Help Grow Your Business With ESG

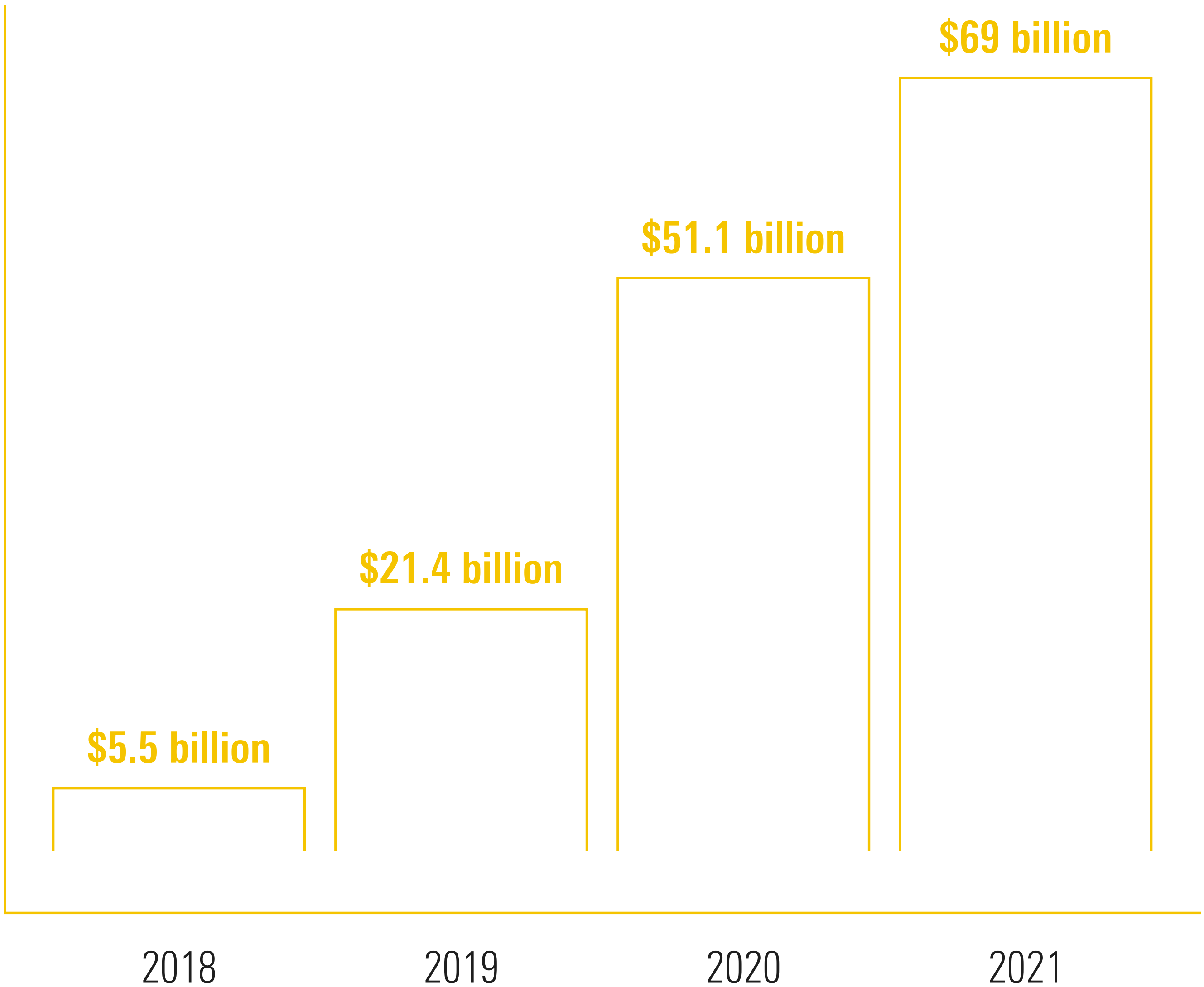
A 4-Step Guide to Offering ESG Investments to Your Clients

