Morgan Stanley

INSTITUTE FOR SUSTAINABLE INVESTING

Morgan Stanley

INVESTMENT MANAGEMENT

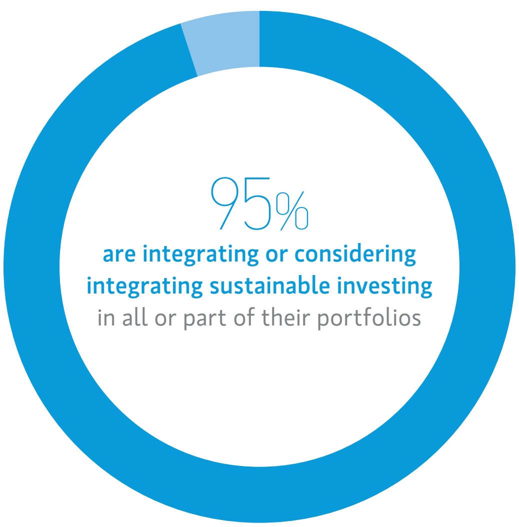
# Sustainable Signals

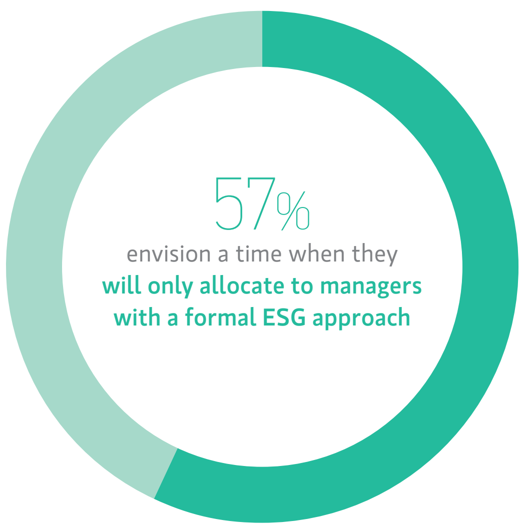
## Asset Owners See Sustainability as Core to the Future of Investing

---

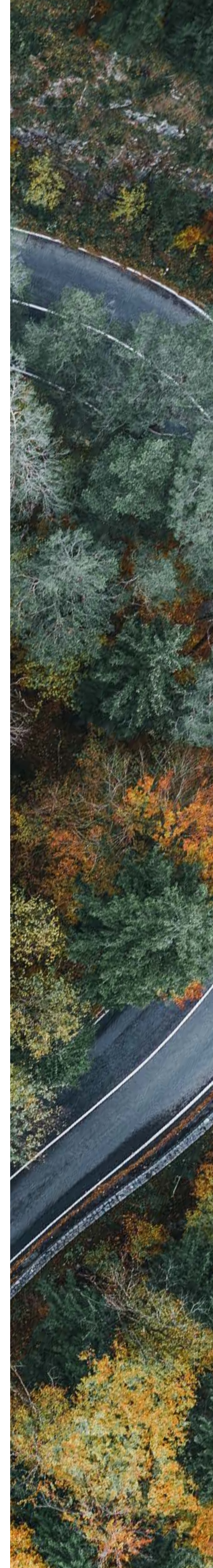
Asset owners worldwide now routinely incorporate environmental, social and governance (ESG) factors in their decision-making. In a decisive shift toward the adoption of sustainable investing, four in five institutions surveyed are currently integrating ESG considerations into the investment process. Moreover, 57% foresee a time when they will only allocate to third-party investment managers with a formal ESG approach. These are among the key findings of Morgan Stanley's second Sustainable Signals survey of institutional asset owners. As sustainable investing grows more sophisticated, asset owners also seek better tools and data to measure their social and environmental impact.

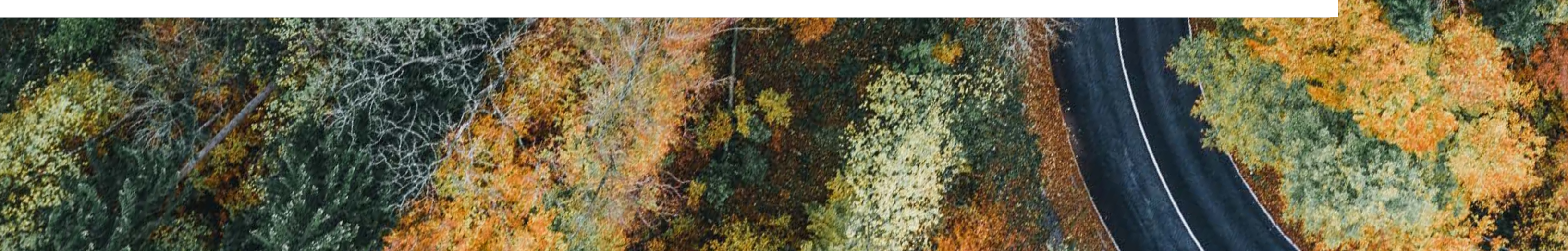
**Among institutional asset owners:**




This material is developed by Morgan Stanley Investment Management and the Morgan Stanley Institute for Sustainable Investing. Morgan Stanley is the parent company of Morgan Stanley Investment Management Inc. and its affiliates. References to "Morgan Stanley" in this document refer to the parent company, not to Morgan Stanley Investment Management Inc. In some instances, Morgan Stanley Investment Management Inc. may leverage or be a part of Morgan Stanley's processes and/or initiatives related to sustainable investing.





