U.S. Sustainable Fund Flows: Q3 2023 in Review

Sustainable funds continued to struggle more than conventional peers.

Morningstar Manager Research

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How We Define the U.S. Sustainable Funds Universe

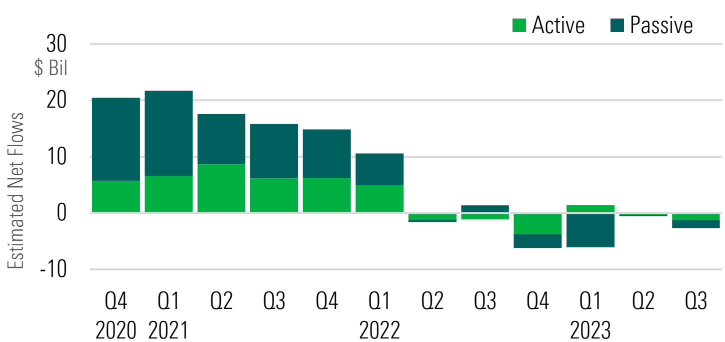
The U.S. sustainable fund universe encompasses open-end funds and exchange-traded funds that focus on sustainability, impact, or environmental, social, and governance factors (per the prospectus). While many funds now consider environmental, social, and governance criteria as one factor in the security-selection process, those included in the sustainable funds universe make their commitment clear and prominent, usually through binding guidelines. Funds of funds and feeder funds are included in the count of funds but excluded from flows and assets calculations. Money market funds are excluded from this report.

For more on Morningstar's Sustainable Attributes Framework, see:
https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/bltd622f21f7860fdb4/Morningstar_Sustainable_Attributes_Definitions.pdf

Key Takeaways

- Investors pulled $2.7 billion from sustainable funds in 2023's third quarter, marking the segment's **fourth-consecutive quarter of outflows**.
- The broader universe of U.S. funds also lost nearly $3.9 billion, but the **relative decline in demand was more significant for sustainable funds** compared with conventional peers.
- **Many factors are in play behind the outflows**, including a challenging macroenvironment with inflation, high interest rates, and recession fears, but also ESG-specific factors such as political backlash.
- Driven by withdrawals and poor market performance, **assets** in sustainable funds **shrank back below $298.8 billion**.
- **One fund – iShares ESG Aware MSCI USA ETF ESGU – accounted for most of the segment's outflows**, shedding nearly $2.1 billion in the third quarter.
- Similarly, Parnassus Core Equity PRBLX was responsible for nearly half of the period's withdrawals from actively managed offerings, marking its **eighth-consecutive quarter of outflows**.
- At the end of the third quarter, the group of U.S. **sustainable funds numbered 661**, up 11% from the start of the year.
- Sustainability-focused **product development slowed significantly** in the third quarter. Fewer new funds launched than at any point in the past three years.
- For the first time in recent history, sustainable fund **closures and departures** (funds moving away from ESG mandates) **outpaced new products**.

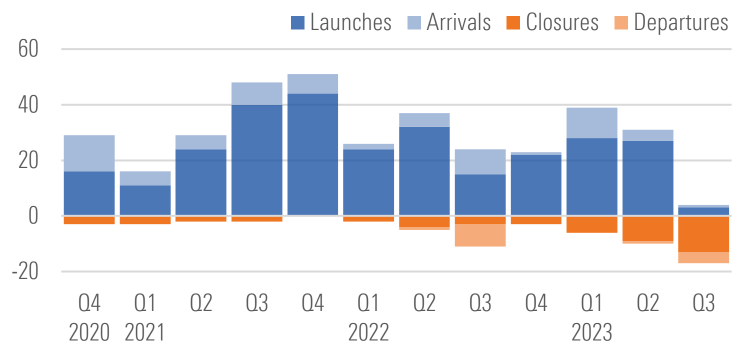
U.S. Sustainable Fund Flows



Sustainable Funds With Highest Outflows

Fund Name	Ticker	Fund AUM ($ Million)	Net Flows ($ Million)
iShares ESG Aware MSCI USA ETF	ESGU	12,102	-2,078
Parnassus Core Equity	PRBLX	25,496	-601
iShares Global Clean Energy ETF	ICLN	3,140	-278
Parnassus Mid-Cap	PARMX	5,316	-229
TIAA-CREF Social Choice Equity	TISCX	5,655	-185

Sustainable Funds: New Arrivals & Departures



Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

U.S. Sustainable Fund Flows & Assets

Investor appetite waned but for a trio of sustainable bond funds.

Weaker Demand for Sustainable Funds Persisted Through a Fourth-Straight Quarter of Outflows

Investors pulled $2.7 billion from sustainable funds in the third quarter, for a total of $14.2 billion over the past year.

