CHANGEBRIDGE CAPITAL

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Industry Perspective:

The Sustainable Investing Revolution

Industry Perspective: Sustainable Investing

While some investing trends are transient, the emergence of *sustainable investing* is more indicative of a structural shift in the way investors allocate capital. The premise of this movement is simple - *the potential to benefit financially while doing good*. ***Through this lens, the old axiom "maximize value to shareholders" has been replaced by a more conscientious directive to "maximize value to all stakeholders."***

From an investor's perspective the consequences of this new edict cannot be underestimated. The foundational principle of an entire industry - a fixation upon *shareholder* returns - was examined and deep fissures were revealed. It is being modified (if not summarily replaced) by a new form of investing.

In this *Industry Perspective* the team at Changebridge highlights origins of sustainability, frames current considerations for investors, and offers a perspective on how this new form of *corporate consciousness* can be integrated into actively managed strategies.

A Sustainable Mindset

Entrenched in moral considerations, evidence of socially responsible investing goes back thousands of years[1]. Prehistoric people practiced *animism*, which meant they considered that all things had a living soul and spiritual power. Greek and Roman cultural studies reveal a relationship between beauty and the life-giving properties of nature. Ancient Egyptian culture was dependent on the fertility of the Nile. Buddhist teachings in Asia established a connection between the environment and societal progress – placing nature and not man at the center of the universe. Centuries later, theologian Thomas Aquinas traversed the complexities between individual freedom and our personal responsibility to do good. In 1759, Adam Smith, a moral philosopher and father of modern economics wrote in *The Theory of Moral Sentiments* that if governments neglect the protection of our livelihood and earth, the entire population suffers. New England transcendentalists in the 19th century advocated a liberal, self-reliant, and nature-oriented lifestyle.

Recent ESG Milestones
2004 - UN introduces the term "ESG" in a paper called "Who Cares Wins"
2006 - Introduction of the six principles for responsible investing (PRI)
2015 - Paris Agreement brings all nations to commit to climate goals
2016 - UN agrees on 17 sustainable development goals (SDGs)

If our pursuit of a harmonic relationship between personal desires and societal needs is innate, then the rapid incorporation of *Environmental, Social and Governance (ESG)* principles into the modern investing lexicon is even more astonishing. ***A recent convergence of societal demands, environmental imperatives, and economic incentives has fomented a revolution in investing.***

In 2020, flows into sustainable funds represented 24% of overall flows into U.S. stock and bond funds for the year. It was not so long ago that sustainable fund flows failed even to register above 1% of overall fund flows. Sustainable ETFs attracted about 7% of overall ETF flows for the year. While investors pulled $289 billion out of open-end funds for the year, sustainable open-end funds attracted $17.4 billion. Investors pulled money from U.S. equity, sector-equity, international-equity, and allocation funds in 2020, but added money to sustainable funds in each of those category groups[2].

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[1] https://deutschewealth.com/content/dam/deutschewealth/cio-perspectives/cio-special-assets/esg-yesterday-today-tomorrow---history-of-esg/CIO%20Special%20-%20ESG%20yesterday,%20today,%20tomorrow.pdf

[2] https://www.morningstar.com/articles/1019195/a-broken-record-flows-for-us-sustainable-funds-again-reach-new-heights

Types of Sustainable Investing

While there are important differences between "impact investing", "socially responsible investing", and "sustainable investing", collectively these disciplines serve to highlight gaps in modern finance and capitalism. Proponents of each strategy have chosen to expand their investment criteria beyond profits, also taking into consideration an investment's impact upon society[3].

Impact Investing – refers to investments intended to generate a measurable, beneficial social or environmental impact alongside financial return. Impact investments provide capital to address societal issues. The objective is to help a business or organization accomplish specific goals, such as a non-profit dedicated to the research and development of clean energy, regardless of whether financial success is guaranteed.

Socially Responsible Investing (SRI) – encompasses investment strategies which seek to consider both financial return and social/environmental good. These strategies actively eliminate investments according to ethical guidelines. The underlying motive could be religion, personal values, or political beliefs. SRI uses ESG factors to apply screens on the investment universe, for example avoiding investments in controversial businesses or allocating towards investments that contribute to charitable causes.

ESG & Sustainable Investing – investing in consideration of environmental, social, and governance practices can be used to enhance traditional financial analysis by identifying potential risks and opportunities beyond technical valuations. There is an overlay of social consciousness, but the main objective of ESG and Sustainable investing remains financial performance.

Profits & Purpose

It seems reasonable to question if investors would embrace the tenants of "stakeholder capitalism" so enthusiastically without a correlation to risk-adjusted returns.

