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THE
Envestnet Edge
INSIGHTS FROM ENVESTNET | PMC

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Investing with impact: increasingly a matter-of-fact

With the growing interest in impact investing, advisors need viable, accessible solutions that allow them to easily pivot client portfolios toward the priorities of key investor groups such as millennials and women.

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This month's Edge is a bit of a departure. Rather than focusing solely on big picture trends, we will discuss some specific products and approaches that are part of a larger trend that we believe will be a key to the future: impact investing. And for our clients to continue to be what we call "the essential advisor," having a suite of tools and options to satisfy that need will be imperative. Hence our shifting gears this month to talk specifically about what we are working on and what we intend to offer as solutions.

Over the past decade, a steady drumbeat in the financial world seemed to signal that the era of impact investing has arrived. Like reports of the death of Mark Twain however, those prognostications were greatly exaggerated, for the average investor most of all.

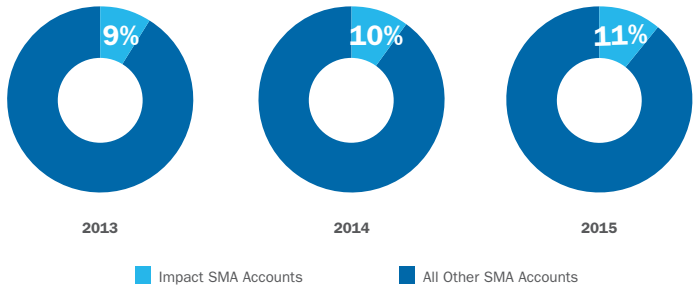
Yes, global pension plans were investing an ever-larger portion of their many trillions of dollars according to "impact" criteria, ranging from environmental to social to corporate governance. For decades, private institutions have screened out investments in companies whose businesses they find morally objectionable, such as gambling, tobacco, alcohol, and pornography. But impact investing for retail or individual investors has

lagged those trends, and financial advisers have been reluctant (Figures 1 and 2) to construct portfolios that incorporate impact criteria out of concern that doing so might negatively affect performance.

Now, however, we think we are nearing an inflection point at last. One reason is that after years of pensions and endowments and private institutions tilting their investments towards impact, it is increasingly clear that there need not be concerns about the trade-off between performance and impact, or between "doing well" and "doing good" (Figure 3). Although it is too soon to know if impact leads to long-term outperformance, it is fairly clear that it does not, per se, raise the risk of underperformance. And, as advisors and their clients embrace "personal benchmarks" that take a more holistic view of client needs, rather than a narrow one of beating an arbitrary bogey, impact investing is rising to the fore as a primary tool for achieving those goals.

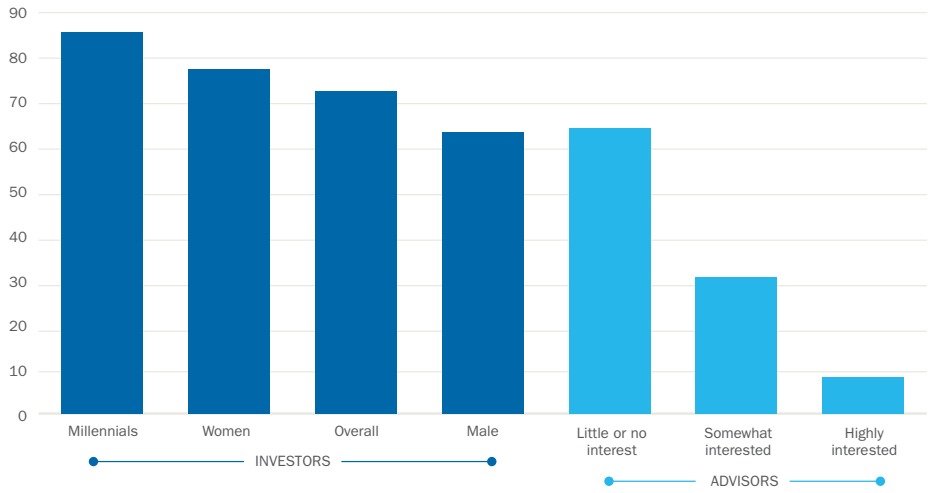
To wit, 84% of millennials and 76% of women, according to a recent Morgan Stanley survey,[1] state that investing with an eye to impact—environmental, social, and corporate governance, especially—is a central goal for them. Other firms

Figure 1:
Impact SMAs remain a small proportion of overall SMA accounts
Growth in % impact SMA accounts on Envestnet platform, 2013-2015