## Key Insights

Our survey shows rapid momentum for sustainable investing among asset owners globally, and provides insights into their motivations, priorities and challenges. The results build on similar findings from the Institute for Sustainable Investing's 2019 surveys of asset managers and individual investors, indicating that ESG considerations are widely integrated across the investment value chain.

1

### Asset owners increasingly embrace sustainable investing.

- Adoption increased from 70% in 2017 to 80% in 2019
- Constituent demand (81%) and financial return potential (78%) are driving uptake

2

### Asset owners seek better tools and data to measure sustainability.

- Forty-five percent believe social and environmental returns matter as much as financial returns
- Yet, 33% lack adequate tools to assess investments against their ESG goals
- And, 29% cite the lack of quality data as the main barrier to sustainable investing

3

### Environmental issues are the top choice for thematic and impact investors.

- Priorities include climate change, water solutions, plastic waste and the circular economy
- And, 88% seek to impact these themes on a global scale

4

### ESG integration remains the most common approach to sustainable investing.

- Nine in ten asset owners (92%) adopting or considering sustainable investing apply ESG integration in their portfolios
- Across all approaches, investors find the highest quality sustainable investing strategies in public equities (78%) and fixed income (69%)

5

### Investment managers can play a key role in ESG reporting and education.

Asset owners agreed third-party investment managers can help their organizations with:

- Portfolio reporting on sustainability and ESG performance (86%)
- Education on sustainable investing approaches, issues and trends (81%)

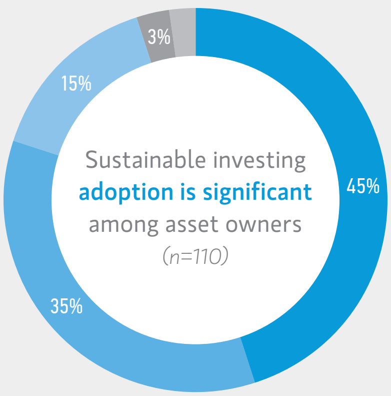
## Methodology

This report presents results from an online survey by Greenwald & Associates on behalf of Morgan Stanley Investment Management and the Morgan Stanley Institute for Sustainable Investing. Between October 14 and December 16, 2019, 110 asset owners in North America, Europe and Asia/Pacific responded. These included financial institutions, insurers, pensions and other large asset owners. Our 2017 asset owners survey findings were based on 118 responses from the same three regions.

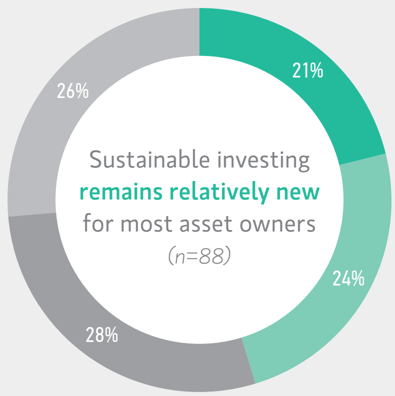
In this survey, we defined sustainable investing as the practice of making investments in companies or funds that aim to achieve market-rate financial returns while considering positive social and/or environmental impact.

# Asset owners increasingly embrace sustainable investing

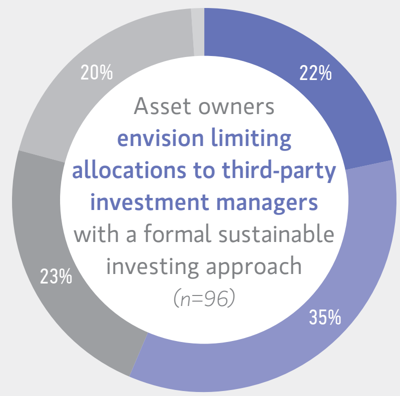
The survey results indicate that asset owners are adopting sustainable investing in record numbers. Eight in ten actively integrate ESG factors into the investment process across the board or in part of their portfolio—up 10 percentage points in two years. A further 15% are considering doing so. Not only is sustainable investing now mainstream, but 57% of asset owners foresee a near future where they will limit allocations to managers with a formal ESG approach. Among this group, 42% expect to change this selection criteria within two years and 39% within five years.




Is sustainable investing integrated into your investment process?
- Yes, across the board
- Yes, within a portion(s) of our portfolio
- No, but we are actively considering
- No, we considered but chose not to pursue
- No, we have not considered



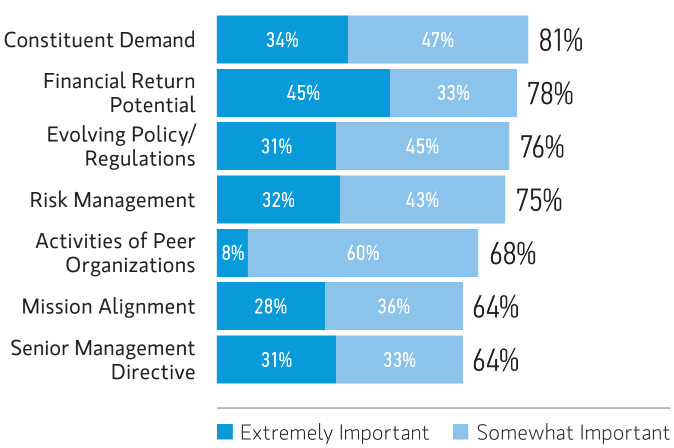

Length of time practicing sustainable investing
- <1 Year
- 1–2 Years
- 3–4 Years
- 5+ Years



