

U.S. Sustainable Fund Flows: First-Quarter 2023 in Review

One fund accounts for nearly all outflows.

Morningstar Manager Research

20 April 2023

Contents

- 1 Key Takeaways
- 2 Flows
- 8 Assets
- 9 New Funds

Alyssa Stankiewicz

Associate Director, Sustainability Research

Contributors

Hortense Bioy, CFA

Jason Kephart, CFA

Megan Pacholok

Important Disclosure

The conduct of Morningstar's analysts is governed by Code of Ethics/Code of Conduct Policy, Personal Security Trading Policy (or an equivalent of), and Investment Research Policy. For information regarding conflicts of interest, please visit: <http://global.morningstar.com/equitydisclosures>

Key Takeaways

- ▶ Investors pulled \$5.2 billion from sustainable funds in 2023's first quarter, driven by a single fund — iShares ESG Aware MSCI USA ETF ESGU — which bled \$6.5 billion.
- ▶ These withdrawals mark sustainable funds' third quarter of outflows in a year.
- ▶ Sustainable active funds bounced back into positive territory following three consecutive quarters of outflows.
- ▶ Offerings from BlackRock and Vanguard dominated the top flow-getters, as they usually do.
- ▶ Higher equity and bond valuations drove sustainable fund assets to nearly \$296 billion, their highest point since the first quarter of 2022.

The U.S. Sustainable Fund Universe

At the end of 2023's first quarter, the group of sustainable open-end and exchange-traded funds domiciled in the United States numbered 638, up nearly 7% from the start of the year.¹ For a fund to be included in Morningstar's sustainable funds universe, it must hold itself out to be a sustainable investment, and the fund's intent should be apparent from a simple reading of its prospectus. While many funds now consider environmental, social, and governance criteria as one factor in the security-selection process, those included in the sustainable funds universe make their commitment clear and prominent, usually through binding guidelines.²

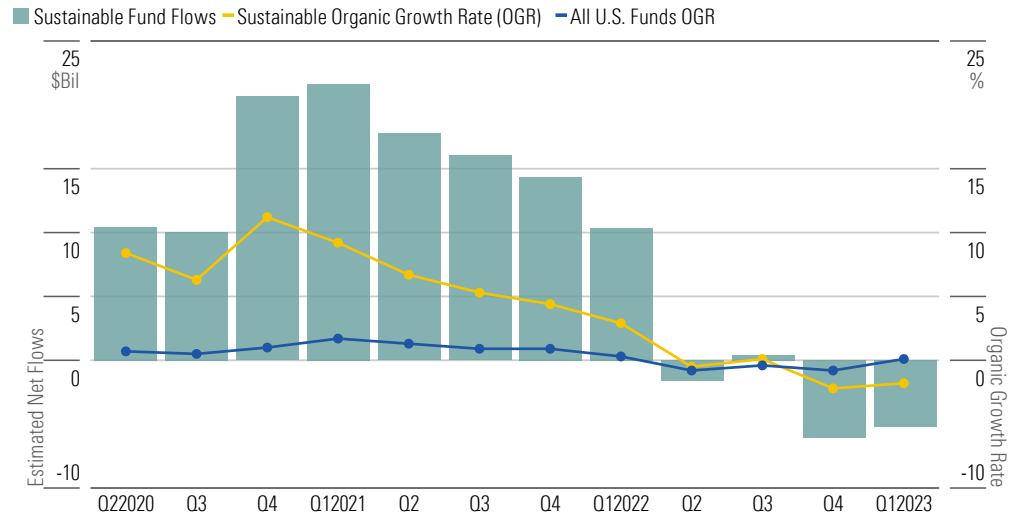
¹ Morningstar's sustainable funds universe excludes money market funds and feeder funds. Funds of funds are included in the count of funds but excluded from flows and assets calculations.

