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Wall Street's New Clothes? A Primer on ESG Investing

January 11, 2022 by Alex Jantsch, CFA, CAIA®

"Those would be just the clothes for me. If I wore them, I would be able to discover which men in my empire are unfit for their posts. And I could tell the wise men from the fools." — Hans Christian Anderson, The Emperor's New Clothes

There's an early episode of Seinfeld where Jerry, Elaine, and George are about to order lunch. Jerry begins to order a tuna sandwich, eliciting a visceral reaction from Elaine. "Oh the dolphin thing," Jerry retorts, referring to the tuna drag nets that dolphins are often caught in. "Can't you incorporate one unselfish act in your day," begs Elaine. Jerry tries to justify it otherwise. "I let people in during traffic, I'm a good person." He relents and changes his order, but not before he hears another plea. George had recently been tipped off about a "sure thing" investment with a good story by a friend of a friend and subsequently badgers Jerry into co-investing. Jerry bails after losing more than half his money. George decides to go "down with the ship," but ends up more than doubling his money. When investors don't really understand what makes a good story also a good investment, luck and emotions can determine divergent outcomes. The specifics matter even more when the story has a moralistic undertone. George ordered the tuna anyway.

"Without a sense of purpose, no company, either private or public, can achieve its full potential. It will ultimately lose its license to operate from key stakeholders…companies must ask themselves: What role do we play in the community?" — Larry Fink, in a 2018 letter to global CEOs

Larry Fink is the CEO, Chairman, and founder of BlackRock, the largest investment management firm in the world. In 2018, he wrote a public plea for the corporate world to shift from a pure profit motive to what some are calling "sustainable capitalism," in order to make the world a better place for future generations. One financial journalist, Andrew Ross Sorkin, called it a potential "watershed moment on Wall Street." This was not the first time someone had made assertions that private corporations have societal responsibilities. Corporate social responsibility is not a new concept, by any means. It was, however, the first time such an influential ***investment*** company made such an explicit threat to corporations. Regardless, that letter is credited with rapidly accelerating a shift in how Corporate America courts Wall Street money.

It's hard to challenge such an altruistic ideal without feeling like you're telling the "Emperor" he has no clothes, at risk of being branded a fool. But ***good*** financial advisors exist to challenge new trends, distinguishing fleeting fads from changing fundamentals. No one serious is arguing that corporations shouldn't do all they can to make the world a better place. Yet, it is perfectly reasonable to ask whether investment and retirement accounts are the right funding sources for that mission. How does the investment industry even measure for "societal good" in an investment process? And what effect does that have on investment returns? Rather than make a political argument about ideals, the primary focus here will be practical application.

The Theory: How Does ESG Investing Work?

"The first step toward clarity in examining the doctrine of the social responsibility of business is to ask precisely what it implies for whom." – Milton Friedman, Friedman Doctrine

Environmental, Social, and Governance (ESG) investing is the formal name for this investment trend. For most individuals, this consists of finding an investment manager who will incorporate ESG factors into their investment process. For investment managers, this consists of finding companies to invest in that meet

elevated standards for how well a company helps improve society. Corporations rely on these investors to help fund business growth plans (or keep them afloat!), so executives are incentivized to appease them.

In theory, broader acceptance of ESG investing is supposed to increase funding costs for corporations that do not meet society's ESG standards because fewer investors are willing to give them money. In extreme cases, activist ESG investors can even directly influence higher costs in their quest to force change. Higher costs usually mean lower profits, all else equal. Regardless, it can be distracting to management's focus on business goals. In this scenario, broader acceptance of ESG investing alone might present a future risk to all investors. Even those who do not care about ESG issues. A potential self-fulfilling prophecy. This theory is unproven but is presented as an alternative to an established theory.

