Morgan Stanley

INSTITUTE FOR SUSTAINABLE INVESTING

Sustainable Signals:

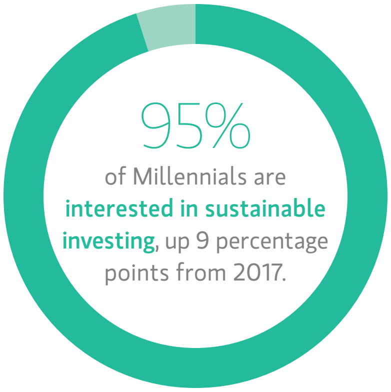
Individual Investor Interest Driven by Impact, Conviction and Choice

Executive Summary

Sustainable investing continues to make gains. Investor familiarity and enthusiasm is at an all-time high. More than 8 in 10 U.S. individual investors (85%) now express interest in sustainable investing, while half take part in at least one sustainable investing activity. As the market matures, reaching $12 trillion in the United States alone,[1] individual investors are also driving innovation. Increasingly proactive, they seek products and solutions across asset classes tailored to their interests. They also want to measure the environmental and social impact of their investments.

These are among the key findings of Morgan Stanley's third Sustainable Signals survey of individual investors, which reinforces a picture of a field coming into its own since 2015.

Among individual investors:



Key Insights

Our findings reveal four central themes and provide important insights for investment professionals seeking to satisfy today's increasingly sophisticated and proactive sustainable investor:

1

Investor interest and adoption continues to rise.

Interest in sustainable investing reached new heights for the second consecutive time in our survey of individual investors. Eighty-five percent of the general population and 95% of Millennials now express interest in sustainable investing. This trend also extends to adoption, with 52% of the general population and 67% of Millennials taking part in at least one sustainable investing activity. Not all interest looks the same, however. Investment professionals can help narrow the gap between interest and adoption by developing products and solutions that address investors' increasingly diverse attitudes and preferences.

85%
are interested in sustainable investing.

2

Investors want products that match their interests.

With nearly all respondents interested in sustainable investing, more individual investors seek products that target specific impact areas. Overall, 84% of respondents wanted the ability to tailor their investments to their values, up four percentage points from 2017, and rising to 90% among Millennials. A new question for our 2019 survey also found strong interest among investors for tracking the impact return on their investments. Eighty-four percent wanted an impact report, rising to 91% among Millennials. This sends a strong signal to investment professionals seeking to attract and retain the most committed cohort of individual investors.

84%
want the ability to tailor their investments.

3

Investor conviction outweighs financial trade-off concerns.

More than 8 in 10 individual investors (86%) believe that corporate ESG practices can potentially lead to higher profitability and may be better long-term investments, and 88% believe that it is possible to balance financial gains with a focus on social and environmental impact. Nevertheless, perceptions of trade-offs linger, with 64% agreeing that investors must choose between financial gains and sustainability. This suggests investment professionals can further boost adoption with improved investor education that dispels trade-off myths.

86%
believe companies embracing ESG practices may potentially be more profitable and may be better long-term investments.

4

Investors want more product choices.

The range of sustainable investing products and solutions currently available has not kept pace with investor demand. Two-thirds of respondents (65%) cited lack of available financial products as a barrier to adopting sustainable investing. Public equity was the only asset class that a majority of respondents could identify as having quality sustainable investing strategies. Soaring interest in sustainable 401(k) plans has outpaced perceptions of availability by a factor of two. While many asset management firms are expanding sustainable investing solutions,[2] our findings suggest more is needed to meet investor demand.

65%
cited lack of available financial products as a barrier to including sustainable investing in their portfolios.

Methodology

The Morgan Stanley Institute for Sustainable Investing produced this third edition of our Sustainable Signals individual investor survey to further build the body of insight and analysis on the growth of sustainable investing among individual investors. Brunswick Insight collected data through a 57-question online survey conducted February 7-14, 2019. The sample size was 800 U.S. individual investors with minimum investable assets of $100,000. The survey also included an oversample of 200 Millennials, aged 18-37.

DEFINITIONS

INVESTABLE ASSETS: Investments other than those in retirement accounts, 401(k) plans or personal real estate.

SUSTAINABLE INVESTING: The practice of investing in companies or funds that aim to achieve market-rate financial returns while pursuing positive social and/or environmental impact.

ACTIVE INDIVIDUAL INVESTORS: Individuals that make most or all investment decisions themselves, or with support from a financial advisor or family member.

Key Finding 1: Investor Interest and Adoption Continues to Rise

Results from the third Morgan Stanley Institute for Sustainable Investing survey of individual investors reaffirm that sustainable investing has entered the mainstream. Both interest and adoption of sustainable investing continue their steady climb, further emphasizing that sustainable investing is here to stay. While the gap between interest and adoption persists, it also signals opportunities for investment professionals as sustainable investing matures and grows more sophisticated.

