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Breaking Down ESG, SRI and Impact Funds – Are advisors and clients speaking the same language?

As society collectively moves toward social and environmental consciousness, investors have shown a growing desire to incorporate their social or ethical values and beliefs into their investment portfolios. In response, investment strategies like Socially Responsible Investing (SRI), Environmental, Social and Governance (ESG), and Impact Investing have emerged.

As these terms became more commonplace in advisor-client conversations, their definitions have become so mixed and muddled that the good intentions behind them are often overshadowed by frustration or missed expectations. To help, this study supplies advisors, asset managers, and their clients with valuable information about the mutual funds and ETFs that employ ESG, SRI, and Impact strategies so that all parties can have informed conversations and make smart, mutually beneficial investment decisions.





While these definitions are still evolving or the subject of legitimate debate, these are the definitions and datasets we relied on:

As the basis of our study, we compiled a list of 471 funds using two lists—funds that carry the Morningstar® attribute Socially Responsible Fund, which uses a broad definition [available here](#), and a proprietary list of ESG funds based on asset manager websites and other publicly available information, which we created within YCharts for our users.

If you would like to share any of the visuals below with your clients or colleagues, click the link below each image to download it for free! The findings contained in this guide are data-driven and unbiased, but are not meant to serve as investment advice.

Environmental, Social and Governance (ESG)

A company's practices related to ESG factors that may have a material impact on the investment's performance. ESG investing focuses on companies that limit their negative societal impact, deliver benefits to society, or both.

Environmental factors

Energy consumption, pollution, climate change, waste production, natural resource preservation, animal welfare.

Social factors

Human rights, child and forced labor, community engagement, health and safety, stakeholder relations, employee relations.

Governance factors

Quality of management, board independence, conflicts of interest, executive compensation, transparency and disclosure, shareholder rights.

Socially Responsible Investing (SRI)

Actively eliminates or selects investments according to specific ethical guidelines based on religion, personal values, or political beliefs. Some SRI strategies incorporate avoiding ESG factors like labor violations or environmental damage.

Impact Investing

Investing with an objective to help a business or organization create something or deliver a service that is beneficial to society or the environment. Examples include debt financing for an environmental improvement project and investing in a non-profit that provides community resources.



How to spot an ESG fund

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A little over 25% of funds we studied actually include the “ESG” moniker in their names. And while it’s relatively easy to spot mutual funds and ETFs whose names include “environmental,” “social,” “responsible,” or other related keywords, **nearly 1 in 3 ESG and SRI funds carry no indicative naming at all.**

Funds without ESG or SRI-related names could result from a few imaginable situations: companies improving their ESG standards and reporting over time, a happy accident based on fund managers’ prescient stock picking, or by circumstance of the varied and ever-evolving criteria that constitute ESG and SRI.

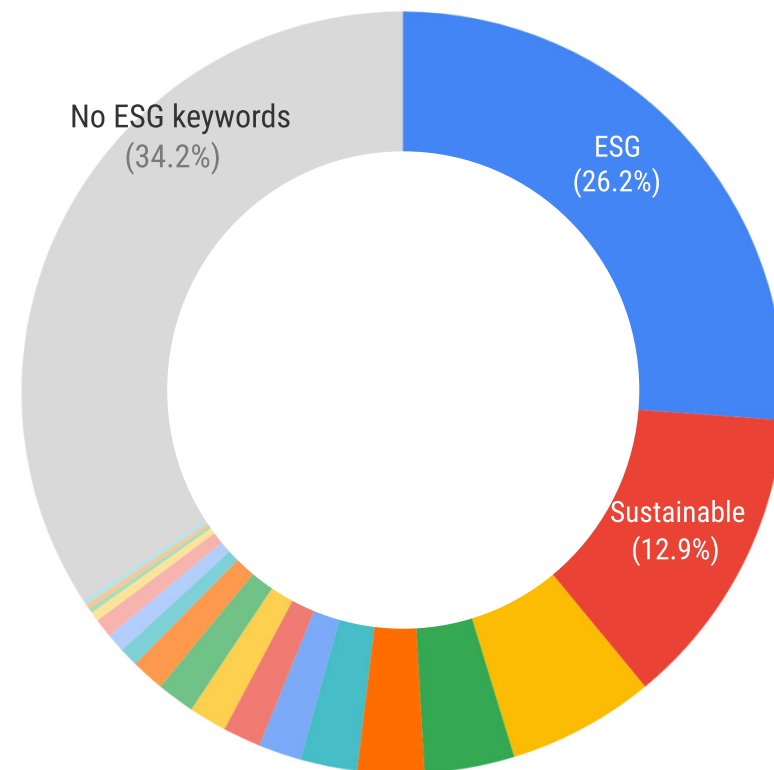
Top 10 Fund Families – Most ESG & SRI Funds	Total AUM of Funds in Study (\$MM)	# of Funds in Study
iShares	34,949	27
Calvert Research and Management	24,422	28
GuideStone Funds	21,897	20
Morgan Stanley	15,687	8
TIAA Investments	13,120	6
Dimensional Fund Advisors	12,345	9
Invesco	8,047	10
Pax World	7,185	11
Eventide Funds	6,552	7
UBS Asset Management	4,025	8