In 1970, economist Milton Friedman published an article stating that "the social responsibility of corporations is to increase its profits." This would become known as the Friedman Doctrine. It's been an influential guide for the relationship between corporate management and shareholders but is maligned by ESG activists. It is often misunderstood. His argument is chiefly that the decision to undertake any social responsibility initiatives that ***might*** affect profitability is that of the owners, i.e. shareholders, not the corporate executives. If increasing profits was not the company's sole objective, shareholders must explicitly sign off and customers must be told the potential impact these social responsibility "taxes" might have on the pricing of a company's product. This is what makes Larry Fink's plea different from the activists and corporate executives who pushed corporate social responsibility in the past. His firm represents those shareholders, explicitly incentivized by what they desire. The new theory is not in complete opposition to the old one, but rather an extension of it.

The point that Milton Friedman was making is that altruism isn't without costs. Take the recent actions by the Woman's Tennis Association (WTA). The WTA pulled all tournaments out of China indefinitely after the Chinese government supposedly silenced a global tennis star, Peng Shuai. It's objectively the right thing to do if the WTA wants to put pressure on China to change. Unfortunately, it is estimated that the WTA might leave more than $1 billion of China based revenue on the table over the next decade[1]. The WTA had just over $100 million in annual revenue in 2018 when they signed the agreement[2]. If they cannot replace that revenue, their growth plans are crippled. Economists call this "opportunity cost". This is an extreme example, and the WTA doesn't have to answer to public shareholders. The prudence of ESG investing comes down to whether public corporations save more from lower financing costs than any opportunity costs incurred for actively making the world a better place. That's a fine line, and you rarely get real change by walking a tightrope.

All of this is relatively easy to grasp, but the implementation of ESG investing is where it starts to get convoluted. Albert Einstein was fond of saying that the problem is more essential to identify than the solution, because if you can't identify the fundamental problem then the solution is impossible (and a waste of time and money). When investors are deciding whether to pay someone to help them invest based on the idea that they are participating in a solution, the most essential part of that process becomes understanding how good those investment managers are at measuring the problem.

Components of ESG: What Data is Being Measured?

"If you can't measure it, you can't improve it." – Peter Drucker, Influential Management Consultant

Examples of Measurable Governance Factors		
Directors - Structure/Independence	Regulatory Fines & Issues	Executive Compensation
Transparency of Business Plans	Legal Fines & Lawsuits	Tax Strategy
Political Lobbying & Donations	Supply Chain Management	Capital Allocation
Corruption & Bribery Issues	Risk Management	Cyber Security

“Governance” factors have been around the longest, by far. They typically span issues that have to do with efficient capital allocation, management oversight, executive compensation, etc. The idea is that a well-run company with good oversight and a good history of allocating capital to profitable projects is less likely to waste investor capital on money-losing activities or get the company in legal/regulatory trouble. This focus is as old as Wall Street. Warren Buffett famously likes to buy companies that are well run by an honest leader of good character, letting that individual continue to run the company. Broadly speaking, corporate governance factors are the “easiest” category of the three to measure because the revolution of databasing required corporate disclosures on governance issues already happened decades ago. There are grey areas, but many of these factors have proven effects on the investment risks and returns. Ensuring there are good stewards at the top of a company makes a big difference for investor faith in whether management can efficiently execute their goals, whatever they may be.

Examples of Measurable Environmental Factors		
Energy Usage/Carbon Footprint	Water Usage	Unsustainable Farming Practices
Renewable Energy Usage	Animal Welfare	Product Lifecycle
Business Waste Management	Deforestation	GMOs

“Environmental” factors came into the public fold next and are probably the most self-explanatory of the three categories. The goal is to identify the best and worst companies based on their environmental impact. Don’t, however, confuse the obviousness for simplicity. For example, there are three scopes of carbon emissions that make up a carbon footprint. Scope 1 is direct carbon emissions, such as from a company car. Scope 2 consists of direct energy purchases, such as electricity and heat. Scope 3 is a catch all for indirect impacts throughout a company’s supply chain. Scope 3 emissions reportedly account for 70% of a company’s carbon footprint[3], are difficult to accurately measure, and nearly impossible to mitigate completely without significant costs. The original “carbon neutral” push focused corporate efforts on “offsetting” emissions impact through funding environmental projects to earn “carbon credits”. This process is prone to companies buying off their impact rather than mitigating it. The new mantra is “Net Zero Carbon”, which focuses on direct reductions of corporate emissions with less focus on “offsetting” impact with carbon credits. This revolution began decades ago, but corporate environmental disclosures still aren’t a global standard. The better the disclosures have gotten, the larger the problem seems, and the more the goalposts will continue to move. Even the best renewable energy technologies have environmental impacts when built to scale.