A study released in November 2020, estimated that 1 in 3 dollars of overall assets under management in the U.S. is now subject to some type of sustainable investment strategy.[1]

1 Source: Report on US Sustainable and Impact Investing Trends, US SIF Foundation, 2020. https://www.ussif.org/trends

The Opportunity for Sustainable Investing

Financial markets suffered through a severe downturn in the first half of 2020, but even during the early pandemic-related turbulence, data shows how Environmental, Social, and Governance (ESG) focused portfolios continued to attract investors in 2022. Morningstar, Inc. fund flow data shows sustainable investments recording net inflows of $69 billion in 2021.[2]

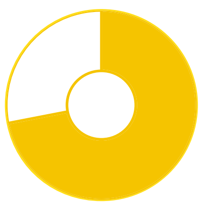


For Illustrative Purposes Only.

2 Source: Morningstar Direct. Data as of December 31, 2021.

Who is Interested in ESG?

Recent research dispels the idea that ESG-focused investing is only of interest to younger generations. This interest is actually very consistent across all age groups. Morningstar, Inc. research supports this study, with 72% of respondents, of various ages and genders, expressing interest in sustainable investing.[3]



72% of people express interest in sustainable investing

Breakdown by Age[4]

Percentage of investors who considered ESG factors before investing:

77% of Millennial
(1981-1996)

64% of Generation X
(1965-1980)

61% of Baby Boomers
(1946-1964)

Talk About ESG Investing With Your Clients

Research shows your clients have interest in sustainable investing, and most advisors have yet to develop a strategy to offer and review these options with clients. Advisors who have this conversation will likely discover it helps grow their practice by differentiating it from others, deepening relationships with families and retaining more assets from generation to generation. Be sure to at least assess client interest in ESG products—if you don’t, it is likely someone else will.

3 The True Faces of Sustainable Investing Busting Industry Myths Around ESG, Morningstar, Inc.
4 The Allianz ESG Investor Sentiment Study as of December 2018.

51% of non-ESG investors want their advisor to speak to them about ESG Investing.[5]

83% of investors agree that advisors who discuss sustainable investing are more forward-thinking.[6]

5 State Street Center for Applied Research Survey of Retail Investors, December 2016
6 Nuveen, The Fifth Annual Responsible Investing Survey, Dec. 9, 2019

How Advisors Can Explain and Offer ESG Products to Clients

Step 1: Start With the Basics

What is Sustainable Investing?

We define sustainable investing as a long-term approach that incorporates ESG factors into the investment process. Here are examples of some of the issues ESG investors consider important.

Exhibit 1 ESG Factors Investors Care About

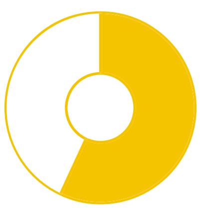
Environmental
Climate and environmental stewardship
- Climate change and carbon emissions
- Air and water pollution
- Energy efficiency
- Waste management
- Water scarcity
- Biodiversity and deforestation

Social
Well-being of multiple stakeholders
- Gender and diversity policies
- Safety and quality controls
- Human rights
- Labor standards
- Privacy and data security
- Employee engagement

Governance
Transparency, capacity, purpose
- Board diversity
- Corporate ethics
- Executive compensation
- Bribery and corruption policies
- Lobbying activities
- Accounting practices

It is important to discuss ESG factors with clients clearly and succinctly so they understand what sustainable investing means. We offer the ESG Factors graphic as a useful guide for describing the variety of considerations in play.

In spite of its rise in popularity and demand, ESG investing and related investment products can be a mystery to many clients. The oldest, and most limited, type of ESG investing focuses on exclusionary screening, which simply avoids investing in industries with negative ESG characteristics. A broader, and more modern, type of ESG investing is based on sustainability—these products feature a strong tilt toward the highest-scoring ESG companies and often involve direct engagement to promote better sustainability outcomes as part of the investment objectives. A company that builds small water treatment facilities (and trains local residents on construction and maintenance) may be a sustainable investment.