² The prospectus' Principal Investment Strategies section should contain enough detail to leave no doubt that ESG concerns figure prominently in the investment process. For the occasional borderline case, we further consulted the fund reports, websites, and pitchbooks or spoke directly with portfolio managers to confirm the role that sustainability criteria play in a fund's process.

Sustainable Funds Fare Worse Than Conventional Peers ... Again

Investors pulled \$5.2 billion from sustainable funds in the first quarter, for a total of nearly \$12.4 billion from these funds over the past year. Global macroeconomic pressures, including an ongoing energy crisis and rising fears of recession, have driven this retreat.

Exhibit 1 U.S. Fund Flows: Sustainable vs. All U.S. Funds



Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

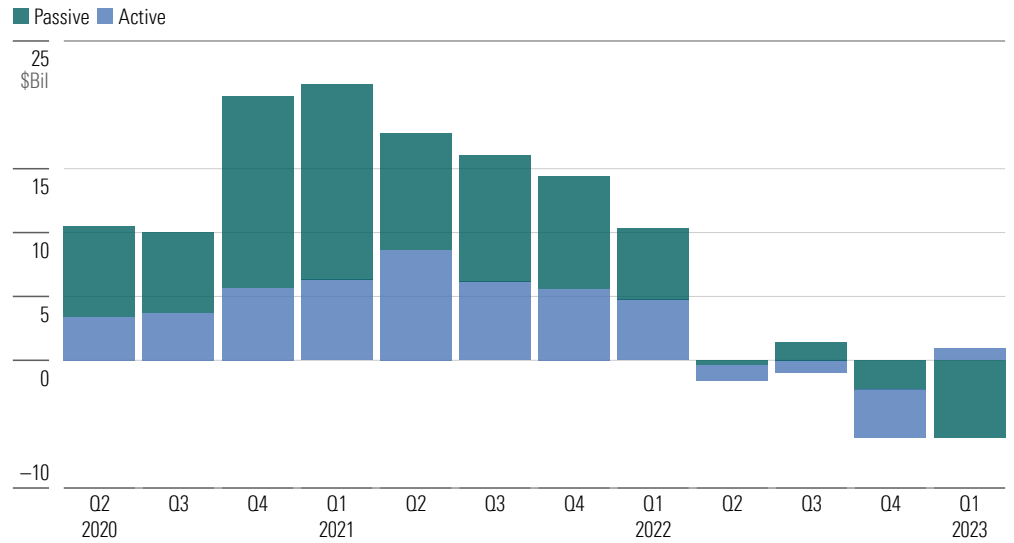
The weaker demand for sustainable funds in the last three months was a notable departure from the total universe of U.S. open-end and exchange-traded funds, which saw \$17 billion in net inflows during the same period, down from their typical \$100 billion-plus quarterly haul, but positive nonetheless.

Consequently, for the second quarter in more than five years, the U.S. sustainable funds segment saw a lower organic growth rate than the total U.S. fund universe. Calculated as net flows as a percentage of total assets at the start of a period, the organic growth rate puts the magnitude of fund flows into perspective. During the first quarter, sustainable funds contracted by 1.8% compared with a tiny 0.08% growth in the overall U.S. funds market.

Active Funds See Inflows for the First Time Since Spring 2022

Sustainable actively managed funds broke a three-quarter outflows streak and bounced back into positive territory, netting a modest \$91 million during the period. This is a brighter picture than their outflows in 2022 but still well below their average quarterly intake of \$6.7 billion in 2021.

Exhibit 2 Sustainable Fund Flows



Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

Meanwhile, passive funds shed nearly \$6.1 billion in the first quarter of 2023, bucking a multiperiod trend of holding down the fort for U.S. sustainable funds. If not for one fund—iShares ESG Aware MSCI USA ETF—passive funds would have ended the quarter in the black.

