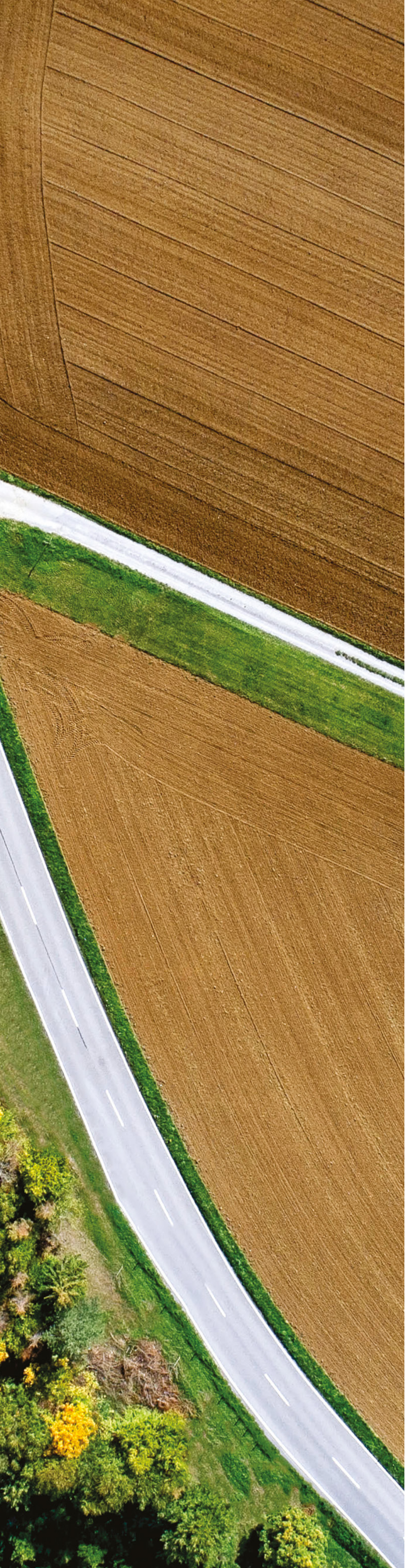
New York Life Investments

Risks and Opportunities to Unlock Alpha Potential

A GUIDE TO SUSTAINABLE INVESTING

At its core, sustainable investing is about using data to manage risks and identify opportunities.

The phrases “ESG investing” (environmental, social and governance investing), “sustainable investing” or “responsible investing” have recently been sparking varying reactions, opinions and schools of thought. It’s crucial to provide context, facts, and examples to clarify what these phrases entail.[1] For New York Life Investments, we view sustainable investing as a way to use data to manage risks and identify opportunities, leading to the potential to unlock alpha in an investment portfolio.



A company's practices could also impact stock performance

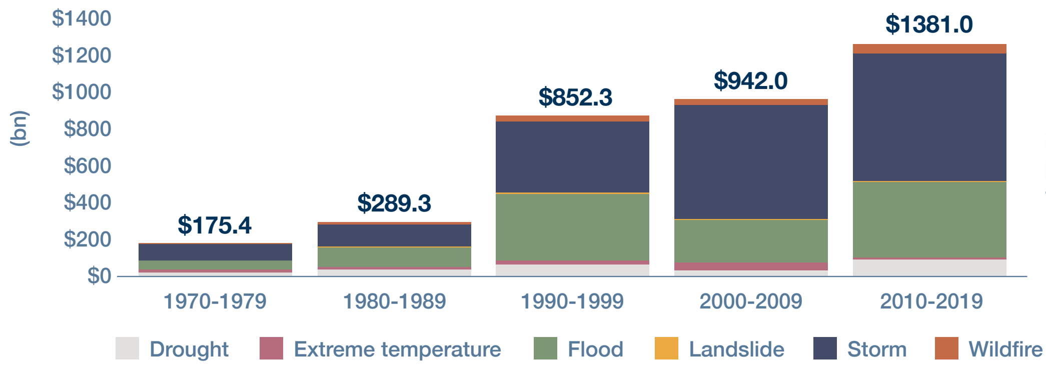
The world is changing rapidly, and as investors, it is essential to evolve how we invest, and how we think about data and risk. In today's hyper-connected world, intangible assets like a company's reputation, image, and responsible practices are a large part of its value and can significantly impact its stock price. For example, data breaches or social responsibility missteps can quickly become public knowledge, causing immediate financial repercussions. Incidents like the Boeing plane blowout, Facebook data breach, Volkswagen emissions scandal, and Adidas-Kanye collaboration highlight the financial consequences of controversies. These are examples of ESG factors that can have a substantial impact, even though they are not visible on a balance sheet or income statement. ESG data—a key component of sustainable investing—provides a framework to assess a company's practices and potentially mitigate these risks.

