustainable investment portfolio. By the end of 2014, institutional investors had invested more than $1.2 trillion using negative screening, according to US SIF Foundation, a Washington-based trade association promoting sustainable investing, of which Brown Advisory is a member. Screening can target myriad businesses beyond those already mentioned, including gambling, adult entertainment, nuclear power and faith-based concerns such as stem cell research.

The most common factor used in screening measures is the amount of revenue a company generates from a particular line of business. A cut-and-dried approach of zero tolerance is the simplest application of this method. Screening becomes more complex when investors are open to considering companies that generate revenue, up to a certain limit, from a line of business that they find undesirable. Screening grows especially complicated when an investor examines a company's supply chain and related businesses.

WHERE THERE'S SMOKE

For example, an investor can easily determine the degree of their portfolio's association with tobacco companies such as Altria, British American Tobacco or Phillip Morris. At first glance, the forbidden list would not include a company like Core-Mark Holdings, which distributes merchandise primarily to convenience stores in the U.S. Core-Mark, however, generates about 68% of its revenue distributing cigarettes and other tobacco products made by companies such as Philip Morris and R.J. Reynolds, according to MSCI, which provides data on companies' environmental, social and governance (ESG) practices.

The same holds true with fossil fuel considerations. Investors can easily screen out oil, coal and other companies in the energy sector, but they may also want to exclude many chemical companies that own fossil fuel reserves but are not screened as fossil-based companies.

Investors can also gauge companies' levels of carbon emissions, aiming to either identify those with high emissions or, through so-called positive screening, to find companies with a comparatively small carbon footprint. Investors should be aware that only 53 companies worldwide report 100% of their carbon emissions, according to a Bloomberg assessment of greenhouse

BY CHAD LARSON
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gas emissions disclosure dated July 22, 2016. In addition, emissions reported by third parties are rough estimates, often based on a company's industry and size. Such measures do not reflect the fact that companies within the same peer group can generate very different amounts of carbon dioxide.

In another example of positive screening, some 8,000 businesses have endorsed the U.N. Global Compact, which measures adherence to 10 internationally recognized principles for corporate behavior in human rights, treatment of workers, environmental stewardship and curbing corruption. ESG data providers such as MSCI apply these principles and grade companies as pass, fail or "on watch." Investors can then use these broad measures for both positive and negative screening.

HIGH STAKES

The filtering of companies involved in stem cell research and human cloning illustrates the nuance and ethical stakes that can come into play when building a sustainable portfolio. Some screening methods can be precise enough to rule out the use of stem cells from embryonic or fetal tissue but to not exclude companies engaged in research using adult stem cells.

The United States Conference of Catholic Bishops (USCCB) will not invest in companies engaged in human cloning and "in scientific research on human fetuses or embryos that 1) results in the end of pre-natal human life; 2) makes use of tissue derived from abortions or other life-ending activities; or 3) violates the dignity of a developing person." The USCCB says new forms of research "will be evaluated on a case-by-case basis."

MSCI screens out similar companies, along with businesses that produce technology that could be used in research involving human embryonic stem cells, fetal tissue or fetal cell lines. To date, MSCI has not identified any publicly traded companies engaged in human cloning.

In general, screening enables investors to know more about the companies they own and more closely monitor their holdings. This can be valuable for charities and foundations that want to ensure their holdings do not conflict with their mission.

One client we advise discovered from a screening exercise that 3.1% of its foundation's portfolio was associated with fossil fuel reserves, weapons, tobacco and stem cell research—all of which contradicted the foundation's objectives. Our clients determined that such a small percentage did not warrant immediate action but appreciated the deeper understanding of their foundation's assets. Empowered by screening-based knowledge, the client and other investors can push forward with greater confidence in their long-term investment plans. B

A Selection of Screens

ANIMAL WELFARE
Companies that test product ingredients on animals, breed animals for animal testing, exhibit animals and operate factory farms.