A growing body of evidence indicates that the pursuits of profits and purpose are not mutually exclusive. Morningstar noted that 2020 was a good year for sustainable investments. The better relative performance of sustainable funds was tied to their focus on companies with better ESG profiles and their alignment with the transition to a low-carbon economy. In 2020, sustainable funds demonstrated that investing with an emphasis on how a company manages material ESG risks and how it manages key stakeholders can produce good returns in an uncertain economic environment.[4]

A full 60% of investors now say that sustainability considerations play a 'major role' in manager selection, with large institutions and European investors continuing to lead the way. This figure has risen from 41% in 2018[5]. A recently released meta-study by NYU Stern, in partnership with Rockefeller Asset Management, examined the relationship between ESG activities at organizations and their financial performance in more than 1,000 research papers from 2015-20. *Amongst the studies key takeaways were improved financial performance over longer time horizons, ESG integration as an investment strategy performing better than negative screening approaches, ESG investing providing downside protection (especially during a social or economic crisis), and evidence that sustainability initiatives at corporations may improve risk management and innovation[6].*

[3] https://www.investopedia.com/financial-advisor/esg-sri-impact-investing-explaining-difference-clients/

[4] https://www.morningstar.com/articles/1017056/sustainable-equity-funds-outperform-traditional-peers-in-2020

[5] https://www.institutionalassetmanager.co.uk/2021/02/08/295576/asset-owners-say-esg-expectations-now-play-major-role-manager-selection

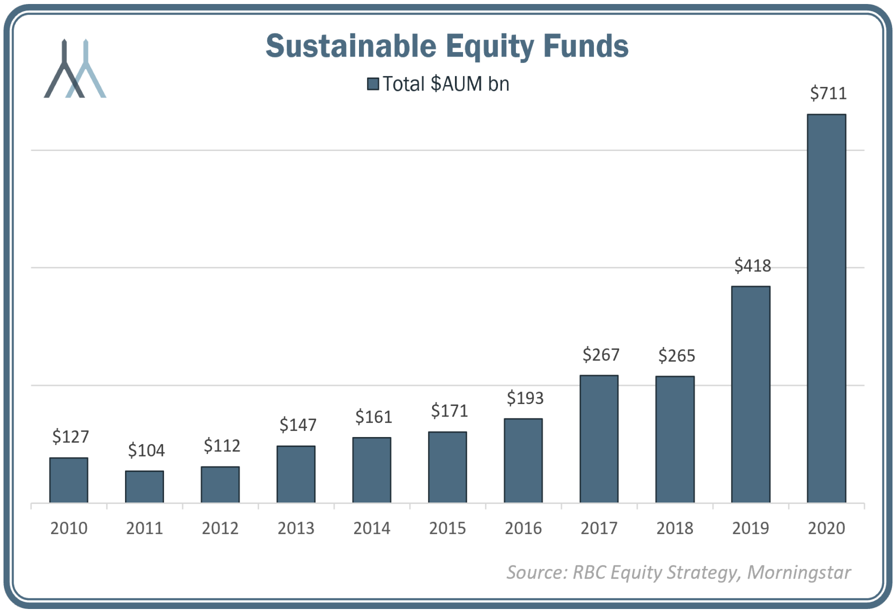
[6] https://www.stern.nyu.edu/sites/default/files/assets/documents/NYU-RAM_ESG-Paper_2021%20Rev_0.pdf

Quantifiable Concerns

While strategies predicated on quantifiable ESG data are prevalent, they may have inherent flaws worthy of our understanding. Many of the ESG strategies available in the marketplace today are predicated on two primary considerations; 1) Is ESG data structured and accessible? And 2) Where do these companies (with structured ESG data) rank in relation to each other?

Minding the Gap

The origins of ESG data collection date back to the early 1990's, based on a recognition that conventional financial data did not measure the full cost or benefit of a company's interaction with society and the environment. Early attempts to measure "intangible value" by the likes of *MSCI ESG* and *Sustainalytics* presaged decades of additional data collection by an array of service providers, spanning Environmental, Societal and Governance paradigms.



Despite these efforts, 84% of investors say that obtaining consistent ESG reporting across asset managers and asset classes is challenging, with 55% calling this a "major challenge."[7]

As different regulations continue to emerge around ESG matters, regional fragmentation is increasing along lines of methodology and transparency. *ESG data is simply not available for many of the small- and mid-sized companies that investors should be taking into consideration. This is because much of the available data is obtained from companies that have the scale, resources, and incentives to provide structured ESG metrics. Compounding this self-reporting bias, the data-aggregators are prioritizing their efforts upon the same, larger companies.*

The result is a coverage "blind spot" for ESG investors. The mere presence of formattable data becomes a relative advantage (regardless of what the data reveals) leaving many investment opportunities out of the discussion. This is akin to ESG investors exclusively searching for a lost set of car keys *"under the streetlight, because the light is much better here."*[8]

A Question of Integrity

The second issue regarding quantitatively based ESG investing is the inconclusive nature of the data itself. The mere suggestion that a set of scores and numeric rankings can accurately reflect a company's overall impact to the *environment*, *society* and its commitment to *governance* does not strike the team at Changebridge as a particularly credible assertion.

