



STATE OF THE FIELD REPORT 2017

We are pleased to provide this brief overview of the ESG investment world, with highlights from the work of many colleagues and partners in the field. There is a lot of terrific activity sprouting up in this arena, thanks to the courageous ground-preparing and seeding work of those who have been engaged for the past 20, 30, 40 and more years. As we marvel over the green shoots that are emerging, we thank those who sowed those seeds and made this current energetic emergence possible.

MOST IMPORTANT CHART OF THE YEAR:

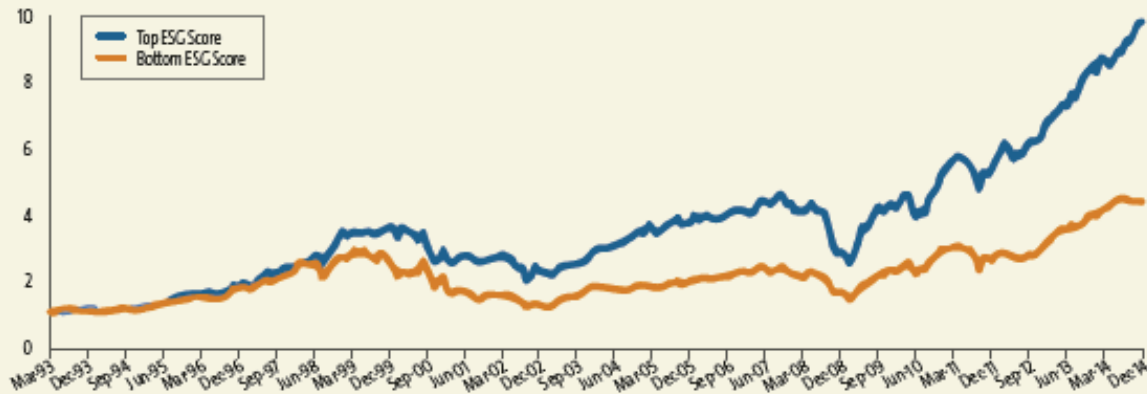
WHEN APPLYING MATERIAL ESG FACTORS TO STOCK SELECTION...

George Serafeim and colleagues at Harvard Business School applied guidance from the Sustainability Accounting Standards Board (SASB) to explore how materiality matters to ESG data. Industry by industry, they mapped recommended reporting topics to data points that reflected company investments in material sustainability areas.

Controlling for systematic risk factors and opportunity sets, they analyzed stock prices for each decile of "ESG improvers" on material factors—that is, focusing on only those ESG factors deemed material for each company's industry. The chart shows the best 10% and worst 10%.

The divergence shown in the chart expresses the potential for alpha generation. That is, to the extent investors can identify material factors and apply them to stock selection, they may gain an edge by separating stocks more likely to perform better (blue line) and worse (red line) over time.

EVOLUTION OF \$1 INVESTED IN MARCH 1993



Source: Mozaffar Khan, George Serafeim, and Aaron Yoon, "Corporate Sustainability: First Evidence on Materiality," *The Accounting Review*, forthcoming. <http://ssrn.com/abstract=2575912>

ESG (Environmental, Social and Governance) Investing is defined as a focus on identifying companies that create a positive impact through their business operations and overall activities.

Alpha is defined Alpha, often considered the active return on an investment, gauges the performance of an investment against a market index used as a benchmark, since they are often considered to represent the market's movement as a whole. The excess returns of a fund relative to the return of a benchmark index is the fund's alpha.

Chart from Calvert; data from Serafeim et al

For fundamental investors, academic analysis of the ESG world has sometimes been frustrating: many researchers lump together disparate funds or disparate companies or disparate data and tried to reach general conclusions about the usefulness of looking “beyond finance.” And to be fair, until very recently there was not much choice. We did not have enough data or enough of an analytical framework to do otherwise – so each study was loaded with lots of caveats and footnotes and exceptions, rightfully so.

