


The Portfolio Smile

Portfolio Sustainability and a New Approach to Client Conversations



American consumers have never been more informed about their choices and how to incorporate their personal values into their buying decisions. Although these behaviors have lagged somewhat in the wealth management and investment arenas, we increasingly find that clients wish to apply the same expectations of “personal expression” in their financial portfolios. These expressions can include a wide range of values-based priorities or social, environmental, and religious considerations. As an adviser, preparing now to help translate your clients’ articulated values and preferences into a customized portfolio expression will better position you to accommodate this emerging trend.

About Saturna

Saturna Capital, based in Bellingham, Washington State, has been dedicated to values-based investing for more than 25 years, focusing on the importance of sustainable financial management. Since 1989, Saturna has managed the Amana Mutual Funds, which invest according to faith-based values.

As an asset manager, Saturna Capital prioritizes the education and empowerment of its investors. As an employer, we are committed to worker ownership and employee wellness. As a community leader, Saturna promotes philanthropy through donations directed by employees as well as through corporate giving specifically aimed to promote the arts, education, and the environment.

Please consider an investment's objectives, risks, charges, and expenses carefully before investing. To obtain this and other important information about the Saturna Sustainable Funds in a current prospectus or summary prospectus, please visit www.saturnasustainable.com or call toll free 1-800-728-8762. Please read the prospectus or summary prospectus carefully before investing.

The Saturna Sustainable Funds are distributed by Saturna Brokerage Services, member FINRA / SIPC. Saturna Brokerage Services is a wholly-owned subsidiary of Saturna Capital Corporation, adviser to the Saturna Sustainable Funds.

Sustainability and Benefits to Advisory Practice Management

As a financial adviser, positioning your practice to help clients discuss their values and interests elevates the value of your services. Sufficient evidence exists to confirm that investors have an interest in developing a better relationship with their advisers; a recent practice management survey by TIAA Global Asset Management found that 74% of the survey respondents would be willing to work with advisers who can deliver competitive returns and positive social impact. The survey also found that 69% of the respondents felt they would have a stronger relationship with an adviser who could help them invest according to their personal values.

By simply being prepared to have conversations regarding a client's personal values, a financial adviser has the chance to extend beyond financial and performance metrics and build personalized and long-lasting client adviser relationships.

The two-stage advisory model can suffer from lack of innovation: advisers generally use the same well-recognized, generic investment vehicles and products as other advisers, which ultimately are subject to the same capital market outcomes of the asset class. As a financial adviser, you may or may not outperform a benchmark, but over the long run, the best that one can do is map out long-term capital market returns, assuming you are able to keep clients invested throughout the top-to-trough cycle. Incorporating the "third-leg" of client advisory planning services can help overcome the shortcomings of the simplified two-stage advisory model.

Advisers that take pride in helping their clients achieve their goals by keeping them on track toward a specific plan now may need to account for suitability of values-based investment vehicles and understand their impact beyond investment metrics.

As a result, advisers need a reliable process for engaging clients who say they want "good" companies or outcomes in their portfolios but may be unable to convey what that means exactly. As a sustainable asset manager for nearly three decades offering strategies that have employed a range of negative and positive screens to meet values-based client needs, we at Saturna Capital can empathize with this scenario. That's why we've created a tool that helps advisers steer a conversation toward the appropriate values expression for each client's preferences. When a client's portfolio matches the expression of his or her personal values, we say that the portfolio "smiles." The "smile" refers to Saturna Capital's graphic representation of the wide spectrum of potential strategies available today to values-based investors.

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As sustainable strategies have proliferated and may become mainstream, the role of the adviser has evolved to go beyond the traditional adviser model that typically focuses solely on determining a client's goals, financial target number, and appropriate asset allocation.

Now the savvy adviser will spend nearly as much time ensuring values alignment for the rapidly growing segment of investors who insist on doing well by doing good.

The Sustainability Smile: a visual tool to help you guide clients toward portfolios that express their personal values.



What's Your Client's Expression?

Establishing a values-based portfolio expression for your client is not all that different from forming a traditional individual investment portfolio as it also reflects long-term financial objectives that consider time horizon, risk, and potential returns. However, in the case of sustainability, an investment adviser can play a critical role in translating a client's aspirational interests and values into the investment vehicles that serve to meet their financial objectives.

The adviser is tasked with identifying and prioritizing the greater environmental, social, or other values-based criteria that their clients want their portfolio to reflect. Helping your client envision what his or her ideal portfolio expression may look like gives both parties a path to identify appropriate investment vehicles and the means to track the impact portion of the investment process. In collaboration with your client you can map out what can be measured, keeping in mind that the surge of intentional investment opportunities is not so evolved as to incorporate all specialized strategies. The industry has developed rapidly, and will continue to evolve.