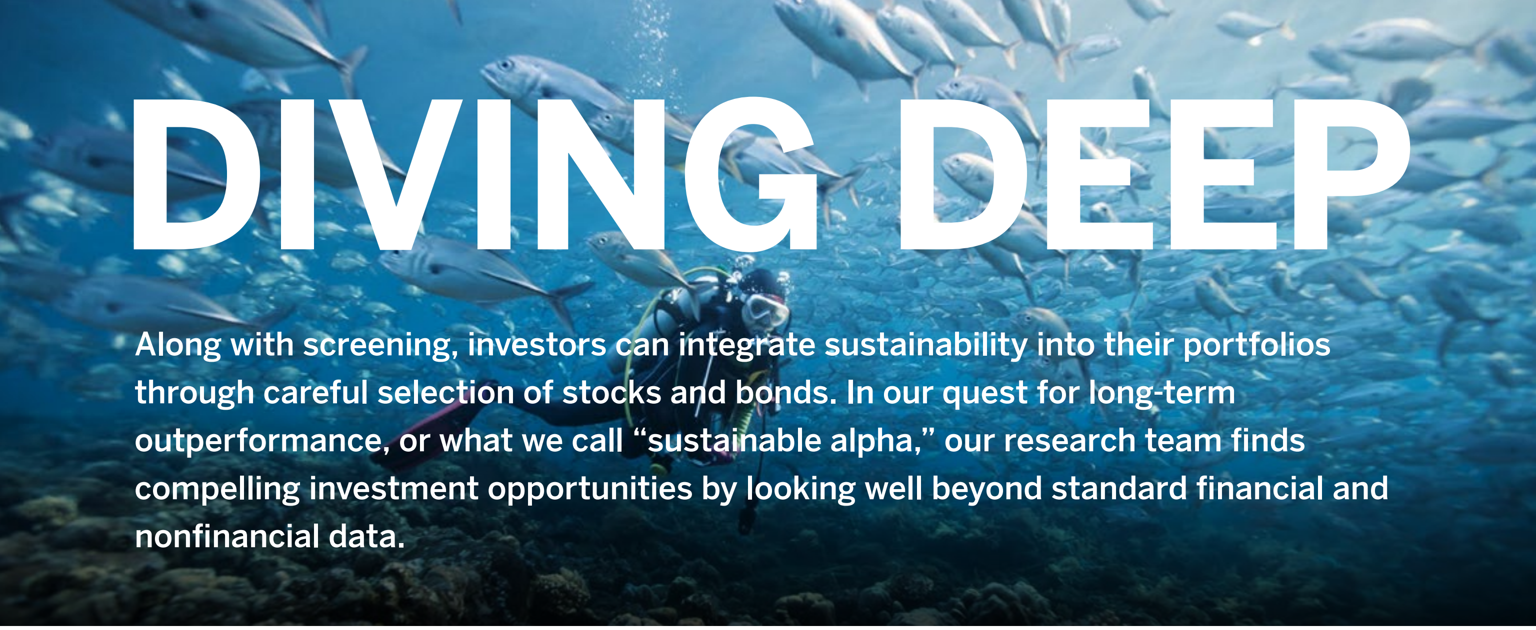
CHILD LABOR
Companies involved in egregious instances of child labor, in child labor-related litigation and that resist improved practices.

NUCLEAR POWER
Companies that own or operate nuclear power plants, or that provide key products or services to the nuclear power industry.

PREDATORY LENDING
Companies associated with potentially unfair practices such as payday, installment, pawn and title loans.

WOMEN BOARD MEMBERS
The number and percentage of women on a company's board of directors.

SOURCE: MSCI ESG RESEARCH, 'BUSINESS INVOLVEMENT SCREENING RESEARCH,' SEPTEMBER 2016.



DIVING DEEP

Along with screening, investors can integrate sustainability into their portfolios through careful selection of stocks and bonds. In our quest for long-term outperformance, or what we call "sustainable alpha," our research team finds compelling investment opportunities by looking well beyond standard financial and nonfinancial data.

ARM Holdings rose to dominance among makers of smartphone microprocessors by focusing on energy efficiency rather than pure computational power and speed. **WhiteWave Foods** has grown faster than its more conventional rivals because of its commitment to producing organic, healthful and minimally processed foods.

Both ARM and WhiteWave have staked out a competitive advantage by seeking to reduce their environmental impact. In July, they each gained validation for their success—their share prices surged by double digits—after Softbank announced a plan to buy ARM Holdings and Danone said it will acquire WhiteWave.