Total number of fund families in our study: 147

The largest fund families in the social and environmental investing business are BlackRock-managed iShares, Eaton Vance’s Calvert Research and Management, and GuideStone Funds, the nation’s largest faith-based mutual fund family. As ESG grows in popularity, the top 10 list shown here includes some niche names, but also many of the 10 largest asset managers in general.

Frequency of ESG & SRI Keywords in Fund Names

- ESG (26.2%)
- Sustainable (12.9%)
- Impact (6.2%)
- Social/Socially (3.8%)
- Green (2.8%)
- Responsible (2.4%)
- Clean (1.8%)
- Aware (1.6%)
- Environment/Environmental (1.6%)
- Water (1.6%)
- Climate (1.4%)
- Change (0.8%)
- Women (0.8%)
- Alternative (0.8%)
- Renewable (0.4%)
- Solar (0.2%)
- Wind (0.2%)
- Ethical (0.2%)
- No ESG keywords (34.2%)



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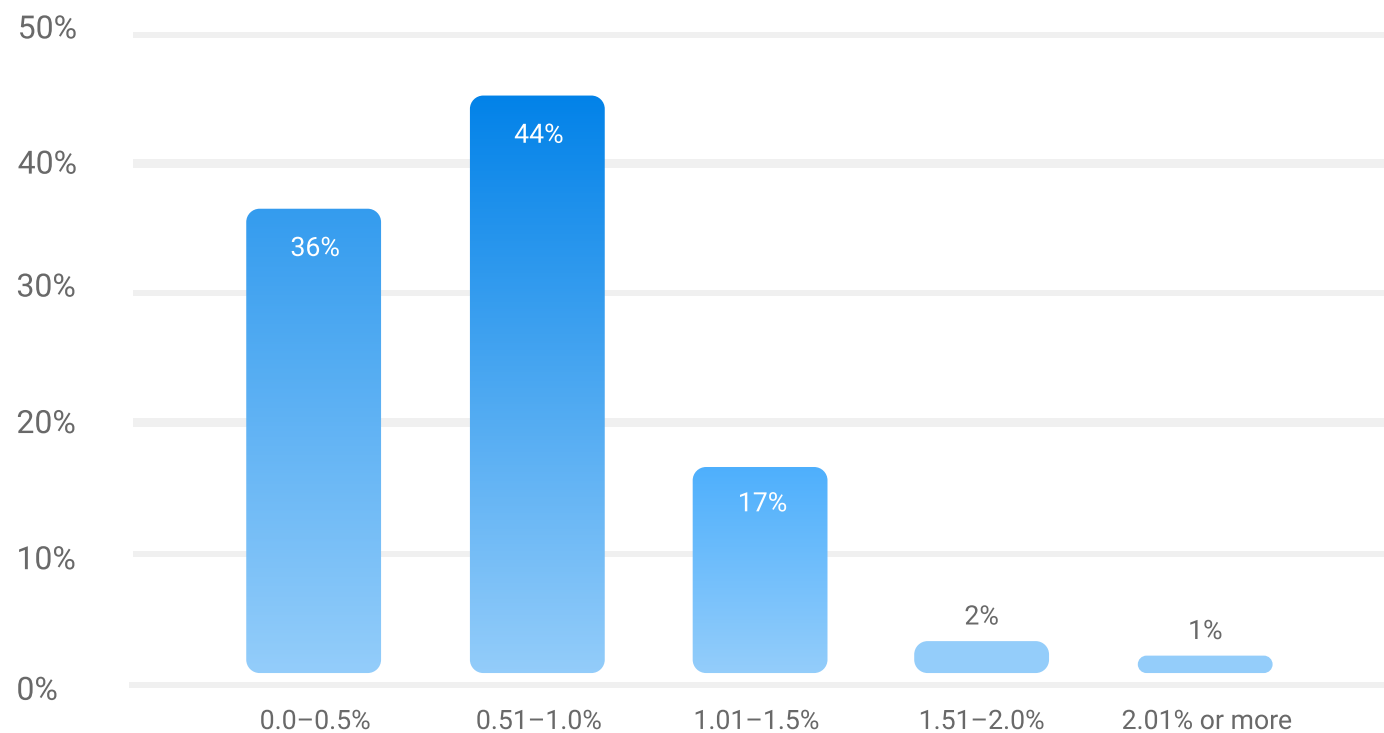
Because of the additional research and fund management required, you might expect ESG and SRI strategies to be expensive. But, nearly 80% of funds we studied have expense ratios lower than 1% of assets. **In fact, funds that are advertised as ESG or SRI are less expensive**, on average, than those that aren't marketed as such but have still earned the designation.