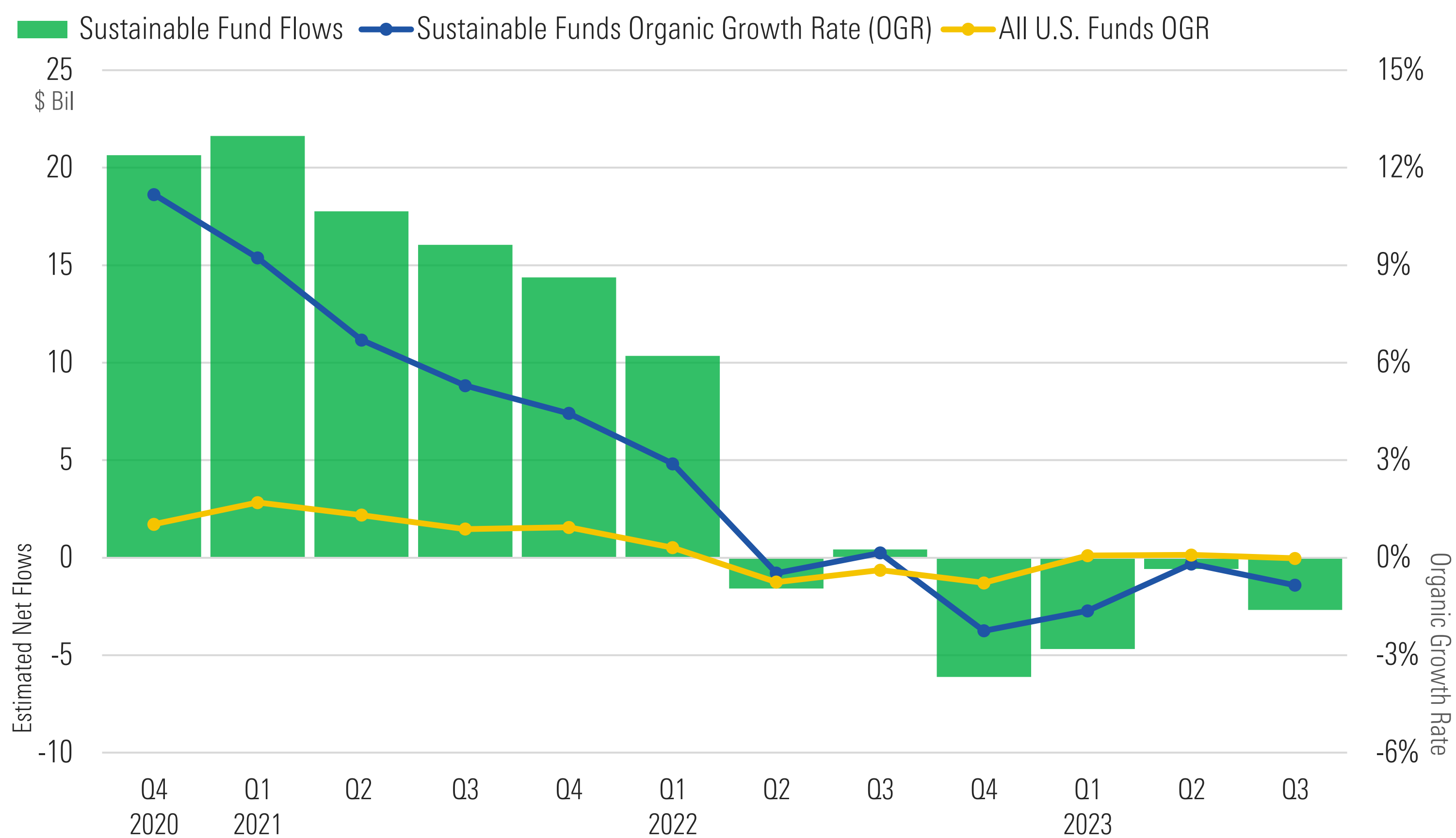
- These withdrawals mark the segment's fourth-consecutive quarter of net outflows.
- Although the motivations behind outflows cannot be perfectly quantified, many factors are in play. These include rising energy prices, high interest rates, concerns about greenwashing, and political backlash.

The broader universe of U.S. long-term funds also lost nearly $3.9 billion over the period, but the relative decline in demand was more significant for sustainable funds compared with conventional peers.

- The organic growth rate* puts the magnitude of fund flows into perspective. During the third quarter, sustainable funds contracted by 0.85% compared with a tiny 0.02% decline in the overall U.S. funds landscape.

* The organic growth rate is calculated as net flows during a period as a percentage of total assets at the start of a period.

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



Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

The Third Quarter's Retreat Affected Active and Passive Funds Alike

Outflows were split almost evenly between actively managed funds and index-tracking counterparts. Both groups shed more than $1.2 billion apiece during the period.

- Sustainable actively managed funds and their passive peers have suffered outflows in five of the past six quarters.
- As shown in the exhibit to the right, passive funds saw inflows during 2022's third quarter, and actively managed funds collected funds in 2023's first quarter.

