CHANGE FINANCE

SRInsights

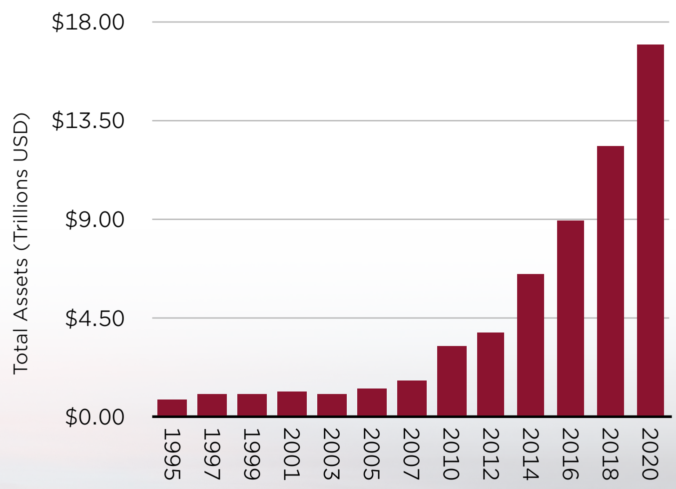
From Dollars to Dogmas

What Drives Sustainable and Responsible Investors

In 2020, we witnessed the consciousness of capital markets shift and corporate behavior begin to change. As more than $51.1 billion flooded into mutual funds and ETFs with environmental, social, and governance (ESG) mandates, investors and asset managers alike realized the positive impacts their portfolios could have on society, the environment, and the economy.[1] Increasingly, investors and their advisors are advancing discussions beyond familiar topics such as savings goals and risk tolerance. Conversations are now more often advancing to emotionally charged topics ranging from racism to religion. While such interactions fuel the exponential growth of sustainable and responsible investing (SRI), researchers are working to identify the key psychological and behavioral drivers that lead investors to abandon traditional portfolio management in favor of portfolios that seek return and impact. The team at Change Finance has reviewed and summarized their findings in an effort to facilitate optimal investor-advisor interactions.

Change Finance collected and analyzed data from behavioral driver analyses conducted in eight countries and across various market indices that included institutional, high net worth, and retail investors. The results of this research indicate that investors pursue SRI portfolios with ESG data integration for three primary reasons: **Altruism**, **Autonomy**, and **Performance**.

Growth of Sustainable Investing in the US



Source: USSIF

ALTRUISM

Many SRI investors view their investment portfolio as a means to promote the public good. Research shows that those individuals are more likely to invest larger sums in ESG-oriented portfolios while expressing a willingness to forego a degree of financial return to maximize positive impact on people and the planet.[2] Altruistic investors are likely to embrace advisory firms and asset managers that engage in shareholder advocacy, regardless of the higher fees that may be associated with those services.

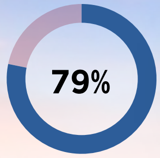
AUTONOMY

Just as individuals may leverage fashion or diet to signal their values to society, investors can reinforce their social identity by aligning their portfolios with their viewpoints. By integrating personal values and investments, individuals can feel a sense of autonomy that improves engagement and feelings of personal accomplishment. Investors motivated by autonomy are likely to express satisfaction with thematic portfolio holdings that reinforce their social identification, such as funds dedicated to gender equality, clean energy technology, or water conservation.

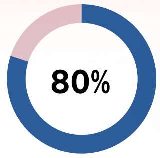
PERFORMANCE

Research indicates that a majority of individuals believe the integration of ESG data will mitigate risk and enhance returns. For example, a 2020 Morgan Stanley survey found that 80% of investors view ESG performance as a precursor to higher corporate profitability, while 78% of investors associate sustainable investing with risk mitigation.[4] A meta-analysis from over 1,000 individual studies validates these viewpoints and confirms that most researchers find a positive or neutral correlation between ESG portfolios and superior risk-adjusted returns.[3]

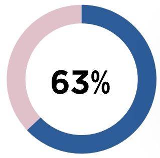
Findings from Change Finance's 2021 **ESG Asset Allocation Trends Report** confirms that advisory firms across the country are doing an excellent job of addressing all three key behavioral drivers. For example:



