Impact Investing at Laird Norton Wealth Management

Q&A with Gino Perrina and Jeanne Goussev

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Gino is LNWM's Chief Investment Officer and has close to 20 years of experience in investment analysis, strategy and risk management.

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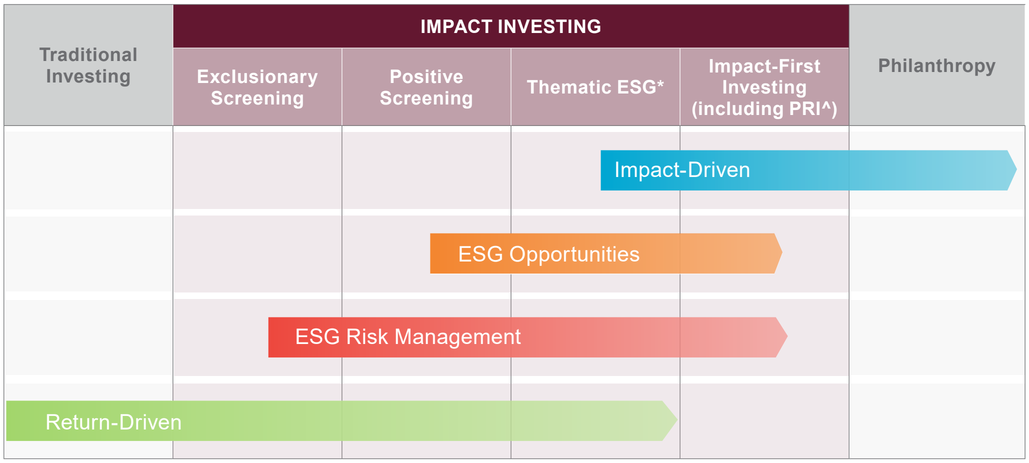
There is no single way to define impact investing, which over the decades has been known by many different names, including socially responsible investing (SRI) and ESG (Environmental, Social, Governance) investing. Regardless of the name, the goal is the same: To align your investments with what you value and what you think would benefit society. How do you start? To get specifics on how we partner with our clients to create impact with their portfolios, we sat down with LNWM's Chief Investment Officer Gino Perrina and Jeanne Goussev, LNWM Managing Director of Fiduciary Services.

Q: If someone wants to align at least some of their investment portfolio with their values, how do they start?

Jeanne: When we start to talk to clients about their investment needs and expectations in context of their values, we often refer to what we call the spectrum of investing (see below). On one end of the spectrum is traditional market investing, with return as the primary driver. Way over on the other end of the spectrum is philanthropy, where social good is the driver. Impact investing is the expanding area in between, where we help clients continue to invest for growth while also investing in the types of companies that align with their values.

Keep in mind that impact investing does not replace philanthropy, and many of our clients do both; it becomes another lever for doing social good with one's assets.



*Enviromental, Social, Governance (ESG) focused.
^Program Related Investment (PRI) is a loan, equity investment, or guaranty, made by a foundation in line with its charitable mission rather than to generate a return.

Gino: First, it's important to define what we mean by impact investing. It's investing in companies, funds and projects to generate both a measurable social benefit and a financial return. It's an established but evolving phenomenon whereby ESG investors play a role in influencing, when possible, structural changes in corporate citizenship domestically and abroad.

How do we help our clients get started? Often, we start by showing clients how their existing portfolios rate on a variety of Environmental, Social and Governance (ESG) factors (see box at right). By putting an ESG overlay on an existing portfolio, clients can see what they own in context of what is important to them. This report card, if you will, can act as a baseline for discussion. It can open up conversations on different ways to have an impact.

ESG Impact

Common non-financial factors used to evaluate and rank companies and projects:

Environmental

- Carbon emissions
- Renewable energy use
- Pollution/waste
- Sustainability initiatives
- Natural resource use

Social

- Worker health and safety
- Workforce diversity
- Gender pay equity
- Privacy/data security
- Community outreach

Governance

- Board structure and diversity
- Executive pay
- Anti-bribery/corruption
- Political lobbying/donations
- Tax strategy

Q: What are those different ways?

