

Sustainability & Investor Success

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- 1 Why incorporating ESG into an investor's toolkit is no longer optional
- 2 How to think more clearly about ESG Risk
- 3 How Morningstar's suite of ESG Ratings can help

Michael Jantzi, Sustainalytics

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ESG Investing is at an Inflection Point



Integration



Impact



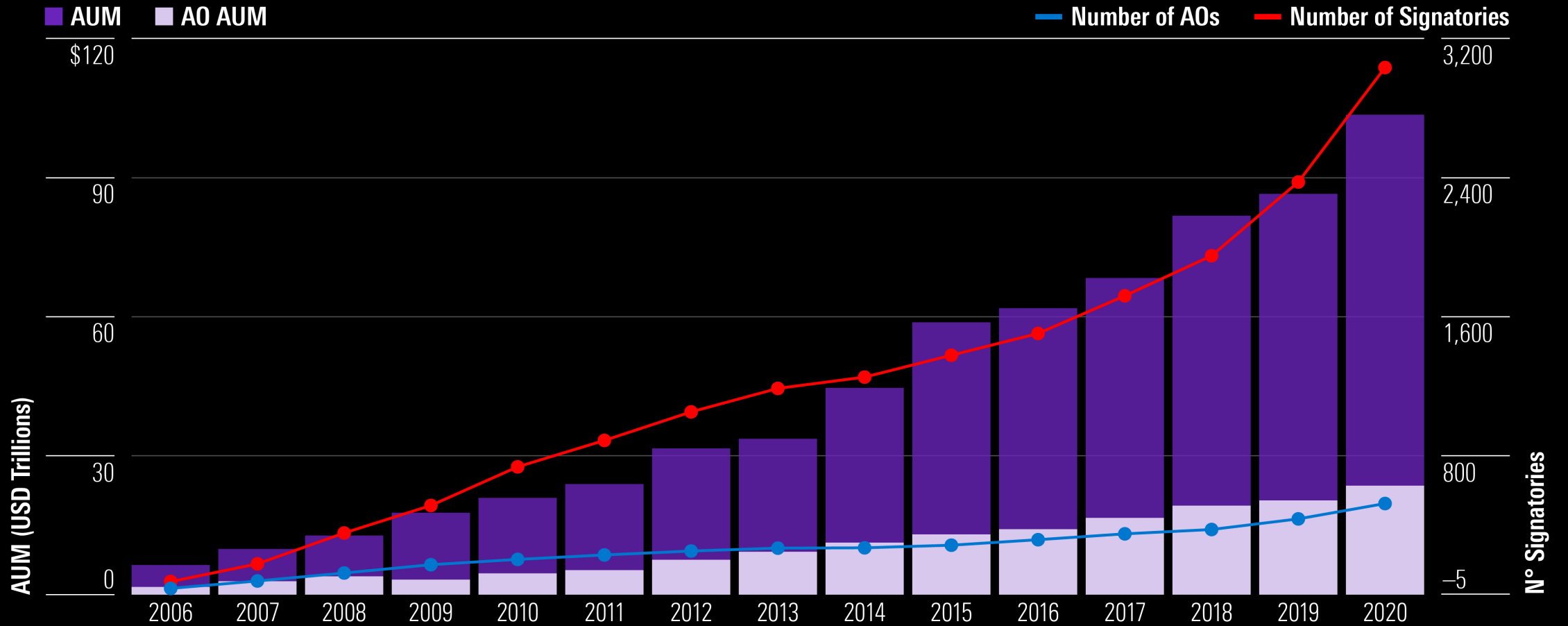
Alignment



Regulation

Integration

PRI Signatory Growth



Impact



Green Bonds

enable capital-raising and investment for new and existing projects with environmental benefits



Social Bonds

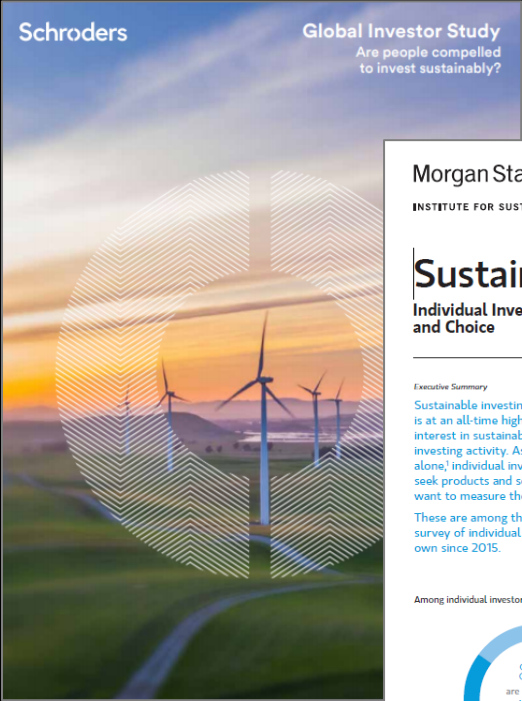
are use of proceeds bonds that raise funds for new and existing projects with positive social outcomes



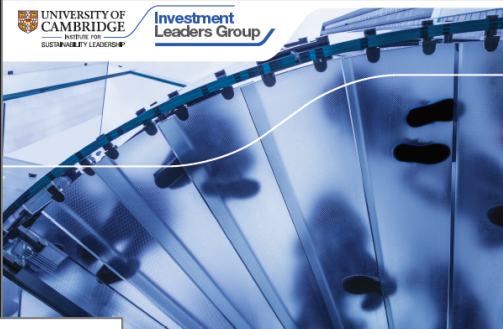
Sustainability Bonds

are bonds where the proceeds will be exclusively applied to finance or re-finance *a combination of both Green and Social Projects*

Alignment



Schroders 2019
Global Investor Study



Morgan Stanley
INSTITUTE FOR SUSTAINABLE INVESTING

Sustainable Signals: Individual Investor Interest Driven by Impact, Conviction and Choice

Executive Summary
Sustainable investing continues to make gains. Investor familiarity and enthusiasm is at an all-time high. More than 8 in 10 U.S. individual investors (85%) now express interest in sustainable investing, while half take part in at least one sustainable investing activity. As the market matures, reaching \$12 trillion in the United States alone, individual investors are also driving innovation. Increasingly proactive, they seek products and solutions across asset classes tailored to their interests. They also want to measure the environmental and social impact of their investments.

These are among the key findings of Morgan Stanley's third Sustainable Signals survey of individual investors, which reinforces a picture of a field coming into its own since 2015.

Among individual investors:

- 85% are interested in sustainable investing, up 10 percentage points from 2017.
- 95% of Millennials are interested in sustainable investing, up 9 percentage points from 2017.

Walking the talk: Understanding consumer demand for sustainable investing

A study by the Cambridge Institute for Sustainability Leadership

Cambridge Institute for Sustainability Leadership 2019 Survey

Morgan Stanley Sustainable Signals 2019 Survey

Regulation

SUSTAINABILITY MATTERS

Sustainability Matters: Overwhelming Opposition to Proposed Regulation Limiting the Use of ESG in Retirement Plans

