Responsible Investing:

Aligning Personal Values with Investing Dollars

HIGHLAND
FINANCIAL ADVISORS

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Introduction

With investors increasingly concerned about the potential moral implications of certain business practices, many individuals are seeking opportunities to align their personal values with their investment decisions. This has led to an increased interest in responsible investing. According to the Institute for Sustainable Investing's 2017 "Sustainable Signals" report, 75% of individual investors surveyed are interested in sustainable investing. This number is even higher among millennials, with 86% of people in that cohort expressing an interest in sustainable investing.[1]

In its most basic definition, responsible investing refers to any investment strategy that considers environmental, social, and corporate governance (ESG) criteria to generate both long-term competitive financial returns and positive societal impact. There are a wide array of terms used to describe responsible investing approaches, often interchangeably, such as socially responsible investing (SRI), sustainable investing, and impact investing. While used synonymously, there is a distinction between these terms. As there is currently no standard definition or single investment strategy to describe responsible investing, it can be overwhelming for those seeking to align their values with their investing dollars. Although 75% of individuals surveyed reported an interest in sustainable investing, only 38% of them have actually taken action to align their portfolios with their values.[2]

This paper will help shed light on the history of responsible investing, differing approaches to responsible investing, the role shareholders play, and the strategy HIGHLAND has developed to help those who wish to pursue responsible investing.

The History and Evolution of Responsible Investing

The roots of responsible investing date back centuries to biblical times. For example, Jewish law had directives about investing ethically as well as the responsibilities of business and land owners to act morally. Likewise, Halal investing required, and still requires, investment decisions to be made in accordance with Islamic principles. These require that investors share in profit and loss, that they receive no interest (riba), and that they do not invest in a business that is prohibited by Islamic law, or sharia. In the mid-1700s, the Quakers prohibited their members from participating in the slave trade. John Wesley, one of the founders of Methodism, detailed the fundamental tenants of moral investing in his sermon, "The Use of Money."

These religious foundations marked the beginnings of what is now often referred to as Socially Responsible Investing, or SRI. SRI was most commonly a faith-based approach employed by investors whose investment mandates were to avoid so-called "sin" stocks such as alcohol, tobacco, gambling, and pornography.

The modern origins of responsible investing can be traced to the 1960s. Events like the Vietnam War and key themes including the civil rights movement, concern for the environment, and the push for women's equality ignited an impassioned political climate that brought the issues of social and environmental responsibility to the forefront. In particular, a 1972 photo from the Vietnam War of a nine-year old girl running with her back on fire from napalm prompted outrage against Dow Chemical, the compound's leading manufacturer.

Interest in SRI exploded in the 1980s in the wake of several high profile environmental disasters like Chernobyl, Exxon Valdez, Three Mile Island, and Love Canal. Investors at that time also took action through SRI in solidarity with the protest movement against the apartheid regime in South Africa. Individual investors, religious organizations, corporate and public pension plans, and university endowments began divesting from companies operating in South Africa as a sign of their opposition to apartheid. This played an important role in dismantling the country's racist laws and policies.

In recent years, issues such as mass shootings, human rights violations, governance-based corporate scandals, LGBTQ rights, unsafe working conditions, and the climate crisis have awakened investors and served as rallying points for those seeking to align their investing dollars with their values. Just in the past year, interest in responsible investing has grown

[1] "Sustainable Signals: New Data from the Individual Investor," Morgan Stanley Institute for Sustainable Investing, August 7, 2017, https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable_Signals_Whitepaper.pdf (accessed March 26, 2018).
[2] "Sustainable Signals: New Data from the Individual Investor," Morgan Stanley Institute for Sustainable Investing, August 7, 2017, https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable_Signals_Whitepaper.pdf, (accessed March 26, 2018).

substantially following the Equifax data breach, the U.S. withdrawal from the Paris Climate Accord, and President Trump's plans for deregulation by scaling back the Environmental Protection Agency.

According to the US SIF Foundation's 2016 "Report on US Sustainable, Responsible and Impact Investing Trends," as of year-end 2015, roughly $8.72 trillion is invested in the United States in professionally-managed portfolios using one or more of the investment strategies that together define sustainable, responsible, and impact investing. That represents nearly one out of every five dollars under professional management. In the 21 years between the first Trends report in 1995 and the most recent 2016 report, responsibly-managed assets have grown from $639 billion to over $8.72 trillion, an increase of 1,265%.[3] US SIF: The Forum for Sustainable and Responsible Investment, formerly known as the Social Investment Forum, is the leading voice advancing sustainable, responsible, and impact investing. Its mission is to rapidly shift investment practices toward sustainability, focusing on long-term investment and the generation of positive social and environmental impacts.[4]

While the recent corporate scandals, environmental concerns, and political environment have served to increase the demand for responsible investing, there are other key factors driving growth as well.