The risk landscape is changing

A decade ago, economic risk dominated the risk landscape. Today, environmental, social, and governance risks can be just as, if not more, significant. Extreme weather events, such as wildfires that impact air quality, severe hurricanes, droughts, and flooding, have huge economic impacts. Since 1970, we've lost over $3 trillion due to extreme weather events, with losses over the last decade totaling seven times greater than the previous decade.[2] These events will likely increase in the future, making these risks essential for investors to consider.

Extreme weather: Expensive and increasingly common

Reported economic losses due to weather in US$ ($bn)



$3.6tn

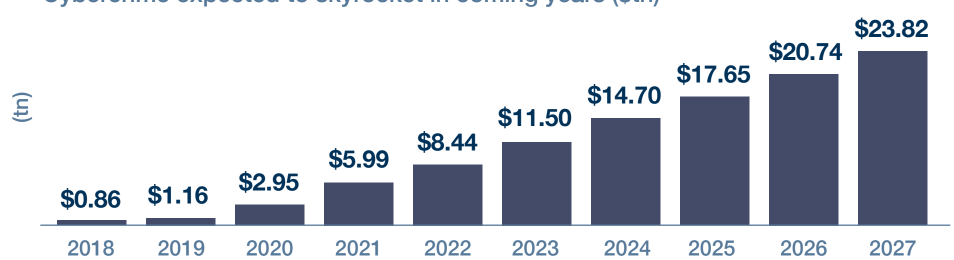
in losses in 50 years, with losses from last decade 7x greater than 1970s

Data as of December 2021. Sources: World Meteorological Organization (WMO): Atlas of Mortality and Economic Losses from Weather, Climate and Water Extremes

Additionally, cybersecurity risks are becoming more significant, with costs projected to increase by 31 times in the next decade.[3] Considering this additional data provides a broader perspective on future risks.

Cybersecurity: A future reality and more than a rounding error

Cybercrime expected to skyrocket in coming years ($tn)



Projections show

31x

increase in 10 years

Data as of November 2022, using current exchange rates. Sources: Statista Technology Market Outlook, National Cyber Security Organizations, FBI, IMF

Opportunities in sustainable investing

There are significant opportunities, however, with more than $9 trillion of capital needed annually to meet net-zero targets by 2050.[4] One of the biggest areas of opportunity may be in the energy transition, which can be defined as the shift from fossil-based systems of energy production and consumption to renewable energy sources like wind, solar, and battery power. For instance, the Inflation Reduction Act of 2022 allocated $370 billion for clean-energy projects, with $312 billion already invested in climate-related initiatives.[5] Companies involved in the lower-carbon economy transition, such as semiconductor or electric vehicle companies, are witnessing increased demand for their products and services.

Companies across sectors recognize the opportunity

Companies are increasingly focused on evolving their business models to capitalize on these opportunities. Examples include Rivian in the sustainable transportation sector,[6] Apple aiming for a carbon-neutral value chain by 2030,[7] and Nike moving toward zero carbon and zero waste.[8] Sustainable investing aims to identify companies that are evolving and leaning into sustainable opportunities.

Corporations incorporating sustainable practices – Examples shown here:

