NIEMANN CAPITAL MANAGEMENT

The Big ESG Disconnect is Creating Big Opportunity

Advisors can build stronger relationships and potentially gain massive market share with an ESG value add

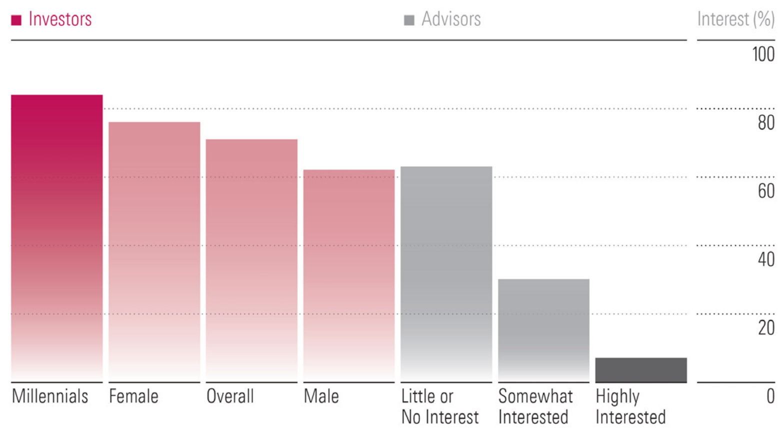
by Alan Alpers, Patrick O'Connor, Niemann Capital Management

There is a big ESG disconnect between investors and advisors. Investor interest in Environmental, Social and Governance (ESG) products is copious and widespread (*see chart*). However, most advisors are not nearly as interested, nor are they initiating ESG discussions with clients. In fact, almost 90% of ESG discussions that occur, at all, begin with the client initiating the conversation, according to a Legg Mason survey.[1]

Three common reasons for the lack of interest among advisors: **1.** Many advisors are not ESG educated **2.** Prevailing myth that ESG products underperform **3.** Not enough ESG solutions on platforms

Due to the lack of ESG interest among advisors and the underperformance myth, many wealth management firms either do not have ESG products on their platforms, or they have too few. Yet, more than 70% of individual investors are interested in ESG and 1 in every 5 professionally managed dollars in the US is already invested with ESG criteria. In other words, 20% of the entire US market, or $8.72 trillion, is currently invested with ESG considerations.[2] A significant portion of the $8.72 trillion is in public plans, but research strongly suggests that large numbers of individual investors want access to ESG as well. ESG is particularly popular within the millennial generation and among women, from all generations.

Different Interests A high percentage of millennials and women say they are interested in ESG investing. Financial advisors? Not so much.



Sources: Morgan Stanley Institute for Sustainable Investing, Cerulli Associates.

Chart by Morningstar

According to a Morgan Stanley and Cerulli Associates survey, 84% of millennial investors are interested in ESG. This generation is now the largest generation in the US and their wealth is set to soar in the years ahead. This group of investors is expected to inherit $30 trillion in the next 30 years, during the "great wealth transfer." But it's not just the money they are inheriting. Millennials are inheriting the world and all the challenges that come with it, such as war, pollution, diseases, inequality and so forth. The millennial generation is particularly concerned about environmental challenges, like climate and clean water, which are key investment issues within the 'E' pillar of ESG. They are also concerned about disease prevention and cures in healthcare, which are key issues in the 'S' or Social pillar of ESG. *(continued on page 3…)*

1 Legg Mason: The Appealing Investment Advisors Aren't Pitching

2 US SIF: US Sustainable, Responsible and Impact Investing Trends 2016

Introducing Niemann Capital Management ESG Portfolios

Niemann Capital Management has been researching and developing ESG and Gender Diversity (GD) strategies for nearly a year. After thorough analysis, it is our belief that we can successfully integrate ESG and GD factors into our proprietary approach to investing. We researched several data providers and have chosen an industry leader to produce ESG and GD analytics. As a result, Niemann is now offering a Risk Managed ESG and a Risk Managed ESG Gender Diversity portfolio. Each portfolio will have a global universe of US stocks and international ADRs. The universes will be ranked by ESG and GD factors. Niemann's propriety security selection process will be applied to construct the portfolios with the most attractive opportunities. Both portfolios will have Niemann's powerful downside protection feature to help prevent catastrophic losses in bear markets.

Niemann Risk Managed ESG

Class: Global Equities
Style: Active management, tactical, core, growth
Structure: Separately Managed Account
Universe: US stocks, international ADRs
Screens: ESG ranking, RS, risk-adjusted return
Factors: Climate change, natural resources, pollution & waste, environmental opportunities, human capital, product liability, stakeholder opposition, corp. governance, corp. behavior
Downside protection: Cash/cash equivalents
Appeal: All Generations, HNW, UHNW

Niemann Risk Managed ESG Gender Diversity

Class: Global Equities
Style: Active management, tactical, alternative, growth
Structure: Separately Managed Account
Universe: US stocks, international ADRs
Screens: Gender diversity ranking, RS, risk-adjusted return
Factors: Board diversity, executive diversity, equal pay
Downside protection: Cash/cash equivalents
Appeal: Women, all generations HNW, UHNW

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The ESG disconnect underscores a potential conflict at the personal-values level, between investors and advisors. Most advisors are not recognizing the deeper needs of millennials, and traditional strategies are not addressing those needs. That's a big problem, particularly for advisors. Data show that 66% of children have been firing their parents' advisor.[3] That stat is likely to get worse for advisors not offering ESG products. Advisors offering ESG have a clear competitive advantage for increasing market share. In fact, 87% of millennials say they would stay with an advisor who communicates about ESG investment strategies.[4]

The opportunity for advisors to increase market share with women investors from all generations could be even more powerful. "There is a strong gender-rising movement today that will continue. Wouldn't women be more intrigued in companies that promote women equally? We also want to feel connected with an investment that puts our personal values front and center," said Managing Director Cary Carbonaro at United Capital, a national investment advisory firm with with approximately $17 billion in assets under management.

