

Mission-Aligned Investing

Define Approach Implement Measure

Measure

by William Parker, CIMA[®], Associate Director of Wealth Consulting, Senior Consultant

Sarah Hinman, CPA/PFS, CFP[®], Senior Consultant

Shreya Canakapalli, CFA, Senior Consultant

June 2020

In our fourth installment, **Mission-Aligned Investing: Measure**, we answer: ‘**How do you measure a mission-aligned portfolio?**’

Your organization set the objective, picked the strategy and selected the manager. Now it is time to measure the investment’s ongoing performance and impact, both fundamentally and quantitatively, on a risk and return basis. How do you effectively measure performance?

The measurement of an Environmental, Social, Governance (ESG) portfolio or fund is complicated because there is currently no industry standard. Some managers take a more quantitative approach by considering a variety of data points, whereas others provide more qualitative measurements on the ESG impact. Thus, making comparisons and conclusions difficult. For the most part, as many ESG investors know all too well, it is up to your organization to define a set of metrics to measure financial return and social impact. Fear not, we are here to help!

As with any portfolio, the central question becomes “*what did you set out to do and are you doing it?*” While this is no different from the scrutiny applied to any section of the investment portfolio, this question becomes less clear-cut when investor values are integrated. We recommend re-framing the question to “*Does the investment mandate chosen align with the value set we’ve laid out to meet the objective overall?*”

For example, an investor looking to safeguard against tobacco, a divestment strategy aimed at excluding holdings related to tobacco, might suffice. Even within this strategy, we recommend a periodic review and update of the holdings list. However, for the investor who wants to integrate certain values such as minority and women’s inclusion

This report is intended for the exclusive use of clients or prospective clients of Fiducient Advisors. The information contained herein is intended for the recipient, is confidential and may not be disseminated or distributed to any other person without prior approval of Fiducient Advisors. Any dissemination or distribution is strictly prohibited. Information has been obtained from a variety of sources believed to be reliable though not independently verified. Any forecasts represent future expectations and actual returns, volatilities and correlations will differ from forecasts. This report does not represent a specific investment recommendation. Please consult with your advisor, attorney and accountant, as appropriate, regarding specific advice. Past performance does not indicate future performance and there is a possibility of a loss.

into their portfolio, the measurement task is more complicated. For that reason, we established a **Mission-Aligned Investing Scorecard**, which encompasses a list of criteria used to measure the investment against.

When it comes to measuring the impact and return of an ESG strategy, we favor a holistic approach. A **Mission-Aligned Investing Scorecard** incorporates criteria that most investors regularly review and evaluate today while allowing for a framework to measure mission-alignment. This is important because ESG investing, by design, does not fit neatly into today's traditionally-evolved metrics and management. Risk and return are measurable, however, they are influenced by the mission-alignment served. This **Mission-Aligned Investing Scorecard** can be used regardless of the value set adopted or whether the investor is an individual, family office, endowment or retirement plan.

The **Mission-Aligned Investing Scorecard** brings full circle why an investor chose the ESG strategy in the first place:

- What was the underlying motivation?
- What was the original thesis for the investment?
- What were the screening/integration thresholds considered when the decision was made?
- Are strategies and thresholds memorialized in the IPS?

The **Mission-Aligned Investing Scorecard** focuses on three distinct areas of measurement: relative performance, manager due diligence and values alignment.

1. Relative Performance Evaluation: In assessing a particular Mission-Aligned Investing strategy, investors can evaluate their investment's performance against traditional benchmark measurements (S&P 500, etc.) instead of an ESG-relative benchmark.

With the increasing popularity of ESG investing, a number of values-based indices were introduced for benchmarking purposes. MSCI, a leading industry ESG data provider, alone publishes 34 ESG-specific indexes. We do not, however, advocate using these specific indexes for two reasons:

- First, we do not want to change the benchmark just to make relative performance look more attractive. ESG does not and should not equate to a 'return sacrifice'. At its core, ESG investing is a methodology the same as style, process or sector that managers' favor. ESG will go through periods of favorability depending on market conditions.
- Second, ESG values-specific benchmarks are not as relevant since the space is customized and investor specific. In fact, one of the biggest challenges is that there are very few one-size-fits-all funds, products or indices. What it means to be religious, environmentally conscious or an advocate for gender inclusion differs

from organization-to-organization and portfolio-to-portfolio. Efficiency, scalability and profitability are behind the variety of off-the-shelf products.

It is important to keep in mind that the reliance on relative performance exclusively as a way to measure Mission-Aligned Investing can be counterproductive. Periods of over- and under- performance should be expected. Depending on one's risk tolerance, performance thresholds should be stated upfront in the investment policy statement and outlined with all other investments.

2. Manager Monitoring/Due Diligence: As with any investment within a portfolio, an investor should monitor the portfolio manager based on well-established assessment pillars:

- 1) Organization
- 2) Team
- 3) Process
- 4) Portfolio Construction

Questions commonly asked include:

- What is the manager's sustainable investment strategy and how does a change in any of the pillars affect the thesis for sustained success?
- How long has the team been in place?
- How long have members of the team engaged in ESG investing?
- How they incorporate ESG into the investment process?
- How they think of risk when selecting investments to build the portfolio?

Like any successful investment, the team's depth, tenure and knowledge, support from the organization and adherence to its process is paramount to selecting and retaining a fund manager.

