Targeted Impact: Three New Sustainable Investing Solutions from LNWM

By Ronald G. Albahary, CFA® and Josh Hile, CPA, CFA®

RONALD G. ALBAHARY, CFA®
Ron is Chief Investment Officer at Laird Norton Wealth Managemt

JOSH HILE, CPA, CFA®
Josh is Director, Investment Strategy & Research at Laird Norton Wealth Management

In the past two years, we've seen a growing interest in sustainable investing among our clients as well as investors in general. The two likely catalysts: climate change is becoming more real in the form of severe weather-related events; and the high toll of COVID-19 has opened people's eyes to the extent of socioeconomic inequality.

In 2021, a major focus for the LNWM investment team was to develop targeted ways to invest in positive environmental and socioeconomic change. The result is three new "thematic solutions" for LNWM clients, two of which are a collaboration with sustainability leader Calvert Research & Management. We sat down with LNWM CIO Ron Albahary, CFA, and Josh Hile, CFA, Director, Investment Strategy and Research, to find out more.

Q&A with Ron Albahary and Josh Hile

What are thematic sustainable investing solutions and why now?

RON: We set out to establish a thematic framework that targets a compelling set of environmental and social impact issues, seeks a competitive risk-adjusted rate of return over a full market cycle, and lowers the barrier to entry for investors who don't necessarily have access to opportunities in the private market but want to allocate a portion of their portfolio to sustainable impact.

The operative word here is "targeted." Currently, most ESG investments are general in scope: ESG managers (indexes and actively managed funds) use third-party ESG ratings to find publicly traded companies with relatively high composite scores on Environmental, Social, and Governance metrics.

We believe investment decisions driven by ESG scores are not an effective way to drive large-scale change on the environmental and social issues that are top-of-mind for our clients. More broadly, though, we see a future movement towards maximizing "return on impact" as well as return on investment. To do that, capital needs to be mobilized in a targeted way in the public markets to affect large-scale change in public companies.

"Capital needs to be mobilized in a targeted way in the public markets"

JOSH: Advances in data gathering and analysis have made it possible to zero in on which companies are actively implementing changes at the operational level, for example, to shift to clean-energy sources, or to diversify their management teams, or help to fund things like access to capital, affordable housing and education in the regions they operate in. This allows for sustainable investing to become more targeted. And it has also provided us with better analytical tools we can use to gauge how closely our clients' portfolios are aligned with the issues they care about most.

What is unique about LNWM's thematic solutions and how are they structured?

JOSH: We're focusing on people as well as planet, with two of our thematic solutions targeting socioeconomic impact: Empowerment and Community Health & Wellness. Currently there's a dearth of options in social impact investing via public equities. So early last year, we approached Calvert, a pioneer in sustainable investing, and worked with them to define criteria for social impact and how to implement that through separately managed accounts (SMAs) at Parametric [Portfolio Associates], a leader in portfolio customization.

From the start, we wanted our thematic solutions to align with the United Nation's Strategic Development Goals (see box). And, as a whole, they align with all 17 UN SDGs. For Empowerment, we

UN Sustainable Development Goals (UN SDGs)

In 2015, the United Nations adopted 17 core Sustainable Development Goals (SDGs) to provide a blueprint for global issues that need to be addressed for the well-being of people and planet. Although the SDGs were intended to guide nations, they are now widely recognized by investment managers as guideposts for making impact investments.

For example, LNWM's Empowerment solution targets seven SDGs (blue frames below), with the investable goals shown in orange frame: SDG 1: No Poverty, SDG 3: Good Health & Well-being, SDG 5: Gender Equality, SDG 8: Decent Work and Economic Growth, SDG 10: Reduced Inequalities, SDG 16: Peace, Justice and Strong Institutions, SDG 17: Partnerships for the Goals. (The four non-investable goals are likely positive outcomes of progress on investable goals.)

focused on three areas (1) DEI – companies that are increasing diversity, equity and inclusion in their workforce through hiring, promotion and other policies; (2) companies providing access to financial products and services for underserved populations; and (3) companies that not only treat their own workers humanely but also demand that all their suppliers and other input providers also adhere to human rights policies. We think a focus on these three issue areas is a way to help reduce rising inequality and create opportunity for more people on a global scale.