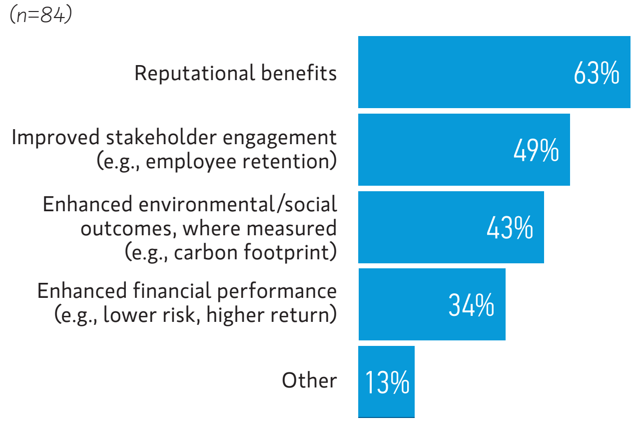

- Yes, we already do
- Yes, we are moving in that direction
- No
- Not sure
- N/A

Many factors are fueling adoption. Frontrunners include constituent demand (81%), financial return potential (78%) and evolving policy and regulation on ESG disclosure around the world (76%). Asset owners who already practice sustainable investing identify clear benefits to reputation and stakeholder engagement, as well as improved environmental and social outcomes where measured.

**What are the most important factors driving the adoption of sustainable investing?**
*(n=87)*



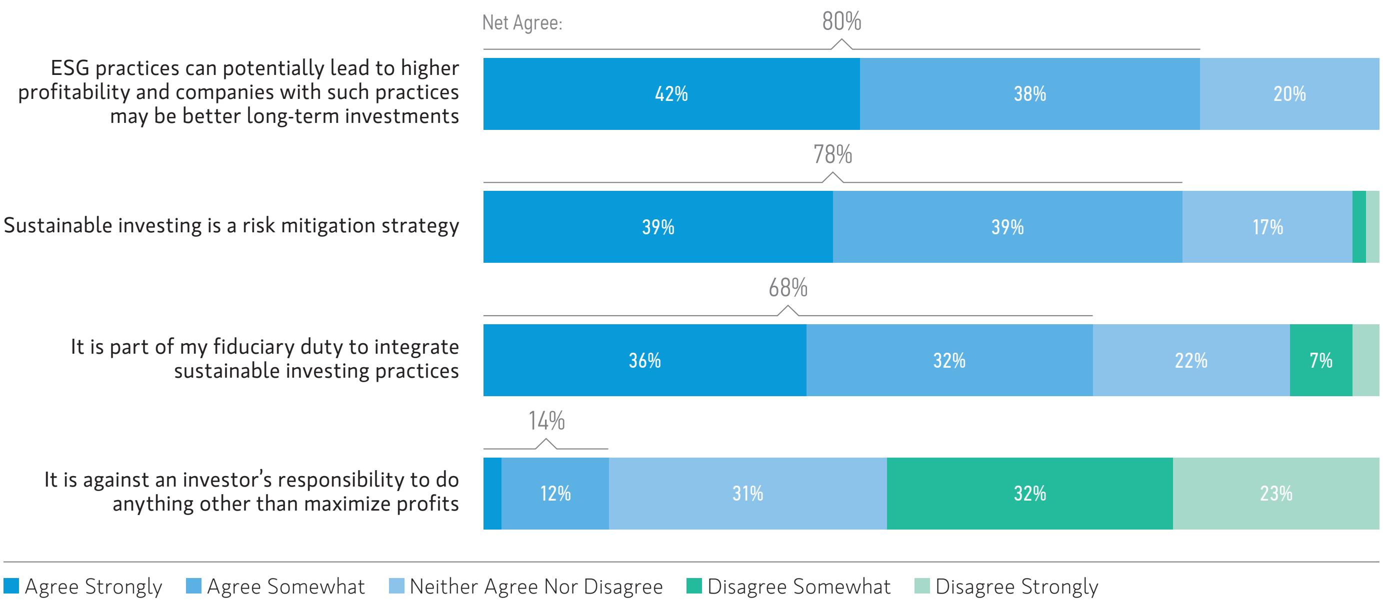

**What benefits are asset owners observing from adopting sustainable investing?**
*(n=84)*



# Asset owners seek better tools and data to measure sustainability

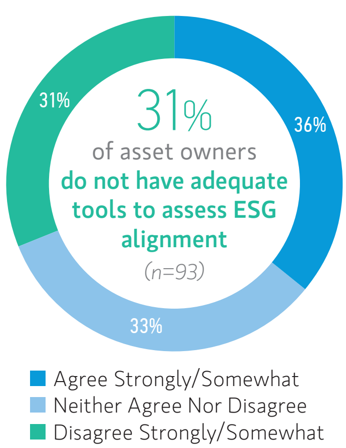
As sustainable investing goes mainstream, asset owners' perspectives on returns are changing. Almost half (45%) now believe that generating social and environmental returns is as important as generating financial returns (53% put financial returns first). In addition, 80% agree that companies with ESG practices may be better long-term investments.