Majority of advisors avoid discussing ESG due to a perceived lack of knowledge.

Conversation Tip:

Ask your clients about their values and convictions surrounding environment, social, and governance principles.

80% of advisors report having a deep conversation about values with their clients has resulted in clients increasing their investment and loyalty.[7]

7 Nuveen, The Fifth Annual Responsible Investing Survey, December 9, 2019

Step 2: Answering the "Why"

Why ESG investing matters to your clients.

The consideration and assessment of company ESG practices is rapidly becoming more important for long-term investments. Therefore, all investors should understand why ESG matters.

Conversation Tip:

Review how companies managing ESG risks may have a competitive advantage over others.

Assessing and Mitigating Risk:

There is a growing awareness of the potential financial impact of environmental, social, and governance issues. In recent years, there have been numerous events with wide-reaching implications for company leadership, sales and stock prices. Current business models must be responsive, and investors need to have the information to identify successful leaders whose companies aim to mitigate risk by having good sustainability practices.

Emerging Regulations

New ESG regulations are accelerating globally, underpinned by a movement to make these disclosures a standard part of corporate communications. EU and UK regulations now require asset managers, advisors, and pension funds to consider ESG risk as part of their fiduciary duties. EU regulators also require credit rating agencies to disclose how ESG factors are considered. This reflects a broader trend toward integrating ESG into financial decisions.

About 97% of sustainable finance policy revisions were developed since 2000, with over 80 new or revised policy instruments in 2019.[8]

8 Taking Stock: Sustainable Finance Policy Engagement and Policy Influence, PRI, 2020

Step 3: Tackling Common ESG Myths

Even with the exponential growth and adoption of sustainable investing, there are still many misconceptions on the topic.

First Myth: Sustainable Investing is a Fad
There are currently over 2,700 signatories of the UN-led Principles for Responsible Investment (PRI) agreement. This group represents global assets totaling about $90 trillion.[8]

By signing, these asset management firms agreed to:

1. Incorporate ESG into investment decisions,
2. Be active shareholders,
3. Promote ESG disclosures from companies invested in,
4. Promote ESG adoption across the industry,
5. Be transparent in all ESG activities, and
6. Work with signatories to promote these principles.

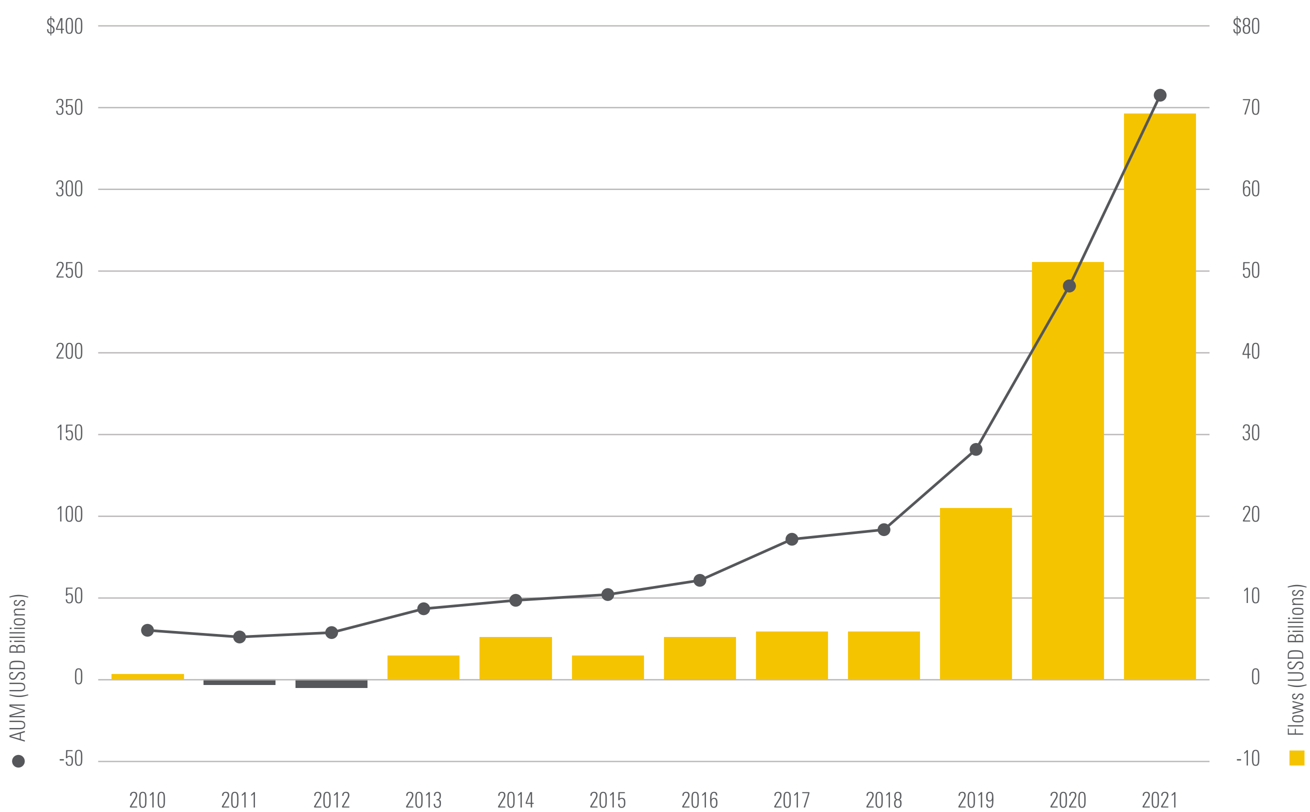
A global survey of institutional investors and hedge fund managers (representing $6 trillion in assets). They found 84% of managers had demonstrated increased interest in ESG-oriented funds and strategies.[9]

