# Responsible Investing and ESG: What's right for your portfolio?

## What comes to mind when you think about responsible investing?

**I'm just not sure.**

*If I knew there were investments with good performance, I'd feel more comfortable investing.*

**It makes sense to me.**

*I think about where my money's going and I expect to get good returns without compromising my values.*

**Prove it.**

*Show me comparable risk and return, because these are my investments — not my donations.*

**I like the idea of it**

*I'd need to know more about how I could stick with my overall investment strategy and invest in more sustainable companies.*

There's no right or wrong answer to the question. We each have our own set of goals, based on our views and our life experiences. So while some people may want to prioritize certain environmental, social and governance issues, it's the combination of financial benefits plus non-financial benefits that often drives the decision to invest.

## What is ESG?

Environmental, social and governance (ESG) are labels for the key factors and considerations used by investment decision makers. ESG investments are similar to traditional investments except they go a step further in the investment decision-making process. In evaluating stocks or bonds as part of the investment process, ESG investments consider the impact of environmental, social and governance factors in addition to traditional financial factors. An investment might exclude certain companies or industries that have low ESG scores (negative exclusion), or it might focus on including "best-in-class" companies with high ESG scores (positive inclusion). They are available in exchange-traded funds (ETFs) or mutual funds, similar to traditional investment funds.

**Environmental, Social and Governance Factors that Affect a Company's ESG Score**

**Environmental**
- Climate Change
- Water Management
- Pollution

**Social**
- Labour Standards
- Human Rights
- Healthy and Safety

**Governance**
- Executive Pay
- Business Ethics
- Corporate Governance

## Why should I consider ESG investments?

The purpose of ESG investments is is to allow investors to better manage risks to generate sustainable, long term returns. That means aiming to minimize the risk of losses and it can also mean looking for opportunities to add returns. Identifying ESG-related risks and opportunities can improve investment returns by:

- Identifying and limiting exposure to longer-term and systematic risks (like climate change),
- Identifying and limiting exposure to nearer-term and company-specific risks (like data security), and
- Adding exposure to companies with a good track record of managing ESG-related issues, which can lead to better investment returns.

There are many benefits of investing in ESG solutions, depending on your reasons for investing:

→ Investing in companies with good ESG ratings can mean **lower risk over time.**

→ Investing in companies with good ESG ratings can mean **more growth over time.**

→ I want my **kids to focus more** on saving and investing, and they're interested in ESG issues.

→ I can **meet my financial goals** while investing in sustainable companies.

→ My investments should **reflect what I care about.**

→ I want to **avoid companies that have a negative impact.**

→ I want to **invest in companies that have a positive impact.**

These benefits go hand in hand. So while you might appreciate the impact an investment has on improving gender diversity, for example, you could be motivated to invest by learning that companies with gender-balanced leadership have tended to outperform those without.

## What the data shows:

- By screening out companies with poor environmental and social scores, investors could have avoided 9 out of 10 bankruptcies in the S&P 500 between 2005 and 2015.[1]
- Shares of companies with more women in senior management have outperformed those with male-dominant management.[2]
- Comparing 400 global stocks across three different timeframes, companies with the highest governance scores outperformed those with the lowest governance scores by an average of 2%.[3]

**CASE IN POINT**

"A year before Equifax Inc. disclosed a breach that compromised the private information of 145.5 million consumers, a big financial company warned of signs that the credit reporting firm was failing to protect its data.

Index provider MSCI Inc. cautioned in an August 2016 report that Equifax was ill-prepared to face the increasing frequency and sophistication of data breaches." After examining company records, MSCI analysts said they found no evidence of regular cybersecurity audits, employee training to recognize risks, or emergency plans to respond to an intrusion. On privacy and data security, Equifax scored zero.

As a result, Equifax was booted from a family of MSCI indexes that pick stocks based on how well companies perform on environmental, social and governance criteria, known by the shorthand ESG. 'If you're an investor or asset manager and you see these rock-bottom evaluations of Equifax, it had to have given you pause," said Jon Hale, head of sustainability research at Morningstar Inc. "This is an instance where ESG analysis was really ahead of the curve.'"

