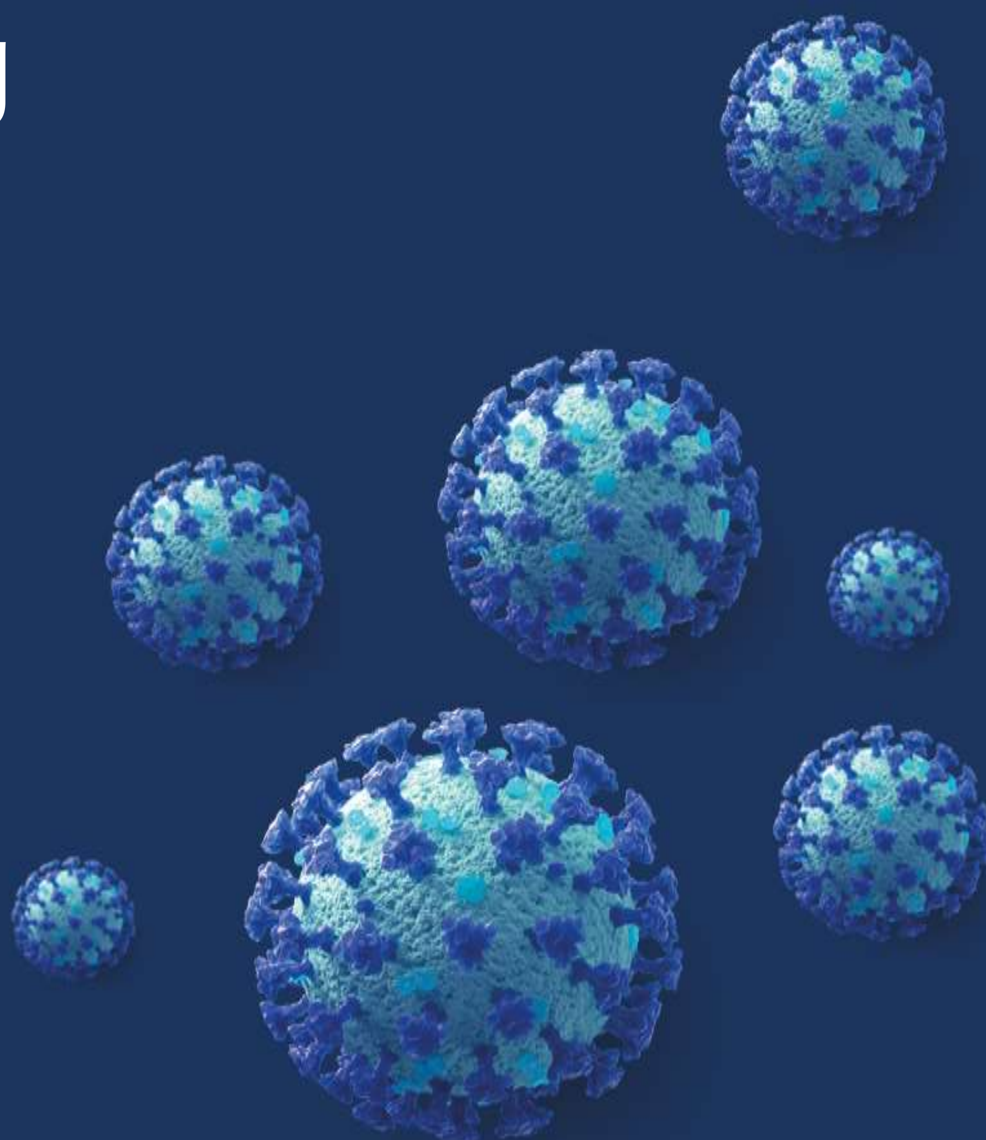
MERCER

COVID-19 elevates the value of responsible investing



April 2020

Covid-19 elevates the value of responsible investing

"Unprecedented, disruptive, game-changing" — these are commonly heard words describing the COVID-19 pandemic and the shock it is creating for businesses, economies and governments, testing the fabric of our society and culture. Undoubtedly, this may mean significant changes for the world and the way we do business and interact with each other for the foreseeable future.

