

Perspectives

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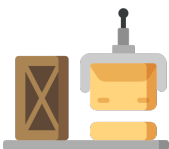



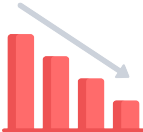
Sustainable Investing in a Post-COVID World

Defined as an unpredictable occurrence that is beyond the scope of normal expectations, a black swan event is rare and has potentially severe consequences. Even as COVID-19 spread across the globe in late March, the level of disruption ultimately caused by the virus came as a surprise to most. The global pandemic that followed suit was certainly a black swan event with some economists dubbing it the first sustainability crisis of the 21st century. Looking through the lens of traditional environmental, social, and governance (“ESG”) factors, the pandemic has touched all major ESG elements in both positive and negative ways and will shape how we think about these issues going forward. Exhibit 1 below provides some generic examples.



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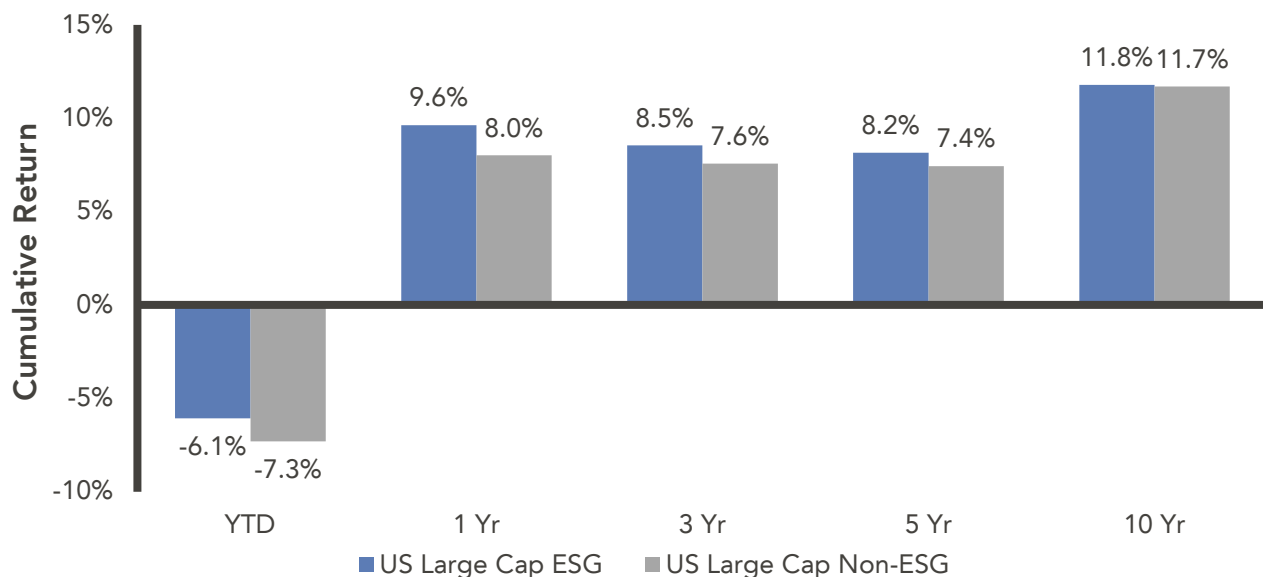
Exhibit 1: Impact of COVID-19 on ESG Factors

	E	S	G
POSITIVE IMPACT	Reduction in personal carbon emissions 	Enhanced awareness around supply chain management and labor practices 	Success of work from home protocols may open the door for more women in C suite roles 
NEGATIVE IMPACT	Increase in single-use plastic following shift to disposable products 	Stressed conditions for certain essential service providers 	Decreased cash on hand as a result of stock buybacks 

From a market perspective, stocks experienced the sharpest sell-off in history; while no sector was left unscathed, some relative winners and losers were identified. Of note was the outperformance of sustainable investing strategies compared to their non-sustainable counterparts. The purpose of this newsletter is to dive deeper into the performance of sustainable investing strategies during the past several months and attempt to provide insight into what investors, investment managers, and companies will be seeking from a sustainability perspective in a post-COVID world.

