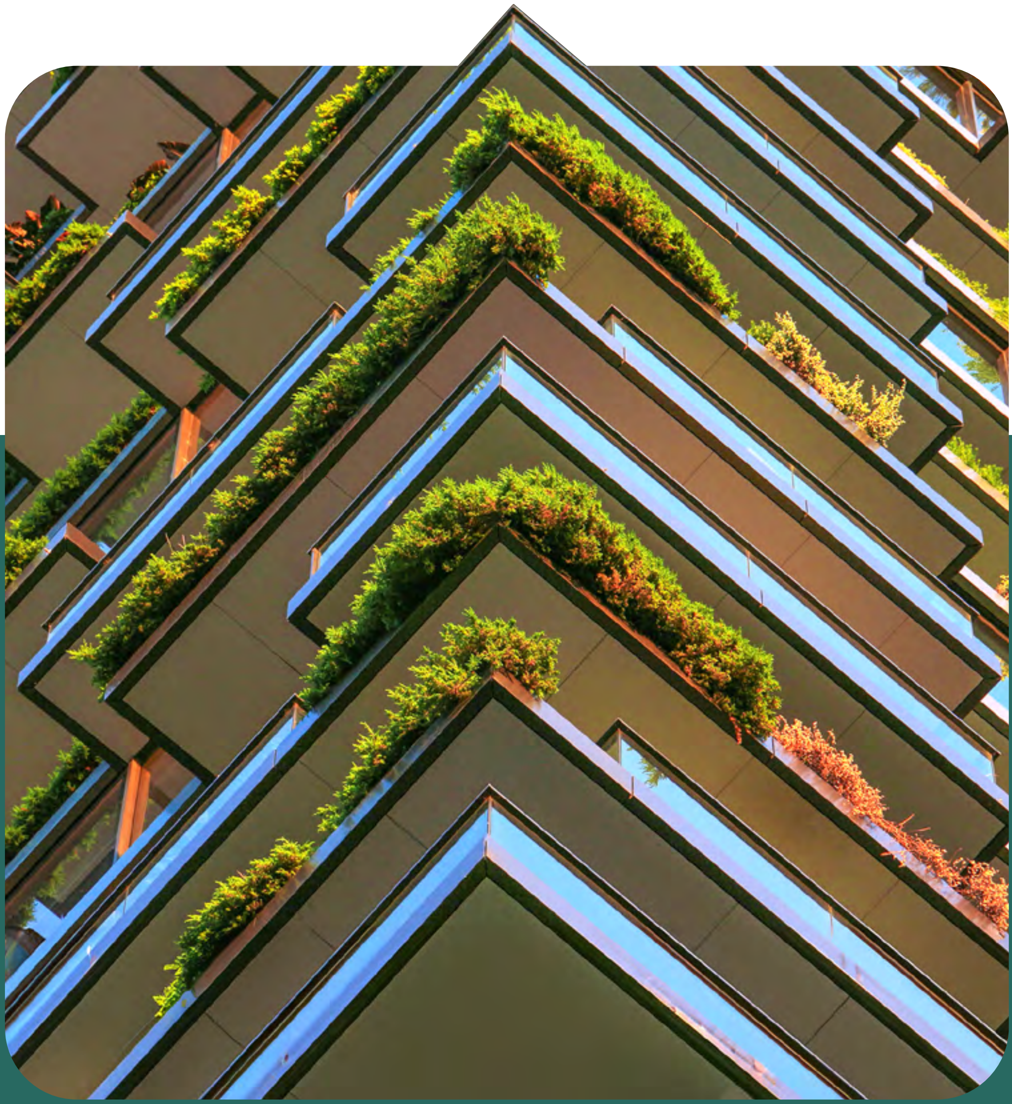
New York Life Investments

Dispelling the Three Most Common Myths

A GUIDE TO SUSTAINABLE INVESTING



Overcoming misconceptions about sustainable investing

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.

Misunderstandings and persistent myths can lead investors to underestimate the benefits of a sustainable investing approach. In this piece, we address three key myths of sustainable investing and shine light on the realities and objectives behind it.

As of June 2024, the global sustainable fund universe stood at $3.1 trillion USD according to Morningstar.

This encompasses open-ended funds and exchange-traded funds that, through their prospectus or other regulatory filings, claim to focus on sustainability, impact, or ESG factors.[1]

Myth 1

Sustainable investing puts social agenda ahead of financial goals

Reality: Sustainable investing utilizes additional data (ESG data) with the goal of enhancing financial returns.