That is why this work from George Serafeim (HBS), Mozaffar Khan (U.Minn), and Aaron Yoon (HBS student) is so important. Over the past few years the Sustainability Accounting Standards Board (SASB) has created an analytical framework that maps the relevance of ESG issues industry-by-industry. For example, if you are a mining company, we should care a lot about your safety and environmental record, while if you are a retailer, your supply chain and employee policies are more important.

Serafeim & co mapped the SASB framework for materiality to existing ESG data, a painstaking chore, and then analyzed the differences between companies that were highly engaged in the sustainability issues that are most relevant to their businesses, versus their peers who were not engaged.

The results are meaningful, and encouraging for anyone who is interested in using fundamental analysis and ESG information to make investing decisions. Look! There’s not much difference if you take the homogenized “all measures equal” approach, but there is a huge performance gap that opens up when you look at the issues that are relevant for each type of business.

I feel like I am burying the lede here --- **747 bp alpha!** That is the spread between highest and lowest decile of ESG investment in this group’s analysis. All of the normal caveats about this type analysis apply, but this is INTERESTING. It is well worth your time to read the full paper: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2575912

Panel B: Investments in *Material* Sustainability Issues

Parameter	Value Weighted								Equal Weighted							
	Low Investment				High Investment				Low Investment				High Investment			
	Quintile		Decile		Quintile		Decile		Quintile		Decile		Quintile		Decile	
Estimate	t	Estimate	t	Estimate	t	Estimate	t	Estimate	t	Estimate	t	Estimate	t	Estimate	t	
Intercept	-0.0011	-0.63	0.0024	1.85	-0.0019	-1.04	0.0043	2.63	0.0016	1.44	0.0038	2.34	0.0014	0.90	0.0036	2.17
Market	1.0812	22.31	0.9344	28.23	1.0913	20.91	0.9532	23.46	1.0636	38.25	1.0636	25.92	1.0741	29.87	1.0567	24.10
SMB	-0.2158	-2.52	-0.2342	-4.26	-0.2631	-2.93	-0.1902	-3.15	0.1430	2.90	0.2418	4.08	0.1484	2.21	0.1700	2.83
HML	-0.0962	-1.13	0.1051	1.94	0.0231	0.20	0.0683	1.17	0.3819	8.25	0.6367	8.66	0.5659	9.76	0.5580	7.69
UMD	-0.0231	-0.39	-0.0186	-0.45	-0.0506	-0.82	-0.1153	-2.24	-0.1167	-4.09	-0.1875	-2.90	-0.1243	-2.58	-0.1686	-3.43
LIQ	0.1279	2.72	0.0818	1.96	0.1505	2.65	0.0830	1.86	0.1055	3.70	0.1258	2.19	0.1888	4.83	0.1150	2.11
N	261		261		261		261		261		261		261		261	
Annualized Alpha	-1.27%		2.91%		-2.23%		5.24%		1.96%		4.65%		1.63%		4.38%	
Difference in Alphas			4.18%**				7.47%***				2.69%*				2.75%*	