Gino: There are basically four major approaches to impact investing, and they are not mutually exclusive. In practice, to achieve each client's objectives we use a combination of these approaches implemented through a variety of investment vehicles:

1. **Exclusionary screening**, which is basically "do no evil," in which we work with fund managers to avoid companies that do not meet certain criteria (carbon emissions, gambling, etc.).
2. **Positive screening** ("do good"), whereby we include managers who invest in companies that rate highly on ESG factors (see box at right). Typically, these funds are either best-in-class relative to their peers or have some thematic approach to solving ESG challenges by investing in targeted companies and/or targeted market segments, such as alternative energy solutions.
3. **Direct investments in the private markets** — either equity or debt – in projects created to address a specifc social or environmental need, such as clean energy or affordable housing. For instance, we have a Renewable Power Fund (now closed to new investment) that participates in renewable energy projects with quantifiable impact around the globe.
4. **Activism**, whereby you as a shareholder can try to impact the behavior of specific public companies through proxy voting or by initiating/supporting shareholder proposals. Starting this year, the SEC seems to be taking a more passive stance on public companies' opposition to shareholder proposals, increasing the efforts required by advocacy groups.

Q: How do you help people decide how much to commit to impact investing?

Jeanne: This is a difficult question as it depends on each client's unique circumstances —their liquidity needs, time horizon, level of interest. We first work with each client to see how impact investing fits into their specific portfolio, and how this would affect their investment priorities. Many clients have specific return requirements. Clients who are foundations, for example, usually have mandatory payout rates of 5% annually (plus inflation), so we tend to aim for market-like returns when making impact investments. Other clients tell us: I want maximum impact and don't care as much about return. In those cases, we can propose a wider range of options.

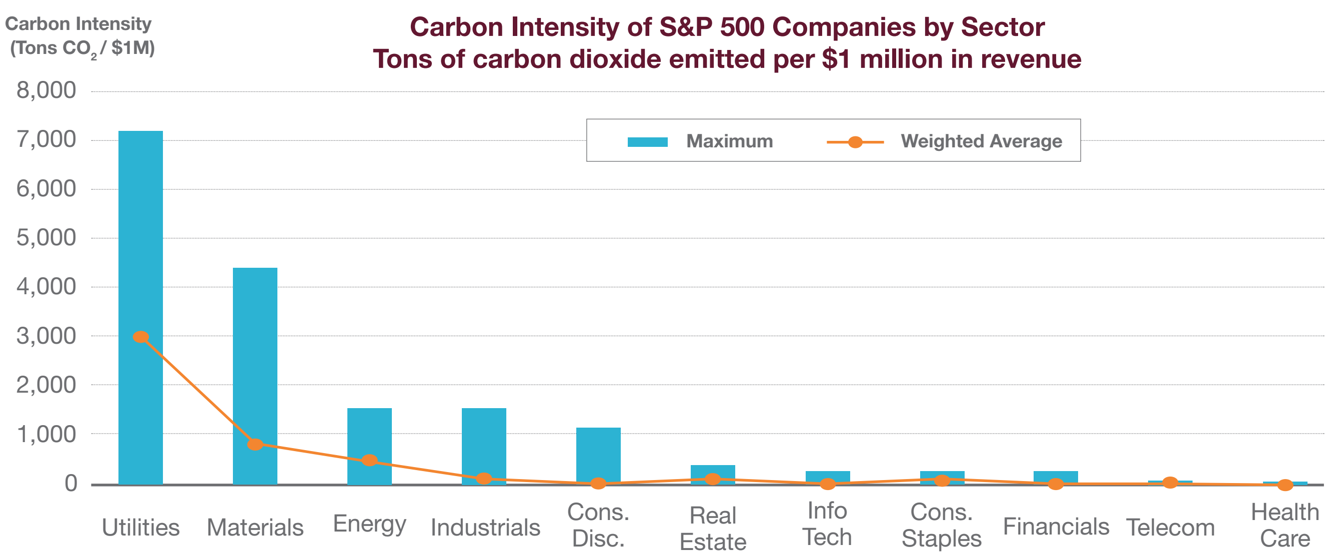
Usually, it's an incremental process. Most clients who take the first step into impact investing like the intentionality of it, and from there it usually builds. For instance, a portfolio that is free of fossil fuels is a big first step. Then clients often say, "I want to do more." Next steps could be a positive-screen portfolio that includes ESG funds with an emphasis on the issues they care about, and even further, direct investment in private funds that target specific issues, such as renewable energy or affordable housing.