Just how popular has ESG investing become?

If you're not fully convinced about ESG's popularity, here's a statistic: the assets under management of iShares ESG Aware MSCI USA ETF (ESGU), one of the largest ESG index funds, have grown more than 820% in the last year, and by nearly 73,000% over the last three years. That extreme growth puts ESGU's net fund flows in the top 1-2% of all Large Cap Blend funds, ESG or not.

We're still in the advent of ESG, but investors have rushed into mutual funds and ETFs that employ the strategy. On average, fund flows into Large Cap ESG and SRI funds have been particularly strong as investors are more familiar with the companies in those funds, and more information is available to rating companies about their environmental, social, and governance controls. **Large Cap funds are somewhat of a 'path of least resistance' into ESG for most advisors and investors.**

Distribution of Expense Ratios – ESG & SRI Funds



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Expense Ratios By Fund Naming/Advertising

Average

With ESG/SRI keywords in fund name	0.62%
No ESG/SRI keywords in fund name	0.87%

Advisors and investors should note: managers of ESG and SRI funds without indicative names likely have no obligation to continue meeting that standard; however, based on ESG's popularity, asset managers may strive to retain the labels.

Fund Flows by Category – ESG/SRI Fund Adverage (\$millions)



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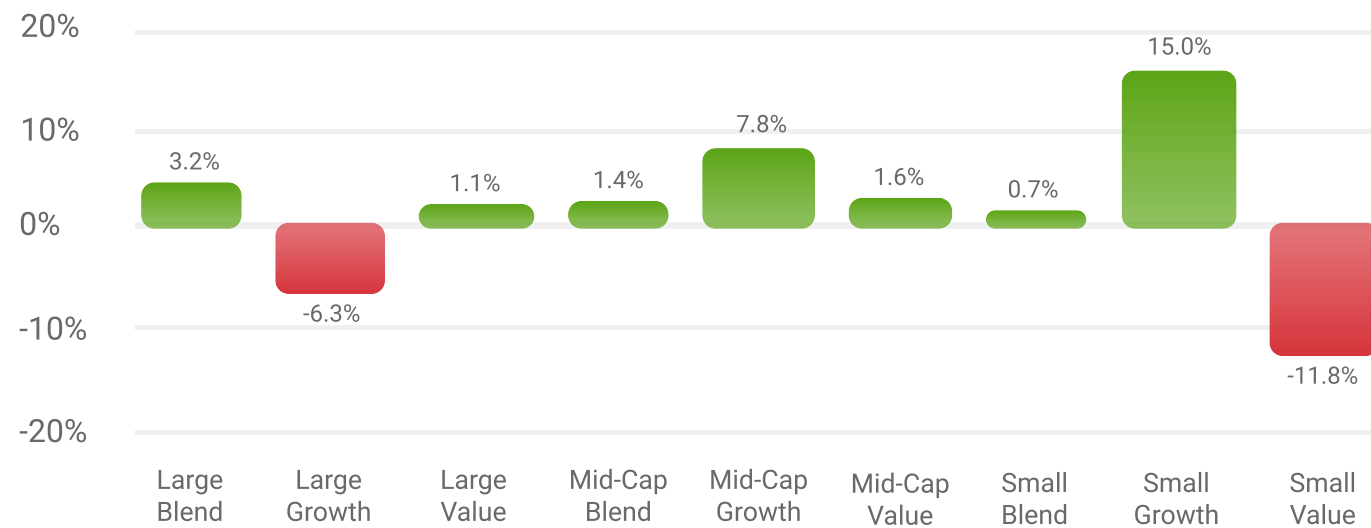
