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EXPERT AVAILABLE: COMPLEXITIES OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE-FOCUSED (ESG) INVESTING

As ESG Investing Becomes a Bigger Priority for Institutions, Grasping the Nuances – Including What the Real Goal is and Why, Not So Much Whether, a Manager Considers ESG Factors – is Key to Getting Satisfying Results

Boston (May 6, 2010) – As more institutions conclude that considering environmental, social and corporate governance (ESG) factors when making investment decisions can impact investment portfolio performance and better align investments with broader social objectives, a new set of questions and issues emerges, according to a recent Market Commentary from **Cambridge Associates LLC,** the provider of independent investment advice and research to institutional investors and private clients.

"Investors must come to terms with why they seek ESG integration: Is it primarily performance, primarily ethics or a sincere belief and defensible thesis in the potential to maximize both? Only by clearly understanding their own rationale will investors be able to build a portfolio of managers that meets their real objectives," said Kyle Johnson, Managing Director at Cambridge Associates and the author of **"ESG Integration: For Performance, For Ethics, Or For Both?"**

Mr. Johnson is available to discuss the issues, nuances and questions that investors with ESG priorities should take into account. For instance, he can address…

- **Why understanding and articulating one's ESG rationale is so important.** ESG factors may be material to investment performance – i.e., they can contribute to alpha – and are thus legitimate criteria (among many others) to consider when making investment decisions. However, using ESG factors solely to enhance investment performance will not necessarily and automatically lead to the construction of a portfolio of companies with "better" ESG records, i.e., better ethical records. Investors who have given a lot of thought to ESG priorities may make manager selections that are more on-target.

- **ESG and performance.** While some investors believe that the consideration of ESG factors can enhance performance, others ask whether ESG investing will necessarily inhibit alpha generation. The answer to that is, "no." Some skilled managers that use ethically based ESG screens and indicators have outperformed – and might be expected to continue to outperform – their benchmarks. "One cannot make blanket statements about alpha-oriented ESG managers, just like one cannot make blanket statements about active managers in general. As with any

active manager, the investment success of ESG managers will depend on their overall investment skill, not simply whether they use ESG factors," Mr. Johnson said.

- **Whether investors with ESG priorities should consider traditional managers.** One should not assume that traditional managers – those who don't explicitly label themselves as ESG managers – are overlooking ESG factors. Many do consider them when they believe they're material, even if the manager doesn't characterize the process as having an ESG integration component. However, there's no guarantee that these managers' portfolios will be populated with companies with better ESG records. "The challenge for ESG investors is determining whether they're comfortable with a traditional manager's more ethically agnostic approach to ESG integration," he said.

- **The range of ESG factors.** ESG factors can include a spectrum of indicators pertaining to a company's impact on various stakeholders. Examples include, but are not limited to: a company's carbon footprint, human rights policies as they pertain to business relationships with dictatorial regimes, union relationships, employee gender and ethnic diversity, product safety record, child labor policies, creation of products that serve particularly vulnerable populations and products that mitigate or prevent environmental damage.

- **The difference between ESG and "SRI," socially responsible investing.** SRI is an older term, and it implies that ethical concerns and objectives are the primary reasons why these investors incorporate ESG factors into decision-making. The term "ESG integration," in contrast, does not implicitly or explicitly offer the motivation (ethics, alpha, etc.) that drives the investor. It simply implies a category of investment process.

- **What ESG investors should ask managers.** The key question for ESG investors to ask their managers is not so much whether they integrate ESG factors into their investment decision-making process, but why they do so. Only by asking this question will the investors be able to assess whether the manager's objectives are aligned with theirs. "It's hard to clearly define the universe of ESG managers and to understand, simply by the ESG label alone, the manager's rationale for using ESG indicators. As a consequence, the ESG manager universe will be defined, in significant part, by investor preference rather than by an external set of criteria," Mr. Johnson said.

- **What to be skeptical about.** ESG investors should be cautious of vague generalities about how a given ESG manager's screens should help generate alpha. Investors should push managers to disclose any ethical commitments that might be "hidden" in the supposedly alpha-generative ESG indicators they use. And investors should be suspicious of managers that purport to use ESG indicators for purely alpha-generative purposes if they run both traditional and ESG versions of the same strategy.

- **The most important thing not to forget.** A manager's skill, rather than use of an ESG checklist, is likely to be a central determinant of the manager's performance results.

To receive a copy of the Market Commentary and/or arrange a discussion with Kyle Johnson at Cambridge Associates, please contact Itay Engelman at Sommerfield Communications at 212-255-8386 or itay@sommerfield.com.

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