Examples of Measurable Social Factors		
Alcohol	Nuclear Weapons	Community Relations
Gambling	Predatory Lending	Workplace Benefits
Tobacco	For Profit Prisons	Workplace Safety
Civilian Firearms	Gender Equality	Forced/Immigrant Labor
Adult Entertainment	Racial Equality	Board of Dir. Diversity
Conventional Weapons	LBGTQ+ Equality	Charitable Contributions

The evolution of “Social” factors is less linear and far more confusing. This category is the most broad, subjective, and hardest to measure of the three. Societal values are continuously evolving, whereas good corporate governance and environmental preservation are largely cross generational. That evolution is valuable to understand. Some of the earliest ESG investors were religious (“faith-based investing”), and they originally focused on easily definable social vices. No alcohol, gambling, adult entertainment, tobacco, etc. These investors mainly wanted to avoid being associated with businesses that promote *sinfulness*. That is a completely different, and far more attainable, investment goal than trying to financially punish corporations for not actively making the world a better place.

The modern social movement is more concerned with progressive ideals of equality and community improvement than temperance. In many cases, investors who belong to the newer school are often fine with the social vices. It's not as important to many younger investors that Anheuser Busch makes alcohol, so long as they don't discriminate against women and minorities, don't use forced labor, and donate to community charities. These types of issues are paramount to faith-based investors too, but equality is far more subjective and difficult to measure than how much of a company's revenue is derived from alcohol sales. Additionally, the social issues religious investors care about may not always align with modern progressive ideals. Yet, all the above are often commingled into a morass of sometimes conflicting social values within most ESG investment strategies.

ESG Ratings Companies: Who Is Measuring the Data?

"Measurement is fabulous. Unless you're busy measuring what's easy to measure as opposed to what's important." – Seth Godin, Influential Marketing Consultant

Evaluating ESG issues is not the same expertise as investing purely for profit. Once investment managers realized the daunting a task of measuring ESG issues, the question turned to whether to build an entirely new expertise internally or outsource the work to a firm that already has the expertise. Investment managers naturally turned to their data providers for help. MSCI and Morningstar are two of the largest data providers to the investment management industry. In 2010, both MSCI and Morningstar acquired separate ESG ratings agencies to make a push for market share of the ESG ratings business. In the U.S., MSCI is currently the largest ESG ratings agency. Morningstar's Sustainalytics brand is a comfortable second.

ESG ratings agencies are similar to financial credit ratings agencies. They share a goal of trying to standardize the evaluation of corporate investment risks, but they differ greatly in scope. The goal of financial credit ratings agencies is to evaluate whether companies can pay their current financial obligations. That formula is some complex mix of cash in the bank plus expected cash earnings minus cash owed to financiers. Almost every needed datapoint for that is a required financial disclosure for every public company. Even with all the necessary disclosures, credit ratings gave investors false confidence leading up to the 2008 Financial Crisis.

The ESG ratings world has no helpful disclosure standards and a far messier mission statement. That is incredibly important to understand. It results in drastically different ESG ratings between providers. For example, ESG ratings agencies treat data that is unavailable or not provided by the company differently. Some assign the company a zero score for that specific issue, and some assign the company the median score for the industry peer group. Some use statistical modeling to guess the missing data. That is wholly uninformative to real ESG impacts, but influential nonetheless. It's difficult to understand the impact without seeing just how dissimilar ESG ratings are.