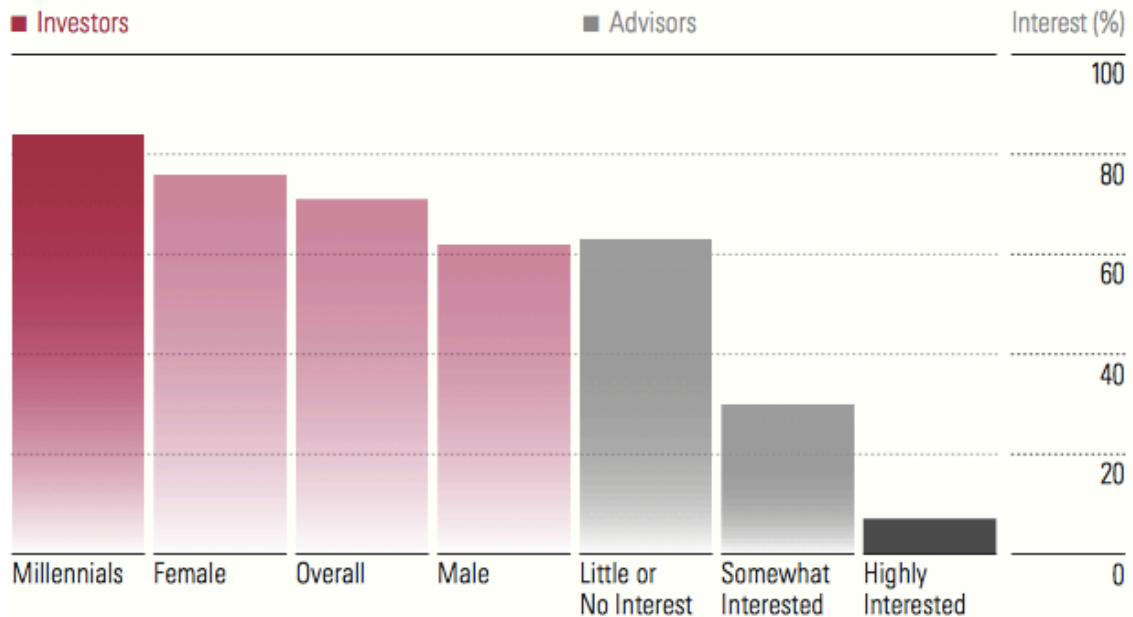
EVOLUTIONS IN ESG SUPPLY AND DEMAND:

INDIVIDUAL INVESTOR DEMAND CONTINUES TO GROW, AND ASSET MANAGERS ARE INCREASINGLY RESPONDING:

Two notes on the chart below –

- 1) **Overall interest in ESG investing is 70%+.** There has been a lot written about millennial and female interest in ESG investing, but this sometimes overshadows the fact that over 60% of non-millennial men are interested too, which leads to total interest that tops 70%. When is the last time that 70% of any survey group was interested in anything?
- 2) **Advisor activity** does indeed look shockingly low when compared with client interest... But I'd note that the 30% of advisors who are starting to engage in this area was somewhere around 10% just a few years ago.

Different Interests A high percentage of millennials and women say they are interested in ESG investing. Financial advisors? Not so much.

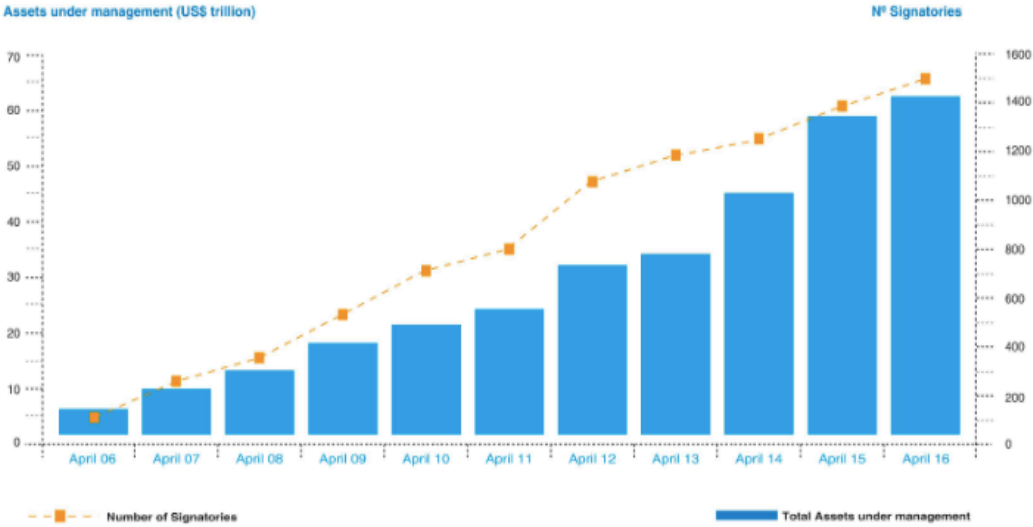


Sources: Morgan Stanley Institute for Sustainable Investing, Cerulli Associates.