One Fund Throws a Wet Blanket on Passive Flows

During the first quarter, former star iShares ESG Aware MSCI USA ETF shed nearly \$6.5 billion, almost 15 times more than the second-biggest loser for the quarter. This fund was the top flow-getter among U.S. sustainable funds in 2020 and 2021, and it held the crown as the largest U.S. sustainable fund at the end of 2022 despite outflows during the year. What took place in March set it back to third place.

Exhibit 3 Bottom 10 Sustainable Fund Flows in First-Quarter 2023

Fund Name	Ticker	Fund AUM (\$ Million)	Net Flows (\$ Million)
iShares ESG Aware MSCI USA ETF	ESGU	14,238	(6,463)
Invesco Floating Rate ESG	AFRAX	2,805	(443)
Parnassus Core Equity	PRBLX	25,317	(393)
TIAA-CREF Social Choice Equity	TISCX	5,789	(355)
iShares MSCI KLD 400 Social ETF	DSI	3,551	(342)
Parnassus Mid Cap	PARMX	5,863	(254)
iShares Global Clean Energy ETF	ICLN	4,864	(237)
iShares ESG Advanced Total USD Bond Market ETF	EUSB	587	(213)
iShares MSCI USA ESG Select ETF	SUSA	3,259	(207)
Pioneer	PIODX	6,680	(199)

Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

By contrast, some of the funds in the bottom 10 have sustained outflows over multiple quarters. Four of these funds—Parnassus Core Equity PRBLX, TIAA-CREF Social Choice Equity TISCX, Parnassus Mid Cap PARMX, and iShares MSCI USA ESG Select ETF SUSA—were among the bottom 10 funds for outflows in 2022. This marks the sixth-consecutive quarter for outflows from Parnassus Core Equity, though it remains the largest U.S. sustainable fund to this day.

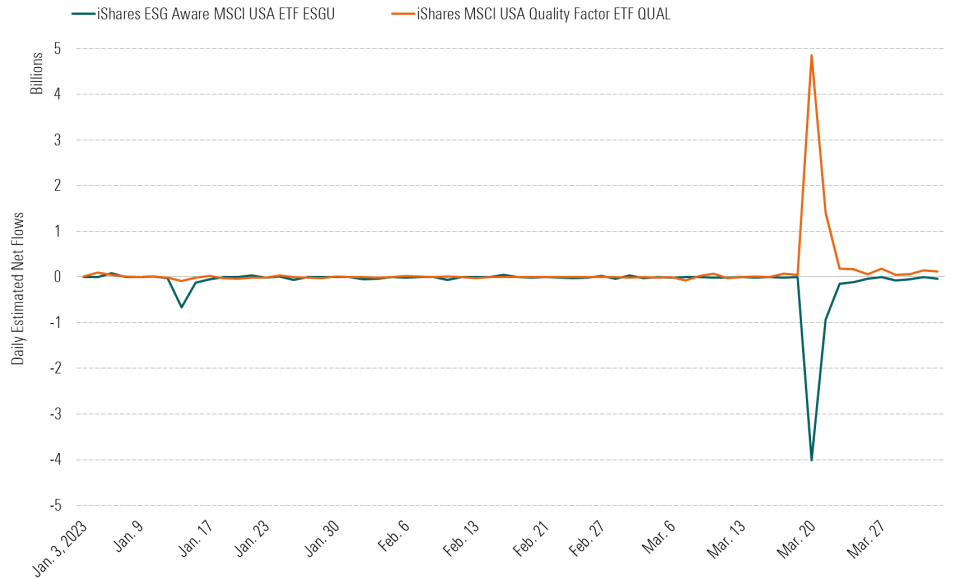
Once-Popular iShares Fund Loses \$5 Billion in One Week

During the week of March 20, 2023, former star iShares ESG Aware MSCI USA ETF shed more \$5 billion.

