It's a New World

ESG investing as the new standard

It's a new world.

It's hard to imagine a world without climate change, social injustices, and corporate ethics failures. These issues have become ingrained in our daily lives reaching the news headlines daily, it is no longer possible to ignore them in our investment decisions.

Political pressure, greater regulation, and advancements in technology are all helping to shift investors beliefs, and behaviours around ESG investing. This shift will take time, but it is beginning to gain momentum. In the first half of 2020, the Principles for Responsible Investing (PRI) signatories increased by 28%, to more than 3,000 entities, and assets under management grew 20%, to more than 100 trillion USD. At the end of 2019 the Responsible Investment Association reported over $3.2 trillion in responsible investments with growth of 48% over two years. In 2020, ESG ETFs saw global net flows of approximately 75 billion USD, more than three times the prior year, or approximately 10% of overall ETF net flows globally. It was also a growth year for new ESG ETF products, with more than 120 being launched globally. (MSCI Q1 2021 ESG Transparency Report).

Institutions are evolving their policy benchmarks to include ESG. Many believe security selection and portfolio construction processes should evaluate ESG characteristics alongside other strategic, business and financially material company characteristics (e.g., valuations, growth and profitability). The Edelman 2019 Trust Barometer Special Report indicates that more than 87% of Canadian institutional investors have changed their voting and engagement policies to be more attentive to ESG risks.

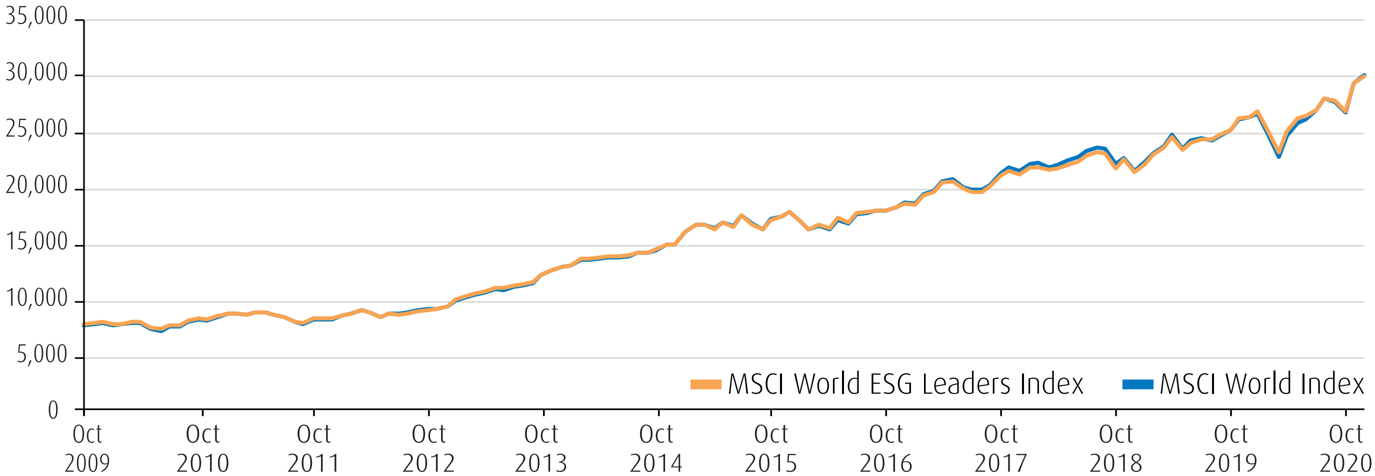
ESG investing has been around for decades but only now seems to be coming to light in mainstream investing. We can chalk this up to growing awareness of corporate ESG incidents, enhanced ESG data and analytics, an increase in investor interest and a greater range of products available. What's clear is that attitudes towards investing in our world have changed, and with good reason. With the global pandemic, and demonstrations over social injustices, investors are beginning to hold corporations responsible for their performance on environmental, social and governance benchmarks. This is not a passing trend and represents a new normal in terms of investment expectations and fiduciary duty.

In 2018 the United Nations Environmental Programme Finance Initiative (UNEP FI) specified that the modern interpretation of fiduciary duty includes "the consideration of ESG issues in investing decision-making." While Europe is ahead in shifting their fiduciary duty to include ESG integration as a regulatory requirement, North America shows signs it is next to follow suit. (UNPRI: Fiduciary Duty in the 21st Century).