Chart from Morningstar, data from Morgan Stanley, 2016

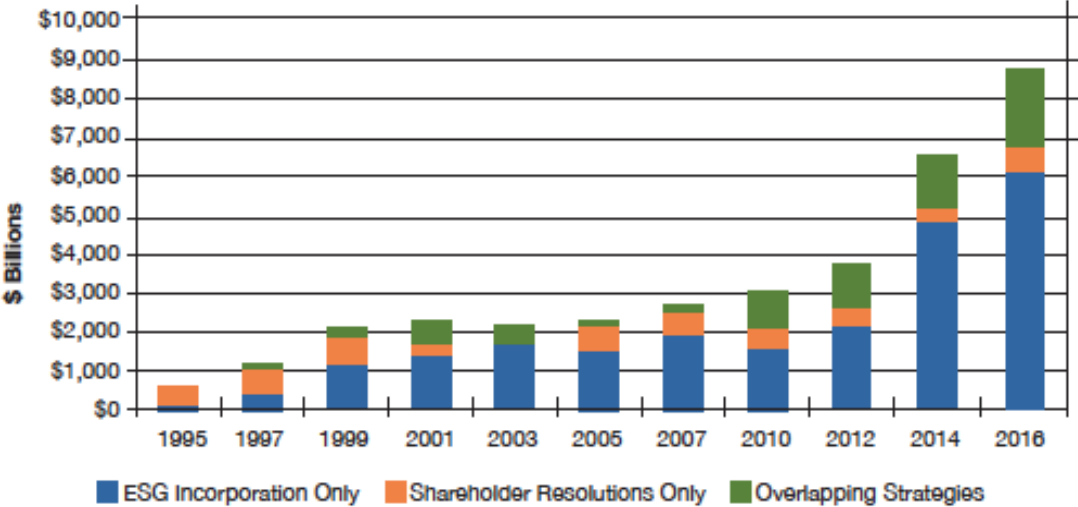
INSTITUTIONAL COMMITMENT IS GROWING, TOO:

UN PRI SIGNATORIES (\$62 trillion, 1500 signatories)



...LEADING TO MEANINGFUL TOTAL ASSET GROWTH:

Fig. A: Sustainable, Responsible and Impact Investing in the United States 1995–2016



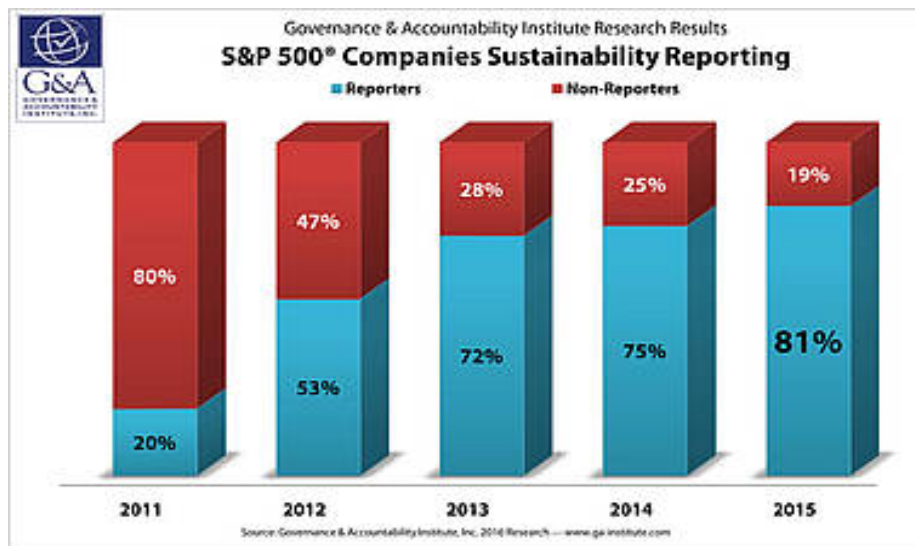
SOURCE: US SIF Foundation.