Nike

Moving towards zero carbon and zero waste

Apple

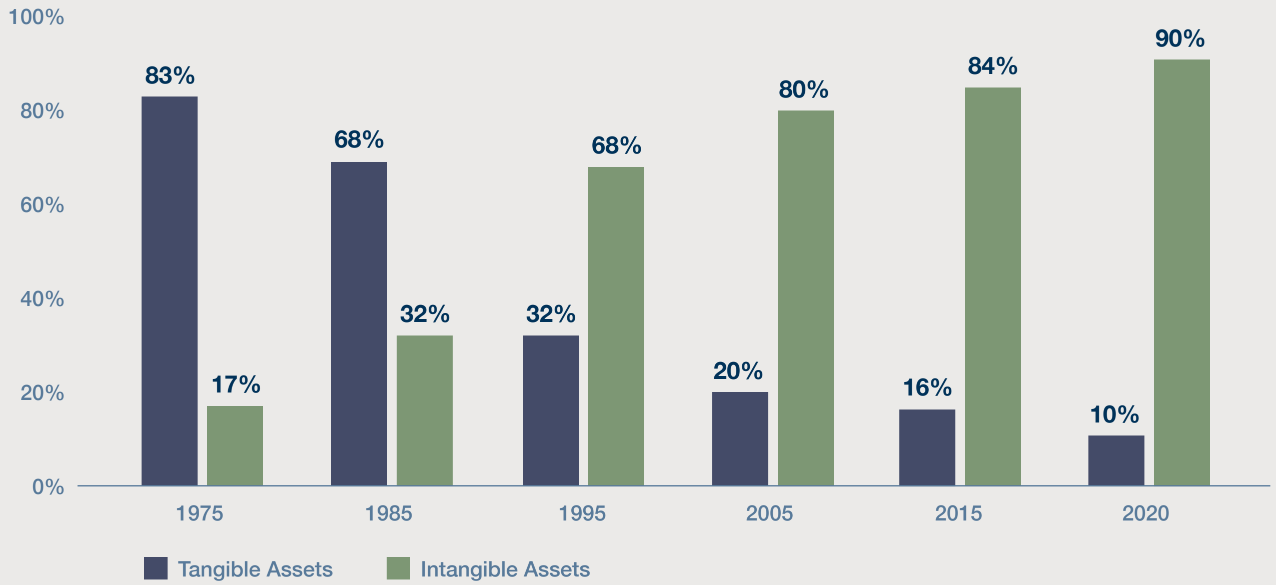
Progressing towards ambitious 2030 climate goals by launching carbon neutral products

Rivian

Creating electric vehicles to reduce our environmental footprint

Furthermore, value drivers have shifted, with intangible assets becoming more significant than tangible assets for companies. In 1975, tangible assets such as a company's products, machinery, or buildings represented 85% of a company's value. Today, this number has flipped with 90% of a company's value being tied to intangible assets like intellectual capital, patents, and brand value.[9] Understanding a company's true value requires looking beyond traditional financial statements to additional data sources.

Nontraditional risks and opportunities can be overlooked in traditional financial analysis



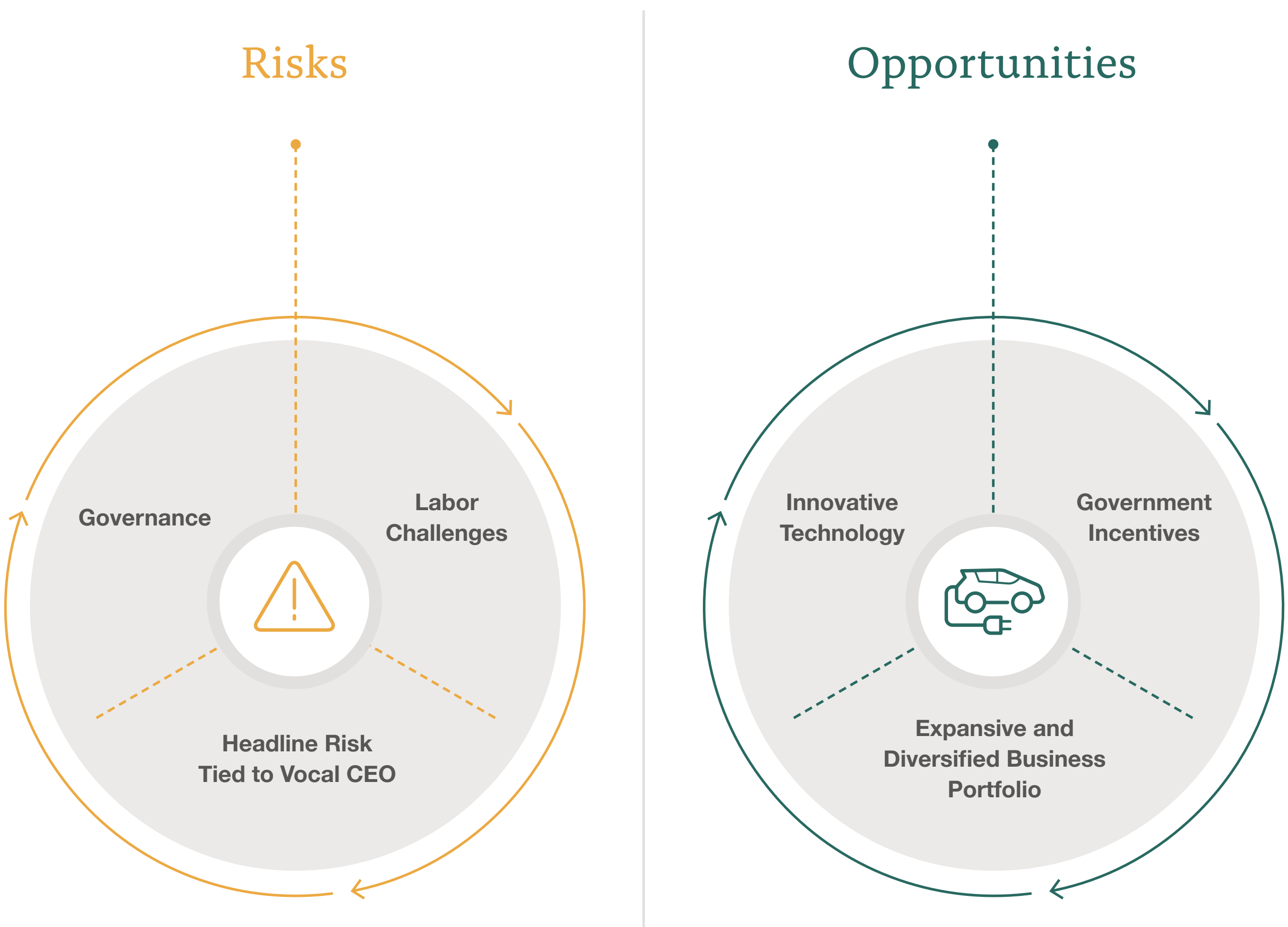
Source: Ocean Tomo LLC, Intangible Asset Market Value Study, 2020.