Correlation is a statistical measurement of the strength of a relationship between two variables, measured on a scale of -1 (not correlated, inversely related) to +1 (perfect correlation, identically related). We can use this measure to understand if different ratings agencies give the same company a similar rating, extrapolated across all public companies. The correlation of ratings made between each of the major U.S. ***credit ratings agencies*** is between 0.94 and 0.96, indicating minimal variation in the rating of most companies between different ratings agencies. On the other hand, the correlation of ratings made between each of the major U.S. ***ESG ratings agencies*** is between 0.07 and 0.74, indicating large differences in how each publicly traded company is rated by the different ratings agencies[4]. The cutoff point for being "highly correlated" is typically anything above 0.70. The average correlation between six ESG ratings agencies, analyzed by the CFA Institute in August 2021, was 0.35.

How Similar Are ESG Ratings Between Companies?

Ratings Agencies:	MSCI	S&P	Sustainalytics	CDP	ISS	Bloomberg
MSCI		0.357	0.351	0.163	0.330	0.374
S&P	0.357		0.645	0.350	0.139	0.744
Sustainalytics	0.351	0.645		0.293	0.217	0.584
CDP	0.163	0.350	0.293		0.070	0.441
ISS	0.330	0.139	0.217	0.070		0.213
Bloomberg	0.374	0.744	0.584	0.441	0.213	

Source: CFA Institute, BDO USA LLP

The lack of corporate ESG data disclosures can be overcome with time and effort. PriceWaterhouseCoopers, a major corporate accounting firm, is planning to hire 100,000 people over the next five years to address ESG reporting issues. That would be an increase of around 35% in their workforce[5]. The remainder of the "big four" accounting firms (Ernst & Young, Deloitte, and KPMG) are likely to follow suit to differing degrees. Many countries are starting to require corporate ESG disclosures. Europe has always been on the forefront here. India recently announced that it would require all companies to disclose ESG issues. The U.S. has not announced any formal requirements yet.

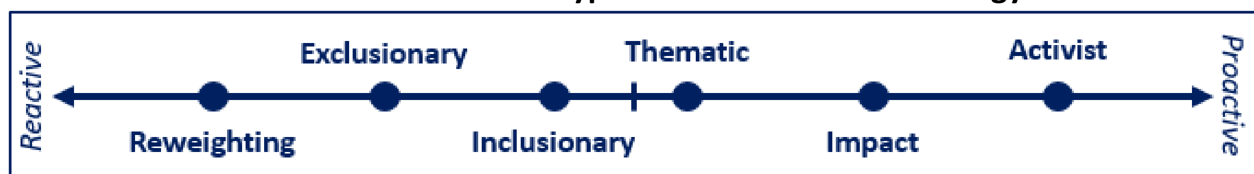
Requiring ESG data disclosures isn't a harbinger for progress on ESG issues. The more standardized the ESG disclosure and rating processes become the more companies begin to understand the rules of the road. This doesn't equate to real change, but rather corporate adaptation. European companies generally have better average ESG ratings than U.S. companies. Not necessarily because U.S. companies don't care as much about ESG issues, but because European regulators already paved that road. ESG ratings agencies sometimes resort to sending out corporate surveys, scrubbing websites, searching Google, polling consumers, etc. to get needed information for U.S. companies. It is still a cobblestone street on this side of the Atlantic.

ESG "Flavors": How Principled Is ESG Investing?

"Reactive people are driven by feelings, by circumstances, by conditions, by their environment. Proactive people are driven by values – carefully thought about, selected and internalized values." – Stephen Covey, Seven Habits of Highly Effective People

Lack of easily measurable data aside, societal values aren't as black and white as a company's ability to pay back what they have borrowed. That creates an inherent opacity to ESG investing that makes it easy to over-promise and under-deliver without investors knowing any better. So, for the sake of simplicity, it is helpful to divide ESG investing into six categories based on how proactively each approach attacks ESG issues. It is easier to espouse values than it is to boldly follow them no matter the costs.