AND THERE ARE OTHER IMPORTANT LEVERAGE POINTS, TOO:

- Morningstar and Mercer sustainability ratings for funds
- CFA inclusion of ESG in its curriculum
- Shifts in DOL guidance on fiduciary duty to encourage/require ESG analysis

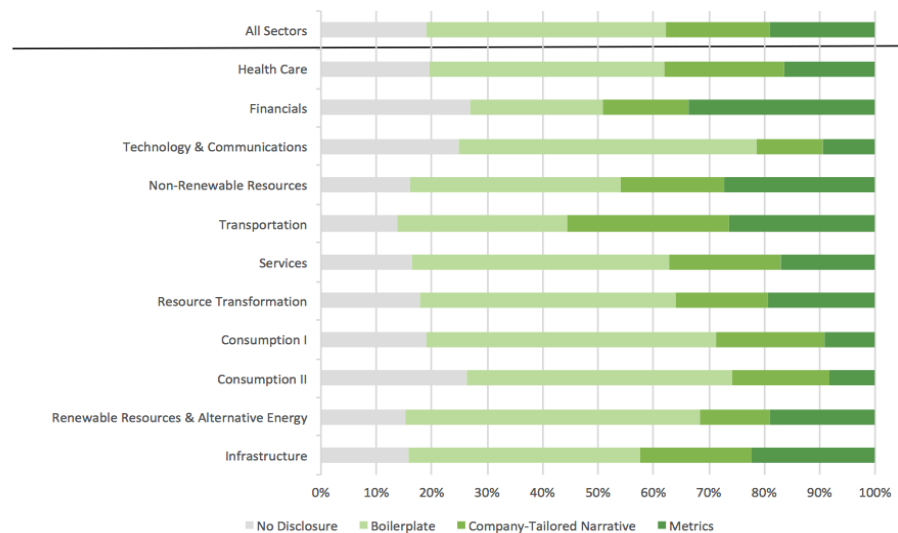
EVOLUTIONS IN ESG DATA

SCOPE AND QUALITY OF ESG DATA CONTINUES TO GROW...



Data: ga-institute.com

Figure 2. Sustainability disclosure in SEC filings for FY 2015 (by sector)



Data: SASB State of Disclosure report, 2016 (based on 2015 SEC data)

You can read lots more about data disclosure in the SASB “State of Disclosure” report:
<http://library.sasb.org/wp-content/uploads/2016/11/StateofDisclosure-Report-113016v2.pdf>

...BUT THIS DATA IS NOT YET FULLY CONSISTENT OR COMPLETE

This stage of development brings several challenges and opportunities:

- A number of metrics currently focus on whether ESG policies are in place at a company, but that is just the beginning. We don’t yet have as much insight on the impact of those policies or on performance against their goals.
- Moreover, any investor knows that every company is different – even those in similar businesses have products and processes that vary widely. So even when we have all the data we could dream of, this more nuanced context will be required to make the most of it.
- Against the backdrop of those challenges, information is rapidly developing and expanding – so how best to approach the analysis? Some simple rules:
 - We can compare data from different sources to increase insight.
 - We can support efforts that are developing reporting standards and frameworks for analysis, like [SASB](#) and the [GRI](#).
 - We can acknowledge that real live human beings have something to add to this process that cannot be delegated to a robot. Hooray!
- *For a more detailed analysis of one major ESG area, supply chain and human rights, which includes some of the points above, see this helpful report NYU Stern: <http://bhr.stern.nyu.edu/statement/2017/3/8/report-reveals-gaps-in-social-performance-metrics-needed-by-investors-to-identify-leading-companies>*
- *For a more broad-based look at how sustainability reporting is evolving, and how it related to the UN Sustainable Development Goals, see this report from the GRI: <https://www.globalreporting.org/information/news-and-press-center/Pages/Future-Trends-in-Sustainability-Reporting.aspx>*

EVOLUTIONS IN SHAREHOLDER ENGAGEMENT

Do you ignore proxies because you read a whole statement years ago and fell asleep over the fine print on page 33? Well, wake up, buttercup! Proxies are pretty exciting these days.

The most important mega-trend in shareholder proposals: ask for information.