In the trusts we manage, especially multi-generational ones, the clients who set up the trust can specify that they want us, the trustee, to prioritize impact investing and ESG, and we have conversations about how to do that.

Gino: In impact investing, you are investing for both return and impact. Usually, the higher the impact, the more of a focus on certain investments and sectors, and the lower the diversification. This can increase risk and affect potential return. So we advise clients on what the trade-offs are and how impact investments are likely to alter the risk/return profiles of their portfolios.

Q: Can you give us an example of how screening works?

Gino: Depending on the client, we may implement a negative screening strategy, whereby certain companies or industries are removed as possible investments. Or we can use a strategy known as integration, whereby companies that score highly on desired ESG attributes get more weight than those that score low. An investor can still have exposure to a certain sector, but that exposure will be in companies that meet certain criteria.



Source of Data: Parametric, MSCI ESG Research, S&P Dow Jones® Indices, 2018.

For example, the average carbon intensity of all companies in the S&P 500 is roughly 190 tons of carbon dioxide per $1 million in revenue, but this varies considerably by sector. The highest carbon emissions are concentrated in utilities, materials and energy (see chart on the previous page).

By eliminating most of the companies with high carbon intensity (say those with more than 500 tons of carbon emissions per $1 million in revenue), it is possible to create a portfolo with greatly lower levels of carbon intensity (in the range of 70% less) yet which still closely tracks the S&P 500.

Q: What are your criteria for impact investments?

Gino: Our framework for impact investing is grounded in the same well-proven investment principles we use for all our portfolios: Asset allocation is a key driver of return, diversification is key to limiting risk, and due diligence is imperative. These things do not change when we invest for impact.

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We are as rigorous, perhaps even more so, when doing due diligence on impact investments. Here, evaluating success goes beyond the traditional measures, risk and return. With clients, I often refer to this as the "utility of return" – the combination of financial return and social value of an investment. Defining utility for each of our clients helps define the appropriate strategy.

In doing due diligence, we sometimes come across impact investments whose managers attempt to use the ESG mantra to justify lower rates of return, or what I call "access cheap capital." Of course, there are instances when the social good from an investment might well justify a lower rate of return. However, we begin every diligence process with the premise that an investor does not have to give up return, and that the potential return on any investment should justify the risk.

Q: How do you evaluate publicly available ESG funds?

Gino: Be it an ESG index fund or an actively managed fund, we look to see which ESG ratings the fund managers are using, and how they integrate those factors into their investment process. There are now at least four major commercially available ESG ratings services, in addition to internally developed databases, that managers use to evaluate companies and other investments.

The ESG ratings services have an incentive to differentiate their ratings and methodologies; otherwise just one rating service would suffice. We point out those rating differences as much as possible to clients, as well as what they're based on. For instance, a fossil-fuel-free fund might include oil and gas pipelines (but not producers) and still make it into a fund. We really do dig down into the ESG ratings systems and the actual holdings of our asset managers to make sure they are doing what they claim to be doing, and that this aligns with the kind of impact our clients want to prioritize.