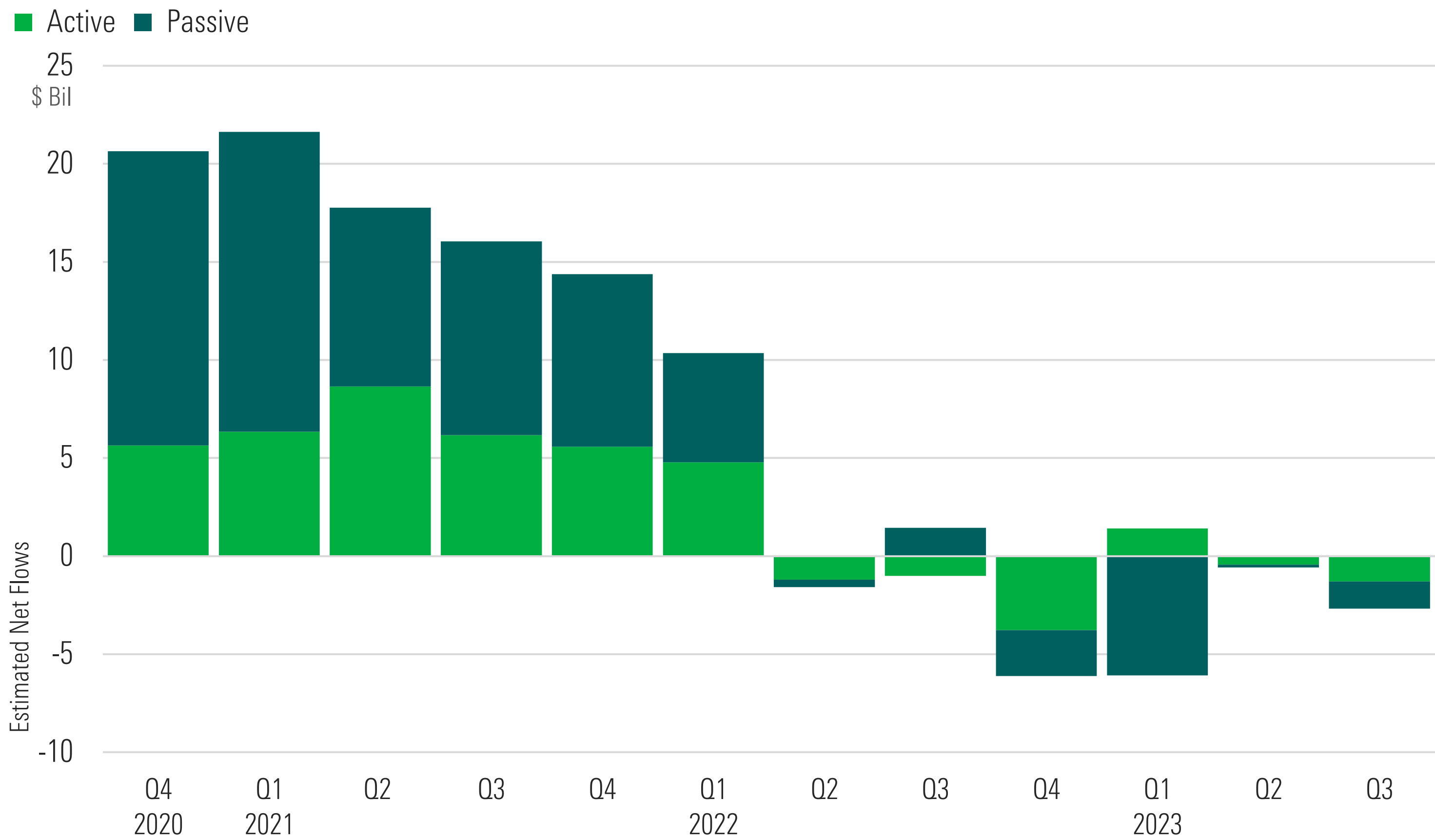
One passive fund – iShares ESG Aware MSCI USA ETF ESGU – lost nearly $2.1 billion during the period.

- Without this fund, sustainable passive funds would have seen minor gains.

Similarly, one fund accounted for nearly half of the quarter's withdrawals from actively managed offerings.

- Parnassus Core Equity PRBLX lost more than $600.7 million during the third quarter, marking its eighth-consecutive quarter of outflows.

Sustainable Fund Flows



Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

Bond Funds Gained Amid Rising Rates

Sustainable bond funds were the lone recipients of net new money for the third-consecutive quarter. Sustainable fixed-income offerings collected nearly $639.3 million as investors sought to lock in attractive yields.

