

## **DiMeo Schneider & Associates, Nonprofit Investment Stewards Podcast**

*Episode 7, December 16, 2020*

### **ESG Investing for Stewards: Part 1 — With Shreya Canakapalli**

[00:00:00] Welcome to Nonprofit Investment Stewards with Bob and Devon Francis from DiMeo, Schneider and associates, Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment foundation or retirement plan investments, this podcast exists to help stewards, improve performance, reduce costs and discover strategies that enable your charitable organization to prosper and advance its mission.

[00:00:28] Now onto the show. Hello, and welcome back to the non-profit investment stewards podcast. I'm Bob DiMeo as always joined by co-host Devon Francis. I am really excited about today's episode for two reasons. First, we kick off a new mini series on a topic that is near and dear to many endowment and foundation stewards, ESG, or environmental, social governance investing.

[00:00:55] The other reason I'm excited. This is our very first episode where rather [00:01:00] than having an outside guest, we actually have one of our own very talented colleagues. She's not only a consummate professional. She knows a great deal about ESG and SRI investing. So let's get into this Devon, where do you stand on the topic and what can listeners expect?

[00:01:17] Oh, I couldn't be more thrilled. Bob, as I mentioned in our inaugural podcast, ESG investing is one of the things I'm particularly passionate about. So I'm really excited to discuss this topic. I serve on our mission aligned investing committee and I work with several clients who are driven by ESG guidelines.

[00:01:34] And on a personal note, I'm also very invested in doing my part to combat climate change and help further social justice. So the topic to me is important, not only professionally, but also personally. So in this mini series, we will hear from three guests. I'll leave you hanging for a moment about this episode, but in the next two parts of the series, we'll hear from a client who incorporates ESG guidelines in their portfolio [00:02:00] construction process.

[00:02:01] And then we'll also hear from an investment manager who was on the forefront of the ESG movement. So I think we've got a great series for you. So today, as Bob mentioned, we are so thrilled to be joined by one of our DiMeo Schneider teammates. Shreya Canakapalli, Shreya is one of the firm's senior consultants and she serves alongside me on our mission aligned investing committee.

[00:02:24] Shreya is a CFA charter holder, and she's been with the firm since 2012. So Shreya Welcome to the podcast. Well, thank you both for having me.

[00:02:44] Sure. Uh, Devon mentioned I'm a senior consultant. I work with several non-profit clients. I'm on portfolio construction, asset allocation manager, selection and performance monitoring. I am a member of the mission aligned investment. Team, [00:03:00] um, as well as our research forum, that's responsible for the selection and monitoring of all investment products that ultimately are used by our clients.

[00:03:09] I graduated from Indiana university Bloomington and started my career at Northern trust before moving over to DiMeo Schneider. And while I won't claim to be an avid football fan, um, I did receive several text messages this past weekend from my friends. When the Hoosiers is broken at the top 10 rankings for, for football, phenomenal.

[00:03:30] That's I think the first time since the eighties, so go Hoosiers indeed. So Shreya some folks who are listening today may be newbies when it comes to ESG investing to help provide some

foundational information. Can you please describe the evolution of ESG investing and perhaps what the different acronyms might mean?

[00:03:52] Absolutely. So if you look at responsible investing, it's really been around for a very, very long time [00:04:00] and has religious roots dating back several centuries. So if you're looking at Islamic law, for example, they've always provided. Clear guidelines on prohibited investments. A few of which entail investments in, in things like gambling and alcohol.

[00:04:17] Similarly, the Methodist movement also outlined specifics on stocks and sectors for investors to avoid. So this concept is, is definitely not new, but as the social landscape has evolved, other issues have come into the spotlight from humans, right? And labor standards to board composition. And of course, climate change.

[00:04:37] This leads us to the three buckets that converge under ESG environmental that focuses on preservation of our planet, social that looks at workplace practices and people, and lastly governance. That seeks to understand how well a company is run acronyms that might be used for ESG or social [00:05:00] responsible investing or SRI, sustainable investing and impact investing as well.

[00:05:06] And Shreya, how do we at DiMeo Schneider define mission aligned investing. Mission aligned investing is really a broad term and results in each one of our clients really ending up with a slightly different flavor of ESG or mission aligned investing. Our goal here is to really seek to incorporate. A client's mission by using their capital to build a portfolio that, that aligns with their values and beliefs.

