Sustainable Investment in the United States: Today and Future

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Abstract. Global warming has become a severe issue that threatens the human's lives. Gun control, corruption, and social mobility are also severe issues in the US. Sustainable investment directs investment capital to enterprises that not just pursue the highest profit but also want to make positive environmental and social impacts. This paper demonstrates the current status of Sustainable Investment in the US. and what the prospect of Sustainable Investment is in the following five to ten years. It explains major sustainable investment strategies. Then, it reviews the current status of sustainable investment in details and some corresponding ongoing corporate actions in the market utilizing industry fact to make predictions for the following five to ten years. Finally, it demonstrates major concerns, solutions to the concerns, and future opportunities in the sustainable investment industry.

Keywords: Sustainable Investment; United States

1 Introduction

A climate report of the United Nations shows that if people continually consume fossil fuel like today, the global average temperature will warm up 2.7 degrees Fahrenheit above preindustrial levels by 2040[1]. Worse, food shortages, wildfires, and a mass die-off of coral reefs are happening because of global warming, which will threaten human's lives. If global warming continues on this trend, extreme weather and natural disasters will occur more frequently than it is today. The severe cold weather in the U.S. in early 2019 caused at least 21 people's deat[2]. In the same period, an extreme heatwave also led to mass wild horses and camel's death in Australia, where the ecological balance is threatened. Gun control, corruption, and social mobility are also severe issues in the U.S. In asset management industries, a new concept called "Sustainable Investing" became popular in the last decade because it has a positive impact to environment and society. Sustainable Investing is also called "Socially Responsible Investing (SRI)", "Environmental, Social, and Governance (ESG) investing", "Green Investing", or "Ethical Investing", etc. It includes a broad aspect from human right, gender equality, poverty, anti- corruption, to environment protection.

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Sustainable investment is investing the future of the world where investors want to live. It directs investment capital to enterprises that not just pursue the highest profit but also want to make the world a better place. “Better” is a relative term. It means the world is to be safer, more comfortable, and more pleasurable. Advanced technology and statistics can help measure the environmental and social impact caused by sustainable investment. Does the U.S. asset management market have the potential to implement a large scale (more than 50%) sustainable investment?

2 Major Sustainable Investment Strategies

There are three major investment strategies: exclusionary screenings, ESG integration, and impact investing (UBS, 2018).

Exclusionary screening refers to excluding the companies or industries that are not aligned with investors’ values like traditional fuel and weapon companies.

ESG integration refers to integrating environmental, social, and corporate governance criteria into traditional investing process. Environmental criterion evaluates a company’s impact on the environment. The evaluations include but not limited to pollution and emission, water-related issues like usage and waste disposal, usage of renewable energy, recycling, etc. Social criterion evaluates the organization behaviors that impact employees, consumers, suppliers, and the social community. The corporate governance criterion evaluates if the company applies accurate and transparent accounting methods, if the company gets involved with illegal issues, if stockholders have the right to vote, and if the company has great entrepreneurs and management teams to ensure sustainable growth.

Impact investing refers to investing in measurable environmental and social impact within a financial return. Some institutions, including UBS and other venture capital and private equity firms, already build the impact investing evaluation models in measuring the environmental and social impacts of the investments. The impacts are now quantifiable.

Of the three strategies, ESG integration is the most adopted strategy by institutional investors.

3 Current Status of Sustainable Investment in the United States

Sustainable investment has become popular in the last decades. Resultingly, sustainable investment funding has shown much growth. For example, in the United States, 6.57 trillion dollars out of 36.8 trillion dollars professionally managed assets was sustainably invested by the end of 201[3]. Twelve trillion dollars out of 46.6 trillion dollars professionally managed assets was sustainably invested by the end of 2017. Through calculation, sustainable investment had a 16.25% four-year compound annual growth rate from 2013 to 2017 in the US, compared with traditional investing that had a 3.43% four-year compound annual growth rate. Sustainable investment grew much faster than traditional investing.