On March 17, the fund had nearly \$19 billion in assets. It lost more than one fifth of that base on the roller-coaster Monday that followed. This timing matched a change to BlackRock's flagship target allocation ETF model portfolios, which had nearly \$40 billion in assets under advisement as of December 2022. In March, BlackRock's model portfolio management team pared back the allocation to iShares ESG Aware MSCI USA ETF in its portfolios and largely replaced it with iShares MSCI USA Quality Factor ETF QUAL.³

³ As model portfolios are not directly investable, it is impossible to perfectly track the impact of management recommendations. By looking at these two funds' daily net flows, though, we can approximate the effect the models have had.

Exhibit 4 Easy In, Easy Out: Flows Into Quality ETF Mirrored Outflows From ESG ETF



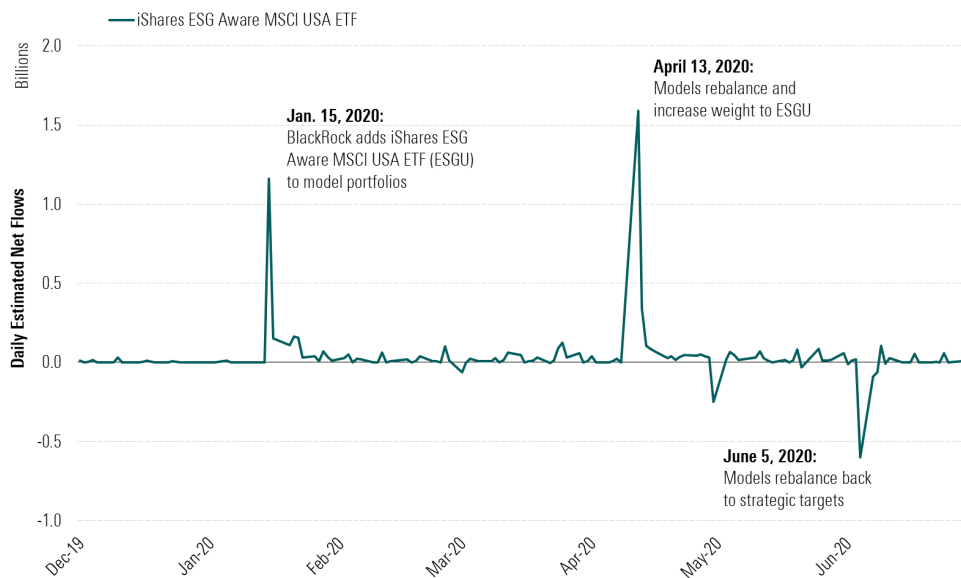
Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

Ongoing economic uncertainty was the principal driver behind this trade. The ESG and quality funds have some similarities, but stocks in the latter tend to have **wider moats than the former**, meaning they tend to have more stable earnings and are better positioned to ride out a recession.⁴

This isn't the first time BlackRock's model portfolio recommendations have driven flows into or out of iShares ESG Aware MSCI USA ETF.

⁴ The Morningstar Economic Moat Rating represents our view of the magnitude of a company's competitive advantage over peers, together with its durability in the long term.

Exhibit 5 iShares ESG Aware MSCI USA ETF Daily Net Flows



Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

In January 2020, management [put this fund on the map](#) when it added it to the flagship model portfolio series. Exhibit 5 shows a clear spike in investors purchasing the ETF when it was added to the models, followed by a larger spike when the team boosted its weight in the portfolios.

A New Face Joins the Top 10 Flow-Getters

GMO launched GMO Resource Transition [GMOYX](#) on Feb. 15, and it quickly catapulted to third place in terms of first-quarter flows. The fund invests in natural-resources companies that it believes will benefit from the clean energy transition. This includes companies involved in mining, precious metals, forestry, and building materials, but it generally excludes traditional oil & gas companies.