[00:05:35] And it's, it's important that in this scenario, we also maintain an appropriate long-term return and risk target that allows the client to achieve overall goals and objectives. For example, if you're looking at a community foundation, several of which we work with, they may be more drawn towards some of the social aspects of mission aligned investing, and could seek to incorporate elements such as maybe [00:06:00] diversity and inclusion, labor standards into their portfolio.

[00:06:04] Whereas, if you looked over the last few years, several college campuses faced pressure from students and other sources to act to slow down the impact of global warming. As a result, we saw several endowments looking more closely at incorporating environmental factors to make a difference with their capital.

[00:06:24] So really we work very closely with our clients to help them define mission aligned investing and what it means for them and ultimately how this translates into an investment portfolio. That's great. So it's really quite a customized approach. Absolutely. Yep. So within our client base, what are some of the trends or issues you see our clients focusing on when it comes to ESG investing?

[00:06:50] Sure. So if you're looking just broadly at history investing, most people have probably seen these headlines, but 2020 was actually a record year for [00:07:00] inflows into ESG or sustainable investing products. Morning star actually reported that in the first two quarters of 2020, we saw about \$21 billion flow into sustainable investing products.

[00:07:15] And this compares to about 21 billion for the entire year of 2019. So we've seen a significant uptake in ESG activity. And before I talk about our client base, I also did want to mention that if you're just looking at performance of sustainable funds, you'll see that most sustainable funds have also outpaced both benchmarks as well as their conventional peers.

[00:07:40] Of course, some of the sector allocation. Within these funds has been a major driver. So for example, most of the sustainable investing funds are underweight energy and overweight

technology. Both of which, you know, have, have performed pretty differently in this market environment, but more specific to what we're [00:08:00] seeing in terms of our clients.

[00:08:01] We're just seeing a lot more interest from our clients, both current, as well as prospective clients, when we're responding to any requests for proposal, most, most endowments and foundations are asking about our mission aligned investing, or ESG capabilities, how we implemented in portfolios, what kind of products we look at, how we help them measure the impact of the strategy as well as.

[00:08:27] Just in general, what the overall landscape has evolved over the last few years. And then more recently just given all of the activity that we saw this this summer social factors are definitely gaining more prominence within this, within this space. More and more. We're seeing clients inquire about minority and women based investment firms and trying to incorporate such investments into their capital and into their portfolio.

[00:08:57] You might've seen yields recent announcement, and [00:09:00] while they're not a client of ours, They did actually recently announced that they're looking more at managers in their endowment and these managers will be evaluated against their diversity efforts. We're most likely going to see this trend continue.

[00:09:14] And our research team is already looking at how they can be at the forefront of this, how we can bring to our clients investment options that incorporate some of these social aspects as well. Sure. Yeah. That's super insightful. Anything else you'd like to share on how stewards or board members or committee men investment committee members overseeing an endowment or foundation might approach or establish mission aligned investing?

[00:09:41] Yeah, it's, it's really important to first determine what the underlying motivation is for mission aligned investing. It could be part of the endowment or foundations, purpose, or mission. Again, to give you an example, we work with a client whose mission it is to improve lung health and [00:10:00] reduce the frequency of lung disease.

[00:10:01] And so this naturally leads them to exclude any tobacco related investments in their portfolio to the extent possible. So we're looking at four different approaches and these aren't quite distinct. You'll see a lot of overlap between these approaches, but the four approaches are exclusionary integration, proxy voting, or shareholding, shareholder engagement, and lastly, impact investing.

[00:10:26] So under exclusionary as the name implies investors look to limit or exclude certain securities that don't align with their values integration on the other hand looks at not only excluding the bad actors, quote unquote, but also including some of the securities that are moving the needle in more of that positive direction.

[00:10:47] If you looked at some of the guidelines published by the United States conference of Catholic bishops. Initially back in 1991, there were mostly exclusionary in nature to avoid participation in harmful [00:11:00] activities, or do not do no harm as the conference puts it, but they understand again that the marketplace has evolved.

[00:11:06] They are more investment opportunities. As recently as 2003, they actually made changes to their guidelines, guidelines that now. Are more positive in nature and not only seek to avoid certain securities, but also promote the cost, um, and good as they put it. So this inquiry investment in companies that again, uh, promoting the values of, of USC CV.

