Does Doing Right Mean Investing Well?

"Know what you own, and know why you own it."
- *Peter Lynch*

Socially responsible investing, or "SRI", has been around for decades. SRI is the practice of investing in companies that reflect an individual's or organization's beliefs. In general, SRI avoids sectors and / or companies that are in opposition to an investor's views – for example, an investor who believes that smoking should be outlawed could practice SRI by avoiding investing in tobacco companies.

A new offshoot of SRI based on environmental, societal and governance (or "ESG") factors has been developed more recently. ESG, a term first coined in 2004, is a factor-based investment style that rates companies on various metrics regarding their environmental and governance practices, as well as their broader impact on society. These factor rankings are then used as the basis for inclusion into investor portfolios.

Exchange-traded funds, or ETFs, are a popular vehicle for investors to participate in the ESG themes. Growth in this space has been explosive, with over $30 billion of assets flowing into ESG ETFs over the past twelve months.

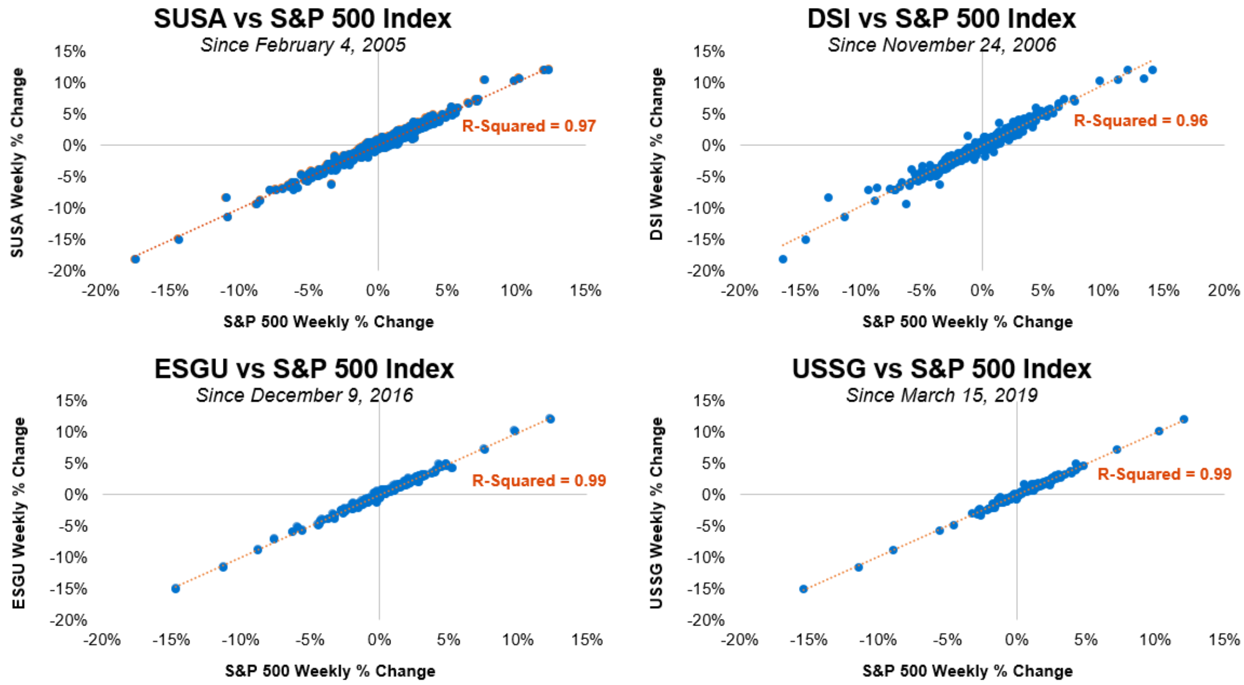
These ETFs tout rigorous screening processes and sophisticated scoring systems that uncover only the most worthy companies for inclusion into an ESG portfolio. But what does an investor *really* get when investing in such a specialized product?

Naturally, a sense of "doing the right thing" accompanies making such an investment – and it's difficult to put a price on that. However, from strictly an investment point of view, ETFs focused on environmental, societal and governance factors don't provide investors with an experience much different than the broader market.

The charts on the following page illustrate the weekly returns of the four biggest ESG exchange-traded funds, plotted against the weekly returns of the S&P 500 Index. Note that the time periods for each chart are different – these date ranges coincide with each ETF's inception date.