The acquisitions are validating the approach of Brown Advisory's Large-Cap Sustainable Growth strategy, whose composite returned 15.4% over the five-year annualized period ending July 31, gross of fees.* That compares with a median return of 11.7% annually for U.S. managers focused on environmental, social and governance (ESG) factors and the 13.6% annualized return of the S&P 500 Index.

We bought shares in WhiteWave in December 2015, in recognition of the healthy-living category of foods moving mainstream. Danone bought WhiteWave for 19% more than the previous day's share price. We bought ARM Holdings in July 2011 and held on even as oversupply slowed growth in smartphones sales. We were confident that the company's energy-efficient chip design would give it an edge in supplying the silicon neurons for products ranging from computer servers to wearable devices. On July 18, 2016, Softbank announced plans to buy the company at a 43% premium to the prior day's closing price.

To find these under-appreciated opportunities for our equity and bond strategies, we dive deep beneath the surface of corporate disclosures, regulatory filings and investor releases. We look for fundamental strengths, attractive valuations and what we call Environmental Business Advantage (EBA™). Companies with EBA pursue environmental strategies that have the potential to strengthen financial performance and increase shareholder value. Through original sustainability research into stocks and fixed income securities—including diligence into government databases, company transcripts and interviews with executives—we find strengths that are not apparent in standard company reports.

REARWARD VIEW

"A lot of the information companies provide is backward looking and risk-focused rather than forward looking and opportunity oriented," according to Daniel Esty, a Yale Law School professor and director of the Yale Center for Environmental Law and Policy. "The reporting is not consistent across industries or across companies, so it's very hard to make accurate comparisons," said Esty, a member of Brown Advisory's Sustainable Investing Advisory Board.

When sizing up a company's opportunities and risks, portfolio managers vary widely in how they weigh ESG factors. As a result, strategies focused on sustainability range broadly in performance. Some portfolio managers use ESG data to find companies that they believe are less harmful than others. They focus largely on industries that have low environmental footprints, including technology and financial services companies. The limited diversification from such an approach may pose risks.

* Please see page 12 for additional information on the Large-Cap Sustainable Growth strategy.

BY KARINA FUNK, CFA
Head of Sustainable Investing and Large-Cap Sustainable Growth Co-Portfolio Manager

AMY HAUTER
Sustainability Analyst, Fixed Income

Passive investment strategies focused on ESG goals take a best-in-class approach, mimicking the sector allocation of their benchmark index by finding top ESG scorers within each industry. For example, they may overweight companies that have low carbon emissions and vice versa. Such strategies aim to match the risks and returns of the broad market and as such are unlikely to outpace the benchmark.

Still other managers gather together a pool of companies with favorable ESG characteristics. They then construct their portfolios by using traditional measures for valuation and performance.

Our strategy is different from all of the above. After identifying a company with strong fundamentals, one of the first steps in our search for EBA is to comb the database of MSCI, a New York-based research firm. This helps us to spot companies that face ESG risks, such as labor-management tensions, excessive vulnerability to commodity prices or inappropriate incentives for executive compensation. We also review company reports detailing efforts to promote sustainability in operations, including reductions in the use of water, energy or materials used in production. Such disclosure is surging, with the proportion of companies in the S&P 500 Index that publish sustainability reports increasing to 81% in 2015 from less than 20% in 2011.

Still, a company may expand its reporting on sustainability without actually reducing its environmental impact or risk, or improving its competitiveness and profitability. With that in mind, the Financial Stability Board—created in 2009 by the G20, a group of leading developed and developing nations—mobilized a task force of executives in 2015 to build a framework for climate-related disclosures applicable across myriad industries.

Led by former New York City Mayor Michael Bloomberg and made up of executives from companies ranging from JPMorgan Chase to Unilever to Tata Steel, the task force is constructing a model for financial risk reports that will be geared to the needs of investors, lenders, insurers and other stakeholders. Former SEC Chairwoman Mary Schapiro serves as an adviser.

