Saturna White Paper: Sustainability Series

Sustainable Investing: What You Need To Know

As consumer awareness of sustainable investments grows, the term has been applied in all manner of product positioning. But what does it mean when an investment product adopts the sustainability label? When investors ask, "What is sustainable investing?" they often find that no clear or concrete definition exists.

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What is Sustainable Investing?

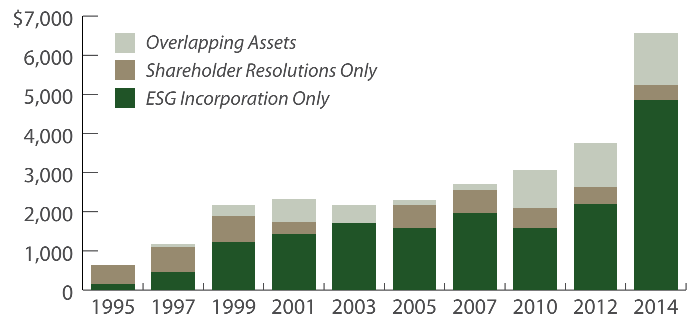
Despite the lack of a definition, sustainable investment products and strategies proliferate to meet demand. US SIF – The Forum for Sustainable and Responsible Investment states in their 2014 Trends Report that one out of every six investment dollars is in sustainable investment strategies. This represents over $6.6 trillion – yes, *trillion* – in US-domiciled invested assets.[1] US SIF expects continued growth over the coming years.

Sustainable investing, or socially responsible investing (SRI), is a catch-all category encompassing broad investment objectives, such as ethical investing, impact investing, negative screening, and integrated investing. At its most basic level, sustainable investing incorporates environmental, social, and governance (ESG) criteria in the investment process. ESG objectives can differ among investors based upon their priorities: a faith-based organization may place greater emphasis on social or governance factors in its investment process than an environmental-based organization would, for example. Regardless of the organization's emphasis, the important point is that ESG-oriented investors seek to integrate some element of their value sets in the investment portfolio's construction.

Investors often express surprise when they learn that the concept of sustainable investing traces back nearly 250 years to religious groups in the 18th century, such as the Methodists and Quakers.[2] Methodists were "firmly opposed" to the slave trade (including investing in companies profiting from it) and in the present day continue to avoid investments in alcohol, tobacco, and gambling related companies. Similarly, the Quakers shunned investments in slave trade related companies and war profiteering.

This early set of exclusionary criteria would later be classified as negative screening – the explicit avoidance of specific companies or industries using faith-based or values-based criteria.