Despite being investors’ favorite way to get ESG and SRI exposure, Large Cap ESG funds seem to struggle against their category peers in terms of performance. Large Growth ESG funds have underperformed versus the category average, while Small Growth ESG funds beat their category average by a whopping 15 percentage points in the last year.

ESG performance vs. the market

Exactly half of the ESG and SRI equity funds we examined outperformed the S&P 500 Total Return on a year-to-date basis. Measuring from each fund’s inception date, that figure falls slightly to 40%—or two out of every five funds.

Additionally, the “virtue signaling” by equity funds with ESG keywords in their names appears to be advantageous. **A considerably higher percentage of funds with ESG or SRI-related names have outperformed their benchmark, especially in 2020.**

Performance Spread: Avg ESG/SRI Fund 1Y Total Return Less Category Avg 1Y Total Return



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Fund managers have heard the buzz around ESG, and have responded in kind by creating new ESG and SRI investment products. In fact, more than half of the funds we examined have debuted within the last five years, and a greater percentage of those include ESG-related terms in their names year after year.

Percent of ESG/SRI Funds outperforming their benchmark

	2020	Since Fund Inception
All ESG & SRI Funds	50%	40%
With ESG/SRI keywords in Fund Name Only	55%	45%
No ESG/SRI keywords in Fund Name Only	41%	31%

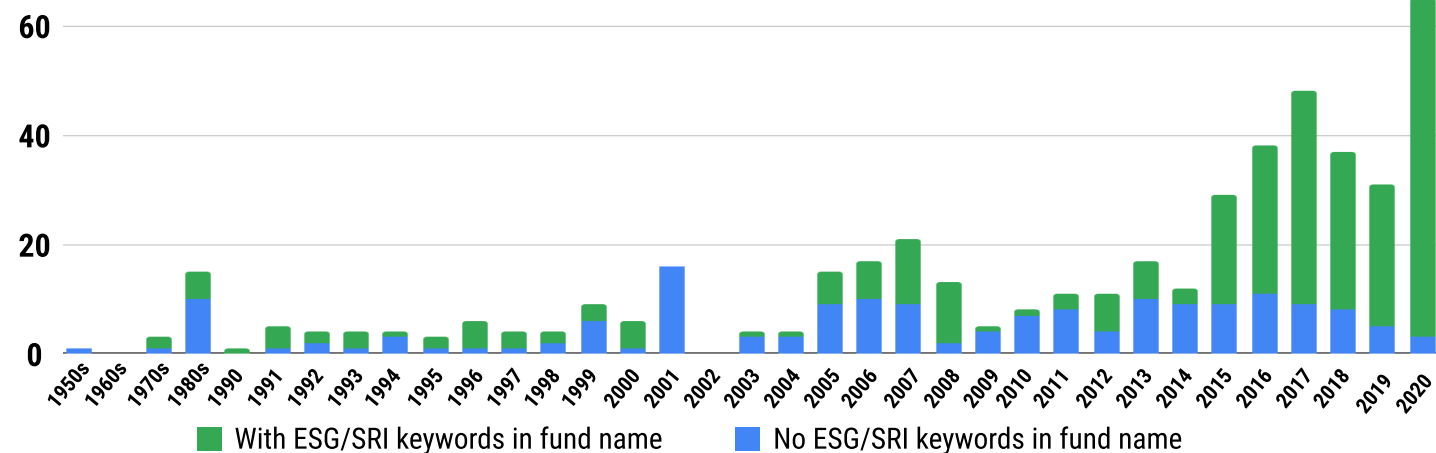
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* Benchmark: S&P 500 TR; Based on 300 equity funds incepted Dec 1989 or later

