

What is impact investing?

Impact investing is a term that has different meanings for different people. On the face of it, impact may seem subjective and the kinds of impact an investor would like to make are likely as unique as he or she is. Nevertheless, as the impact investing space has grown, a more concrete definition can be advanced.

Bank of America Global Wealth and Investment Management has adopted the Global Impact Investing Network's definition and views impact investing as: "investments made into companies, organizations and funds with the intention to generate measurable social and environmental impact alongside a financial return." Other common terms for aspects of impact investing include socially responsible investing (SRI); environmental, social and governance (ESG) investing; and values-based investing (VBI). While they have some distinctions, they share common elements of investing strategies designed to create positive change in society.

In its simplest terms, impact investing is the process of choosing an investment with the goal of generating both financial returns and non-financial impact. These investments span the spectrum of asset classes and vehicles, such as publicly traded equities, fixed income instruments and private investments.

In the impact fund space, new public/private financing structures are receiving interest from for-profit institutions and policy makers from the White House to local municipal issuers. In the last few years, there has been a marked increase in social impact partnerships where return is predicated on the success of addressing a particular social issue that results in government cost savings, as well as green bonds that allow investors to gain scalable access to alternative energy and sustainable projects. The Green Bond market stood at US \$121 billion as of April 30, 2016. The universe is now comprised of 700+ bonds, from 26 countries in 24 currencies.

Examples of ESG Factors

Environment

Published goals and progress in managing environmental impact return
Resource utilization - water, waste, energy
Dedicated sustainability office, liability management

Social

Corporate philanthropy, community involvement
Working conditions, supply chain management
Updated and inclusive HR policies, progressive pay policies

Governance

Reporting and disclosure
Published policies, balance of powers, board structure
Product recalls, fines, settlements, consumer and employee lawsuits

There are even companies, including newer structures known as B Corporations, which have a “double bottom line,” with a dual objective of financial return and social or environmental benefit. Impact investing is an area of investments that is growing, driven by entrepreneurs, established business leaders and mainstream investors.

Is there a tradeoff between “doing well and doing good?”

When impact investing started to emerge in the 1970s, investors used negative screening—excluding certain stocks or industries from portfolios—to align investments with their values. For example, an investor may have chosen to screen out investments related to alcohol, tobacco or weapons manufacturers.

While excluding certain investments can provide the benefit of better aligning a portfolio with an investor’s values, this approach can be limited as an investment approach. Negative screens can sometimes amplify risk by eroding diversification and potentially causing unintended concentration of exposure to specific firms or sectors that can result in a portfolio’s failure to perform in-line with a benchmark or achieve an expected rate of return. While some investors accepted this as the price for honoring their beliefs, many did not. And shortfalls in returns entrenched negative perceptions about impact investing.

A good example of how negative screening can lead to significant underperformance can be seen in the energy sector. Ten years ago, investors concerned about climate change had to rely on negative screening of carbon-intensive investments, like coal and oil companies or alternately, invest in a nascent clean tech strategy. When energy markets increased in value substantially over the last decade, and clean tech went through a significant correction, investors lacked a viable alternative to provide them exposure to the energy sector and they missed out on significant gains with no recourse.

However, the impact investing landscape has come a long way since the 1970s. Today, investors and fund managers harness the power of increased availability of impact data from companies and data providers to review investments using positive environmental, social and governance data. This combined with modern portfolio construction techniques helps reduce the risk and performance drawbacks of negative screening.

Changes to the impact investing landscape

Evolution in the impact investing space has largely been a result of pressures coming from the investing community itself. Large institutions and private foundations—including pension funds and endowments—are one group of investors that have been asking for more responsible investment strategies. There is also a strong demand from individual investors, who demand more transparency in their investments across impact traits, such as sustainability and

² Social Impact Bonds are a new and evolving investment opportunity which are highly speculative and involve a high degree of risk. An investor could lose all or a substantial investment. There is no secondary market nor is one expected to develop for these investments and there may be restrictions on transferring such investments.

³ Bank of America Merrill Lynch, “Corporates & EMs Going Green (bonds)”, Thematic Investing, June 18th, 2015 issue.

governance. These individual investors are driving the era of the “conscious consumer,” shopping at organic food stores, buying clothing and accessories from companies with social missions and driving environmentally sensitive cars. Finally, the historic COP21 agreements in 2015 will drive increased global reporting on greenhouse gas emissions as well as innovation in how private capital can be harnessed to address climate change.

Institutional investors were some of the first to start incorporating impact investing criteria into their mandates and are taking an increasingly formalized approach to impact investing. One example of this trend is The California State Public Employee Retirement System (CalPERS) that recently issued a statement that it would evaluate all managers along ESG lines. Such definitive action by one of the largest pension funds in the country has a profound impact on the behavior of other investors. Further evidence is seen in the 2,200 financial institutions, asset managers, service providers and other industry participants that have signed the Principles for Responsible Investment.