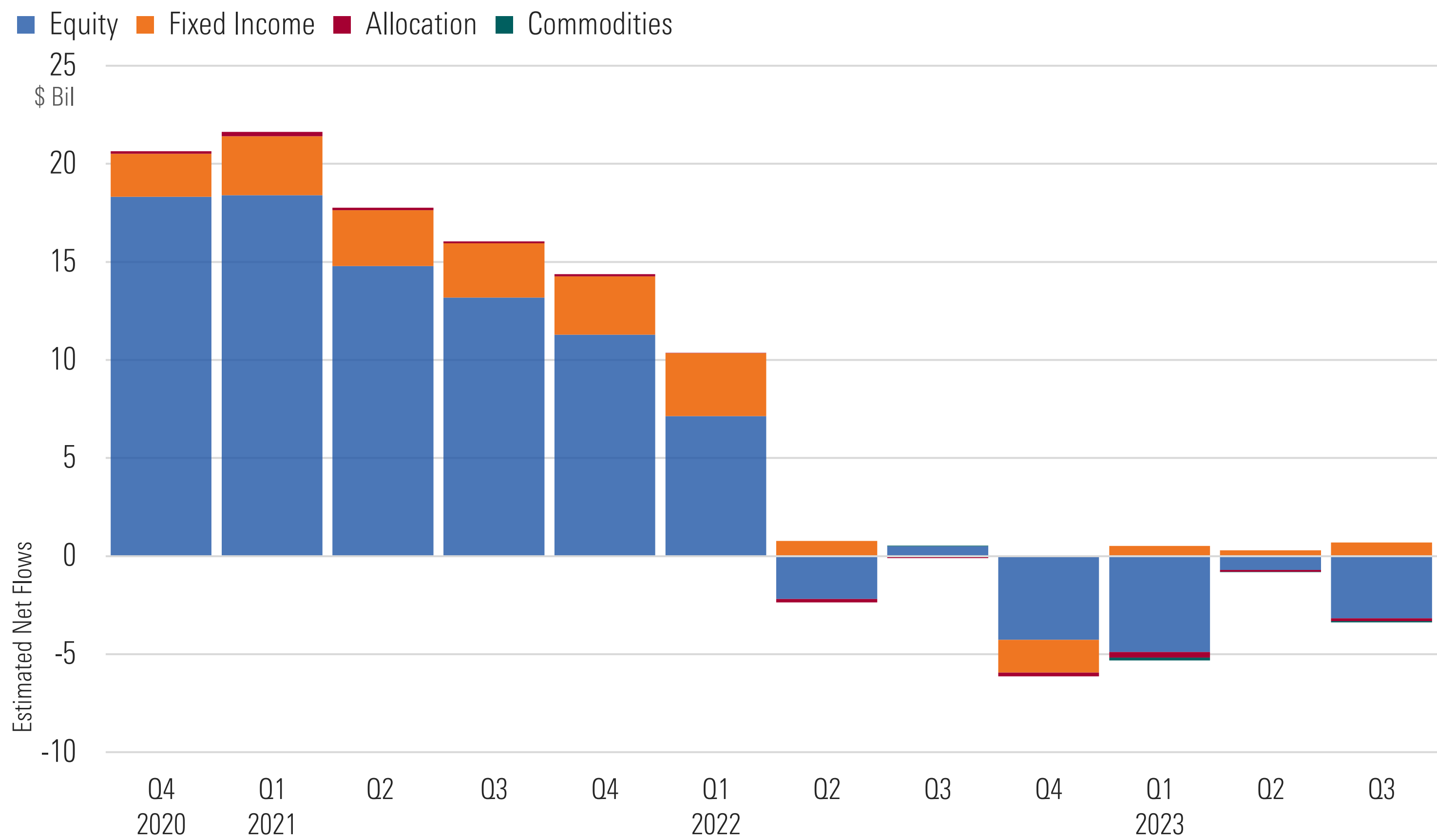
On the other hand, sustainable equity funds endured a fourth-consecutive quarter of outflows. Affected funds range from diversified offerings that minimize environmental and social risks to more concentrated strategies in renewable energy or electric vehicles.

- iShares Global Clean Energy ETF ICLN is the largest U.S. climate fund but shed more than $794.2 million so far this year.

Barely visible in the exhibit to the right, sustainable commodity funds debuted in 2022's third quarter and have suffered outflows in every quarter since.

- There are just 13 sustainable commodity funds in the U.S. sustainable funds landscape, most of which trade carbon credits.
- The largest is KraneShares Global Carbon ETF KRBN, with more than $486.5 million in assets at the end of the third quarter.

Sustainable Fund Flows by Asset Class



Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

Passive Funds Dominated the Top 10 Flow Recipients

The third quarter's biggest winner extended its streak at the front of the pack. IShares ESG U.S. Aggregate Bond ETF EAGG has landed among the top 10 flow recipients for the past five quarters, collecting nearly $1.5 billion over that time.

Two additional bond funds have benefited from inflows as investors seek to lock in attractive yields.

- Calvert Core Bond CLDAX collected $124.4 million during the third quarter, driving a substantial 20% organic growth rate. This marked the fund's seventh-consecutive quarter of net inflows.
- IShares ESG USD Corporate Bond ETF SUSC saw $99.2 million in net new money during the quarter.

