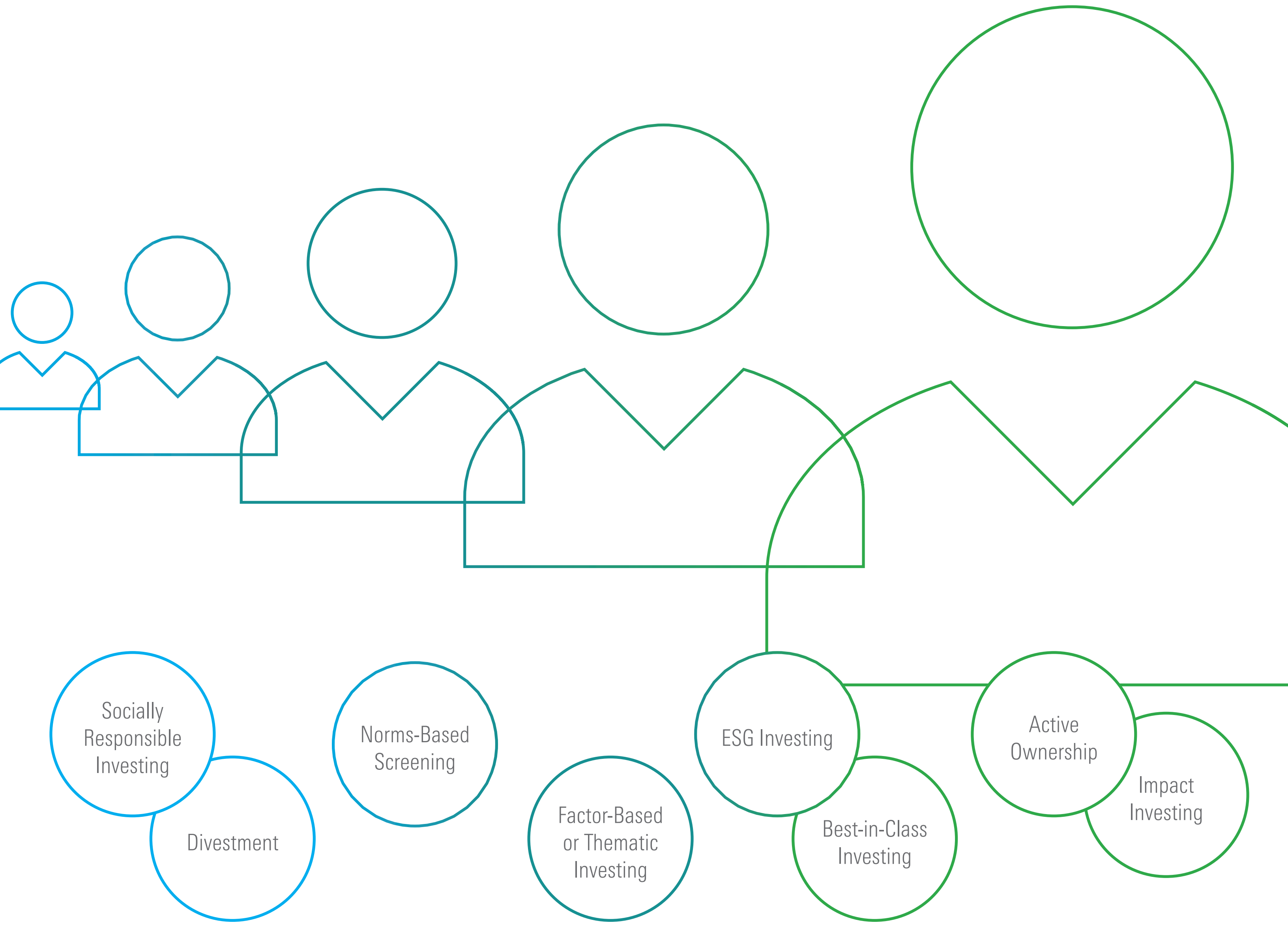
What's in a Name?
The Many Dimensions of Sustainable Investing



A lot of people find the idea of sustainable investing appealing, but what does it really mean and how can you start investing this way? The concept originally had its roots in socially responsible investing, but as it's grown in popularity, it has also grown more complex. There is now a range of nuanced investing approaches that all fall under the sustainability umbrella, accompanied by a flood of often-confusing names and information. The differences in these approaches come from what each aims to accomplish and how.