Yet, adoption is far from universal. A recent Merrill Lynch survey showed that less than 25% of investors know that impact investing options are available to them. There is evidence that some institutions lack the understanding of how ESG investing works. A survey of 200 university endowments by the Commonfund Institute found that just 53 are “actively engaged in responsible investing,” with just 17 having formally incorporated ESG criteria. Factors such as the difficulty of finding suitably knowledgeable investment managers and a lack of understanding by decision-makers have limited adoption.⁷ The same report also shows that certain investors, such as investment managers at public funds in more politically conservative states, may neither support the specific goals of some ESG investments nor be willing to risk a backlash by critics of those investments.

A significant hurdle that investors, especially institutional boards, face in adopting more robust impact investing guidelines is concern around breaching fiduciary duty and whether ESG investments will deliver competitive returns. Seen leading the way are mission-aligned investors, such as endowments, foundations and schools. These investors are

broadening their analysis of both companies and investment managers to incorporate ESG considerations and becoming conscious of their fiduciary duty in considering other factors beyond simply maximizing short term returns. In fact, the PRI has asked the Department of Labor to examine its definition of fiduciary duty to incorporate these concepts.

Though institutional assets are much larger than those of individual investors, individual investors are driving the demand for impact investing. The U.S. Trust Annual Insights on Wealth and Worth survey indicates a growing desire among wealthy individuals and families to use their wealth for societal impact. More than half of the investors surveyed said that social impact investing is “the right thing to do.” In addition, 49% say they want to make a positive impact on the world and 53% say that corporate America should be accountable for its actions.⁸

These same investors are also changing how they approach investing, with nearly six in ten investors stating that they now consider the social and environmental impact of the companies they invest in to be an important part of their investment decision-making process. And the numbers are even higher for millennial investors. When evaluating investments, 93% of millennials consider social, political or environmental impact important!⁹

The new generation does not see financial and social returns as being separate, and this reflects a change in the structure of the market. Historically, philanthropy was the main avenue where investors could be socially oriented and express their values. However, according to the U.S. Trust 2016 Insights on Wealth and Worth survey, younger generations see no reason to separate investing and impact, which is why 85% of Millennials and 55% of Generation X are interested in or currently use social impact investments.¹⁰

Corporate and governmental response to investor demand

In response to the demand of the investor community and consumer trends a growing number of companies are reporting impact investing and social responsibility data; and the quality of this data is improving.

In 2011, only 20% of the S&P 500 companies issued corporate

⁴ Amanda White, CalPERS gives its managers ESG ultimatum, May 22nd, 2015 available at: www.top1000funds.com/news/2015/05/22-calpers-gives-its-managers-esg-ultimatum

⁵ The United Nations-supported Principles for Responsible Investment (PRI) Initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making practices. For details about this initiative, visit: www.unpri.org/about-pri/about-pri/

⁶ Merrill Lynch 2014 ESG Market Research, November 2014.

⁷ Implementation Hinders Sluggish Endowment ESG Uptake, by Tim Sturrock, FundFire, May 5, 2015.

⁸ Political Minefields Impede ESG Adoption, by Tim Sturrock, FundFire, May 8, 2015.

⁹ “Fiduciary Duty Concerns Create ESG Roadblock,” by Tim Sturrock, Fund Fire, September 25th, 2015.

¹⁰ U.S. Trust 2016 Insights on Wealth and Worth Highlights. Data available at: <http://www.ustrust.com/ust/pages/insights-on-wealth-and-worth-2016.aspx>.

¹¹ U.S. Trust 2016 Insights on Wealth and Worth Highlights. Data available at: <http://www.ustrust.com/ust/pages/insights-on-wealth-and-worth-2016.aspx>.

¹² U.S. Trust 2016 Insights on Wealth and Worth Highlights. Data available at: <http://www.ustrust.com/ust/pages/insights-on-wealth-and-worth-2016.aspx>.

social responsibility reports. By 2014, 80% of the S&P 500 companies were creating corporate social responsibility reports.

There has also been substantial growth in indexes, network services and other collaborative or aggregative sources of social responsibility data from a range of financial index providers. Industry leading data providers like MSCI, Sustainalytics, Thompson Reuters and Bloomberg are all providing data to inform impact investing decisions, with now large teams of ESG focused analysts collecting thousands of ESG data points on companies. However, data from these sources is sometimes difficult to put in context and no one provider has become the go-to source providing easily comparable data in a universally accepted standard.