Community Health & Wellness has a broader scope; it focuses on affordable housing; product responsibility; health care and nutrition; quality jobs; education and access to basic services such as clean drinking water, sanitation, energy, waste collection and broadband Internet. We targeted these issue areas for their potential to create strong and vibrant communities. Initially, the focus will be on quality jobs, healthcare and product responsibility since these are the most investable areas.

RON: Working with Calvert enables us to offer clients exposures that have been thoroughly vetted, digging far deeper below the surface of "headline metrics" to determine material impact, and which consider the systems-level thinking (the interrelationship of environmental and social challenges) required to invest in companies for positive impact.

Both of our social impact solutions – Empowerment and Community Health & Wellness – are SMAs [separately managed accounts] made up of 150 to 200 publicly traded equities selected by Calvert Research & Management, using a wide variety of criteria to evaluate performance on the issues being targeted. Calvert will review holdings semi-annually and update based on their research results. The companies selected by Calvert range from multinationals to small and mid-size firms, but the portfolios will not be as diversified as a global equity index. So there might be higher volatility and returns are not geared to track a particular index.

How are you applying thematic investing to address environmental issues?

JOSH: We're just as excited about Planet Sustainability & Innovation (PSI) because we believe that positive environmental change requires work on three interrelated fronts: (1) infrastructure and renewable energy; (2) water; and (3) environmentally related tech innovation. Our solution is comprised of three strategies that complement each other and

GAUGING IMPACT

The key characteristics LNWM looks for in strategies that target positive environmental and/or social impact:

INTENTIONALITY – Each solution has set specific goals, often aligned with specific UN SDGs (see box on previous page), that are widely recognized guideposts for sustainable investing.

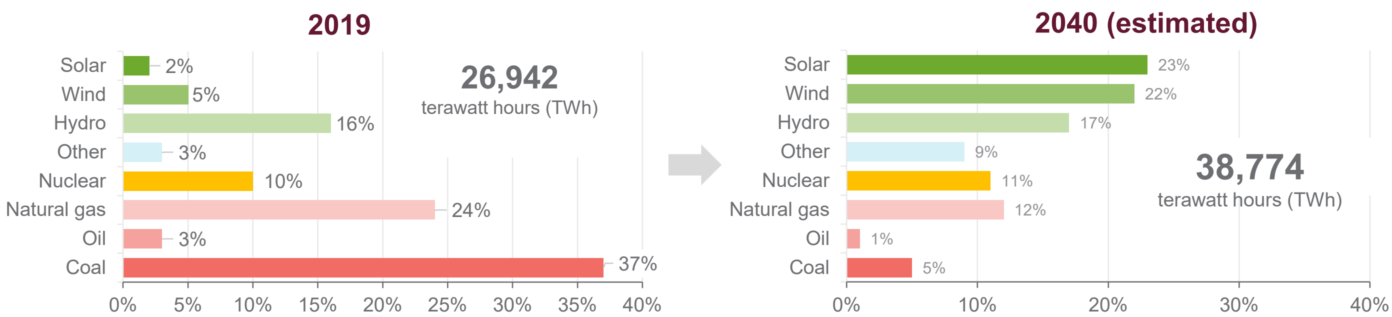
CONTRIBUTION – We seek investment managers that, in addition to investing in companies leading efforts in targeted issue areas, engage with portfolio companies by encouraging them to do more and take action through shareholder resolutions and other measures when insufficient progress is being made.

MEASUREMENT – Since measuring impact outcomes is challenged by inconsistent data and frameworks, we seek asset managers committed to finding meaningful ways to define, report and improve the metrics within their issue areas, be it renewable energy usage, workplace diversity/opportunity, or investment in affordable housing and healthcare.

specialize in each issue area, all of which have actively managed public equity mandates and have been vetted by our comprehensive due diligence process for intentionality, contribution, and measurement (see box on previous page).

We are after positive change, not just companies that have top ratings on ESG metrics currently. Therefore, our Planet Sustainability & Innovation solution will have a fairly large allocation to electric utilities transitioning to renewable energy (wind, solar, biomass) and away from fossil fuels (coal, oil and natural gas). Currently utilities, in general, are among the lowest rated on ESG metrics and have been stripped out of many ESG portfolios. But we think that is a mistake when considering their ability to drive true return on impact by reducing greenhouse gas emissions as they execute on energy transition away from fossil fuels.