8 PRI welcomes 500th asset owner signatory, Lorenzo Saa, January 27, 2020
9 KPMG International, CREATE-Research, AIMA and CAIA, "Sustainable investing: fast-forwarding its evolution", as of February 2020.

Global survey found 84% of managers increased their interest in ESG-oriented funds.[9]

It would be easy, but incorrect, to claim that data supporting the increased interest in environmental, social and governance-focused investing is being pushed by fund producers. With over thousands of funds available to invest in, investors have no shortage of choices. This is why the dramatic jump in ESG-focused funds is so meaningful. Per Morningstar, Inc., at the end of 2020, the group of sustainable open-end funds and ETFs available to U.S. investors numbered 392, up 30% from 2019. The group has experienced a nearly fourfold increase over the past 10 years, with significant growth beginning in 2015. This interest continues even through the COVID-19 pandemic.

Sustainable Funds Annual Flows and Assets



Source: Morningstar. Data as of December 31, 2021. For illustrative purposes only. Includes funds that have been liquidated; does not include funds of funds.

Second Myth: ESG Investors Must Accept Lower Returns

This is one of the most hotly debated elements of the ESG growth story, but it doesn't need to be. In theory, if an investment is restricted to a certain subset of the investing universe, one would expect some reduced returns. However, the data suggest ESG funds may outperform traditional funds, especially for ESG funds with lower fees. The above-50% outperformance rate for surviving sustainable funds, those that existed 10 years ago and still exist today, in most categories over multiple time periods indicate that investors taking the ESG route were less likely to miss out on returns than if they had invested in traditional funds. However, because ESG funds represent a subset of the investment universe, returns may differ from traditional investments.

Sustainable Funds' Outperformance* Rate by Morningstar Category (%)

	Outperformance* Rate of of Sustainable Funds			
Category	**1-Year**	**3-Year**	**5-Year**	**10-Year**
Global Large-Cap Blend Equity	75.1	73.7	76.9	67.3
Global Large-Cap Growth Equity	60.3	**43.2**	**37.5**	56.7
Global Emerging Markets Equity	**41.3**	60.0	58.8	50.0
U.S. Large-Cap Blend Equity	76.4	71.4	76.9	81.3
Europe Large-Cap Blend Equity	71.1	75.0	67.2	55.1
Eurozone Large-Cap Equity	63.5	63.0	60.6	62.3
EUR Corporate Bond	58.0	58.5	62.2	**33.3**
All Categories	**65.6**	**65.6**	**64.4**	**58.8**

Source: Morningstar Direct. Morningstar Research. Data as of December 31, 2019. For illustrative purposes only. Past performance is not a guarantee of future results.
*This table shows the percentage where the sustainable fund outperformed the equivalent "traditional" fund over the term shown

Conversation Tip:

Based on data, it appears there is no direct performance impact for sustainable investing.

