


ESG AS EASY AS 123:

Understanding ESG and the
 LeafHouse Investment Sustainability Technology™

Environmental, Social, and Governance (ESG), in its simplest terms, is the process of evaluating companies and investments that seek to achieve a positive and material impact on society. Along with ESG, investors may come across familiar terms that relay a similar message, such as Sustainable Investing, Responsible Investing, or Socially Responsible Investing. Regardless of the term used, the general goal is the same: to align corporate growth with positive investor values.

Environmental	Social	Governance
<ul style="list-style-type: none"> ○ Clean Energy ○ Climate ○ Carbon Footprint ○ Waste Reduction/Disposal ○ Natural Resources Preservation 	<ul style="list-style-type: none"> ○ Human Rights ○ Diversity and Gender Equality ○ Well-being of consumers and employees ○ Community Involvement 	<ul style="list-style-type: none"> ○ Ethical Business Practices ○ Responsibility to Shareholders ○ Accountable Governing Bodies ○ Reasonableness of Executive Compensation
		

We are often asked, “Is an ESG strategy appropriate for my client?” LeafHouse Financial (“LeafHouse”) intends to address this question by outlining five (5) ESG screening strategies, explaining the relative approach taken to portfolio construction, and reviewing the LeafHouse Investment Sustainability Technology™ (LIST™).

LeafHouse Investment Sustainability Technology™ (LIST™):

Using the LeafHouse Grade Point Average® (“LeafHouse GPA®”), a proprietary screening algorithm, LeafHouse identifies funds that pass the LeafHouse GPA® screening and that promote sustainability. The LeafHouse algorithm processes security performance and risk data which results in a corresponding LeafHouse GPA® score for each security. The combination of the LeafHouse GPA® and qualitative investment process is the backbone of all fund evaluations for LIST™.

The objective of the LeafHouse GPA® is to deliver quality investment services to Defined Contribution (DC) and Defined Benefit (DB) retirement plan sponsors that incorporate fiduciary management principles and

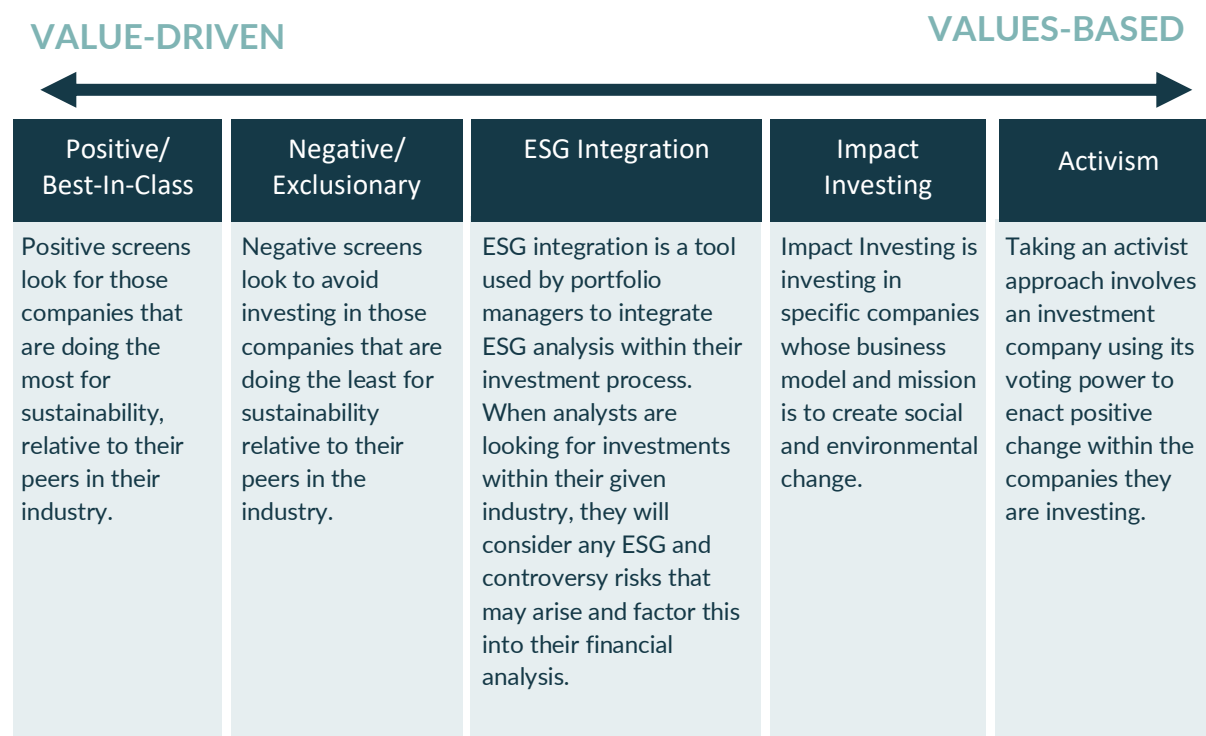
Employee Retirement Income and Securities Act (ERISA) best practices. The program encompasses a comprehensive and systematic process that aims to enable LeafHouse to document and prudently select, evaluate, and monitor funds using generally accepted investment principles. LeafHouse believes this fund evaluation and monitoring methodology provides a consistent and documented process that aims to fulfill fiduciary obligations and to make investment decisions solely in the best interests of plan participants and their beneficiaries. In our opinion, this is accomplished by incorporating U.S. Department of Labor (DOL) expectations within the methodology, along with modern investment management theory and techniques used by large pension plans, foundations, and endowments.