OF THE ESG MUTUAL FUNDS AND ETFS MOST COMMONLY RECOMMENDED BY FINANCIAL ADVISORS OUTPERFORMED THEIR RESPECTIVE BENCHMARKS OVER A TRAILING THREE-YEAR PERIOD



OF THE SAMPLED ESG-ORIENTED PORTFOLIOS INCLUDED A THEMATIC ELEMENT THAT REFLECTS THE PERSONAL VALUES OF THE INVESTOR



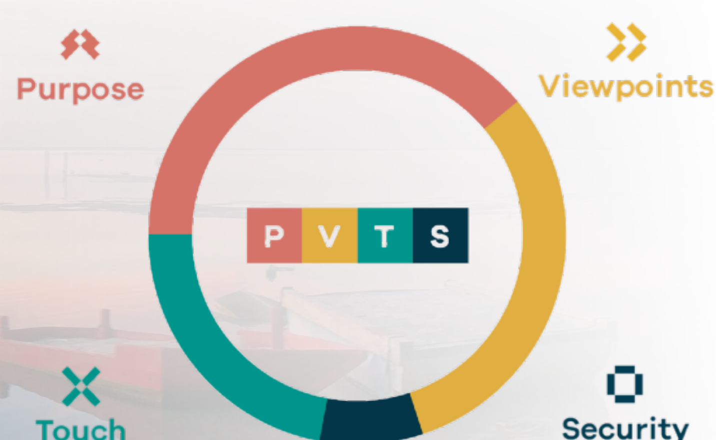
OF THE SAMPLED ASSET MANAGERS ENGAGE IN MEANINGFUL SHAREHOLDER ADVOCACY, AMPLIFYING THE POSITIVE IMPACT SOUGHT BY MANY SOCIALLY AND ENVIRONMENTALLY CONSCIOUS INVESTORS

Understanding the specific behavioral drivers motivating ESG investors is critical for those in the position to offer portfolio management and advisory services. An investor who is primarily interested in seeing their personal values reflected in their portfolio is unlikely to be satisfied by model portfolios offered by a third party. An investor who exclusively considers ESG data as a risk mitigation tool may be adverse to pay an expense premium for shareholder advocacy services, and an investor driven by altruism may prefer to see impact-oriented reporting over traditional financial statements.

For those investors and advisors seeking to explore, enhance, and expand their understanding of this topic, we recommend exploring the services provided by **Positivly** (a paid endorser of Change Finance). Positivly is a financial technology platform enabling advisors and investors to understand and quantify behavioral drivers across multiple dimensions including *purpose*, *viewpoints*, *security* and *touch* (relationships). We believe the Positivly framework aligns well with the behavioral drivers identified by Change Finance. Positivly incorporates years of research in positive psychology, investment science, and proprietary algorithms by Harvard and Wharton academics. While sophisticated, it provides a simple tool for investors to define financial outcomes that go far beyond risk assessment and raw returns. Each individual can thus define and achieve their own unique version of financial happiness.

Positivly

- **FINANCIAL PERSONALITY ASSESSMENT**
- **GROUNDED IN POSITIVE PSYCHOLOGY**
- **ENHANCE CLIENT ENGAGEMENT**
- **BUILD HYPER-PERSONALIZED PORTFOLIOS**



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[1] Hale, Jon. 2021. “A Broken Record: Flows for U.S. Sustainable Funds Again Reach New Heights.” *Morningstar*, January 28. https://www.morningstar.com/articles/1019195/a-broken-record-flows-forus-sustainable-funds-again-reach-new-heights

[2] Riedl, A. and Smeets, P. 2017. “Why Do Investors Hold Socially Responsible Mutual Funds?”, *Journal of Finance*, 72(6), pp. 2505–2550. doi: 10.1111/jofi.12547

[3] Whelan, T., Atz, U., Van Holt, T., Clark, C. 2021. “Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published between 2015-2020.” NYU | Stern, February 10. https://www.stern.nyu.edu/experience-stern/about/departments-centers-initiatives/centers-of-research/center-sustainable-business/research/research-initiatives/esg-and-financial-performance

[4] Morgan Stanley Institute for Sustainable Investing. 2019. *Sustainable Signals: Individual Investor Interest Driven by Impact, Conviction, and Choice.* Morgan Stanley. https://www.morganstanley.com/content/dam/msdotcom/infographics/sustainable-investing/

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