Compared with traditional investments analysis tools such as credit ratings, there is no broadly accepted source or methodology for evaluating impact investments. In fact, there is no single, standardized way to evaluate the impact of any securities in this space. Efforts are underway to develop frameworks for measurement, notably through the Sustainability Accounting Standards Board (SASB), to define materiality thresholds for the environmental, social and governance factors to qualify as an impact investment, but the market is still evolving towards this goal.

Enhancements to data quality and portfolio construction

While there is still room to grow, the structural changes in the markets and financial innovation have dramatically improved how managers can incorporate impact analysis into their portfolios. Investors are increasingly armed with better data and improved portfolio construction techniques that make it even easier to integrate impact into an investment process.

The proliferation of data means that investors have the environmental, social and governance data that, along with traditional financial analysis, they can use to make informed decisions around investing in sustainable companies. Investors no longer have to focus on leaving out specific exposures through negative screening, but rather can use ESG integration to replace them with other investments that

have similar risk/return characteristics thereby mitigating the risks of exclusion. With the improvement in available data, the number of strategies that now incorporate impact investing into their portfolios has grown significantly (see exhibit 2). ESG factors were incorporated into 925 investment funds in 2014, up from 720 two years earlier and 55 in 1995 as more and more mainstream managers see how they can use impact criteria in their investment management processes. Even when faced with imperfect data, investors can now make better choices that allow them to maintain a balanced portfolio.

What does ESG integration look like? A simple example exists in the healthcare space. While traditional negative screening focused on removing tobacco companies, positive integration allows investors to take that capital and invest it in another consumer goods company that provides healthy drinking water to the developing world, or a healthcare company that manufactures life saving drugs.

Using substitution methods based on the advances in factor-based analysis as well as portfolio optimization techniques, investors can employ positive ESG factors to remove certain exposures and substitute others while maintaining the overall risk and reward characteristics of the portfolio. For example, an investor worried about climate change can exclude a coal

Exhibit 1: Active Weights vs. Market Indices

Market	Index	Time Period	Energy	Materials	Utilities
	MSCI ACWI	Jan/1/1997-Dec/31/13	-5.51%	1.59%	2.75%
	Russell 3000	Jan/1/1988-Dec/31/13	-4.33%	0.67%	3.08%
	S&P/ASX 200	Jan/1/2002-Dec/31/13	-4.48%	2.42%	1.26%
	S&P/TSX Composite	Jan/1/2000-Dec/31/13	-12.39%	5.89%	3.67%

Source: Aperio Group LLC.

Aperio Group's study focuses on hypothetical equity portfolios obtained by excluding carbon industries from standard market indices in Australia, Canada and the U.S., as well as a Global Index. In each market, Aperio excluded from the universe the readily available GICS (Global Industry Classification Standard) industry of Oil, Gas and Consumable Fuels from the broadest available index. In the second step, the remaining stocks are re-weighted so that the portfolio can track the index as closely as possible. The re-weighting process takes into account the fundamental risk characteristics of the excluded assets, such as their size, valuation ratios, leverage, and liquidity. A quantitative optimization is used to match the risk characteristics of the Tracking Portfolio as closely as possible to the risk characteristics of the index.

Exhibit 2: Investment Funds Incorporating ESG Factors 1995-2014

Market	1995	1997	1999	2001	2003	2005	2007	2010	2012	2014
Number of funds	55	144	168	181	200	201	260	493	720	925
Assets under management (\$ billion)	\$12	\$96	\$154	\$136	\$151	\$179	\$202	\$569	\$1,013	\$4,306

Source: US SIF Foundation.

Note: ESG funds include mutual funds, variable annuity funds, closed-end funds, exchange-traded funds, alternative investment funds and other pooled products, but exclude separate accounts and community investing institutions.

¹³ Governance & Accountability Institute Flash Report. Available at: www.ga-institute.com/nc/issue-master-system/news-details/article/seventy-two-percent-72-of-the-sp-index-corporate-sustainability-reports-in-2013-dram.html

¹⁴ US SIF, "Report on US Sustainable, Responsible and Impact Investing Trends 2014," executive summary, at page 13: www.ussif.org/Files/Publications/SIF_Trends_14.FESummary.pdf

company, but add a firm making investments in renewables to retain exposure to the energy sector. Another technique is selecting stocks based on financial and ESG factors, then using optimization to neutralize any sector biases that resulted from this approach.

Improvements in portfolio construction techniques now allow investors and fund managers to incorporate robust quantitative and factor research analysis into their investment decision processes to help build a portfolio with positive impact and return. However, investors still have to be careful about the degree to which they alter the portfolio from the reference index or benchmark. A recent study by the Aperio Group on portfolio substitution shows that divesting from carbon intensive investments can prove difficult. For example, optimized carbon-free portfolios in markets with large concentrations in carbon assets historically have generated substantial tracking error, resulting from sector overweighting that occurs over time. Exhibit 1 shows these sector biases that resulted from a study by Aperio in which they created hypothetical carbon-free Tracking Portfolios over different time periods across four geographies.

