Why Impact? Why Now?

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Investing with impact is not a new idea. Throughout the history of the financial markets, some form of impact investing has existed. From the Quakers back in 1898, through divestment in South Africa, the screening of tobacco and firearms, and the divestment of fossil fuels most recently, over time investors have found ways to express their values through investment capital as a way to advocate for change (see figure 1). In the past, adoption had not spread beyond a few passionate groups and mission-focused organizations. In the past decade, however, adoption has accelerated and, thanks to several compounding factors, demand has grown exponentially.

The term "impact investing" has been used broadly to define a spectrum of investment options across the public and private markets with varying impact emphasis. Impact investing can take the

Figure 1

THE TRADITION OF INVESTING WITH IMPACT

Pre-1900	1898	Quakers Friends Fiduciary Corporation founded and adopts no weapons, alcohol, or tobacco investment policy
1901–2000	1968	Ford Foundation creates Program-Related Investments to place endowment funds directly into income-generating project with a social purpose
	1973	Interfaith Center on Corporate Responsibility founded and files first shareholder resolution
	1977	Congress passes Community Reinvestment Act to reduce discriminatory credit practices against low-income neighborhoods; Pax World launched first socially responsible investing mutual fund; Sullivan Principles of Action and Divestment announced due to apartheid in South Africa
	1984	US SIF, the sustainable investing industry association, founded
	1990	Domini Social Index created (now MSCI KLD 400 Social Index)
	1993	$625 billion screened to exclude investment in South Africa as a result of apartheid
2001–2010	2000	Norway Government Pension and the United States' largest pension, CalPERS, commit to 100% integration of sustainability over 15 years
	2006	Rockefeller Foundation launches major impact investing approach and the term emerges globally; United Nations Principles for Responsible Investment launched—assets under management (AUM) by signatories is $4 trillion
	2009	Bloomberg adds significant sustainability news and ESG data coverage to its platform
	2010	Harvard launches Initiative for Responsible Investment (IRI), previously at Boston College
2011–Present	2011	White House convenes investors, policymakers, and entrepreneurs focused on impact investing; Sustainable Accounting Standards Board launched and Michael Bloomberg named chair in 2014
	2012	350.org catalyzes fossil fuel divesting campaigns across college campuses; US SIF Trends Report: $3.74 trillion in U.S. sustainably managed assets
	2015	Pope Francis releases Encyclical Letter that includes call to action on climate change mitigation; United Nations Principles for Responsible Investment AUM by signatories reaches $59 trillion, a 29% year-on-year increase
	2016	US SIF Trends Report: $8.7 trillion in U.S. sustainably managed assets, representing 33% growth from 2014

Source: Morgan Stanley Wealth Management (2017) form of restriction screening; environmental, social, and governance (ESG) integration; thematic exposures; and targeted forms of private investments (see figure 2). Similar to traditional investments, impact investments can be delivered at low minimums as well as higher-minimum custom-fit private solutions, and there is much variation across offerings. Unlike traditional investments, impact strategies utilize non-financial data as well as financial data in the investment selection process.

The demand for sustainable investing strategies has risen most dramatically in the past five years. In the United States, professionally managed sustainability-oriented strategies grew by 76 percent in just the two years between 2012 and 2014—with $6.57 trillion accounting for more than one out of every six dollars under professional management in the United States. Before 2012, there had been a five-fold increase in the seven years prior.[1] In a 2017 poll conducted by Morgan Stanley's Institute for Sustainable Investing, 75 percent of individual investors said they are interested in sustainable investing, 85 percent of millennials said they are interested, and 71 percent of those polled said they believe companies with leading sustainability practices may be better long-term investments.[2] Evidently, the growth of investing with impact has momentum.

MORE DATA PLEASE

Recent statistics around investing with impact are consistent with other consumption trends toward values alignment and greater transparency. With the ability to research information via mobile devices, consumers have detailed information at their fingertips to make informed choices about how they spend their money. For example, 10 years ago independent documentaries such as *Food, Inc.* (in 2008) and *King Corn* (in 2007) spurred an overhaul of the production and use of high fructose corn syrup (HFCS) via the widespread dissemination of information about the adverse health effects of HFCS, the products that contain it, and the big businesses that profited from its production. Growing