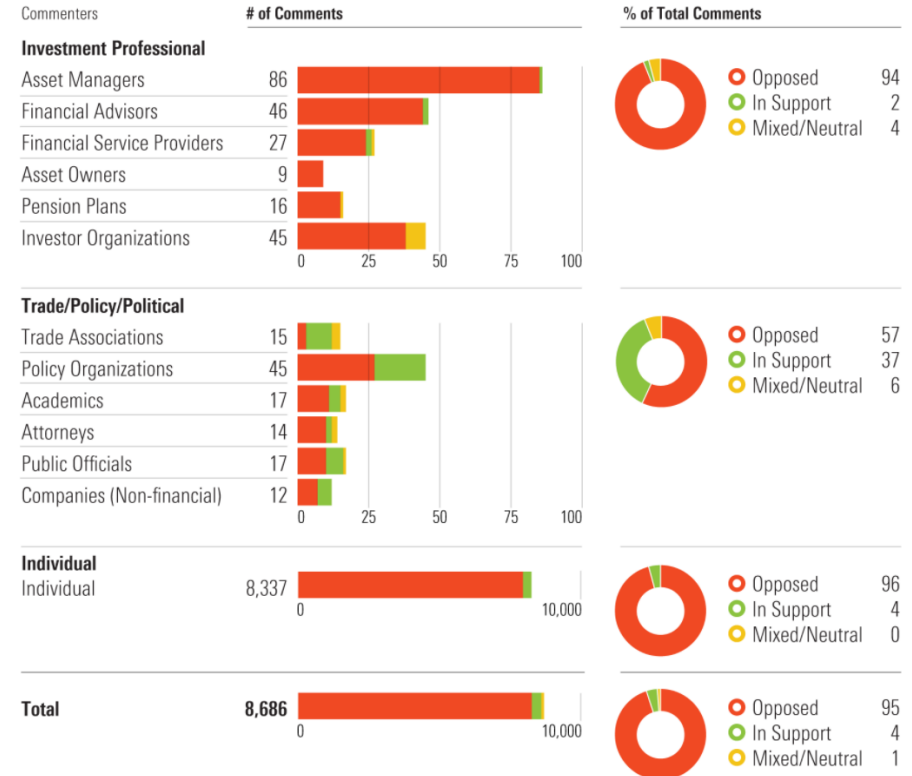
Investors take exception to Department of Labor proposal in public comments.



Jon Hale, Ph.D., CFA
Aug 20, 2020



Public Comments on U.S. Dept of Labor Proposed Rule, "Financial Factors in Selecting Plan Investments"



Public comments on U.S. Dept. of Labor Proposed Rule, "Financial Factors in Selecting Plan Investments," downloaded by authors from <https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95>.

Simon MacMahon, Sustainalytics

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Common Misunderstandings



ESG is not just about values



ESG is not restricting



ESG can support traditional investment objectives

What is ESG?

- ESG is simply more information on a company's situation, its products and its management of its impacts and risks.
- ESG information should then be seen as an extension of the traditional financial information set.
- Alternative and additional information can only enhance decision making. How you use ESG in your investment process is entirely up to you and your clients.

The Motivations for Using ESG in Your Investment Process



ESG and Values-Based Investing

Energy



Arctic Oil
& Gas



Nuclear
Power



Oil & Gas



Oil Sands



Shale
Energy



Thermal
Coal



Genetically
Modified Plants
& Seeds



Palm Oil



Pesticides

Environment

Values-Based



Alcoholic
Beverages



Cannabis



Tobacco



Fur & Specialty
Leather



Adult
Entertainment



Gambling



Pork
Products

Business Practices



Animal
Testing



Predatory
Lending



Whale
Meat



Controversial
Weapons



Military
Contracting



Riot
Control



Small Arms

Defense & Military

Life Ethics



Abortion



Contraceptives



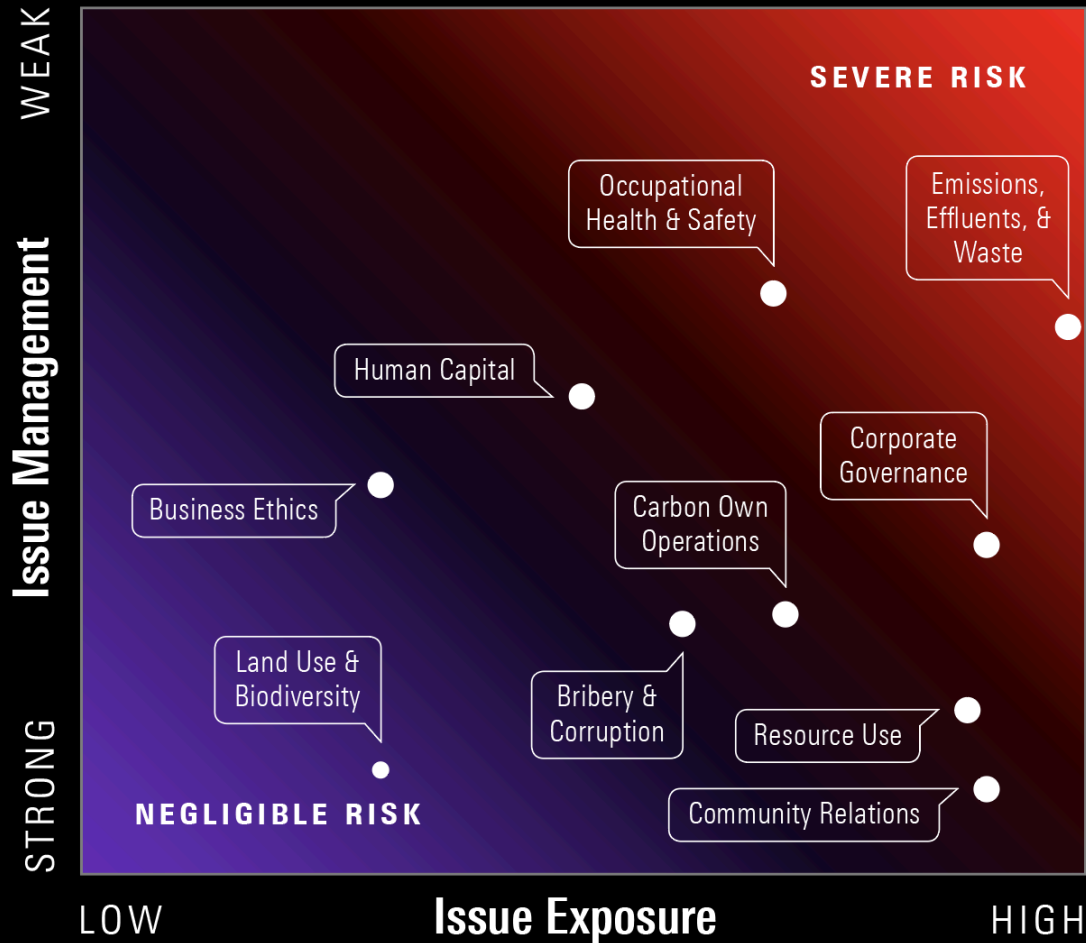
Human Embryonic
Stem Cells

Impact Themes and Sustainable Development Goals

- Impact Themes
- Sustainable Development Goals



What is ESG Risk?



ESG Risk

ESG Risk looks at all the ESG issues that a company is exposed to that have the potential to materially (i.e. financially) affect their company's performance. We then assess how much of that risk is well managed by the company and how much unmanaged risk remains.

Issue Exposure

Is the degree to which a company is exposed to Material ESG Issues (e.g. human capital or land use and biodiversity)

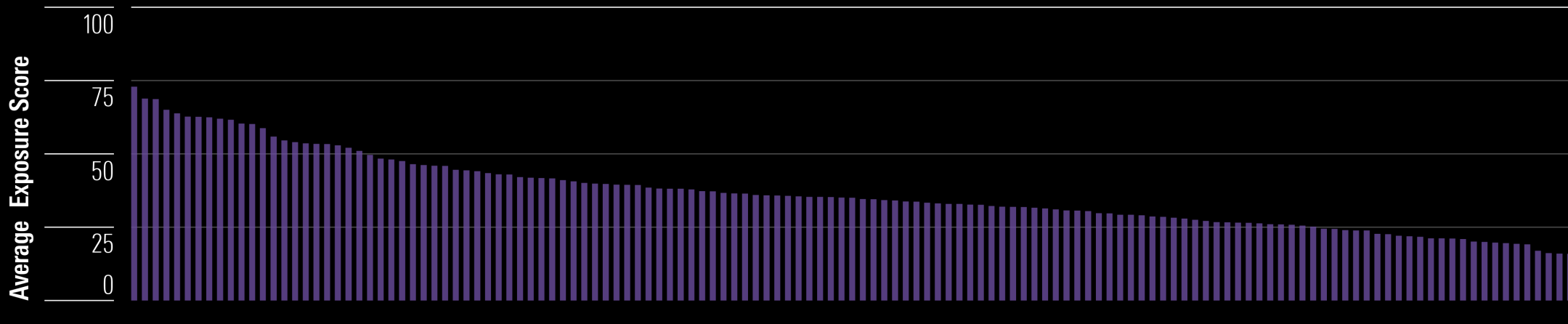
Issue Management

Measures a company's preparedness and track record in managing its exposure to its material ESG issues through an assessment of policies, programs, management systems and controversies.