Information: Today, investors have access to more data and research than ever before. This allows investors to become better educated and make more informed decisions in regard to where they are allocating their investment capital. Corporations are also becoming increasingly transparent about their environmental, social, and corporate governance practices. This has allowed for research firms to collect, measure, and report on responsible investing data. Firms like Morningstar, Sustainalytics, MSCI, and Thomson Reuters have been at the forefront of this movement. Although there is no standardized framework for responsible investing data, initiatives advanced by organizations such as the Sustainability Accounting Standards Board (SASB) and the Global Reporting Initiative (GRI) have sought to establish industry standards on reporting and disclosure.

The Sustainability Accounting Standards Board is the independent standards-setting organization for sustainability accounting standards that seeks to foster high-quality disclosure of material sustainability information designed to improve the effectiveness and comparability of corporate disclosure on ESG factors. The mission of the Sustainability Accounting Standards Board is to develop and disseminate Sustainable Accounting Standards that help public corporations disclose material decision-making information to investors.[5]

The Global Reporting Initiative is an independent organization that seeks to empower decisions that create social, environmental, and economic benefits by helping businesses and governments improve their reporting of impact on critical sustainability issues. The mission of the Global Reporting Initiative is to empower decision makers everywhere, through sustainability standards and a multi-stakeholder network, to take action towards a more sustainable economy and world.[6]

Performance: Real world results using mutual funds and exchange-traded funds (ETFs) have effectively dispelled the myth that investing in a responsible manner means sacrificing returns. For example, the MSCI KLD 400 Social Index, an index that provides exposure to companies with outstanding environmental, social, and governance (ESG) ratings and excludes companies whose products have negative social or environmental impacts, has a compound annualized return of 10.06% since its inception on May 31, 1994 through December 31, 2017. Over this same time period, the S&P 500 had a return of 9.90%.

Figure 1. Parnassus Core Equity Fund vs. S&P 500
August 31, 1992 - March 31, 2018

Source: Morningstar

[3]"Report on US Sustainable, Responsible and Impact Investing Trends 2016," US SIF Foundation, 2016, https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf, (accessed March 26, 2018).
[4]US SIF: The Forum for Sustainable and Responsible Investment, https://www.ussif.org/about (accessed March 26, 2018).
[5]Sustainability Accounting Standards Board, https://www.sasb.org/about-the-sasb/ (accessed March 26, 2018).
[6]Global Reporting Initiative, https://www.globalreporting.org/information/about-gri/Pages/default.aspx (accessed March 26, 2018).

Additionally, the Parnassus Core Equity Fund (PRBLX), which is the largest equity mutual fund with an environmental, social, and governance criteria mandate, has outperformed the S&P 500 since its inception on August 31, 1992.

Cost: A second common myth that has been dispelled is that investing in a responsible manner means paying higher fees. There are a number of index tracking exchange-traded funds (ETFs) and mutual funds that offer broadly diversified exposure at a low cost. Even the cost of actively managed mutual funds in the responsible investing space has declined to be in line with the industry average.

Figure 2. Average Expense Ratio by Morningstar Category

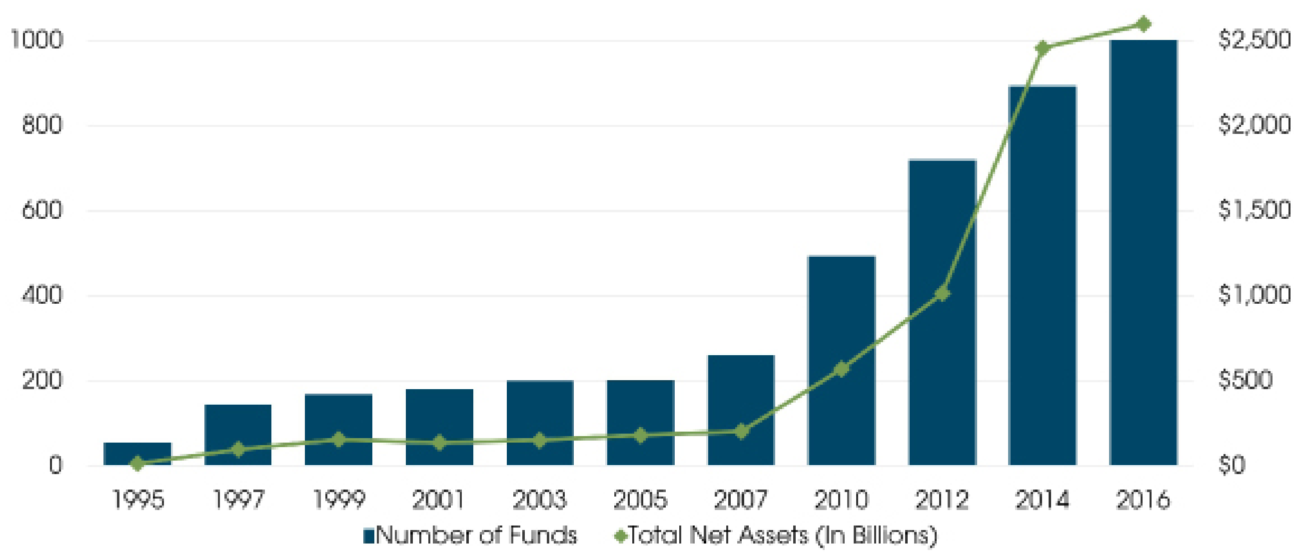
	ESG Funds	Non-ESG Funds
Large Blend	0.69%	1.13%
Large Growth	1.09%	1.16%
Large Value	0.96%	1.10%
World Stock	1.15%	1.28%
Foreign Large Blend	1.14%	1.24%
Intermediate-Term Bond	0.74%	0.86%

