Doing Well by Doing Good

Sustainable and responsible investing via environmental, social, and governance (ESG) metrics has come a long way. Here's how, and why that matters.

In his 1962 book, *Capitalism and Freedom*, University of Chicago economist Milton Friedman called corporate social responsibility a "fundamentally subversive doctrine" in a free society. As he put it, "There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."

How the "game" has changed since then! Depending on one's moral compass, ESG investing can exclude purveyors of liquor, tobacco, munitions, and nuclear power plants; businesses that waste huge amounts of natural resources or pollute excessively; companies that overpay their executives, deny workers' rights or access to health care, hire overseas sweatshops or don't hire enough women and minorities; enterprises that support or operate in repressive countries; or firms that sell genetically modified foods among others. More likely to be included are companies that respond to investor concerns about carbon footprints, environmental degradation, resource stewardship, product and workplace safety, employee diversity, business ethics, and community relations. And that has led to a profound transformation of the asset management business.

ESG Flexibility at Virtus

We believe that ESG principles impact a company's financial performance, competitive positioning, brand equity, and shareholder value. We fully encourage and support our affiliated investment managers and select unaffiliated subadvisers who are committed to the United Nations Principles for Responsible Investment (UN PRI), an international network of investors committed to:

1. Incorporating ESG issues into investment analysis and decision making.
2. Actively incorporating ESG issues into ownership policies and practices.
3. Seeking appropriate disclosure on ESG issues by the entities in which they invest.
4. Promoting acceptance and implementation of the Principles within the investment industry.
5. Working together to enhance the effectiveness of implementing the Principles.
6. Reporting on their activities and progress towards implementing the Principles.

As of June 30, 2021, 82% of Virtus' assets under management were managed by affiliates or subadvisers that are signatories to the UN PRI.

Why ESG Investing Matters

According to the research firm Opimas, the value of global assets applying ESG metrics to investment decisions has more than tripled over eight years, to $40.5 trillion in 2020.[1] As for the United States, US SIF: The Forum for Sustainable and Responsible Investment reports that sustainable investing assets now account for $17.1 trillion—or one in three dollars—of the total U.S. assets under professional management—a 42% increase over 2018.

Of course, estimates of ESG assets under management may vary, since ESG reporting standards are very much in flux. Rules in Europe, the largest market for sustainable investing, are considered more developed. At any rate, financial professionals should have plenty of opportunity to help investors align their long-term investment goals with their personal values as the risks and economic costs of climate change and infectious diseases continue to make headlines. According to a recent Broadridge survey, six in 10 financial professionals (particularly younger and female) already use ESG funds, and 81% of financial professionals plan to use ESG over the next two years.

[1] Sophie Baker, "Global ESG-data driven assets hit $40.5 trillion," Pensions & Investments, July 2, 2020.

Increasing Focus on Climate, among Other Risks

Cerulli Associates, a research and consulting firm specializing in asset management and distribution trends worldwide, reports that nearly all (98%) U.S. asset managers that have an ESG integration approach are evaluating underlying portfolio companies' climate-related risk. But risk assessment encompasses a wide variety of other issues as illustrated in the following two graphics.

ASSET MANAGERS: TOP 20 ESG THEMES INCORPORATED INTO ESG INTEGRATION PROCESS, 2020

Rank	Issue	Category	ESG Integration/Consideration
1	Climate change/carbon	Environmental	98%
2	Human rights	Social	90%
3	Labor standards	Social	90%
4	Pollution	Environmental	90%
5	Energy efficiency	Environmental	90%
6	Board issues/composition	Governance	90%
7	Clean water/water scarcity	Environmental	87%
8	Responsible supply chain/material sourcing	Governance	87%
9	Bribery and corruption	Governance	87%
10	Waste management	Environmental	83%
11	EEO/Diversity	Social	81%
12	Data protection and privacy	Social	79%
13	Gender	Social	79%
14	Sustainable natural resources/agriculture	Environmental	79%
15	Employee engagement	Social	77%
16	Civilian firearms	Social	72%
17	Community relations	Social	71%
18	Executive compensation	Governance	71%
19	Conflict risk	Social	69%
20	Audit committee structure	Governance	69%