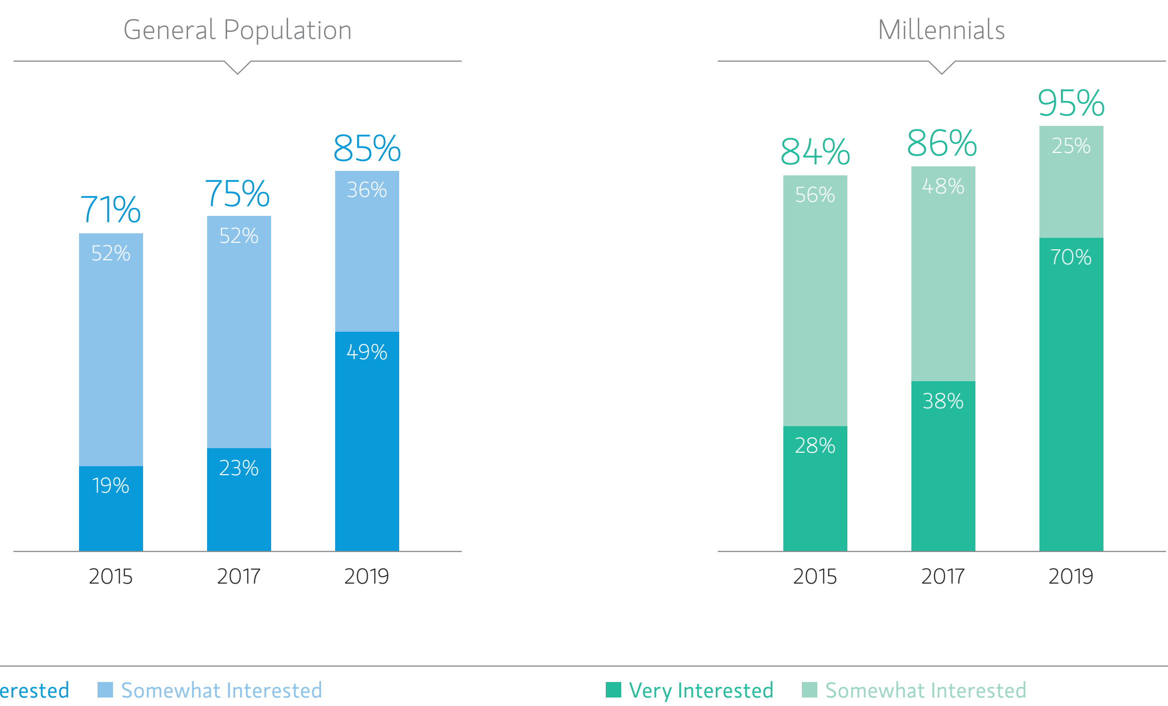
Our latest poll supports a steady upward trend in sustainable investing (Figure 1). Eighty-five percent of the general population of individual investors and 95% of Millennials expressed interest in sustainable investing, rising 10 percentage points and nine percentage points respectively since 2017. The gap between men and women interested in sustainable investing has all but disappeared, dropping from 17 percentage points in 2017 to three in 2019. The increase in respondents who are "very interested" in sustainable investing is perhaps the most pronounced change between 2017 and 2019, growing 26 percentage points among the general population and 32 percentage points among Millennials. Across all respondents, a positive feedback loop, where growing interest in sustainable investing triggers greater adoption, is underway.

With a majority of the general population (52%) and two-thirds of Millennials (67%) now adopting at least one sustainable investing activity (Figure 4), the trend reveals attitudes and preferences that will drive the market's future and help close the gap between interest and adoption.

Interest in Sustainable Investing Jumps in 2019

FIGURE 1

How interested are you in sustainable investing (also known as impact investing) which is the practice of making investments in companies or funds which aim to achieve market-rate financial returns while pursuing positive social and/or environmental impact?