Step 4: A Dual Mandate: Helping reach clients financial and sustainability goals

It's time to leave behind more than just an inheritance.

Our ESG portfolios are focused not only on helping reach financial goals for the long-term, but also aligning client's investments with their values.

ESG Asset Allocation Portfolios

Our ESG Asset Allocation Portfolios combine our valuation-driven asset allocation approach with ESG-focused mutual funds and ETFs to create core portfolios for investors with a preference for sustainability.

U.S. Sustainability Moat Focus Portfolio

The Morningstar U.S. Sustainability Moat Focus Portfolio seeks to invest in companies with moderate to low ESG risk and long-term competitive advantages that are undervalued within an equity-focused, Separately Managed Account (SMA).

Morningstar ESG Asset Allocation Portfolios

ESG Asset Allocation Portfolios help provide a professionally managed diversified investment with exposure to ESG-friendly assets across the globe. This allows an investor to make the entire portfolio ESG-friendly while aiming to reduce risk and improve return potential.

Sustainable Approach

We aim to generate a positive societal impact by selecting funds with high levels of ESG integration.

Diversified Exposure

We offer professionally managed portfolios that are diversified both financially and across ESG investing styles. We diversify our ESG approach by investing across a variety of ESG strategies rather than catering to an isolated ESG issue.

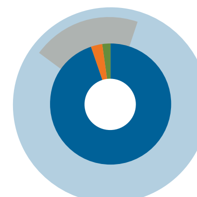
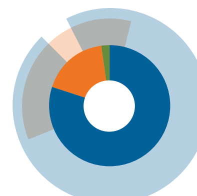
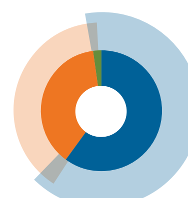
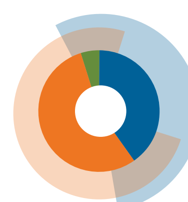
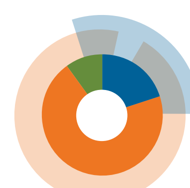
Morningstar ESG Focus

Incorporates research from Morningstar, Inc., a sustainable investing leader who has recently acquired Sustainanalytics, a global leader in ESG research. This ensures that our ESG-managed portfolios are informed by quality information and insight.

Conversation Tip:

The Morningstar ESG Asset Allocation investments must meet strict ESG practice criteria and be selling for less than market value based on our analysis to meet your financial goals.

Alts Cash Equity Fixed Income

PORTFOLIOS	GOAL	ASSET CLASS RANGE	ALLOCATION
Aggressive Growth	Long-term capital appreciation. The portfolio invests primarily in domestic and foreign equities, while seeking to cushion equity market downturns with modest exposure to fixed-income securities.	0-20% 0-25% 80-100% 0-20%	
Growth	Long-term capital appreciation. Designed to help investors to take advantage of the potential for stock market growth by investing primarily in domestic and foreign equities.	0-20% 0-25% 65-95% 5-35%	
Moderate Growth	Long-term growth with moderate volatility. Built with a focus on providing balanced and varied exposure by investing in both equity and fixed-income securities.	0-20% 0-25% 45-75% 25-55%	
Income and Growth	Moderate capital appreciation combined with current income. Combines the growth potential of equities with the balance that fixed-income securities can provide.	0-20% 0-25% 25-55% 45-75%	
Conservative	Protection from capital loss and a safeguard against inflation. Invested in fixed-income and equity securities, it's designed to be best suited for investors who seek current income and stability.	0-20% 0-25% 5-35% 65-95%	

Asset classes shown are determined by Morningstar Category groups. Allocation at the individual account level may vary. Neither diversification nor asset allocation ensure a profit or guarantee against a loss. Those asset classes noted may be known to be a growth engine, income producer, or volatility dampener but there is no guarantee this will hold true. For illustrative purposes only.