There seems to be a common impression that shareholder proposals are often extreme – proposing that Exxon exit the energy business, for example, or that an entire board of directors be replaced. Once in a while you do get a sensational story like that, but the more important trend is to frame proposals as straightforward requests for information on important environmental, social, and governance issues. This type of request has a quiet

genius to it – shareholders might have lots of mixed reasons for owning stocks, but who doesn't want to know more? The premise here is the same as for all other sorts of disclosure: once we have more information, shareholders can better assess a company's risks and opportunities, and decide for themselves what further action suits them.

Do you think all of that sounds like bureaucracy without impact? Last year's pay disclosure win at eBay is linked to new policies and increased disclosure at a number of companies. And ExxonMobil's board addition of Dr. Helen Avery, a climate scientist, is big news too. Both BlackRock and State Street have focused on climate risk disclosure as a key area this year, with State Street also vocally advocating for more women on boards. There's an interesting iterative loop at play here, since the asset managers' own shareholders (including those at BlackRock, BNY/Mellon, T Rowe, and even Vanguard) have asked for increased clarity on the managers' proxy voting guidelines.

Proxy topics of interest:

- **RISING ISSUES:** board diversity, employee diversity, indigenous rights, industrial agriculture (especially animals).
- **ONGOING ISSUES:** political activity, climate change.
- **WATCH THIS:** the Business Roundtable has proposed that larger holdings should be required for filing shareholder proposals, which would obviously disadvantage smaller owners in the proxy process.

IF YOU READ ONE THING on 2017 proxy issues, make it this:

- **PROXY PREVIEW REPORT** --- this is a terrific and thorough summary of proxy issues, produced annually. *All asset managers and owners owe thanks for this work to As You Sow, Sustainable Investments Institute, Proxy Impact, and their numerous sponsors and collaborators, including Walden, Trillium, and First Affirmative amongst others.*
<http://www.proxypreview.org>

LIBRARY OF HELPFUL RECENT REPORTS

- **WRI Sustainable Investment Landscape Report:** This summary from the World Resources Institute is a useful summary of the shifting sustainable investing landscape, highlighting the increase in various resources as well as the most common barriers to engagement. If you are just starting to engage in this area, it's a great concise overview. [http://www.wri.org/publication/sustainable-investment-landscape?ct=t\(2017_February2_17_2017\)](http://www.wri.org/publication/sustainable-investment-landscape?ct=t(2017_February2_17_2017))
- **US SIF Responsible and Impact Investing Trends Summary:** This is the most widely cited data regarding responsible and impact investing, and for good reason – it's a bottom-up compilation of asset manager data that has a long history, unlike much of the data in this area. Note that this approach intentionally takes a “big tent” measure of sustainable investment activity. <http://www.ussif.org/content.asp?contentid=40>
- **GIIN Impact Investing Trends Report** - Impact investing, cousin of ESG investing, can be hard to quantify, in part because lots of the activity is private markets based. That makes this summary from the Global Impact Investing Network extra-helpful. [https://thegiin.org/knowledge/publication/impact-investing-trends?ct=t\(2017_February2_17_2017\)](https://thegiin.org/knowledge/publication/impact-investing-trends?ct=t(2017_February2_17_2017))
- If you want to see what some of the larger investment firms are doing in this area, here are some of their reports:
 - **Goldman Sachs**, including the provocatively titled “Is ESG as Important as P/E?”: <http://www.goldmansachs.com/s/esg-report/>
 - **Morgan Stanley Institute for Sustainable Investing**, including sustainable investing research and their 140-product Impact Platform for clients: <http://www.morganstanley.com/what-we-do/institute-for-sustainable-investing>
 - **BlackRock Impact**, including details on their investment approaches: <http://www.blackrockimpact.com>
 - **State Street**, including some useful surveys, papers, and plans for tapping into their own data: <http://www.statestreet.com/ideas/articles/investing-enlightenment.html>. SSGA is also responsible for [Wall Street girl statue](#), part of their work to highlight the importance of women on corporate boards.
- With increased engagement at large firms, it's all the more important to recognize the expertise of groups with longstanding dedication to values-centric investing and ESG. Here are links to some of pioneers in SRI/ESG/Sustainable investment management (an admittedly incomplete list):
 - **Baldwin Brothers** <http://www.baldwinbrothersinc.com>
 - **Boston Common Asset Management** <https://www.bostoncommonasset.com>
 - **Calvert Investments** <https://www.calvert.com> (now part of Eaton Vance)
 - **Domini Impact Investments** <https://domini.com>
 - **First Affirmative Investment Network** <http://www.firstaffirmative.com>