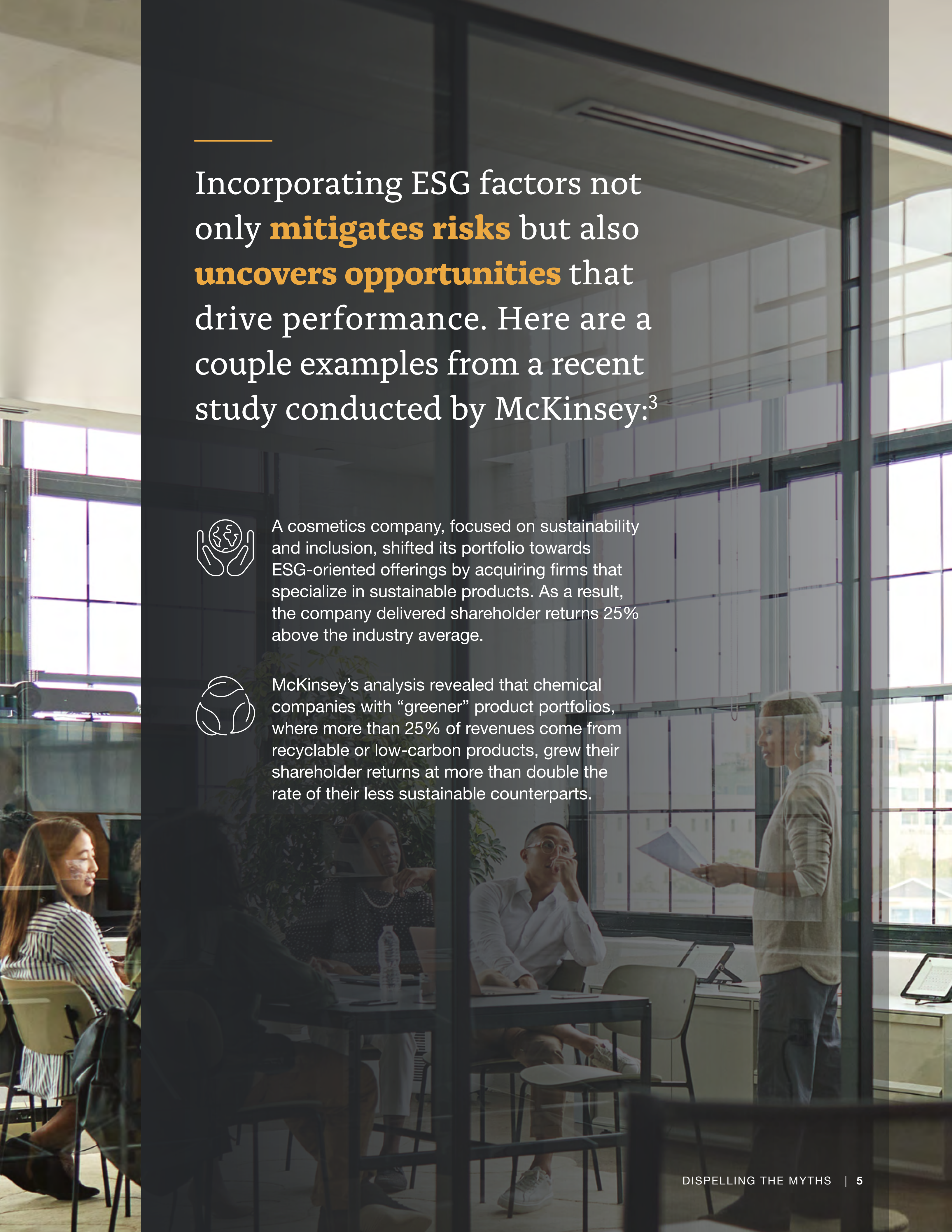
Recent discussions about sustainable investing seem to imply that values and social objectives are being placed ahead of financial objectives. In reality, sustainable investing is much more nuanced. At New York Life Investments, we view sustainable investing as a holistic approach to analyzing risk and opportunity, layering in environmental, social and governance data in addition to traditional financial data that can be found in a company's financial statements.

Additional data points that can be captured by the sustainable investing lens are items such as:

- A company's energy consumption.
- Adherence to safety and regulatory standards.
- Employee turnover rate.
- Corporate governance issues like board oversight and transparency.

A classic example of how ESG data can help with analyzing risks is the collapse of Enron in 2001. Enron was once praised as an innovative energy giant and was the seventh largest company by revenue[2] — and its demise serves as a powerful reminder of the consequences of poor corporate governance and financial misconduct. Enron used deceptive accounting practices to hide massive debts and inflate profits, misleading investors and regulators alike. When the scandal came to light in 2001, it triggered one of the largest bankruptcies in U.S. history, erasing billions in shareholder value and devastating employee pensions.

The Enron scandal exposed the dangers of unchecked corporate governance and lack of transparency, key elements that the "G" in ESG seeks to address. By incorporating ESG factors, investors can better assess risks like these and avoid potential pitfalls that traditional financial analysis might miss.