Sustainable and Responsible Investing in the US
1995-2014, in billions

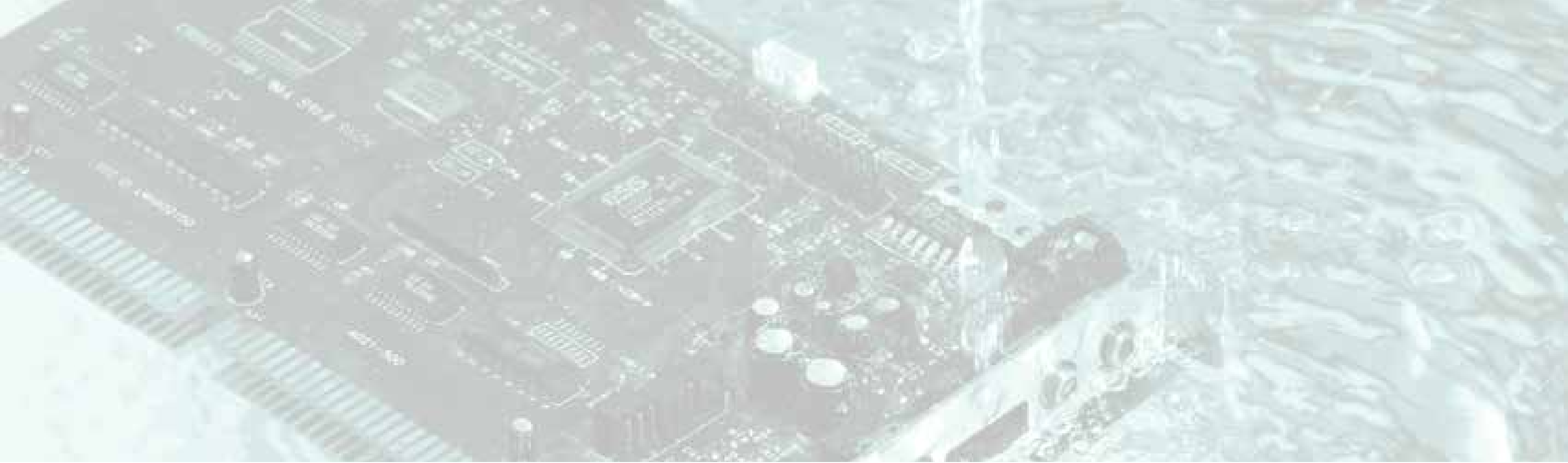


Source: US SIF Foundation

Much later, in the 1980s, investors began to see opportunities to alter public policy through shareholder activism and engagement, and faith-based investing began to expand beyond exclusionary processes to include proactive characteristics, as well. Perhaps the most memorable shareholder engagement during that time – the South African Apartheid Divestment campaign – saw General Motors board member Reverend Leon Sullivan leading the charge to withdraw the company's investment portfolios from the region. The Reverend authored a code of corporate conduct for American companies doing business in South Africa, and though GM was not the first company to divest, the firm's actions attracted considerable attention and broadened the campaign's legitimacy, encouraging other large US corporations and endowments to follow suit.

Reverend Leon Sullivan

The efficacy of the divestment campaign began to sow the seeds of positive investment screening. Just as negative investment screening seeks to eliminate undesired business activities from a portfolio, positive screening seeks to include attributes deemed favorable from an ESG/SRI perspective and, ultimately, for investment performance.



Key Themes: Water and Energy

British Petroleum's Deepwater Horizon oil spill disaster in 2010 offers a cogent example of how focusing on a company's environmental performance can prove to be as important as understanding its financials. Successful ESG investing goes beyond avoiding the next potential environmental or governance crisis: it requires identifying how companies form competitive business advantages relative to their peers. The current evolution of sustainable investing – what we now more appropriately identify as ESG investing – focuses on key ESG factors that materially impact their industry.

For example, the semiconductor industry requires tremendous amounts of water and energy to manufacture semiconductor chips, accounting for significant capital and operating costs. According to the Sustainable Accounting Standards Board's Semiconductor Research Brief 2014, a complete water management system, including wastewater recycling, can cost between 1.0 and 1.5 percent of a semiconductor fabrication plant's capital costs. The industry spends about $1.0 billion on water and wastewater systems and services every year. According to some estimates, the industry would save over $100 million in operating costs annually from the reduction, reclamation, and recycling of water.

The economics of improving water and energy efficiency in the semiconductor industry compel investor attention. Improving water efficiency and reducing consumption serves to mitigate, although not eliminate, the risk of rapidly rising water prices in communities that face considerable water shortages, as seen recently in California. Pursuing sustainability requires investors to evaluate the geographic, topographic, and demographic risks inherent to business activities; the benefits of an ESG-oriented portfolio can include resiliency to nonfinancial factors that, in turn, can have a profound effect on overall investment performance.

Saturna's Approach

At Saturna, our 25 years of applying a values-based approach to investing provides firsthand insight into the risk mitigation dimensions of sustainable, SRI, and ESG investing. We recognize that the popularity of sustainable investing will grow as more investors discover investment strategies that consider their personal values while helping protect against risks often ignored in the investment process. The risk consciousness fostered by ESG criteria, along with Saturna's emphasis on long-term profitability, ensures that the Saturna Sustainable Funds take a holistic and future-oriented approach to investing.

Footnotes:

[1] *Report On US Sustainable, Responsible and Impact Investing Trends 2014. 10th Edition. US SIF, The Forum for Sustainable and Responsible Investing. http://www.ussif.org/Files/Publications/SIF_Trends_14.F.ES.pdf*

[2] *Berry, Melissa D. History of socially responsible investing in the U.S. ThomsonReuters.com, August 9, 2013. http://sustainability.thomsonreuters.com/2013/08/09/history-of-socially-responsible-investing-in-the-u-s/*

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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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