Investment Insights

Sustainable Investing: The Evolution and Bessemer's Approach

Diana D. Vaillancourt
Investment Communications Manager

Bessemer Sustainable Leaders Portfolio Management Team

Desiree Davis
Director of Sustainable Investing

Gregory Sivin
Director of Quantitative Portfolio Management

Highlights

- The practice of investing in keeping with personal values is becoming increasingly popular among institutions and individuals, including Bessemer clients.
- At the same time, the variety and number of associated investment solutions have expanded greatly, along with the terms used to describe them — socially responsible investing, ESG investing, sustainable investing, and others.
- In this Investment Insights, we provide an overview of the rapidly evolving sustainable investing space, Bessemer's investment approach, and the ways we assist clients looking to align their investments with their personal values.

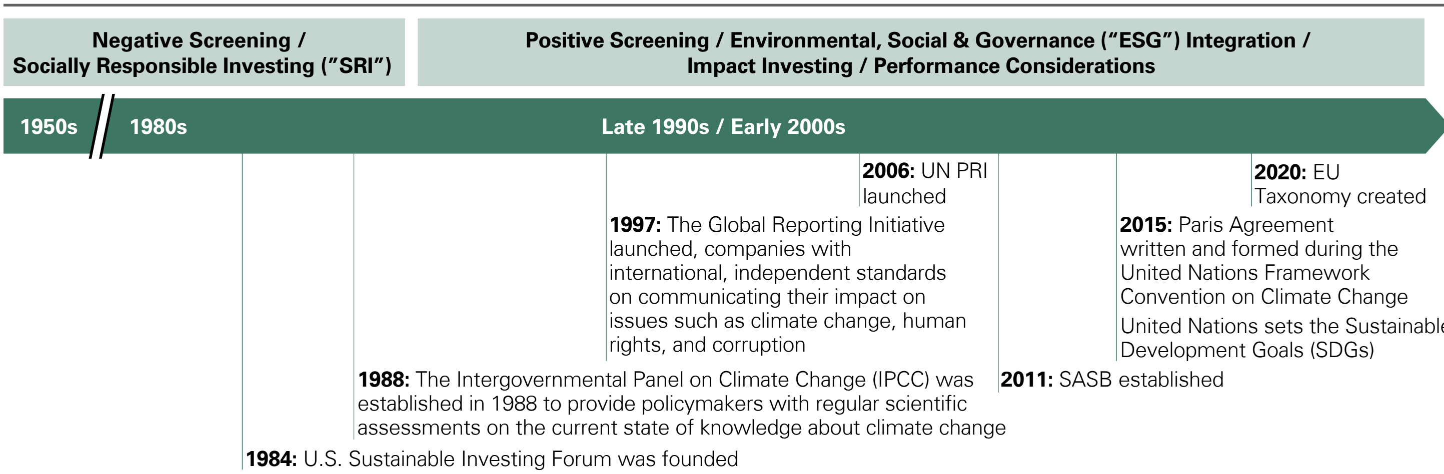
Although the practice of investing in accordance with personal values has been around for centuries, it has increasingly gained momentum among both individuals and institutions over the last decade. As investor interest has grown, so have the number and variety of available investment solutions and the terms associated with them — socially responsible investing, ESG integration, sustainable investing, value-based investing, and impact investing, among others. At its core, sustainable investing is a practice that considers environmental, social, and governance factors alongside financial factors in the investment decision-making process. In this report, we will use sustainable and ESG investing interchangeably.

At Bessemer Trust, we continue to focus on staying abreast of sustainable investing developments, helping interested clients navigate this rapidly evolving space, and recommending investment solutions that align most closely with their personal values and goals.

The Evolution of Sustainable Investing

The implementation of sustainable investing has evolved over time. As Exhibit 1 demonstrates, once an approach focused on negative screening and value judgments, ESG

Exhibit 1: The Evolving Sustainable Investing Landscape



Source: Bessemer Trust & the Commonfund

investing today has evolved beyond simply supporting a set of values when investing in companies — it now focuses on finding value *in* companies.