Data as of March 15, 2017 Source: Morningstar Direct, Fidelity Investments

Availability: Asset managers are increasingly offering responsible investment options in the form of mutual funds and exchange-traded funds (ETFs) available to most investors. According to the US SIF Foundation's 2016 "Report on Sustainable, Responsible and Impact Investing Trends," there are now over 1,000 dedicated funds with nearly $2.6 billion in assets in the United States.[7] While the number of investment choices used to be limited in scope, the number of investment choices has expanded beyond U.S. large cap stocks to U.S. small cap stocks, non-U.S. stocks, and bonds.

Awareness: As implementation of responsible investing has increased, so too has the number of organizations devoted to the field. The United Nations Principles for Responsible Investing (PRI) is the world's leading proponent of responsible investment. The PRI works to understand the investment implications of environmental, social, and governance factors and to support its international network of investor signatories in incorporating these actors into their investment decisions. Since the Principles were launched in April 2006, the number of signatories has increased from 100 to over 1,800.[8]

Figure 3. Investment Funds Incorporating ESG Factors, 1995 - 2016



Data as of December 31, 2017. US SIF Report on Sustainable, Responsible and Impact Investing Trends 2016.

[7]"Report on US Sustainable, Responsible and Impact Investing Trends 2016," US SIF Foundation, 2016, https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf, (accessed March 26, 2018).
[8]Principles for Responsible Investment, https://www.unpri.org/about (accessed March 26, 2018).

In addition to PRI, other organizations such as US SIF: The Forum for Sustainable and Responsible Investment and The SRI Conference on Sustainable, Responsible, Impact Investing have been instrumental in helping investors and investment professionals direct the flow of investment capital toward companies doing well.

Approaches to Responsible Investing

The early adopters of SRI, those seeking to integrate their personal values into their investment decision-making, primarily used an exclusionary approach. This approach uses screens to avoid investing in companies engaged in certain practices. In the last few decades, responsible investors have sought to make a greater impact by moving beyond SRI's purely exclusionary screening approach.

The movement toward integrating environmental, social, and governance (ESG) factors into traditional investment analysis aims to evaluate how effectively companies are addressing key ESG issues in order to uncover hidden risks and identify opportunities for added return. The philosophy behind this approach is that ESG principles and practices have the potential to contribute to a company's financial performance. Thus, "good companies" have lower financial risk and higher return potential than "bad companies."

Investors who are interested in responsible investing have myriad options. Responsible investment products can be placed in four general categories:

Socially Responsible Investing (SRI): The SRI approach to responsible investing is one centered on exclusion or avoidance. The approach seeks to intentionally avoid investing in companies that generate revenue from objectionable activities, sectors, or geographies. There are a wide variety of investment products that use negative screening techniques, ranging from approaches that restrict a small number of stocks to those that exclude a much broader segment of the market. The most commonly used screens are alcohol, tobacco, gambling, pornography, weapons, and fossil fuels.

Environmental, Social, and Governance (ESG) Integration: The ESG integration approach can be thought of as a best-in-class approach that builds upon the SRI approach. Each company in the investment universe is assigned a score or rating based on environmental, social, and governance (ESG) considerations. The score or rating is used to identify which companies to include or exclude from the portfolio, as well as how to weight the companies in the portfolio. Companies with good ESG scores are assigned a higher weighting and those with bad scores are assigned a lower weighting. This approach is often combined with an exclusionary screen.

There are many issues that fall under environmental, social, and governance, and they can often become intertwined. Examples of ESG issues include, but are not limited to:

Figure 4. Environmental, Social, and Governance (ESG) Criteria

Environmental	• Climate change and carbon emissions • Air and water pollution • Energy efficiency • Waste management • Water scarcity • Biodiversity and deforestation
Social	• Gender and diversity policies • Human rights • Labor standards • Employee engagement • Customer satisfaction • Community relations
Governance	• Board composition • Executive compensation • Audit committee structure • Bribery and corruption policies • Lobbying activities • Political contributions

Source: Morningstar

The ESG integration approach may allow for companies that are "doing good" to be included in a portfolio, even if their sector has unfavorable ESG attributes as a whole. For example, the energy sector is often excluded from portfolios utilizing a purely exclusionary approach due to their exploration, production, and distribution of greenhouse gas-emitting fossil fuels. However, there are energy companies that do make positive impacts in ways that are not always recognized.