"What we need is consistent and regular reporting across the broad swath of companies that investors might be looking at," Esty said in an interview with Brown Advisory. "The aim is to establish a reporting structure that is routine and institutionalized, much like the way that companies currently report to the SEC."

We have found that even with solid data, the impact of a company's environmental strategy on its competitive position is not obvious at first glance. So we rely on our own digging to identify companies with EBA.

For example, in March 2015, we began seeking out a possible investment in a company that builds and maintains wireless towers, attracted by the business model's prospect of recurring revenue and rising demand from mobile phones and other digital devices.

ABOVE AND BEYOND

While we identified three companies that met this fundamental business criteria, only one—American Tower—appeared to hold an Environmental Business Advantage. Responses to a questionnaire drawn up by CDP, a London-based research firm formerly known as the Carbon Disclosure Project, and subsequent interviews with American Tower management, including senior executives in some emerging markets, revealed that the company exceeded environmental compliance measures and invested in environmental strategies to bolster its competitive advantages.

An example of American Tower's EBA is its providing of shared backup power generators for about 12% of its 27,200 towers in the U.S. This enables customers to avoid the disruption and risks from the construction and maintenance of their own generators, which tend to be energy inefficient. Through the service, American Tower seeks to help customers trim the losses from power outages and generator depreciation, which cost the industry about $15 billion each year. In addition, by

seeking to improve its environmental performance, American Tower could speed regulatory approvals and minimize environmental risk to itself and its customers. Finally this helps the company's reputation outside the U.S., where environmental practices help win business.

Having identified American Tower's EBA, we purchased shares in September 2015. Since then, its stock has risen 25% as of Aug. 22, 2016.

Beyond equity-focused strategies, our approach to "sustainable alpha" helps our Core Sustainable Fixed Income strategy identify a company's weaknesses and more accurately forecast profitability. For example, during the second quarter we bought bonds in Digital Realty, the largest owner and operator of stand-alone data centers. The company's warehouses of servers store and transmit data for customers ranging from IBM to AT&T to Facebook. Highly dependent on electricity, Digital Realty has been a leader in adopting renewable energy, cutting one of its primary costs and boosting profitability.

We also bought bonds issued by Novelis, a global leader in recycling aluminum and producing rolled aluminum goods. The company has streamlined operations in recent years, reducing greenhouse gas emissions and cutting costs for water and energy use. During the course of five years, Novelis boosted the amount of recycled aluminum used in production to 52% from 30%, thereby trimming greenhouse gas emissions by 13% and increasing aluminum production by 5%. The company aims to expand its use of recycled aluminum to 80% by 2025.

Sustainability can create competitive advantages and help a company avoid risk, grow revenue, reduce costs or expand market share. By digging deep through original research, we seek to help investors find these underappreciated opportunities.

Full Immersion

While pursuing fundamental research into a company's business model and valuation, the Large-Cap Sustainable Growth strategy takes a three-level approach to identifying and monitoring Environmental Business Advantage (EBA), or strategies that boost financial performance and increase shareholder value:

Level 1: Strategic Risk Assessment

After identifying an attractive company, we look for signs that it is vulnerable to an environmental, social or governance (ESG) risk, such as excessive exposure to commodity prices, labor-management tensions or inappropriate incentives for executive compensation. We comb the database of MSCI, a research firm focused on sustainability, to gauge a company's ESG risk exposure and how it manages such risks, and to identify controversies it has faced in the past or may face in the future. We also review government databases for any information on environmental fines, and analyze a company's code of conduct and sustainability reports describing management systems related to the use of water, energy and other resources. We publish our findings in a strategic risk assessment.

Level 2: EBA Research

In a second report, we plunge into original research to measure a company's EBA, gathering information at industry conferences and poring over public filings, investor presentations, sustainability reports, CDP responses, academic research and case studies written by a company, supplier or customer. We interview industry thought leaders and a company's chief sustainability officer and other management. We also leverage the fundamental research of Brown Advisory equity research analysts.

Level 3: Updates

After buying shares in a company, we continuously freshen our EBA research reports with both quantitative and qualitative information to ensure the thesis underlying the investment remains solid and tracks our expectations. We look for warning signs among several sources, including academic reports, industry studies, press releases and company presentations.