Alternative strategies may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

U.S. Sustainability Moat Focus Portfolio

The Morningstar U.S. Sustainability Moat Focus Portfolio seeks to invest in companies with moderate to low ESG risk (measured by Sustainalytics' ESG Risk Ratings) and long-term competitive advantages (measured by the Morningstar Economic Moat Rating) that are attractively valued within an equity-focused, Separately Managed Account (SMA).

Morningstar® ESG Capability

The portfolio employs four Morningstar teams (Morningstar Equity Research, Morningstar Indexes, Sustainalytics and Morningstar Investment Management) combining their research and experience.

Robust, Transparent ESG Data

Sustainalytics, a Morningstar company and global leader in ESG research, provides ESG data and ratings for this portfolio, focusing on ESG risk factors that could be material to financial performance.

Widening the Moat

Investing in companies with durable competitive advantages, or Wide Economic Moat Rating assigned by Morningstar Equity Research team, to provide powerful criteria for stock selection.

ESG and Equity Ratings within the Portfolio[10]

ESG Risk Rating	Medium, Low, or Negligible
Morningstar Economic Moat Rating	Wide Moat
Controversy Score	Four (out of five) or lower in trailing three year period
Carbon Risk Ratings	Carbon Risk Score less than 30 (out of 100). If the security is rated for Carbon Risk, its risk rating cannot be High
Thermal Coal	Excludes Thermal Coal
Product Involvement Screening	• Companies with no more than 50% of revenue derived from tobacco products • No involvement in production of controversial weapons • No involvement in manufacturing of civilian firearms • No involvement in thermal coal extraction or power generation
Fair Value Estimate	The portfolio selects stocks based on lowest current market price to Morningstar Fair Value estimate
Sustainability Rating	Targets Globe Rating of four globes or higher for the overall portfolio[11]

Portfolio Facts

Index	Morningstar U.S. Sustainability Moat Focus Index
Number of Stocks	40–80
Minimum Investment	$75,000
Investment Type	SMA
Underlying Investments	U.S. Equity Stocks
Inception	March 31, 2021

10 Please refer to end disclosures for more information and definitions of ratings.
11 Targets Globe Rating of four globes or higher for the overall portfolio rating. Underlying companies may have a lower rating.

Definitions:

Morningstar Sustainability Rating™
Morningstar Sustainabilty Rating™ is intended to measure how well the issuing companies of the securities within a fund's portfolio holdings are managing their financially material environmental, social and governance, or ESG, risks relative to the fund's Morningstar Global Category peers.

The Morningstar Sustainability Rating calculation is a five -step process. First, each fund with at least 67% of assets covered by a company-level ESG Risk Score from Sustainalytics receives a Morningstar Portfolio Sustainability core. The Morningstar Portfolio Sustainability Score is an asset-weighted average of company-level ESG Risk Scores. The Portfolio Sustainability Score ranges between 0 to 100, with a higher score indicating that a fund has, on average, more of its assets invested in companies with high ESG Risk.

Second, the Historical Sustainability Score is an exponential weighted moving average of the Portfolio Sustainability Scores over the past 12 months. The process rescales the current Portfolio Sustainability Score to reflect the consistency of the scores. The Historical Sustainability Score ranges between 0 to 100, with a higher score indicating that a fund has, on average, more of its assets invested in companies with high ESG Risk, on a consistent historical basis.

