

An in-depth look at ESG investing



What is ESG investing?

ESG investing incorporates environmental, social and governance (ESG) considerations along with traditional financial measures such as corporate profitability, growth potential and stock valuation analysis. ESG investing includes two common approaches to investing in a sustainable or socially conscious way, which are distinguished by broadly considering E, S and G issues and by prioritizing traditional financial measures and return performance alongside ESG. In contrast, values-based investing, such as thematic and faith-based strategies, differs because of a narrowed focus and the priority given to ESG considerations ahead of financial performance.

ESG investing is evolving and gaining recognition with more investors. Information and corporate disclosure of ESG policies or strategies are becoming more available; however, data standards and regulation of the industry are still developing. In addition, a growing number of ESG-focused research firms are providing ESG data and evaluations for investors to consider.

Two approaches to ESG investing:

1 ESG integration

2 ESG intentional

Performance and ESG investing

While all investments perform differently over time, we believe ESG investing approaches generally should have a neutral impact on investment performance. Like traditional funds, we believe performance will vary depending on the investment team's skill, the investment process and the fund's internal expenses. Over time, highly rated ESG companies have performed roughly in line with a broad group of global companies.* However, be sure to consider all risks and opportunities before investing.

*Source: Morningstar Direct. Comparison of the global MSCI ACWI NR Index and the MSCI ACWI ESG Leaders NR Index measured from 10/1/2007 to 7/31/2022.

Past performance is not a guarantee of future results.

1. ESG integration

With this approach, ESG information is incorporated into fundamental analysis, to the extent it has a material financial impact on the investment decision and the value of the company.

When it comes to professionally managed investments such as mutual funds and exchange-traded funds (ETFs), ESG integration is the most common approach. In fact, many traditional funds may already integrate ESG considerations in their investment processes.

Edward Jones follows this approach for our individual stock recommendations. We believe material ESG-related risks and opportunities must be understood to make a thorough investment decision because they may impact a company's competitive position, growth prospects and valuation over the long term. Understanding material ESG-related risks and opportunities is just one part of the analysis process.

How could ESG considerations impact a company's value? Here are some examples:

- Energy companies may face increased costs from complying with carbon emission regulations or reduced demand for fossil fuels. This could decrease company profitability.
- Health care companies risk costs associated with product recalls, safety concerns and loss of consumers' trust. This could negatively impact sales.
- Opportunities for consumer staples companies may include solving an environmental waste concern with new recycling services or packaging innovations that could reduce costs or lead to sales in a new market.

Most fund managers and investment analysts consider governance risks in their investment processes. Many more are increasingly considering the environmental and social aspects because they recognize the potential impact on performance. However, traditional funds may not be marketed and viewed as ESG investments because they prioritize traditional financial goals and don't have a stated ESG goal.

2. ESG intentional

ESG intentional funds have a clearly stated ESG goal and a more in-depth ESG investment process. ESG information is intentionally prioritized alongside fundamental analysis and financial goals when making the investment decision. These funds generally have access to dedicated ESG research teams, leverage proprietary ESG data and investment processes, and/or engage with company management teams to push for what they believe to be positive change. But not all ESG intentional funds are designed the same.

ESG intentional funds follow a variety of approaches. For example, some focus on companies with favorable ESG ratings, while others focus on companies that are on the path to improving their ESG profiles. Many funds combine these two approaches.

It is your choice whether to add ESG intentional funds to your portfolio. You can build a well-diversified portfolio and achieve your financial goals without them. However, these funds may help you meet your personal nonfinancial goals. ESG intentional funds and ETFs use various strategies and, in many cases, have limited performance track records.

Like traditional funds, ESG intentional funds perform differently depending on various factors, including the investment team's skill, the strength of the investment process and each fund's internal expenses. The prioritization of ESG considerations alongside traditional financial measures should have a neutral impact on performance. To identify ESG intentional funds that we expect to outperform their benchmark, consider those recommended by Mutual Fund Research. To invest in ESG intentional funds, please discuss with your financial advisor.

ESG ratings

Edward Jones uses MSCI (a well-established ESG research provider) for ESG ratings and data. Companies are evaluated on key environmental, social and governance factors that are pertinent to their industries and then scored based on their level of ESG risk relative to industry peers.

Relative ratings provide a way to distinguish the best or worst companies from an ESG lens within all sectors, which we believe is important to build a diversified portfolio. MSCI ESG ratings measure a company's resilience to long-term, financially material ESG risks and the ability to manage those risks.

MSCI considers several key ESG issues, which fall into broader themes of concern to investors. Examples include:

- Carbon emissions
- Renewable energy
- Labor health and safety
- Product safety and quality
- Corporate pay
- Tax transparency

In addition to scoring a company's policies and business practices, MSCI also incorporates a controversy score, which evaluates new developments and recent news about key ESG issues. MSCI combines ESG ratings on individual fund holdings to produce its ESG fund ratings.

Edward Jones provides ESG ratings from MSCI in our research opinions for individual stocks.

This table shows the range of MSCI's ESG ratings:



Getting started with ESG intentional funds

- We believe incorporating ESG investing is an investor choice. Discuss with your financial advisor whether ESG intentional funds are aligned with your financial and nonfinancial goals.
- If you are making any changes to your portfolio to incorporate ESG intentionally, remember to align with your portfolio objectives.
- For those who would like to build an ESG portfolio, we offer Edward Jones ESG Sample Portfolios, detailed below.

Edward Jones' ESG portfolios

Edward Jones' ESG portfolios are built using ESG intentional mutual funds and ETFs that we recommend. ESG portfolios align with Edward Jones Investment Policy Committee's investment guidance and principles, as well as diversification exposure across sectors, regions, asset classes, styles and portfolio managers.

If a particular asset class doesn't have a recommended ESG intentional fund, your financial advisor can use traditional strategies to help ensure this asset class is reflected in your portfolio, if appropriate. An ESG intentional portfolio contains a minimum 80% ESG intentional funds, in any portfolio objective. MSCI ESG ratings for the overall portfolio are also provided.