The newest fund to reach the top 10 flow recipients is IQ Candriam U.S. Mid Cap Equity ETF IQSM, which launched in October 2022 and raised nearly $172.1 million in its first year.

- Well known in Europe, this is only Candriam's third U.S.-domiciled fund. The firm earns a Morningstar ESG Commitment Level of Advanced.

Top 10 Sustainable Fund Flows in Third-Quarter 2023

Fund Name	Ticker	Fund AUM ($ Million)	Net Flows ($ Million)
iShares ESG U.S. Aggregate Bond ETF	EAGG	3,232	470
iShares MSCI USA ESG Select ETF	SUSA	3,836	436
Goldman Sachs International Equity ESG	GSISX	983	248
First Trust NASDAQ Clean Edge Smart Grid Infrastructure	GRID	1,020	230
Fidelity US Sustainability Index	FITLX	2,471	205
Brown Advisory Sustainable Growth	BAFWX	7,635	195
Vanguard FTSE Social Index	VFTNX	15,245	134
Calvert Core Bond	CLDAX	641	124
iShares ESG USD Corporate Bond ETF	SUSC	1,076	99
IQ Candriam U.S. Mid Cap Equity ETF	IQSM	169	94

Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

The Largest Sustainable Funds Extended Their Outflows

With $25.5 and $12.1 billion in assets, respectively, Parnassus Core Equity PRBLX and iShares ESG Aware MSCI USA ETF ESGU are two of the largest funds in the U.S. sustainable funds landscape.

- These two funds have also landed among the 10 biggest losers for each of the past four quarters.

Parnassus Core Equity has been one of the 10 biggest losers for two years straight, shedding more than $3.9 billion over that period.

- Parnassus attributes a portion of the fund's outflows to the launch of a less-expensive collective investment trust and the subsequent conversion of investors from one vehicle to the other. Our data includes only open-end and exchange-traded funds.

IShares ESG Aware MSCI USA ETF once featured in BlackRock's flagship Target Allocation ETF model portfolio series, which boosted demand for this fund since 2020.

- Following a change to the model portfolios, this fund has shed more than $9.2 billion so far in 2023, driving a 47% contraction to the fund's asset base.

Bottom 10 Sustainable Fund Flows in Third-Quarter 2023

Fund Name	Ticker	Fund AUM ($ Million)	Net Flows ($ Million)
iShares ESG Aware MSCI USA ETF	ESGU	12,102	-2,078
Parnassus Core Equity	PRBLX	25,496	-601
iShares Global Clean Energy ETF	ICLN	3,140	-278
Parnassus Mid-Cap	PARMX	5,316	-229
TIAA-CREF Social Choice Equity	TISCX	5,655	-185
Pioneer	PIODX	6,791	-175
iShares ESG Aware MSCI EM ETF	ESGE	4,104	-160
Calvert Equity	CSIEX	6,509	-155
Impax Large Cap	PXLIX	1,245	-118
Global X Conscious Companies ETF	KRMA	533	-115

Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

Assets in Sustainable Funds Wavered

Driven by withdrawals and poor performance, assets in sustainable funds shrank back below $298.8 billion at the end of 2023's third quarter.