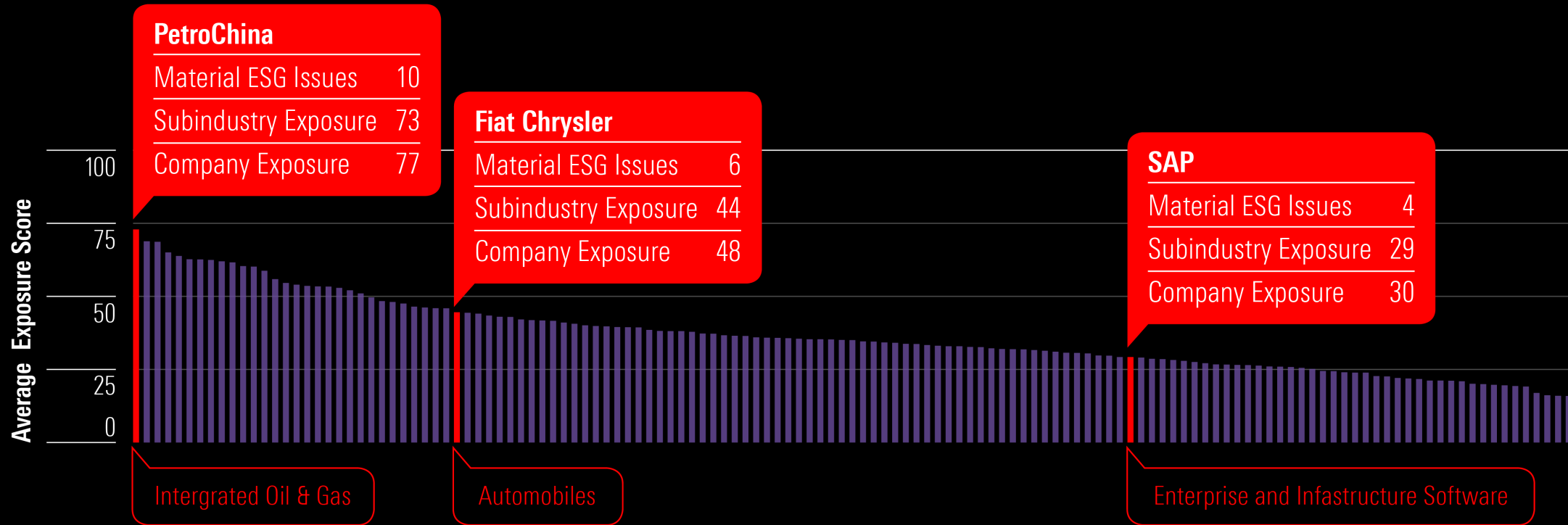
Issue Exposure – Issue Management = Unmanaged ESG Risk
(for that issue)

ESG Risk Varies Across Different Industries and Companies

- Subindustries face different levels of ESG risk; divergence can be very significant.
- Level of risk is determined by exposure to different ESG issues.
- Exposure is driven by industry affiliation, business model, cultural background, financial strength, geographic structure of revenues and assets, etc.



ESG Risk Varies Across Different Industries and Companies



Daniel Rohr, Morningstar

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Morningstar Equity Research



125 Researchers, 1,558 Companies, 1 Methodology

Americas
67 Researchers
767 Companies

Europe, Africa, Middle East
17 Researchers
328 Companies

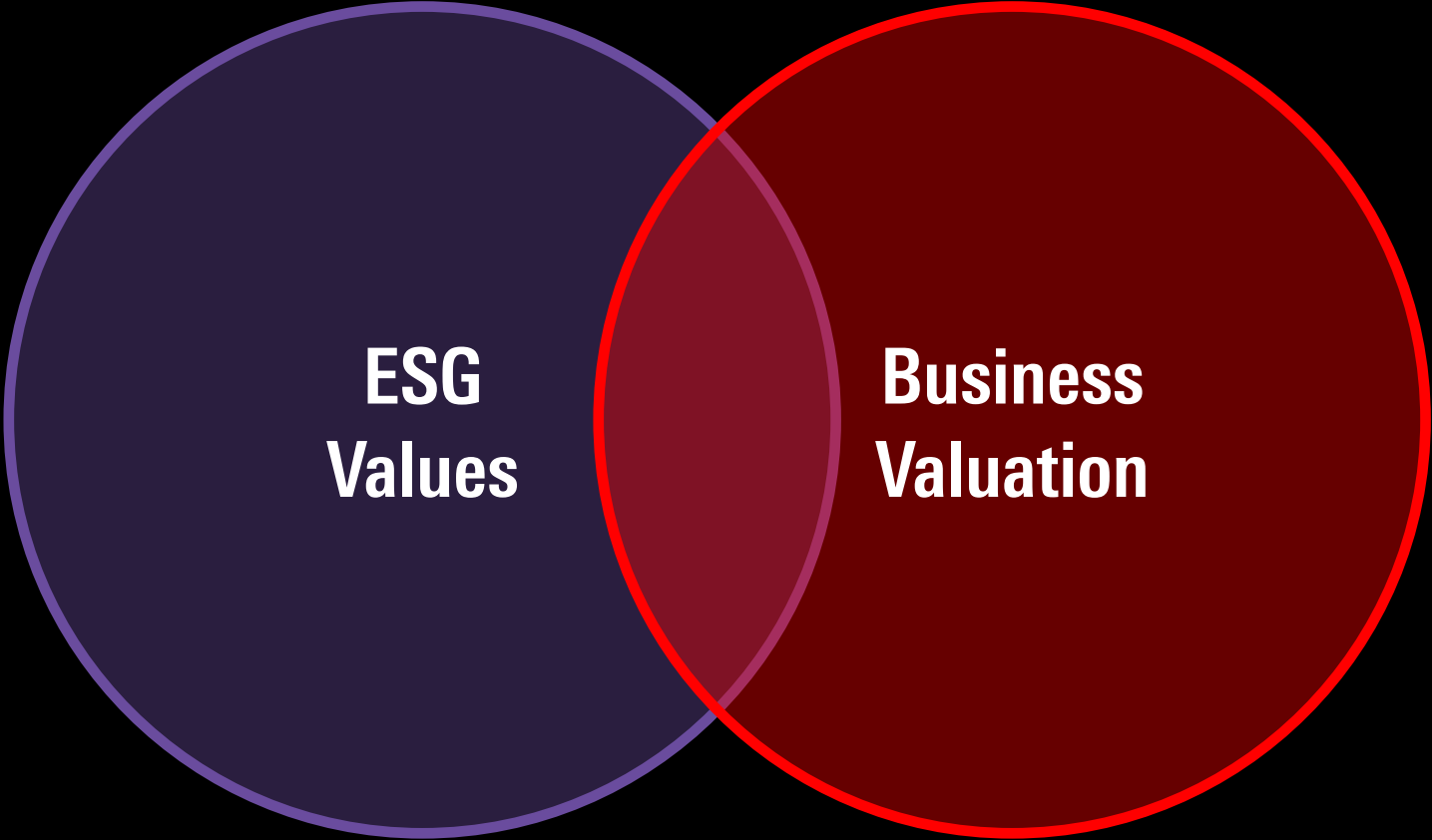
Asia
25 Researchers
304 Companies

Australia & New Zealand
16 Researchers
159 Companies

Methodology

Fundamentals-Focused | Long-Term Oriented | Objective: Business Valuation

Values & Valuation: Considerable Overlap, But Far from Perfect



Facebook's "bad" behavior has led dozens of brands to boycott the site...

CVS, Dunkin', Lego: The Brands Pulling Ads From Facebook Over Hate Speech

An effort to pressure Facebook to crack down on hate speech and misinformation has prompted dozens of advertisers to say they'll stop spending on the platform. Here are some of the biggest companies involved.