Key Finding 2:
Investors Want Products That Match Their Interests

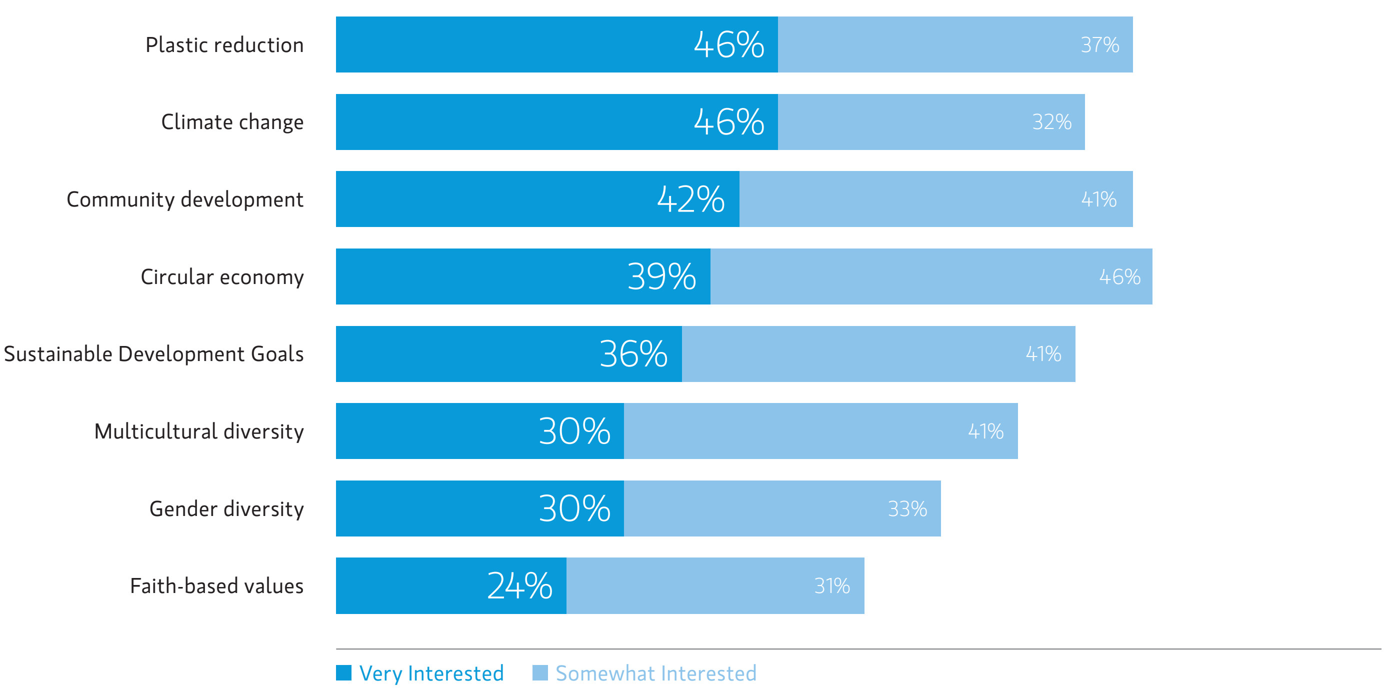
People's values and interests help draw them to sustainable investing, with a younger generation that strongly believes their investment decisions can make an impact. Among all investors polled, 84% expressed interest in products that enable them to bring their investments in closer alignment with the issues they care about most. Among Millennials, 90% sought greater opportunity to tailor their investment impact. Investors also showed a strong desire to measure social and environmental impact alongside financial results. More than 8 in 10 (84%) indicated they would welcome an impact report charting their portfolio's progress against social and environmental themes.

Driving this desire for products tailored to individual interests is a growing sense of agency among investors. Overall, 71% agreed that their investment decisions can influence climate change, up 17 percentage points from 2017. That figure rises to 85% among Millennials, 44% of whom believed this strongly. Even more respondents, 84% among the general population and 89% among Millennials, agreed their investments could lift people out of poverty through economic growth (Figure 3). These beliefs align closely with the sustainability themes respondents expressed the most interest in addressing through their portfolios. Forty-six percent were "very interested" in plastic reduction and climate change and 42% were "very interested" in community development (Figure 2).

Respondents Showed Most Passionate Interest in Targeting Plastic Reduction and Climate Change Through Sustainable Investing

FIGURE 2

Below are different types of sustainable investing and impact investment themes. For each one, please indicate how interested you would be in including it in your investment portfolio, assuming that each investment would achieve similar market-rate financial returns.



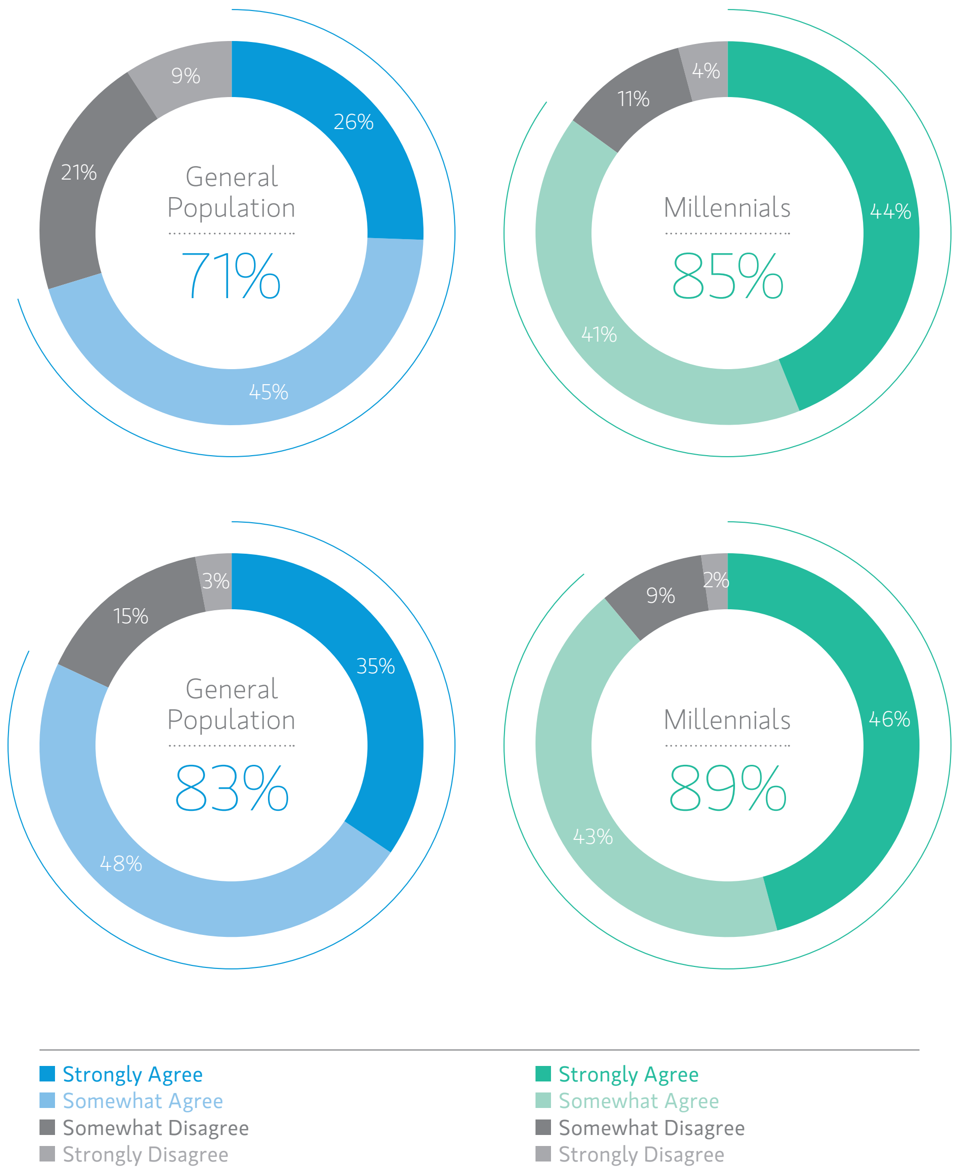
Investors Believe They Can Affect Change Through Their Investment Decisions