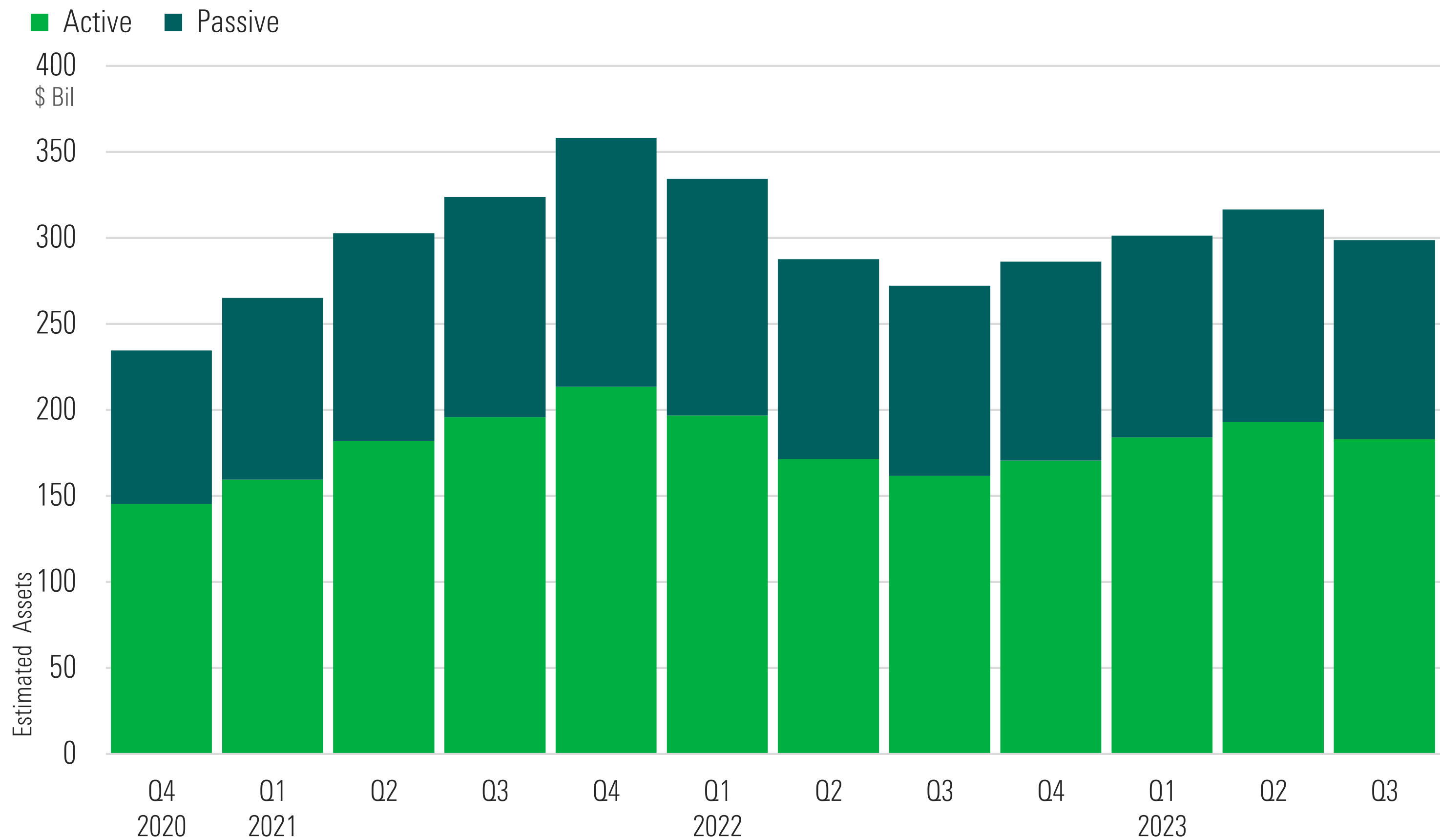
- This represents a 17% decline from the all-time record of $358.2 billion at the end of 2021 but a 10% increase from the recent low of $272.2 billion in 2022's third quarter.

By comparison, assets in the broader U.S. funds landscape also peaked at the end of 2021 and slid by 14% through to the end of September 2023.

Volatile markets further drove assets downward.

- The median sustainable large-blend equity fund lost 3.3% during the quarter, slightly below the Morningstar US Market Index's 3.2-percentage-point fall.

Sustainable Fund Assets



Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

U.S. Sustainable Funds: Arrivals & Departures

Product development slowed while fund closures picked up.