Third, the Morningstar Sustainability Rating is then assigned to all scored funds within Morningstar Global Categories in which at least thirty (30) funds receive a Historical Sustainability Score and is determined by each fund's Morningstar Sustainability Rating Score rank within the following distribution:

- High (highest 10%)
- Above Average (next 22.5%)
- Average (next 35%)
- Below Average (next 22.5%) and
- Low (lowest 10%)

Fourth, we apply a 1% rating buffer from the previous month to increase rating stability. This means a fund must move 1% beyond the rating breakpoint to change ratings.

Fifth, we adjust downward positive Sustainability Ratings to funds with a with high ESG Risk scores. The logic is as follows:

- If Portfolio Sustainability score is above 40, then the fund receives a Low Sustainability Rating
- If Portfolio Sustainability score is above 35 and preliminary rating is Average or better, then the fund is downgraded to Below Average
- If Portfolio Sustainability score is above 30 and preliminary rating is Above Average, then the fund is downgraded to Average
- If Portfolio Sustainability score is below 30, then no adjustment is made.

The Morningstar Sustainability Rating is depicted by globe icons where High equals 5 globes and Low equals 1 globe. Since a Sustainability Rating is assigned to all funds that meet the above criteria, the rating it is not limited to funds with explicit sustainable or responsible investment mandates.

Morningstar updates its Sustainability Ratings monthly. The Portfolio Sustainability Score is calculated when Morningstar receives a new portfolio. Then, the Historical Sustainability Score and the Sustainability Rating is calculated one month and six business days after the reported as-of date of the most recent portfolio. As part of the evaluation process, Morningstar uses Sustainalytics' ESG scores from the same month as the portfolio as-of date.

Please click on http://corporate1.morningstar.com/SustainableInvesting/ for more detailed information about the Morningstar Sustainability Rating methodology and calculation frequency.

ESG Risk Score
Sustainalytics' ESG Risk Ratings are designed to help investors identify and understand financially material ESG risks at the security and portfolio level. The ESG Risk Ratings are based on a two-dimensional materiality framework that measures a company's exposure to industry-specific material risks and how well a company is managing those risks. ESG Risk Ratings are categorized across five risk levels: negligible, low, medium, high and severe. Ratings scale is from 0-100, with 100 being the most severe.

Economic Moat
The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define excess economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

To assess the direction of the underlying competitive advantages, analysts perform ongoing assessments of the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

All the moat and moat trend ratings undergo periodic review and any changes must be approved by the

Morningstar Economic Moat Committee, comprised of senior members of Morningstar's equity research department.

Controversy Level Distribution
Sustainalytics scores companies based on their involvement in ESG-related incidents, or controversies, which are depicted as a range from None to Severe, where None equates to no evidence of a controversy and Severe equates to a controversy that could have a severe impact on the environment or society and presents a high risk to the company. The controversy levels are represented on a scale from 0 to 5, where 0 stands for None and 5 for Severe.

At the Portfolio level, we calculate the proportion of the portfolio holdings (long positions only) with a controversy level from Sustainalytics, and if that percentage is 67% or higher, a breakdown of the AUM is displayed for each of the controversy levels.

Sustainalytics Carbon Risk Score
The Sustainalytics Carbon Risk Score evaluates the degree to which a company's economic value is at risk in the transition to a low-carbon economy. The rating is based on an assessment of a company's overall carbon exposure and its management of that exposure, and ranges from 0 to 100. It recognizes that not all industries and not all companies are equally exposed to carbon risk. A company's carbon risk is defined as the unmanaged carbon exposure that remains after considering the management activities being taken to mitigate it.

Morningstar Fair Value Estimate
The Morningstar Fair Value Estimate tells investors what the long-term intrinsic value of a stock is, helping them see beyond the present market price.

Morningstar calculates the fair value estimate of a company based on how much cash we think the company will generate in the future. When determining the fair value estimate, Morningstar also takes into account the predictability of a company's future cash flows--the uncertainty rating. A stock with a higher uncertainty rating requires a larger margin of safety before earning a 4- or 5-star rating.

The Morningstar Fair Value Estimate is a measuring stick for determining long-term intrinsic value.