Estimated Shift in Global Energy Sources 2019 vs. 2040



Source: Wellington Investment Management, World Energy Outlook 2020 Sustainable Development Scenario, International Energy Agency.

Water preservation and desalinization will also become increasingly important given global warming. And the technology for things like energy storage will be key as we move toward more electrification. Since we view all of these areas as growth areas, the fund managers we work with in this space have the experience and methodology to zero in on the leaders in each sector.

How will you measure impact?

RON: Measuring impact is the most challenging component of sustainable investing given the lack of standardized data and data frameworks. As such, measuring impact will involve a multi-dimensional approach incorporating a variety of data sources and insights. For example, our PSI thematic solution will provide clients with data on exposure to climate innovation and efficiency, power merchants and generation, renewable energy, the transmission grid, access to and innovation related to clean water, and resource sustainability such as agricultural productivity.

Where we can quantify and provide reliable data on factors such as carbon intensity or greenhouse gas emissions, we will. Finally, we expect to provide a view on level of alignment with UN Sustainable Development Goals and some relative-to-benchmark comparisons of exposures, ESG risks, and positive impact on people and planet. We see impact reporting as an evolutionary work-in-progress as the data sources improve and as we receive feedback from clients.

JOSH: We're working with Calvert Research & Management on our social impact solutions because we firmly believe that Calvert has the leading-edge research capabilities required to gauge impact and keep improving on that. Just as important, Calvert can drive impact through its in-house corporate engagement team that pro-actively advocates for material change at portfolio companies. We believe Calvert's engagement efforts are effective because they are well-informed, focused on long-term outcomes and built on collaboration AND escalation. If a company is not responding meaningfully on an important issue, the Calvert team is willing to apply pressure by filing shareholder resolutions, alerting other investors to key concerns and speaking out in the media.

What are you looking forward to in 2022?

JOSH: Top of everybody's agenda, I think, is working with the investment team at Wetherby Asset Management, the newest member of the Laird Norton group of companies. Wetherby is a leader in impact investing, and we have much to learn from each other as we collaborate on developing new tools and investment platforms in sustainable investing.

> "We are after positive change, not just companies with top ESG ratings"

RON: Totally agree with Josh. We will be partnering with Wetherby and our clients to drive a new type of "ROI" – return on impact. I firmly believe that investing in sustainability, from sustainable agriculture, energy efficiency, to racial inequality and workforce training (and many other issue areas), is likely to pay big long-term dividends, both financial and non-financial. We are at an inflection point because of investor demands on companies, companies responding to those demands with concrete actions, and more data and analytics available to keep companies accountable. All this will support the massive shift that is required to protect the environment and reduce socioeconomic inequality.

ABOUT THE AUTHOR

Ronald G. Albahary, CFA® is Chief Investment Officer at Laird Norton Wealth Management. As the head of LNWM's Investment Strategy and Research Group, Ron determines the firm's investment strategy, directs the investment selection process, and works in tandem with LNWM's client services teams to deliver investment solutions structured to attain each client's unique goals. Prior to joining LNWM, Ron served as CIO or CEO at regional investment firms focused on ultra-high-net-worth families and foundations. Earlier in his career, he held leadership positions in the private client business of major global financial institutions, including Merrill Lynch and Northern Trust Private Bank. Ron has a degree in economics from the Wharton School at the University of Pennsylvania and currently serves as advisor to the Center for High Impact Philanthropy at the University of Pennsylvania.

Josh Hile is a Director within Laird Norton Wealth Management's Investment Strategy and Research Group. He is responsible for analyzing developments in global equities markets and providing recommendations to LNWM's Chief Investment Officer, as well as conducting ongoing due diligence and monitoring of equity asset managers, including mutual funds, separately managed accounts and limited partnerships. Josh is a Chartered Financial Analyst® (CFA®) and a Certified Public Accountant. He earned his MBA at the University of Washington.

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801 Second Avenue, Suite 1600, Seattle WA 98104   206.464.5100   800.426.5105   lairdnortonwm.com

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