FIGURE 3

Please indicate if you agree or disagree with each of the statements below.

It is possible for my investment decisions to **influence the amount of climate change caused by human activities**.

It is possible for my investment decisions to **create economic growth that lifts people out of poverty**.



Respondents' desire for tailored solutions raises both opportunities and challenges for the asset management field. While more sustainable investing products are being developed than ever before, our fourth key finding (see page 11) suggests that some investors continue to struggle to find alignment with their personal priorities, and refrain from sustainable investing as a result. However, the industry appears to be anticipating and acting on this bottleneck. In a 2018 survey of 300 U.S. asset managers, conducted by Morgan Stanley's Institute for Sustainable Investing, 68% said their firms expected high growth from customized sustainable investing solutions and were allocating resources accordingly.[3]

A Virtuous Cycle: Consumer Behavior and Investor Action

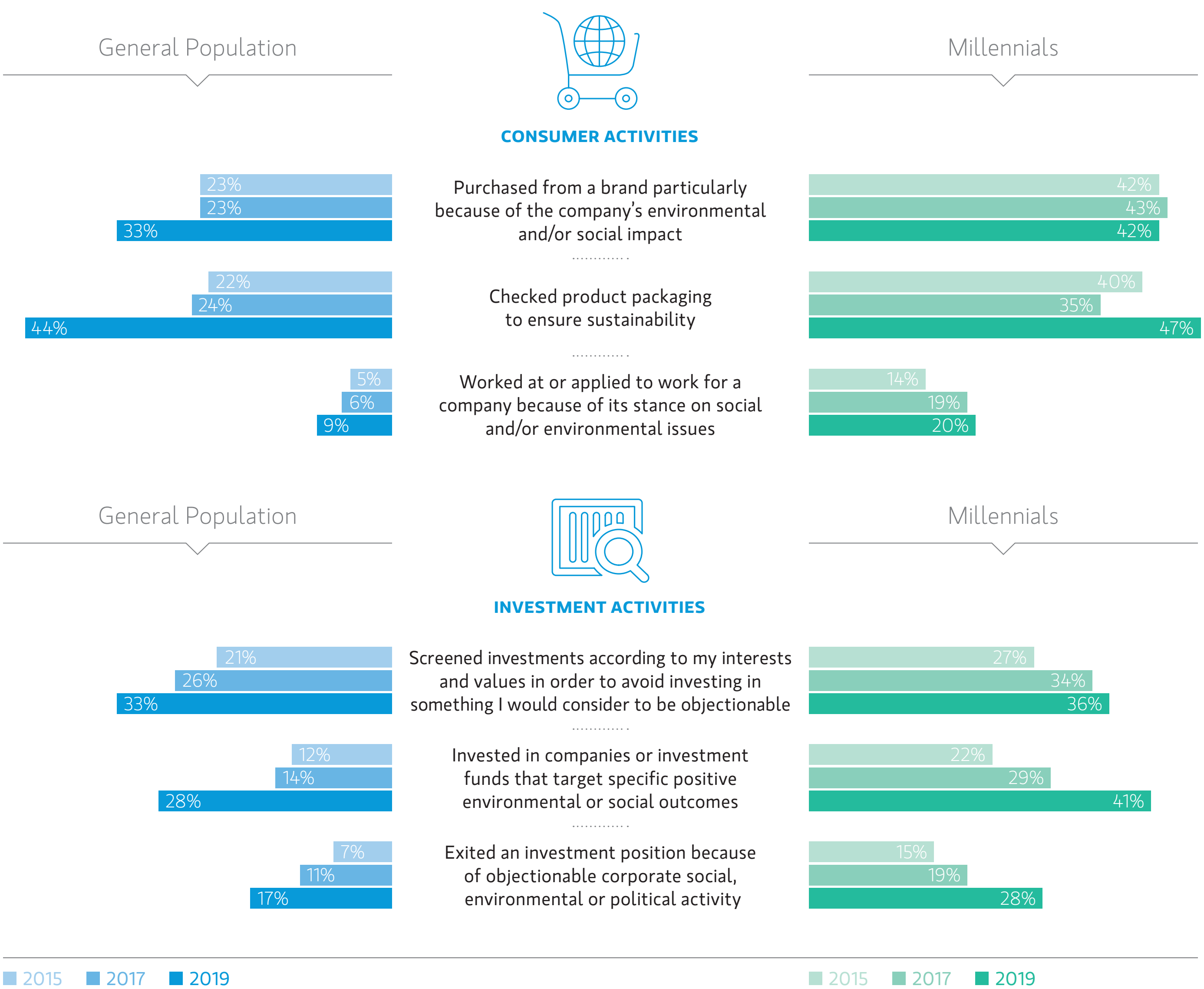
Our individual investor survey also revealed a growing connection between individuals' behavior as consumers and investors (Figure 4). For example, 44% of respondents reported checking product packaging to ensure its sustainability while 33% reported both buying from a brand because of its social or environmental record and screening their investments in line with their values. Behaviors also aligned on specific sustainability issues. Among respondents who reported checking product packaging over the past year, half (49%) expressed interest in reducing plastic through their investments. Fifty-two percent of the general population and 67 percent of Millennials have adopted at least one of the three sustainable investing activities listed in Figure 4, with a marked increase in investors making investments that target specific environmental or social outcomes, rising 14 percentage points among the general population and 12 percentage points among Millennials.