Critics of sustainable investing have often pointed to performance, arguing that investors must give up returns in exchange for these “feel good” investments. Over the past few years, evidence has been building to show that in fact the opposite is true: poor corporate stewardship tends to result in underperforming stocks. Additionally, sustainability-focused funds have proven to be resilient during times of market turmoil. The chart below shows the trailing performance (as of May 31st, 2020) of 1,175 U.S. large-cap strategies, distinguishing between those that identify as integrating ESG factors into the traditional financial analysis and those that do not.

▾ **Exhibit 2:** Trailing Returns for U.S. Large-Cap Funds



Source: eVestment

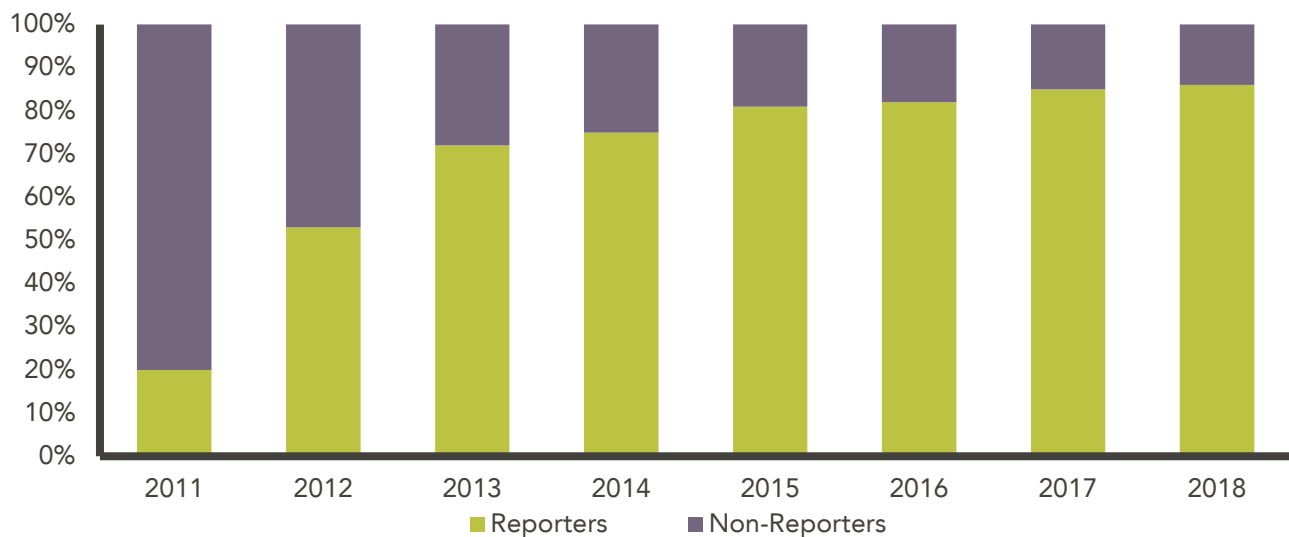
Over the trailing 3-year period, ESG integration funds have outperformed their non-sustainable counterparts by nearly 100 basis points. It’s also worth noting that on average, the standard deviation of these two strategy types has been roughly the same; meaning, investors in these ESG integration funds have benefited from higher returns without taking on additional risk. The trend is similar for global and non-U.S. large-cap funds.

Some of this recent outperformance can be attributed to the fact that most ESG integration strategies either exclude or underweight the energy sector, which continues to be pummeled by a supply glut. However, we also saw similar protection from sustainability-focused funds during the late-2018 market downturn. What else is contributing to the long-term outperformance of these funds, particularly in times of market stress? Companies incorporating sustainability factors into their businesses tend to be viewed as higher quality and in turn lower volatility; these tend to attract risk-adverse investors during times of market turmoil. Additionally, these companies tend to be more agile and transparent. The ability to quickly adapt to shifts in business, social, and economic practices was and will continue to be vital to a company’s success going forward. For example, the push by Tyson Foods, Inc. (“Tyson”) to keep its production

facilities open at the expense of the health and safety of its workers resulted in the continued spread of the virus among the company's employees. Tyson now faces demand hurdles after China announced a partial suspension of imports from the company; it is also the subject of an investigation by U.S. Senators Elizabeth Warren (D-MA) and Cory Booker (D-NJ). It should then come as no surprise that Tyson has historically been the subject of shareholder activism campaigns with concerns over animal welfare, pollution, and board diversity. Companies with poor governance practices tend to see that risk spill over into the environmental and social elements as well.