Divesting carbon investments meant a shift not to other sectors but to related ones—in this instance to the utilities and materials sectors. The difficulty of this narrow substitution highlights the difficulty of smart screening and the skill required to create robust impact portfolios. However, when done right, with the combination of better data and improved processes, the impact on portfolio performance can be mitigated. Most managers now run optimization processes to neutralize large sector bets which can help reduce tracking error.

of commentary shows that using ESG-related criteria actually helps to augment traditional financial analysis by increasing an investor's ability to assess risks that sit outside of the balance sheet, but are critical to the financial well-being of the company. Therefore, when used alongside traditional financial and risk analysis, this data can lead to better investment decision making.

From a practical standpoint, using impact analysis to evaluate companies can help mitigate risk, regardless of whether the investment is being evaluated for impact. There is wide recognition that companies that do not have good governance, that lack good management, that fail to consider environmental risks or that disregard community impacts are ignoring risks to their bottom line.

In fact, there is a range of ESG-related risks that companies

face. Issues such as climate change, health and safety concerns, and issues with transparency, risk management and governance can have a direct financial impact when they affect a company's operations. The classic case of this is of course the BP oil spill. Poor supply chains and labor policies, and the associated potential PR backlash, can pose a significant reputational risk that translates into lost sales, lower valuations and, in the extreme, consumer boycotts.

In Exhibit 4, looking at the available analysis helps bring these issues into focus. A recent study by Breckenridge shows that using ESG factors enhanced an investment manager's ability to perform credit analysis and evaluate risk management more broadly—so much so that the firm now uses ESG factors in all its investment decisions. The correlations of ESG factors to financial factors were found to be very low and when using

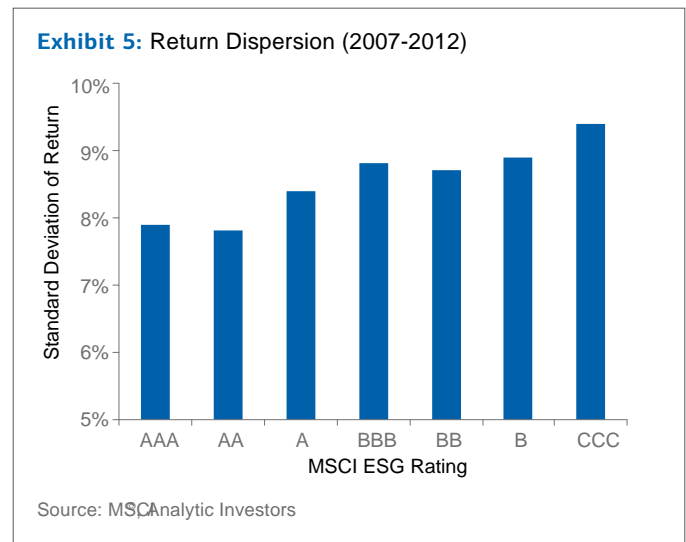
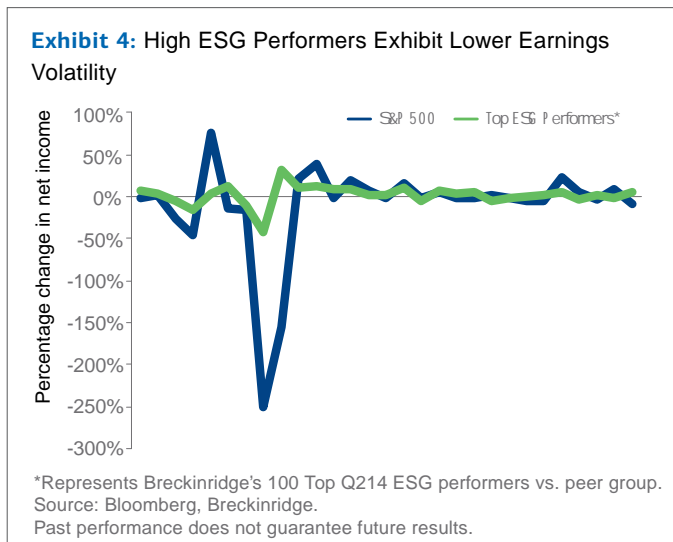