**Many asset owners share favorable perspectives on ESG and sustainability**
*(n=93)*

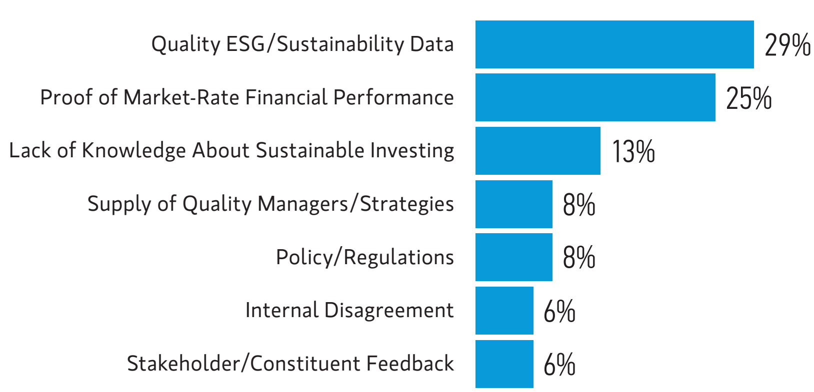



Asset owners are eager to measure and report portfolio impacts, but nearly a third (31%) lack adequate tools to assess how investments align with their ESG goals. Overall, the lack of quality data is now viewed as the most significant barrier to sustainable investing. Asset owners are looking to third-party research and ratings, rankings and data providers to help fill these gaps, but may not be able to source the data they need given ongoing data quality challenges.

**My organization has adequate tools to assess the alignment of our investments with our sustainable investing goals**



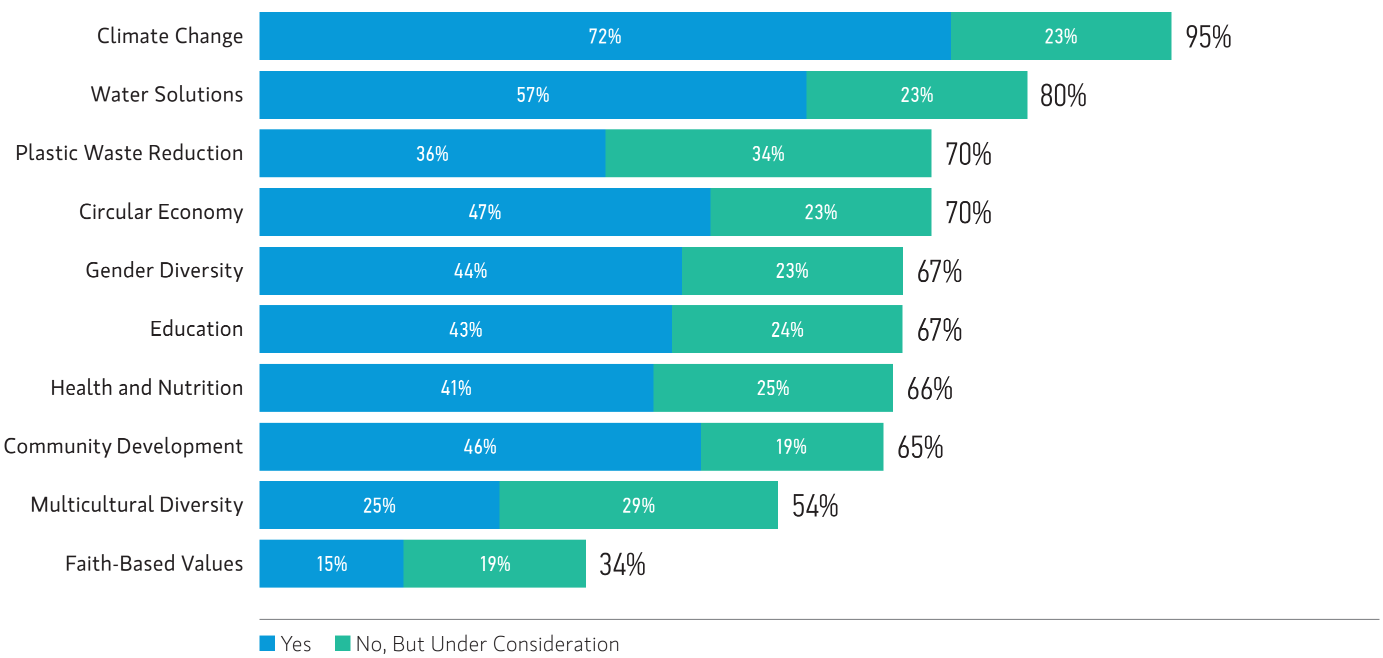

**Data quality remains a top challenge for those adopting or considering sustainable investing** *(n=77)*



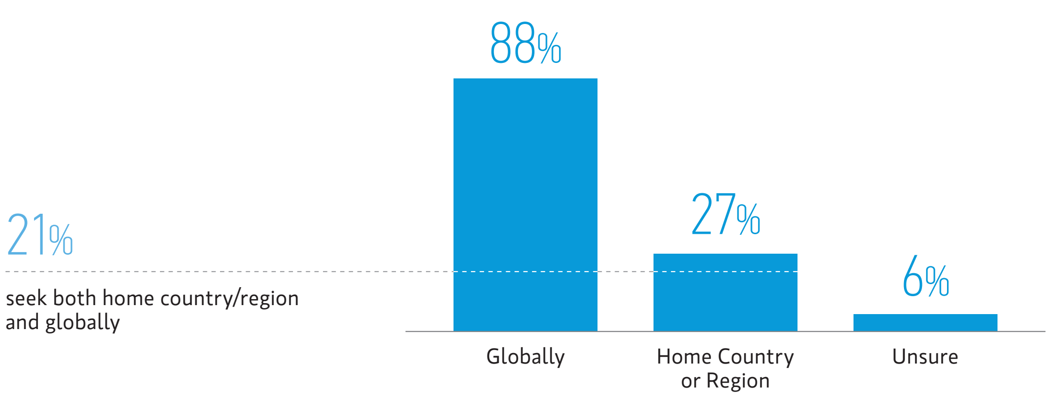
# Environmental issues are the top choice for thematic and impact investors