Exhibit 6 Top 10 Sustainable Fund Flows in First-Quarter 2023

Name	Ticker	Fund AUM (\$ Million)	Net Flows (\$ Million)
iShares ESG Aware MSCI EM ETF	ESGE	4,369	477
BlackRock Sustainable Advantage Large Cap Core	BIRIX	1,170	475
GMO Resource Transition	GMOYX	448	460
iShares ESG U.S. Aggregate Bond ETF	EAGG	2,720	419
Calvert Equity	CSIEX	6,652	419
Brown Advisory Sustainable Growth	BAFWX	6,780	306
Vanguard FTSE Social Index	VFTNX	14,265	240
Dimensional US Sustainability Core 1 ETF	DFSU	357	209
iShares ESG USD Corporate Bond ETF	SUSC	989	159
Vanguard ESG International Stock ETF	VSGX	3,354	157

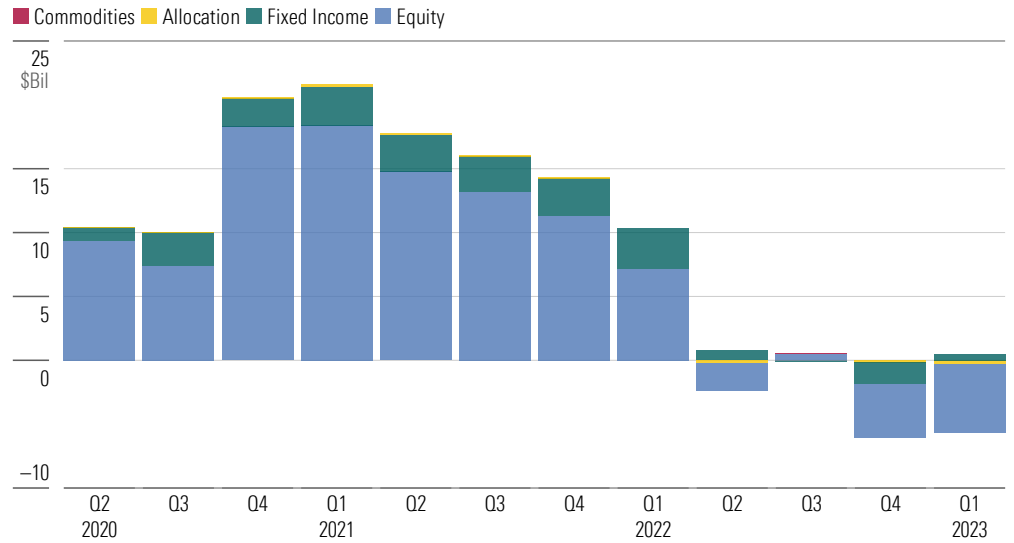
Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

Aside from GMO's new entrant, BlackRock and Vanguard dominated the top flows table, as they usually do, with four and two funds making it to the top 10, respectively. One of these funds—iShares ESG U.S. Aggregate Bond ETF EAGG—has landed among the top 10 for each of the past three quarters.

Sustainable Bond Funds Bounce Back

During the first quarter of 2023, sustainable bond funds boomeranged back into positive territory with a modest \$500 million collection. Two BlackRock funds—iShares ESG U.S. Aggregate Bond ETF and iShares ESG USD Corporate Bond ETF SUSC—led the way, netting \$420 million and \$159 million, respectively. Meanwhile, sustainable equity funds shed \$5.4 billion during the quarter, their third quarter of outflows in the past year. Here, too, iShares ESG Aware MSCI USA ETF drove the overall narrative.