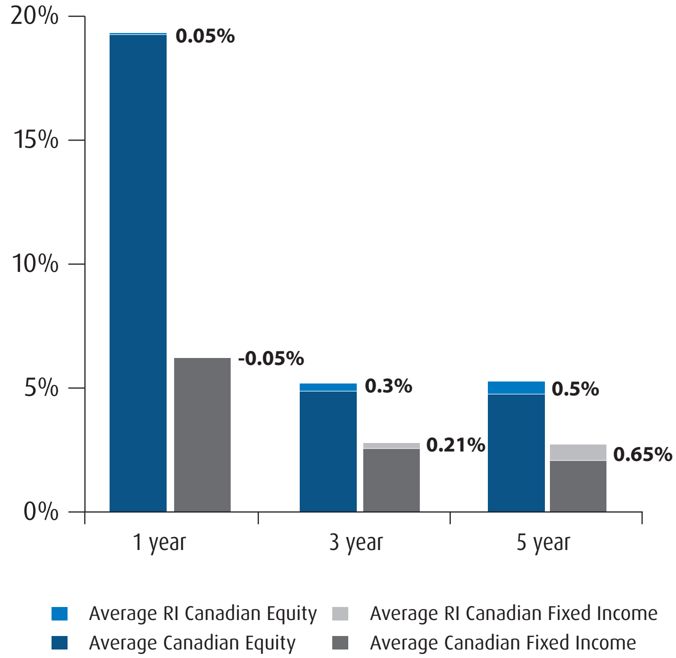
– *The Wall Street Journal*[4]

## Values and valuations

Research confirms that responsible investing is not an either/or decision when it comes to investment performance. Using ESG investments may reduce risk and offer the potential for greater long-term returns, compared to similar funds that do not include ESG considerations.

But investing today could help protect portfolio returns from the next data security breach, environmental catastrophe or management crisis.

**Comparable Historic Performance of Responsible Investing**




Source: "Responsible Investment Funds in Canada, Highlights from Q4 2019," RIA Canada. Compounded returns, as of December 31, 2019.

## How do I choose the ESG investments that are right for me?

Investors have a range of options in terms of expected return, risk, income and diversification. An advisor can help develop a portfolio focused on achieving your long-term goals.

**ESG ETFs** - Equity and Fixed Income ETFs that are designed to represent the performance of companies that have high ESG ratings relative to their peers.

**ESG Mutual Funds** - The opportunity to benefit from active fund management, which can provide downside protection, risk control, flexible mandates and the potential to outperform the market.

**"I want to balance risk and reward."**
You want your money to work for you but not keep you up at night. A balanced investment option often appeals to investors looking for an easy-to-use, diversified and sustainable portfolio for retirement, college savings or other medium- or long-term goals.

**"I need a reliable source of income."**
You want to keep your money invested but need to draw income on a monthly basis. A dividend-focused option is designed to provide potential for growth and income for the long term.

**"I'm looking for global growth."**
You want to cast a wide net to grow your money over time. A global equity option can offer diversification across industries and more than 20 developed countries.

## A smart approach to responsible investing

Our ESG investments are powerful tools for building diversified portfolios with sustainable results. We believe that considering ESG factors can give investors a powerful edge, to generate returns while mitigating risks, which is why it plays an important role in our investment process.

By encouraging better risk reduction and more sustainable growth, we aim for a more consistent approach to responsible investing while continuing to act in our clients' best interests. This is how we boldly grow the good with ESG investments.

1. Bank of America Merrill Lynch, "ESG Matters – Global".
2. Credit Suisse Research Institute, "The CS Gender 3000 in 2019: The changing face of companies".
3. Kelly Tang, Seeking Alpha, "Exploring the G in ESG: The Relationship Between Good Corporate Governance and Stock Performance – Part 2".
4. *The Wall Street Journal*, "A Warning Shot on Equifax: Index Provider Flagged Security Issues Last Year,"October 6, 2017
5. By number of staff and clients based on public information produced by Sustainalytics, Vigeo/EIRIS, Oekom, ISS and Trucost as of August 2016.

## BMO's ESG Solutions

**Expertise**
Dedicated Responsible Investment Team with 20 investment specialists around the globe

**Track record**
35 years of responsible investing experience

**Breadth**
Market-leading range of ESG stock, bond and balanced funds, across active and index solutions

**Engagement**
Extensive global engagement and voting program

Visit our website to learn more about ESG investing and BMO's solutions, or talk to your advisor about how ESG investing might fit your goals.

**www.bmogam.com/rileaders**