Make a Mark

More than ever before, investors do not have to make a cut-and-dried choice between portfolio investment and philanthropy. Several options have emerged, enabling them to do good while also doing well.

BY ETHAN BERKWITS
Private Client Strategy Analyst

BRIGID PETERSON
Endowments & Foundations Advisor

Henry David Thoreau did not live to see the rise of impact investing, but he captured the spirit of it with a simple insight—"Goodness is the only investment that never fails."

Impact investors align their assets behind their advocacy, whether it be for advances in environmental stewardship, human livelihood or public policy. Although simple in intent, impact investing is often complex in execution. Each investor needs to find, personally, the most comfortable balance between generating financial returns and pursuing their environmental or social goals.

Philanthropies faced that same challenge in the 1960s while laying the groundwork for impact investing in the U.S. Organizations, including the Ford Foundation, succeeded in 1969 by winning federal approval for so-called program-related investments that generated income from projects rooted initially in philanthropy.

While determining their preferred mix of doing good and doing well, investors need to set clear goals, clarify their tolerance for risk and establish an expectation for financial returns. In short, they need to decide how they define success. Taking those initial steps opens up several avenues for achieving impact with varying possible returns—from thematic investments in stocks that offer the potential to outperform the broader market, to token returns in structures with an approach closer to outright philanthropy.

Publicly traded companies. Many companies contribute to society beyond the creation of jobs or the promotion of prosperity. "Impact stocks" can vary on a risk/return basis as much as any other shares. An example of investors backing certain impact efforts is in the clean-tech sector, which encompasses products and services including lighting, electric motors, energy efficiency, recycling and renewable energy.

While clean-tech companies are focused on overcoming some of our most critical environmental problems, many shares in such companies have been especially volatile. During the past five years, two exchange-traded funds—Guggenheim Solar and PowerShares Wilderhill Clean Energy—have each fallen more than 39%.

Active research can lead to meaningful returns in impact stocks based on the simple logic that the way to make money is to invest in companies that are fundamentally strong. Take Acuity Brands. By far the leading lighting distributor in North America, Acuity has grown thanks to its strong fundamentals and demand for its energy-saving LED lighting systems. During the past one- and five-year periods as of Sept. 6, 2016, Acuity stock has surged 35% and 564%, respectively.

Green bonds. These securities fund environmental or climate-related projects. The benefits of the projects are often certified through a process developed under the Green Bond Principles. But in most respects, green bonds perform like other bonds, with similar credit and duration profiles. Our Core Sustainable Fixed Income strategy makes liberal use of green bonds within its portfolio. We purchased a Georgia Power green bond in 2016 that is backing the production of 250 MW of wind energy—an amount that can provide power to more than 50,000 homes. We assess the potential return and risk for a green bond no differently than we do for any other bond that we buy for clients.

Shareholder engagement. Stockholders can push for change through proxy votes, shareholder resolutions and/or dialogue with company executives. Through formal shareholder channels, investors have achieved many worthwhile changes, such as increased reporting of climate risks. But investors can sometimes influence a company just by posing thoughtful questions. In routine communications with Akamai in 2015, Brown Advisory portfolio managers inquired whether the company planned to transition to renewable energy sources. At the time, the company cited challenges to adopting clean energy because of its need to operate data centers in several countries to mitigate risk. The following year, however—citing advocacy for a carbon footprint reduction from shareholders and dialogue with institutional investors, including Brown Advisory—Akamai executives announced plans to reach a 50% renewable energy target by 2020.

Social impact bonds (SIBs). These bonds finance public-private partnerships aimed at providing social services through a performance-based contract. SIBs are backed by government entities but tap private impact investors for initial funding. If an SIB program succeeds, the government repays principal and a modest return to the impact investors. On the flip side, if it fails, the impact investor does not receive repayment. Given the structure of SIBs, investors should view these differently than conventional bonds. SIBs are not backed by tax revenue or the creditworthiness of the issuer. The return hinges on the outcome of a government-backed social program.