Incorporating ESG factors not only **mitigates risks** but also **uncovers opportunities** that drive performance. Here are a couple examples from a recent study conducted by McKinsey:[3]

A cosmetics company, focused on sustainability and inclusion, shifted its portfolio towards ESG-oriented offerings by acquiring firms that specialize in sustainable products. As a result, the company delivered shareholder returns 25% above the industry average.

McKinsey's analysis revealed that chemical companies with "greener" product portfolios, where more than 25% of revenues come from recyclable or low-carbon products, grew their shareholder returns at more than double the rate of their less sustainable counterparts.

Myth 2

Sustainable investing leads to underperformance

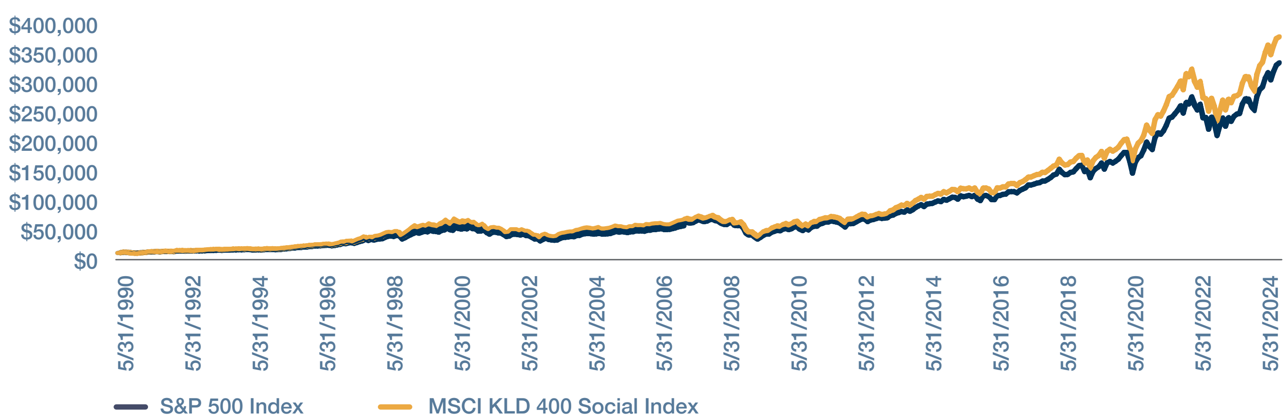
Reality: Sustainable investing has historically performed in line or better than conventional (or non-ESG) strategies.

The "performance trade-off" is probably the most entrenched misconception surrounding sustainable investing. Many investors assume they need to sacrifice returns in order to invest while considering ESG factors.

In reality, that is not the case. For example, the MSCI KLD 400 Social Index, one of the oldest sustainability indexes, shows long-term outperformance compared to the S&P 500 Index.[4] This demonstrates the potential for sustainable investing strategies to deliver competitive returns over the long run.

Historical data indicate strong long-term performance

Growth of $10,000



McKinsey studied a pool of nearly 2,300 public companies and analyzed them by growth, profit and sustainability.

They ultimately found that companies that had good financial performance AND integrated "ESG" into their products, operations, or overall business model, outperformed companies that lagged in incorporating ESG, as measured by total shareholder return[3].

Myth 3

Sustainable investing means an exclusionary approach that screens out entire sectors such as fossil fuels

Reality: Sustainable investing encompasses a range of investment approaches – some of which include fossil fuel companies.

The myth that sustainable investing strategies are purely exclusionary has some basis in history. Many of the original, socially responsible investing strategies — thought to have had their roots with the Quakers and Methodists in the 1700s — followed an exclusionary approach that allowed religious and other organizations to avoid investments that violated their worldview.[5] In modern investing, exclusionary or "screens-based" approaches avoid stocks or bonds of companies in certain sectors, either due to client preference or because these sectors can be seen as too risky.

However, in contrast to strict negative screens, investment managers are increasingly seeing the benefits of integrating ESG data into their analysis and identifying innovative companies rather than excluding whole sectors.

In practice, this investing approach could lead to investing in companies within sectors such as technology, industrials, or energy that are ahead of their peers in anticipating regulatory change and adapting their business model accordingly. Instead of a blanket exclusion of a sector or industry, this would lead to a more nuanced analysis that focuses on investing in companies within the sector that are best positioned for opportunities, based on underlying ESG data.

One area of opportunity where this approach is becoming more common is often referred to as the energy transition.

The energy transition 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. Initiatives like the Inflation Reduction Act of 2022, which allocated $370 billion for clean-energy projects,[6] are supporting companies involved in the energy transition. Companies such as semiconductor or electric vehicle companies are witnessing increased demand for their products and services. For some sustainable strategies, integrating this type of ESG-related data into traditional financial analysis could lead to a more inclusionary, rather than exclusionary approach.