[00:11:31] Proxy voting or shareholder engagement. On the other hand, investors that look at this approach have to own the underlying securities. So again, it's not really for every client in every

capital base, but if you're looking at how this is accomplished, most, most of the owners of these securities look to cast their vote or proxy directly to engage with companies on various topics through this mechanism.

[00:11:56] For this strategy, we typically recommend, again, [00:12:00] that a client engage with a third party proxy voting service that, that votes these proxies on their behalf in line with their ultimate goals and objectives under this mission aligned investing. And lastly we have impact investing. I know there are various definitions for impact investing, but really the way we look at it under impact investing asset owners make targeted investments that align with their mission.

[00:12:26] And the goal here again is to make an impact first. So while financial returns are important with impact investing, their importance may be sometimes a notch below that, of the impact generated through the investment. A client will typically look to access impact investments through the private markets.

[00:12:47] And because again, of the various considerations that come with impact investing, we recognize that this particular strategy may not be for all nonprofit clients. That's great. Shreya so [00:13:00] we've got four possible ways of implementing ESG. One is the exclusionary approach. Two is the integrated approach.

[00:13:09] Three is proxy voting or shareholder engagement, and then four is impact investing once a client has identified their underlying motivation, kind of defined their values and decided which approach or approaches they are going to employ. How do you go about implementing ESG within a nonprofit portfolio?

[00:13:32] Yeah. And so this is again where the fun starts, right? You, you do all of the legwork and now you're getting to put that into action. There there's several ways to go about implementing an ESG portfolio, similar to how we talked about approaching it or defining it. But we start really with creating a screening criteria for the portfolio.

[00:13:54] And again, we rely on. Several ESG databases and tools available in the [00:14:00] marketplace to look through, into security as an investment products. So here with implementation, it's important to understand how restrictive a client wants to be. Is this a zero tolerance portfolio where the client won't accept any sort of investment in, in.

[00:14:18] That goes against their values or are they willing to work with the materiality threshold based on revenue or some other factor? A zero tolerance portfolio will naturally lead to excluding more securities and this could lead to higher tracking error relative to benchmarks. So again, it comes down to how the client wants to go about doing it and what the overall impact will be.

[00:14:42] Not only in terms of accomplishing the overall goals and objectives, but also. Looking at the impact on returns for the long-term portfolio. So based on asset level, we'll utilize various investment strategies. Be it mutual funds, commingled vehicles, [00:15:00] or if the client has enough assets, we'll also work with a customized, separate account to accomplish the overall goals and objectives of this portfolio.

[00:15:10] Sure I had working with clients, myself and the charitable organizations and nonprofits over the years. This is all terrific and really a lot of potential good, and an operator Trinity for these good stewards to even further advance and implement mission, but it doesn't come without challenges. And can you talk a little bit about some of the challenges that exist in implementing ESG Sri or any of the above?

[00:15:34] I see three main challenges, really when it comes to implementing ESG, the first of which is just the availability of data and standardizing of data when it comes to looking at companies to include

or exclude within the portfolio. So we've definitely seen improvements in the availability of data and access to data.

[00:15:56] Again, to give you a quick stat here in 2016, [00:16:00] over 80% of companies within the S and P 500 had published a sustainability report in 2019. That number was at 90%. So we're definitely making progress in terms of understanding how companies are, are looking at sustainability and the efforts being made there.

[00:16:18] However, at the same time, it's important to remember that most of the data reported right now is done. So in a very voluntary basis and the company may convey what they think is important, as opposed to what you as an investor might think is an important. So there's really no standard for companies right now.

[00:16:36] But there are industry efforts being made to, to accomplish that a couple of main branches, the global reporting initiative, for example, and the sustainability accounting standards board or SAS SPI are two of the main organizations that are looking to create a framework that companies can use to then start reporting sustainability efforts.

[00:17:00] [00:17:00] But we haven't quite seen a tipping point with either one of these organizations. The second challenge is, is investment opportunities. Of course, this has been a growing space. I had referenced the, the sheer amount of inflows that we've seen into sustainability products. And I, and I really appreciate that this.

[00:17:20] Area will continue to evolve. But as I'd mentioned, there are more products on that environmental side or that sustainability side. What we're yet to see is maybe product in that social and governance space. But again, given some of the efforts being made by some of the larger capital owners, some of the larger endowments and foundations, I fully suspect that we'll continue to see products being developed in the.

