

ASK THE INSTITUTE

What Is Social Impact Investing (SII)?



Social impact investors seek to invest with a purpose and realize a direct impact. They care not only about monetary returns but also where their assets are invested. SII provides an opportunity for investors to more closely align their personal values with their investment objectives.

What Financial Returns Should Investors Expect?

There is a widely held misconception that SII imposes performance hurdles. In fact, studies suggest that, over the long term, responsible investment strategies have usually met or exceeded the performance of comparable traditional investments on both an absolute basis and a risk-adjusted basis.¹

1. Sources: *Journal of Banking and Finance*, 2005; *Journal of Banking and Finance*, 2011; and *Journal of Investing*, 2011

How Do I Align My Investments With My Values?



Key Takeaways

Social impact investing (SII) aims to align investors' personal values with their investment objectives.

- ▶ Studies suggest that SII does not detract from investment performance and, in fact, can be beneficial.
- ▶ The coming of age of Millennials may reinforce the trend of investing with purpose as well as for profit.

How Do Investors Align Portfolios With Personal Values?

Investors can choose investments that exclude companies whose actions run counter to their values and instead invest in companies or vehicles that strive to make a difference and align with their principles.

How Large Is the SII Market?

The responsible investing industry is growing in size and becoming increasingly diverse. According to a recent study, SII assets in the U.S. grew by an estimated 76 percent from 2012 to 2014; assets under management now reach approximately \$8.7 trillion, up from \$3.7 trillion in 2012 and \$629 billion in 1995; and today, SII accounts for about \$1 out of every \$5 under professional management in the U.S.² Client demand is a key driver for growth in SII. We anticipate that the volume and types of SII investments will only grow larger over time.

2. Source: *The Impact of Sustainable and Responsible Investment*, June 2016

What Common Impacts Do SII Investors Hope to Gain? SII aims to effect change in areas such as:



AGRICULTURE



ANIMAL RIGHTS



EDUCATION

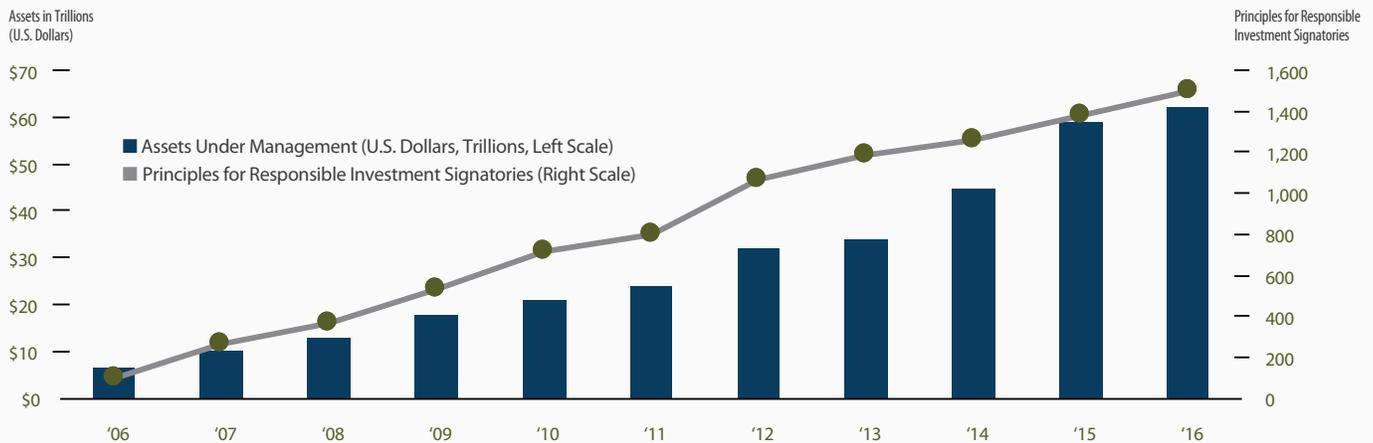


ENVIRONMENT



HEALTH CARE

Global Presence: SII Continues to Grow Worldwide



Source: Principles for Responsible Investing—annual figures. Latest data as of April 2016.

The United Nations-backed Principles for Responsible Investment, a global initiative launched in 2005, has seen increases both in assets under management and in its number of signatories, representing more than 50 countries that have agreed to the principles of responsible investing.

What Are the Key Elements of Social Impact Investing?

Evolving lexicon: A variety of terms have been used to describe SII throughout its history, including responsible investing; environmental, social, and (corporate) governance (ESG) investing; social investing; values-based investing; and sustainability, responsibility, and faith-based investing, to name a few.

Performance and outcomes: SII considers two key objectives: investment performance and social outcomes. SII not only seeks returns that are comparable with traditional investments of like asset classes—but also

seeks tangible social impact or solutions to a wide variety of social and environmental issues.