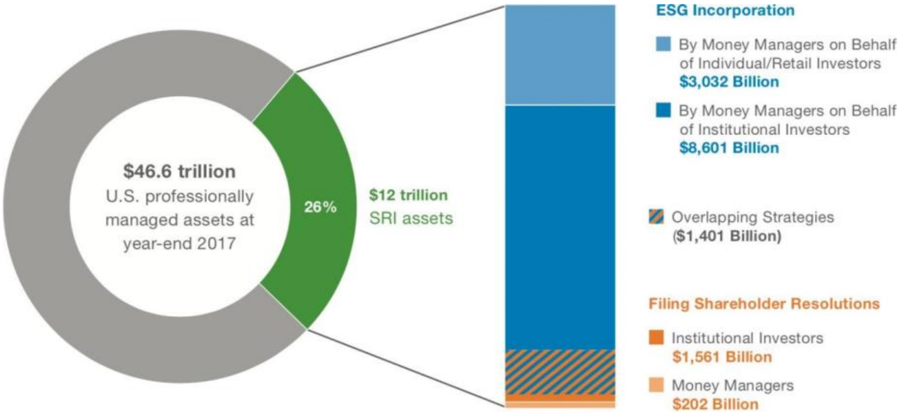

Fig. 1. Size of Sustainable, Responsible and Impact (SRI) Investing 2017.US SIF. (2018, October 31). US SIF Foundation's Report on US Sustainable, Responsible and Impact Investing Trends2018. Retrieved from https://www.ussif.org/trends

As shown in figure 1, 11.6 trillion dollars out of 12 trillion dollars incorporated ESG integration. Among 11.6 trillion dollars sustainably invested assets, 3.032 trillion dollars, accounting for 25.27% of 12 trillion dollars, were invested on behalf of the individual. 8.601 trillion dollars, accounting for 71.68% of 12 trillion dollars, were invested in behave of institutionalinvestors.

Fig. 2. Money Manager Assets, by Type, Incorporating ESG Criteria 2017.US SIF. (2018, October 31). US SIF Foundation's Report on US Sustainable, Responsible and Impact Investing Trends2018. Retrieved from https://www.ussif.org/trends

As shown in figure 2, of the 11.6 trillion dollars in assets, 2,608 billion dollars, accounting for 22.48%, are in mutual funds, ETFs, variable annuities, and closed-end funds, where the general public can invest. Five hundred eighty-eight billion dollars, accounting for 5.07%, are in alternatives, including private equity and venture capital funds, hedge funds, and property funds. Seven thousand four hundred ninety-nine billion dollars, or 64%, are uncategorized assets that were managed through undisclosed investment vehicles because voluntary disclosure is limited byinstitutions.

As shown in figure 3, Top 5 ESG criteria that were considered by investors are climate change/carbon, tobacco-related restriction, conflict risk, human rights, and transparency and anti- corruption. Climate change/carbon factor is the most considered, influencing 3 trillion dollars in assets. The tobacco-related restriction is the second to be considered, influencing 2.89 trillion dollars assets. 1.9 trillion dollars were subject to restrictions on investments in weapons/civilian firearms with a 500% increase since 2016, but not shown in figure 3[4]

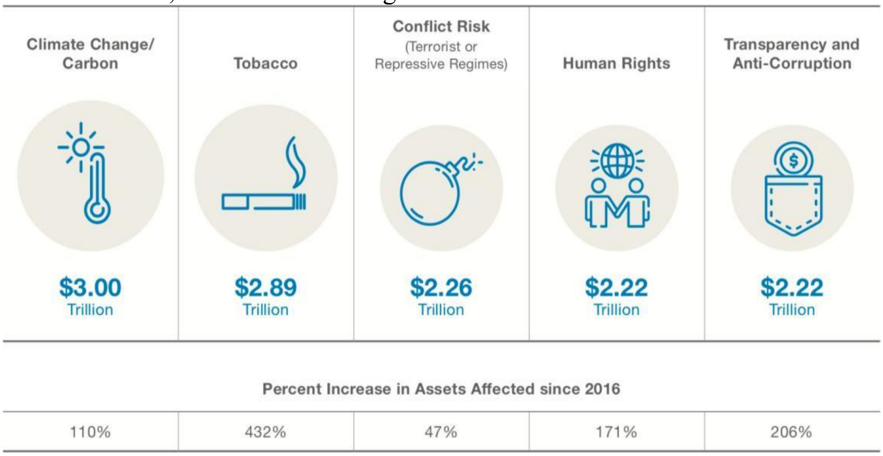

Fig. 3. Top Specific ESG Criteria for Money Manager 2017

Note: Criteria have overlaps. Year showed in the heading of percent increase is the beginning of the year.