[00:17:47] In the S and G space and more availability for investors looking to prioritize those areas of ESG. And then lastly, you know, tying into what I've mentioned about [00:18:00] companies not having a standardized reporting metric, we tend to see the same thing when it comes to managers. And so it becomes a little bit challenging to measure the actual impact of the overall portfolio.

[00:18:16] Managers are even newer to this type of reporting, given that some of the products have been created in the last decade or so. So what we're seeing now, again, in terms of just standardizing the recording, many managers are using the UN sustainable development goals or UN SDGs as a framework to report how their portfolio is stacking up.

[00:18:39] Just to give you a quick rundown on what the UN SDGs are. There's 17 goals where all member nations of the United nations have. Pledged to start working towards, and these are fairly broad in nature, ranging from zero poverty, zero hunger, all the way to sustainable consumption, [00:19:00] climate change life on land.

[00:19:01] So various factors here that the tie in nicely with, with the efforts being made by asset managers or investment managers, when it comes to. Sustainable sustainable products. And so again, they're using the UN SDGs as a framework to say, this is how our portfolio stacks up against these 17 different criteria.

[00:19:25] And that again, just allows us as consultants working closely with our clients to be able to truly measure. What the impact of the overall ESG portfolio has been. That's great. Thanks. Thanks Shreya. It does sound like there are certainly challenges, but we're moving in the right direction. So that's great.

[00:19:46] You've provided so much important background on ESG investing and, and some of the challenges and the developments that are being made. Can you just share with us broadly, how do you help clients? Do you maybe have [00:20:00] a, a S. A story or two that you could share to help illustrate how we go about helping our clients.

[00:20:06] Absolutely. Yeah. So again, here, you know, we work very closely with our clients from. Helping them define and evaluate how to practically implement th their chosen ESG framework to then, you know, helping with the governance piece of it, making sure their investment policy statement is up to date and captures this, the strategy within the portfolio.

[00:20:29] So to give you a quick. Story about how we've worked with the client. We have a large university endowment that several years ago based on donors for the university as well, as well as based on efforts from students started to go down the path of understanding what, what a, a. Divestment from fossil fuels would look like.

[00:20:54] And at that point in time, they were somewhat at the forefront of understanding going through this [00:21:00] process. Really, we help them again from that that four step process of exclusionary integration. Proxy voting as well as shareholder engagement, understand what would be best suited for the portfolio.

[00:21:13] Ultimately, we agreed on a mix of all four of them, less. So for impact investing, just given that again, the goal was here to produce a portfolio with the ability to outpace their spending rate, grow into the future and make sure that the endowment lasts into perpetuity. And so we created a portfolio having gone through several rounds of discussion analysis that, you know, ultimately doesn't have great tracking error relative to a conventional portfolio, but still accomplishes their goals of removing fossil fuels from the, from the portfolio to the extent possible.

[00:21:52] So we looked at a divestment and integration approach when it came to traditional equities and fixed income. [00:22:00] We're still working a little bit on that international and emerging market piece. We were also able to incorporate some alternative investments within hedge funds and private equity. That again, further this mission of reducing, reducing the impact of fossil fuels positively impacting climate change as well.

[00:22:20] That's that's really the process that we went through. It is an iterative process. We continue to look at it and as more products become available, more, more data becomes available. This is something that we're constantly looking at, but that's kind of how we started the process. And we're nowhere close to being done by any means, but, but we're making some good progress here.

[00:22:43] Sure we had Frank Kelly of DWS on it was really a special edition post-election show and he believe it or not touched a fair amount on ESG and Sri investing and had some very encouraging and insightful [00:23:00] words for a go-forward look into that space. What do you and folks, if you haven't heard that go back, it's a episode number five, but Shreya, what do you think will be the biggest factor impacting the ESG marketplace going forward?

[00:23:13] Yeah, that's, that's definitely an interesting one, frankly speaking. I do think it will be centered on climate change. It's becoming a topic that everyone's talking about. We're having record years of, of warm temperatures. And so I think there needs to be some action that, that allows. Asset owners and asset managers to, to work together to potentially positively impact climate change.

[00:23:44] And it's actually, if you looked very recently, the UK announced that they will require all companies, all public companies that are listed on their exchanges to start reporting climate metrics. This is the first country that's come out with [00:24:00] regulation such as this. And we do think that other countries might follow suit.