3. Mission-Alignment: The next step in the measuring process is evaluating the alignment of values and impact of the investment, which is the most esoteric part of Mission Aligned Investing.

Morningstar (Sustainalytics) and MSCI are preeminent when it comes to providing meaningful ESG metrics and data on a company and fund level. As more sophisticated data becomes readily available, investors should assess if and how managers respond to this by asking the following questions:

- How is new ESG data incorporated into an investment manager's process? What ultimate impact does this have on the overall portfolio?
- Does the materiality of this data lead to any changes in the implementation of ESG and the manager's definition of value?

- Is this still in-line with an investor’s value set and objectives?

Given the ever-changing nature of the ESG landscape, it is important to rely on your investment advisor to monitor these developments.

In addition to the **Mission-Aligned Investing Scorecard**, we recommend periodic review of shareholder engagement and Impact Reports disclosed by the manager. Shareholder engagement is typically disclosed through a proxy voting report and sheds light on alignment with investors’ established values by providing information on how the manager voted for various corporate actions.

Impact Reports are a recent trend and typically provide qualitative and quantitative ESG information on underlying portfolio companies. These reports, however, are not uniform and there is no industry standard. That being said, more and more frequently, managers are communicating the impact of their portfolio using the United Nations’ Sustainable Development Goals (UN SDGs) framework.

With over 190 member nations adopting the 2030 Agenda for Sustainable Development, the UN SDGs through 17 specific targets and indicators pave the way for more sustainable planet by the year 2030. They encompass ending poverty, protecting the environment, the planet and human rights, generating prosperity and peace for all people and more.

SUSTAINABLE DEVELOPMENT GOALS



Source: United Nations

It’s easy to see how well ESG investing fits into these SDGs and with more adoption, the SDGs could become an industry standard for Impact or Sustainability Reports.

Ultimately, the **Mission-Aligned Investing Scorecard** along with proxy voting and Impact Reports allow investors to measure both the financial and non-financial impact of their ESG strategy on an ongoing basis and judge whether or not it meets their objectives.

As we have said before, there is no one-size fits all when it comes to values-based investing and through the four-part series of Define, Approach, Implement and Measure we laid out a pragmatic and prudent strategy to Mission-Aligned Investing. Understanding the motivation by defining the mission helps investors fulfill their objective while minimizing risks and maximizing returns. A well thought out approach and implementation will enhance both portfolio construction and policy language. And lastly, ongoing measurement will allow investors to answer the question “*what did you set out to do and are you doing it?*”

For more information on Mission-Aligned Investing or ESG please contact any of the professionals at Fiducient Advisors.

About the Authors



William Parker, CIMA®
Associate Director of Wealth Consulting
Senior Consultant

Bill provides investment consulting services to nonprofit organizations, corporate executives, family trusts and other private investors. Bill services clients by providing advice and expertise on asset allocation, portfolio design, investment policy statements, manager search process and overall investment management. In the Associate Director role, he maintains oversight of The Wealth Office® co-consultants and client service associates. He is a member of the firm’s Mission-Aligned Investing Team. Prior to joining the firm, Bill was a Senior Associate in the Sales & Service division of Northern Trust Global Investments where he was responsible for both institutional and wealth client relationships. Earlier in his career, Bill held positions on the trading floors of both the New York Stock Exchange and Chicago Board of Trade. He earned a BA in Philosophy & Political Science from Fordham University, a Master in Business Administration (MBA) from Lewis University and a Master of Science in Finance (MSF) from Lewis University. He obtained the title Certified Investment Management Analyst (CIMA®) from the Investments & Wealth Institute™ accreditation program at the Wharton School of Business. Bill is a member of the Economic Club of Chicago. He is an avid runner and completed the Ironman Triathlon®.



Sarah Hinman, CPA/PFS, CFP®
Senior Consultant

Sarah provides investment consulting services to nonprofit organizations, corporate executives, family trusts and other substantial investors. She services clients by providing advice and expertise on asset allocation, portfolio design, investment policy statements, manager search process and overall investment management. Sarah chairs the firm's Mission-Aligned Investing Team. Prior to joining the firm in 2017, Sarah was an Associate Financial Advisor and Financial Planning Analyst at Trinity Financial Advisors. Sarah earned a BS in Accounting from the University of Illinois at Urbana-Champaign and a BA in Fashion Marketing and Management from The Illinois Institute of Art in Chicago. Sarah also earned a Master of Accounting Science from the University of Illinois at Urbana-Champaign. She is a Certified Public Accountant (CPA)/Personal Financial Specialist (PFS) and is a Certified Financial Planner (CFP®). Sarah also passed the CFA Level I exam. In her free time, Sarah enjoys cooking and fashion and supports a local retailer, Embellish Boutique, with marketing and accounting.



Shreya Canakapalli, CFA
Senior Consultant

Shreya supports institutional clients by providing counsel and guidance on portfolio design, asset allocation, manager selection, investment policy statements and performance monitoring. She is a member of the firm's Endowment & Foundation Business Council, Research Forum and Mission-Aligned Investing Team. Prior to joining the firm in 2012, Shreya was a Knowledge Investment Analyst at The Northern Trust Corporation. She received a BS in Finance and Economic Consulting from Indiana University in Bloomington. Shreya is a CFA® charterholder and member of the CFA Society of Chicago. Shreya is on the Associate Board for Urban Initiatives and enjoys traveling, sociology and jigsaw puzzles.