Source: Cerulli Associates

ESG FACTORS ARE CRUCIAL RISK/RETURN DRIVERS Global Risks in Terms of Impact

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
1st	Asset price collapse	Fiscal crisis	Financial failure	Financial failure	Fiscal crisis	Water crisis	Climate action failure	Weapons of mass destruction	Weapons of mass destruction	Weapons of mass destruction	Climate action failure
2nd	Deglobal-ization (DM)	Climate change	Water supply crisis	Water crisis	Climate action failure	Infectious diseases	Weapons of mass destruction	Extreme weather	Extreme weather	Climate action failure	Weapons of mass destruction
3rd	Oil price spikes	Geopolitical conflict	Food shortage crisis	Fiscal imbalances	Water crisis	Weapons of mass destruction	Water crisis	Water crisis	Natural disasters	Extreme weather	Biodiversity loss
4th	Chronic disease	Asset price collapse	Chronic fiscal imbalances	Weapons of mass destruction	Unemploy-ment	Interstate conflicts	Involuntary migration	Natural disasters	Climate action failure	Water crisis	Extreme weather
5th	Fiscal crisis	Energy price volatility	Volatile energy and agriculture prices	Climate action failure	Information infra-structure breakdown	Climate action failure	Energy price shock	Climate action failure	Water crisis	Natural disasters	Water crisis

Economic · Environmental · Geopolitical · Societal · Technological

Source: World Economic Forum 2010-2020, Global Risks Reports. Note: Global risks may not be strictly comparable across years, as definitions and the set of global risks have evolved with new issues emerging on the 10-year horizon. For example, cyberattacks, income disparity, and unemployment entered the set of global risks in 2012. Some global risks were reclassified: water crises and rising income disparity were re-categorized first as societal risks and then as a trend in the 2015 and 2016 Global Risks Report, respectively.

Risk and Returns

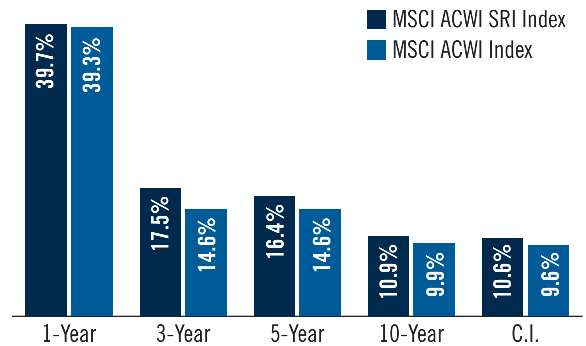
Does good ESG translate into good financial performance? According to McKinsey partner Robin Nuttall, there have been more than 2,000 academic studies and around 70 percent of them find a positive relationship between ESG scores on the one hand and financial returns on the other, whether measured by equity returns, profitability or valuation multiples.

"Increasingly, another element is the cost of capital," he added. "Evidence is emerging that a better ESG score translates to about a 10 percent lower cost of capital as the risks that affect your business, in terms of its license to operate, are reduced if you have a strong ESG proposition."[2]

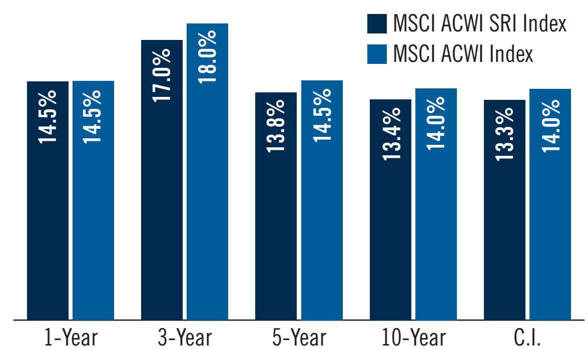
Consider the historical returns of ESG investing as represented by the MSCI ACWI SRI Index versus the broader MSCI ACWI Index.