TECH

Facebook Tries to Contain Damage as Verizon Joins Ad Boycott

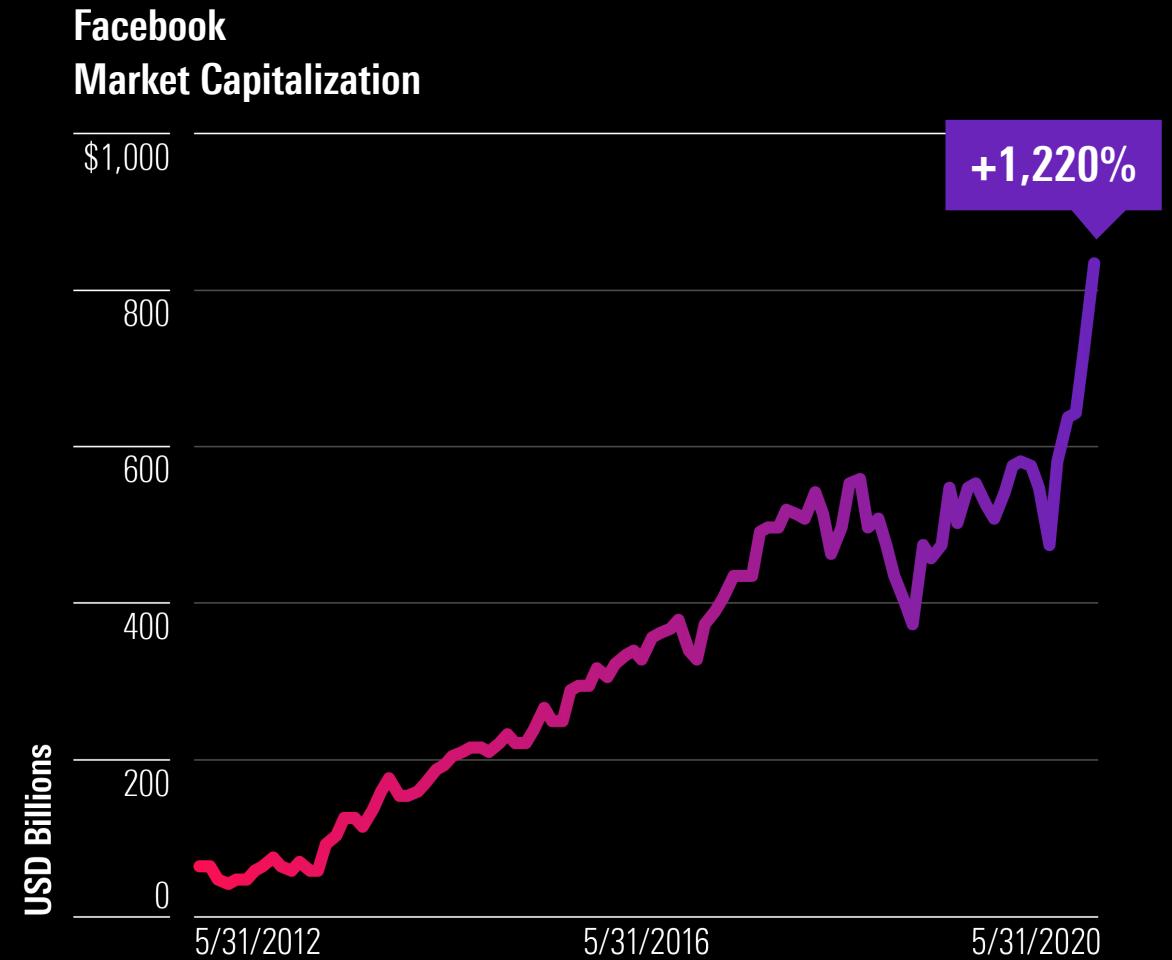
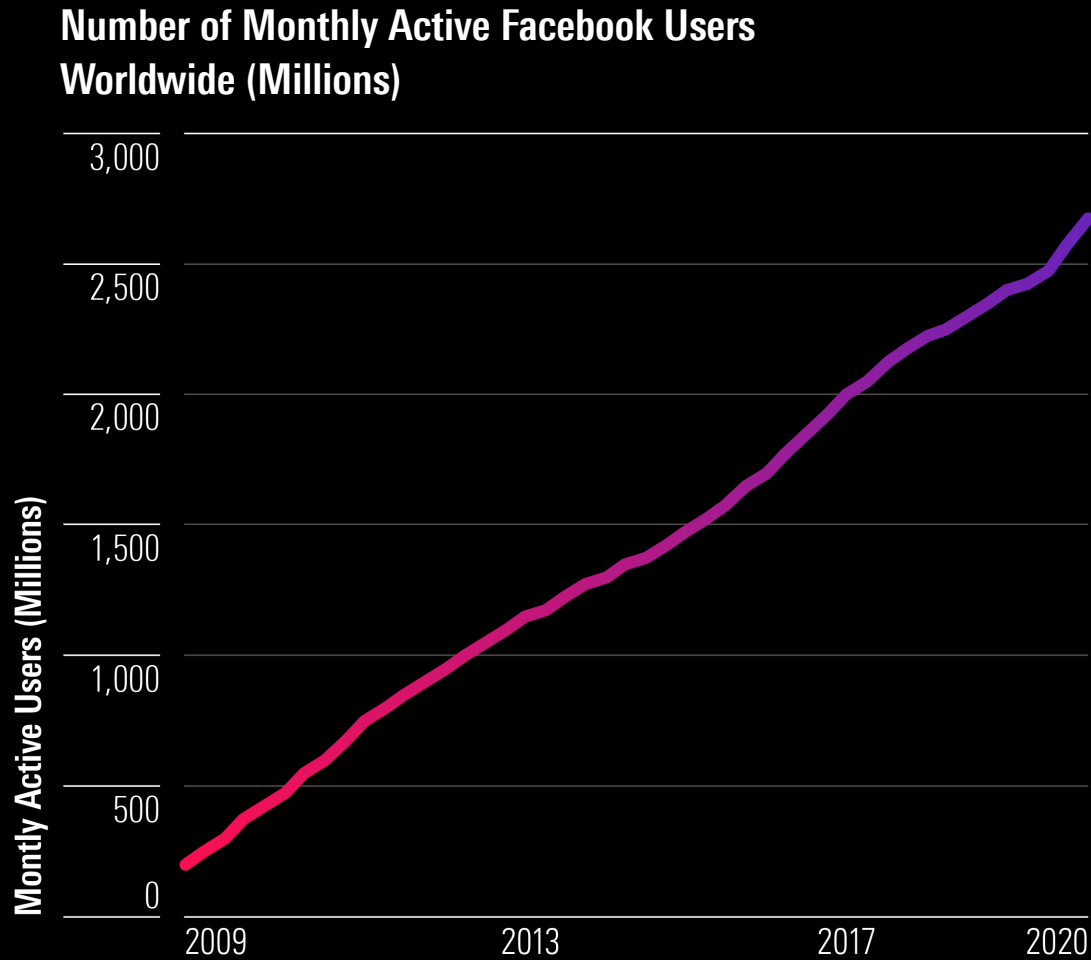
Social network tells advertisers it takes civil-rights groups' concerns seriously, but won't 'make policy changes tied to revenue pressure'