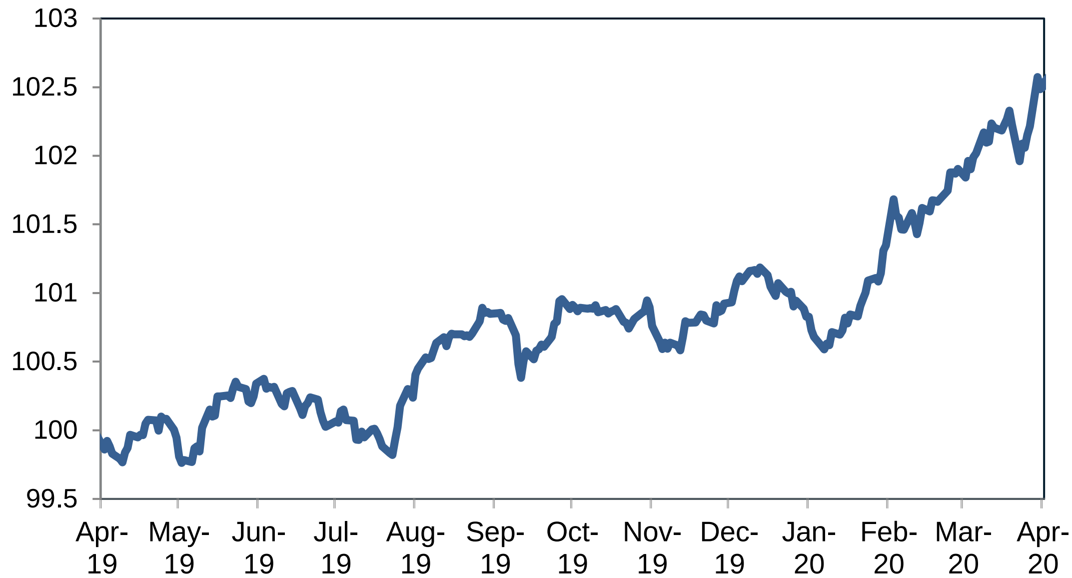
The silver lining is that the effects of this disruption should accelerate the analysis of potential future system shocks, differentiating companies that build resiliency across their entire value chain and those that do not. Responsible investing (RI) and environmental, social and governance (ESG) analysis has been evaluating and evolving systems approaches and studying resilience for some time. The value of ESG analysis is becoming increasingly clear.

We believe there is no better short-term evidence of this value than the performance of RI indices and investment strategies during this and the 2008 financial crisis. The sector-neutral MSCI ACWI ESG Leaders Index, for example, has outperformed the broad ACWI Index especially through the most recent market downturn in February and March of 2020 (Figure 1). We do note that style factors have a significant role to play in performance (in fact, the Momentum index outperformed the ACWI the most over Q1 2020, in addition to quality, growth, and minimum volatility indices).[1] In the case of the MSCI ACWI ESG index, the largest factor contribution was pure ESG followed by quality, volatility and momentum according to MSCI.[2]

[1] Source: Datastream; MSCI ACWI style performances in USD for Q1 2020

[2] MSCI, MSCI ESG Resilience presentation, April 7 2020

Figure 1. Outperformance of MSCI ACWI ESG Leaders Index versus MSCI ACWI



Source: MSCI

Morningstar also found that for the first quarter of 2020, out of the 26 ESG index funds the firm tracks (US, global, emerging markets), 24 outperformed. Of 206 sustainable equity and ETF funds in the US, 44% ranked in the top quartile, 70% in the top two and only 11% in the lowest quartile based on year-to-date performance net of expenses.[3]