Close to half of asset owners polled (48 of 110) employ thematic or impact investment approaches. The top four issues they seek to address are environmental—climate change, water solutions, plastic waste and the circular economy. For social issues, gender diversity and education are the top priorities. Almost nine in ten (88%) want to drive impact globally, while a quarter (27%) target investments within their home country or region.

**What matters most to thematic and impact investors?**
*(n=48)*



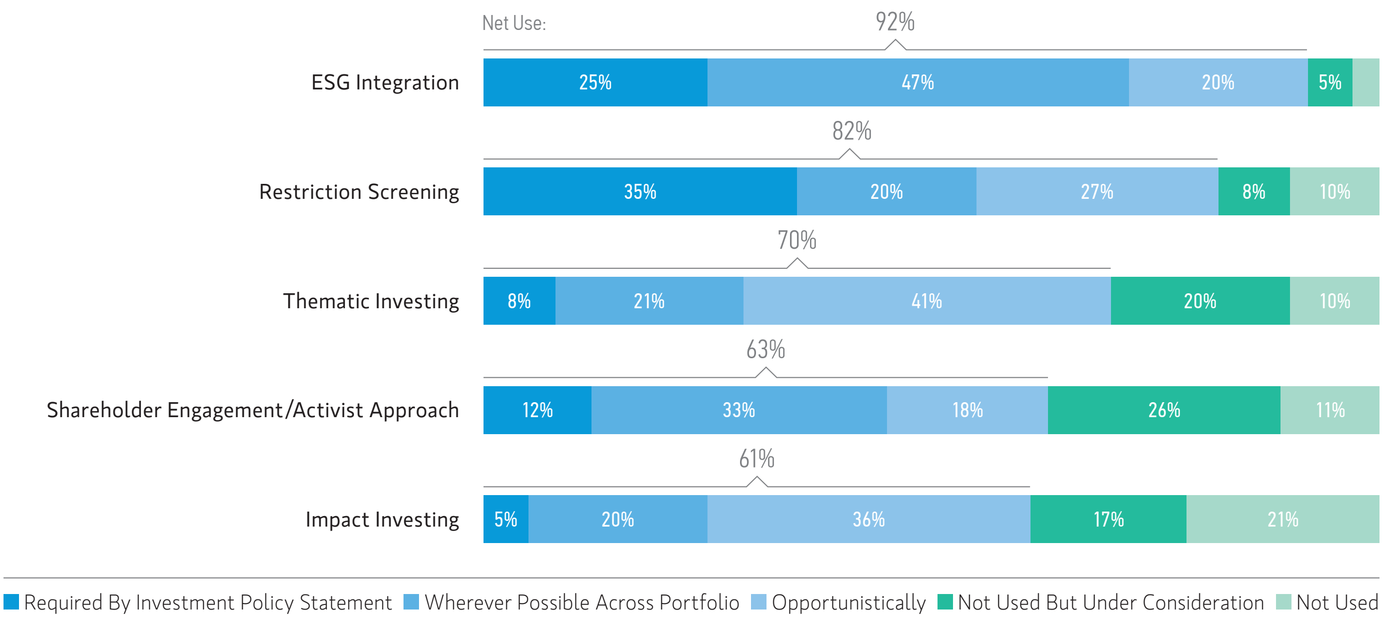

**Most thematic and impact investors seek to drive impact at the global level**
*(n=48)*



# ESG integration remains the most common approach to sustainable investing

Six in ten asset owners adopting or considering sustainable investing use multiple approaches, but there are clear leaders. ESG integration is employed by nine in ten (92%) survey respondents, including 47% who do so 'wherever possible across their portfolios'—up from 41% in 2017. Eight in ten (82%) employ restriction screening, most commonly for weapons, tobacco and coal.

**ESG integration and restriction screening are the most popular sustainable investing approaches**
*(n=67)*




## Sustainable Investing Approaches Defined

In this survey, sustainable investing approaches were defined as follows:

