

Quick takes

Investor Insights from UBS Asset Management



Beyond going green

How to increase your potential to invest smart and **make an impact**

Investing with impact, or sustainable investing, is an idea that is gaining more attention in investment markets. And it's not just for environmentalists and alternative energy enthusiasts. More and more, both institutional and individual investors are realizing that companies embracing sustainable business practices generally outperform those that don't. This means you can invest in great companies while making an impact on our world.

Sustainable investing, an investing approach that incorporates environmental, social and governance (ESG) factors in an investment process, is far from a new concept. In fact, the first investment fund using non-financial criteria in the security selection process can be traced back to 1928.¹ Since then, total US-domiciled assets under management using non-financial factors has grown to USD 8.7 trillion.²

What's in a name?

Despite gaining considerable steam over the past several years, there is still some confusion about the key concepts of sustainable investing. Many investors associate sustainable investing with the "old school" notion of socially responsible investing (SRI), which focuses more on excluding companies that produce products or services that may not align with investor values from their portfolios, such as alcohol, weapons, tobacco and gambling.

But sustainable investing strategies have evolved, and while some strategies still take an exclusionary approach, there has been a shift toward combining ESG factors with traditional financial valuation considerations to make investment decisions. By leveraging ESG factors, we believe portfolio managers can gain insight into a company's business practices and other characteristics that generate opportunities and mitigate risks that contribute to the long term success of companies and their environment. The list of ESG criteria is long and ever-changing, but some examples include environmental policy and management, climate change strategy, health and safety, working conditions, board structure and business ethics, to name a few.

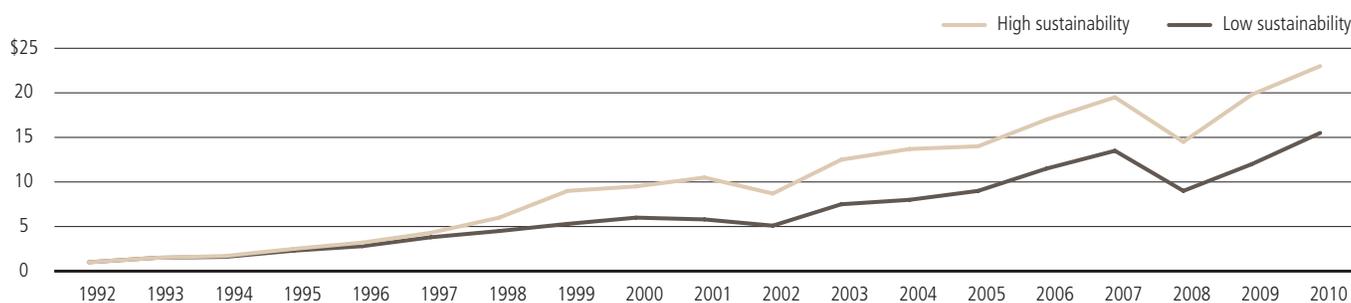
Pairing portfolios with purpose and performance

Although sustainable investing has experienced robust growth, some traditional investors may be hesitant to jump on board. One reason: the idea that sustainable investing requires sacrificing financial results—a relic from the days when such strategies relied on "negative screening." Still another concern for some is that the screening process could lead to less diversified portfolios with less favorable risk-return characteristics than unconstrained portfolios. But sustainable investing has evolved, and so should investors' thinking. Instead of perceiving sustainable investing as a strategy that limits the investment universe, they should view it as one that focuses on companies within a universe that may provide better results.

In fact, academic research has found that companies ranked as highly sustainable, according to standards set by the Sustainability Accounting Standards Board (SASB), outperform companies with lower ratings on the same issues (see Figure 1). According to Harvard research, firms that adopt ESG practices may realize greater profits and higher stock values while also improving their corporate reputations.³ And the financial markets are taking note of the value of intangible assets such as brand recognition, research and development and patents. In the past several decades, the implied asset value of the intangible assets as valued by the S&P 500 grew from 17% in 1975 to a whopping 84% in 2015 (see Figure 2).

