



Di Iorio Family Wealth of RBC Dominion Securities

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The New Meaning of Sustainable Investing

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Sustainable Investing is a theme that has gained significant momentum over the last few years. Sometimes referred to by terms like ESG (environmental, social, and governance) investing, or SRI (socially responsible investing), these can generally all be seen as synonymous, and are related to the incorporation of “sustainability” into the investment process when managing assets. According to a report published by McKinsey (linked below), at the start of 2016 it was estimated that more than 25% of the \$88 trillion of assets under management worldwide were managed under an approach that incorporated some form of ESG screening.

We often see external portfolios in the industry that seemingly place little to no weight on sustainability during their portfolio construction. This may be because many still associate sustainable investing with the process of excluding companies that operate in certain industries/sectors from the investable universe (ex. oil companies, tobacco companies, etc.). This approach of being exclusive of companies that fall into certain categories is known as negative screening, and is becoming less and less prevalent as the field of sustainable investing evolves. Instead, the new focus of the discipline is on positive screening, which is much less black and white. Rather than excluding companies based on their operations, positive screening looks to highlight and support companies which demonstrate positive environmental, social, or corporate governance practices.

This evolution in the sustainable investing model takes the focus away from limiting the investable universe, and instead focuses on encouraging the progression and adoption of sustainable business practices by all companies no matter which industry they are a part of. This of course has the effect of increasing the attractiveness of companies that operate in areas like renewable energy, or those which promote things like gender diversity. However, it also allows for the recognition and support of companies operating in industries traditionally viewed in a negative light (ex. oil producers), which establish themselves as leaders in other areas such as land restoration, or use their financial capacities to support social issues like poverty alleviation.

The increased interest in the idea of sustainability has been driven in large part by the recognition of the valuation premiums, and generally superior financial performance, of companies which implement superior ESG standards relative to their peers. An article from October 2017 published in the Financial Times (linked below) presents some potential explanations of this outperformance. There is some debate about whether these superior outcomes are due to a general trend towards favoring companies which try to practice one of Google's old mottos, "Don't be evil", or if it stems from the increasing risk of financial consequences that can be placed on companies which do not act ethically or are found to be in breach of things such as environmental regulations. In either case, it is clear that the risk associated with poor ESG practices is rapidly becoming more severe in both reputational as well as financial capacities.

There is no doubt that this is a trend which will continue to gain momentum as more companies realize the positive impact reforming their ESG policies can have. To us, taking sustainability into consideration should clearly be a part of the investment approach, and we continue to integrate it into our own portfolio decision making process.

McKinsey Report:

<https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/from-why-to-why-not-sustainable-investing-as-the-new-normal>

Financial Times Article:

<https://www.ft.com/content/80c833ce-b994-11e7-8c12-5661783e5589>

Sincerely,
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