Outsourced ESG investment solution

Public university foundation

Client case study

The organization

A public university foundation (the "Foundation") has an endowment of over $100 million in assets. The endowment is intended to support the university in perpetuity through contributions to student scholarships, academic programs, and faculty projects.

The challenge:
Aligning the investment objectives and mission

The Foundation staff and investment committee desired two major changes to the investment program:

1. Move to an outsourced investment solution

After years of working with an investment consultant, the Foundation made the strategic decision to move to an outsourced chief investment officer (OCIO) provider who would be a true partner and act as a co-fiduciary. This would increase the breadth and depth of the Foundation's investment solution and free up staff to focus on the primary work of the Foundation.

2. Reduce carbon exposure in the investment portfolio

The Foundation concurrently recognized a need for greater awareness of environmental, social, and governance (ESG) risk factors internally as well as a desire to shift the investment portfolio towards its responsible investing goals. To help meet its goals, the Foundation sought a partner with the capabilities to customize a responsible investing solution. The university had a long, extensive background in environmental studies, spanning over 50 years, and it was a pioneer in its state to develop a college dedicated to the education of future environmental scientists and leaders. Naturally, and like many of its peers across the country, the university was also seeing greater interest from its student body and faculty to amplify its responsible investing efforts.

To that end, the Foundation staff consciously began the journey to sensibly reduce carbon exposure in their investment portfolio. The Foundation wished to align the investment design with its stakeholders' views regarding carbon exposure in the endowment—without sacrificing financial return. In order to achieve this, the Foundation sought an investment solution that would help meet its mission as well as its return requirements and do well while doing good.

Strategic goals

- Work with an OCIO provider to enhance investment solution and free up staff resources.
- Shift investment portfolio towards responsible investing goals without sacrificing financial returns.

The solution

The Foundation approached Russell Investments with the desire for an outsourced investing partner that could also help meet its responsible investing goals.

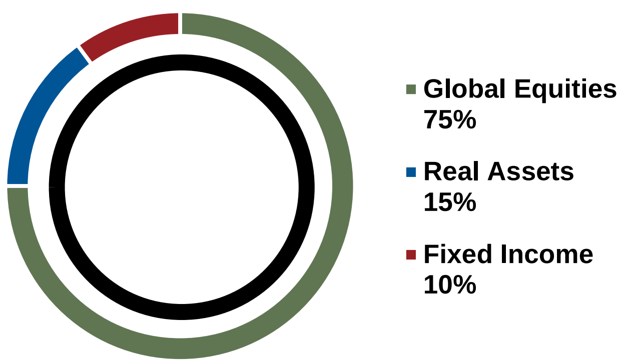
Fortunately, Russell Investments had already been doing work in this area, initially for international clients in countries where responsible investing mandates have existed for a number of years, but more recently for U.S.-based clients. This work provided the underpinnings of a new **sustainable multi-asset growth strategy** (the “strategy”) that would explicitly take ESG considerations into account, generating long-term capital growth while pursuing a low-carbon approach to reduce ESG-related risks and simultaneously emphasize exposure to green energy technology. Russell Investments spent time walking the client through the design of the strategy to understand if it would meet their needs, providing the required alignment of the investment portfolio with the Foundation’s fundamental objectives.

The sustainable multi-asset growth strategy

The strategy follows the underlying investment characteristics of our multi-asset solution with a significantly reduced carbon footprint, while enhancing the overall sustainability profile.