SIBs typically fund preventive programs and are attractive to governments aiming to spend money on projects that will avert greater costs in the future. Social Finance, a global nonprofit that pioneered the SIB concept, sold the first social impact bond in 2010 to fund programs aimed at reducing convict recidivism. Since then, SIBs have sought to address issues ranging from homelessness, youth crime and asthma among the poor. In a U.S.-based example, Goldman Sachs, J.B. Pritzker and United Way created the first social impact bond aimed at financing early childhood education in 2013. The Utah-based program expands access to preschool in order to avert the expense of high-cost remedial programs or special education for students in grades ranging from kindergarten through high school. We are very interested in seeing how SIBs evolve. The concept is still young, and many of the SIB structures to date have been first-of-their-kind initiatives.

Private funds*. Private equity and angel investors were among the first to back impact investing through the financing of businesses and myriad projects, including clean-tech, water, agriculture and infrastructure. Today there are many options for qualified purchasers, from private equity funds from managers such as Generation, to microlending investments with entities such as Microvest or Root Capital, to real estate investments focused on affordable housing or on redevelopment in targeted areas. Private funds vary on a risk/return basis, and each requires a careful, case-by-case review.

The potential return from a private-fund impact investment can rival that of conventional private equity or, for projects with a philanthropic intent, can be quite modest.

For many years investors faced a stark choice between devoting their capital either to philanthropy or to their investment portfolios. Impact investing opens up a spectrum of opportunities in between. As Thoreau would have perhaps put it, today there are many more ways to invest in goodness.

*Private funds may be only available to Qualified Purchasers and/or Accredited Investors.

Pulling it all Together

When embracing sustainability, families and institutions often affirm their highest ideals.

Nurturing Well-Being Through Sustainable Investing

Nancy Klavans is hardly a newcomer to the idea of backing projects that improve the lives of others. Since 1991 the Germeshausen Foundation created by Nancy's parents, Polly and Ken Germeshausen, has made innovative grants linking different fields including education, the arts, sustainability, religion and peace- building.

In 2001, Nancy* decided to bring the same focus to the foundation's investment portfolio. Only a few of the investments were aligned with environmental stewardship and other value-based goals. As her investment counselors, we started by helping the Klavans use screening to curtail their investments in companies tied to fossil fuels, gambling and weapons production. With our guidance they also invested in a group of strategies that use environmental, social and governance research to identify companies that could outperform over the long-term, or what we call sustainable alpha.

Nancy and her family decided to go further by backing innovative, forward-looking leaders who are willing to take risks as they strive to build a stronger sense of community and improve people's lives. The foundation's investment return is focused on advancing many of the same philanthropic goals as its grant making. For example, some initiatives are impact investments targeting early-stage companies, including the use of advanced technology and distribution systems to build a supply chain for localized food production.

To date, the Klavans have aligned more than 85% of their portfolio to sustainable investing and nearly 100% is fossil-fuel free. While deploying their assets to benefit the environment and society, the family has not compromised on returns. Since January 2014, their foundation's portfolio has outperformed the 4.7% average annual gain by its benchmark of bonds and stocks. The Klavans show the success possible when a family takes a step-by-step approach to putting their investments and grant making on parallel tracks.

*We are grateful to the Klavans for allowing us to share their journey in sustainability.

DUNE THORNE
Head of Boston Office,
Portfolio Manager

Unity Through Sustainability

We have found that leaders of an institution grow closer together as they work to align their investment decisions with their organization's values. Through detailed give and take, they clarify their core objectives and achieve stronger unity around common goals.

For example, we advise an agency that is devoted to creating jobs and protecting the environment by expanding the use of renewable energy. During an eight-month period, we helped its investment committee draw up a policy statement fully synchronizing the organization's mission and portfolio holdings.

Committee members tackled some tough questions. Should the institution hold stock in companies with fossil fuel reserves? Should the endowment reject mutual funds with any exposure to the fossil fuel industry? After several extended discussions, the committee decided against holding shares in the fossil fuel sector and limited its holdings to mutual funds with no more than 10% exposure to the industry.

Today, the institution's diversified portfolio includes equities and fixed income, and we are helping to identify sustainable investments outside the U.S., including in emerging markets.

By clarifying its goals and rallying behind a long-term plan for a sustainable portfolio, the institution set some of the essential building blocks for successful investing.

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