Considering Responsible Investing?
Here's why you should

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For many, 2020 was seen as a "critical year for addressing climate change." Riding on a wave of environmental activism, the hope was that the 2020 UN Climate Change Conference (COP26), scheduled in November of last year, would solidify plans to reduce global carbon emissions. Instead, COVID-19 and anti-racism movements refocused public attention, overshadowing many pressing environmental concerns and postponing COP26. But while this period of upheaval seems to have sidelined the momentum that environmental concerns were gaining, the social inequalities revealed have pushed many conscious investors to explore sustainable investments — specifically those focused on companies with strong environmental, social, and corporate governance (ESG) principles.

ESG in a nutshell

Environmental, social, and governance (ESG) criteria are standards used to measure a company's sustainability and ethical impact. Socially-conscious investors use this criteria to screen potential investments.

Environmental (E) criteria focus on environmental concerns, such as a company's carbon footprint, sustainable development plan, or how they handle potential issues around air or water pollution.

Social (S) criteria focus on social relationships, such as employee treatment, consumer protection, or even a company's stance on human rights matters.

Governance (G) criteria consider how executives and boards of directors manage companies, including issues of gender diversity, lack of transparency, and failure to attend to stakeholders' concerns.

5 reasons to consider ESG investments

With many things taking a backseat to the current pandemic, sustainable investing may not be top of mind. But aside from creating a more ethical portfolio, there are many reasons why you should consider investments that prioritize ESG criteria. Here are five:

1. **Deliver similar or greater returns while upholding ESG values.** One 2019 study comparing the total returns of ESG-focused funds against traditional counterparts from 2004 to 2018 found no financial trade-off when investing in ESG factored funds. In fact, there was evidence of their comparative stability. Canadian data reflects this, with 74% of sustainable funds in Canada outperforming their peers in the volatile first half of 2020. And investors are aware of this, 53% of those asked cited better performance as a driving factor in their choice to pursue sustainable investing.
2. **Changing government sentiment.** As the newly-elected leader of the world's largest economic power, U.S. President Joe Biden's proposed environmental approach may signal a boost to the sector. He's stated his commitment to re-joining the Paris Agreement, a target of decarbonization of the power sector by 2035, and a goal to adopt net-zero greenhouse gas emissions by 2050. With China, the world's second-largest economic power and worst emissions offender, also pledging to adopt a net-zero plan for 2060, we see a significant shift in global commitment to the reversal of climate change. Governments are getting serious about supporting a greener direction and public policy will drive ESG investing success.
3. **Risk management.** While ESG factors are often tied to ideas of good citizenship or environmental advocacy, sustainable investing can also be used as a risk-management tool. Well-managed companies don't tend to fall victim to boycotts, public relations problems, or a failure to plan for a changing economy. Think of a car company that neglects to prepare for the future low-carbon market or a business that fails to ensure its workers' safety and security. One study has shown that by screening out companies with low environmental and social scores, investors could have avoided 9 out of 10 bankruptcies in the S&P 500 between 2005 and 2015.
4. **Supporting sustainability.** With the growing awareness of environmental and human rights issues, many people are making choices with the hope of creating change. Some two-thirds of high-net-worth millennials surveyed in the United States saw their investment decisions as a way to express their social, political, or environmental values. More than one-third of high-net-worth baby boomers echoed the same idea. There is a marked interest in sustainable investing and the potential it has to effect change, and investors are rewarding forward-thinking businesses with their investment dollars.
5. **Sustainable investing is the future**. ESG investments are enjoying a global moment, but it's one that seems poised to continue. In the United States, sustainably focused investments have doubled over the past three years. Canada saw growth as well, with 2020 first quarter inflows outpacing the whole of 2019. More and more investors are insisting on investments that allow them to put their money where their values are, and with so much choice available, it's entirely possible to build a portfolio that's both profitable and ethically aligned.

Gaining Momentum

No longer seen as a fad, sustainable investments have gained considerable momentum in the past few years, with over $30 trillion in global assets managed with a sustainable strategy in 2018. In Canada, responsible investment assets now represent 61.8% of professionally managed assets. The latest available information shows these investments grew from $2.1 trillion at the end of 2017 to $3.2 trillion by the end of December 2019 — a 48% increase over two years.

With the uncertainty of COVID-19 and the sharp focus on current human rights issues, environmental concerns are not as highlighted as they were at the beginning of 2020. But although these concerns have been temporarily deprioritized at the hands of the pandemic, eventually, COVID-19 will end, and the previous call for environmental action will resume.

Public sentiment is changing, and many investors are insisting that companies be held accountable to ESG criteria, and they're choosing to invest their hard-earned dollars in the industries that rise to this challenge

Making ESG part of your portfolio

With the push toward sustainability becoming mainstream, many people are looking for their investments to reflect the world they want to live in — one that mirrors their personal values. Screening can help investors build portfolios that reflect these preferences.

A negative screening approach will exclude specific sectors and has historically been used to screen out "sin stocks" — investments in categories like alcohol, weapons, gambling, etc., that many consider unethical or problematic. While this is the least expensive and easiest screening option, this simplified approach may neglect important context.

A positive screening approach doesn't exclude entire sectors, companies, or industries. Instead, it offers a more proactive focus, evaluating different companies within an industry to find the ones with the most progressive ESG policies. This technique provides the opportunity to invest in companies or sectors that have improving ESG metrics.

It's not necessary, however, to choose one approach over the other. Many investors can successfully incorporate both strategies in their portfolios, screening out investments that go against their ESG values while also using positive screening to include investments in companies in those sectors that contribute to their ESG values.

Final Thoughts

Shifting global priorities, which place sustainability as imperative for good business and economic growth, are changing the way people invest. BMO professionals understand that ESG investments are powerful tools for building diversified portfolios with sustainable results.

For more information, speak with your BMO financial professional

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