US SIF. (2018, October 31). US SIF Foundation's Report on US Sustainable, Responsible and Impact Investing Trends 2018. Retrieved from https://www.ussif.org/trends

4 Institutions Actions and Facts

Institutions in the US took plenty of action to offer socially responsible products in the market. For example, UBS Asset Management launched their first ESG exchange-traded fund ETF) early of April 2019[5]. The new ETF integrated ESG screening that excludes companies with poor ESG score or the producers of tobacco or controversial weapons in the S&P 500 equity index. Morningstar launched ESG Asset Allocation Managed Portfolios that include a series of five funds of ETFs and mutual funds in May 2019 due to the growing demand of investment advisors whose clients are concerned with ESG issue[6].Figure 4 is attached below:

Rank	Fund	Score*	Benchmark index	Focus	Assets $M	1-year total return (%)	3-year total return (%)	5-year total return (%)
1	Brown Advisory Sustainable Growth (BIAWX)	97.45	Russell 1000 Growth	Environmentally Friendly	748	+9.3%	+13.0%	+12.6%
2	Calvert Equity (CSIEX)	91.41	Russell 1000 Growth	ESG	2,298	+11.3%	+11.4%	+10.8%
3	Ave Maria Growth (AVEGX)	86.66	S&P 500	Religiously Responsible	613	+7.6%	+12.5%	+9.7%
4	Putnam Sustainable Leaders (PNOPX)	84.36	Russell 3000 Growth	ESG	4,261	+4.2%	+11.9%	+11.0%
5	Vanguard FTSE Social Index (VFTSX)	84.09	FTSE4Good US	Socially Responsible	4,508	+5.6%	+11.2%	+11.0%
6	Iman (IMANX)	77.06	Dow Jones United States Islamic Market	Religiously Responsible	105	+0.1%	+11.5%	+10.6%
7	Calvert U.S. Large Cap Core Responsible Index (CSXAX)	76.13	Russell 1000	ESG	1,376	+4.7%	+9.7%	+9.8%
8	Neuberger Berman Sustainable Equity (NBSRX)	74.99	S&P 500	ESG	2,131	+6.7%	+9.5%	+8.5%
9	Green Century Equity (GCEQX)	74.40	S&P 500	Environmentally Friendly	252	+3.8%	+9.8%	+9.4%
10	Ave Maria Rising Dividend (AVEDX)	74.39	S&P 500	Religiously Responsible	858	+7.0%	+9.9%	+7.8%

*The score takes into consideration one-year, three-year and five-year annualized returns, weighted equally. Scores range from zero to 100.

Fig. 4. ESG Funds with the Highest Score Chasan, E. (2018, November 30). The Top 10 Socially Conscious Funds. Retrieved from https://www.bloomberg.com/graphics/2018-ten-funds-with-a-conscience/

Bloomberg also ranked the top 10 sustainable funds with the best performance in 2018[7]. All ten sustainable funds have a considerable return in the past one year to five years. Most of the ten funds had a higher return comparing with their benchmark index.

5 Future Prediction

Assuming that sustainably and traditionally invested assets historically had 16.25% and 3.43% growth each fiscal year, and will continue this trend, it can be roughly estimated that in the next five years since 2017, there will be 25.48 trillion sustainably invested assets and 40.96 trillion traditionally invested assets in 2022, as shown in figure 5. Sustainably invested assets will have a 112.31% cumulative growth, accounting for 38.35% of professionally managed assets by the end of 2022. If the growth rate stays the same, sustainably invested assets will surpass traditionally invested assets in 2027. However, some concerns or obstacles will slow down sustainable investment adoption.

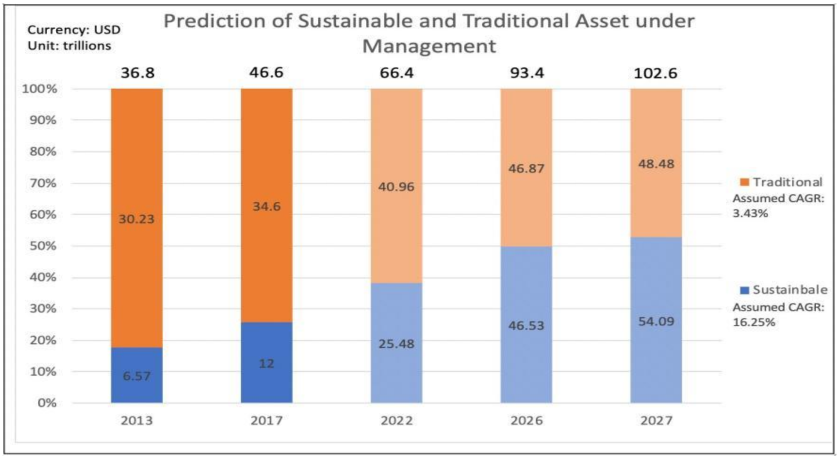

Fig. 5. Prediction of Sustainable and Traditional Asset under Management

Note: The prediction is based on the data from US SIF Foundation in 2013 and 2017 fascial years. The prediction is generated by using Compound Annual Growth Rate formula. CAGR = (Ending value / Beginning value) ^ (1 / Number of periods) – 1