This means that when searching for the right mutual fund or ETF to meet your needs, even a random selection has a relatively good chance of outperforming; however, more targeted research into specific ESG and SRI funds would no doubt increase your odds of finding the right fund for your needs.

ESG & SRI Funds by Inception Year

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Energy: The surprise sector defining winners and losers

Some have attempted to explain away ESG performance with a truncated, somewhat cynical definition: ESG fund managers simply overweight technology, and underweight energy. And largely, that’s true—tech stocks are the proverbial lighthouses of ESG, and traditional energy companies are its antithesis. That’s why it’s shocking to see energy-focused ESG funds among the best and worst performers of 2020.

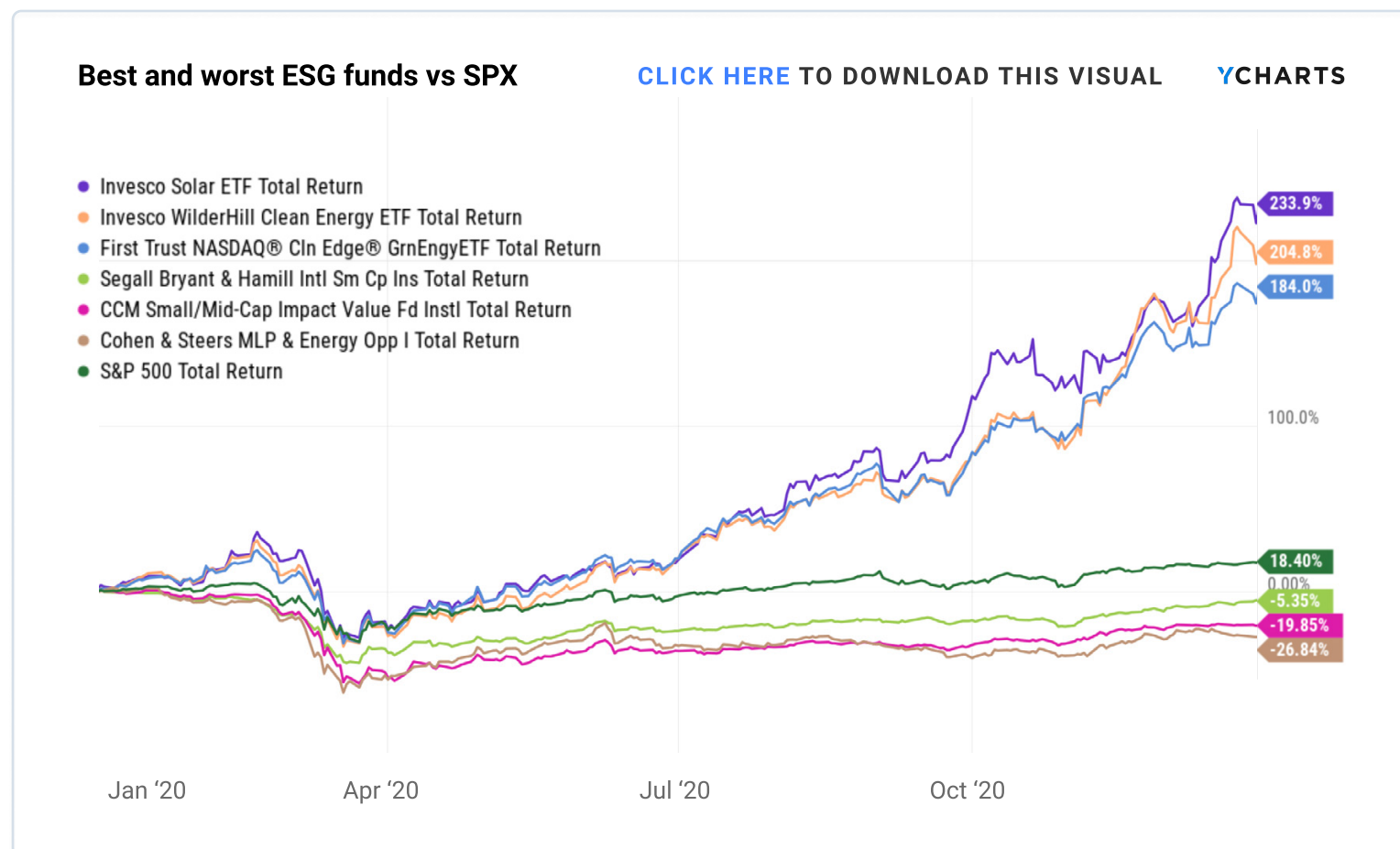
The three best performing ESG funds of 2020 each grew in excess of 180%, and all employ investment strategies focusing on clean or renewable energy sources. The very worst performing fund in our study, Cohen & Steers MLP & Energy Opportunities (MLOIX), is a “who’s who” of the largest oil and gas MLPs in the world.