How Proactive Is Each Type of ESG Investment Strategy?



(Does Not Accurately Represent Magnitude of Proactivity, Only General Order)

Reweighting ESG strategies seek to minimize investing in the worst rated corporations on ESG issues. An investment manager can take a broad index, such as the S&P 500, and apply their ESG standards to that universe of stocks. The resulting portfolio invests less (more) money in companies with lower (higher) ESG ratings than otherwise. This approach doesn't exclude many corporations from investment. Regardless, it is

an inherently reactive approach because you cannot measure relative ESG ratings until after data is gathered and analyzed. Since few companies are truly punished for a poor ESG track record within this approach, it is unlikely to force change quickly or negatively affect a corporation's cost structure.

Exclusionary ESG strategies take this a step further, by seeking to avoid investing in the worst rated corporations on ESG issues. Sometimes whole industries are excluded. An ESG ratings threshold or percentage of revenue from a specific business activity is outlined and any company that violates that rule gets eliminated. A common cutoff is companies rated in the bottom 20% or those with greater than 5% of revenue from the shunned industry. It is more proactive than simply reweighting, but still unclear whether this accomplishes the goal of forcing change in the worst companies. Combined, Reweighting and Exclusionary ESG strategies currently account for the vast majority of ESG-related investment assets.

Inclusionary ESG strategies seek the opposite of the Exclusionary approach, investing in only the best actors on ESG issues. Inclusionary approaches typically invest in a smaller number of companies and have higher standards to meet before investment. It's still a reactionary approach that relies on data measured after the fact, but focusing on rewarding only the best in each industry is more proactive than just eliminating the worst. This approach better incentivizes everyone, even median rated companies, to chase the gold standard.

Thematic ESG strategies often have a narrower, more proactive goal aimed at a solution to a specific problem within one of the three ESG categories. This is inherently forward looking. An example is an investment strategy focused on the global transformation from internal combustion engines to electric vehicles. Long-term, forward-looking leadership of this industry is impossible to predict, so the investment net is cast wide. If the "theme" is correct then the investment is likely successful, regardless of the losers along the way. At least, that's the theory. But the handoff from old industry to new industry isn't a clean break. Telsa may have gotten electric vehicles widespread attention, but their success awoke the formidable big budget research & development divisions at every major auto company. And for every Tesla, there will be many promising companies like Nikola, Nio, and Byton that lose investors a lot of money.

Impact ESG strategies are often focused on the project level, rather than the company level. This approach can either attack the current problem or focus on finding a long-term solution, but the goal is to better focus investments towards specific impact. The highest profile example of this type of approach is with "green bonds" or "sustainable development bonds," which are bonds issued to fund specific ESG related projects. This is the primary approach that provides investors access to ESG related investments in the bond market. Additionally, of the top 10 green bond issuers, seven are entities of global governments[6].

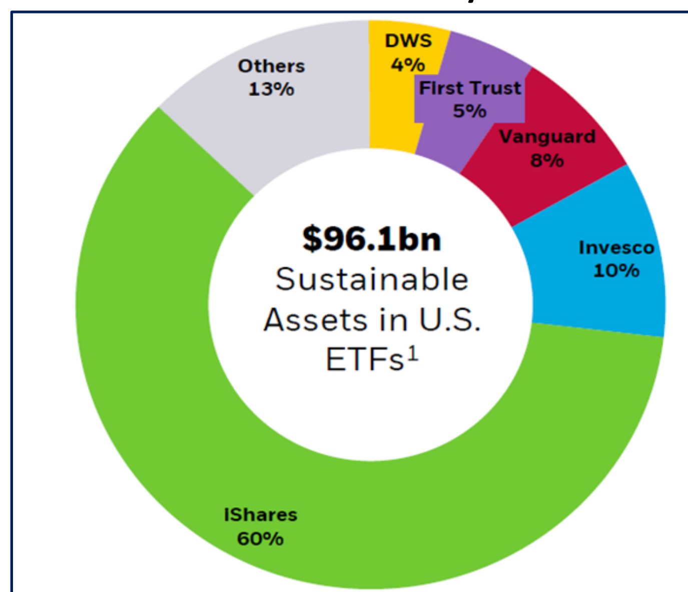
Activist ESG strategies are the most aggressive at attacking the ***current*** problem. The goal of this approach is to mitigate future issues directly from the source. It requires a deep understanding of who the worst corporate actors are. Instead of running away from those companies, this approach requires investing in those companies to get a seat at the table with corporate management. It is an aggressive investment approach that can lead to volatile investment returns. As such, it is almost always offered as a private fund, available only to the already wealthy (i.e. accredited investors and qualified purchasers). The goal is to force management to change and become better at making the world a better place. The ESG police! Or are they firefighters?