Three Reasons Why People Choose to Invest Sustainably

1 | To lower the amount of risk in a portfolio.

2 | To align with their personal or religious values.

3 | To take an active role in influencing an issue or behavior, either at a particular company or in society as a whole.

What Exactly Is Sustainable Investing?

First, let's start with that umbrella term. Morningstar defines sustainable investing as a long-term approach that incorporates environmental, social, or governance factors into the investment process. (You might see environmental, social, and governance often shortened to "ESG.") Here are some examples:

Environmental	Social	Governance
Climate change and carbon emissions	Gender and diversity policies	Board composition
Air and water pollution	Human rights	Executive compensation
Energy efficiency	Labor standards	Audit committee structure
Waste management	Employee engagement	Bribery and corruption policies
Water scarcity	Customer satisfaction	Lobbying activities
Biodiversity and deforestation	Community relations	Political contributions

As a sustainable investor, you'd make your investment decisions after considering information that may include a company's environmental record, how it treats employees, and how it pays its executives—to name just a few examples. ESG scores can help with the process by adding these factors together to provide one overall picture of a company. You could invest either in these company stocks directly or through a mutual fund that holds stocks or bonds from companies with high sustainability ratings.

Some investors apply sustainability-based approaches as part of their portfolio, while others choose to build their whole portfolio this way. And different investors have different motivations for using them. It's helpful to think of sustainable investing as an overall destination with lots of different routes to get you there.

Following the Guard Rails of Exclusionary Screening

This is a strategy you can pursue if you don't want to invest in certain things—whether it's because of your beliefs or you want to reduce risk. Exclusionary investing actively avoids owning stock in industries such as firearms, military contracting, gambling enterprises, and tobacco. For example, some investors choose to exclude gas and oil investments from their portfolio because they're ethically opposed to their business practices, while other investors might do the same thing because they're concerned about the volatility associated with that industry.

Socially Responsible Investing

You may already have heard of socially responsible investing, a predecessor to sustainable investing. Exclusionary screening is often part of the values-based strategy used to build the portfolio of a socially responsible fund, or SRI fund. Socially responsible investing is a strategy that aims to create value for investors while benefitting internal and external stakeholders—including employees, governments, and the general public.

EXAMPLE

Parnassus, Calvert, iShares, and a growing number of other fund companies offer a choice of SRI-focused funds.

Norms-Based Screening

Norms-based screening is another type of exclusionary investing. It describes the practice of filtering out certain investments based on whether they conform to global standards and norms established by multinational governing bodies. Within the norm-based framework, one common practice is the exclusion of investments from countries with repressive governments, like Sudan.

EXAMPLE

International accords including the Kyoto Protocol, the OECD Guidelines for Multinational Enterprises, and the UN Global Compact offer shared frameworks to evaluate investments.

Divestment

Divestment is a large-scale, socially led movement to eliminate investments based on objections from investors or community members. Where the other exclusionary investing tactics we've described work on an individual level, divestment takes place on a bigger scale—and therefore can lead to greater change in a shorter time. Citizens, students, and communities can start grass-roots movements to help convince local governments, schools, and organizations to pull their money out of investments they feel are unethical. Many groups today, for example, are questioning whether their assets should be invested in firearms or ammunitions companies after the increase in mass shootings around the country.

EXAMPLE

The University System of Maryland Foundation pledged in June 2016 to move its $1 billion scholarship endowment away from fossil-fuel investments.

Making a Difference by Including Sustainability

Inclusionary Investing

If you want to invest in companies that actively choose to pursue sustainable practices through their business, then you can take an inclusionary investing approach. This approach uses characteristics that are important to the investor to screen for and find companies that fit them, rather than by just ruling some companies out.

> Keep in mind that inclusionary investors can use any kind of criteria to find investments.

ESG investing is an inclusionary approach where an investor uses E, S, and G criteria in their decision-making process. Keep in mind that inclusionary investors can use any kind of criteria to find investments. For example, some investors may choose to invest in the same "sin stocks" that others deliberately avoid if these companies are the best performing stocks in their sector.

Best-In-Class Investing

The best-in-class investing approach can include investment in companies that have the highest rated ESG performance for their industry or sector—even if that industry rates lower than others on overall sustainability. Choosing the best-in-class oil and gas companies, for example, allows investors to build a well-rounded portfolio and still pursue sustainable investing.