Exhibit 7 Sustainable Fund Flows by Asset Class

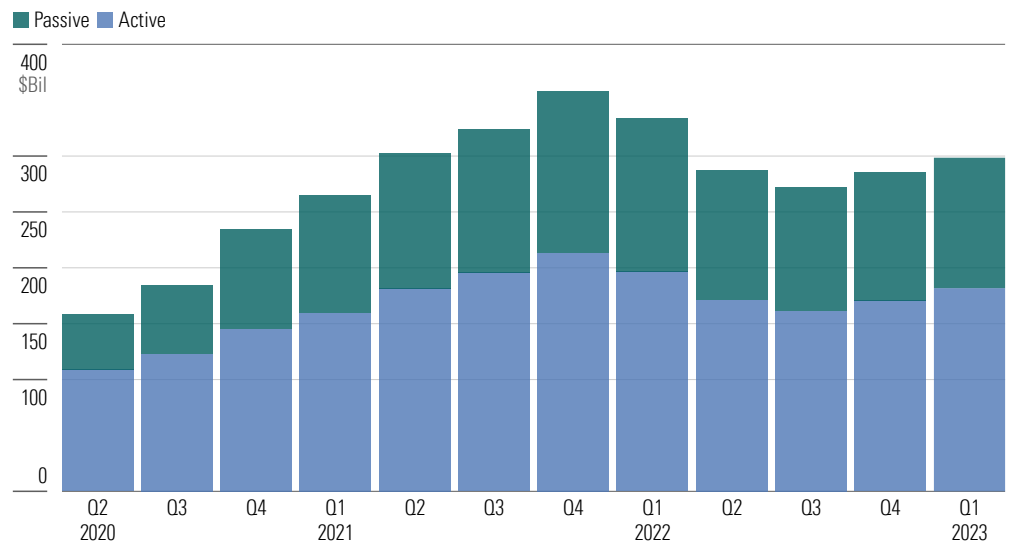


Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

Assets in U.S. Sustainable Funds Rise on the Back of Market Appreciation

Despite outflows from sustainable funds, rising equity and bond markets drove assets in these funds to nearly \$296 billion, their highest point since the first quarter of 2022. This still represents a 17% decline from the all-time record of \$358 billion at the end of 2021. By comparison, assets in the broader U.S. market also peaked at the end of 2021 and slid by 14% through to the end of March 2023.

Exhibit 8 Sustainable Fund Assets

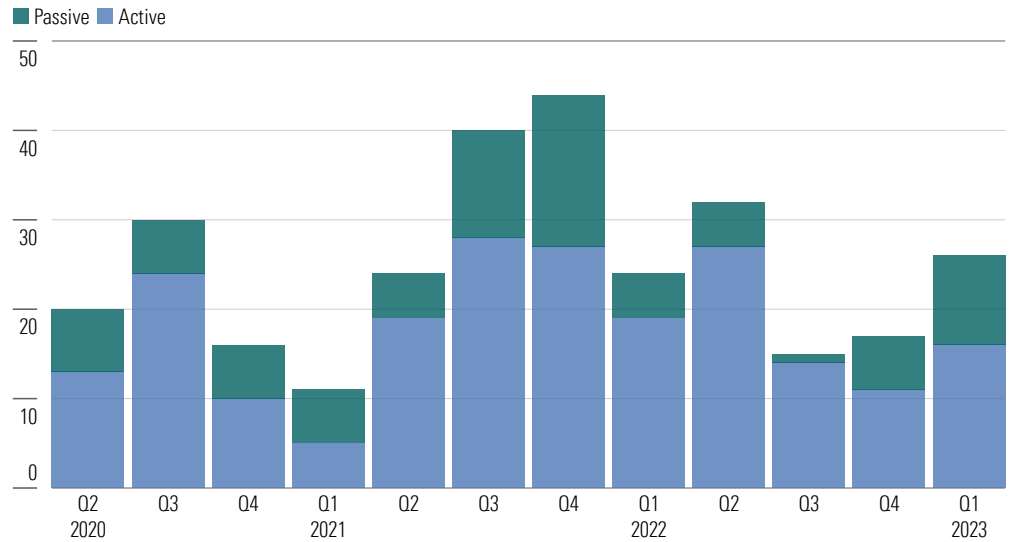


Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

Despite Turbulent Demand, Product Development Picks Back Up

Although investors have largely pulled out of sustainable funds over the past year, some asset managers continue to see prospects for growth. During the first quarter, 27 new sustainable funds came to market, down from the record 44 in 2021’s fourth quarter but up from the latter half of 2022.

