LITMAN GREGORY ASSET MANAGEMENT

A Sustainable Investing Lexicon

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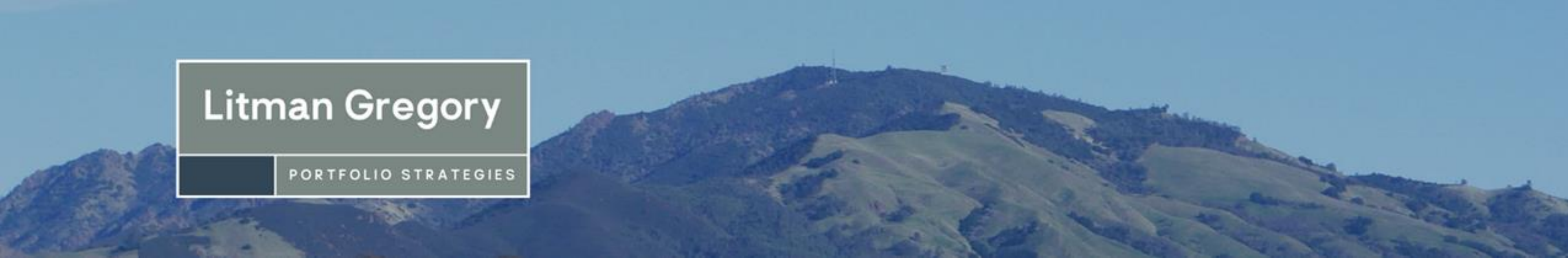

A Sustainable Investing Lexicon

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Sustainability is about long-term stewardship of precious assets. Most familiarly, environmental sustainability seeks to manage natural resources to avoid harmful destruction or depletion. Sustainable *investing* applies this same idea to the quest for durable financial returns that also support positive outcomes for society and the planet.

For Litman Gregory, sustainable investing begins with our core strategy of focusing on the long term in our decisions, working to build resilient portfolios that can navigate a variety of scenarios, relying on research and analysis, and working only in the best interests of our clients. Beyond these foundational practices, sustainable investing specifically incorporates environmental, societal, and corporate governance considerations that can impact long-term financial returns. Sustainable investing can also reflect specific values and ethical beliefs.

Today there is more awareness of sustainability in general and this has helped propel greater interest in sustainable investing. We have researched this type of investing and worked with clients to implement sustainable strategies for several years, and we are excited to see this segment of the investment landscape grow and mature. (Though of course as with any fast-growing area of the financial markets, strong research and a healthy dose of skepticism are critical in evaluating the options.)

Still, with more tools than ever to support our clients in building sustainability into their investment program, we want to begin sharing some of our thinking on this evolving space. A good place to start is simply defining terms—because there are many of them and their meanings aren't precise. Here is how we classify and think of strategies for sustainable investing.

Socially Responsible Investing

For many investors, Socially Responsible Investing (SRI) is the most well-known strategy. Also called "values-based" or "do-no-harm," these strategies are designed to reflect an investor's religious, personal, or ethical beliefs. SRI strategies have historically worked by *excluding* companies or industries that run afoul of personal priorities. (This type of approach is also known simply as an exclusionary strategy.) Commonly, exclusions begin with alcohol, tobacco, and certain weapons-related companies and may be broadened to other holdings considered controversial or offensive.

SRI strategies can be an effective way to reflect personal or organizational beliefs; however, it is important to implement these approaches thoughtfully with an understanding of how limiting the opportunity set can affect performance. When adding SRI to a portfolio, we work with clients to discuss the tradeoffs and how we can ideally optimize returns while also reducing exposure to the areas they wish to avoid.

Impact Investing

On the other end of the spectrum lies Impact Investing. Impact strategies invest with the intention of generating a positive, measurable societal impact, alongside an acceptable investment return. (As an aside, this is one of the terms that can be confusing because it is also possible to refer to the whole of sustainable investing as impact investing since it is aligned with having an impact on the broader world. We use the term *impact* to encompass a specific class of sustainable investments that take a more active, intentional approach to achieving specific outcomes.)

Recognizing that all companies have some kind of impact, investing for a specific type of impact can be achieved in numerous ways. For example, within mutual funds we have identified a handful of managers and firms whose efforts have led to specific improvements for the companies whose stocks or bonds they hold. Focus issues have included expanding the use of renewable energy, conserving water, and increasing gender diversity and pay equity. There is also a vast universe of private impact vehicles that can get very targeted on specific communities or causes.

Thematic Investing

Another way to achieve impact can be through Thematic Investing, which concentrates investments on a specific idea or theme. These can be appealing approaches to complement a diversified portfolio for investors who have strong convictions and/or want to participate in the growth of an emerging industry or trend. Funds that invest in companies supporting the transition to renewable energy sources is an example of a thematic investment; supporting women-led companies might be another. Because of their narrow focus, these investments should be considered in the context of a more diversified portfolio.

Environmental, Social, and Governance (ESG) Investing

The framework that most closely integrates sustainability with traditional investing is ESG Investing, by which environmental, social, and governance considerations are incorporated into investment decisions as part of a passive index or active strategy and most commonly applied to equity or bonds. Such factors might include efficient use of natural resources and efforts to reduce greenhouse gas emissions (E), employee turnover and workplace safety (S), and independent boards of directors and other checks and balances (G). ESG evaluation can and often does play a role in exclusionary/SRI and impact strategies. (Adding to the confusion, ESG is another term that may be used to encompass the entire sustainable investing landscape.)

The overall goal of ESG strategies is to identify high-quality companies for which there is a strong financial and non-financial ESG investment case. We recommend several Exchange Traded Funds (ETFs) that take a *best-in-*

class approach using ESG data to rank companies and identify the leaders within a given industry. The actively managed funds we recommend typically employ *ESG integration* strategies that systematically evaluate ESG factors as part of the manager's risk and return analysis for individual investments or sectors. (In our experience, it is also the case that many non-ESG active managers look at some ESG elements, typically corporate governance, as part of their investment valuation process.)

Today and Looking Forward

The universe of sustainable investment strategies is dynamic and continues to evolve. Already we have identified a strong complement of funds and ETFs to support clients who wish to explore this path.

Looking ahead, this is an area of ongoing research for Litman Gregory. We expect to see more high-quality investment options over time giving our clients more opportunity to align investment goals and positive personal and societal impact.

We invite you to view our Sustainable Investing brochure to learn more or contact us with any questions.

—Litman Gregory Investment Team