Engine No. 1 is an activist investment company that is "purpose-built to create long-term value by driving positive impact through active ownership." In May 2021, they successfully won three seats on the board of directors at Exxon Mobil. They did this by convincing other Exxon investors to vote for their nominees, via a process known as a "proxy fight". Engine No. 1 only purchased around $40 million of Exxon stock. Exxon is a $289 billion company. This investment manager needed about 0.02% ownership and a lot of chutzpah to achieve the desired result. The proxy fight reportedly cost Exxon Mobil between $35 million-$100 million, a

direct effect of their lackluster ESG performance in the eyes of their investors. Engine No. 1's message resonated in a way that imposed real costs on Exxon. A real David versus Goliath story.

It's helpful to note that Jennifer Grancio, one of the founders of Engine No. 1, is an industry veteran. She co-founded BlackRock's iShares ETF business. Not coincidentally, the iShares platform is ***the*** largest ETF issuer and one of the largest ESG investors in the world. BlackRock, Vanguard, State Street, and Fidelity are Exxon's four largest shareholders, accounting for more than 20% of the company's shares[7]. Not an uncommon position for the four largest U.S. investment managers. It is hard to win any corporate proxy fight without convincing those four firms to vote for the cause. In this version of the story, David understood who had the real power to defeat Goliath. That is helpful in effecting change, but an uncomfortable concentration of Wall Street power that is still growing.

BlackRock's iShares ETF Business Currently Dominates ESG Investing



Source: Bloomberg LP

Investor Implications: What Are the Costs of ESG Investing?

"Everything has a price, but not all prices appear on labels" – Morgan Housel

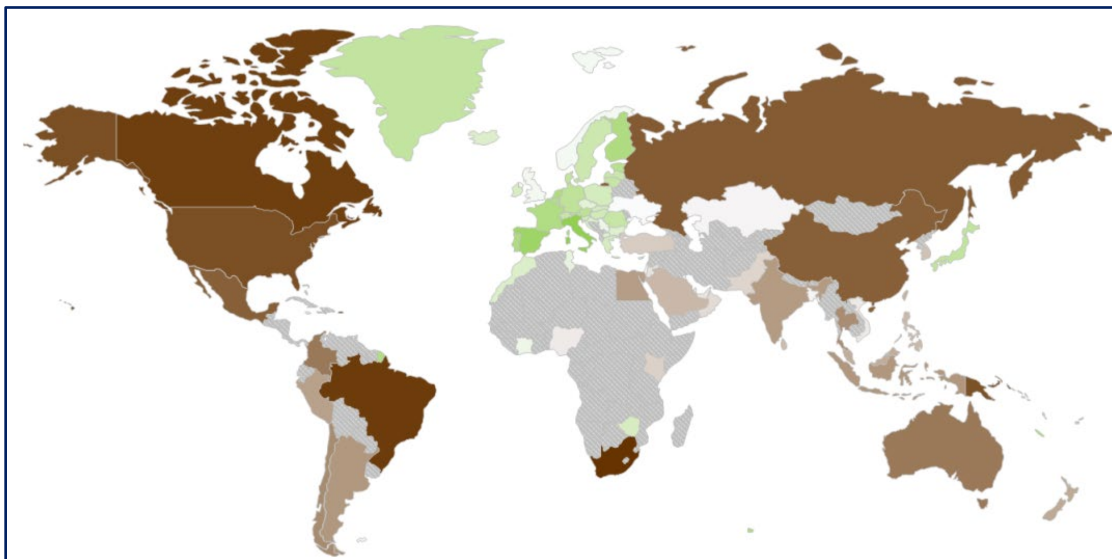
Let's get the sticker price of ESG investing out of the way. It is undeniably higher. In 2020, Morningstar found that ESG focused investment strategies had an average investment management fee of 0.61% versus 0.41% for non-ESG strategies[8]. A 50% premium. Building an entirely new expertise internally or buying the necessary data from an external ESG ratings agency is not free for investment managers. This provides reasonable justification to regulators for why ESG investing cost investors more. In this respect, ESG investing is a change in fortunes for Wall Street, reversing a decades long trend towards lower fees for investors. If it is truly valuable to investors, then the sticker price is not a problem.

