SUSTAINABILITY THE NEW STANDARD FOR INVESTING

iShares by BlackRock

Audio Script

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Audio Script:

Thank you for joining today's presentation on sustainability, the new standard for investing. Sustainability can be a broad term and is used in many contexts. To some of you, it may connote an ability to thrive in the long run. To others, it may align with your worldview. But what we're going to discuss today is how sustainability fits in an investment conversation. My hope for today is that you come away with the shared knowledge that sustainable investing is truly a new comprehensive standard for investing that can provide better outcomes for investors over the long-term.

Sustainable investing started with the premise that the investing world may have been missing something; and let me illustrate this with a company example.

In 2015, Volkswagen became embroiled in a now infamous scandal. The company admitted that they cheated on emissions tests violating the US Clean Air Act. The CEO resigned and its stock plummeted. This is not just a story about a company that harmed the environment. This is also a story about how investors who owned the Volkswagen stock never saw this coming. Company reports earnings results and other traditional measures of financial analysis simply weren't enough.

Turns out, there were many red flags. Former executives dominated the supervisory board, creating a lack of outside perspective. There were too many significant shareholders on the board. Volkswagen also had a culture where sales teams were under immense pressure to hit their targets. Traditional financial analysis did not capture these risks and may not always give us the clearest view on its own. So sustainable investing is about incorporating a critical additional lens alongside financial analysis. Assessing risks and opportunities across environmental, social and governance issues can help investors make a better assessment of an investment.

So our agenda for today will cover First, what is ESG. Second, the risks that ESG analysis helps us uncover. Third, the opportunities ESG analysis helps us capture. Fourth, why sustainable investing is becoming the new standard for investing. And fifth, how you can start investing sustainably today. Let's dive into the first topic of what is ESG.

Sustainable investing is defined as combining traditional investment approaches with environmental, social and governance insights. ‘E’ stands for environmental, ‘S’ stands for social, and ‘G’ for governance. Analysis across E, S and G pillars can reveal risks and opportunities not captured by a traditional financial analysis.

Let's look at each of these in more detail. The environmental pillar includes issues like climate risk, natural resource usage, pollution and waste control and innovation in areas like clean technology. The social pillar includes issues like human capital management, product safety and liability, data privacy and health and safety of workers and communities. The governance pillar includes issues like accounting practices, ownership and control structures, board independence and corporate ethics.

Analysis across E, S and G expands the scope of financial analysis to reveal both risks and opportunities. For example, companies exposed to increasingly frequent extreme weather events can face disruptions to their operations. Companies that produce poor quality products may face costs related to product recalls, litigation and reduced customer loyalty. On the opportunities front, companies developing products to improve water efficiency may benefit from rising demand for such products due to worsening water scarcity. Companies investing in clean technologies such as electric vehicles or battery technology may benefit from favorable policies as well as growing consumer demand. Sustainable investing doesn't throw out traditional financial analysis, but rather its supplements and enhances it.

Let's move on to the next section and look at some real-life examples to understand how critical investing with a sustainable lens can be. Our first case study is about Vale, one of the world's largest mining companies. In January of 2019, its Brumadinho dam disaster released $3 billion gallons of mine waste, that's about 4,500 Olympic pools worth, and tragically killed almost 300 people. Financial analysts at the time were generally positive on Vale prior to the disaster in January 2019, with consensus price targets broadly trending well above its share price. However, it was given the second lowest possible ESG rating by MSCI, a leading ESG ratings provider, due to its history of similar accidents and lack of oversight, including a previous dam collapse in 2015. More specifically, Vale scored poorly across an analysis of its health and safety measures, its impact on local communities and effects on biodiversity and land use. The day of the dam collapse, Vale's stock price fell by over 20%. This example illustrates how ESG analysis can reveal risks not captured by traditional financial analysis.

Climate change is another major environmental risk facing companies today. It will pose significant risks to the economy in the coming years. Over the last five years, the total cost of billion-dollar weather and climate disasters has exceeded $600 billion. In addition, the annual frequency of these types of events has more than doubled. The negative ramifications of environmental issues can either be felt over a long period of time, such as with climate change, or suddenly, as in the case of Vale. Companies that prioritize environmental issues, including climate risk, may do better over the long term.

Let's take another company example and focus on a social issue: data privacy and security. In September of 2017, Equifax, the credit reporting agency, announced the largest data breach in US history, which had significant reputational and financial repercussions for the company. The breach affected 150 million people. At the time, financial analysts were generally positive on the company, rating the stock as a buy. But MSCI's ESG analysts had downgraded Equifax as early as August 2016 to the lowest possible ESG rating due to a lack of strong controls related to data security. This is yet another example of how ESG analysis helped identify risks that were not captured by traditional financial analysis.