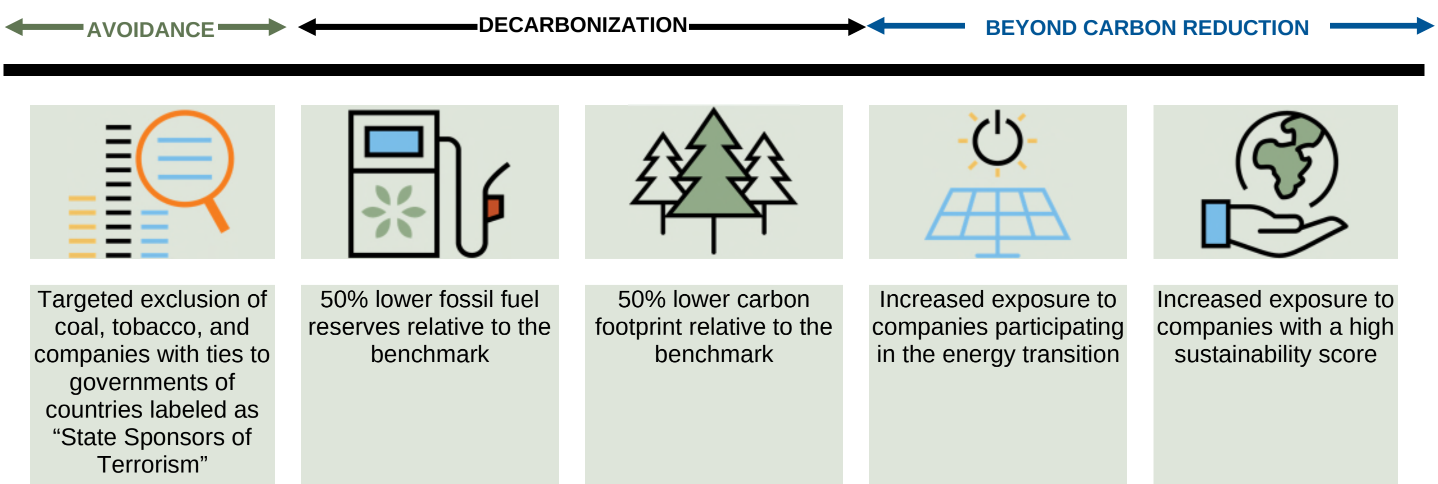
The strategy offers a diversified portfolio of global stocks, global real estate, global infrastructure, return-seeking fixed income, and opportunistic investments. The basis of the strategy is a dynamic mix of skilled third-party managers (selected by Russell Investments’ portfolio management team) combined with Russell Investments’ positioning strategies.

Exhibit 1: Strategic asset allocation[1]



As of March 31, 2021.

Exhibit 2: The strategy targets the following objectives without altering the underlying investment engine



The sustainable multi-asset growth strategy integrates the consideration of ESG risk factors at a higher level than other Russell Investments strategies. In particular, the strategy tilts the global equities allocation towards companies that are expected to contribute to, and benefit from, the transition to a low-carbon economy and away from companies with the greatest exposure to ESG-related risks. The strategy also excludes, from its equities and real assets allocations, companies with significant involvement in coal-related activities, such as thermal coal mining and power generation, which contribute disproportionately to climate change. In addition, the strategy excludes tobacco companies and companies with ties to governments of countries labeled as “State Sponsors of Terrorism” from the equities and real assets allocations.

What sets the sustainable multi-asset growth strategy apart from other strategies of its kind is that it builds on and refines the standard “decarbonization” approach. In the past, many responsible investing solutions focused on bluntly reducing exposure to carbon emissions and / or divestment from fossil fuel reserves within equity portfolios, via simple exclusionary screening. Russell Investments’ research has found that these approaches can backfire, unintentionally reducing exposure to renewable energy sources (as renewable energy production is correlated with high emissions) as well as adversely affecting the sustainability profile of a portfolio.[2] What this means is that a standard decarbonization approach could end up overlooking a firm that may currently have a higher carbon footprint, but is investing heavily in renewable energy and shows promise for greater sustainability in the future.

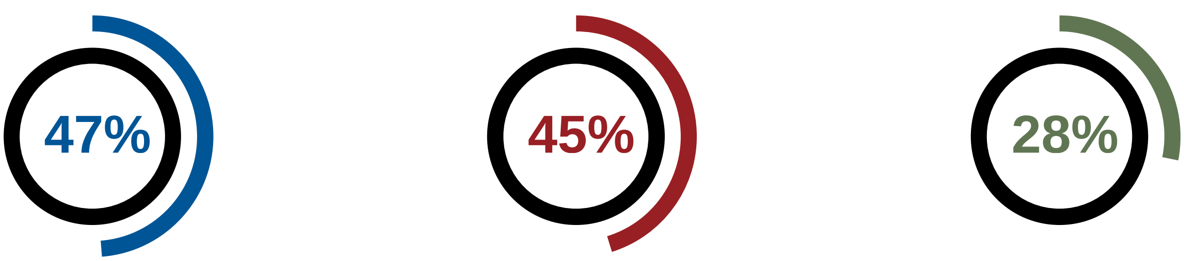
The sustainable multi-asset growth strategy avoids the pitfalls of traditional decarbonization by reducing carbon exposure while incorporating an additional consideration: It seeks to prevent unintentional reductions in exposure to those firms that may have a greater carbon footprint today, but are developing renewable energy sources and are on a trajectory for greater sustainability in the future. Russell Investments’ research also indicates that traditional ESG scores can often fall short of their stated goals, which points to the need for scoring metrics that discern which factors are truly “material” or relevant to a business’s sustainability outlook and future financial success, in order to become better predictors of long-term return potential. To that end, Russell Investments has developed a material ESG scoring tool that allows us to differentiate companies that score high on ESG issues that *are* financially material to their business, from those that score high on issues that are *not* financially material to their business. This helps us incorporate relevant, impactful ESG considerations into our clients’ portfolios and better enhance returns.