While the ESG integration approach relies on past data to determine whether companies have acted in an ESG-friendly manner, it also has a forward-looking element. After all, investors want to know how a company's ESG policies and practices will affect the company and its financial performance in the future. In this respect, ESG integration focuses on the sustainability of a company's earnings.

For example, a pesticide producer located in India relied heavily on sales of a pesticide that used the chemical compound Endosulfan. India was the largest manufacturer of Endosulfan, representing approximately 70% of the world's production. Concerns about Endosulfan have existed since 2000 due to its negative impact on biodiversity and the health-related issues it can cause. As a result, the chemical was banned in 60 countries; however, it was not prohibited in India as of 2007. An ESG integration approach would have removed the chemical's manufacturer from the investable universe because its historic earnings were irrelevant and unsustainable. Given the restrictions on Endosulfan use in most advanced economies, it was likely a similar ban would be applied in India at some point in the future. When the Supreme Court of India banned the production and use of Endosulfan in 2011, it negatively impacted the manufacturing company's stock price.[9] This example reinforces our belief that sound ESG practices and return sustainability are positively related, and weak ESG practices will at some point negatively impact company returns.

Thematic Investing: The thematic investing approach focuses on a specific ESG theme and structures a portfolio around companies or industries that support that theme. It involves selecting a specific area in which the investor aims to achieve an ESG-related improvement, then choosing a fitting vehicle that will aim to generate a financial return. In this sense, thematic investing is aligned to a specific issue rather than a broad-based, socially-driven objective. Examples of ESG themes include, but are not limited to: clean energy, water, gender equality, agriculture, community building, education, and healthcare.

Thematic investing represents a narrower and more targeted approach than SRI and ESG integration. Thus, thematic investing is generally treated as a smaller allocation within an investor's portfolio because of its increased risk due to higher concentration in specific sectors.

Impact Investing: Impact investing is the investment into a company, fund, or organization with the intention of generating a measurable positive social and/or environmental impact alongside a financial return. Hence, this approach harnesses the financial markets to not only produce returns, but also to provide targeted funding to make effective, positive environmental and/or social change in the world.

This may not seem too different from the definition of ESG integration, but there is a subtle distinction. ESG integration considers ESG data alongside the various other financial reporting data to determine which companies are included in a portfolio. Impact investing is the intentional investment in a company, aimed to purposely enact positive impact.

Impact investing is typically available through a private equity structure, and thus may have investor restrictions. Private equity investments are generally limited to accredited investors or qualified purchasers, have liquidity provisions and high costs, and lack transparency.

The Role of Shareholders

A key role shareholders play in the advancement of positive environmental, social, and governance practices employed by companies around the globe is shareholder engagement. In the past, shareholder engagement centered on financial reporting. Shareholders would engage with companies by participating in quarterly earnings calls or attending annual shareholder meetings. However, as responsible investing has grown, fund companies have engaged with portfolio companies to advocate for improved corporate policies, more sustainable business practices, and greater accountability.

Examples of effective shareholder engagement strategies include, but are not limited to, the following:

Direct Dialogue: Fund companies initiate direct dialogue with corporate management through face-to-face meetings, phone calls, and letters to address issues of concern to investors. These dialogues take place during the process of evaluating companies for investment as well as after through ongoing monitoring of portfolio holdings. Fund companies will regularly meet with companies to discuss emerging issues, push for improvement upon issues of concern, and monitor progress towards stated goals.

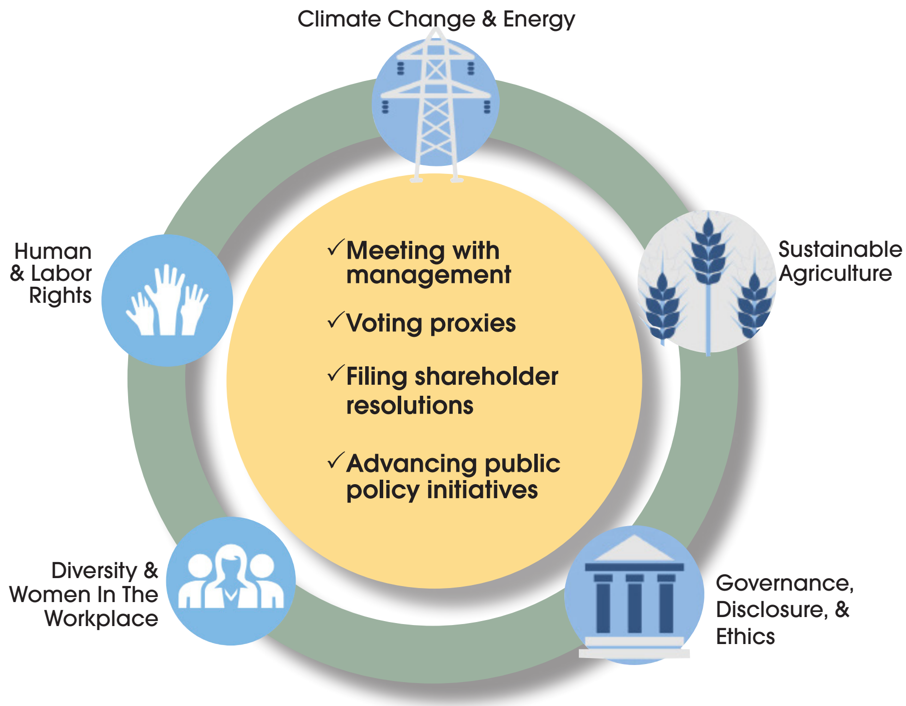
Shareholder Proposals: Shareholders in publicly traded companies are allowed to introduce shareholder proposals, or resolutions, to company management to be voted on at the next annual shareholder meeting. Sponsoring a shareholder resolution allows an issue to be voted on by all shareholders through a proxy ballot. Shareholder proposals are an important piece of responsible investing because they afford shareholders a meaningful way to encourage corporate responsibility and discourage unsustainable or unethical company practices.