There is a spectrum of sustainable investing approaches that vary in focus on generating social and financial returns. As Exhibit 2 demonstrates, ESG, or sustainable investing, lies toward the left side of the spectrum because it focuses on both. The theory is that incorporating material ESG risks and opportunities in company analysis will help investors make better investment decisions as such risks and opportunities will materially impact the pricing of companies over time. Traditional investing delivers value by investing capital into opportunities that carry expected risks commensurate with expected returns. Sustainable investing may balance traditional investing with environmental, social, and governance-related insights in order to improve long-term outcomes.

Many investors question whether sustainable investments may generate "concessionary" returns. This has also been the subject of many academic studies for which findings have been mixed as they largely depend on the implementation of ESG in public markets; the study of private direct-impact investments is much more difficult given a lack of data. One meta-study of this issue, conducted by the University of Oxford and Arabesque Partners, analyzed over 190 academic studies and concluded that "88% of the research shows that solid ESG practices result in better operational performance of firms and 80% of the studies show that stock price performance of companies is positively influenced by good sustainability practices."[1]

Bessemer's quantitative strategies team conducted its own research on the topic after analyzing many academic studies. Their comprehensive findings can be found in "A Morality Tale of ESG: Assessing Socially Responsible Investing," which appeared in the Spring 2017 issue of The Journal of Wealth Management. In the paper, the team presents evidence that indicates that incorporating ESG into a robust quantitative investment process can provide investors with a portfolio that outperforms a benchmark while allowing investors to embrace ESG.

Investors are increasingly considering non-financial metrics as part of their analysis in order to identify material risks and growth opportunities. As the metrics in Exhibit 3 demonstrate, this data allows them to gain a holistic understanding of the companies that they seek to analyze. Proponents of analyzing ESG considerations as part of investment decisions believe the practice simply makes good business sense. Good corporate governance practices generally benefit both employees and shareholders, good environmental stewardship can lower risk for the company, and good social initiatives can improve employee relations and lead to a happier, more productive workforce.

Exhibit 2: Spectrum of Objectives

Traditional Investments	Sustainable / ESG Investing	Impact Investing "Return First"	Impact Investing "Impact First"	Venture Philanthropy	Philanthropic Donations
• Conventional equity and fixed-income instruments • Conventional alternative instruments	• ESG Integration • Sustainability themed strategies • Portfolio health checks and reporting	• Thematic impact funds and notes • Green bonds and green loans • Impact private equity • Impact venture capital	• Social impact bonds • Outcome-driven loans	• Donations are given as seed capital with the expectation of operational sustainability through mentoring by investors	• Pure charitable giving with no expectation of financial return
Market Returns			Concessionary Returns	No Financial Returns	

Purely Profit-oriented ← Investment — Grant → Purely Socially Oriented

Source: Bessemer Trust, Credit Suisse, Finance Department and Impact Advisory

[1] University of Oxford and Arabesque Partners, From the Stockholder to the Stakeholder, March 2015.

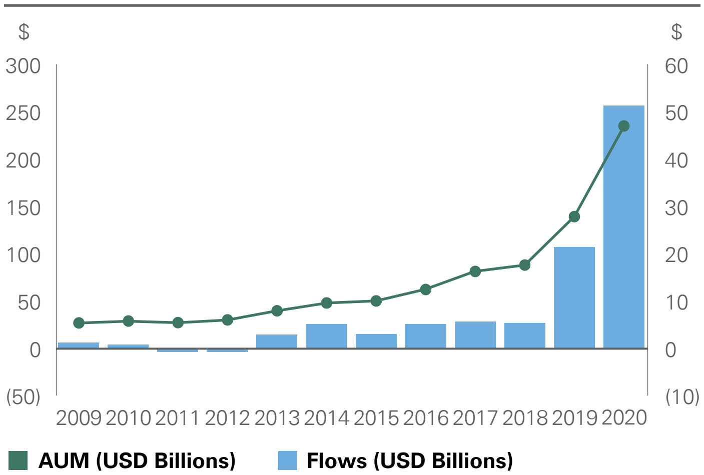
Exhibit 3: Commonly Used ESG Metrics

Environmental	Social	Governance
Common Metrics	**Common Metrics**	**Common Metrics**
• Biodiversity • Climate Impact • Energy Efficiency • Environmental Reporting • Fossil Fuels • Pollution Prevention • Resource Depletion • Spills, Fines • Waste Management • Water Usage / Scarcity	• Animal Welfare • Community Relataions • Corporate Philanthropy • Employee Diversity • Employee Rights • Fair Lending • Gender Equality • Human Rights • Product Quality and Safety • Supply Chain Audits • Worker Safety Record • Working Conditions	• Board Independence • Corporate Behavior • Executive Pay • Political Contributions • Shareholder Rights • Transparency