THE BENEFITS OF BEING "GOOD TO THE CORE"
ESG, historically stronger risk-adjusted returns

Total Returns (Annualized) as of 6/30/21



Risk (Standard Deviation) as of 6/30/21



Past performance is not indicative of future results.
Source: Allianz Global Investors US LLC, citing MSCI. The Common Inception (C.I.) date is 5/31/11, the first date MSCI World SRI Index data is available. Top bars show average annual total returns, while bottom bars show standard deviation. The MSCI ACWI SRI Index (net) includes large and mid-cap stocks across 23 Developed Markets (DM) countries and 27 Emerging Markets (EM) countries. The index is a capitalization weighted 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. Constituent selection is based on research provided by MSCI ESG Research. The MSCI ACWI Index (net) is a free float-adjusted market capitalization-weighted index that measures equity performance of Developed and Emerging Markets. The indexes are calculated on a total return basis with dividends reinvested. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.

Clarifying Standards

Amid the growing popularity of ESG investment products, the Securities and Exchange Commission has stepped up efforts to address disclosure gaps and compliance requirements to safeguard investors. The initial focus of a recently created Climate and ESG Task Force will be to identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules. The task force will also analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies.

For its part, CFA Institute, a global association of investment professionals, recently published an exposure draft of global standards. "The pandemic has galvanized both interest and real action in ESG investing," said Margaret Franklin, CFA, President and CEO of CFA Institute. "And there is widespread support for standards that will bring greater clarity and efficiency to the identification, comparison and presentation of products with ESG-related features."

While definitional and "what is considered material" issues still need to be sorted out, CFA Institute encourages the incorporation of ESG data into the investment process so that investors can be more informed about the decisions they are making.

[2]Sara Bernow and Robin Nuttall, "Why ESG Is Here to Stay," McKinsey (podcast), May 26, 2020.

About Virtus Investment Partners

Virtus Investment Partners (NASDAQ: VRTS) is a distinctive partnership of boutique investment managers singularly committed to the long-term success of individual and institutional investors. The company provides investment management products and services through its affiliated managers and select subadvisers, each with a distinct investment style, autonomous investment process, and individual brand.

VIRTUS
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To learn more visit virtus.com or call us at 800-243-4361.

PRI Signatories as of August 2021

> Ceredex Value Advisors – In process

> Duff & Phelps Investment Management Company – 10/12/2018

> Kayne Anderson Rudnick Investment Management, LLC – 1/29/2019

> Seix Investment Advisors – 7/16/2021

> Sustainable Growth Advisors, LP – 9/23/2014

> Vontobel Holding AG – 1/5/2010

> Wellington Management Company LLC – 4/26/2012

IMPORTANT RISK CONSIDERATIONS

Sustainable Investing: Because a portfolio focuses on investments in companies that the Manager believes exhibit strong environmental, social, and corporate governance records, the portfolio's universe of investments may be smaller than that of other portfolios and broad equity benchmark indices.

Consideration of ESG factors could cause funds or managed accounts to perform differently compared to funds or managed accounts that do not have such considerations. The consideration of ESG factors may result in forgoing opportunities to buy certain securities when it might otherwise be advantageous to do so, or selling securities for ESG reasons when it might otherwise be disadvantageous to do so. In addition, there is a risk that companies identified for investment by considering ESG factors do not operate as expected when addressing ESG issues. There are significant differences in interpretations of what it means for a company to have positive ESG factors. In addition, there are possible inconsistencies in third-party ESG research providers' ranking criteria and results.

Investing involves risks and the possible loss of principal. This report is based on the assumptions and analysis made and believed to be reasonable. However, no assurance can be given that the opinions or expectations will be correct. This report is intended for informational purposes only and should not be considered a recommendation or solicitation to purchase securities.