Technology

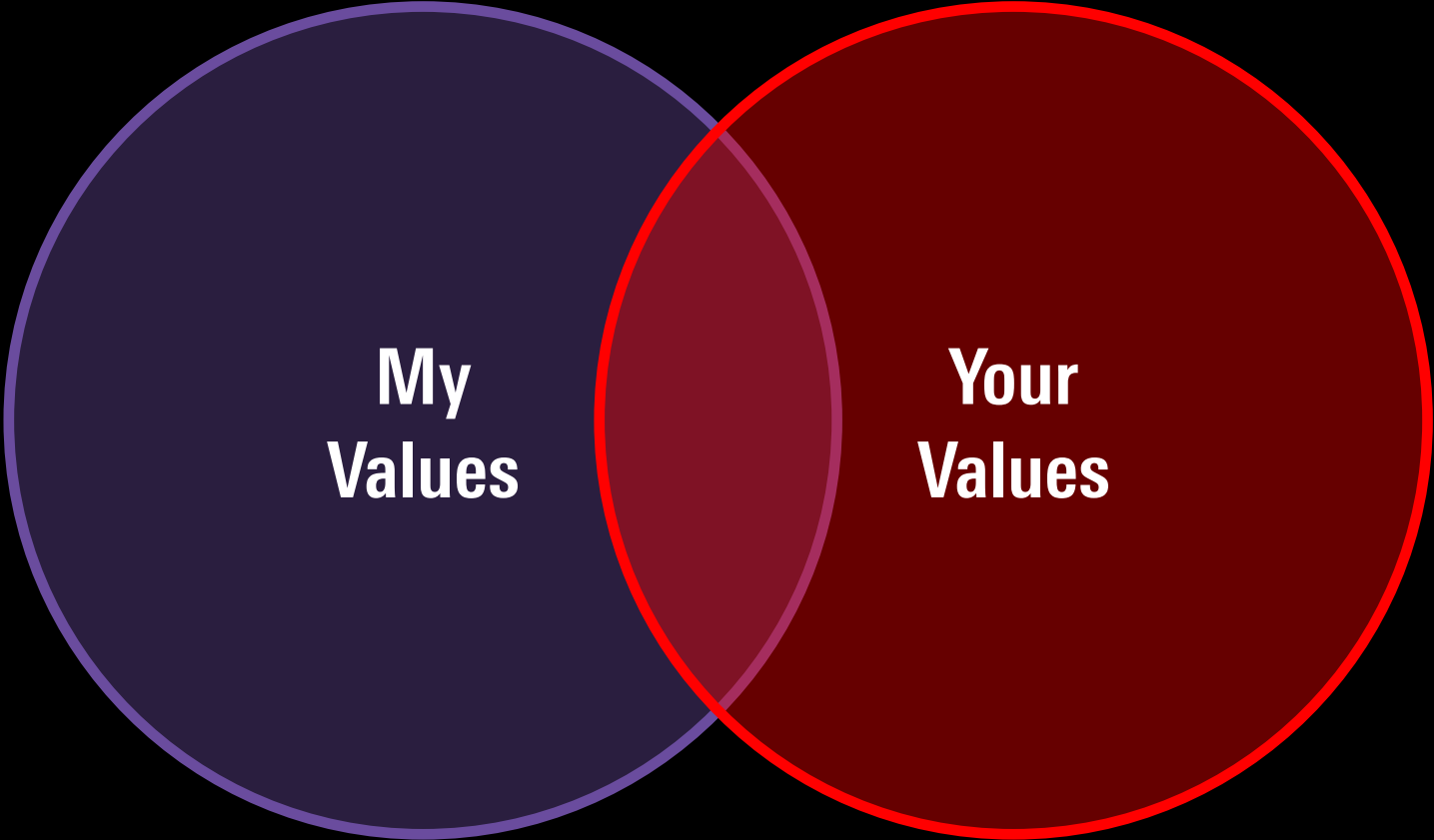
Facebook faces a growing advertising boycott after consumer goods giant Unilever joins

Unilever said it will pull its advertising from Facebook, Instagram and Twitter for the rest of 2020 in response to hate speech on the social media sites.

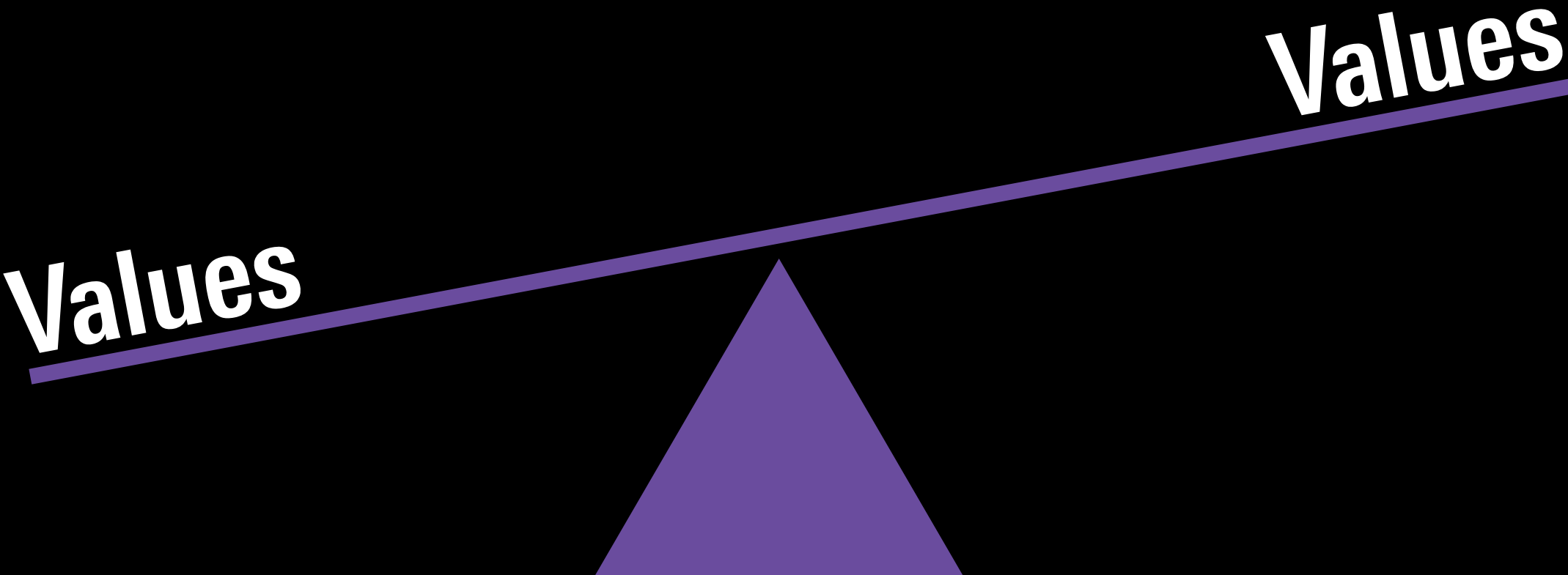
...but also facilitated the firm's ascent to market leadership.



Values & Valuation: Whose gets to define what's good and what's bad?



Values & Valuation: Without a unit of measure, how can we weigh trade-offs?



Is ESG investing hopelessly at odds with traditional investing?



Risk-based approach to ESG *augments* traditional investing.



Applying the risk-based approach: Facebook

“ While we don’t think the impact of such a boycott by advertisers on Facebook revenue will be significant (as we indicated in our June 29 note), we remain concerned about the long-term risk of increased regulations. Facebook’s reaction to the boycott movement could lead to various organizations and politicians demanding changes to Section 230 of the Communications Decency Act, which provides liability protection for online firms. As we mentioned in our March Observer, “Antitrust Flexing Its Anti-Big-Tech Muscle: Google and Facebook Do Not Face Significant Damage,” with Facebook further taking editorial control of content, it may be viewed in courts and by lawmakers as a publisher and not a distributor, possibly removing the protection of Section 230.”