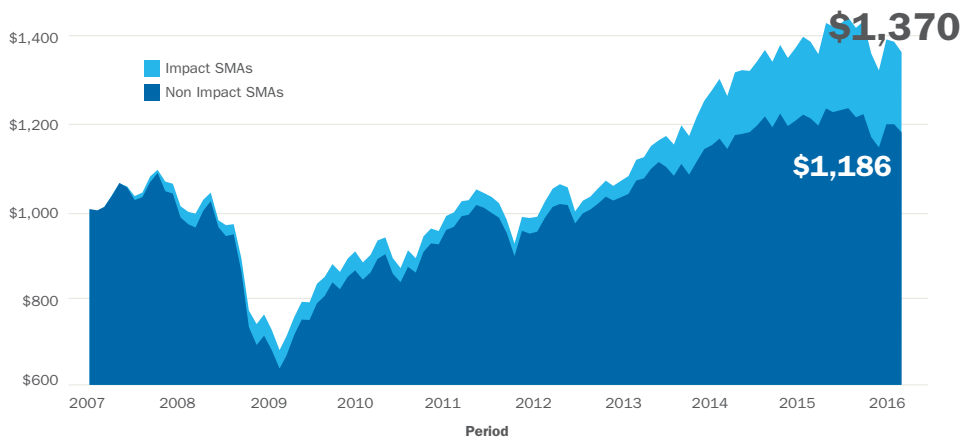
Source: ENVESTAT Intersection, April 2016.
Data from impact and non-impact SMA portfolios, consisting of funds managed by PMC and/or third-party fund strategists, on the Envestnet platform from 2013 to 2015.

Figure 2:
Investors are interested in impact investing; advisors, less so



Source: Morningstar Magazine, December/January 2016.
Data via Morgan Stanley Institute for Sustainable Investing and Cerulli Associates.

Figure 3:
Doing well and doing good are not mutually exclusive
Hypothetical growth of $1,000 in impact and non-impact SMAs (Jan 2007 to Dec 2015)



Source: ENVESTAT Intersection, April 2016.
Data from impact and non-impact SMA portfolios, consisting of funds managed by PMC and/or third-party fund strategists, on the Envestnet platform from 2007 to 2016.

surveying their clients, ranging from BlackRock to J.P. Morgan, have come to similar conclusions. Accordingly, they are dedicating more research and resources to reconfiguring asset management with products and approaches that embed impact principles in portfolios that use both qualitative and quantitative methods.

Our approach

It's one thing to identify a need. It's another thing to satisfy it. A proliferation of impact funds has emerged in recent years, though they still number in the low hundreds, making them a small portion of the overall universe of thousands of actively managed mutual funds and ETFs. Even so, that's a sufficiently large number of options to make an easy choice complicated, given the amount of due diligence required to suss out the best ones.

For years, Envestnet PMC has screened managers, and in partnership with Veris, has also performed due diligence on impact managers. Now, however, working with the groundbreaking firm Sustainalytics, we are significantly expanding both our menu of options and the scope of our research. We not only are augmenting our list of impact managers, but also are working to apply various impact screens so advisers and investors can create quantitative portfolios tilted toward impact that closely track the performance of major underlying indices.

We are doing this based on the simple conviction that these tools are vital for investors. In fact, they represent our own commitment to impact principles and to fiduciary standards of acting in the best interests of clients.

But these tools are also part of a larger wave. The entire industry appears to be tracking the demographic and cultural shift of more women, more millennials, and more concerned people in general who articulate a desire for their investments to be a positive force in the world, and not simply a positive force for their own or their families' lives. For sure, millennials control only marginal assets at present, and it may be that as they age and acquire more wealth, their stated commitment to impact might waver in the face of other concerns. But if the options exist to tilt any and all investment toward impact with similar performance profiles, it seems likely that today's stated intent will become tomorrow's actual behavior.

You can see the growing demand in every corner of the financial services world: more organizations such as Sustainalytics are doing intensive research on global companies, and scoring thousands of them on how well they meet (or fall short) of acceptable standards on everything from environmental impact to employee compensation to carbon intensity. You can see it in the United

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Nations Global Compact and reporting principles, and in how most of the world's major corporations are making these concerns central at the board and C-suite levels. And you can see it in public attitudes in Europe and the United States, where a substantial portion of the world's investible assets reside.

Being able to integrate these factors both quantitatively and qualitatively into portfolios is and will be ever more vital. Having flexible tools ranging from active to passive, from funds that explicitly integrate impact criteria to a basket of stocks that tilt in that direction, will be essential to the advisor, to the client, and by extension to the world as it evolves. Welcome to Impact Investing 2.0. ■

April Take-Away:

Demand is growing for flexible approaches to meet investors' needs for impact investments. As the entire industry tracks this demographic and cultural shift, advisors require tools to help their clients' investments be a positive force in environmental, social, and corporate governance. To meet that need, and in line with our own commitment to impact principles and fiduciary standards, we are expanding our research and menu of options with quantitative portfolios that closely track the performance of major indices.

[1] Morgan Stanley, "Sustainable Signals: The Individual Investor Perspective", February 2015.

About ENVESTAT: Envestat delivers regular digests of business intelligence designed to provide context to the decisions that financial advisors and enterprise business owners face every day. While the regular digests provide insights that revolve around a quarterly theme, our quarterly, Envestat Intersection connects these insights to highlight the significance of the quarterly theme and its impact on advisory practices. The data provided is derived from Envestnet user data composite and has not been independently verified.

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