The strongest argument for ESG investing being "valuable" to investors is that it lowers investment risks. There is real data to back this up for a lot of ESG issues, especially within governance. In the new age of social media shaming, any corporate misstep that becomes public spells a long night for the public relations team. Warren Buffett has long proved that public branding can help protect a company from competition or speed up their demise. But investors need to put this into perspective. ESG investing looks to help investors with ***company specific*** risks, not broader market risks. During market turmoil, investors are concerned with how the health of the economy affects corporate profits. Consumers often shift to cheaper products during economic stress,

disproportionately affecting profits of companies that offer higher priced products. The cheapest products are often produced by companies that don't adhere to higher ESG standards. ESG investing does not inherently protect capital in times of market turmoil. Only chicken soup for the investor's soul.

How ESG investing impacts investment returns is the wildcard. Since there is no discernable standard for ESG investing yet and new ESG issues are being incorporated every year, the true effect is hard to evaluate. The costs are visible and explicit. The benefits are often opaque and a moving target. Still, researchers at the University of Augsburg discovered an important point when they analyzed the effect of carbon emissions on investment returns. Using data from ESG ratings agencies, they divided all publicly traded companies by country and gave each country a combined "carbon beta" score based on sensitivity of each country's market to carbon risk. Countries like Brazil, Canada, South Africa, and the U.S. naturally have the higher carbon betas because these markets have a high number of traditional mining and energy companies that often get lower ratings. Europe and Japan have the lowest carbon betas. European governments were early adopters of regulatory standards for ESG issues. Japan's stock market is heavily concentrated in technology companies, the market sector the researchers found had the lowest median carbon beta.

How "Green" or "Brown" Is Each Country's Public Stock Market?



More brown = higher carbon beta. More green = lower carbon beta. Grey = not enough data

Source: "Carbon Risk" by Görgen, Jacob and Nerlinger, University of Augsburg

To make the analysis of investment returns easier, the researchers broke the world into quintiles based on each country's carbon beta. What they found was that both the "greenest" (top 20%) and the "brownest" (bottom 20%) groups, "exhibit risks stemming from the uncertain transition process from a carbon-based to a low-carbon economy." Higher carbon risks did have a negative effect on investment returns, but so did the lower carbon risks. It was the quintiles in between that offered better risk adjusted returns. The takeaway is that both extremes, proactive change and ignorance of change, have real investment costs. This explains why the more proactive ESG approaches often have more volatile performance. What it also means is that there is a fiduciary argument to be made that the most reactive ESG approaches, such as Reweighting and Exclusionary strategies, could be more prudent because they have higher exposure to the middle of the pack than the extremes. The tradeoff is that more reactive approaches don't effect much change.