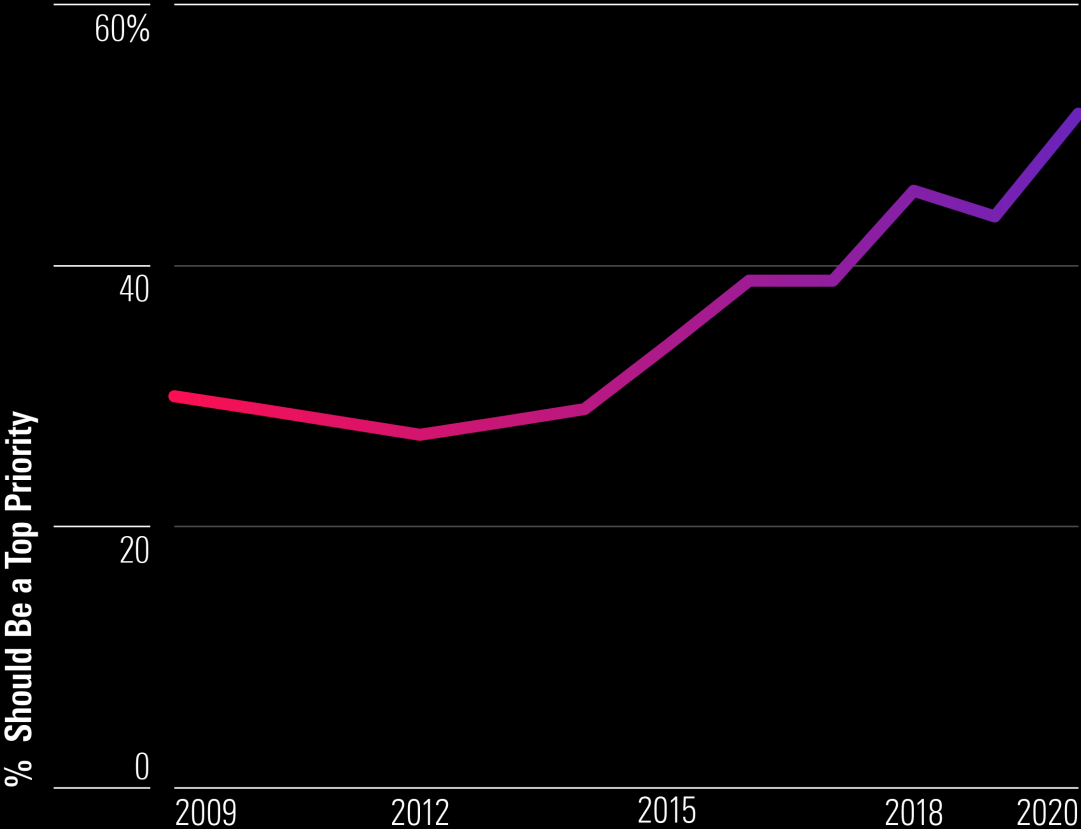
Ali Mogharabi, Senior Analyst covering Facebook (July 8, 2020)

Risk-based approach to ESG is not divorced from value judgments.

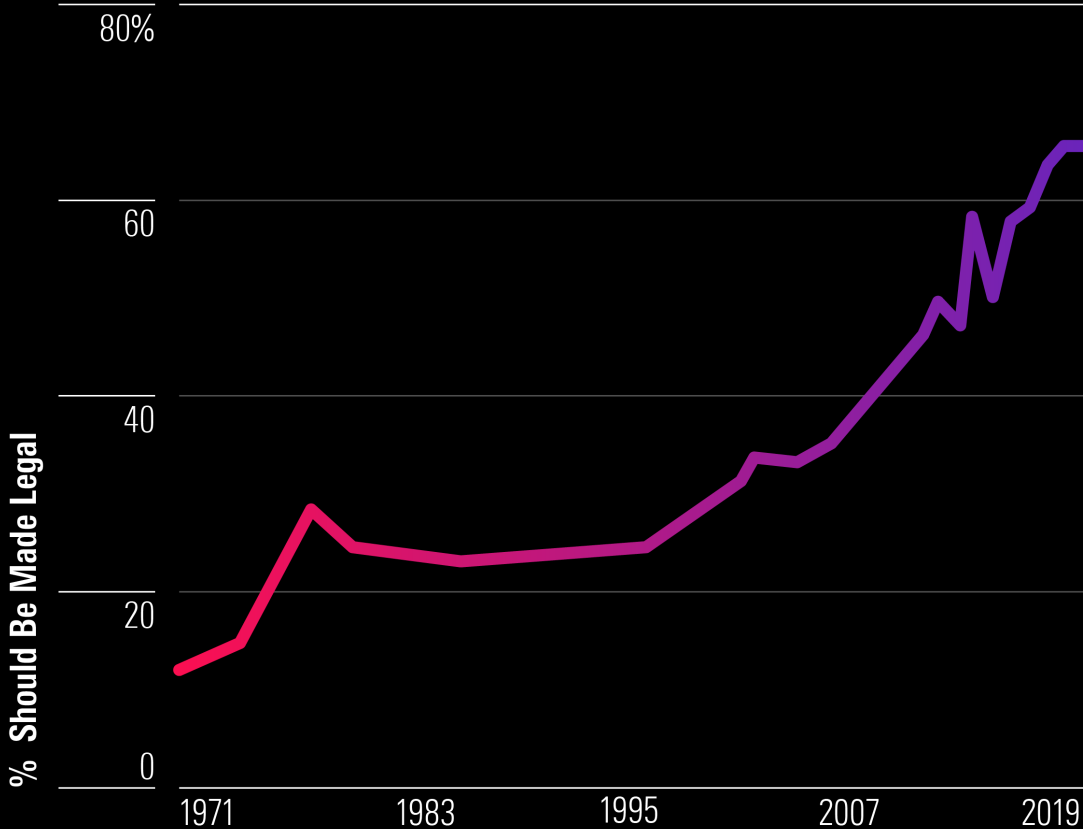


Society's values change slowly, so many ESG risks are "long-dated".

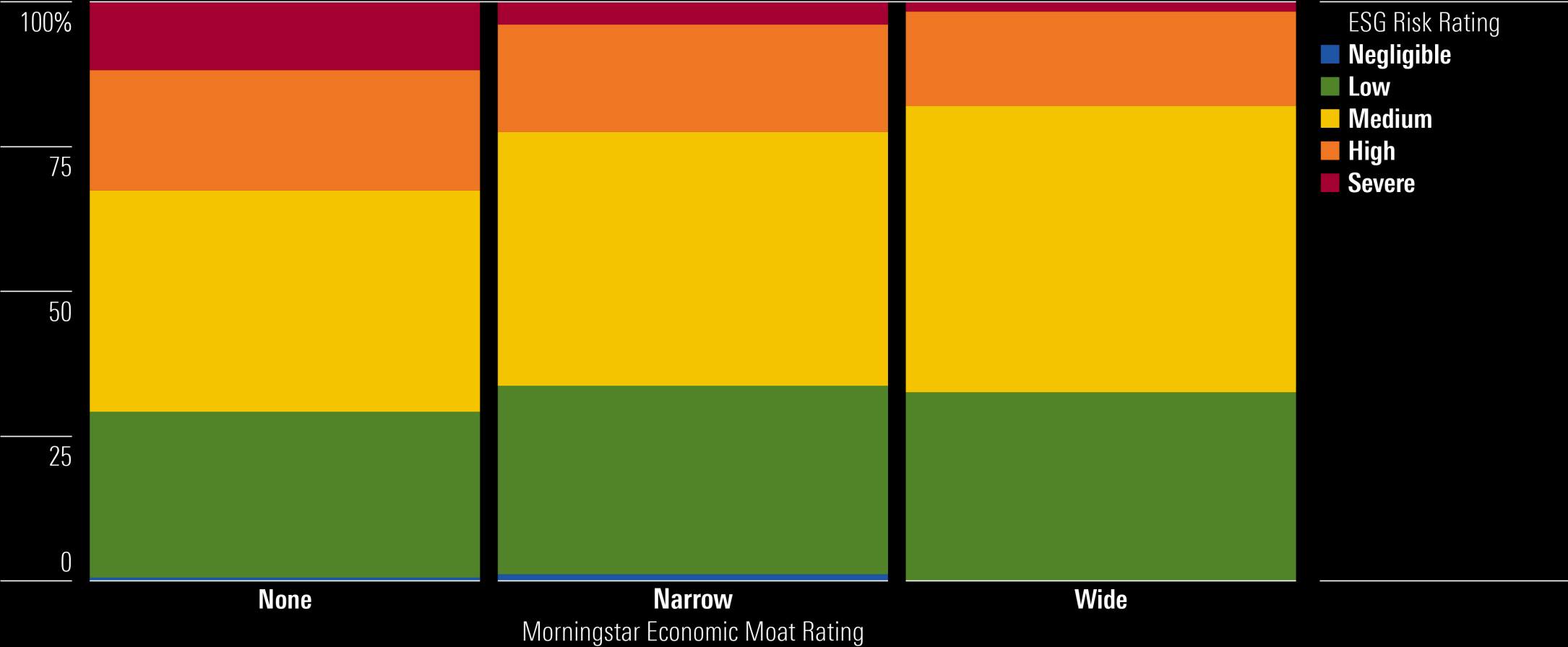
Share of US adults who say dealing with global climate change should be a top priority for the president and Congress



Share of US adults that think the use of marijuana should be made legal



Firms with less ESG risk exposure are more likely to possess a durable competitive advantage.