> *"Everything that can be counted does not necessarily count; everything that counts cannot necessarily be counted."*
>
> \- Albert Einstein

While ESG factors translated into financial ratios and quantitative inputs can help investors make reasonable assumptions, the process stands to benefit from a fundamental, humanistic approach to evaluating the tradeoffs that all businesses make between their obligation to shareholders, employees, customers, and the environment.

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[7] https://www.institutionalassetmanager.co.uk/2021/02/08/295576/asset-owners-say-esg-expectations-now-play-major-role-manager-selection

[8] https://en.wikipedia.org/wiki/Streetlight_effect

Fundamentally Sustainable

Across the investment process, the Changebridge team applies a distinct form of ***"quantamental"*** research. Meaning, the team aims to combine *quantitative tools* (to reveal areas of inefficiency) with *fundamental analysis* (to achieve a deeper understanding before making portfolio decisions) across the three stages of ***idea generation***, ***valuation analysis***, *and* in the process of making company-level ***sustainability assessments***.

By applying this quantamental approach to the team's sustainability efforts, Changebridge can attempt to analyze a broader set of companies *(not beholden to the self-reporters)* and the team can aim to achieve a more holistic view of a company *(less vulnerable to statistical biases*) when making its sustainability assessment. *If a company garners high ESG attributes alongside strong financial characteristics, it can become a more suitable investment candidate for the team to consider.*

Motivations to include a "sustainability assessment" into the investment process are myriad. Implicitly, the team feels compelled to *affirmatively* answer the question that all asset managers should be addressing regarding their role in advancing sustainability topics. At Changebridge, engaging with management teams on ESG matters, establishing expectations, monitoring progress, and voting on behalf of shareholders along the lines of ESG considerations all feel like preconditions for a truly modern asset management philosophy.

Investing in businesses that achieve a high sustainability assessment from the team, but not yet recognized in the broader market can reveal a path to superior risk-adjusted returns. As MSCI concluded in their 2018 research paper, "Enhancing Economic Value with ESG," companies with higher ESG ratings had higher average ROIC and were valued at a premium compared to companies with lower ESG ratings[9].

Within Changebridge's two actively managed strategies, the **Long/Short Equity ETF (CBLS)** and the long-only **Sustainable Equity ETF (CBSE)**, investors often observe portfolio holdings that differ materially from the most prevalent ESG portfolios and indices. The team consciously seeks to garner insights that would be difficult to capture from a purely quantitative perspective.

Changebridge is not looking under the same streetlight at the same set of factors as other ESG investors. The team analyzes opportunities in areas of the market that are less visible, which require the application of fundamental analysis and judgement. The team believes this level of diligence can be rewarding for investors – and a range of stakeholders.

Investors interested in learning more about Changebridge Capital's actively managed ETFs (CBLS and CBSE) can find information on the funds at www.changebridgefunds.com.

[9] https://www.msci.com/www/research-paper/enhancing-economic-value-with/0958602799

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Investors should consider the investment objectives, risks, charges, and expenses of the funds carefully before investing. This and other information are contained in the Fund's prospectus, which may be obtained by visiting www.changebridgefunds. com or by calling 617-717-2912. Please read the prospectus carefully before you invest. Past performance does not guarantee future results.

Investing involves risk. Principal loss is possible. As an ETF, the funds may trade at a premium or discount to NAV. Shares of any ETF are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Market Returns are based upon the midpoint of the bid/ask spread at 4:00 p.m. Eastern Time, when the NAV is normally calculated for ETFs. Your return may differ if you trade shares at other times. The equity securities held in the Funds' portfolio may experience sudden, unpredictable drops in value or long periods of decline in value. This may occur because of factors that affect securities markets generally or factors affecting specific issuers, industries, or sectors in which the Funds invest. The Funds are considered to be non-diversified, which means that they may invest more of their assets in the securities of a single issuer or a smaller number of issuers than if they were diversified funds. As a result, the Funds may be more exposed to the risks associated with and developments affecting an individual issuer or a smaller number of issuers than funds that invest more widely. This may increase the Funds' volatility and cause the performance of a relatively smaller number of issuers to have a greater impact on Fund performance.

Applying ESG criteria to the investment process may exclude securities of certain issuers for non-investment reasons and therefore the Funds may forgo some market opportunities available to funds that do not use ESG criteria.
Short selling is an investment strategy utilized in CBLS, which involves the sale of securities borrowed from a third party. The short seller profits if the borrowed security's price declines. If a shorted security increases in value, a higher price must be paid to buy the stock back to cover the short sale, resulting in a loss. The Fund may incur expenses related to short selling, including compensation, interest or dividends, and transaction costs payable to the security lender, whether the price of the shorted security increases or decreases. The amount the Fund could lose on a short sale is theoretically unlimited. Short selling also involves counterparty risk – the risk associated with the third-party ceasing operations or failing to sell the security back.

The Funds are new with a limited operating history.

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