There are obvious examples of the market no longer rewarding profitable, high ESG risk companies with the valuations they once did. The tobacco industry is a money printing machine. The industry, in general, has been one of the best long-term investments in the history of the stock market. Now tobacco companies routinely

trade at valuation ratios well below the market average and pay dividend yields well in excess of the broader market. This is a highly profitable industry with immense, recession resistant pricing power but is facing increasing societal concerns surrounding tobacco's social impact. Investors should not ignore that potential impact on investment returns.

On the other hand, the increasing popularity of ESG investing has also seen the valuations of unprofitable, lower ESG risk companies, even those that ultimately failed, trade well above average market valuation ratios. The short-term effect has been to drive those stock valuations higher than current earnings justify, a positive for early ESG investors. The longer-term effect is lower expectations for future returns as future earnings catch up, bringing valuation ratios lower. A negative for later ESG investors. It is estimated that 25% of new investment dollars in the U.S. are now going into ESG focused investment strategies. That percentage is near 50% for Europe[9]. That is the current trajectory that U.S. investors are on. Overall, global ESG investments have topped $35 trillion, or 36% of all professionally managed assets[10].

Conclusion: Where Does ESG Investing Go from Here?

"A repeating rhyme of history is a never-ending competition between explorers and exploiters. Exploiters here doesn't mean taking advantage of others – it means extracting some form of yield from a previously explored and discovered opportunity – but it sometimes results in it" – Josh Wolfe, Lux Capital

In "The Emperor's New Clothes," the Emperor is obsessed with showing off to his constituents. His obsession leaves room for the swindlers to promise him the impossible, for a price. To an extent, Wall Street is the emperor and investors around the world are the constituents. The swindlers are still largely unknown. The regulators play some role in this story too, and it hasn't been a helpful one thus far. What seems obvious, though, is that Wall Street has attempted to set up a standardized process for rating corporations based on their perceived societal impact before there is a standardized corporate disclosure process. But Wall Street is putting the cart before the horse for a reason. There are career risks from both rejecting ESG investing (losing clients who increasingly desire it) and embracing it (regulatory trouble from overpromising and overcharging). Investors are demanding an opaque product and regulators are waiting to see how it shakes out before pouncing on who ***they*** think the swindlers are. Damned, if you do. Damned, if you don't.

For an investment manager, the risk of inaction on a client request is to slowly become irrelevant in a competitive industry. The risk of overpromising or overcharging is regulatory action. It's a risk Wall Street is willing to take. There are some truly pioneering explorers in the ESG realm, but there will inevitably be many exploiters who take advantage of an investor's willingness to pay more to invest according to their personal values. But the difference between *living* according to your values and *investing* according to your values is that you are asking someone who has never met you to interpret those values. It's the classic principal-agent problem. Each side has their own motivations. It's difficult to discern whether values truly align between the principal (investors) and the agent (investment manager), or if one side is taking advantage of the other's naivety for their own gain.

If the ESG investment trend continues to accelerate, ESG issues will start becoming incorporated into every investment manager's process regardless of ESG label. It's already happening. Almost every approved investment strategy on Arvest's trust platform, most of which are not ESG focused, have added a slide detailing their ESG evaluation process to their sales presentations within the last year or two. It is mostly reactive approaches focused on avoiding the worst ESG risks rather than proactively trying to force change, but the moralistic story sells. Who doesn't want to make the world a better place? Investment managers are remarkably good at incorporating new market realities into their investment processes, and even better at

selling the story behind it. And therein lies the problem for financial advisors, like Arvest, in weeding out the explorers from the exploiters.

Ultimately, ESG investing is not going anywhere but it will morph. Investors interested in ESG investing must determine how proactive they want to be in effecting change and what they are willing to give up to try. "Investing for profit" and "investing to make the world a better place" aren't mutually exclusive, but they don't often play well together because change has costs. Additionally, no one has the same idea of how to make the world a "better place," making it hard to measure what investors are getting for the added costs. But Wall Street works differently than the Field of Dreams. If you ask for it, they will build it. Both explorers and exploiters, alike.

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