**RESTRICTION SCREENING**
Exclusionary, negative or values-based screening of investments.

**ESG INTEGRATION**
Proactively considering ESG criteria alongside financial analysis.

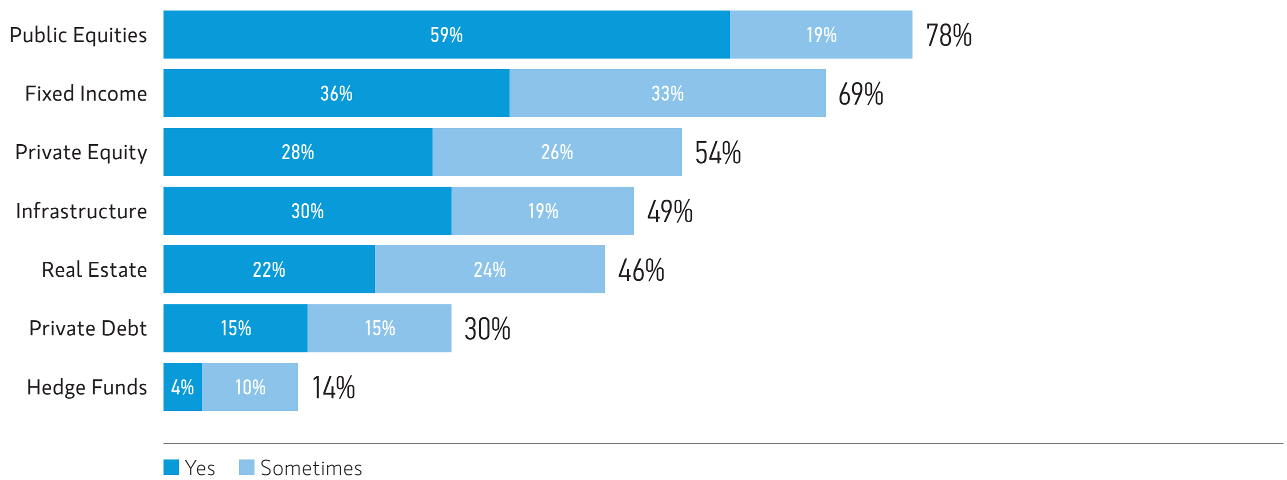
**THEMATIC INVESTING**
Pursuing strategies that address sustainability trends such as clean energy, water, agriculture or community development.

**IMPACT INVESTING**
Seeking to make investments that intentionally generate measurable positive social and/or environmental outcomes.

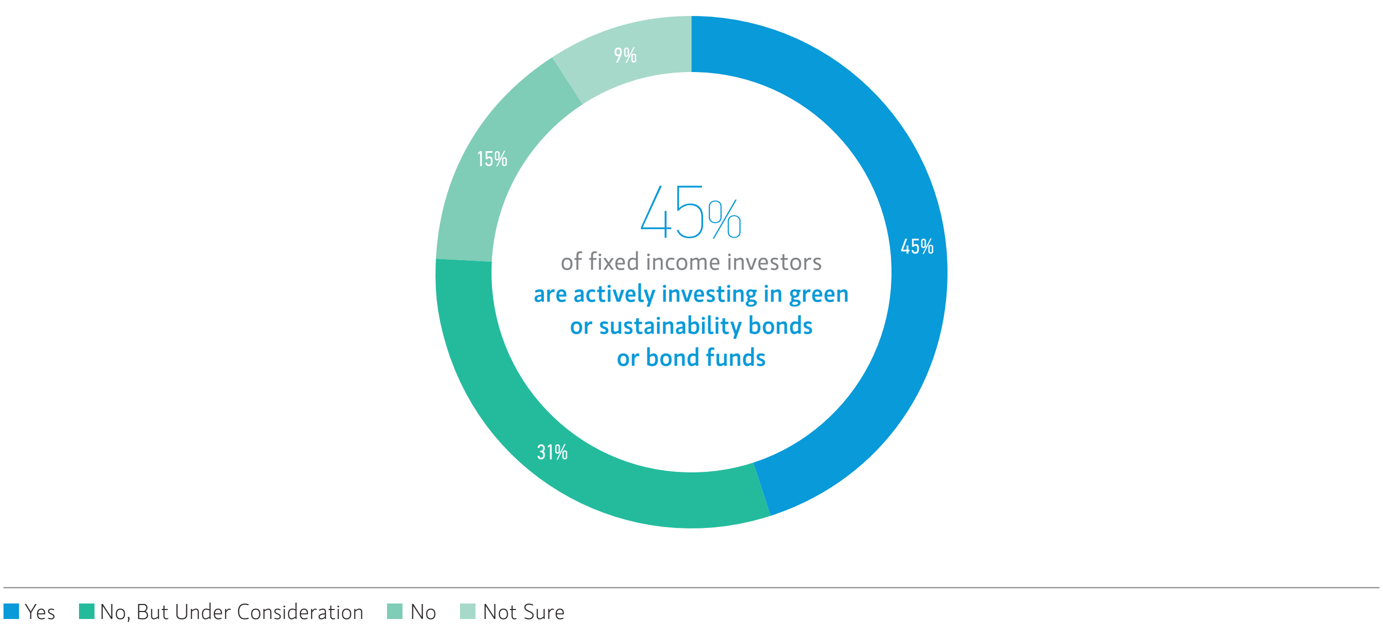
**SHAREHOLDER ENGAGEMENT**
Direct company engagement or activist approaches.

Public equities (78%) and fixed income (69%) are the asset classes where most investors find quality sustainable investing strategies. Almost half (45%) of asset owners allocating to fixed income reported investing in green or sustainability bonds or bond funds, reflecting the exponential growth of the market. A further 31% are considering these fixed income investment opportunities.