Among Millennials, values also carry over to career choices, with 20% reporting that they worked at, or applied to, a company because of its stance on social and/or environmental issues.

Consumer and Investor Behaviors Complement Each Other

FIGURE 4

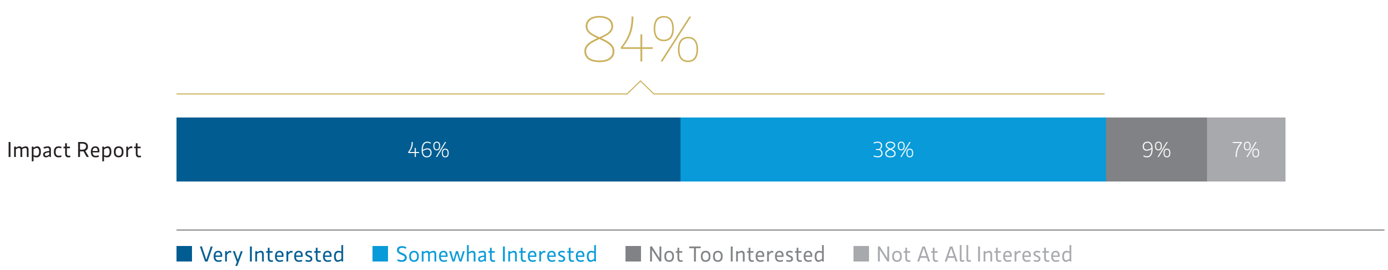
Please indicate if you have done the following in the past 12 months.



Investors Show Strong Interest in Understanding the Impact of Their Investments

FIGURE 5

How interested would you be in receiving a report on the impact generated by a sustainable investment portfolio?



Investors Seek to Measure Their Impact

Investors' growing belief that their dollars can make a difference goes hand in hand with a desire to measure their impact. Eighty-four percent of respondents expressed interest in an impact report that tracks social and environmental return on their sustainable investments (Figure 5). These results suggest that the industry's ability to define, measure and track nonfinancial impact will be critical in the evolution of sustainable investing and its rapid growth. Developing offerings like impact reports that accommodate individual investors' interests can help close the gap between interest in sustainable investing (85%) and adoption of sustainable investing activities (52%).

Millennials were the strongest supporters of transparency around impact reporting, with 91% interested in an impact report. This desire to understand the impact of their investment choices sends a strong signal to investment professionals seeking to attract and retain the most passionate cohort of individual investors.

91%

of Millennial respondents expressed interest in an impact report that tracks social and environmental return on their sustainable investments.

In our 2018 survey, "Sustainable Signals: Growth and Opportunity in Asset Management," asset managers acknowledged that clients are asking more frequent and sophisticated questions about impact outcomes and data. They also cited the need for better data on sustainability impact to address clients' interests and spur future growth. Seven in ten, however, expressed concern that the industry currently lacks standard metrics to measure nonfinancial performance, hindering their ability to quantify impact for clients. Given the clear desire for transparency from individual investors, this suggests a pressing need for a collective industry effort to improve the tracking and reporting of sustainable investing impact.[4]