EXAMPLE

One example of a fund that holds companies with best-in-class sustainability practices is the Pax World Balanced Fund PAXWX.

Factor-Based or Thematic Investing

Factor-based/thematic investing is another type of inclusionary investing that can focus on a narrower range of sustainability themes—such as alternative energy, environmental services, or sustainable agriculture. It's important to keep in mind that these investment strategies are meant to enhance an already-diversified portfolio. Because their strategies are so focused on a particular industry or theme, they are too risky to act as stand-alone investments.

EXAMPLE

The Guinness Atkinson Alternative Energy Fund GAAEX and Firsthand Alternative Energy Fund ALTEX are two examples of factor-based investing.

Choosing the Direct Approach

Impact Investing

If you want to do well while also doing good for the world, impact investing aims for financial returns along with social and/or environmental value. This approach attempts to measure not only the financial gains but also the positive environmental or social effects of an investment. Some examples of impact investing include companies that deliver clean water to rural villages, companies that build low-income housing, and companies that give away a percentage of their products to those in need. One of the keys to impact investing is making sure there are clear expectations about how to measure and report on the social progress the investment is bringing. Here's more information about impact investing.

EXAMPLE

Stonyfield Farms, Tesla, Warby Parker, Honest Tea, and Zipcar were all funded by impact investors with the aim of pursuing both profitability and industry-leading sustainability practices.

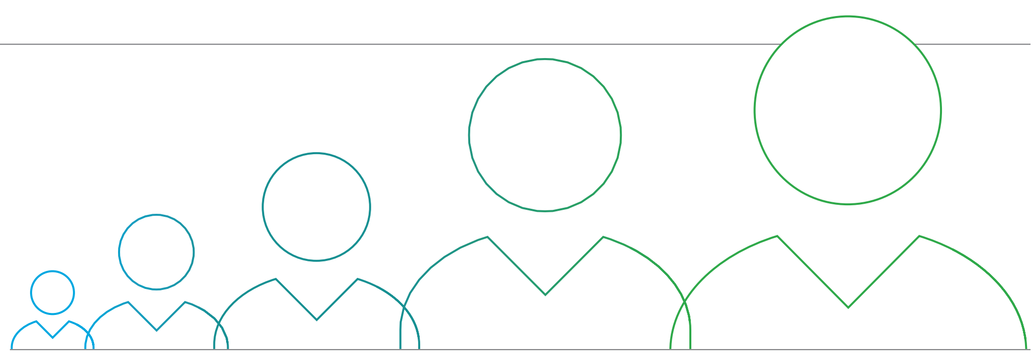
Active Ownership

How involved do you want to be as an investor? Active ownership is an approach where investors take advantage of their rights as shareholders to make changes they believe will improve the long-term value of their investment. If sustainability issues are important to you, you can use this strategy to influence the behavior of a fund or company through proxy votes and shareholder resolutions.

EXAMPLE

Trillium Asset Management engaged with 36 companies in the first half of 2016 to propose shareholder resolutions around environmental, social, and governance issues. Topics ranged from renewable energy with a telecommunications company to gender wage gaps within a financial services firm and board diversity in a transportation company.

Sustainable Investing Approaches



> > > > > > > > > > Rising Level of Investor Involvement > > > > > > > >

Exclusionary Screening
- Socially Responsible Investing
- Norms-Based Screening
- Divestment

Inclusionary Investing
- ESG Investing
- Best-in-Class Investing
- Factor-Based or Thematic Investing

Investor-Directed Approaches
- Impact Investing
- Active Ownership

How Can I Get Started?

If you'd like to begin investing sustainably, one way to start is to look up a fund you're interested in and check its Morningstar Sustainability Rating™ on Morningstar.com. Keep in mind that a fund must hold stocks and fall within certain guidelines for us to be able to rate it.

No matter what your priorities are, there are many different ways to pursue your investing goals while keeping sustainability in mind.

A fund's Sustainability Rating doesn't make it good or bad—it just tells you how sustainable the companies are in a fund's portfolio. Before deciding whether a fund meets your needs, we always recommend that you get an in-depth view of its fees, performance, management team, and more.

If you're interested in learning more about our ratings and how we built them, you can read our complete methodology and see if our view of sustainable investing matches up with your goals. No matter what your priorities are, there are many different ways to pursue your investing goals while keeping sustainability in mind.

Learn more about the Morningstar Sustainability Rating

Visit **www.morningstar.com/company/sustainability**