Source: Bessemer Trust, CFA Institute, Sustainalytics

Interest in sustainable investing continues to grow on a global basis, with increasing demand from institutional and retail investors, increasing focus from regulators, and recognition by notable institutions. For example, in 2020, global sustainable fund assets hit a record $1.7 trillion, while U.S. sustainable assets hit a record $236 billion following a record net flow year of $51 billion (shown in Exhibit 4). Moreover, per a Deloitte analysis, ESG-mandated assets are expected to make up half of all managed assets in the U.S. by 2025.[2] Lastly, the industry-recognized CFA Institute has formally committed to the development of sustainable investing, and as a part of its commitment, plans to increase ESG content by 130% in the next curriculum edition.

Exhibit 4: Sustainable Funds Flows and Assets



Includes Sustainable Funds as defined in Sustainable Funds U.S. Landscape Report. Includes funds that have been liquidated; excludes funds of funds.

Source: Morningstar

Bessemer's Approach to Sustainable Investing

Ultimately, we believe sustainable investing is a family decision based on shared values. At Bessemer, we believe it is imperative that we continue to follow and have a view on the sustainable investing space so that we can be thoughtful about the solutions that we provide to clients.

Within the left-hand side of the sustainable investing spectrum, we focus our efforts on sustainable investing because it fits well within our overall investment strategy. Our approach focuses on investing in high-quality companies that have a sustainable competitive advantage, strong management teams, and are leaders in their respective industries. We believe these companies are positioned to outperform over long time horizons.

To this end, we developed a proprietary global equity ESG strategy using our fundamental equity portfolio management combined with an MSCI ESG score overlay. MSCI is our long-term business partner with a history of providing benchmark solutions via construction and maintenance of indices for more than 50 years. Recently, Bessemer expanded the relationship to leverage its unique leadership role in providing ESG research. Combining internal Bessemer portfolio management holdings with MSCI scores results in a portfolio that reflects the Bessemer fundamental equity team's best ideas, inclusive of ESG scores. We size positions utilizing a proprietary quantitative process that optimizes for risk and return characteristics as well as ESG scores relative to the benchmark. In managing this strategy, we

[2] https://www2.deloitte.com/us/en/insights/industry/financial-services/esg-investing-performance.html

MSCI and ESG Research

MSCI is an investment research firm that provides stock indexes, portfolio risk and performance analytics, and governance tools to various types of players within the global investment industry. Its ESG origins date back to 1972, and its first ESG index was launched in 1990. It has been rating companies based on industry-specific material ESG risks since 1999. Today, MSCI offers a range of ESG solutions including research, ratings, indexes, and analytics. MSCI ESG ratings are designed to help investors understand ESG risks and opportunities and integrate these factors into their portfolio construction and management process. The research focuses on the intersection between a company's core business and the industry issues that can create significant risks and opportunities for the company. Companies are rated on a AAA-CCC scale relative to the standards and performance of their industry peers.

aim to construct a portfolio that maintains high-quality companies, an attractive ESG score, and outperforms the benchmark over a market cycle. Additionally, we have worked on customized mandates for clients with specific themes they wish to implement. We have also partnered with various external ESG managers and continue to evaluate more options.

On the philanthropic end of the spectrum, family meetings can help families get started in this space. Our experts are available to facilitate these meetings, identify shared values and interests, devise grant-making plans, and align those with effective sustainable investing strategies. For clients that maintain private foundations or donor-advised funds through the Bessemer Giving Fund, we can help identify and vet nonprofit social enterprises to receive grants or program-related investments. We can also assist clients in connecting to sustainable investing experts and networks.

We continue to stay abreast of sustainable investing developments and weigh different types of solutions for clients. If you are interested in sustainable investing, please speak with your Bessemer advisor about what sustainable investing means to you, and how we can be of service.

With special thanks to Head of Philanthropic Advisory Caroline Hodkinson for her contributions.

Other sources: CFA Institute; MSCI