**Asset classes with quality sustainable investing strategies among those currently practicing or considering sustainable investing**
*(n=77)*



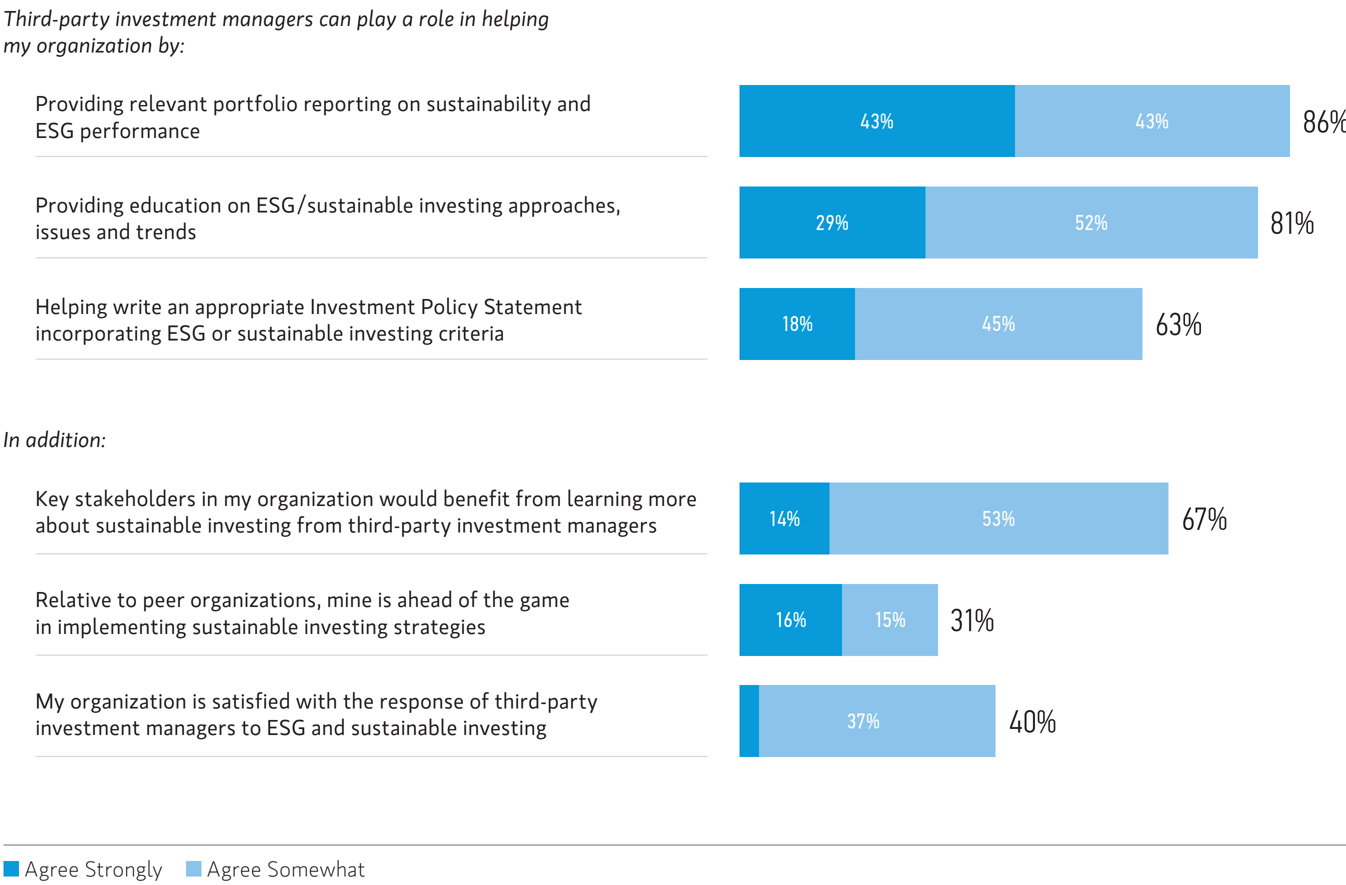

**Nearly half of asset owners allocating to fixed income are investing in green or sustainability bonds or bond funds**
*(n=53)*



# Investment managers can play a key role in reporting and education

The rapid mainstreaming of sustainable investing presents a clear business opportunity for third-party investment managers. Two-thirds of asset owners (67%) want key stakeholders in their organization to learn more about ESG integration, impact investing and thematic investing. And more than eight in ten (86%) see a role for outside investment managers in portfolio reporting on ESG performance and in sharing expertise on approaches, issues and trends.

**Asset owners see growing role for third-party investment managers**
*(n=93)*



## About Morgan Stanley Institute for Sustainable Investing

The Morgan Stanley Institute for Sustainable Investing is housed within the Global Sustainable Finance group and chaired by Morgan Stanley's Chairman and CEO, James Gorman. The Institute works to accelerate the global adoption of sustainable investing and finance strategies. Its Advisory Board, comprised of corporate, sustainability, academic and philanthropic leaders, helps ensure that our approach to sustainability and sustainable investing is comprehensive, rigorous and innovative.

Morgan Stanley Investment Management leverages and benefits from Morgan Stanley's decade-plus commitment to sustainable finance. Positioned at the nexus of the firm's business units and the broader sustainable finance market, the Morgan Stanley Institute for Sustainable Investing serves as a unique resource and partner on innovation, knowledge sharing and thought leadership.

## About Morgan Stanley Investment Management

Globally, Morgan Stanley Investment Management (MSIM) actively invests more than $550 billion across public and private markets. MSIM's mission is to serve clients by achieving their investment objectives, and providing a comprehensive array of investment solutions, competitive results and enduring relationships. The global suite of products and services offered span the risk/return spectrum across geographies, investment styles and asset classes, including equity, fixed income, alternatives and private markets.