This case study shows that, like environmental issues, social issues can also have an impact on companies. Another example of a social issue is human capital management. Every year, about two million American workers leave their jobs due to unfairness and discrimination. The estimated cost of replacing them is $64 billion. Unfair treatment and discrimination of employees has a cost to business. Strong human capital management can impact a company's ability to attract and retain top talent and reduce costs related to turnover.

Governance issues like board structure and diversity, accounting practices and corporate ethics can help investors assess the quality of controls and management at a company. The Volkswagen example that we walked through at the beginning of the presentation illustrates how lack of strong governance can impact a company. In addition, a study has shown that companies that have gender diversity in their executive teams have higher profitability than companies with poor gender diversity. And here's why it matters for your portfolio. Investment strategies that incorporate ESG analysis may have reduced or eliminated exposure to companies like Volkswagen, Vale and Equifax with identified ESG risks.

So far, we've illustrated why ESG analysis is critical to risk management. There is also tremendous opportunity in considering sustainability issues.

As a society, we have more information at our fingertips than ever before. The expanded access to information is driving consumer choices, including choices related to sustainability. Surveys show increasing consumer demand for products and businesses that prioritize sustainability. No matter your personal view, this demand can have an impact on business.

In addition to these broad sustainable practices, companies related to specific sustainable teams like clean energy may also be poised to grow over the long term. One estimate projects that $2 trillion in New investment will be needed over the next decade to implement renewable energy targets that have been set globally. Investors looking to capture sustainable themes like renewable energy may add exposure to strategies that provide access to such companies in their portfolios.

Now that we've covered how ESG analysis can help investors identify risks and opportunities not captured by traditional financial analysis, it hopefully shows why there is growing recognition that sustainability is a critical part of any robust investment process.

With this growing recognition, we are seeing more ESG data and growing demand for sustainable investments. For example, companies are disclosing more ESG information. Nearly 90% of S&P 500 companies are disclosing ESG issues over 20% in 2011. In addition to that, large institutions like central banks, public pension firms and insurance firms are recognizing that sustainability risks are investment risk and are integrating ESG considerations into their investment processes. One study showed that 70% of institutional investors have implemented ESG strategies. Personal investors are also expressing interest. Behavioral scientists at Morningstar found that 72% of the US population expressed at least moderate interest in sustainable investing, and 45% had some of the higher levels of interest.

As a result of this growing demand, assets in sustainable investing are growing rapidly. Sustainable ETFs have grown at 79% compound annual growth rate since 2015 to the end of the first quarter of 2021. Sustainable mutual funds have grown at 23% compound annual growth rate over the same period. Blackrock projects that sustainable indexed investments globally will add $1 trillion in new assets between 2020 and 2030.

By now, you are likely wondering how you can get started investing sustainably. So let's walk through a couple easy ways you can incorporate sustainability into your portfolios.

First is through using Core ESG building blocks. Consider customizing your core portfolios by replacing traditional market cap weighted exposures with ESG ETFs that offer broad market exposure while seeking sustainability objectives. The iShares ESG Aware ETFs provide building blocks for portfolio construction across the US equities, international equities and fixed income. They provide exposure to companies with positive ESG characteristics while seeking to maintain a tight tracking error to the relevant broad market. This allows you to continue to pursue your financial objectives while applying an ESG lens. For example, ESGU provides exposure to large and mid-cap US stocks with favorable ESG characteristics. Similarly, EAGG provides exposure to investment grade bonds from issuers with favorable ESG characteristics.

Another approach is to consider investing in themes for long term growth potential while helping address the world's most pressing challenges. The iShares Global Clean Energy ETF, or ICLN, provides access to the largest global companies involved in the production and distribution of renewable energy and equipment. Renewables are set to represent 3/4 of the $12 trillion the world will invest in new power technology through 2040. Renewable energy companies may be positioned to benefit from this transition.

The iShares MSCI Global Impact ETF, or SDG, provides exposure to global companies that derive revenue from products and services that address themes related to the United Nations Sustainable Development Goals. The UN Sustainable Development Goals or SDGs are a set of 17 goals that represent a universal call to action to end poverty, protect the planet and improve the lives and prospects of everyone everywhere. The goals address some of the most pressing global challenges, such as nutrition, sanitation, education and climate change. Companies providing products and services to address these challenges may be positioned for long term growth. Investors can consider strategies like ICLN and SDG as satellite exposures within their portfolios to express a view on these types of themes.

In conclusion, sustainable investing is about pursuing better outcomes for your investment portfolio, as well as for the world. Investing with sustainability issues insight can help you identify risks and opportunities that are not captured by traditional financial analysis. iShares is committed to providing a platform of choice for investors looking to invest sustainably. Thank you for joining me today.

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