Figure 2

INVESTING WITH IMPACT

MINIMIZE NEGATIVE IMPACT → TARGET IMPACT

	RESTRICTION SCREENING	ESG INTEGRATION	THEMATIC EXPOSURE	IMPACT INVESTING
IMPACT PRIORITIES	Managing exposures by intentionally avoiding investments generating revenue from objectionable activities, sectors, or geographies	Proactively considering ESG criteria alongside financial analysis to identify opportunities and risks during investment process	Focusing on themes and sectors dedicated to solving sustainability-related domestic and global challenges	Allocating to investment funds focused on private enterprise structured to deliver specific positive social and/or environmental impacts
CHARACTERISTICS	Differentiated by restriction criteria and degree of shareholder advocacy Not proactively seeking environmental and social impact	Differentiated by ESG integration process and degree of shareholder advocacy May also include screens	Differentiated by macroanalysis, sustainability research, and sector focus	Differentiated by impact approach, regional focus, liquidity, and impact reporting May have investor restrictions
INVESTMENT EXAMPLES	Mutual fund that excludes companies from buy universe (e.g., tobacco, firearms, coal mining companies	Separately managed account incorporating analysis of ESG performance into stock selection process	Exchange-traded fund tracking index of renewable energy companies	A private equity fund focused on emerging consumers or project-level renewable energy investment
	PUBLIC AND PRIVATE MARKETS			PRIVATE MARKETS

Source: Morgan Stanley, "Investing with Impact: Creating Economic, Social and Environmental Value" (2017), https://www.morganstanley.com/assets/pdfs/articles/investing-with-impact.pdf awareness, advocacy, and then consumer outrage forced food producers to provide details on labels to meet the demands of the market. With more information about what was within the products consumers were eating, consumers responded by decreasing their consumption of products with HFCS.[3] Now, in grocery aisles across the United States, detailed nutritional information has become the norm, and what's more, many food products tout a lack of HFCS. Thus consumers have demonstrated a preference for products that offer positive long-term benefits on several levels, and the market has had to respond accordingly. This is just one simple example of how consumer trends can shift the status quo of an entire industry.

Investment trends are following consumption trends. Traditionally, investors have decided to buy shares or finance companies, both public and private, on the basis of financial data. Asset managers and retail investors alike have relied on financial factors to determine what to buy, when to buy it, and in what quantity. As of late, information beyond the customary balance sheet has become available to portfolio managers. Reports on a company's ESG practices, or non-financial data, are becoming more accessible and more standardized. A recent study by the CFA Institute finds that 73 percent of all portfolio managers incorporate non-financial data into their decision-making process.[4] As of 2016, assets defined as "sustainably invested" accounted for one out of every five dollars under professional management in the United States.[5] Impact investing strategies still represent a minority percentage of assets in relation to traditional investments, but the majority of portfolio managers utilize non-financial data, so clearly there are legitimate analysis reasons for incorporating non-financial data into the selection process.

Plus, investors are technically consumers of investment products, therefore it's fair to assume that at some point consumers will apply the same level of scrutiny to investments that they do to all the other products they purchase. Like the food industry, the desire of a small group of impassioned consumers (that is, investors) could lead to wholesale changes to disclosures and data for the financial industry beyond what is offered in an annual report. It's easy to assume that those products that are able to demonstrate positive long-term benefits on several levels are likely to perform better than those that are unwilling to adapt.

NO SACRIFICE TO THE UPSIDE

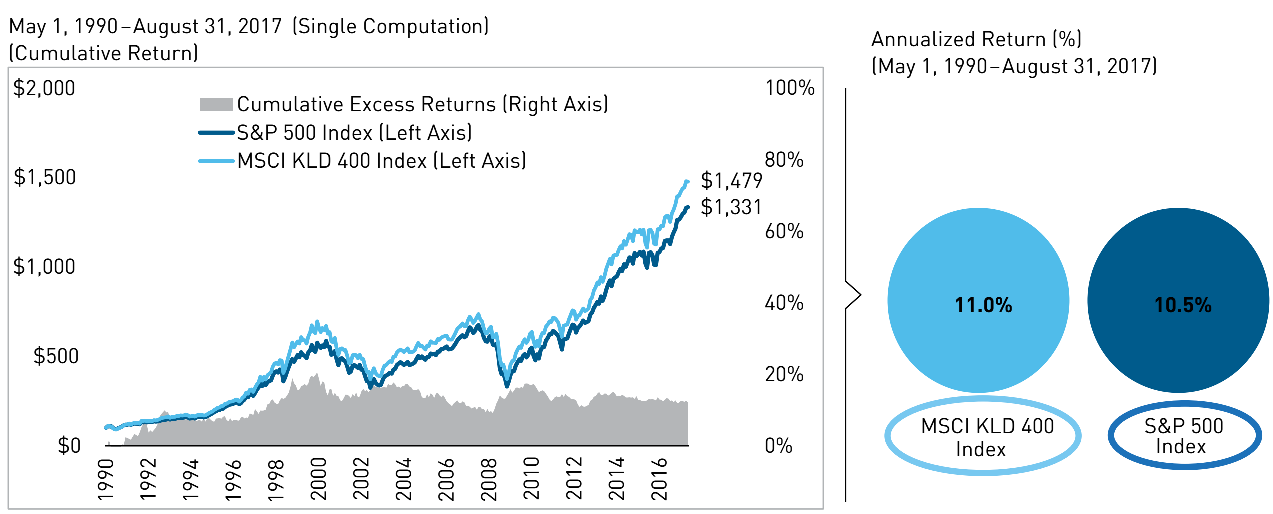
With the recent swell of interest and changes in consumption trends, why only in the past 10 years has growth of impact investing been so dramatic? The likely culprit is a myth upheld by advisors and investors that incorporating non-financial data in the investment process does not lead to favorable results. That myth has been dispelled by multiple reports with varying time frames. For example, in a recent study by Morgan Stanley's Institute for Sustainable Investing, the data show that the opposite is true. When comparing the MSCI KLD 400 Index to the S&P 500, sustainable strategies often have performed in line with or better than their traditional counterparts (see figure 3).