Exhibit 9 Sustainable Fund Launches



Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

Calvert, long seen as a sustainable-investing pioneer in the U.S., launched six new exchange-traded funds during the period, most of which replicate preexisting U.S. mutual funds from the firm. One exception is Calvert US Large-Cap Diversity, Equity and Inclusion ETF CDEI, which has been available in Europe since early 2022 but just debuted to U.S. investors.

New Sustainable Funds Launch With Multi-Asset Strategies in Mind

Three of the first quarter’s largest new U.S. sustainable funds were fixed-income ETFs from Putnam. Putnam ESG Core Bond ETF PCRB, together with its ultrashort and high-yield siblings, follows a straightforward sustainable-investing approach that focuses on the best performers (from an ESG perspective) within each fixed-income sector.

Exhibit 10 Largest New Sustainable Funds in First-Quarter 2023

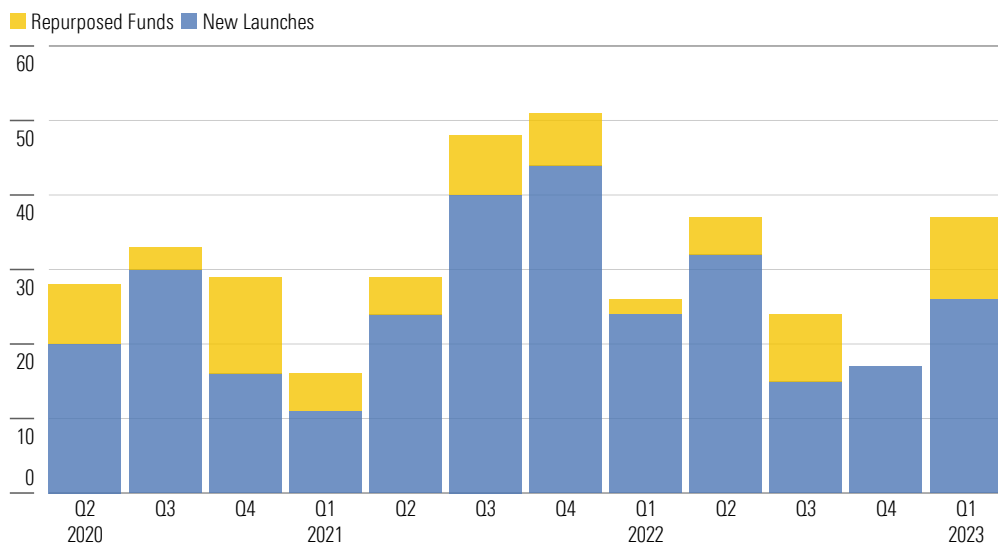
Fund Name	Ticker	Inception Date	Fund AUM (\$ Million)
Putnam ESG Core Bond ETF	PCRB	1/19/2023	463
GMO Resource Transition	GMOYX	2/15/2023	448
Putnam Panagora ESG International Equity ETF	PPIE	1/19/2023	129
Putnam ESG Ultra Short ETF	PULT	1/19/2023	119
GuideStone Funds- Impact Equity	GMEYX	1/27/2023	112
Calvert US Large-Cap Core Responsible Index ETF	CVLC	1/30/2023	110
Putnam ESG High Yield ETF	PHYD	1/19/2023	102
GuideStone Funds- Impact Bond	GMBYX	1/27/2023	63
Cromwell Foresight Global Sustainable Infrastructure	CFGIX	1/31/2023	48
Brown Advisory Sustainable Value	BASVX	2/28/2023	31

Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

These ETFs, along with two new Putnam Panagora ESG ETFs and a couple of funds with longer track records, are destined to be building blocks for Putnam's new Sustainable Retirement target-date strategy, borne out of the firm's previous RetirementReady funds.