Exhibit 6: MSCI KLD 400 Social Index

Annual Return	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
MSCI KLD 400 Social Index	-12.08	-20.10	28.47	10.31	3.00	13.26	3.72	-34.94	31.73	11.89	1.60	13.24	36.20	12.72
MSCI World Index	-11.02	-21.65	31.01	12.32	6.41	15.70	5.78	-36.98	28.72	17.17	1.23	16.41	33.39	12.51
S&P 500	-11.89	-22.10	28.68	10.88	4.91	15.79	5.49	-37.00	26.46	15.06	2.11	16.00	32.39	13.69
MSCI KLD 400 Social Index vs S&P 500	-1.06	1.55	-2.54	-2.01	-3.41	-2.44	-2.06	2.04	3.01	-5.28	0.37	-3.17	2.81	0.21
MSCI World Index vs S&P 500	-0.19	2.00	-0.21	-0.57	-1.91	-2.53	-1.77	2.06	5.27	-3.17	-0.51	-2.76	3.81	-0.97

	Std Dev			Sharpe		
	3 Year	5 Year	10 Year	3 Year	5 Year	10 Year
MSCI KLD 400 Social Index	8.70	11.52		1.92	1.27	
MSCI World Index	8.71	12.24	15.22	1.94	1.30	0.50
S&P 500	8.56	11.74	14.72	1.94	1.34	0.49

Source: MSCI Returns as of 7/31/15
Historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction.

these factors, Breckinridge was able to identify additional credit risks. Furthermore, they found that companies that manage their ESG risks tended to be more stable credit risks and had lower earnings volatility¹⁷.

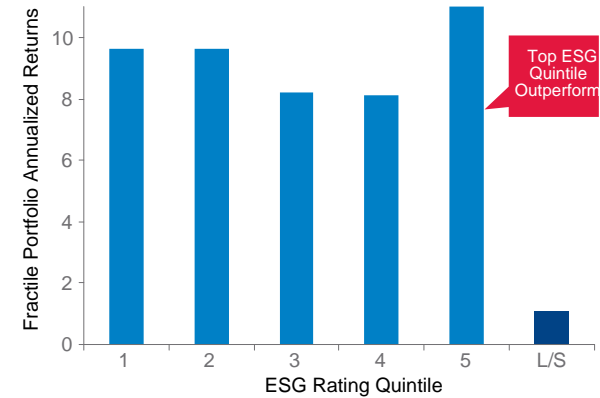
In addition, a paper by Analytic Investors also analyzed the volatility of MSCI ESG rated companies (mapped to the seven point letter scale with ratings from AAA (highest) to CCC (lowest)) found that higher rated ESG companies had a more stable return pattern, leading to the potential for ESG analysis to preserve capital in a portfolio (see exhibit 5).

Another study by Deutsche Bank Climate Change Advisors analyzed existing academic and practitioner research and found that companies identified as having high CSR or ESG rankings historically have had a strong correlation with superior risk-adjusted securities returns¹⁸. These companies typically have a lower cost of debt capital and equity, which is likely a reflection of the market rewarding them with a lower cost of capital in exchange for lower risk. However, in the same study, companies designated as having SRI qualities, which primarily use exclusionary screens, showed little additional benefit, although they did not underperform the broader market¹⁹.

While ESG data and ratings do help inform investors and their use may even lower portfolio volatility, it is important that investors do not confuse ESG ratings with an expected performance or credit rating, like sell side buy/sell ratings or a Moody's rating. For example, investors also frequently are provided with the evidence that the KLD index has outperformed the S&P 500. The MSCI KLD 400 Social Index tracks the top 400 U.S. companies with outstanding ESG ratings and excludes companies whose products have negative social or environmental impacts. However, when you look at the attribution of returns, much of the performance has to do with sector bets or owning/not owning individual companies, not as a result purely derived from the firms' ESG ratings. However, the index, does exhibit lower volatility over the long term, adding to the thesis that historically, investing in these companies has at the very least preserved capital in a portfolio context (see exhibit 6).

While there is debate as to whether ESG ratings can lead to enhanced performance, multiple studies and Bank of America's Global Wealth & Investment Management Chief Investment Office's internal analysis show that there are benefits to the risk-adjusted return profile of a portfolio. Out of the actively managed public equity strategies that met both investment and ESG integration criteria, 60% outperformed other GWIM

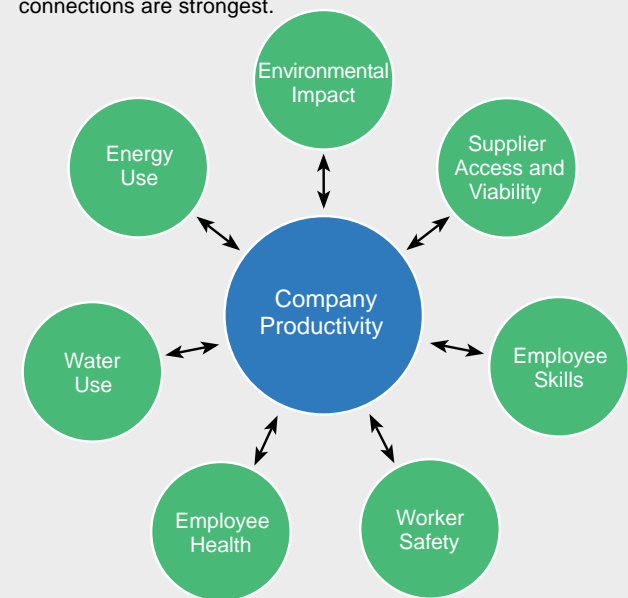
Exhibit 7: Average Monthly Quintile Return of Size Adjusted ESG Score