Typically, companies ranked as highly sustainable outperform companies with lower ratings on the same issues.

Figure 1. Research has shown that typically highly sustainable companies outcompete and outperform
Growth of 1 USD invested in an equally weighted portfolio of high sustainability firms vs. low sustainability firms



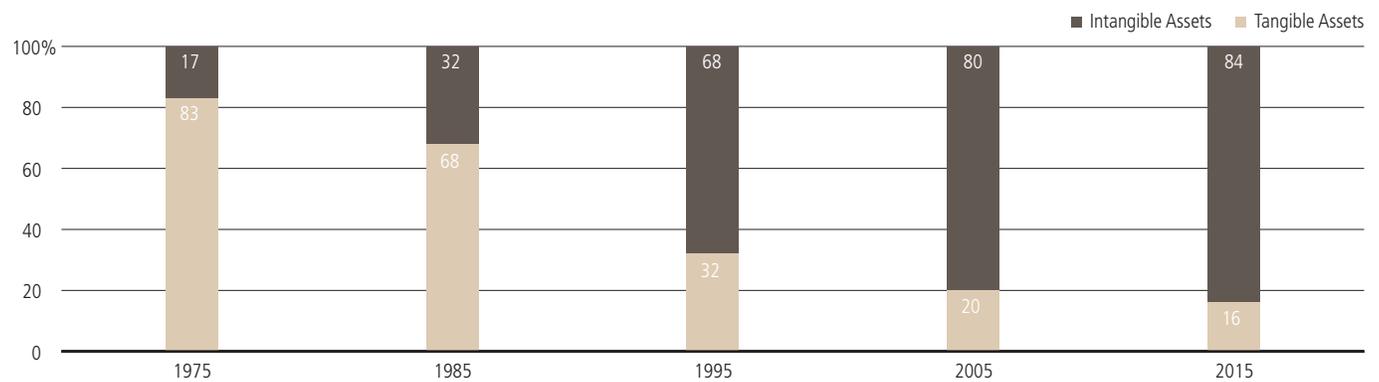
Source: Eccles, Robert G., Ioannis Ioannou, and George Serafeim. "The Impact of Corporate Sustainability on Organizational Processes and Performance." *Management Science* 60, no. 11 (November 2014): 2835–2857. The "High Sustainability group," as defined by the study's authors, comprises companies that adopted all or most of certain environmental and social policies, outperformed the "Low Sustainability group," as defined by companies that adopted almost none of these policies. Total sample 180 US companies. For illustrative purposes only. This does not represent the performance of any particular investment, and does not take into consideration any applicable fees, taxes or expenses. Past performance is not a reliable indicator of future returns.

¹ Knoll, Michael S., Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment, *Business Lawyer* (Feb. 2002).

² US SIF Foundation, *Report on US Sustainable, Responsible and Impact Investing Trends, 2016*.

³ Khan, Mozaffar and Serafeim, George and Yoon, Aaron S., Corporate Sustainability: First Evidence on Materiality, *The Accounting Review*, (November 9, 2016).

Figure 2. Sustainability factors drive market value



Source: Ocean Tomo, "Ocean Tomo's Intangible Asset Market Value Study," January 2015.

Making money while making a difference

We believe, as sustainable investing gains momentum, investors have come to realize that the strategy goes beyond following their personal beliefs. In a low-growth world, they have come to recognize it as a viable investment opportunity for potentially generating robust, long-term returns. If you would like to consider an allocation to impact investing, talk to your Financial Advisor about UBS Asset Management's sustainable investing strategies.

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Index definitions:

- The S&P 500 Index is an unmanaged, weighted index comprising 500 widely held common stocks varying in composition. Returns consist of income, capital appreciation (or depreciation) and currency gains (or losses).

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