This initial screening, via the LeafHouse GPA®, provides our Investment Committee with a group of funds that are ranked above their peers in corresponding investment categories. LeafHouse then uses Sustainalytics, which is a well-known global leader in ESG ratings, to determine each passing fund’s ESG score. We have a threshold of “Average” or better when determining whether an ESG fund will be placed in an investment lineup. As the FlexFiduciary™, LeafHouse considers advisor and plan sponsor input and feedback when choosing from the screened list of ESG funds to build a lineup to fit their client’s needs.

Qualifying a company or strategy as “ESG” is not a uniform approach as there are different, competing third-party companies and analysts researching without defined criteria. For example, a company may have an “Above Average” Sustainalytics score because a company satisfies the “G” in “ESG” by providing a dividend to its shareholders. For a Values-Based investor, this may not be ideal because this type of investor may be more concerned about social issues over governance. As with any investment decision, taking a secondary in-depth look can serve to enhance a client’s portfolio for value while also helping it align with their values.

Screening Methods:

There are five screenings methods currently used industry wide: Positive screens, Negative screens, ESG Integration, Impact Investing and Activism. These screening methods can be used individually, as an isolated screen, or together to fulfill a manager’s investment process.



A common misconception is that ESG investments have only positive aspects related to environment, society, or corporate governance. It is important to keep in mind these screening methods seek to identify relative, rather than absolute, value. For example, an oil and gas company may potentially be included in an ESG portfolio because they are actively committed to the goal of finding cleaner energy solutions, relative to their peer group, or converting some of their energy output to alternative energy sources such as wind or solar power.

It is important to note the differences between “Value-Driven” and “Values-Based” approaches. Value-Driven investing focuses on common investment themes that are fundamentally driven. This includes Conventional Research investment processes and an ESG screen to the fundamental analysis phase of investment research. Values-Based investing focuses on investing in companies looking to make an impact or that align with an investor’s personal values.

Creating a sustainable investment strategy using the screening methods outlined above allows for both a large pool (Positive / Negative screening) or a narrowly focused (Impact / Activist) approach. For Positive / Negative screening and ESG integration, the standards can be much looser, and often allow a company to be included for screening that may be counterintuitive to an ESG strategy. Under the Impact and Activist approach, the investments screened are more restrictive due to its sectionalist nature. As an example, financial companies are not often seen as ESG friendly companies. However, some of these companies are committed to not only ESG issues at a company level but are also committed, and heavily invested, to the UN Sustainable Development Goals (SDGs), the global standard for sustainable goals.



When focusing on non-Activist and non-Impact strategies, consideration must be given to the fact that these strategies have dual goals: performing at a high level and remaining committed to an ESG approach. Under these circumstances, strategy managers create a screening system that involves reviewing companies on a relative basis. This means a company without a direct commitment to ESG may be included in a portfolio because the strategy’s manager believes it is the best option available for obtaining the portfolio’s risk/return profile.

Portfolio Construction Considerations:

When reviewing a company or strategy for a client, it might be best to consider the client’s specific goals and to ask a few targeted questions, as illustrated below.

- Companies that may not be viewed as ESG friendly may be the most committed to ESG
 - Will my client accept this viewpoint, considering the specific company's goals of disclosing material sustainable information?
 - Should emphasis on specific investments align with companies that are committed to SDGs?
- Securities are generally included as part of a larger portfolio on a relative basis
 - Does my client want a Values-Based or a Value-Driven approach for their specific portfolio?
 - Are there any absolute portfolio constraints or exclusions?
- Differing viewpoints on ESG criteria
 - Is my client aware that each investment company may view ESG criteria differently?
 - Does my client understand that a Values-Based approach may come with different inherent biases?

ESG continues to grow in the retirement plan market and will likely be an important element of the advisor-client relationship for years to come. DOL Guidance states that you may only select a sustainability focused fund if the analysis determines that the fund has equal or superior risk adjusted returns when compared to the peer group. By way of LIST™, LeafHouse is able to construct a socially responsible, ESG solution for retirement plan sponsors. This will allow participants to gain exposure to a selection of sustainable funds through their working years and retirement.

It is incumbent upon the advisor or plan sponsor to fully understand that their input can help appropriately select an investment that aligns with the investor values of their clients. As the FlexFiduciary™, LeafHouse is open to fund recommendations and ESG strategies from advisors and plan sponsors. LeafHouse is excited about the possibilities that ESG offers and sees this as an opportunity to invest in a socially responsible manner without giving up performance.

The opinions expressed are those of the LeafHouse Financial Advisors. The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass.

LeafHouse is a registered investment advisor. Registration does not imply a certain level of skills or training. More information about the firm, including its investment strategies and objectives, can be found in our ADV Part 2, which is available, without charge, upon request. Our Form ADV contains information regarding LeafHouse's business practices and the backgrounds of our key personnel.