One Retirement-Ready Series Gets a Sustainable Makeover

Most of the new options available to investors were launched with sustainable mandates, but firms also occasionally change the investment strategies of existing funds to target sustainable outcomes. In the first quarter of 2023, 11 funds were repurposed to adopt sustainable mandates, although this should be viewed more appropriately as two strategies. Of the quarter's 11 repurposed funds, 10 were individual vintages of the aforementioned Putnam Sustainable Retirement target-date strategy, which the firm overhauled in February.

Exhibit 11 New Sustainable Funds

Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

The future of ESG investing in the [U.S. target-date landscape](#) has been on unsteady footing since 2020, when the U.S. Department of Labor all but banned ESG strategies from serving as the qualified default investment alternative, or QDIA, in defined-contribution plans. When President Joe Biden entered office in 2021, the tone from the DOL turned more favorable, but the debate is far from over. Putnam's sustainable target-date foray marks the third such series on the market, following the Natixis Sustainable Future series from 2017 and the BlackRock LifePath ESG Index series in 2020.

Exhibit 12 Repurposed Funds in First-Quarter 2023

Name	Ticker	Morningstar Category	Fund AUM (\$ Million)
Putnam Sustainable Retirement 2030	PRRTX	Target-Date 2030	233
Putnam Sustainable Retirement Maturity	PRMYX	Target-Date Retirement	217
Putnam Sustainable Retirement 2025	PRRPX	Target-Date 2025	207
Putnam Sustainable Retirement 2040	PRZZX	Target-Date 2040	196
Putnam Sustainable Retirement 2035	PRRYX	Target-Date 2035	191
Transamerica Large Core ESG	TIAFX	Large Blend	167
Putnam Sustainable Retirement 2045	PRVYX	Target-Date 2045	129
Putnam Sustainable Retirement 2050	PRRUX	Target-Date 2050	92
Putnam Sustainable Retirement 2055	PRTLX	Target-Date 2055	46
Putnam Sustainable Retirement 2060	PRTYX	Target-Date 2060	14
Putnam Sustainable Retirement 2065	PCJQX	Target-Date 2065+	1

Source: Morningstar Direct, Manager Research. Data as of March 31, 2023.

The new offerings and repurposed funds brought the total number of sustainable open-end and exchange-traded funds in the U.S. to 638 at the end of the quarter. ■■

About Morningstar Manager Research

Morningstar Manager Research provides independent, fundamental analysis on managed investment strategies. Morningstar views are expressed in the form of Morningstar Medalist Ratings, which are derived through research of three key pillars — People, Process, and Parent. The Morningstar Medalist Rating is the summary expression of Morningstar’s forward-looking analysis of investment strategies as offered via specific vehicles using a rating scale of Gold, Silver, Bronze, Neutral, and Negative. A global research team issues detailed research reports on strategies that span vehicle, asset class, and geography.

Medalist Ratings are not statements of fact, nor are they credit or risk ratings, and should not be used as the sole basis for investment decisions. A Medalist Rating is not intended to be nor is a guarantee of future performance.

About Morningstar Manager Research Services

Morningstar Manager Research Services combines the firm's fund research reports, ratings, software, tools, and proprietary data with access to Morningstar's manager research analysts. It complements internal due-diligence functions for institutions such as banks, wealth managers, insurers, sovereign wealth funds, pensions, endowments, and foundations. Morningstar’s manager research analysts are employed by various wholly owned subsidiaries of Morningstar, Inc. including but not limited to Morningstar Research Services LLC (USA), Morningstar UK Ltd, and Morningstar Australasia Pty Ltd.

For More Information

Connor Furlan
Connor.Furlan@morningstar.com



22 West Washington Street
Chicago, IL 60602 USA

©2023 Morningstar. All Rights Reserved. Unless otherwise provided in a separate agreement, you may use this report only in the country in which its original distributor is based. 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 as of the date written and are subject to change without notice. Except as otherwise required by law, Morningstar 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. The information contained herein is the proprietary property of Morningstar and may not be reproduced, in whole or in part, or used in any manner, without the prior written consent of Morningstar. To license the research, call +1 312 696-6869.