Proxy Voting: Shareholders have an opportunity to weigh in on important issues of corporate governance and sustainability at annual shareholder meetings. Most shareholders are unable to attend the annual meetings in-person; therefore, they participate by way of a proxy vote. Proxy ballots typically include proposals from company management on topics such as the election of the board of directors, execu-

[9] "Excel Corp Slumps on Endosulfan Ban," The Economic Times, May 17, 2011, https://economictimes.indiatimes.com/markets/stocks/news/excel-corp-slumps-on-endosulfan-ban/articleshow/8378045.cms (accessed March 26, 2018).

tive compensation, or approving a merger or acquisition. Every fund manager has a fiduciary duty to vote proxies in the best interests of its shareholders. In many respects, proxy voting is the most direct means by which shareholders can influence corporate behavior by voting on important matters to advance the company's environmental, social, and governance practices.

Figure 5. Shareholder Engagement



Institutional investors (i.e. mutual fund companies), as stewards of investor assets, are the biggest shareholders in the world. In the past, institutional investors have traditionally done little to hold company management accountable on environmental, social, and governance issues. The burden of accountability fell at the feet of active investors, who sought to advocate for change or sell their shares to express displeasure with management. However, with increased investor awareness about issues of corporate responsibility, institutional investors have started to flex their muscles. Perhaps one of the highest-profile examples of this can be found with BlackRock. In his most recent annual letter to CEOs, BlackRock's founder and CEO Larry Fink called on CEOs to not only deliver financial performance, but also to make a positive contribution to society. To receive the support of BlackRock, companies must benefit all of their stakeholders, not just shareholders.[10]

The advocacy of institutional shareholders has already shown signs of significant impact. For example, in June 2017 large institutional investors such as BlackRock, State Street Global Advisors, and Vanguard voted against Exxon Mobil to require the company to report on climate change.[11] In January 2018, Jana Partners and the California State Teachers' Retirement System pressed Apple to study the impact of excessive phone use on the mental health of children.[12] These more recent prominent examples show the significant potential influence large institutional investors can have in promoting positive progress.

HIGHLAND's Approach to Responsible Investing

At HIGHLAND, we develop, implement, and monitor diversified portfolios designed to help investors meet their unique long-term investment objectives. We do not try to time the market or pick winning securities. Instead, we follow an evidence-based approach that applies Nobel Prize-winning research to practical investing.

Our view is there is no silver bullet to participate in the upside of markets and avoid the downside. Risk and return are interrelated, but avoiding unnecessary risk is fundamental to achieving a positive investment experience. Therefore, we construct portfolios with the goal of delivering long-term returns while minimizing risk. This is accomplished through global diversification across fixed income, equity, and alternative strategies targeting risk premiums, or dimensions of higher expected returns.

Figure 6. Dimensions of Higher Expected Returns

Fixed Income	• Term Premium • Credit Premium
Equity	• Market Premium • Value Premium • Size Premium
Alternative	• Reinsurance Risk Premium • Alternative Lending Risk Premium • Variance Risk Premium • Style Risk Premium

[10]"Larry Fink's Annual Letter to CEOs: A Sense of Purpose," BlackRock, 2018, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (accessed March 26, 2018).
[11]Eric Rosenbaum, "Exxon Mobil Loses Support of a Powerful Voice in Climate Change Policy," CNBC, August 31, 2017, https://www.cnbc.com/2017/08/31/investing-power-vanguard-votes-against-exxon-mobil-on-climate-change.html (accessed March 26, 2018).
[12]"Open Letter From Jana Partners and CALSTRS to Apple Inc.," Think Differently About Kids, January 6, 2018, https://thinkdifferentlyaboutkids.com/ (accessed March 26, 2018).

We believe investing responsibly does not have to come at the expense of sacrificing long-term investment returns or compromising core investment principles. In this effort, we have developed the HIGHLAND Sustainable Impact Portfolios that are founded on our core investment philosophy while addressing the environmental, social, and governance issues important to investors looking to align their values with their investing dollars.