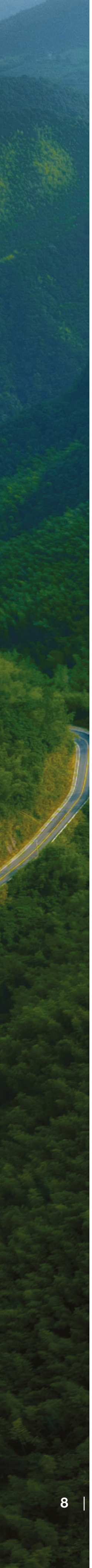
Understanding a company's true value requires **looking beyond traditional financial statements** to additional data sources.

Tesla illustrates how ESG data can be analyzed. While some view Tesla favorably due to its position in the electric vehicle space, concerns about governance and human capital risks still exist. Tesla's case emphasizes the need to weigh both risks and opportunities across all ESG factors to understand a company's direction, as these nontraditional risks and opportunities can impact the company's performance potential.

Case Study: Tesla, an electric vehicle provider

Nontraditional risks and opportunities impact performance potential





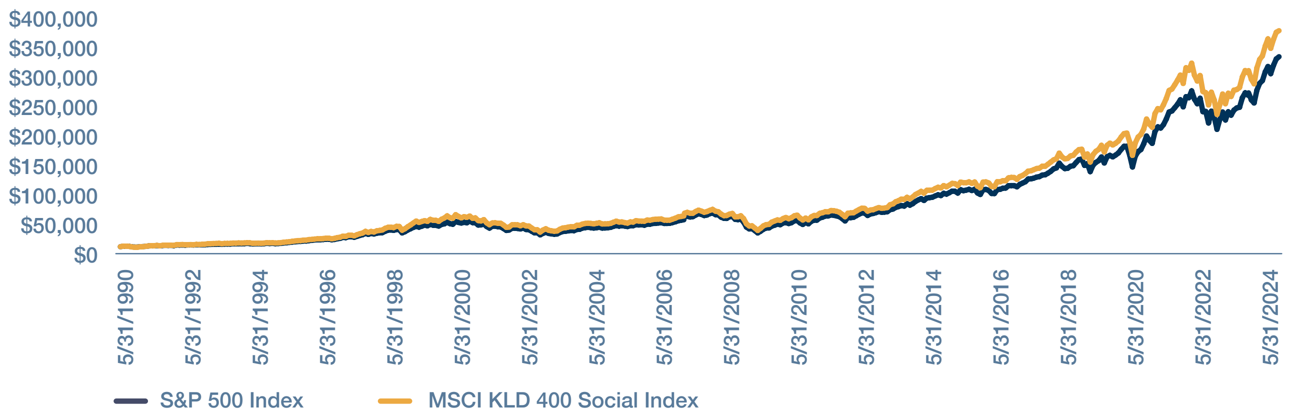
ESG metrics and investment performance

The sustainable investing space is still evolving, with different investment managers taking different approaches and interpretations. The correlation between ESG scores from third-party providers like MSCI and Sustainalytics is below 0.5, unlike credit ratings where the correlation is above 0.9.[10] This variability highlights the importance of comprehensive data analysis beyond one or two ratings providers.

