What is an ESG Fund?

HORAN WEALTH

ESG stands for Environmental Social and Governance and refers to the three key factors when measuring the sustainability and ethical impact of an investment in a business or company. Morningstar defines a strategy as a “Sustainable Investment” if it is described as focusing on sustainability, impact, or environmental, social, and governance (ESG) factors in its prospectus or other regulatory filings. ESG’s three central factors are: environmental, social and governance criteria.

Environmental criteria examines how a business performs as a steward of our natural environment focusing on:

- Waste and pollution
- Resource depletion
- Greenhouse gas emission
- Deforestation
- Climate change

Social criteria looks at how the company treats people and concentrates on:

- Employee relations & diversity
- Working conditions, including child labor and slavery
- Local communities; seeks explicitly to fund projects or institutions that will serve poor and underserved communities globally
- Health and safety
- Conflict

Governance criteria examines how a corporation polices itself – how the company is governed and focuses on:

- Tax strategy
- Executive remuneration
- Donations and political lobbying
- Corruption and bribery
- Board diversity and structure

Considerations before investing in ESG funds

1. ***ESG is a newer space with a limited performance history***; past performance is no guarantee of future results. This goes with any investment you evaluate, but keep in mind that the ESG space is new. Performance that has been reported is short-term and does not indicate a perpetual trend.

2. ***Does your ESG fund avoid investment in certain sectors/industries or just certain companies?*** Some funds do not invest in certain industries, regardless of the potential for ESG suitable investments. Some just avoid certain companies within those industries. It is important to know what exposures you may or may not be missing in your ESG investment when compared to other investment options.

3. ***Risks/Tradeoffs***: Because ESG funds may not invest in certain companies and/or industries, investor returns could be different than the overall market. Investors should know they could potentially sacrifice returns by investing in ESG products. For example, if the oil and gas industry performs well in the market, and your ESG fund that excludes these companies from their fund because of the environmental hazard, the fund could underperform the broader market. The opposite of this would be true if the oil and gas industry underperforms. Be aware that ESG returns can vary from the overall market.

4. ***Expenses:*** ESG funds can hold higher than “normal” expense ratios than index funds or other actively managed funds. Pay attention to the expense ratio. If you invest $10,000 in a fund that has a 1% expense ratio, it means you will pay $100 in management fees for owning that fund each year. ESG fund expense ratios vary and it is important to evaluate this factor before deciding to invest.