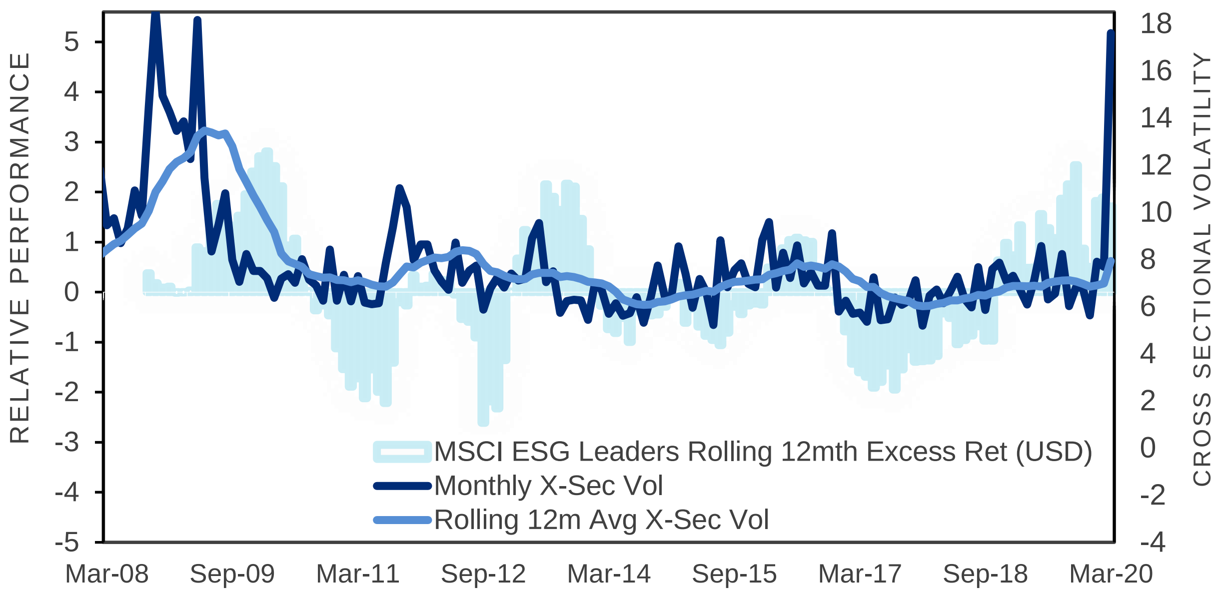
A similar pattern emerged during the 2008 financial crisis, with the MSCI ESG Leaders Index outperforming through the earliest phase, as shown in the light blue vertical bars in Figure 2, below. Given a large spike in volatility this past month similar to levels seen during the 2008 crisis (represented by the dark blue line below), it will be interesting to see if similar ESG performance patterns emerge. Highly rated ESG firms tend to be less cyclical and are more likely to be in the technology, healthcare and consumer nondurables sectors — all of which will likely do better in the current market environment and through the COVID-19 economic downturn.[4] Among these patterns is the possible underperformance as markets rebound and cyclicals and energy potentially become more favorable.

---

[3] Hale J. "Sustainable Funds Weather the First Quarter Better Than Conventional Funds," Morningstar, April 3, 2020, available at https://www.morningstar.com/articles/976361/sustainable-funds-endure-the-first-quarter-better-than-conventional-funds

[4] Spellman GK et al. ESG Matters, ISS, January 9, 2020, available at https://www.issgovernance.com/library/esg-matters/.

Figure 2. Cross-sectional volatility and relative performance of MSCI ESG Leaders versus MSCI World



Note: The light blue vertical bars represent the relative performance of the MSCI ESG Leaders Index compared to the MSCI World Index. The dark blue line represents the monthly cross-sectional volatility of the global stock market, and the light blue line is the smoothed rolling 12-month average cross-sectional volatility.

Sources: Refinitiv, Mercer.

Longer-term performance

There is much more to ESG performance, however, than just more robust performance through short-term market shocks. Since its inception in September 2007 to February 28, 2020, the MSCI ACWI ESG Leaders Index has returned 5.24% compared to 4.48% for the broad market and has outperformed in the one-, three-, five- and 10-year timeframes as well.[5]

A comprehensive examination of hundreds of published reports and academic studies over the past several decades also showed a positive relationship between ESG factors and company financial performance (CFP).[6] More than 90% of these showed a neutral or positive connection between ESG and CFP. Recent Harvard research focusing on the materiality of ESG factors also supports the case.[7] Long gone are the days when responsible investing was assumed to come at the cost of performance.

[5] https://www.msci.com/documents/10199/9a760a3b-4dc0-4059-b33e-fe67eae92460

[6] DWS Global Research Institute. Digging Deeper Into the ESG Corporate Financial Performance Relationship, September 2018.

[7] Khan MN et al. "Corporate Sustainability: First Evidence on Materiality," Harvard Business School Working Paper, No. 15-073, March 2015, available at http://nrs.harvard.edu/urn-3:HUL.InstRepos:14369106.

Future trends in RI from COVID-19

The COVID-19 pandemic and market correction and the extreme situation in which many companies now find themselves may highlight areas of additional study on ESG performance as well as evaluate its further added value.

Many responsible investors value companies with long-term resilience planning in their supply chains and labor forces, among many other "S" (Social) factors. Can ESG factors and RI identify companies that have invested in resilience, since they may be in a better position to weather the COVID-19 storm?

RI has been pushing companies to do more scenario planning for pressures and shocks related to climate, water stress and social issues, to name a few. Companies that have been doing this type of analysis should now be in a better position to manage the COVID-19 pandemic scenario as well. Will funds that value this approach also be able to manage market shocks?