Source: MSCI ESG Research, Compustat, IBES, Russell, S&P, Thomson Reuters, MSCI Deutsche Bank Quantitative Strategy.
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The Connection Between Competitive Advantage and Social Issues

There are numerous ways in which addressing societal concerns can yield productivity benefits to a firm. Consider, for example, what happens when a firm invests in a wellness program. Society benefits because employees and their families become healthier, and the firm minimizes employee absences and lost productivity. The graphic below depicts some areas where the connections are strongest.



Source: Porter and Kramer, "Creating Shared Value," Harvard Business Review

¹⁷ "ESG Integration in Corporate Fixed Income," study by Breckenridge Capital, January 2015: www.breckinridge.com/insights/whitepapers/esg_integration_in_corporate_esg

¹⁸ The MSCI ratings are based on MSCI ESG Research's Intangible Value Assessment (IVA) methodology. MSCI ESG IVA identifies the key ESG drivers for each industry, calculates a company's risk exposure, analyzes the companies' risk management strategies and ranks each company against its industry peers.

¹⁹ "Sustainable Investing: Establishing Long-Term Value and Performance," by Mark Fulton, et al., DB Climate Change Advisors, Deutsche Bank Group, June 2012: www.institut.com/content/_media/Sustainable_Investing_2012.pdf

²⁰ "Sustainable Investing: Establishing Long-Term Value and Performance," by Mark Fulton, et al., DB Climate Change Advisors, Deutsche Bank Group. Abstract released on SSRN Network, June 12, 2012: www.papers.ssrn.com/sol3/papers.cfm?abstract_id=2222740

CIO Due Diligence analyst covered strategies, which on average have a higher risk-adjusted return than the universe.

Do impact investments also offer the potential for alpha generation?

There is a growing body of research on the alpha-generating potential of impact investing, both empirical studies by companies and academic evaluations. While multiple studies have emerged, it is difficult to generalize about their conclusions and whether impact investing can generate superior returns in comparison to traditional strategies. However, it is worth noting that a significant portion of the timeline of these studies include a period in which negative screening was the predominant approach. Given the enhancements in data and portfolio construction techniques identified above, these results would likely look different if this analysis was conducted again in ten years' time.

Also, when looking at ESG ratings for public companies, a high rating does not automatically equate with high performance expectations. In fact, when looking at an individual company analysis performed by Deutsche Bank the most highly ESG-rated companies did show slight outperformance, but the lowest rated ESG companies outperformed the second and third highest quintiles (see exhibit 7, previous page).

However, other studies have shown that firms that have made a proactive commitment to being environmentally and socially responsible and are serious about good governance practices, also referred to in much of the academic studies as "sustainable companies," are generally better run, more profitable and enjoyed associated cost savings. One could deduce that these savings would allow an investor to create a portfolio of such companies and, if not capture some element of outperformance, at least provide the potential to deliver strong relative performance to the broader market.

Michael Porter, who authored the early work on shareholder value, has done much work on linking corporate value to the emphasis that companies place on responsible and sustainable business models, which he calls "shared value."

Similarly in exhibit 8, a study performed by Eccles, Ioannou and Serafeim analyzed two sets of 180 U.S. companies from 1993 to 2010. One set of companies had adopted sustainability policies by 1993 and were termed "High Sustainability" companies, while the other set had not and were termed "Low Sustainability" companies. "High sustainability" companies delivered returns 47% higher than their low-sustainability equivalents between 1993 and 2010 while exhibiting lower volatility, both on a value and equal weighted basis.

Exhibit 8: Figure 1-Evolution of \$1 Invested in Stock Market in Value-Weighted Portfolio