In addition, Deutsche Bank as well as three professors from Harvard Business School have produced research showing that companies with positive ESG

Figure 3

INVESTING WITH IMPACT HASN'T COMPROMISED PERFORMANCE

The MSCI KLD 400 Index tracks companies that meet best-in-class ESG criteria and has delivered favorable performance with comparable risk relative to the S&P 500 Index.



Source: Morgan Stanley Wealth Management (2017) attributes often are better financial performers.[6] In sum, sustainable leaders across industries are demonstrating the ability to compete, and they often outperform their peers over the long term.

WHY NOW?

GLOBAL IMPERATIVE

The numbers regarding our future sustainability challenges are crucial to any conversation regarding investing with impact. In 1900, the world population was estimated at 1.7 billion and by 2000 had increased to approximately 6.1 billion. By 2050 it is forecast to reach 9.7 billion. As the world's population grows, the global demand for resources such as water, food, and energy are projected to rise as much as 55 percent, 60 percent, and 80 percent, respectively, by 2050.[7] Regardless of one's political views, the facts surrounding population growth and the scarcity of resources are indisputable. Companies that either profit by working to resolve the globe's sustainability challenges or maintain this focus as part of the corporate culture inevitably will have an advantage over others. In fact, according to a report by the World Business Council for Sustainable Development, by 2050, the business opportunities for sustainability-focused companies are expected to be between $3 trillion and $10 trillion annually, or up to 4.5 percent of global GDP.[8] The current state of the globe demands conversation around how each person can have the most impact in every facet of life, including investing. As the collective consciousness becomes more aware of this global imperative, people will respond by asserting their worldviews with how they spend and give money and how they invest money, and impact investing is the natural solution.

WEALTH TRANSFER: WOMEN AND MILLENNIALS

The call for impact investments has been growing in the past decade, and women and millennials account for most of this growth. The Sustainable Signals poll conducted by Morgan Stanley's Institute for Sustainable Investing asked, "How interested are you in sustainable investing, which is the practice of making investments in companies or funds that aim to achieve market rate financial returns while pursuing positive social and/or environmental impact?" Among women, 84 percent said they were interested; among men, 67 percent said they were interested. In the same poll, 89 percent of millennials versus 80 percent of the overall population said they were likely to invest in a fund they could tailor to their personal interests and goals.[9] Obviously, the two segments of the population that have demonstrated the greatest interest are women and millennials. Advisors ought to pay attention because these are also the two groups most likely to be in charge of the majority of wealth over the next few decades.

The statistics regarding the present-day generational wealth transfer are equally persuasive. As of 2016, more than $12 trillion of financial and non-financial assets are shifting from those born in the 1920s and 1930s to baby boomers—those born between 1946 and 1964. Over the next 30 to 40 years, an additional $30 trillion in financial and non-financial assets will pass from boomers to their heirs in North America alone.[10] The wealth transfer from boomers to their children could be almost three times what they inherited themselves.

The data regarding the transfer of wealth to women is equally impressive. In the United States, women exercise decision-making control of more than $11.2 trillion, or 39 percent of investable assets, according to the Center for Talent Innovation's report on female investors. By several estimates, women are expected to control two-thirds of total wealth over the next 15 years.[11] When looking beyond the United States at the transfer of wealth to women globally, women are expected to inherit 70 percent of the $41 trillion in intergenerational wealth transfer expected over the next 40 years.[12]

The Center for Talent Innovation survey also reported on the investment preferences of women. It found that 90 percent of women agreed that "making a positive impact on society is important" and, of those interviewed, 77 percent of women said they want to invest in companies with diversity in leadership. In addition, the survey identified "significant discrepancies between men and women's desire to fund gender equality, diversity in leadership and the environment."[13] Because women and millennials clearly have expressed their desire to align their investments with their values, and roughly two-thirds of the nation's wealth will be in women's hands by 2030[14] and $30 trillion will pass to the heirs of boomers by 2050,[15] it is apparent advisors should take note and evolve their practices accordingly.