The goal of sustainable investing is to deliver performance through a long-term stakeholder-centric approach that gives management a deeper understanding of the risks and opportunities of its business. Will this stakeholder approach now pay off?

Finally, will even more asset owners create mandates aligned with Sustainable Development Goals (SDGs) and a vision of a more sustainable world, creating a self-fulfilling feedback loop?[8] Eventually, investing capital in companies that align with the SDGs and this vision may become increasingly favorable over short-term-oriented and exploitive business models. COVID-19 may well accelerate interest in creating mandates that make economies and society more sustainable, resilient and equitable. And perhaps that's not such a bad thing.

Monika Freyman, CFA
Head of Responsible Investment for Mercer Canada

[8] For one example among many others, PGGM has identified and created an investment mandate around four focus areas: climate, water, food security and healthcare. See https://www.pggm.nl/english/what-we-do/Pages/Focus-areas.aspx.

Important Notices

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.

This contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity without Mercer's prior written permission.

Mercer does not provide tax or legal advice. You should contact your tax advisor, accountant and/or attorney before making any decisions with tax or legal implications.

This does not constitute an offer to purchase or sell any securities.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed.

For Mercer's conflict of interest disclosures, contact your Mercer representative or see http://www.mercer.com/conflictsofinterest.

This does not contain investment advice relating to your particular circumstances. No investment decision should be made based on this information without first obtaining appropriate professional advice and considering your circumstances. Mercer provides recommendations based on the particular client's circumstances, investment objectives and needs. As such, investment results will vary and actual results may differ materially.

Past performance is no guarantee of future results. The value of investments can go down as well as up, and you may not get back the amount you have invested. Investments denominated in a foreign currency will fluctuate with the value of the currency. Certain investments, such as securities issued by small capitalization, foreign and emerging market issuers, real property and illiquid, leveraged or high-yield funds, carry additional risks that should be considered before choosing an investment manager or making an investment decision.

This document summarizes Mercer's views on the medium-term outlook for relative returns from the key asset classes; by medium term we mean one to three years. The views expressed in this report are relevant for reflecting medium-term market views in determining appropriate asset allocation and manager benchmarks. The views expressed are provided for discussion purposes only, does not contain investment advice and do not provide any assurance or guarantee of future market returns.

Information contained herein may have been obtained from a range of third-party sources. Although the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages) for any error, omission or inaccuracy in the data supplied by any third party.

Please see the following link for information on indexes: https://www.mercer.com/content/dam/mercer/attachments/private/nurture-cycle/gl-2019-investment-management-index-definitions-mercer.pdf

Not all services mentioned are available in all jurisdictions. Please contact your Mercer representative for more information.

Certain regulated services in Europe are provided by Mercer Global Investments Europe Limited, Mercer (Ireland) Limited and Mercer Limited. Mercer Global Investments Europe Limited and Mercer (Ireland) Limited are regulated by the Central Bank of Ireland. Mercer Limited is authorized and regulated by the Financial Conduct Authority. Registered in England and Wales No. 984275. Registered Office: 1 Tower Place West, Tower Place, London EC3R 5BU.

Investment management and advisory services for US clients are provided by Mercer Investments LLC (Mercer Investments). Mercer Investments LLC is registered to do business as "Mercer Investment Advisers LLC" in the following states: Arizona, California, Florida, Illinois, Kentucky, New Jersey, North Carolina, Oklahoma, Pennsylvania, Texas, and West Virginia; as "Mercer Investments LLC (Delaware)" in Georgia; as "Mercer Investments LLC of Delaware" in Louisiana; and "Mercer Investments LLC, a limited liability company of Delaware" in Oregon. In November 2018, Mercer Investments acquired Summit Strategies Group, Inc. ("Summit"), and effective March 29, 2019, Mercer Investment Consulting LLC ("MIC"), Pavilion Advisory Group, Inc. ("PAG"), and Pavilion Alternatives Group LLC ("PALTS") combined with Mercer Investments. Certain historical information contained herein may reflect the experiences of MIC, PAG, PALTS or Summit operating as separate entities. Mercer Investments is a federally registered investment adviser under the Investment Advisers Act of 1940, as amended. Registration as an investment adviser does not imply a certain level of skill or training. The oral and written communications of an adviser provide you with information about which you determine to hire or retain an adviser. Mercer Investments' Form ADV Parts 2A and 2B can be obtained by written request directed to: Compliance Department, Mercer Investments, 99 High Street, Boston, MA 02110.

MARSH & McLENNAN COMPANIES