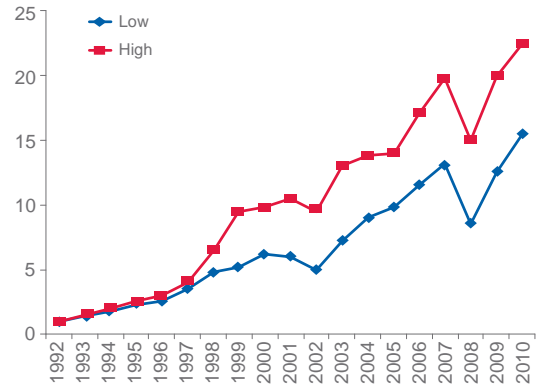


Figure 2-Evolution of \$1 Invested in Stock Market in Equal-Weighted Portfolio²⁴

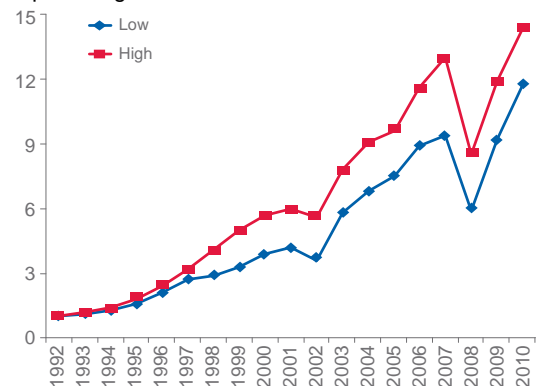


Figure 1 and 2 show the cumulative stock returns of value-weighted and equal-weighted portfolios for the two groups. The researcher identified 90 companies with a substantial number of environmental and social policies that have been adopted for a significant number of years and term these "High Sustainability" companies. Then, they identify 90 comparable firms that have adopted almost none of these policies and term these "Low Sustainability" companies. In 1992, the two groups operate in exactly the same sectors and exhibit almost identical size, capital structure, operating performance and growth opportunities. The performance does not reflect transaction costs. If such cost were reflected the performance would have been lower. **Past performance does not guarantee future results.**

Exhibit 9: Average 5 Year Annual % Return

Value-Weighted	17.1
Equal-Weighted	14.4
Low Sustainability	13.4
High Sustainability	13.2

Source: Cary Krosinsky, Nick Robins, Sustainable Investing: The Art of Long Term Performance. Negative Screening is defined as strategies that eliminate companies with material revenue from tobacco, alcohol, gambling, firearms, apartheid, Sudan.

Sustainable investing is defined as investment strategies that use an "extra-financial best-in-class", "financially weighted best-in-class", "sustainability themes" or "integrated analysis" approach. Extra-financial best-in-class approach is the active inclusion of companies that lead their sectors in environmental or social performance. Financially weighted best-in-class approach is the active inclusion of companies that outperform sector peers on financial, material environmental or social criteria. Sustainability themes approach is the active selection of companies on the basis of investment opportunities driven by sustainability factors, such as renewable energy. Integrated analysis approach uses active inclusion of environmental and social factors within conventional fund management.

²¹ "The Socially Responsible Quant" by Deutsche Bank Markets Research, April 24th, 2013 issue.

²² "Creating Shared Value," by Michael E. Porter and Mark R. Kramer, Harvard Business Review, January 2011: www.hbr.org/2011/01/the-big-idea-creating-shared-value

²³ "The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance," by Robert G. Eccles, Ioannis Ioannou and George Serafeim: Harvard Business Review, November 25, 2011.

S&P 500 Industry Leaders:

Generated Superior Profitability



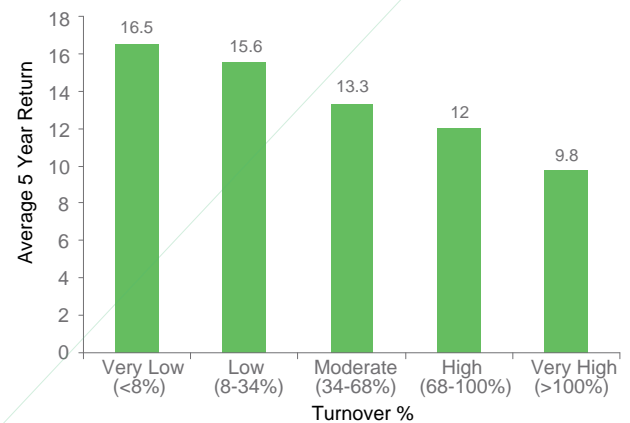
Enjoyed More Stability

Grew Dividends to Shareholders

companies provide an attractive investment opportunity given their greater profitability and relative affordability. While other factors could affect these results in the future, there are multiple studies that link management's consideration of issues like resource efficiency to strong overall results.

In other research, Osmosis Investment Management conducted two separate studies to determine the impact of resource efficiency on firm value. They define resource efficiency as the use of fewer resources to produce one unit of revenue, which is measured using their proprietary resource efficiency score (RES). The first study compared the returns of the Osmosis MoRE Indices, which invest in top decile of resource efficient companies, to benchmark indices using Capital Asset Pricing Model and Fama and French Models. Overall, the study found that the MoRE Indices

Exhibit 10: ESG Funds by Turnover



Source: Cary Krosinsky, Nick Robins, Sustainable Investing: The Art of Long Term Performance.