MORNINGSTAR®

22 West Washington Street
Chicago
Illinois 60602 USA

+1 877 626–3227
mp.morningstar.com
mp@morningstar.com

©2022 Morningstar® Managed Portfolios℠ are offered by the entities within Morningstar's Investment Management group, which includes subsidiaries of Morningstar, Inc. that are authorized in the appropriate jurisdiction to provide consulting or advisory services in North America, Europe, Asia, Australia, and Africa. In the United States, Morningstar® Managed Portfolios℠ are offered by Morningstar Investment Services LLC or Morningstar Investment Management LLC, both registered investment advisers, as part of a discretionary investment advisory service or as model portfolios to third-party advisory programs on a discretionary or non-discretionary basis.

Morningstar® Managed Portfolios℠ offered by Morningstar Investment Services LLC or Morningstar Investment Management LLC are intended for citizens or legal residents of the United States or its territories and can only be offered by a registered investment adviser or investment adviser representative.

The Morningstar® U.S. Sustainability Moat Focus Index is created and maintained by Morningstar, Inc. Morningstar, Inc. does not sponsor, endorse, issue, sell, or promote Morningstar U.S. Sustainability Moat Portfolio and bears no liability with respect to the ETFs or any security. Morningstar® is a registered trademark of Morningstar, Inc. Morningstar®U.S. Sustainability Moat Focus Index is a service marks of Morningstar, Inc.

Morningstar Equity and Credit Research
With more than 120 equity and credit analysts, Morningstar is one of the largest independent sources of equity and credit research in the world. The analysts evaluate companies using a methodology built on fundamental analysis that scrutinizes a company's competitive advantages.

Sustainalytics
Sustainalytics is an environmental, social, and governance and corporate governance research, ratings, and analysis firm. Morningstar, Inc. acquired Sustainalytics in 2020. Sustainalytics provides ESG risk scores on companies and tracks and categorizes ESG-related controversial incidents on companies. Morningstar uses Sustainalytics' company level ESG analytics to calculate ratings for managed products and indexes using Morningstar's portfolio holdings database.

Portfolio construction and ongoing monitoring and maintenance of the portfolios within the Program is provided on Morningstar Investment Services' behalf by Morningstar Investment Management LLC, a registered investment adviser and subsidiary of Morningstar, Inc.

Investment research is produced and issued by subsidiaries of Morningstar, Inc. including, but not limited to, Morningstar Research Services LLC, registered with and governed by the U.S. Securities and Exchange Commission.

The information, data, analyses and opinions presented herein do not constitute investment advice; are provided solely for informational purposes and therefore are not an offer to buy or sell a security; and are not warranted to be correct, complete or accurate. The opinions expressed are those of the author, are as of the date written, and are subject to change without notice. Except as otherwise required by law, Morningstar Investment Management shall not be responsible for any trading decisions, damages or other losses resulting from, or related to, the information, data, analyses or opinions or their use.

Past performance is not a guarantee of future results.

All investments involve risk, including the loss of principal. There can be no assurance that any financial strategy will be successful. Morningstar Investment Management does not guarantee that the results of their advice, recommendations or objectives of a strategy will be achieved. Neither asset allocation nor diversification guarantee future results.

This document contains certain forward-looking statements. We use words such as "expects," "anticipates," "believes," "estimates," "forecasts," and similar expressions to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results to differ materially and/or substantially from any future results, performance or achievements expressed or implied by those projected in the forward-looking statements for any reason.

Morningstar Categories are a proprietary Morningstar data point. While the investment objective stated in a fund's prospectus may or may not reflect how the fund actually invests, the Morningstar category is assigned based on the underlying securities in each portfolio. Morningstar categories help investors and investment professionals make meaningful comparisons between funds. The categories make it easier to build well-diversified portfolios, assess potential risk, and identify top-performing funds. We place funds in a given category based on their portfolio statistics and compositions over the past three years. If the fund is new and has no portfolio history, we estimate where it will fall before giving it a more permanent category assignment. When necessary, we may change a category assignment based on recent changes to the portfolio.
| MIM-BF-1004 | MIMCOMP-10471 | 11/2022