

What is ESG and Why Does it Matter?

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ESG, the latest buzzword in the investment community and one that you are likely to hear a lot more about, is short for *Environmental, Social, and Governance*, the standard criteria that is used in classification for Socially Responsible Investing (SRI), Sustainable Investing and Impact investing. The socially conscious investing landscape has been regaining momentum over the past few years, but the concept has actually been around for decades and continues to evolve to meet the new and growing demand.

The origin of ESG can be traced back to religious groups' interest in excluding "sin" stocks such as alcohol, tobacco, weapons, and gaming industries from their portfolios. While the concept of excluding industries from an investment portfolio to align with one's beliefs may seem reasonable, the strategy failed to gain traction because of the concern that one had to sacrifice returns. Performance headwinds and the rather limited investment solutions presented an uphill battle for the movement, but the industry has begun to adapt, and the trend may be changing.

The recent news of the US pulling out of the Paris Agreement may appear to be a setback for ESG, but it may actually have accelerated the trend. Post announcement, a number of corporations stepped up, publicly outlining their plan to voluntarily reduce emissions. The outpouring of support from the private sector to focus not just on profits, but on the greater social good, appears to be a cultural shift that may be here to stay. One of the reasons for this change in momentum is demographics. The Millennial generation, now the largest population group, will impact future money flows and spending decisions for decades to come. One needs only to study the previous demographic trends beginning in the 1980s when Baby Boomers were the influencing group. Millennials have been raised with increased sensitivity to ideals such as recycling, diversity and environmental protection, the very definition of ESG. It is a core value for this burgeoning population who is more likely to invest with their conscience as the primary motivation.

Why does the Millennial preference for increased socially responsible investing matter? This group is just beginning to accumulate wealth, but will ultimately control the largest sum of money in history as they are set to inherit \$30 to \$40 trillion. Their spending decisions will shape the future of business direction for decades to come. As more investment flows are directed to the most socially responsible organizations, the industry will acknowledge the need to be proactive and position themselves accordingly. Social conscience and profits will be inexorably linked in the eyes of both the corporate leadership and those who buy their products. While we are still in the early innings of this movement, from 2012-2016 ESG investing has grown to a total of \$8.72 trillion dollars*. The asset management industry has already begun to expand the menu of investments that are available to meet this growing demand, and we expect this trend to continue as the industry moves to standardize the ESG criteria as a core investment philosophy. *<https://www.ussif.org/content.asp?contentid=40>

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