[00:24:05] So if you're looking at the European union, they were already looking at similar regulation and this might be the impetus for other countries to start considering that. And with that, I think will come a lot more transparency on how companies are reacting to what is becoming. I know a very important topic of conversation for everyone.

[00:24:29] And I think that will lead to more investment in areas that can help reduce the impact of fossil fuels help reduce the impact of global warming. Ultimately, I do think that that is going to become one of the biggest factors. And we're going to hopefully see more government in state regulation when it comes to how companies are doing their path, their part to reduce the, their carbon footprint.

[00:25:00] [00:25:00] All of your comments have just been so insightful and clearly you have a lot of knowledge on this topic and we thank you for sharing it with us and with our listeners. Before we finish up the episode, we always like to learn a little bit more about, uh, our guests on a personal level. I will leave you with two questions.

[00:25:21] One is kind of from a selfish perspective because I'm an avid reader. So I'd love to know what is your favorite book and why, and then secondly, what do you enjoy doing outside of work for fun when we are not in a pandemic and you can't leave here? Uh, yeah, interesting year for sure. In terms of my favorite book.

[00:25:43] I've been looking for strong women role models. And so one of the places that I landed unsurprisingly was becoming by Michelle Obama. I obviously followed the Obama presidency pretty closely, and I, I, [00:26:00] you know, started looking more and more into her than just reading about her story, reading about how she overcame.

[00:26:08] You know, different, different barriers to, to get to where she is and really stood out for herself. And didn't quite ride in the coattails of, of her husband and his presidency. That was very impressive. And I think it was just very eye opening that if, if you wanted to do something and you kind of set out your mind to do something, it was very much achievable regardless of, you know, your background, your social economic status, and.

[00:26:35] You know, opportunities presented to you. I think it just made me realize that you can open doors for yourself as opposed to expecting doors to be opened for you. I would highly recommend that book. If you haven't read it, I will put that on my list and, yeah. And in terms of what I like doing for fun, this one's a little bit more nerdy, although I guess, uh, during the pandemic we saw [00:27:00] record sales for puzzles, but I've actually always enjoyed working on jigsaw puzzles.

[00:27:05] My husband a few years ago, bought me a very cool artisan puzzle from artifacts. It's a small California based firm and they actually laser cut wood in pieces of the puzzle. And that was probably one of the more fun and challenging puzzles that I've worked on. And then more recently we're working on a magic puzzle company.

[00:27:26] It's a set of three different puzzles. And once you finish them, apparently there there's some tricks in place where the puzzle changes. I'm not entirely sure how that works, but I'll keep you posted, but that's, that's. That's kind of how I looked at de stress and, and spend some time, um, in the evenings working on a puzzle.

[00:27:46] There you go. And it's good exercise for the brain as well. I tell you with our guests, we've had a lot of varied interests from farming to jigsaw puzzles to triathlon. So we really run the gamut here. So Shariah it's been [00:28:00] so excellent to have you on the show. We really appreciate you coming on. If folks want to learn more about ESG investing or if they want to contact you, how might they reach out or where should they go?



[00:28:11] Absolutely. Please feel free to reach out to me on LinkedIn. I'm pretty sure I'm one of the few clinical police on there. So it should be pretty easy to find, but also definitely check out our website. The research and insights section of our website has a lot of great content related to mission aligned investing and just overall portfolio construction and considerations for nonprofit clients.

[00:28:37] Trey. It was so great to have you on the show. And, uh, it's a joy to have you as a colleague and frankly, doing the show just, just reminds me how much I miss being in the office with you and our other wonderful colleagues. So thank you so much. Absolutely thank you for having me. So as we wrap up, remember to subscribe, to and rate the show, your reviews really do help expand the audience.

[00:28:59] Also want to make [00:29:00] listeners aware of a timely guide that Devon and I just co-authored along with another colleague titled six tips to managing endowment and foundation investments. It's a 20 page guide, not only timely, but we hope super useful insights. There'll be a link in the show notes and you can download it without any cost.

[00:29:19] So to all you good stewards. Thanks for investing time to help your nonprofits prosper. We'll connect with you soon on the next episode. Thank you for listening to the nonprofit investment stewards podcast. Click the subscribe button below to be notified of new episodes and visit DiMEO schneider.com.

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[00:29:52] Only seek the advice. Of course. By professionals familiar with your unique circumstances.  
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