Aron Szapiro, Morningstar

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Negative Externalities, ESG Risk, and Policy



Cost on Income Statement



Cost to Others

Financial Regulators Are Concerned

“The ECB, acting within its mandate, can — and should — actively support the transition to a low-carbon economy, in two ways: first, by helping to define the rules of the game and, second, by acting accordingly, without prejudice to price stability.”

Benoît Cœuré, Member of the Executive Board of the European Central Bank

Financial Regulators Are Concerned

“Through the ambitious targets set in the historic Paris climate agreement, and the commitment to be a world leader in renewables, Europe is already leading the fight against climate change. But to get there, Europe’s financial sector must lead the green transition and make our Union the global destination for sustainable investment. There is no greater return on investment than a healthy planet and economy.”

Jean-Claude Juncker, President of the European Commission

U.S. Regulatory Barriers to ESG will Break



ERISA is at odds
with requirements elsewhere
in the world



Other countries' regulators will
define the standards

Hortense Bioy, Morningstar

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Introduction to the Morningstar ESG Commitment Level

Why?

- Surging investor interest in sustainability issues
- More asset managers are incorporating ESG factors into investment decisions
- Growing number of ESG funds
- Strong inflows into ESG funds

Investors need help understanding:

- How ESG informs investment strategies
- Which funds and asset managers are subpar/best-in-class

Introduction to the Morningstar ESG Commitment Level



Scope

All funds and asset managers
rated by Morningstar Analysts

~4,000 funds,
~450 asset managers



ESG Evaluation distinct from
Morningstar Analyst Rating



Complement the Morningstar
Sustainability Rating

Morningstar ESG Commitment Level: for Funds

Leader	Strategies that our analysts believe are the very best ESG offerings, with top-flight resources available to them, that fully incorporate ESG factors into the investment process and have a well-implemented active ownership program.
Advanced	Strategies that our analysts consider well resourced, that integrate ESG factors into the investment process to a significant degree and have a sound active ownership program.
Basic	Strategies that consider ESG factors, but, in our analysts' view, ESG considerations are not sufficiently incorporated into the investment process.
Low	Strategies that do not incorporate ESG factors into the investment process or do so in a very limited way.

Morningstar ESG Commitment Level: for Asset Managers

Leader	Asset managers that our analysts consider the most committed to ESG, with a strong ESG philosophy, extensive ESG policies, significant resources, and a well-implemented and transparent active ownership program.
Advanced	Asset managers that we believe are among the better firms at incorporating ESG factors into their investment processes, are well-resourced, and have a sound active ownership program, but are lacking in one key aspect.
Basic	Asset managers that demonstrate some commitment to ESG but ESG considerations may not be fully integrated across most investment processes. These firms may be relative newcomers to ESG and still building their capabilities.
Low	Asset managers that our analysts believe demonstrate little or no commitment to ESG. These may be firms with limited dedicated resources that incorporate ESG considerations across a small number of strategies.

Morningstar ESG Commitment Level – Methodology Highlights

Funds

3 pillars*

Process

Resources

Asset Manager

Asset Managers

3 pillars


Philosophy & Process

Resources

Active Ownership

* Only 2 pillars for passive funds (Process and Asset Manager)

Morningstar ESG Commitment Level



Introducing the Morningstar ESG Commitment Level

Morningstar Research
October 31, 2020

Executive Summary
Morningstar's manager research team has conducted qualitative, analyst-driven research on active and passive investment strategies and their associated vehicles since 1986. From November 2011, this research has been expressed globally through the Morningstar Analyst Rating™ for funds in addition to an in-depth written report. The Morningstar Analyst Commitment Level supplements this work with a separate, qualitative, analyst-driven evaluation of investment strategies and asset managers from an Environmental, Social and Governance (ESG) perspective. The Morningstar ESG Commitment Level serves investors by:

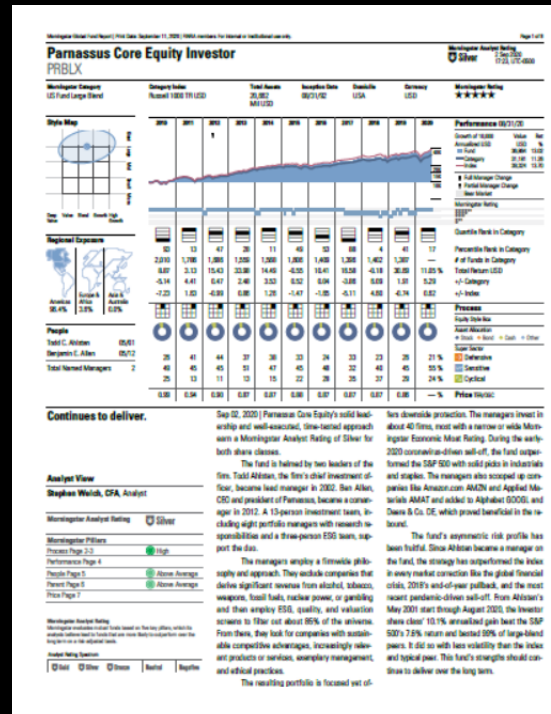
- Clearly defining the features that our analysts believe constitute a strong ESG investment program;
- Identifying those strategies and asset managers that our analysts see as best-in-class in the context of ESG investing;
- Calling out strategies and asset managers that are subpar in their approach to ESG investing;
- Monitoring strategies and asset managers for changes that could materially affect their Morningstar ESG

Introduction
Morningstar is committed to the principle of independence. We do not charge asset managers to produce the Morningstar ESG Commitment Level, nor do we permit asset managers to commission the Morningstar ESG Commitment Level from us. Morningstar commercializes its manager research by including its work in various products and services and through licensing its intellectual property.

Morningstar manager research analysts produce their analysis for the benefit of investors, advisors, and institutions, not asset managers. Morningstar separates its analyst team from any commercial relationships the company may have with asset managers in order to avoid any real or perceived conflicts of interest. Analysts are focused on providing in-depth, accurate, and useful analysis that will help investors identify best-in-class ESG investments and avoid ones that are subpar. Morningstar analysts will deliver their genuine opinion, whether favorable or unfavorable.

Important Disclosures
The content of Morningstar's analysis is governed by Code of Ethics/Code of Conduct/Policy, Personal Security, Trading Policy (if an investment fund), and Investment Research Policy. For information regarding conflicts of interest, please visit: <http://global.morningstar.com/ethicsdisclosures>

White paper in mid-Q4



Parnassus Core Equity Investor
PRBLX

Analyst View
Stephen Walsh, CFA, Analyst

Morningstar Analyst Rating Silver

Performance (as of 10/31/20)
 12-Month: 13.82%
 3-Month: 1.21%
 1-Year: 11.15%
 5-Year: 10.15%
 10-Year: 11.15%

Continues to deliver.
Sep 30, 2020 | Parnassus Core Equity's solid leadership and well-executed, time-tested approach earn a Morningstar Analyst Rating of Silver for both share classes.

Analyst View
The fund is helmed by two leaders of the firm. Todd Altman, the firm's chief investment officer, became lead manager in 2002. Ben Allen, CIO and president of Parnassus, became a co-manager in 2012. A 13-person investment team, including eight portfolio managers with research responsibility and a three-person ESG team, support the duo.

The managers employ a timeless philosophy and approach. They exclude companies that derive significant revenue from alcohol, tobacco, weapons, fossil fuels, nuclear power, or gambling and then employ ESG, quality, and valuation screens to their end about 85% of the universe. From there, they look for companies with sustainable competitive advantages, increasingly relevant products or services, exemplary management, and ethical practices.