Across MSIM's diverse range of investment strategies, the investment philosophy is to generate alpha through active management grounded in sound fundamental research and analytics. The portfolio managers' demonstrated expertise is built on innovative research, rigorous analysis and high-conviction investment decisions.

MSIM believes that ESG factors influence risk, return and opportunity, and our portfolio managers integrate them in a variety of ways in building client portfolios and making investment decisions. MSIM investment teams, and the Global Stewardship team, engage directly with companies to drive change and promote responsible investing practices. Working with the Institute for Sustainable Investing and Morgan Stanley's Global Sustainable Finance team, MSIM provides portfolio solutions that help clients meet their environmental, social and governance goals.

### RISK CONSIDERATIONS

**ESG** strategies that incorporate impact investing and/or environmental, social and governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance.

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in a portfolio.

In general, **equity securitie**s' values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. The risks of investing in **emerging market countries** are greater than risks associated with investments in foreign developed countries. **Fixed income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest-rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. **Longer-term securities** may be more sensitive to interest rate changes. **Real estate investments**, including real estate investment trusts, are subject to risks similar to those associated with the direct ownership of real estate.

**Alternative investments** are speculative, involve a high degree of risk, are highly illiquid, typically have higher fees than other investments, and may engage in the use of leverage, short sales, and derivatives, which may increase the risk of investment loss. These investments are designed for investors who understand and are willing to accept these risks. Performance may be volatile, and an investor could lose all or a substantial portion of its investment.

### DISTRIBUTION

**This communication is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.**

**Ireland:** Morgan Stanley Investment Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's, Quay, Dublin 2, Ireland. Registered in Ireland under company number 616662. Regulated by the Central Bank of Ireland. **United Kingdom:** Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA, authorised and regulated by the Financial Conduct Authority. **Dubai:** Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **Germany:** Morgan Stanley Investment Management Limited Niederlassung Deutschland, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968. **The Netherlands:** Morgan Stanley Investment Management, Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of Morgan Stanley Investment Management Limited. Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branch Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41 (0) 44 588 1074.

**U.S.:** A separately managed account may not be suitable for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required. For important information about the investment manager, please refer to Form ADV Part 2.

**Please consider the investment objectives, risks, charges and expenses of the funds carefully before investing. The prospectuses contain this and other information about the funds. To obtain a prospectus please download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.**

Morgan Stanley Distribution, Inc. serves as the distributor for Morgan Stanley funds.

**NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT**

**Hong Kong:** This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This document should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"); (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This publication has not been reviewed by the Monetary Authority of Singapore. **Australia:** This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accept responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.

**Japan:** For professional investors, this document is circulated or distributed for informational purposes only. For those who are not professional investors, this document is provided in relation to Morgan Stanley Investment Management (Japan) Co., Ltd. ("MSIMJ")'s business with respect to discretionary investment management agreements ("IMA") and investment advisory agreements ("IAA"). This is not for the purpose of a recommendation or solicitation of transactions or offers any particular financial instruments. Under an IMA, with respect to management of assets of a client, the client prescribes basic management policies in advance and commissions MSIMJ to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIMJ accepts such commission. The client shall delegate to MSIMJ the authorities necessary for making investment. MSIMJ exercises the delegated authorities based on investment decisions of MSIMJ, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IAA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20% per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above.

Indirect charges also may be incurred, such as brokerage commissions for incorporated securities. Since these charges and expenses are different depending on a contract and other factors, MSIMJ cannot present the rates, upper limits, etc. in advance. All clients should read the Documents Provided Prior to the Conclusion of a Contract carefully before executing an agreement. This document is disseminated in Japan by MSIMJ, Registered No. 410 (Director of Kanto Local Finance Bureau (Financial Instruments Firms)), Membership: the Japan Securities Dealers Association, The Investment Trusts Association, Japan, the Japan Investment Advisers Association and the Type II Financial Instruments Firms Association.

### IMPORTANT INFORMATION

**EMEA:** This communication has been issued by Morgan Stanley Investment Management Limited ("MSIM"). Authorised and regulated by the Financial Conduct Authority. Registered in England No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Prior to investing, investors should carefully review the strategy's / product's relevant offering document. There are important differences in how the strategy is carried out in each of the investment vehicles.

**A separately managed account may not be appropriate for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing.**

The views and opinions are those of the author or the investment team as of the date of preparation of this material and are subject to change at any time due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment teams at Morgan Stanley Investment Management (MSIM) or the views of the firm as a whole, and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors or the investment team. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific Morgan Stanley Investment Management product.

The description of ESG integration in MSIM's portfolio management teams represent how the portfolio management teams generally implement their investment process under normal market conditions.

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

This communication is not a product of Morgan Stanley's Research Department and should not be regarded as a research recommendation. The information contained herein has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

MSIM has not authorised financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. Additionally, financial intermediaries are required to satisfy themselves that the information in this document is suitable for any person to whom they provide this document in view of that person's circumstances and purpose. MSIM shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary.

This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM's express written consent. All information contained herein is proprietary and is protected under copyright law.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

For more information about the Morgan Stanley Institute for Sustainable Investing, visit **morganstanley.com/sustainableinvesting**.

For more information on Morgan Stanley Investment Management, visit **www.morganstanley.com/im**

© 2020 Morgan Stanley & Co. LLC and Morgan Stanley Smith Barney LLC. Members SIPC. All rights reserved.

9846908 CRC 3094389 Exp. 05/31/2021 Lit-Link: SUSTSIGNALS