New Sustainable Fund Launches Slowed Amid Weakening Demand

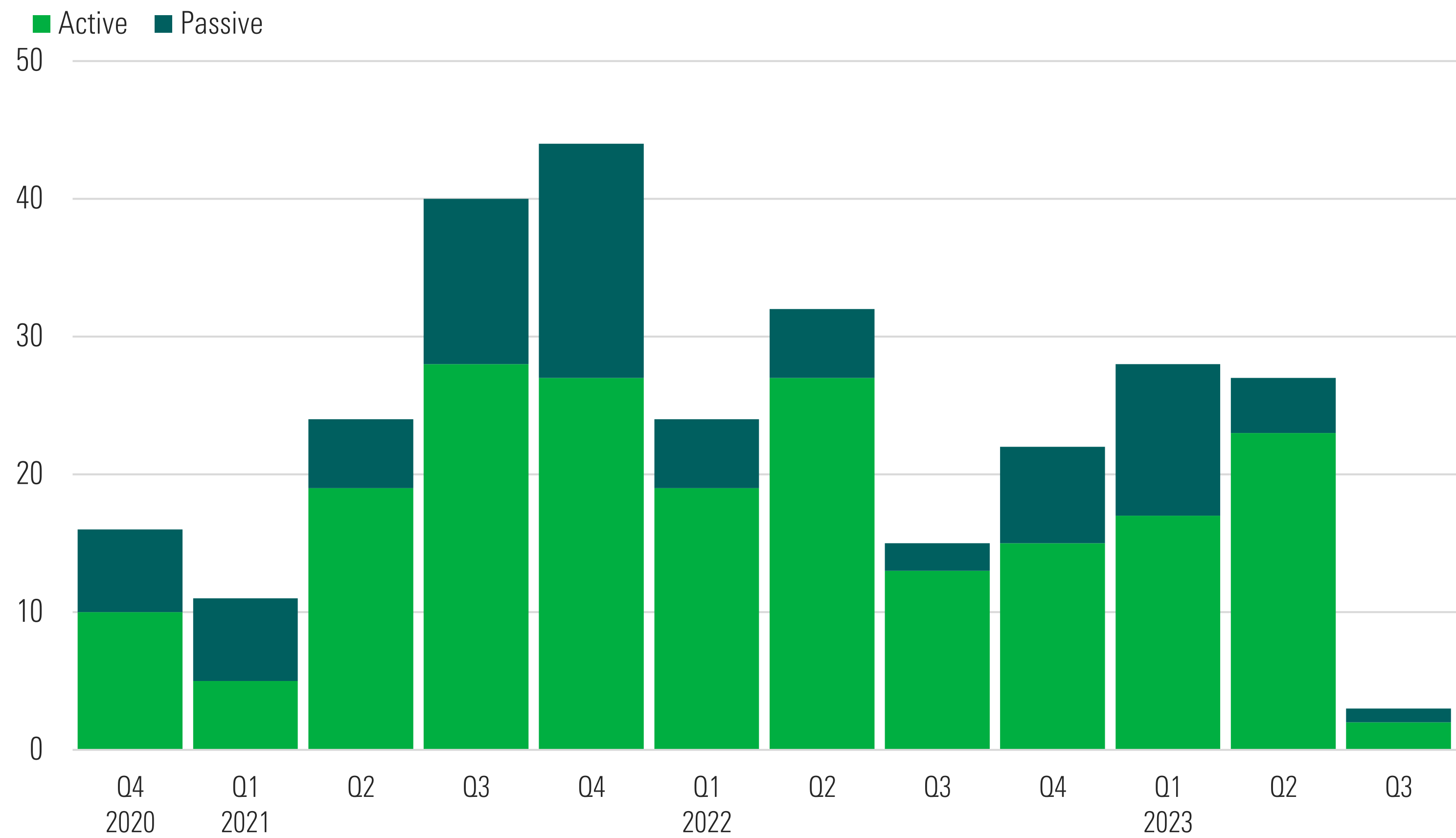
Sustainability-focused product development slowed significantly in the third quarter. Fewer new funds launched than at any point in the past three years.

- Just three new sustainable funds launched during the period, well below the record 44 in 2021's fourth quarter.

Xtrackers launched one new sustainable fund during the period.

- Xtrackers US Green Infrastructure Select Equity ETF UPGR launched in July and reached nearly $4.6 million in assets by the end of September.
- This new launch was muted compared with Xtrackers MSCI USA Climate Action Equity ETF USCA, which launched in April and shot to the top of the second-quarter flows chart.

Sustainable Fund Launches



Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

New Launches Populate Unusual Categories

In the third quarter, three new funds were launched with sustainable mandates. The largest of these came from Xtrackers, the ETF management arm of DWS. Xtrackers US Green Infrastructure Select Equity ETF UPGR tracks an index comprised of companies involved in the production, generation, or distribution of green energy. The index also leverages various sustainability data to minimize ESG risk exposure and avoid involvement in controversial weapons or oil & gas. Including this fund, Xtrackers' ESG-focused U.S. offerings now number 16.

Largest New Sustainable Funds

Fund Name	Ticker	Morningstar Category	Inception Date	Fund AUM ($ Million)
Xtrackers US Green Infrastructure Select Equity ETF	UPGR	Infrastructure	7/12/2023	4.6
Uscf Sustainable Commodity Strategy	ZSC	Commodities Broad Basket	8/8/2023	2.7
Matthews Emerging Markets Sustainable Future Active ETF	EMSF	Diversified Emerging Markets	9/21/2023	1.2

Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

Sustainable Fund Closures Picked Up

For the first time in recent history, sustainable fund departures outpaced arrivals.

- In the third quarter, three new sustainable funds launched and one existing fund was added to the sustainable funds landscape (labeled "Arrivals" in the exhibit to the right).
- During the same period, 13 sustainable funds closed and four funds moved away from ESG mandates (labeled "Departures").

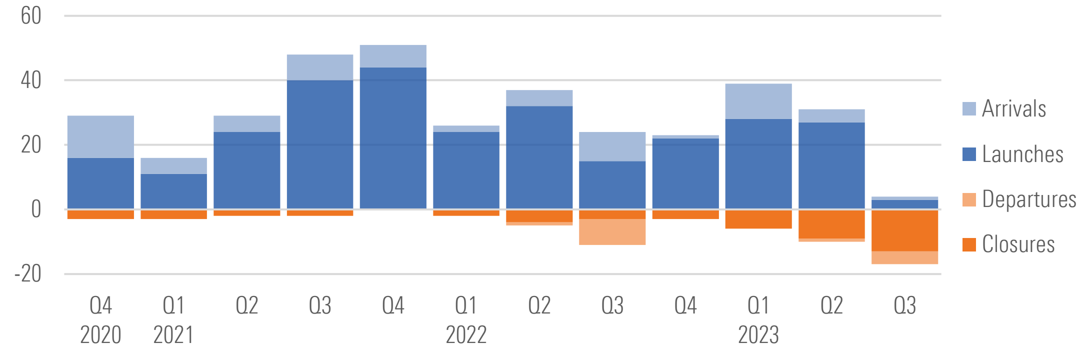
Out of the 13 sustainable funds liquidated during the third quarter, the largest (in terms of assets) came from Columbia Threadneedle, Hartford, and BlackRock.