FILTER EFFECT

Consumers also have shown a desire to align their values with their purchases. For example, many consumers expect and depend on label information listing ingredients or nutritional content when evaluating a food product. Some consumers also are demanding more information about how products are manufactured, how materials for products are sourced, and the long-term effects of a product on the environment. Environmentally conscious consumers often will consider the packaging of the product and whether it can be recycled or will end up in a landfill or pollute the ocean. For consumers who incorporate their values into how they spend their money, access to detailed information is table stakes; having a corporate sustainable report, a consistent corporate culture, a demonstrated authenticity of brand, and a sustainable product through creation, development, purchase, and recycling, have become the new standard. As described in the recent study by the Institute for Sustainable Investing, millennial investors are nearly twice as likely as the general pool of investors to have made a purchase because of a brand's environmental or social impact, and three times more likely to work at or apply to a company because of its stance on issues.[16] Millennials continuously show a pattern of values alignment in the way they decide on what to buy and where to work. Naturally, as they become a more formidable segment of the population that controls the wealth of the nation, millennials are expected to utilize this same values-based framework in their investment and wealth management strategies.

Current wealth transfer encompasses $12 trillion being passed to boomers, and millennials represent a small minority of investors nationwide. Still, as of 2016, millennials represented the majority of the workforce[17] and, as they become a larger share of 401(k) participants and begin to represent the majority of new investors into 529 plans, demand will surge for investments that focus on values alignment. Impact investments with lower minimums designed for investors in the accumulation phase are likely to benefit significantly as millennials enter these stages of life.

VOTE WITH YOUR DOLLARS

For most Americans, the state of the nation's democracy and politics is a huge concern and many clients want to have more influence in all aspects of their lives. By investing in companies that align with personal values, and by using shareholder advocacy to influence corporate change, investors can act now rather than wait several years for the next big election. Investors can demonstrate support for a product, process, or vision just by owning or financing certain companies or initiatives. And, by refusing to own or finance certain companies, investors know none of the capital in their possession supports enterprises that do not align with their values. Advisors can readily engage in meaningful conversations with clients about their worldviews and how they can vote with their dollars by investing with impact.

SAFEGUARD AGAINST DIGITAL DISRUPTION

Across all industries digital disruption has displaced and overtaken all but a few specialized professions. What decides which service perishes or survives? For example, when it comes to housecleaning, child care, and health care, the masses have spoken: A digital solution will never outsource an actual person, even at a higher price. What is the common factor between services as disparate as housecleaning and health care? Trust. Discerning customers just won't allow strangers to clean their homes, watch their children, or treat their illnesses without first establishing trust.

In the financial services industry, advisors are facing a new reality in which a digital service is valued by the marketplace as low-cost or free and service provided by a person may be priced at a premium. To remain on the high end of the value spectrum, advisors no longer can offer only solutions that can be offered digitally (such as asset allocation guidance, investment selection, financial modeling). Instead, to demonstrate high value, advisors now must connect with every client on a more personal level. Impact investing is the one solution that a digital offering cannot easily offer. By having an in-depth values-based conversation about the impact clients want to have with their investments, advisors can differentiate themselves via customization and personalized counsel.

For most advisors, learning about a new product or investment philosophy is easy. The hardest shift for advisors may be developing the skills necessary for personalized counsel such as learning to listen and prompting for a deeper discussion of values, because this has not been the emphasis for the previous generation of advisors. In past decades, a typical conversation with clients would center on investments, performance, and economics because this information was not generally available to the public. Advisors were the source of information for clients in all things related to finance; therefore, they were expected to do the majority of the talking. Now, with information readily available to all investors because of the Internet, high demand for low-cost passive investments, and a desire for more customized counsel and connection, the pendulum has swung in the opposite direction. It is now more important for an advisor to listen instead of talk. Therefore, to earn the highest price for financial service, advisors must take every opportunity to get to know clients on the most human level, become their conduit to the world of finance and economics, and offer a solution that is a complete reflection of the client's life, goals, and values. Impact investing is one of the few solutions that demonstrates the value of this kind of relationship, and it immediately shows the investor why having an advisor is far superior to any digital offering.

WHY NOT?

Over time, the purpose of investing for clients has mostly been to build wealth, provide for a certain lifestyle and freedom, and potentially secure a bright future for loved ones. Now, given the current state of the globe and the scarcity of resources, securing a bright future for ourselves and our loved ones is requiring more thought and consideration. In life, there are many examples of shifting trends that demonstrate considerations being made by the masses to change the trajectory of the planet for a better future. With myths of underperformance dispelled and the business environment in favor of deeper human connection, advisors can offer investing with impact to clients as one more way they can express their worldviews and align their values in one more facet of their lives.

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