You may rightly ask: How does MLOIX even qualify as ESG or SRI? Isn’t the oil and gas industry constantly under environmental scrutiny? Well, some argue that traditional energy giants have a place in ESG strategies, claiming it’s only a matter of time until their operations are converted and they become leaders in clean and renewable energy. Currently, though, those companies derive the majority of their revenue from extracting, refining, and selling oil and gas.

“The do-it-yourself ESG fund”

As an experiment, we created a model portfolio called a “Do-It-Yourself ESG Fund” that embodies the absolute best of ESG (or perhaps its ideal future state?). In this DIY approach to ESG, we first identified the most common holdings across every fund in our study, then found the average of their percentage weights within each fund. The resulting strategy is a winner, to say the least.

The DIY ESG Fund holds 49 stocks, mostly in technology and healthcare, and has easily outpaced the S&P 500 in each of the last five years. That outperformance gap has been especially large in the last year, during which the tech sector has led the market, and energy has lagged.



Annual Total Return: "The Do-It-Yourself ESG Fund" vs. The S&P 500

Year	"The DIY ESG Fund"	S&P 500 Total Return
2016	11.1%	11.1%
2017	24.1%	21.8%
2018	11.1%	4.4%
2019	24.1%	21.8%
2020 YTD	233.9%	18.40%

View how our ESG model portfolio compared to the S&P 500 [➔](#)











This DIY experiment, and the high-performing strategy it led to, raises an important question for advisors and investors: **can you achieve your desired ESG exposure without the help of a mutual fund or ETF?** Looking at our DIY ESG Fund, the answer might be yes, as long as you or your clients are not averse to owning individual stocks.



Is this even ESG?

The largest and most popular ESG and SRI funds look very similar to the S&P 500. Given the growing ubiquity and demand for ESG investing, it's easy to forget that most ESG funds are very new and employ relatively basic strategies.

Historically, socially responsible investing (SRI) was an exclusionary practice that aimed to avoid certain industries like tobacco, firearms, et cetera—elements of that approach have been seemingly carried over in modern ESG strategies, which hold a selection of the largest S&P 500 constituents and thus look very similar to the broad market index.