- Columbia Threadneedle shuttered Columbia U.S. Social Bond Fund in August; it had amassed $35.8 million in its eight years on the market.
- Hartford closed the $9.8 million Hartford Schroders ESG US Equity ETF in July after roughly two years on the market.
- After three years on the market, BlackRock closed two smaller funds – BlackRock U.S. Impact Fund and BlackRock International Impact Fund – with $5.4 million and $4.2 million in assets, respectively.

While sustainability-focused product development slowed, conventional product development picked up.

- Although anecdotal in nature, asset managers report being satisfied with their current sustainable offerings after substantial development. For now, many firms are turning their focus to emerging themes.
- So far in 2023, some of the most popular themes for new fund offerings were Options Trading, Emerging Markets, and Digital Assets.

Sustainable Funds: New Arrivals & Departures



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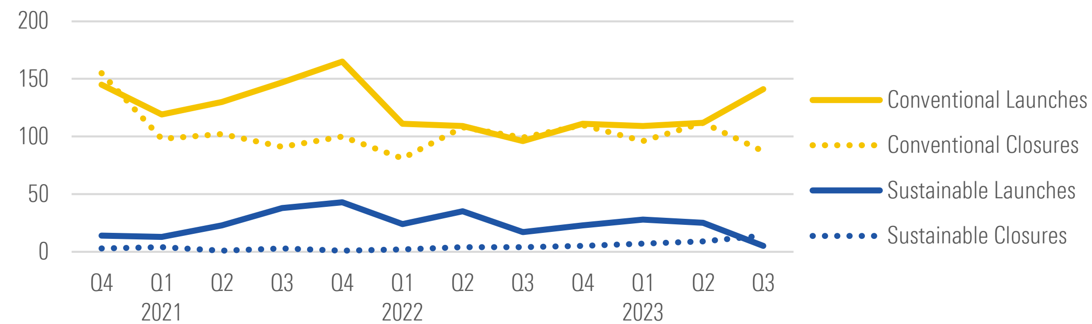
Product Development: Sustainable vs. Conventional Funds



Source: Morningstar Direct, Manager Research. Data as of Sept. 30, 2023.

U.S. Sustainable Funds: Regulatory Updates

Two recent updates and two rules yet to come.

Regulatory Updates

Updates

ESG Options for Retirement Savers

- In September 2023, a **federal judge sided with the U.S. Department of Labor** in a lawsuit concerning "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," the rule finalized by the DOL in November 2022. The rule states that **the duty of prudence* could include the consideration of climate change and other ESG issues**, and it allows for collateral benefits (such as positive impact on people and planet) to act as tiebreakers in plan selection. The rule also lifted prior guidance that made it difficult and risky for employers that wanted to use ESG-focused investment options as default investments for workers automatically enrolling in a qualified plan.

The SEC Set Its Sights on Greenwashing

- In September 2023, the U.S. Securities and Exchange Commission **finalized one rule to help investors better understand and compare funds using ESG criteria in their investment processes**. The commission adopted an amendment to the Investment Company Act's Names Rule, which requires a fund with a name suggesting a focus on a particular type of investment to invest at least 80% of its assets in that style. The amendment broadened the scope of the rule to include "ESG" and "sustainable" funds, compared with the previous focus on terms like "stock" and "bond."

* The duty of prudence is a retirement plan fiduciary's responsibility to make investment decisions based on financially material factors

Still in the Works

Climate Disclosures Should Be Comprehensive, Consistent, and Comparable

- SEC Chair Gary Gensler testified before the House Financial Services Committee in September 2023, casting doubt over the timeline of the upcoming Climate-Related Disclosures rulemaking and potential inclusion of scope 3 emissions. Proposed in March 2022, the rule would require **public companies to enhance and standardize the disclosure of climate-related risks and opportunities**. Although the rule would only apply to company-level climate-risk disclosures, this data would enable funds to provide greater transparency into their climate-risk management strategies, a win for investors. More information about Morningstar's response to the proposal can be found in this article.

Standardizing ESG Fund Disclosures

- In March 2022, the SEC announced a proposal to standardize disclosures concerning funds' incorporation of ESG factors. The proposed rule would **require funds that use ESG criteria in their investment process to disclose more about how they do so** in their prospectuses and annual reports. The proposal identifies and defines three broad types of ESG funds: ESG integration, ESG focused, and impact. The three categories would have different levels of required disclosure. We expect the guidance to be finalized **by the end of 2023**.

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