More than 70% of women are currently interested in ESG. Women have decision-making control of an estimated 40% of the nation's investable assets.[5] Women are expected to control two-thirds of the world's wealth by 2020.[6] Female investors are particularly interested in the Governance or 'G' pillar of ESG. The G pillar focuses on key corporate governance issues, including gender diversity at the board and executive levels. Equal pay is another key issue for women in the G pillar. Advisors who recognize and serve the interests of women investors have a distinct competitive advantage.

When advisors differentiate their value add with ESG portfolios, they have an opportunity to take market share away from the vast majority of advisors who are not yet

MSCI ESG Key Issue Hierarchy - Source MSCI

3 Pillars	10 Themes	37 ESG Key Issues	
Environment	Climate Change	Carbon Emissions*, Energy Efficiency, Product Carbon Footprint	Financing Environmental Impact, Climate Change Vulnerability
	Natural Resources	Water Stress*, Biodiversity & Land Use	Raw Material Sourcing
	Pollution & Waste	Toxic Emissions & Waste*, Packaging Material & Waste	Electronic Waste
	Environmental Opportunities	Opportunities in Clean Tech and in Green Building	Opp's in Renewable Energy
Social	Human Capital	Labor Management*, Health & Safety*	Human Capital Development, Supply Chain Labor Standards
	Product Liability	Product Safety & Quality, Chemical Safety, Financial Product Safety	Privacy & Data Security, Responsible Investment, Health & Demographic Risk
	Stakeholder Opposition	Controversial Sourcing	
	Social Opportunities	Access to Communications, Access to Finance	Access to Health Care, Opp's in Nutrition & Health
Governance	Corporate Governance*	Board**, Pay**	Ownership**, Accounting**
	Corporate Behavior	Business Ethics*, Anti-Competitive Practices*	Corruption & Instability, Financial System Instability

* indicates "universal" issues assessed for all companies in MSCI World
** Board, Pay, Ownership, and Accounting carry weight in the ESG Rating model for all companies.

3 InvestmentNews: The Great Wealth Transfer is Coming, Putting Advisers at Risk

4 TIAA Global Asset Management Survey

5 Morgan Stanley: Power of Purse Highlights Women's Wealth Leadership 1/23/2015

6 MSCI: 2016 ESG Trends to Watch

interested in ESG. It has been estimated that 60-70% of advisors could lose significant market share due to them not having an interest in ESG or not having ESG solutions.

Important and notable: Investor interest in ESG does not end with millennials and women. More than 60% of men from all generations are interested in ESG (*chart pg1*). Interestingly, HNW and UHNW investors, from all generations, are interested in ESG. In fact, one survey suggests that 90% of the wealthiest investors in the US *require* an ESG-informed wealth advisor.[7]

Advisors who want to explore the opportunities in ESG should begin by getting more informed. ESG historical performance and risk analysis is a good place to start. After all, 51% of advisors believe that ESG investing does not provide competitive returns.[8] Their belief is not well founded. In fact, many studies have found the exact opposite, suggesting that ESG can outperform with less risk. 69% of institutional investors surveyed said they expect similar returns from ESG portfolios compared to traditional portfolios. 24% said they expect ESG returns to improve and only 7% said they expect lower ESG returns.[9]

Debunking the ESG Under-Performance Myth

Meta-analysis of over 2,000 ESG studies, dating back as far as the 1970s, revealed that an overwhelming number of studies found ESG has a positive effect on corporate financial performance. Only 10% found a negative effect. This meta-analysis is currently the most comprehensive ESG performance study to date. (University of Hamburg/Deutsche Bank)

In a review of 190 high-quality academic studies, 90% of the studies demonstrated that sound sustainability standards lowered companies' cost of capital, 80% of the studies observed that stock performance and good sustainability practices are positively correlated, and 88% of the studies show that robust ESG practices improved companies' operational performance (Oxford University, 2014).

The Morgan Stanley Institute for Sustainable Investing examined the performance of 10,228 mutual funds and 2,874 SMAs. The institute found investing in vehicles focused on sustainability usually met and often exceeded the performance of comparable traditional investments. This performance occurred at both an absolute and risk-adjusted basis, across asset classes and over time.

Companies that pursue better ESG practices have higher-quality management and better stock performance (Forbes)

"Performance results across ESG universes compared to their broad market counterparts are encouraging – ESG returns have kept pace at lower levels of risk." (Pensions & Investments News)

An S&P 500 ESG strategy outperformed the S&P 500 by 293 basis pts **annualized** from 3/31/2009 to 11/30/2016. (Morgan Stanley/RobecoSAM). $100,000 invested in this ESG strategy would have returned $24,750 more than the S&P 500 returned.

ESG funds do not have a performance penalty

(Morningstar)

ESG factors helped investors achieve "significant outperformance" in emerging markets. "Investors who picked emerging markets stocks based on the environmental, social and governance (ESG) rating potential outperformed those that ignored them." (Cambridge Associates)

7 FactSet: The Culture Challenge: HNWIs vision for the wealth management industry in the information age (pgs. 20-21)

8 TIAA: Investors and their advisors need more education, more communication about responsible investments (2016)

9 Alliance Bernstein: Raising the Bar for ESG Investing Expectations

Disclosure

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