> While ethical considerations still figure in, a growing number of investors see ESG issues affecting financial results. Climate change poses risks and opportunities; workforce relations affect a company's competitive positioning; and checks and balances on corporate management lead to better decision making.
>
> (CFA Institute, July 2020)

ESG considerations are additional factors used in determining business risk, and drivers of value which have proven their worth over the long term. Extensive track records on ESG indexes are available in addition to a wealth of research on the value that ESG ratings can have in helping to avoid major stock drawdowns. Exhibits 1, 2 & 3 show MSCI ESG Leaders Index, widely considered the global benchmark ESG index, relative to its parent and how it can deliver market rate returns over the long run.

Exhibit 1: Growth of $10,000 over 10 years
MSCI World Index (CAD) vs. MSCI World ESG Leaders Index (CAD)



Source: Morningstar, December 31, 2020.

Exhibit 2: Calendar Year Returns (%)

Year	MSCI World ESG Leaders Index	MSCI World Index
2009	12.46	10.39
2010	4.9	5.93
2011	-3.08	-3.2
2012	11.94	13.26
2013	36.12	35.18
2014	14.33	14.39
2015	18.61	18.89
2016	3.54	3.79
2017	13.03	14.36
2018	0.53	-0.49
2019	21.67	21.22
2020	13.27	13.87

Source: MSCI, December 31, 2020.
Past performance is no guarantee of future results.

Exhibit 3: Annualized Returns (%)

Time Lapse	MSCI World ESG Leaders Index	MSCI World Index
YTD	-4.39	-5.48
1 Year	5.34	3.4
3 Year	8.08	7.29
5 Year	7.88	7.5
10 Year	10.54	10.57
Since Inception (Sept 28 2007)	5.21	5.08

Source: MSCI, December 31, 2020.

Why not?

ESG factors can materially impact a corporation's performance, value, and reputation. If you can get market rate returns while lowering drawdown risk, then why not?

Exhibits 2-5 show compelling data using MSCI World ESG Leaders Index as the benchmark for ESG investing to show you can achieve market rate returns while lowering risk. With a beta of 0.99 and a tracking error of just 1.17 ESG Leaders makes a defensive core solution. Research by MSCI and Morningstar shows that companies with higher ESG Rating tend to be more profitable, and have stronger balance sheets. This makes them more defensive in times of market turmoil.

Exhibit 4: Risk Metrics

Risk Metrics	MSCI World ESG Leaders Index	MSCI World Index
Beta	0.99	1
Tracking Error (%)	1.17	0
Turnover (%)	8.83	3.2
Standard Deviation (%, 10 Year)	10.32	10.57
Sharpe Ratio (10 Year)	1.17	1.16

Source: MSCI, December 31, 2020.

Exhibit 5: Fundamentals

Yield	MSCI World ESG Leaders Index	MSCI World Index
Dividend Yield (%)	1.86	1.78
P/E Forward	20.94	20.97
P/BV	3.35	2.92

Source: MSCI, December 31, 2020.

Invest in the best.

BMO Global Asset Management's, BMO MSCI Global ESG Leaders Index ESG (ESGG) is available for 0.25% management fee and provides exposure to the top ESG rated companies in each sector tracking MSCI's Global ESG Leaders Index.

BMO MSCI Global ESG Leaders Index ETF

ESGG

Distribution Yield: 1.8% | Q
Mgmt. Fee: 0.25%
Risk Rating: Medium

MSCI ESG Leaders Index Methodology

Each company in the parent (MSCI World Index) is assessed on a handful of ESG issues that are most relevant to its industry and their business, with governance risk assessed across the board. So while every company has an E, S, and G rating, the components that go into that rating differ between industries. This way a Financial company will not be rated on Water Scarcity Risk, while a soft drink company like Coca Cola, would be. Research has shown that companies that focus on material ESG issues produce better financial performance than those that look at all ESG issues.

Sector Representation	• 50% target sector representation per GICs sector and Sub-Region (to avoid regional and sector biases) relative to parent index
Minimum ESG Rating	• Minimum ESG rating BB
Minimum Controversy Score	• Excludes companies with on-going severe controversies
Weighting Scheme	• Market Cap Weighted • Rebalanced quarterly with ongoing event-related maintenance
Exclusions	• The following activities will use the "Least Restrictive" (as defined in the MSCI ESG Research framework) screen: Alcohol, Gambling, Nuclear Power, Conventional Weapons. • The following activities will use the "Moderately Restrictive" (as defined in the MSCI ESG Research framework) screen: Civilian firearms, Tobacco. • Nuclear Weapons will use the "Highly Restrictive" (as defined in the MSCI ESG Research framework) screen • Controversial Weapons will use the "Most Restrictive" (as defined in the MSCI ESG Research framework) screen. • Companies involved in the mining of thermal coal, unconventional oil extraction, thermal coal-based power generation are also excluded.

BMO Global Asset Management

Let's connect

Call us at 1-800-668-7327

bmo.com/gam/ca/advisor