Despite short-term challenges, the MSCI KLD 400 Social Index, one of the oldest sustainability indexes, shows long-term outperformance compared to the S&P 500 Index.[11] This demonstrates the potential for sustainable investing strategies to deliver competitive returns over the long run.

Historical data points to compelling long-term performance: No need to sacrifice returns

Growth of $10,000



Source: Morningstar, 5/31/24. The S&P 500 Index is a market-capitalization-weighted stock market index that tracks the stock performance of about 500 of some of the largest U.S. public companies. The MSCI KLD Social 400 Index was launched in 1990 and is designed to help socially conscious investors weigh social and environmental factors in their investment choices. Past performance is no guarantee of future results. It is not possible to invest directly in the index.

Unlocking alpha potential in a portfolio

For investors seeking long-term performance, diversification, and customization, integrating ESG data and solutions can be a valuable exercise. As sustainable investing products have now evolved to span a wide range of asset classes – from equity, debt, alternatives, and multi-asset – there are many ways to integrate these solutions into a portfolio. As always, it's important to consider a wide range of factors during portfolio analysis and due diligence.

By partnering with experts and utilizing comprehensive data, investors can unlock the alpha potential that sustainable investing has to offer.

Consider professional guidance

For any investor considering a change to their investment portfolio, it's important to seek the **proper guidance** in order to make informed investment decisions.

Overall, speaking to a financial advisor is a wise next step, as they can help you navigate these decisions, assess your unique circumstances, and develop a portfolio that aligns with your financial objectives and risk tolerance.

1. The terms “ESG investing,” “sustainable investing,” and “responsible investing” are used interchangeably. They all refer to an investment approach that considers factors typically referred to as environmental, social, and governance factors. This approach may differ depending on materiality, strategy, asset class, or client preferences.
2. Data as of December 2021. Source: World Meteorological Organization (WMO): Atlas of Mortality and Economic Losses from Weather, Climate and Water Extremes
3. Data as of November 2022. Sources: Statista Technology Market Outlook, National Cyber Security Organizations, FBI, IMF.
4. McKinsey & Company, Accelerating progress on future-ready infrastructure. February 2024.
5. Updated: July 25, 2023 https://climatepower.us/wp-content/uploads/sites/23/2023/07/Clean-Energy-Boom-Anniversary-Report-1.pdf
6. https://rivian.com/sustainability
7. Apple, “Apple unveils its first carbon neutral products,” 2023.
8. Nike https://www.nike.com/sustainability
9. Represents companies in the S&P 500. Source: https://anderson-review.ucla.edu/boom-of-intangible-assets-felt-across-industries-and-economy/
10. Source: MIT Management Sloan School, “Connecting ESG and Corporate Bond Performance,” 2017. While both entities are leaders in ESG research and ratings, the weakness of correlation between the MSCI and Sustainalytics ESG scores shows that independent research based on fundamentals are essential in accurately assessing a company’s ESG standing.
11. Source: Morningstar, 03/31/24. The S&P 500 Index is a market-capitalization-weighted stock market index that tracks the stock performance of about 500 of some of the largest U.S. public companies. The MSCI KLD Social 400 Index was launched in 1990 and is designed to help socially conscious investors weigh social and environmental factors in their investment choices. Past performance is no guarantee of future results. It is not possible to invest directly in the index.
12. Source: Consumer Goods Technology Journal, “New Research Shows Consumers More Interested in Brands’ Values than Ever,” 4/26/22.

Definitions

Alpha is a term used in investing to describe a strategy's ability to beat the market or provide excess return.

Correlation is a measure of how closely two variables move together over time.

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The **S&P 500 Index** is a market-capitalization-weighted stock market index that tracks the stock performance of about 500 of some of the largest U.S. public companies.

About Risk

Investing involves risk, including possible loss of principal. Asset allocation and diversification may not protect against market risk, loss of principal, or volatility of returns.

This material has been prepared for informational purposes only and is not intended to provide, and should not be relied on for, accounting, legal, or tax advice. You should consult your tax or legal advisor regarding such matters. This material is not intended to be relied upon as a forecast, research, or investment advice, and is not a recommendation, offer, or solicitation to buy or sell any securities or to adopt an investment strategy.

Impact investing and/or environmental, social, and governance (ESG) managers may take into consideration factors beyond traditional financial information to select securities, which could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market.

Further, ESG strategies may rely on certain values-based criteria to eliminate exposures found in similar strategies or broad market benchmarks, which could also result in relative investment performance deviation. Opinions expressed are current opinions as of the date appearing in this material only and are subject to change.

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