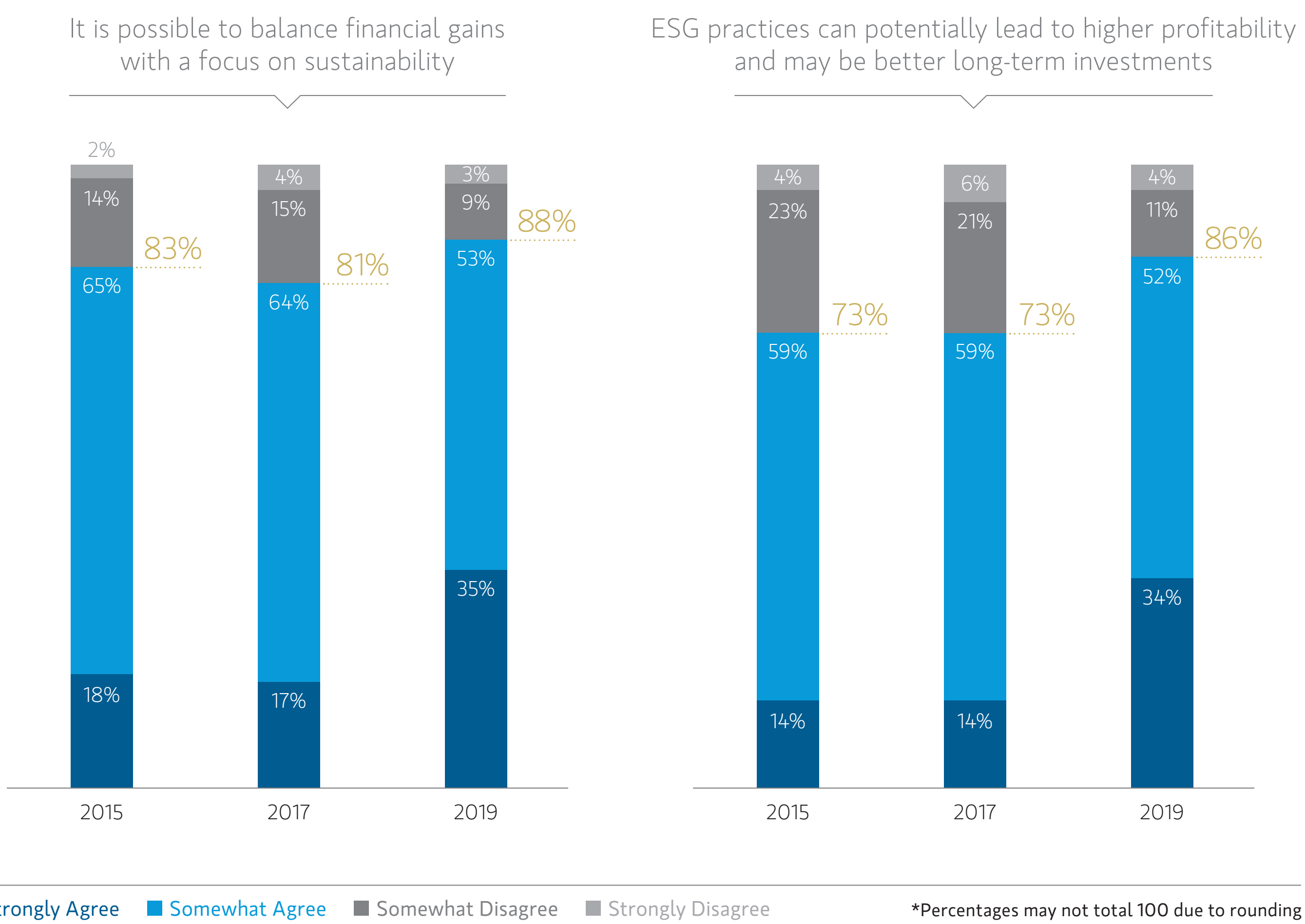
Key Finding 3: Investor Conviction Outweighs Financial Trade-Off Concerns

The mainstream adoption of sustainable investing reflects growing investor confidence that they can generate impact alongside financial returns. In our poll, almost 9 in 10 respondents (88%) agreed it was possible to balance financial gains with a focus on social and environmental impact. Almost as many (86%) believed that companies embracing ESG practices may potentially be more profitable and may be better long-term investments—up markedly from 73% in 2017 (Figure 6). While perceptions of financial trade-offs also strengthened (64%), investors' belief in sustainable investing's long-term benefits clearly outweighs their doubts. This suggests a tipping point in attitudes that investment professionals could leverage to tackle trade-off myths and further boost adoption.

Investors Believe in Potential Profitability of Sustainability

FIGURE 6

*Please indicate if you agree or disagree with each of the statements below.**

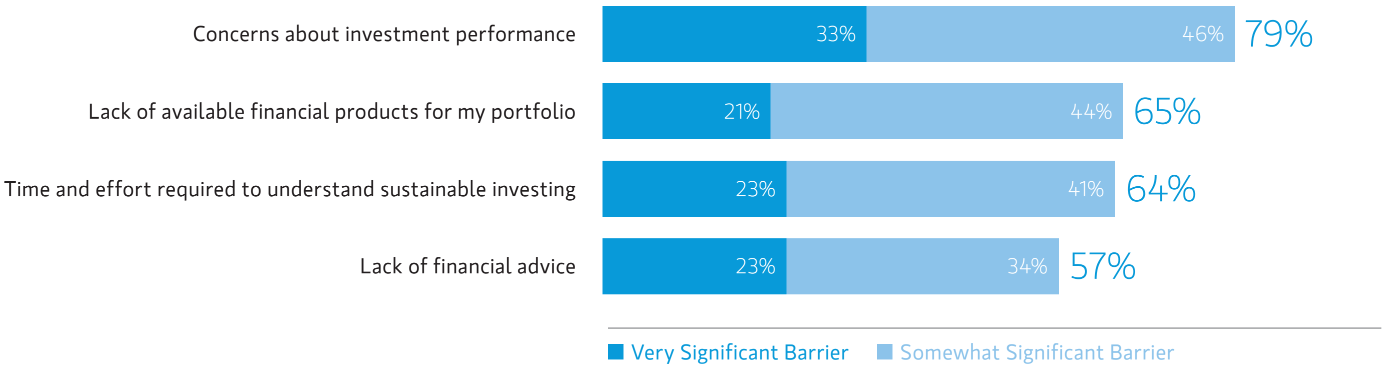


*Percentages may not total 100 due to rounding

Barriers to Adoption Identify Opportunities for Growth

FIGURE 7

How significant are the following as barriers to including sustainable investing in your portfolio?