Company	Potential ESG Concerns	# of ESG/SRI Funds in this study w/ Exposure
 Amazon.com Inc (AMZN)	Global data center footprint requires a massive amount of electricity to operate. Logistics infrastructure produces extensive carbon emissions, although the company has set targets to reduce emissions from the shipping of online orders.	76
 Facebook Inc (FB)	Target of a late-2020 FTC anti-trust claim. CEO Mark Zuckerberg is a frequenter of congressional hearings due to claims of monopolization and data privacy concerns.	60
 Tesla Inc (TSLA)	Electric vehicles are perceived to have a positive effect on reducing emissions, but concerns around the production and recycling of lithium ion batteries complicate the picture.	42
 3M Company (MMM)	In recent years, the 3M company has faced investigations into toxic water contamination in three different states.	11
 Monster Beverage (MNST)	Named in a 2016 report alleging forced labor was used upstream in the company's supply chain. It's since been reported that the company has made major efforts to rectify the situation and add transparency to its supply chain.	11
 Walmart Inc (WMT)	The largest employer in the United States regularly faces anti-competition allegations and criticism over its executive-to-average-employee compensation ratios.	9
 Wells Fargo & Co (WFC)	Perpetrator of widespread fraud in 2016 whereby fake accounts were created by employees on behalf of unknowing customers to boost cross-selling numbers. Wells Fargo would go on to pay millions to the CFPB and billions in civil and criminal suits.	2
 Exxon Mobil Corp (XOM)	Exxon Mobil's core business is exploration, production, and refining of oil, a know contributor to climate change.	2
 Churchill Downs Inc (CHDN)	Churchill Downs is a gaming entertainment, online wagering, and racing company, which stands in contrast to ESG's predecessor, socially responsible investing.	1
 Tyson Foods Inc (TSN)	A Tyson Foods executive is the subject of a recent poultry price-fixing scheme. The company is also facing lawsuits as a result of COVID-19 related deaths while keeping its factories open against orders from local officials.	1



Pulling back the curtain on ESG holdings

An increasingly well-known fact about ESG is the high level of variance or inconsistency from one ESG fund to another. **Not only do the different rating companies arrive at different assessments of individual companies, but so do fund managers making allocation decisions.**

These two factors create a diversity among ESG and SRI strategies that will likely be a positive for investors in the long run (more approaches, more products, more choices), but which creates some short-term confusion. These 10 companies are just a short list of ESG and SRI fund holdings that may be surprisingly present, surprisingly controversial (like Tesla), or really not that much of an issue for a given investor.

S&P 500 Index Ticker: ^SPX		#1 Largest ESG Equity Fund Ticker: WSHFX		#2 Largest ESG Equity Fund Ticker: PRBLX		#3 Largest ESG Equity Fund Ticker: ESGU		"The DIY ESG Fund" created by YCharts Ticker: N/A	
Holding	Weight	Holding	Weight	Holding	Weight	Holding	Weight	Holding	Weight
AAPL	6.4%	MSFT	6.0%	MSFT	5.9%	AAPL	6.5%	AAPL	5.6%
MSFT	5.4%	AVGO	4.7%	AMZN	5.5%	MSFT	5.1%	MSFT	5.2%
AMZN	4.5%	CMCSA	4.2%	DHR	4.8%	AMZN	4.2%	AMZN	4.0%
FB	2.2%	UNH	3.3%	VZ	4.0%	FB	2.0%	DHR	3.2%
GOOGL	1.8%	JNJ	2.5%	CMCSA	4.0%	GOOG	2.0%	GOOGL	2.8%
GOOG	1.7%	PFE	2.3%	DE	3.8%	GOOGL	1.5%	A	2.6%
BRK.B	1.5%	MMC	2.1%	FDX	3.7%	JNJ	1.2%	LOW	2.5%
JNJ	1.3%	INTC	2.0%	COST	3.2%	PG	1.2%	FB	2.5%
JPM	1.2%	VZ	2.0%	BDX	3.1%	V	1.1%	GOOG	2.4%
V	1.2%	HD	1.9%	CME	3.1%	NVDA	1.1%	INTU	2.4%
PG	1.2%	CME	1.9%	GOOGL	3.1%	HD	1.1%	TMO	2.3%
NVDA	1.1%	NOC	1.9%	LIN	3.1%	TSLA	1.0%	MDT	2.3%
UNH	1.1%	HUM	1.8%	MA	3.0%	JPM	1.0%	V	2.3%
MA	1.0%	NSRGY	1.7%	AMAT	3.0%	UNH	1.0%	JNJ	2.2%
HD	1.0%	LMT	1.7%	WM	2.8%	MA	1.0%	TXN	2.1%
DIS	0.9%	BLK	1.7%	MDLZ	2.6%	CRM	0.9%	TSLA	2.1%
VZ	0.8%	JPM	1.5%	NVDA	2.6%	BRK.B	0.9%	COST	2.1%
CRM	0.8%	HON	1.4%	CDNS	2.5%	PEP	0.8%	UNH	2.0%
CMCSA	0.8%	CVS	1.2%	CERN	2.4%	VZ	0.8%	SBUX	2.0%
PYPL	0.8%	CSX	1.2%	SCHW	2.3%	KO	0.8%	MA	1.9%
ADBE	0.8%	DOW	1.1%	VRSK	2.3%	DIS	0.8%	HD	1.9%
NFLX	0.7%	GILD	1.1%	VFC	2.2%	ADBE	0.8%	ADBE	1.9%
WMT	0.7%	UNP	1.1%	BKNG	2.2%	NEE	0.8%	PG	1.9%
BAC	0.7%	MRK	1.1%	ADBE	2.1%	HON	0.7%	NVDA	1.8%
KO	0.7%	PNC	1.0%	SNPS	2.0%	PYPL	0.7%	PYPL	1.8%
Other holdings	59.9%	Other holdings	47.9%	Other holdings	20.7%	Other holdings	61.1%	Other holdings	36.3%