Q: For ESG funds that are actively managed (not passive index funds) how do the managers actually apply ESG ratings to make investment decisions?

Gino: Of the three impact areas – Environmental, Social and Governance – governance is the least ambiguous partly because it is more narrowly focused (preventing self-dealing, conflicts of interest, etc.), and good governance is something that pretty much all asset managers agree is necessary for a company to function and perform well.

Social factors are the most difficult to apply because they are the least regulated and wide-ranging – from gender pay equality, to workforce diversity, to community outreach and volunteerism. So selection here is more nuanced and subjective, as each manager has their own approach to addressing various social issues.

Environmental falls somewhere in between. For the most part, environmental ratings steer ESG managers to invest more in industries like technology, which is inherently less polluting than say utilities. In the past decade, technology has been a great sector in terms of earnings growth and stock price performance, and so the tech overweight by ESG funds has proven quite beneficial.

Additionally, new technology is helping companies address various environmental issues, thereby providing ESG managers with more investment options. For example, ESG managers can invest in utility and energy companies that get much or most of their energy mix from renewable sources, as opposed to avoiding these industries altogether.

Q: How can a family implement impact investing if individuals differ on if or how to do it?

Jeanne: Members of the same family can have different values and objectives when it comes to impact investing. This opens up a conversation that we facilitate by showing what is possible and how to get started incrementally. Talking about impact is a great way to share ideas and knowledge and get younger people interested in managing money because they can see how their values are able to align with their portfolio design. The stories that come from the investments they hold cannot help but draw them in when that alignment exists.

Growth in Sustainable Investing Assets ($ Billions)

Region	2016	2018
Europe	$12,040	$14,075
United States	$8,723	$11,995
Japan	$474	$2,180
Canada	$1,086	$1,699
Australia / New Zealand	$516	$734
Total	**$22,890**	**$30,683**

Note: Asset values are expressed in billions of US dollars. All 2016 assets are converted to US dollars at the exchange rates as of year-end 2015. All 2018 assets are converted to US dollars at the exchange rates at the time of reporting.

Data Source: Global Sustainable Investment Alliance.

Q: What is the future of impact investing?

Gino: I think more and more asset managers will incorporate ESG criteria into their investment process. Here at LNWM, we are expanding our ability to propose new direct impact investments to clients, since there are now many more targeted options with quantifiable impact. We continue to seek out ESG funds in areas that are more challenging but very important from an ESG perspective, such as emerging markets, and to educate our clients about impact, because the tools and possibilities are constantly evolving.

Jeanne: I think impact and ESG investing will continue to grow in appeal, getting more people, and especially younger generations, to pay attention to their investments and adding to the standards by which we measure success, or what Gino would call utility. Impact investing is a sea change happening in our lifetimes, and it's exciting to be part of it.

About the Authors

Gino Perrina, Ph.D., CFA® is the Chief Investment Officer at Laird Norton Wealth Management and has more than 15 years of experience in investment analysis, strategy and risk management. Prior to joining LNWM in November 2015, Gino was a Managing Director at BlackRock Inc. in New York City, responsible for managing risk in the firm's alternative asset portfolios (+$100 billion in total investment). He was also Managing Director of Research and Risk Management at BlackRock Alternative Advisors (2006 to 2010), Head of Fixed Income Research at Russell Investments (2010 to 2012) and a fixed income analyst and portfolio manager at Microsoft and IAC/InterActive Corp.

Jeanne Goussev, JD, CTFA is managing director of fiduciary services at Laird Norton Wealth Management. Bringing to her work nearly two decades of experience in trusts and wealth planning, Jeanne oversees LNWM's fiduciary team and manages our largest trust relationships. She is frequently sought out for her expertise on a wide variety of estate, philanthropic and tax planning matters. She is passionate about working at LNWM and the alignment between advising multiple generations within families on behalf of a firm that has been family owned for more than 50 years.

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