Returns for the Sustainable Mutual Funds included in the study are calculated on a basis from January, 2003 to December, 2007.

Furthermore, in the book, Sustainable Investing: The Art of Long Term Performance, the authors found that a strategy identifying sustainable companies rather than simply screening out companies led to material outperformance for the period (five years trailing from the end of 2007). By investing in companies that have higher ratings on environmental, social and governance factors, the investor is encouraging good corporate practices, thus creating an impact. Exhibit 9 shows the return differences between a sustainable investing strategy identified by the author and a negative screening strategy.

A 2014 study of the CDP Global 500 Universe found that S&P 500 industry leaders on climate change generated 18% higher ROE, 50% lower volatility of earnings over the past decade and 21% stronger dividend growth to shareholders than their low scoring peers²⁵. Therefore, the authors concluded that these

provided excess returns relative to the benchmarks. They also performed a study where they attempted to isolate the impact of resource efficiency (RES) on firm value using data from 2005 to 2012 covering 876 public firms across the world. They found that a one standard deviation increase in RES is associated with 2.2% increase in firm value, significant at the 1% level. This demonstrates the importance of resource management in both margin protection and positive value generation for companies.

Another indication of potential outperformance of ESG strategies can be found in an on average higher active share in

²⁴ Cary Krosinsky, Nick Robins, Sustainable Investing: The Art of Long Term Performance.

²⁵ CDP S&P 500 Climate Change Report 2014. CDP S&P 500 Climate Change Report 2014. www.cdp.net/CDPResults/CDP-SP500-leaders-report-2014.pdf

Methodology: CDP requested annual climate change disclosures from the world's largest companies on behalf of its investor signatories. CDP began scoring company responses in 2007 to provide a gauge of the transparency of climate change information disseminated to the market. Participating companies receive a CDP disclosure score (from 0 to 100) and a band (from A to E). Companies who score in the top 10% are included in an annual index known as the Climate Disclosure Leadership Index (CDLI). CDP's analysis is based on data received by June 28, 2014. The response rate of 70% is based on time of printing.

these strategies. Active Share represents the share of portfolio holdings that differ from the benchmark index holdings. A study by Cremers and Petajisto found that the highest ranking active funds, those with an active share of 80% or higher, outperformed their benchmark indexes.²⁸ The research indicates that funds with high active share may be able to

produce higher returns in some strategies. Our analysis shows that 58% of our ESG strategies rank in the top decile for active share when compared to their respective traditional actively managed peer groups.²⁹

Finally, a key focus of many impact investors is long-term investing, which they believe provides a more sustainable way for companies to generate long term returns rather than a focus on managing quarter to quarter. The study in exhibit 10 shows that due to the generally longer time horizon, buy and hold nature of professional investors in the impact investing space, a resulting benefit to investors in such strategies is the possible reduction of tax consequences, relative to higher turnover strategies.

Thematic impact investing

As integration of impact data into the investment analysis gains traction among investors across the public and private investing space, impact investors are becoming more engaged in directing private capital to climate change, healthcare and education concerns or social inequalities, which in addition to having significant scale economic impacts, also have large impacts on society and the environment. In *A Transforming World*²⁹, Merrill Lynch and U.S. Trust identified numerous such themes as material, long-term investment opportunities, that are also impact investing opportunities (see exhibit 11). BofA Merrill Lynch Global Research has been tracking the performance of many of these themes, which unlike the diversified sustainable strategies that have been highlighted so far, tend to have a more defined impact focus and smaller universe. These thematic investments exhibit the potential for outsized returns but with higher risk, such as in the water space,

Your Financial Strategy

WEALTH ALLOCATION FRAMEWORK

GOALS **ALLOCATION** **PORTFOLIO**



**UHNW Family
Impact Profile**

Risk Allocation

- Lisa and Joe have participated in Habitat for Humanity
- Joe is at a school where student groups engage with 350.org
- Sally supports charities for educating women and girls
- Ian has multiple generations of veterans in his family

Personal
Do not jeopardize standard of living

Goals:

- Invest in ways that support education for women and girls
- Reflect environmentally responsible practices in portfolio
- Reflect important social issues, such as veterans rights and low income community support

Market
Maintain lifestyle

Aspirational
Enhance lifestyle and society



Anna is currently a Managing Director, Head of Due Diligence for the Chief Investment Office, Global Wealth & Investment Management, Bank of America Merrill Lynch.

Anna is responsible for manager research across all asset classes for the wealth management businesses. She also defines and executes investment strategies focusing on impact strategy research, thought leadership and investment implementation.

Prior to this role, Anna was part of the alternative investments group where she advised clients on hedge fund and private assets portfolio construction and became head of research for externally managed alternative investment fund of funds.

She was also a senior analyst in the risk management division