Impact

After an interactive discussion with the client, it was determined that the sustainable multi-asset growth strategy would be a good fit for the Foundation’s needs and expectations. Ultimately, the strategy helped the Foundation achieve its sustainability objectives without materially impacting returns. The strategy’s ESG impact demonstrated a marked improvement across several factors as compared to the MSCI ACWI Investable Market Index (IMI) 50% Hedged Net as seen in **Exhibit 3**.

Additionally, the subsequent performance outcome of this strategy has been aligned with expectations. Russell Investments believes that the long-term strategy to reduce absolute exposure to carbon reserves and emitters will be rewarded (vis-à-vis the broad market).

Exhibit 3: Strategy’s ESG impact demonstrated a marked improvement across several factors



Fossil Fuel Exposure
The strategy had a **46.75% lower fossil fuel exposure** than the MSCI ACWI IMI 50% Hedged

Carbon Footprint
The strategy had a **45.21% lower carbon footprint** than the MSCI ACWI IMI 50% Hedged

Green Energy Ratio
The strategy had a **28.19% higher green energy ratio** than the MSCI ACWI IMI 50% Hedged

Data of 3/31/2021

The benefits

By partnering with Russell Investments, the university was able to immediately reduce carbon exposure in its portfolio by 50% and significantly increase its holdings in companies that are likely to benefit from growth in green energy.

This helped the university make progress towards meeting its stakeholders' needs without adversely impacting the portfolio's return goals, balancing its desire to invest in sustainable strategies with the need to achieve market-aligned returns. The university valued Russell Investments' research and ESG investment processes. It was also pleased to be able to implement the sustainable multi-asset growth strategy with Russell Investments as it recognized that some other providers were not yet ready to launch such a solution. The Foundation looks forward to continuing its shift towards responsible investing, and the Foundation sees the potential for implementing additional ESG strategies focused on other asset classes, such as fixed income.

[1] Strategic allocations may vary based on tactical allocations made by the portfolio manager, which may allow the weightings of each asset class to take advantage of potential opportunities as market and economic conditions change.

[2] Steinbarth, Emily. (2019). "Decarbonization 2.0: A sustainable investing solution for the energy transition." Russell Investments Research.

With years of experience implementing ESG-related solutions for clients globally, Russell Investments is committed to deliver on a dual set of objectives, meeting both investment and ESG sustainability goals.

For more information

Call Russell Investments at **855-771-2966** or visit **Russellinvestments.com/InvestResponsibly**

Important information

This case study represents a unique situation faced by a public university foundation seeking to outsource its investment solution and reduce carbon exposure in the investment portfolio. Case studies are problem-solving stories. We select a situation that is indicative of problems clients in this category are facing. The recommendations described do not represent a standard strategy or set of recommendations made for all advisory clients with similar issues. Each client has unique requirements, challenges, and constraints, and our advisory solutions are tailored to each client's specific needs. Every client's situation, experience and needs are different, and Russell Investments does not imply that the solution herein is appropriate for any other client.

The case study provided is for illustrative purposes only and is meant to provide an example of a type of financial issue a client may have and our process and a methodology to address it. Individual client results will vary based on individual circumstances and market conditions. The results presented were based on a period of fluctuating marketing conditions and the underlying asset allocation, market criteria and assumptions, or the investment advice/strategy followed may have changed materially. There is no guarantee that all clients will experience the same results.

The information expressed herein represents the current, good faith views of the author(s) at the time of original publication and has not been updated. Any predictions, opinions, and other information contained in this material are subject to change continually, without notice.

Nothing contained in this material is intended to constitute legal, tax, securities or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted upon without obtaining specific legal, tax and investment advice from a licensed professional.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

First used: May 2021, Revised November 2022 AI-29488-11-25