- **Generation Investment Management** <https://www.generationim.com>
- **Parnassus Investments** <https://www.parnassus.com>
- **Pax World Investments** <http://paxworld.com>
- **RSF Social Finance** <http://rsfsocialfinance.org>
- **Triodos** <https://www.triodos.com/en/about-triodos-bank/>
- **Trillium Investments** <http://www.trilliuminvest.com>
- **Walden Asset Management** <http://www.waldenassetmgmt.com>
- **Zevin Asset Management** <https://www.zevin.com>

HELPFUL NEWSLETTERS & BLOGS

There is no shortage of news flow for those interested in more frequent updates on ESG and sustainable business – here are just a few of those that I read regularly.

- **Bloomberg Sustainable Finance Briefs** – I am surprised that many people who are deeply engaged in ESG are not yet receiving this excellent regular summary. It is a little more data-intensive than some other resources listed here, cuts across all asset classes, and includes a good dose of international coverage as well. <https://www.bloombergbriefs.com/sustainable-finance/>
- **ImpactAlpha** - This daily brief is a great summary of all things impact – fairly broad-based business stories with a focus on social and environmental value. <http://impactalpha.com>
- **Sustainable Brands newsletters** – I especially appreciate the coverage of large public companies' activities via SB. <http://www.sustainablebrands.com/newsletters>
- **Weekend Briefing from Kyle Westaway** – Westaway is a group of lawyers that focus on serving social entrepreneurs, and Kyle's weekend briefings are a terrific distillation of both short and long term issues around social enterprise, impact, innovation, and growth. They have a new publication especially focused on legal issues as well. <http://weekendbriefing.com>
- **Intentional Endowments Network** - IEN is a newer group, founded in 2014, focused as you might expect on endowments and institutional engagement in ESG. <http://www.intentionalendowments.org/newsletter>

These last two are technically not ESG-centric, but they are my favorite things to read each week. Ed is the best science writer around, and Maria is an incredible polymath, with interests from philosophy to physics to poetry (not that those are so very different, in the end, as she illuminates).

- **The Ed's Up, Ed Yong** - <http://tinyletter.com/edyong209/archive>
- **BrainPickings, Maria Popova** - <https://www.brainpickings.org>

EVOLUTION OF HONEYBEE CAPITAL

In case you missed the note accompanying this report...

Dear Honeybees,

I'm delighted to announce that next month, I will become the first Head of Sustainable Investing with Putnam Investments here in Boston. Many of you know that Putnam has a long tradition of strong fundamental research at the core of its investment process, and I'm excited and honored to join such a terrific team. Of great importance to me, in this new perch we'll have the chance to move many of Honeybee's key ideas from theory into practice.

Honeybee will continue! ...though in somewhat different form, as Honeybee Capital Foundation.

- Our **short posts** on Fridays and Sundays will feature highlights of books, natural creatures, and spiritual ideas that all inspire good investing in its broadest sense.
- Our **giving program** will also continue, including annual reports on the organizations we support.
- And **our website** will evolve to a snazzy new site for Honeybee Capital Foundation at the end of May.

In times of change, it's even easier than usual to see the interdependence of all our endeavors, and this realization fills me with gratitude. Thank you for your engagement in Honeybee's work during these founding years. Due to your friendship, support, and - dare I say - love, this has been a profitable and rewarding endeavor in every possible dimension, and I am grateful that the Honeybee community will continue to thrive as we enter this next phase.

With love,

Katherine

