Q1 | 2022

The Colony Group

Investing with Values

Q1 Observations

After a period of competitive performance versus traditional equity funds, the majority of sustainable equity funds struggled in the first quarter, primarily due to their limited exposure to or avoidance of traditional energy companies. While the Russian invasion of Ukraine will likely accelerate the net-zero transition, supply chain disruptions in the global energy markets may continue to impact traditional energy companies for a while more. In our opinion, investors are best served looking beyond near-term results. We believe it's important to remind investors of the long-term benefits of sustainable investing.

Sustainable Investing Makes Financial Sense

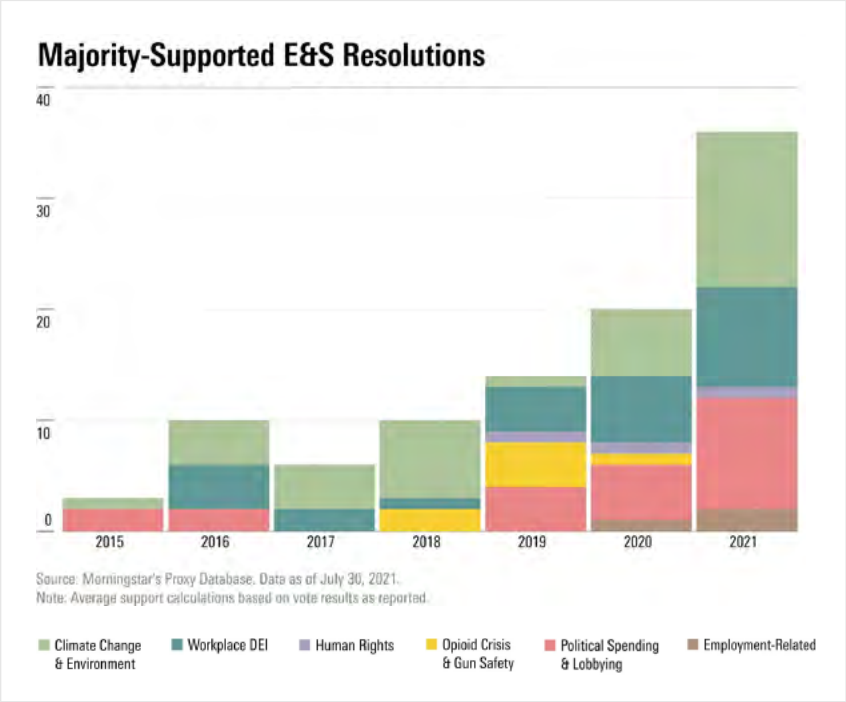
Integrating environmental, social, and governance (ESG) criteria into the investment process allows investors to more clearly understand how companies are managing material risks and opportunities. This integration provides another important lens with which to analyze a company, determine its long-term prospects, and enhance investment decision-making. In addition, the process helps to identify attractive companies that focus on including multiple stakeholders in their success-not only their shareholders but their employees, communities, customers, and supply chains. Thus, key objectives of sustainable investing are to potentially enhance long-term financial returns while simultaneously promoting positive ESG outcomes.

Sustainable funds' performance has generally exceeded that of traditional funds and matched widely used benchmarks. Morningstar shows that from 2012 to 2021, ESG-focused fund large-cap domestic stock funds returned an annualized 15.58% versus 14.87% for all large-cap funds. On an asset-weighted basis, ESG-focused funds essentially matched the return of the S&P 500 during the same period.

In the first quarter, traditional energy companies surged on the back of rising profits generated from a reopening economy and amidst a geopolitical crisis. These tailwinds may persist, but the long-term trend towards decarbonization is intact and may accelerate, especially in Europe. The EU plans to accelerate the Fit for 55 energy transition plan by increasing the deployment rate of renewables by 20%. Shortly after the Russian invasion, the EU unveiled the REPowerEU Plan which aims to make Europe independent of Russian fossil fuels by 2030.