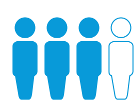


Millennials Raise Trade-Off and Complexity Concerns

Despite this positive picture, the industry still has work to do to convince skeptical investors that investing for social and environmental impact does not necessarily entail financial sacrifice. Somewhat surprisingly, given the rise in sustainable investing uptake between our 2017 and 2019 surveys, the percentage agreeing that "investors must choose between financial gains and sustainability" also rose—from 54% in 2015 and 2017 to 64% in 2019. Millennials were the most skeptical, with 77% believing the trade-off theory, up from 54% in 2017, despite their outsized interest in sustainable investing at 95%.

While this skepticism has not dissuaded 85% of respondents from expressing interest in sustainable investing and 52% from adopting sustainable investing activities, its persistence is a potential drag on industry growth. Seventy-nine percent of surveyed investors cited "concerns about investment performance" as a barrier to adopting sustainable investing (Figure 7). These concerns persist despite studies that show they are unfounded. Morgan Stanley's Institute for Sustainable Investing compared the performance of sustainable funds and traditional funds from 2004-2018 in "Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds." The analysis found that sustainable funds "provided returns in line with comparable traditional funds while reducing downside risk." It also found strong statistical evidence that during a recent period of extreme volatility, sustainable funds were more stable.[5] One factor that could help explain this persistence is the field's perceived complexity. In our survey, 3 in 4 Millennials (74%) cited the time and effort required to understand sustainable investing as a barrier to integrating such products into their portfolio. For financial advisors and asset managers, this sends a clear message that work remains to address investor concern about performance.

Our 2018 survey of asset managers suggests the industry is moving to better educate, inform and support current and would-be sustainable investors. Nine in ten respondents reported that their firms will devote more resources to the topic in the next one to two years, through efforts including employee training (41%), more dedicated time from generalists (36%) and specialist hires (34%).[6]



In our survey, **3 in 4 (74%) Millennials** cited the time and effort required to understand sustainable investing as a barrier to integrating such products into their portfolio.

Key Finding 4: Investors Want More Product Choices

As sustainable investing matures, increasingly sophisticated investors are diversifying their investments by looking for more offerings across a wider set of asset classes. Our survey makes clear that the range of products and solutions currently available has not kept pace with investor demand. Two-thirds of the general population (65%) and three-quarters of Millennials (73%) cited lack of available financial products as a barrier for including sustainable investing in their portfolios. Public equity was the only asset class that a majority of respondents identified as having quality sustainable investing strategies. This perceived lack of quality products across other asset classes could have implications for building and maintaining a portfolio of diversified sustainable investments.

Our survey findings highlighted thus far shed light on the ways in which demand for sustainable investing is outpacing supply. Investors seek solutions that match their interests, have measurable social and environmental impacts and deliver strong financial performance alongside societal benefits. The shortfall in financial products that meet these needs may help explain the gap between investors' stated interest in sustainable investing (85%) and their level of adoption (52%). While the asset management industry has expanded sustainable investing solutions, our findings suggest firms are not doing so fast or far enough to match interest and satisfy proactive investors looking for quality products.