Investors also continue to demand disclosures around sustainable practices. Information is disseminated in real time now, meaning companies face significant reputational risk for not addressing sustainability issues head-on. This is evident by the increase in sustainability reporting published by companies in the S&P 500 Index, jumping from 20% to 86% over the past nine years.¹ As the content of these reports continues to be analyzed by investors and priced into the market, companies that refuse to take a transparent approach will continue to fall behind.

▾ **Exhibit 3:** S&P 500 Companies Producing Annual Sustainability Reports



Source: Governance & Sustainability Institute Research Results

As investors, investment managers, and companies prepare for the next black swan event, concerns surrounding climate risk and inequality seem to be inevitable considerations. Most recently, the Journal of the American Medical Association published research linking climate change with harm to newborn children in the United States. According to the research, which examines more than 32 million births through the course of 52 studies, women exposed to higher temperatures and pollution levels are more likely to deliver premature, underweight, or stillborn babies (of which African-American mothers and their babies are harmed at a much higher rate).² In addition to having devastating societal effects, climate change (as suggested by this research) extends its reach to the economy by impeding upon population growth and in turn, productivity. As the underlying value of companies increasingly becomes reliant on intangible goods such as intellectual property, data, and human capital, these sustainability issues must be weaved into the fabric of risk analysis. While the U.S. Department of Labor has issued proposed regulatory changes around the consideration of ESG factors when making investment decisions, it still recognizes that dysfunctional corporate governance may lead to pecuniary risk that should be considered by fiduciaries.³

We also expect corporate engagement to become a tool more heavily utilized by both investors and active managers, seeking to align investments with sustainability goals and improve the underlying value

for shareholders. As businesses seek to rebuild in a post-COVID world, dialogue between companies and shareholders will be critical to shaping the new normal. Moreover, as managers seek to benefit from this investment trend, the use of dedicated engagement resources will help investors distinguish between sincere sustainability strategies and green-washed products.

While Marquette has long provided sustainable investing solutions for our clients, interest in the space has picked up dramatically over the past several years. As an example, for every \$3M invested by Marquette clients, \$1M is being put towards a sustainable investing strategy. Coinciding with increased investor interest in the space, advances in technology have improved the reliability and abundance of data available to investors to better assess investment managers and companies from a sustainability perspective. To better serve our clients, we are exploring partnerships with data providers in order to screen portfolios for a variety of sustainability issues. Additionally, we have enhanced our manager searchbooks to include sustainability metrics, similar to traditional metrics used to assess an investment strategy. For clients seeking assistance with implementing sustainable investment strategies, we have developed educational workshops focused on aligning the United Nations Sustainable Development Goals ("SDGs") with the client's mission and investment goals. Working with clients to identify which SDGs are of most importance helps to create tailored investment solutions that target the clients' sustainability goals.

As the sustainability landscape evolves, Marquette will continue to provide proactive recommendations to clients seeking to incorporate these elements into their investment portfolios. COVID-19 will leave an indelible imprint on society but markets always find a way to recover. It will then come down to the ability of investors, investment managers, and companies to heed the lessons of this devastating event to best position themselves for the future. ■

NOTES

¹ Governance & Sustainability Institute Research Results

² Bekkar, B., Pacheco, S., & DeNicola, N. (2020). "Association of Air Pollution and Heat Exposure With Preterm Birth, Low Birth Weight, and Stillbirth in the US; A Systemic Review." JAMA Network Open.
<http://doi:10.1001/jamanetworkopen.2020.824>

³ U.S. Department of Labor Employee Benefits Security Administration. (June 23, 2020). "Financial Factors in Selecting Plan Investments." 29 CFR Part 2550. RIN 1210-AB9.

Press release: <https://www.dol.gov/newsroom/releases/ebsa/ebsa20200623-0>

Proposed rule as of June 29, 2020: <https://www.dol.gov/sites/dolgov/files/ebsa/temporary-postings/financial-factors-in-selecting-plan-investments-proposed-rule.pdf>

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