Wall Street Goes Green

What was once a niche investing strategy has gone mainstream. ESG (environmental, social, and governance) funds have proliferated as the world gradually shifts to greener technologies and sustainable energy.

U.S. funds using ESG strategies grew 42% between 2018 and 2020.

The green revolution is upon us. Like it or not, the world is shifting away from fossil fuels toward renewables. Solar and wind farms are sprouting up across the globe. The major car companies are phasing out gas-powered vehicles and transitioning to hybrids or plug-ins. And the Biden administration has announced major green initiatives to support renewable energy and reduce carbon emissions.

This quantum shift has not gone unnoticed by Wall Street. In fact, investing in green businesses has taken off. Companies like Tesla and Nio (electric car companies) and Sunrun (a solar company) have seen their stock prices soar as more and more investors view them as the wave of the future. Funds specializing in green and other socially responsible investments -- called impact, sustainable, or ESG funds -- have proliferated, allowing investors to pursue a broad-based green investing strategy. According to the Forum for Sustainable and Responsible Investment, there are now over 800 registered investment companies offering funds with ESG assets, including 718 mutual funds and 94 ETFs.[1] U.S.-domiciled assets under management using ESG strategies grew from $12.0 trillion at the start of 2018 to $17.1 trillion at the start of 2020, up 42%.[2]

What's Driving Growth?

Several factors are behind this dramatic growth -- first and foremost, demographics. Millennials, at over 70 million strong, are coming of age and now outnumber baby boomers. This new generation is the heir to a huge asset transfer now in progress, and millennials seek to make a difference in society through the investments they make. But investor interest is also growing broadly. A recent Morningstar report found that 72% of the U.S. population expressed at least a moderate interest in sustainable investing, while a Morgan Stanley survey determined that 85% of all individual investors were interested in sustainable investing, up 10 percentage points from 2017.[3] Green technologies have also become cheaper. The prices of some products have fallen dramatically, making them competitive with traditional technologies. The cost of solar power, for instance, has decreased by 80% in the past decade. That of lithium batteries is falling by 20% a year.[4]

What's more, many countries are going greener. The U.S., EU, and China are setting "net-zero" emissions targets, and early this year, the Biden administration rejoined the Paris Accord, which aims to reduce greenhouse gas emissions and limit global warming.

What About Returns?

Proponents of green investing have always had to combat the notion that socially conscious investments underperform the broader universe of investments. Yet there is a growing body of evidence that suggests otherwise. In fact, a number of different studies show that sustainable funds have had comparable, or even higher returns than traditional funds. For 2020, analyses by Morningstar and Morgan Stanley indicate that ESG funds comfortably outperformed their peers. A longer-term study of ESG fund performance from 2004 to 2018 by Morgan Stanley indicated there is "no financial trade-off in the returns of sustainable funds compared to traditional funds, and they demonstrate lower downside risk."[5]

Tips for Green Investing

Investing with a conscience is not that different from investing just for profit. It involves another layer of thinking and analysis, but otherwise calls for the same scrutiny that should be applied to traditional investing.

1. **Define your objectives.** Being 'socially responsible' is a broad mandate. Different funds, companies, and strategies may stress different objectives. Some may focus on environmental factors, some on social or corporate governance. And some may be very specific. So before you choose which best suits your goals, make sure you identify what those goals are.
2. **Strike a balance.** Although, in the aggregate, ESG funds have kept pace with the broader market, many individual funds or stocks have not. When researching candidates, you will want to strike a balance between performance and social objectives, and set limits as to how far you are willing to compromise on one objective to meet the other.
3. **Diversify.** Just like with a traditional portfolio, green investors should also diversify their portfolios by risk and asset class, targeting an asset allocation that is in keeping with their investing time horizon and appetite for risk. ESG funds can now be found in all major asset classes, permitting investors to diversify while pursuing social causes.
4. **Work with a professional.** There are thousands of companies and funds that support green causes. Choosing among them while also adhering to an investment strategy that suits your non-social goals can be complex, so you may want to work with your financial professional to assure that your choices address your unique circumstances and needs.

[1]Source: US/SIF, *Sustainable Investing Basics*, retrieved June 3, 2021.

[2]Source: US/SIF, *2020 Report on US Sustainable and Impact Investing Trends*, November 2020.

[3]Source: CNBC, *'S ustainable investing' is surging, accounting for 33% of total U.S. assets under management*, December 21, 2020.

[4]Source: The Economist, *The Green Meme*, May 20, 2021.

[5]Source: US/SIF, *Financial Performance With Sustainable Investing*, retrieved June

7, 2021.