Debunking five myths about sustainable investing

Like many important trends, sustainable investing has spurred both excitement and confusion, for some in roughly equal measure. Misconceptions about the nature, purpose and even the definition of sustainable investing have taken hold, and it’s sometimes hard to find the signal in the noise.

**WE’LL TACKLE THESE MISCONCEPTIONS ONE BY ONE. BUT FIRST, WE’LL DEFINE OUR TERMS.**

At J.P. Morgan Private Bank, “sustainable investing” is an umbrella term used to describe investment approaches that incorporate financial as well as social and environmental objectives.

**MYTH #1**

Sustainable investing equates to lower performance.

No.

Sustainable investing does not require a performance tradeoff. If we look at environmental, social and governance (ESG) integration as an example, research shows that incorporating ESG factors can enhance a portfolio’s returns by reducing volatility and providing protection in bear markets (Exhibit 1). Think of it this way: Embedding ESG analysis leads to more complete and robust data to analyze companies, and more data can lead to better-informed investment decisions and, potentially, stronger risk-adjusted returns. In that sense, sustainable investing can actually lead to value creation.

Further, we see environmental and social issues as secular, long-term “megatrends” that can potentially offer attractive investment opportunities. Some of these megatrends include investments in clean energy, electric vehicles and new technologies that increase agricultural yield in water-scarce areas.

**EXHIBIT 1: ESG LEADERS HAVE PRODUCED STRONG PERFORMANCE**

<table>
<thead>
<tr>
<th>ESG Equity Leaders</th>
<th>Broad Equity Index</th>
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<tbody>
<tr>
<td>14.0%</td>
<td>14.4%</td>
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<tr>
<td>7.4%</td>
<td>6.9%</td>
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</tbody>
</table>

Source: Morningstar 5/1/10–4/30/20. ESG Equity Leaders = MSCI ACWI ESG Leaders NR USD Index, which invests in the top 50% of MSCI ESG rated companies, Broad Equity Index = MSCI ACWI NR USD Index. See Index Definitions under Important Information.

Past performance is not a guarantee of future results. It is not possible to invest directly in an index.
MYTH #2
Sustainable investing means excluding securities from my portfolio, and therefore reducing my opportunity set.

Not at all.
Exclusionary screening is just one sustainable investing approach; there are several other approaches that proactively select sustainability leaders, rather than focus on removing securities. These include: ESG issues are part of investment due diligence and financial analysis. Targets specific social and environmental issues. Investments are made in companies, organizations and funds to generate positive social and/or environmental impact alongside financial return (Exhibit 2).

Many ESG strategies utilize shareholder advocacy and engagement as key components of their investment approaches; rather than divest from a holding, an investor or manager may use their “voice” as a shareholder to influence a decision.

MYTH #3
Sustainable investing is solely focused on climate and the environment.

Not really.
Climate change and other environmental concerns are a focus for many sustainable investors and also integral to several of the investment solutions at J.P. Morgan Private Bank. However, social and governance issues—the S and G in ESG—are top of mind for clients as well, and they merit consideration in the analysis of companies and funds (Exhibit 3). Arguably, every investment should focus on the G—sound governance practices are critical to the long-term success of businesses. And social issues such as data security, employee health and safety, and diversity practices are increasingly seen as important in company analysis.

We also find that E, S and G issues are often interrelated. For example, water stress is not only a risk to ecosystems, but it also affects human health and well-being. It can intensify social and political fragilities in emerging economies, such as the Middle East and North Africa (MENA), the most water-scarce region in the world.¹ Greater societal stresses can also lead to forced migration across borders. Further, many of these types of environmental risks have been found to disproportionally affect lower-income communities, women and girls. Given the interconnectedness of ESG issues, our sustainable investing solutions consider a wide range of sectors and themes, including the environment, health and wellness, poverty and diversity.

¹J.P. Morgan: Climate Changes Everything, Part II.
MYTH #4
Sustainable investing is just a passing fad.
We don’t think so.

In a recent survey, 87% of millennial respondents noted the importance of ESG factors when they make investment decisions.² However, that shouldn’t overshadow the wide range of investors contributing to the growth of ESG assets. According to Schroeder’s 2019 Global Investor Study, which surveyed 25,000 investors worldwide, more than 60% of respondents under age 71 said that all investment funds should consider sustainability factors when making investment decisions.

At the end of 2014, there were just 111 sustainable investing mutual funds and exchange-traded funds (ETFs) in the public markets. By year-end 2019, that number had grown to 303 funds, including 106 passive options and 77 ETFs.³ Flows into U.S. sustainable funds increased four-fold from 2018 to 2019, growing by $21.4 billion in dollar terms (Exhibit 4). In Europe, flows into sustainable strategies were EUR 120 billion⁴ in 2019, and AUM stood at EUR 668 billion across 2,405 funds.

EXHIBIT 4: SUSTAINABLE FUND FLOWS SET A RECORD IN 2019

MYTH #5
Sustainable investing is expensive, and requires a large asset base.
Certainly not.

Although institutional investors account for 75% of global ESG investments, retail-based investment has been growing more quickly.⁵ There are a growing number of sustainable investing funds, and many carry small minimums. Investor demand for less expensive funds and ETFs is driving flows and shaping asset growth. In the last four years, passive funds and ETFs have accounted for at least 40% of new launches, and now constitute about a third of total sustainable funds in the United States⁶ (Exhibit 5). The entry of large players, coupled with the explosive growth in passive fund and ETF options for ESG investing, have pushed fees down. Asset-weighted ESG ETF expense ratios dropped from 0.27% in 2018 to 0.21% in 2019 in the United States.⁷

EXHIBIT 5: UNIVERSE OF SUSTAINABLE FUNDS CONTINUED ITS MULTIYEAR GROWTH TREND IN THE UNITED STATES

² U.S. Trust, “2018 Insights on Wealth and Worth.”
⁵ Global Sustainable Investment Alliance, “2018 Global Sustainable Investment Review.”
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INDEX DEFINITIONS

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The MSCI ACWI Index is a capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

The MSCI ACWI ESG Leaders Index is a capitalization weighted index that provides exposure to developed and emerging market companies with high Environmental, Social and Governance (ESG) performance relative to their sector peers.

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