Also S&P 500 Top 25 Constituent

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* As of 11/20/2020



How to find an ESG fund that meets your needs

With the growing number and diversity of ESG and SRI mutual funds and ETFs, it’s only becoming more difficult to evaluate, identify, and invest in the fund that most closely aligns with your investing goals and personal criteria for impact, social, or responsible investing.

To zero in on the best ESG and SRI funds for your clients or yourself, here's a screening approach to try:

	Using YCharts WATCH TUTORIAL >	Using Any Tool
1 Start with a universe of all ESG/SRI funds	In the YCharts Fund Screener, click Modify > Attributes > Socially Responsible Fund, to view funds labeled by Morningstar Sustainalytics (definition here). Next click Modify again, select "Add" as the filter type, then click YCharts Proprietary > Fund Groupings > ESG Designated Funds, to view a list of funds YCharts compiled based on publicly available fund information, like asset manager websites.	Regardless of the ratings provider you rely on, starting with all the ESG and SRI funds you have access to ensures you're considering all opportunities
2 Pick your ideal fund category	Click Modify, then select either Broad Category (to choose between Equity, Allocation, and Fixed Income funds, for example) or Category Name (to see more granular groupings) and select the fund category that's best suited for your portfolio.	Are you adding ESG exposure through US equities? Large or small cap stocks? International or Emerging markets? Pick a fund category that agrees with your portfolio's current holdings and target allocations
3 Exclude funds with < 1 year of history and > 1% expense ratios	Next to "Metric Filters" click Add Filter > Equation. Enter "Expense Ratio" as the metric, select "< less than" as the filter type, and type "1" into the value field, then hit Enter. Repeat this step using "Years since Inception" as your metric and "> greater than" as the filter type to exclude funds that began trading within the last year.	Just like any mutual fund or ETF, a short track record should be treated with scrutiny; and, nearly 80% of ESG and SRI funds have fees below 1% of assets—why overpay if you don't have to?
4 Set your preferred sector exposures	Next to "Metric Filters" click Add Filter > Equation. Enter "[Sector Name] Exposure" as the metric, select "< less than" to cap exposure or ">greater than" to set a floor, make a selection in the value field (with "1" being equal to 1% and "10" equaling 10%) then hit Enter. You could also click Add Filter > Range to find funds with sector exposures within a given range.	Choose which sectors will make up the bulk of your ESG/SRI strategy to complement your portfolio and avoid surprises. ESG funds typically overweight technology and underweight energy
5 Look for ESG and SRI-related names and dig deep on holdings	Next to "Security Exposure Filters" click Add Filter, and use the first dropdown menu to set an Include or Exclude filter. Next, enter a company name (like "Apple") or ticker ("AAPL"), set the dropdown menus to "Percentage" and either "Greater-" or "Less than or equal to" depending on your goals, make a selection in the value field (with "1" being equal to 1% and "10" equaling 10%), then click Submit.	Funds whose names include ESG and SRI keywords signal to you that they were intentionally designed to be so; look through fund holdings closely to avoid potential issues with problematic holdings

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