The strategies comprising HIGHLAND's Sustainable Impact Portfolios are:

ESG Fixed Income: The ESG fixed income strategy is designed to offer broad exposure to the government and investment grade corporate bond markets in a manner that integrates environmental, social, and governance (ESG) research with fundamental fixed income analysis to help deliver strong performance alongside social value. The strategy invests in investment grade bonds of issuers with a best-in-class record on ESG issues. The ESG fixed income strategy seeks to add value through duration positioning, yield curve positioning, sector/industry allocation, credit analysis, ESG analysis, and impact investments. The strategy also takes into account materiality, with each sector of the fixed income market having its own pertinent ESG metrics for analysis.

The ESG fixed income strategy addresses key environmental, social, and governance issues important to investors while offering broad diversification and a focus on the dimensions of higher expected returns. In addition, the strategy seeks to make a more clear and measurable social and environmental impact through proactive social investments.

These investments provide direct exposure to socially beneficial issuers and/or individual projects in the areas of affordable housing, community and economic development, renewable energy and climate change, and natural resources. The impact investments go beyond integration of general ESG criteria to incorporate factors such as issuer mission and the objective of the project.

Figure 7. Fixed Income Impact Investment Framework

Investment Theme	Investment Example
Affordable Housing	U.S. Government agency security funding low-and moderate-income housing
Community Economic Development	Vaccine bonds funding global immunization programs
Renewable Energy and Climate Change	Direct investment in large-scale solar energy production facility
Natural Resources	CMBS security funding construction of first LEED Platinum Certified office building in the U.S.

Source: TIAA Global Asset Management

Core Sustainable Equity: The United Nations defines sustainable development as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs."[13] The core sustainable equity strategy addresses the dual priorities of sustainable development by emphasizing investment in companies acting in more environmentally sound ways than their industry peers. The strategy applies a sustainability scoring system within each industry to promote investment in companies with higher sustainability scores and minimize or exclude investment in companies with lower scores. The environmental sustainability considerations include greenhouse gas emissions intensity, land use and biodiversity, toxic spills and releases, operational waste, and water management.

The primary focus is on the greenhouse gas emissions intensity of each company, which considers the most recently reported direct or indirect emissions of carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride. These emissions were all identified as greenhouse gases under the Kyoto Protocol. The strategy also incorporates potential emissions from fossil fuel reserves. While companies with large fossil fuel reserves may not have high emissions, those stored reserves are a source of future potential emissions and may face risk of devaluation due to governmental action or the increased availability of alternative energy sources.

The core sustainable equity strategy considers more than just environmental factors. The strategy may also penalize companies that use particularly intensive factory farming methods, companies identified as manufacturers of cluster munitions and mines that indiscriminately affect humans and the productive use of land, companies cited for child labor practices, and those linked to the production of tobacco.

For example, the DFA US Sustainability Core 1 Portfolio (DFSIX) addresses key environmental issues important to investors while offering broad diversification and a focus on the dimensions of higher expected returns. The primary focus of this portfolio is environmental sustainability because impact can be measured objectively and transparently. The two most important data points to measure from an environmental sustainability perspective are greenhouse gas emissions intensity and

[13]"United Nations, "Report of the World Commission on Environment and Development," December 11, 1987, General Assembly Resolution 42/187.

potential emissions from reserves. The two charts below show the reduction in greenhouse gas emissions intensity and potential emissions from reserves for the DFA US Sustainability Core 1 Portfolio.

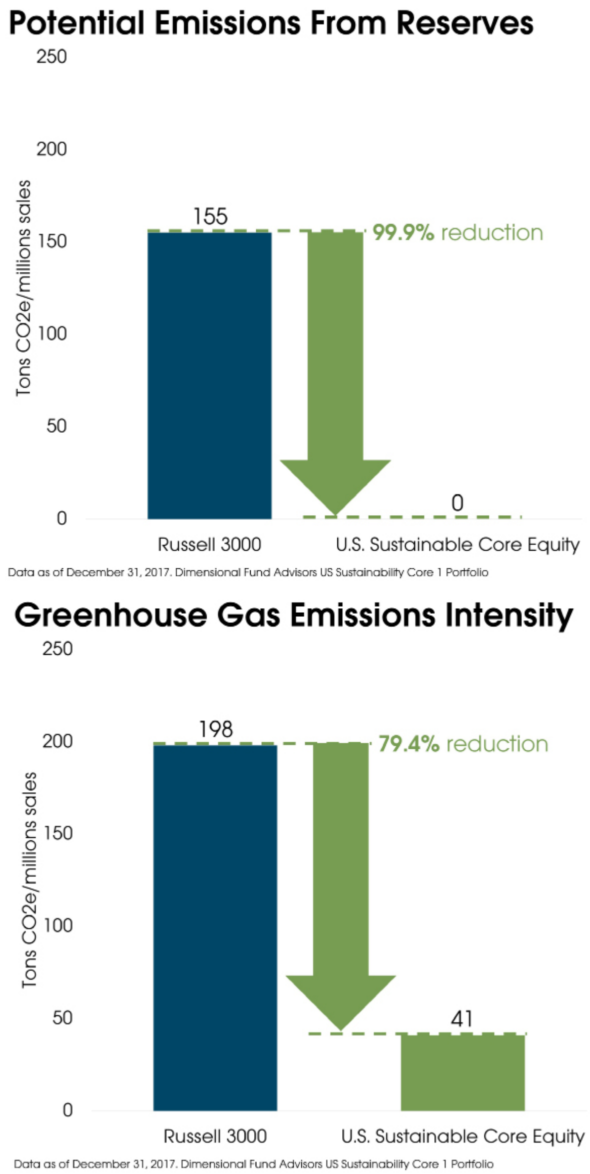
Although the strategy does not specifically target the social and governance components of ESG investing, those components are incorporated in the strategy. Corporate governance is addressed in each and every one of HIGHLAND's investment strategies, not limited to Sustainable Impact Portfolios, through proxy voting policies of the investment managers. The social component of ESG, as mentioned earlier, is addressed in the core sustainable equity strategy through negative screening related to issues of factory farming, cluster munitions, tobacco, and child labor.