Motives: Investors choose to incorporate SII into their strategy for a variety of reasons. Religious convictions were the impetus for the earliest social investors and continue to motivate some investors. Over time, responsible investors' scope grew across religious, political, environmental, and social concerns. Like individual responsible investors, many colleges, universities, foundations, and faith-based institutions choose to align investment strategies with their missions and invest in companies that are consistent with their core values.

Four Key Drivers Fueling Growth of SII:



Accessibility

Accessibility to information has improved tremendously, allowing investors to access higher-quality information.



Investment Performance

Investment performance is supported by quantitative metrics and academic studies offering compelling evidence of how SII can support and enhance performance.



Breadth of Values

Investors' breadth of values is expanding, and responsible investing views are becoming increasingly important for companies and governments.



Demographics

Demographics are changing the landscape as Millennials tend to prefer purpose alongside profit.

Will SII Diminish My Portfolio's Return Potential?

There is a widely held misconception that SII imposes performance hurdles and underperforms traditional investment strategies. At times, this presents challenges for SII managers to assuage investors' hesitations about performance. Early on, many responsible investments excluded (via negative screening) objectionable companies or sectors that were reflected in popular benchmarks, limiting investment choices—many of which were profitable. These shortcomings frequently led to lackluster performance relative to investments without such screening.

Research studies now draw a positive link between ESG factors and long-term performance. Over the long term, socially responsible firms with good governance practices can add shareholder value while pursuing social objectives. As SII strategies have grown more mainstream, studies have found that responsible investment strategies can provide competitive returns relative to a benchmark for both value and growth style approaches.

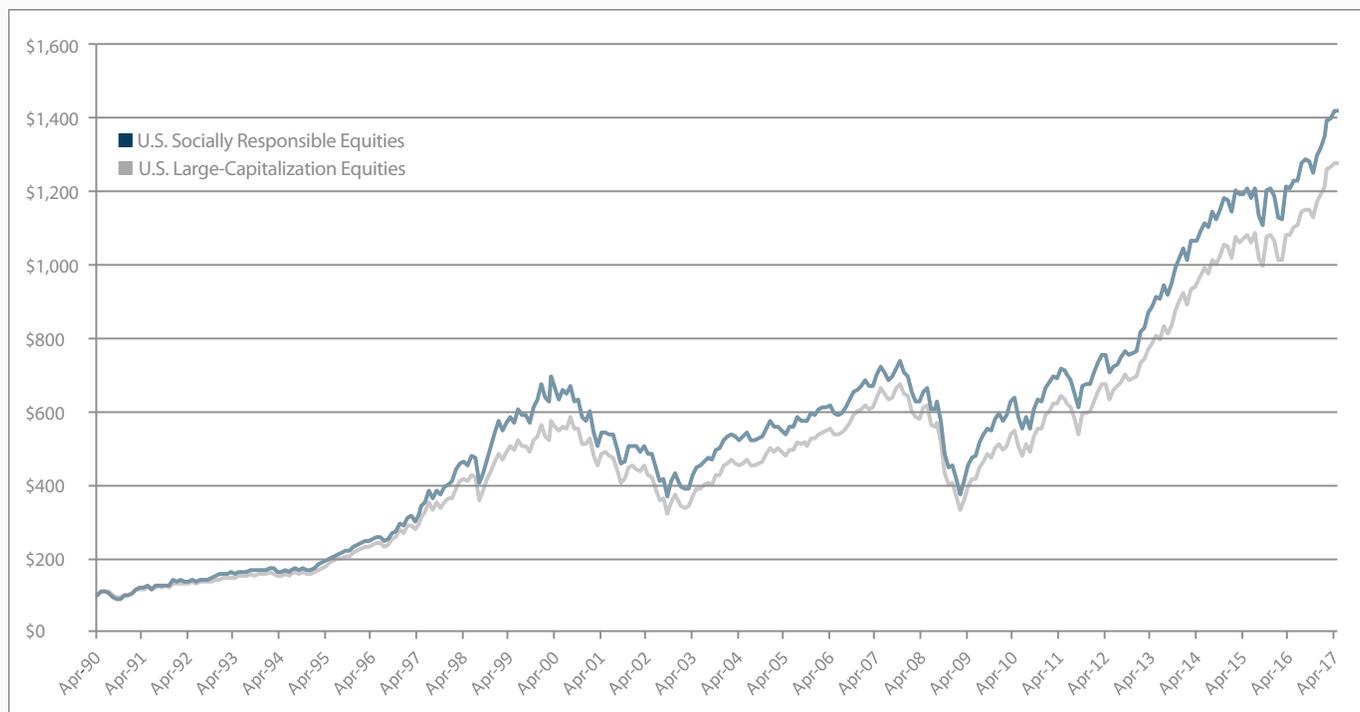
Performance for a well-managed, diversified portfolio should not suffer due to the inclusion of social or sustainable factors. In fact, recent studies suggest that, over the long term, responsible strategies have usually met or even exceeded the performance of comparable traditional investments on both absolute and risk-adjusted bases.¹ Over time, we believe the key drivers of investment performance—diversification and risk management—can be enhanced within an ESG framework.