6 Major Concerns and Solutions

Based on a UBS Investor Watch Report in 2018, only 12% of US investors invest sustainably in 2018 (UBS, 2018). Seventy two percent among younger generation ages from 18 to 34 are already investing sustainably. However, only 6% of investors over 65 are investing sustainably.

The adoption rate is low because of several reasons:

1.Lack of standards and terminology: State Street Global Advisors launched a survey in 2017 showed that over half of institutional investors already implemented ESG strategy but they were confused with ESG standards and terminology (*State Street Global Advisors, 2018).* UBS Investor Watch Report in 2018 also showed that 66% of US investors find sustainable investing terms confusing (UBS, 2018). However, major institutions already developed their ESG scoring or rating systems. For example, SSGA developed R-Factor, an ESG scoring system that utilizes multiple data sources generate an ESG score for listed companies (State Street Global Advisors, n.d.). MSCI also developed an ESG Ratings that rate ESG risks and opportunities within multi-asset class portfolios (MSCI, n.d.).

2. Low awareness: The reason why the Baby Boomer generation lacks sustainable investing awareness, is that the Baby Boom generation grew up without significant environmental or social issues. However, Millennials and Generation Z are growing up with environmental or social issues. Therefore, 72% of the younger generation, ages 18 to 34 are investing sustainably. The Baby Boomer generation prefers sustainable

returns with low-risk investment because the Baby Boomer generation are close to retiring. Institutions should hold the primary responsibility to introduce the concept of sustainable investing.

3. Hard to know the impact: UBS Investor Watch Report in 2018 shows that 79% of investors with no sustainable investment says it is hard to know the impact (UBS, 2018). An article published at Harvard Business Review reveals a lot of good examples that investment eventually turned to measurable impact. For example, a 2016 study demonstrated that high school students who received EverFi's financial literacy program had a $538 less than average consumer debt by the age of 22, compared with another similar group of students who didn't have the program [8]. The additional debt paid an average interest of 81 dollars over five years. Assuming that 1.3 million students completed the program, the economic value of the program would be $105 million in total. The impact is real, andit is measurable.

4. Investor's expectation on return: There is a common bias that sustainable investment is environmentally and socially positive but financially negative. A study conducted by Axioma shows that over half of portfolios that combined with high ESG-scored companies had an 81 to 243 basis points outperforming their benchmarks in the past four years to March 2018 (Thompson, 2018).

7 Opportunities

Although many investor concerns exist, there are opportunities. More and more young generations like Millennials and Generation Z started to be aware of investing sustainably. Ten years later, their adoption rate will be much higher than it is today in the US. Government is taking actions to help make a difference in almost every industry. For example, in the automotive industry, Los Angeles and Seattle will ban fossil fuel vehicles including Gasoline or Diesel types in 2030, and fully implement renewable energy vehicles. It also shows the growth opportunity for renewable energy and electric vehicle industries in the following decade.

8 Conclusion

In conclusion, sustainable investing has become a notable force in the asset management industry. Though there are some issues like lack of standards and awareness and difficulty to know the impact of an investment, there is still a bright prospect of sustainable investing. The individual investor has become a significant force in sustainable investing. Three point zero three two trillion dollars were invested on behave of individual, and the number will continue to grow, which means that the public, who have extra money to invest, also can have an opportunity to make a difference. Institutional investors are making an effort to build up standards of evaluating ESG factors and trying to quantify the impact caused by impact investing. With the fact of standard development and considerable returns of the ESG funds, investors should reconsider the risk and return trade- off to a brand-new mindset of social impact and return trade-off. Traditional investing considers risk and return trade-off, however, social impact and return trade-off has become a notable approach for investors to consider. The impact is real, and it also proves that finance can do good things. The sustainable investment will have a positive development in the future in the US.

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