Figure 8. Core Sustainable Equity Scoring Variables

Consideration	Application
Greenhouse Gas Emissions Intensity	**85% of total sustainability score**
Land Use and Biodiversity **Toxic Spills and Releases** **Operational Waste** **Water Management**	**15% of total sustainability score**

Source: Dimensional Fund Advisors

Figure 9. Core Sustainable Equity Reporting



The benefits of this strategy are reduced exposure to companies with substantial intensity of emissions, companies that have reserves capable of sourcing future emissions, and companies whose practices may otherwise violate certain environmental and social sustainability principles.

Impact Equity: The Global Impact Investing Network defines impact investing as "investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return."[14] The impact equity strategy seeks to make a positive impact by identifying companies that promote environmental sustainability and resource efficiency, equitable societies and respect for human rights, and accountable governance and transparency.

The impact equity strategy builds upon the exclusionary screens and ESG integration approaches used in the core sustainable equity strategy by investing in a smaller subset of companies that have demonstrated a commitment to ESG issues. By investing in a select group of companies, this allows for more material and transparent reporting as well as more active engagement with companies to influence positive environmental, social, and governance practices.

A key component of the impact equity strategy is a focus on materiality, which identifies the ESG factors most relevant to a particular industry or company that are likely to positively influence a company's financial performance and societal outcomes. The strategy combines traditional investment research with thorough ESG analysis to focus on investing in companies with superior responsibility and sustainability characteristics.

[14]Global Impact Investing Network, https://thegiin.org/impact-investing/ (accessed Mach 26, 2018).

The impact equity strategy targets specific company outcomes while achieving a financial return. While the core sustainable strategy has a greater focus on environmental sustainability, the impact equity strategy has an increased focus on advancing social and governance practices and policies, such as gender equality, quality education, no poverty, zero hunger, and good health and well-being.

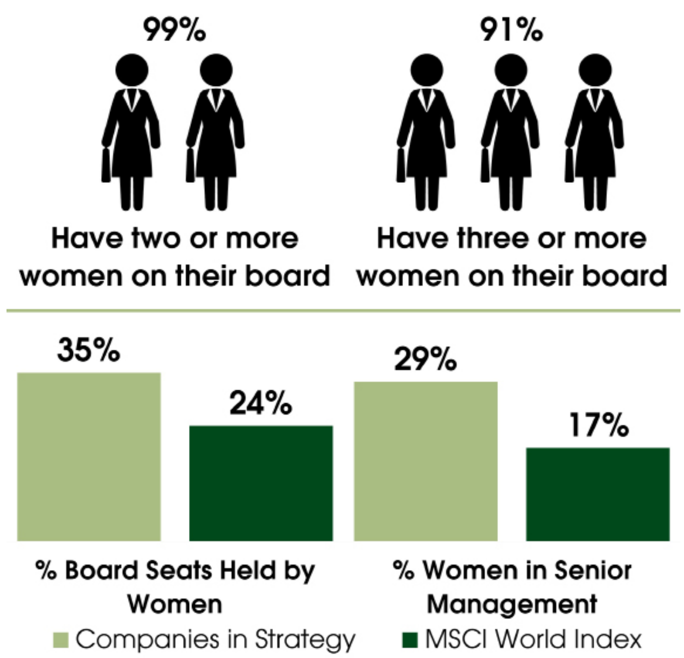
Therefore, the strategy emphasizes companies that are committed to progressing the United Nations Sustainable Development Goals (UN SDGs). The UN SDGs are "a set of goals to end poverty, protect the planet, and ensure prosperity for all." The 17 Sustainable Development Goals are part of the wider 2030 Agenda for Sustainable Development, which emphasizes a holistic approach to end all forms of poverty, fight inequalities, and tackle climate change, while ensuring that no one is left behind. The UN SDGs builds on the success of the 8 Millennium Development Goals (MDGs) that were in effect from 2000-2015.[15]