Creating “Smiling” Portfolios

Incorporated as a visual tool designed to help segment the broad label of “sustainable investing,” the Sustainability Smile is a helpful place for investment advisors and their clients to start when identifying components for an intentional portfolio; the tool offers broad brush definitions of five investment categories, located along a continuum:



Traditional Finance emphasizes most traditional mainstream investing practices where no secondary intentional investment strategy is incorporated.



Integrated Finance can be viewed as an evolutionary development of traditional finance that takes into consideration material, nonfinancial environmental, social, and governance (ESG) factors, and looks at how these factors may improve or impair investment performance.

Integrated finance, or ESG investing, typically considers important environmental impacts, such as a portfolio’s environmental footprint and carbon emissions; social issues, such as supply chain management and diversity; as well as governance practices.



Ethical / Advocacy investing seeks to prioritize religious and broader social considerations in a portfolio’s construction. For example,

Faith-based investors tend to exclude the ownership of certain industries that are not consistent with their faith – typically “sin stocks” such as alcoholic beverages or gambling – but can also extend to community development projects or alleviating poverty.

Advocacy investing aligns the interests of other investors – typically equity investors able to affect change through shareholder resolutions – to encourage companies to improve their business practices.



Thematic / Impact investing emphasizes investments aiming to generate competitive, risk-adjusted returns based on the underlying characteristics of its asset class, whether land, real estate, debt or equity, while demonstrating specific, measurable results to targeted causes or social and economic trends.

Thematic investing tends to focus on a specific market, such as renewable energy, or on demographic trends as a means of allocating capital toward solution-oriented investments.

Impact investing typically seeks to prioritize a broad range of investment activities that focus on measurable social, socioeconomic, health, educational, and other broad human-related agendas that can also include environmental and conservation-oriented projects. For example, an investment may address global poverty issues by offering capital through microloans that support small business.



Philanthropic activities focus entirely on maximizing the value sets of the benefactors with little, if any, regard for investment returns.

The Mainstreaming of Sustainability

Interest among investors who expect their portfolios to express their values is growing. Investment companies have responded in lockstep with investors' interest in intentional strategies; the 2016 report produced by the Forum for Social and Responsible Investment (US SIF) indicates that more than one out of every five invested dollars undergoes some type of socially responsible or sustainability-focused screening. Fund rating firm Morningstar tracks around 200 mutual funds that incorporate responsible investment criteria, and nearly half of these funds launched in the past 10 years, according to David Kathman, a senior fund analyst there. Kathman also notes that over half of the 35 US-based sustainable ETFs tracked by Morningstar have launched since the beginning of 2014.

The Morningstar Star Ratings™ have had enormous influence on investor demand and perceived value of fund companies, and the Morningstar Sustainability Ratings™ are on track to yield similar results.

Simultaneously, Morningstar, in partnership with Sustainalytics, began to formalize investment funds' sustainability ratings in mid-2016 through its proprietary globe icons. Like the Morningstar Star Ratings™, the Morningstar Sustainability Ratings™ offer a quick reference backed by a complex quantitative and qualitative ranking process. The Morningstar Star Ratings™ have had enormous influence on investor demand and perceived value of fund companies, and the Morningstar Sustainability Ratings™ are on track to yield similar results. This means that the public is in a far better position than ever before to develop their own portfolio expressions based on responsible and sustainable criteria.

In bringing awareness of new tools, such as an approach like the "Sustainability Smile," we hope previously reluctant advisors will have more confidence in engaging their clients and having an answer ready for when the next conversation about "good" investments comes up.

Saturna Capital and the Saturna Sustainable Funds offer tools to help you differentiate your practice through sustainable investing.

Saturna White Paper: Sustainability Series

- ◆ *Sustainability Smile: An Advisers Guide to Defining Sustainable Investing Strategies*
- ◆ *Adding Sustainability: Having The Conversation*
- ◆ *Sustainable Investing: What You Need To Know*
- ◆ *ESG Tilts: ESG and Fixed-Income*

About The Author



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Patrick T. Drum, Research Analyst and Portfolio Manager, joined Saturna Capital in October 2014.

He is a select member of the United Nations Principles for Responsible Investment (UNPRI) Fixed Income Outreach Subcommittee and an adjunct professor of finance at Pinchot University, formerly known as Bainbridge Graduate Institute (BGI). Mr. Drum has nearly 10 years of experience integrating ESG considerations into fixed income portfolio management.

He holds a BA in economics from Western Washington University and an MBA from Seattle University Albers School of Business. He is a Chartered Financial Analyst Charterholder (CFA) and a Certified Financial Planner®. Mr. Drum has more than 20 years of investment experience in serving institutions and private clients.

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The Saturna Sustainable Funds limit the securities they purchase to those consistent with sustainable principles. This limits opportunities and may affect performance.



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Saturna Sustainable Funds: The Sustainability Smile - Advsiior

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