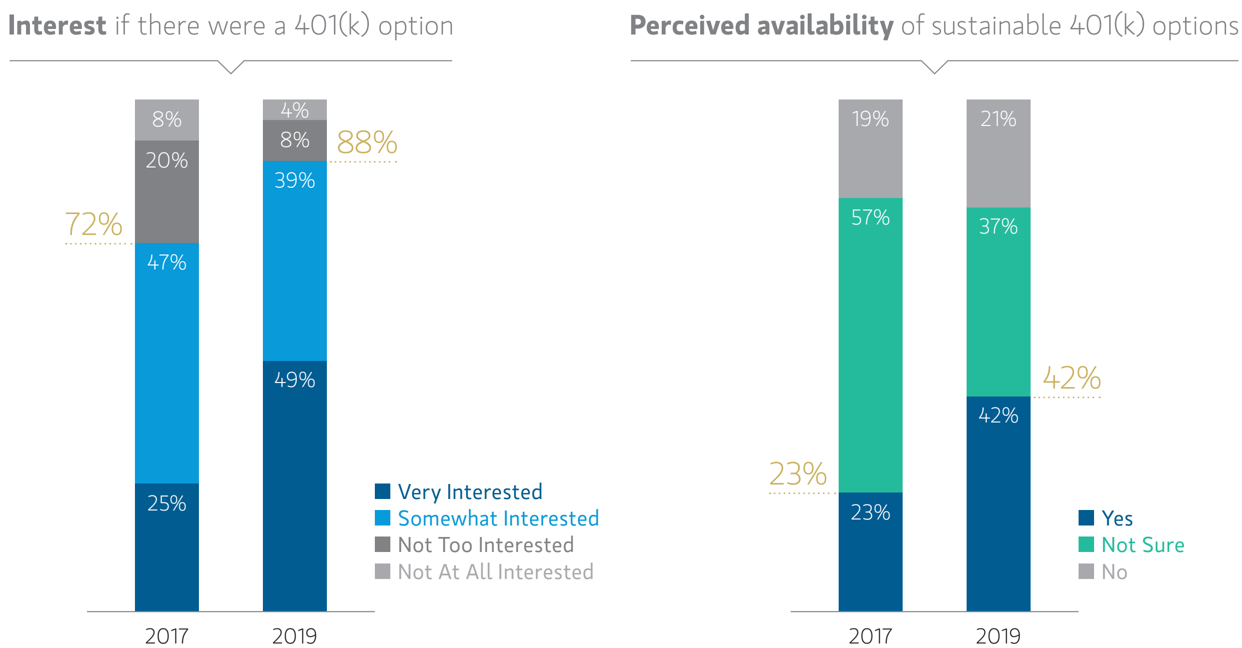
Retirement Funds Bottleneck

Retirement funds offer a case in point on the supply and demand bottleneck. For many individual investors, employer-sponsored defined contribution (DC) plans like 401(k)s represent a significant portion of their investments. As of March 2019, 401(k) plans accounted for nearly $5.7 trillion of U.S. households' financial assets.[7] Among survey respondents with access to 401(k) plans, interest in sustainable 401(k) options jumped 16 percentage points between 2017 and 2019, to 88% (Figure 8). Availability of such options in their retirement funds, according to investors' best knowledge, fell short of this demand—with only 42% aware of such options, 37% unsure and 21% reporting

Demand for Sustainable 401(k) Options Outpacing Supply

FIGURE 8

*How interested would you be in pursuing sustainable and impact investments if they were an option in your 401(k)? To the best of your knowledge, does your 401(k) currently offer sustainable and impact investments as an option?**



*Percentages may not total 100 due to rounding that sustainable investing options were unavailable. These gaps suggest an important role for retirement consultants in working to increase both availability of sustainable 401(k) options and investor knowledge of their options.

Expanding Product Choice

Surging demand should give asset managers and financial advisors the confidence to develop new sustainable investing solutions that help address availability limitations and eliminate the supply bottleneck. A plethora of new ESG-tailored investment vehicles are already in the pipeline and will provide eager investors with expanded choice. In our asset managers survey, 62% of respondents' firms offer mutual funds that integrate sustainability or ESG considerations, followed by alternatives (55%), exchange-traded funds (51%) and separately managed accounts (45%). Sixty-three percent employ more than one sustainable investing strategy across shareholder engagement, restriction screening, ESG integration, thematic investing and impact investing.[8]

To address the other barriers cited in our investor survey, including the lack or complexity of information on ESG investment vehicles, financial advisors should proactively support clients in understanding the products currently available. Financial advisors can also help bridge the gap between interest and adoption by helping clients identify quality sustainable investing solutions that match their interests.

Conclusion

Our survey confirms that sustainable investing is now part of mainstream financial strategy. Given the record adoption rates and interest levels the poll reveals, the question is no longer whether sustainable investing is here to stay, but what are the opportunities and challenges for further growth? On both fronts, our findings send strong signals from investors to help guide the field's evolution.

As understanding of sustainable investing approaches deepens, large majorities of investors are seeking more product options across investment vehicles. They want to tailor their investing to specific issues ranging from plastic reduction to climate change and gender diversity, and to measure impact against these themes.

This is all positive news for the industry, reflecting increasing investor engagement and sophistication. The challenge is to keep pace with demand for new and improved products and solutions in order to maintain momentum and enthusiasm, and reduce barriers to continued growth. Asset managers and financial advisors also need to invest more time and resources in addressing persistent perceptions—not borne out by the evidence—that sustainable investing requires a financial trade-off.

Our Sustainable Signals survey of asset managers, conducted in 2018, suggests that the industry and individual investors are headed in the same direction. Asset management firms are devoting more resources to sustainable investing, expanding such options across product types and asset classes, and building their in-house skills and capabilities. The views of investors captured in this survey suggest the industry may need to double down on this approach to catch up with its clientele.

Notes

1 "Report on US Sustainable, Responsible and Impact Investing Trends," The US SIF Foundation, 2018 (https://www.ussif.org/files/Trends/Trends%202018%20executive%20summary%20FINAL.pdf; accessed on April 1, 2019).

2 "Sustainable Signals: Growth and Opportunity in Asset Management," Morgan Stanley, 2019.

3 Ibid.

4 Ibid.

5 "Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds," Morgan Stanley, 2019.

6 "Sustainable Signals: Growth and Opportunity in Asset Management," Morgan Stanley, 2019.

7 "Retirement Assets Total $29.1 Trillion in First Quarter 2019," Investment Company Institute, 2019 (https://www.ici.org/research/stats/retirement/ret_19_q1; accessed on June 14, 2019).

8 "Sustainable Signals: Growth and Opportunity in Asset Management," Morgan Stanley, 2019.

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CRC 2620890 09/2019