The four ETFs depicted below combine for ~$30 billion of assets under management:

- iShares MSCI USA ESG Select (ticker: SUSA)
- iShares Trust – iShares MSCI KLD 400 Social ETF (ticker: DSI)
- iShares ESG Aware MSCI USA ETF (ticker: ESGU)
- Xtrackers MSCI USA ESG Leaders Equity ETF (ticker: USSG)



Source: Factset, FFWM Research

Examining the charts reveals that an investor expecting a different investment return experience via ESG would have been largely disappointed. In the investment management world, R-squared is generally interpreted as the percentage of a fund's price movement that can be explained by the price movements of a benchmark index. In the charts above, the R-squared for each fund suggests that 96%-99% of the returns for the largest ESG funds can be explained by the returns of the S&P 500 Index.

How can this be? Shouldn't investing in only the most socially responsible companies generate returns different than the broader index? Looking at the underlying holdings of the largest ESG fund – EGSU – reveals how this can be. At the sector level, EGSU's largest discrepancies *relative to the S&P 500* range from +1.1% (Information Technology) to -0.8% (Communication Services). In other words, the sector weightings of EGSU closely resemble those of the S&P 500 Index.

At the individual stock level, EGSU's top five holdings are the exact same as the S&P 500 – Apple, Microsoft, Amazon, Google-parent Alphabet, and Facebook. While the emphasis placed on these five stocks isn't too surprising given the size of the companies, some other choices of what to include (or exclude) does raise an eyebrow.

For example, Aerospace & Defense companies have long been excluded by SRI funds due to their involvement in producing weapons and weapons systems. For this reason, it is not surprising that EGSU would not hold Boeing, Lockheed Martin or Northrup Grumman shares. What is surprising is that EGSU does own Textron, which produces military helicopters. EGSU also owns General Motors but not Ford, yet both traditional combustion-engine car manufacturers are aggressively switching gears to produce tens of thousands of electric vehicles per year in the near future.

The point here is that, with large ESG funds, investors may not be getting exactly what they thought they were. At First Financial Wealth Management, we do our own due diligence in the security selection process so that we know what our clients own in their portfolios. Our Cincinnati-based investment management team adheres to an investment philosophy built upon three main tenets: portfolio diversification, an emphasis on quality, and the flexibility to react to current market conditions.

The emphasis on "quality" requires that we, as legendary investor Peter Lynch said, "know what you own, and why you own it." Our investment philosophy aims to participate in "up" markets while protecting in "down" markets. Knowing what we own and how those securities usually behave in different market environments helps us achieve that "participate & protect" mandate.

Unlike some national investment firms with investment teams that are unavailable to those professionals responsible for client relationships, our Wealth Advisors have a seat at the table during the entire security selection process. Our Investment Management team presents each investment idea to the group and actively solicits feedback on whether or not the security fits into our broader investment philosophy. In our view this not only invites different viewpoints into the due diligence process, but also increases the ability for our Wealth Advisors to explain to our clients not only what they own, but why they own it.

Currently, what we own reflects our belief that the macroeconomic picture is one of rising growth, rising interest rates and rising inflation. This "reflationary" environment has historically benefitted cyclical "value" stocks which should lead the market higher from here, though with the potential for some volatility along the way. In preparation, we recently trimmed our overweight allocations to riskier areas of the market in order to manage total portfolio volatility. Overall though, our client portfolios maintain their cyclical orientation.

Within equities, we previously increased our clients' exposure to larger, more developed international markets. We've also made moves to increase exposure to smaller companies in the US and have added targeted exposure to more cyclical areas of the US large cap space. We believe that, as we enter the second year of the current Bull market, earnings growth will be more important in driving returns rather than expansion in valuation multiples. This just reinforces our position that cyclical "value" stocks should benefit more than expensive "growth" stocks.

In the fixed income area, we remain focused on more credit-sensitive securities (with less exposure to the more cyclical areas of the market) with shorter maturities as a hedge against potentially rising interest rates. Within the alternative market segments, we recently increased our exposure to "real assets" (think commodities and real estate) as a hedge against the potential for higher inflation. We have maintained our exposure to the diversified alternative sector as a hedge against potential market volatility.

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You cannot invest directly in an index. Indexes are unmanaged and measure the changes in market conditions based on the average performance of the securities that make up the index. Investing in small and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. Asset allocation and diversification does not ensure a profit or protect against a loss.

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Are not deposits	**Are Not FDIC Insured**	**Have No Bank or Federal Government Guarantee**	**May Lose Value**