The resulting portfolio is focused yet of-

Global Fund Reports in 2021



Analysts' Small Cap

Performance chart showing various metrics over time.

Stock list:

- 1. Amazon.com Inc. (AMZN)
- 2. Alphabet Inc. Class A (GOOGL)
- 3. Microsoft Corp. (MSFT)
- 4. Facebook Inc. (FB)
- 5. Apple Inc. (AAPL)
- 6. Tesla Inc. (TSLA)
- 7. Netflix Inc. (NFLX)
- 8. Oracle Corp. (ORCL)
- 9. Salesforce.com Inc. (CRM)
- 10. LinkedIn Corp. (LNKD)
- 11. Zoom Video Communications Inc. (ZM)
- 12. Slack Technologies Inc. (WORK)
- 13. Twilio Inc. (TWLO)
- 14. SendGrid Inc. (SGML)
- 15. Braze Inc. (BIAZ)
- 16. Braemar Resources Ltd. (BRMR)
- 17. Bristlecone Software Inc. (BRIS)
- 18. Bluebird bio Inc. (BLBD)
- 19. Bluebird bio Inc. (BLBD)
- 20. Bluebird bio Inc. (BLBD)

All Morningstar products in 2021

Madison Sargis, Morningstar

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Who is the Quant Team?



63

data scientists, researchers, technologists, engineers, and analysts around the globe

PhDs

Bioinformatics
Computer Science
Electrical Engineering
Finance
Fracture Mechanics
Information Technology

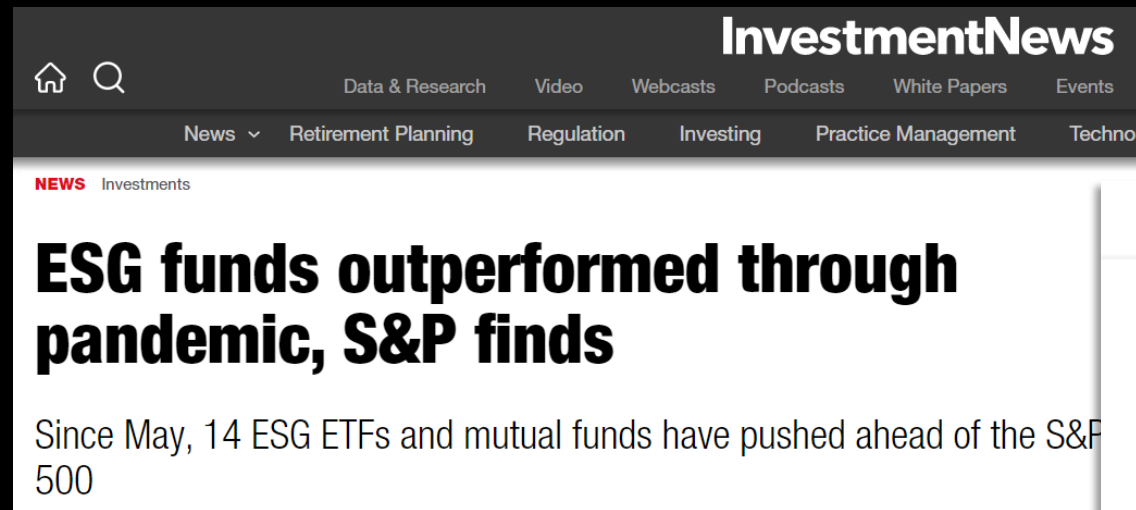
Mathematics
Mechanical Engineering
Policy Analysis
Statistics
Systems Science

Surging Investor Interest in ESG Funds



Source: Morningstar Direct. Data as of 6/30/2020. *YTD 2020 as of 6/30/2020. Included ESG Integration, Impact, and Sustainable Sector Funds as defined in Sustainable Funds U.S. Landscape Report, 2019. Includes funds that have been liquidated, does not include funds of funds.

ESG & Performance



InvestmentNews

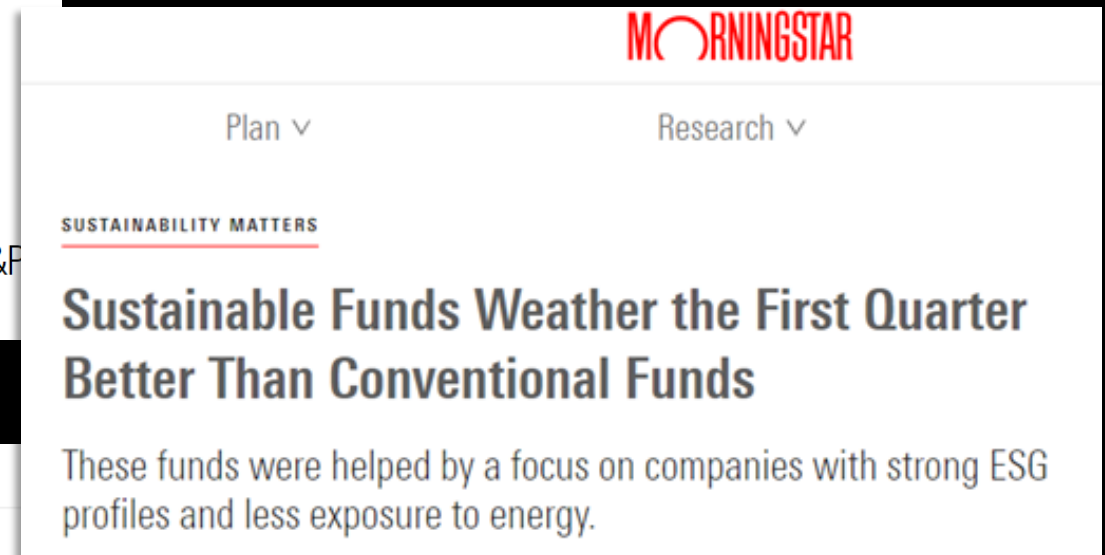
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ESG funds outperformed through pandemic, S&P finds

Since May, 14 ESG ETFs and mutual funds have pushed ahead of the S&P 500



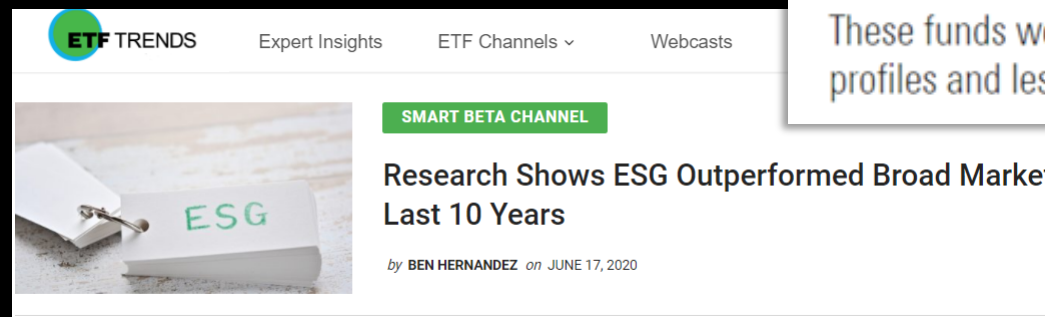
MORNINGSTAR

Plan Research

SUSTAINABILITY MATTERS

Sustainable Funds Weather the First Quarter Better Than Conventional Funds

These funds were helped by a focus on companies with strong ESG profiles and less exposure to energy.



ETF TRENDS Expert Insights ETF Channels Webcasts

SMART BETA CHANNEL

Research Shows ESG Outperformed Broad Market Last 10 Years

by BEN HERNANDEZ on JUNE 17, 2020

Preliminary Findings



So What?

- ESG information cannot be ignored
- Morningstar is committed to helping investors rigorously evaluate ESG
 - Morningstar ESG Risk Model
 - Publishing data on Quarterly Globe Performance

- 1 Why incorporating ESG into an investor's toolkit is no longer optional?
- 2 How to think more clearly about ESG Risk?
- 3 How Morningstar's suite of ESG Ratings can help?



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