Learn the facts

As sustainable investing continues to evolve, myths and misconceptions continue to arise. Our goal is to provide you with reliable facts and insights to help you make informed decisions about investing.

1. Morningstar Sustainalytics, 07/22/24. Global Sustainable Fund Flows: Q2 2024 in Review.
2. New York Times, 11/30/2001. Enron's Collapse: The Overview; Ripples Spreading from Enron's Expected Bankruptcy.
3. McKinsey & Company, 08/09/23. The triple play: Growth, profit, and sustainability.
4. 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.
5. Frank A.J. Wagemans, C.S.A. (Kris) van Koppen, and Arthur P.J. Mol (2013), "The effectiveness of socially responsible investment: a review," Journal of Integrative Environmental Sciences, 10:3-4, 235-252.
6. Climate Power, July 25, 2023. Clean Energy Boom Anniversary Report.

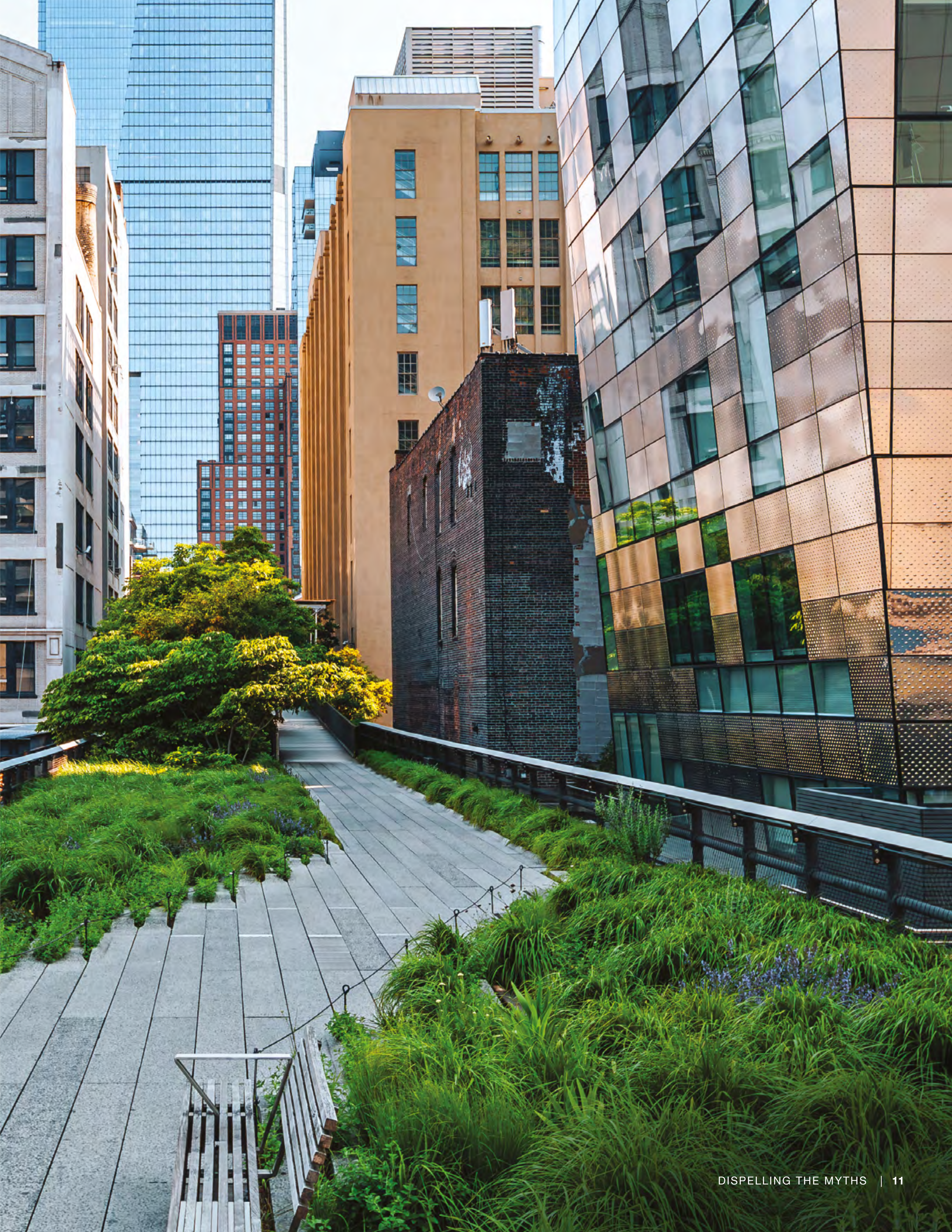
About Risk

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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