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Wealthier with ESG

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ESG, impact investing, socially responsible portfolios—these phrases and buzzwords, all focused on investing based on core values—have boiled down to one commonality for investors. "ESG has become a way to connect impact to earnings," said Craig T. Ayers, senior vice president and senior portfolio manager at Whittier Trust. But it's not only investing in what "feels good." ESG investing is making smart decisions that will perform well today and in the future.

ESG is an acronym that stands for a set of criteria or standards related to environmental, social, and governance characteristics. For investors, ESG has become an area of explosive growth in the last two decades. In 1995, there was about $639 billion invested in sustainability in the United States. Now, more than $12 trillion is invested in socially responsible investments and sustainable investing assets.

Part of the growth, said Ayers, is due to quantification. Today, there are more ESG metrics available from companies for investors to evaluate. In addition, in the past five years, indexes that measure companies with ESG ratings, such as the MSCI KLD 400 Index, have outperformed the S&P 500. Other studies have found that stocks of companies with high ESG performance outpace their competition. And more and more companies are becoming aware of this: 90% of companies in the S&P 500 now publish a sustainability report, up from just 20% in 2011.

While quantifiable metrics make the case that adding an ESG framework to a portfolio can be financially beneficial, Ayers added that personal convictions are a key element to portfolio success.

"Each client has their own idea about what ESG means to them, and they may have a couple key concerns," said Ayers. "For some, this could be divestment in fossil fuels. For others, it could be focusing on companies that invest in employee education or diversity."

But the commonality, he said, is that using ESG metrics can help investors make smart choices they are comfortable with. In the fifteen or so years since the term ESG was coined, it has become "a great indicator of quality, growth, and a growth mindset" for companies, said Ayers.

Here’s why more investors are using this framework to balance their portfolio.

An ESG-Based Portfolio Can Retain Great Performance

“One common concern about ESG is that it limits the companies you can buy,” Ayers said. “But we see that it focuses on companies implementing best practices.”

At Whittier Trust, an ESG portfolio can be created so an investor has the same risk tolerance and financial goals they did with their “traditional” portfolio. Recalibrating a portfolio can take time and research, which is why it can be smart to consider working with an advisor familiar with ESG.

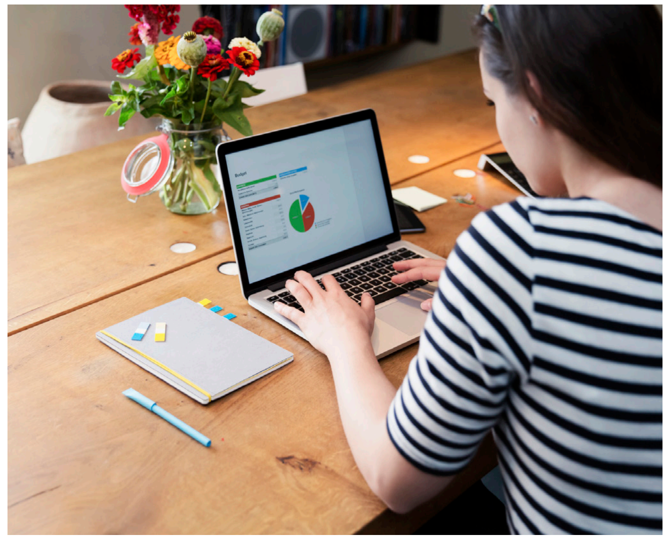
“We may have a client who comes in and says, ‘Sugar is the devil, I can’t invest in X.’ In some cases, we’ll show how X is actually meeting ESG standards, by investing in socially responsible supply chains or investing in employees,” said Ayers. “But we can also say, okay, you don’t have to own X if X is your hot button. We can take it out and replace it with other consumer goods companies, so you won’t miss out.”

ESG Investing May Lower Tax Burdens

“When building an ESG portfolio, ask yourself, ‘What do I want to own for the next twenty or fifty years?” suggested Ayers.

One of the benefits investors have found in ESG is that they may see more stability and growth in companies that have adopted those standards—and may keep those companies in their portfolio for an extended period.

“If you have to turn over a portfolio a lot, you’re going to have to keep paying capital gains,” said Ayers. “With ESG metrics, there’s a quality indication that may lead you to hold onto companies,” and that also unlocks the power of investments compounding over time.



Recalibrating a Portfolio Provides an Avenue for Gifting

One effective way of divesting non-ESG companies is to consider your portfolio in tandem with your philanthropic goals, according to Ayers. Gifting stock can be a smart way to give to charity—and to offload any stock that feels problematic or antithetical to your values. The person gifting also receives a tax write-off, and the charity can sell the stock without paying taxes on the sale.

“I had a client who came with two separate goals: She wanted to give sizable donations to several causes, and she wanted to divest her portfolio of fossil fuels,” said Ayers. “We looked at her portfolio, and I realized that the amount she wanted to give away was roughly similar to the amount she owned in fossil-fuel related companies. It was two separate ideas that turned into a win-win action for both of her goals.”

ESG Frameworks Can Spotlight Future-Thinking Companies

ESG can often be used as a metric to evaluate companies looking toward the future.

"There are some phenomenal examples of companies that are making the upfront investment in things like solar and energy efficiency that will pay off for years and years," said Ayers. "For some clients, it can be a question of, do you want to own fossil fuels or the tech of tomorrow," when it comes to deciding what to sell and what to add to a portfolio.

That said, while modeling, metrics and transparency assess a company's adherence to ESG criteria "greenwashing"—overstating a company's commitments or standards—can occur. That's why it can be valuable for an ESG-driven investor to work with an advisor who can provide expertise, analysis and customized solutions to match an investor's values and financial goals with investment solutions.

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