1. Sources: *Journal of Banking and Finance*, 2005; *Journal of Banking and Finance*, 2011; and *Journal of Investing*, 2011

Will I Face Other Types of Risk With SII Exposure?

Like any investment, SII does come with a distinct set of risks that investors should be aware of. An investment's social policy may mandate that it forgo exposure to certain industries, companies, sectors, or regions. This could cause near-term underperformance compared with similar investments that allow exposure. Moreover, the SII style may shift in and out of favor over time.

SII Strategies and Traditional Strategies Have Performed Similarly



Source: Bloomberg, 05/31/2017. Monthly data. Assumes \$100 invested on April 30, 1990. U.S. socially responsible equities represented by the MSCI KLD 400 Index and U.S. large-capitalization equities represented by the S&P 500 Index.

Information is for illustrative purposes only and does not predict or depict the performance of any investment or the likelihood of achieving any return on an investment. The asset classes shown may not perform in a similar manner in the future. The indices reflect the historical performance of the represented assets and assume the reinvestment of dividends and other distributions and do not reflect the impact of any fees, expenses, or taxes applicable to an actual investment. Stock markets are volatile. Stock values may fluctuate in response to general economic and market conditions and the prospects of individual companies and industry sectors. Sustainable investing focuses on companies that demonstrate adherence to environmental, social, and corporate governance principles, among other values. There is no assurance that social impact investing can be an effective strategy under all market conditions. Different investment styles tend to shift in and out of favor.

Past performance is no guarantee of future results. An index is unmanaged and not available for direct investment. Please see the end of this report for the definitions of the indices shown.

How Is Sustainability Measured?

Using a scoring mechanism of select ESG factors is a common methodology for measuring a portfolio's sustainability or evaluating whether a portfolio is meeting its mandate. Sustainability ratings also help increase transparency and facilitate comparisons across portfolios.

In fact, investors now have access to a wide variety of instruments—exchange-traded funds, mutual funds, and separately managed accounts—that offer customized approaches, including some with lower investment minimums than traditional sectors.

Many investment firms are incorporating an element of SII into their offerings. Wells Fargo Private Bank's dedicated SII team has developed proprietary investment processes for equity, fixed-income, and other SII investment strategies. The team's equity process includes quantitative and fundamental analyses, and its fixed-income process relies on both top-down and bottom-up analyses. Both include a component of ESG analysis to determine the suitability of a particular strategy and evaluate historical performance on both a relative and absolute basis.

Some analysts predict that ESG factors eventually could become a normal part of most investment strategies, particularly for Millennial investors who expect greater transparency from their investments. As Millennials come of age, a large intergenerational wealth transfer is expected to take place. Estimates suggest that about \$30 trillion will be passed down from Baby Boomers to Millennials in the U.S. over the next three to four decades. Surveys suggest that many Millennials view wealth as a means to advance causes they support.

Looking ahead, we expect that the investment choices available for purpose-driven investors will continue to expand. If investing means more than performance to you and you are genuinely concerned about where your money goes, speak with your investment professional about potential risks and opportunities of specific SII strategies that are suitable for your objectives.

How Can I Participate?

Today, SII opportunities for investors continue to evolve. As SII moves further into the mainstream, increasing demand is driving the quantity and quality of investment choices to meet a diverse set of needs. The sheer variety of investment choices available for purpose-driven investors today helps reduce concerns that a particular vehicle is not aligned with an investor's priorities or that choices are available only to high-net-worth investors.

Lloyd Kurtz, Head of Social Impact Investing at Wells Fargo Private Bank:

"Up until about a decade ago, responsible investing largely meant that people avoided certain stocks, such as those of alcohol or tobacco companies. But as the industry has grown, we've seen tremendous change. Many clients want to be able to customize portfolios to their beliefs—whether they are religious, political, or environmental—and we will be able to offer this personal touch to even more clients."

Index Definitions

MSCI KLD 400 Social Index includes 400 companies with high ESG ratings relative to the constituents in the MSCI USA Investable Market Index (IMI) while maintaining sector weights similar to the MSCI USA IMI. The index excludes companies with significant business activities involving alcohol, tobacco, firearms, gambling, nuclear power, or military weapons.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market. Returns assume reinvestment of dividends and capital gain distributions.

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