Figure 11. United Nations Sustainable Development Goals: 17 Goals to Transform Our World

Source: United Nations

For example, an investment approach used in the impact equity strategy takes a thematic approach focusing on gender equality in the workplace. The gender equality strategy focuses on the highest-rated companies in the world for advancing women through gender diversity on their boards and in executive management. Companies are rated based on multiple criteria around gender leadership, including representation of women on the board of directors, representation of women in executive management, female CEOs, female CFOs, and whether the company is a signatory to the Women's Empowerment Principles, a joint initiative of the UN Global Compact and UN Women. The impact of this strategy can be measured transparently in terms of female leadership within the companies invested and gender diversity on corporate boards.

Figure 10. Impact Equity Reporting



Source: MSCI World Index, *Pax Gender Analytics*, 2017.

Core Alternatives: The core alternatives strategy is designed to provide a risk and return profile that is separate and distinct from traditional fixed income and equity assets. We believe considering a wider array of return streams, outside of stocks and bonds, that were not traditionally available to individual investors can provide diversification to protect current wealth and sufficient return potential to grow future wealth.

Because this strategy does not directly invest in stocks or bonds, there are no generally accepted ESG metrics for which to compare these investments. However, two of the investments comprising this strategy have social objectives.

Reinsurance plays an important social role in the global economy by helping the world recover after natural disasters. Further, by removing uncertainty, reinsurance makes it easier for companies to invest confidently in property, plant, and equipment. This allows businesses to grow, economies to expand, and society to prosper. Without reinsurance, the economies around the world would come to a grinding halt with major human consequences following a catastrophic natural disaster. For example, in 2017 alone the reinsurance strategy provided $1 billion of support to the victims of the California wildfires and Hurricanes Harvey, Irma, and Maria.[16]

Alternative lending refers to investors providing credit to borrowers, often without the involvement of banks. The alter-

[15]Sustainable Development Knowledge Platform, https://sustainabledevelopment.un.org/post2015/transformingourworld (accessed March 26, 2018).
[16]Ross L. Stevens, "2017 Shareholder Letter," Stone Ridge, October 31, 2017.

native lending investment provides social benefits for three groups: individuals, small businesses, and students. Individuals and students can access credit at lower rates than would be available through banks. For many small businesses, borrowing on credit cards is the only form of credit available because banks won't service small loans. As a result of alternative lending, small businesses can access credit at a much lower rate. Specifically, since June 2016, the alternative lending strategy has supported 77,749 small businesses by providing 410,009 loans with a total value of $7 billion.[17] In all three cases, the benefits of lower costs provide societal benefits.

Closing Thoughts

Responsible investing in its current state is in its relative infancy. At this point, there is no standard definition or strategy to describe responsible investing, which means there is room for interpretation. For this reason, there are a number of misconceptions around responsible investing, many of which have been debunked through research and real-life data. With that said, the evolution of responsible investing will continue in the future as awareness increases and data reporting becomes more transparent. We are confident that interest and opportunity in the responsible investing space will only continue to grow, and so we will remain up-to-date on the latest developments and share our thoughts on this changing landscape, knowing that nothing is ever set in stone.

We recognize that responsible investing is not for everyone. Investors may prefer to not restrict their investment universe or increase their allocation to companies with strong ESG qualities, choosing instead to donate investment profits to those charities or causes dearest to their hearts. This is perfectly acceptable for those who have a more specific social impact focus (e.g. finding a cure for a specific disease). For those looking to make a broader positive impact with their investment dollars, HIGHLAND's Sustainable Impact Portfolios are the solution.

We also recognize it's unlikely that HIGHLAND's Sustainable Impact Portfolios will be 100% aligned with each individual's unique code of ethics and set of personal values. We believe directional alignment that addresses the environmental, social, and governance issues important to most investors while maintaining broad diversification, exposure to the dimensions of expected higher returns, and that can be implemented in an efficient manner is the right balance for those seeking to invest responsibly.

To learn more about HIGHLAND's Sustainable Impact Portfolios or how you can align your personal values with your investment dollars, please contact a member of the HIGHLAND team.

[17]Ross L. Stevens, "2017 Shareholder Letter," Stone Ridge, October 31, 2017.

Important Disclosure Information

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There can be no assurance that the investment strategy proposed will obtain its goal. Past performance does not guarantee future results. This paper is not a substitute for personalized advice from HIGHLAND Financial Advisors, LLC. A copy of our current written disclosure statement discussing our advisory services and fees is available for your review upon request.

Please contact HIGHLAND Financial Advisors, LLC if there are any changes in your personal or financial situation or investment objectives for the purpose of reviewing our previous recommendations and services, or if you wish to impose, add, or modify any reasonable restrictions to our investment management services.

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What we do matters