Sustainable Investors Have Real Impact

In our opinion, while financial results will inevitable fluctuate, positive ESG outcomes will not. While some might suggest the biggest impacts stem from policy and philanthropy, we've found that investors can participate as well. There are many tangible, and often unappreciated, ways investors can contribute to positive societal change. For example, targeted allocations to thematic funds enable investors to funnel capital towards companies providing solutions to challenges such as energy efficiency, global water scarcity, and gender equality. Furthermore, sustainable fixed income funds can target a host of social and environmental issues such as affordable housing, economic development, minority empowerment and renewable energy. Investing in renewables infrastructure allows investors to contribute to the net-zero transition.



Successful sustainable investors are able to influence corporate boardrooms through active ownership. Active ownership is the process in which fund managers use their influence as shareholders to effect meaningful corporate and public policy change on a variety of ESG issues. During the past year, sustainable fund managers have achieved significant outcomes related to climate-aligned lobbying, science-based emissions reduction targets, diverse board representation, and disclosure of EEO-1 data. Again, these positive outcomes will persist even as short-term investment results vary. With corporations increasingly open to evaluating sustainability issues, we believe the frequency and significance of positive ESG outcomes will increase.

Finding Sustainable Funds That "Walk the Walk" is Hard, But Worth It.

The rise in interest in sustainable investing over the last decade has caused an influx of funds claiming to be sustainable. Morningstar estimates the number of sustainable mutual funds and ETFs grew 36% during 2021 to 534. Approximately 17% of this total are repurposed funds, or funds that formerly deployed traditional strategies but changed their process to incorporate sustainability or ESG considerations. This rapid growth has led to questions about the intentionality of both existing funds and new entrants. Claims of greenwashing, the practice of creating a false impression of a fund's environmental impact, have risen.

Nevertheless, we strongly believe that through careful due diligence and qualitative assessment, we can identify managers that truly deliver both the financial and non-financial objectives investors seek. Exclusionary screens are important but should be complemented with a thorough integration of ESG factors in a manager's research process. We evaluate the manager's active ownership philosophy, strategy, and record. We believe long-term thinking and a true commitment to the principles of sustainability are necessary to realize impact and financial objectives. In this regard, we believe it pays to do our homework.

Sustainable Fund Managers: What to Evaluate

RESPONSIBLE INVESTMENT

- Data Integrity and Transparency
- Research Process
- Portfolio Construction

RESPONSIBLE OWNERSHIP

- Shareholder Advocacy
- Company Engagement
- Impact Reporting

Colony Investing Solutions

Some statistics of interest from The Colony Group's Sustainable Investing Solutions global equity portfolio:

0%
Tobacco Exposure

0%
Controversial Weapons Exposure

74% Less*
Scope 1 Emissions

34% Less*
Scope 2 Emissions

40% Less*
Carbon Intensity

**Relative to MSCI All Country World Index*
Source: Morningstar Direct

For more on Sustainable Investing Solutions, read our Sustainable Investing Primer or our recent article in Worth magazine on thematic investing.

Sustainable Investing in Action

FINANCIAL

- US sustainable fund flows declined by 26% compared with the fourth quarter of 2021 while flows in the broader US funds market declined 65%. Notably, sustainable fixed income funds received record inflows.

ENGAGEMENT

- Green Century filed a shareholder resolution with Coca-Cola, urging the company to increase its use of refillable packaging. In February of 2022, the company announced a goal to have 25% of its beverage portfolio distributed in reusable or refillable containers by 2030. This was the first goal of its kind.
- Boston Trust Walden partnered with other investors to influence Consolidated Edison to take concrete steps towards climate-aligned lobbying. The company committed to annually disclose its process for evaluating the alignment of direct and indirect lobbying activities with its clean energy commitment.
- In 2021, EcoFin led four engagements as a signatory on CDP disclosure and participated in 63 additional additional engagements as a co-signatory.

CORPORATE RESPONSIBILITY

- Recognizing that Latinas are a powerful economic force in the U.S., creating businesses at a rate six times the national average, PepsiCo's Juntos Crecemos platform launched New Jefa-Owned (women owned) campaign aiming to help Latina-owned businesses gain access to business building support services.
- Lowe's launched a debt-free education program for more than 300,000 associates. The comprehensive program provides associates access to free tuition to build careers in technology, supply chain, data analytics and more.
- Apple suppliers made new clean energy commitments and have doubled use of clean power over last year.

Sources: Morningstar, Bloomberg, and engagement reports & publicly available information from funds