Morgan Stanley

INSTITUTE FOR SUSTAINABLE INVESTING

Sustainable Signals

New Data from the Individual Investor

Executive Summary

Two years after the inaugural Morgan Stanley Institute for Sustainable Investing survey of individual investors, the picture of sustainable investing in the United States is stronger than ever. The 2015 survey delivered much-needed clarity on an evolving landscape.[1] The 1,000 total individual investors polled in 2017 followed up on that evolution, and offered ample evidence that sustainable investing was entering the mainstream. Among survey participants, three-quarters reported an interest in sustainable investing. Millennial investors continue to lead the charge. They are twice as likely as the overall pool to invest in companies or funds that target social or environmental outcomes.

The results of the 2017 survey show that awareness and interest in sustainable investing have climbed steadily, as has the percentage of individual investors who have integrated sustainability into their investment decisions.

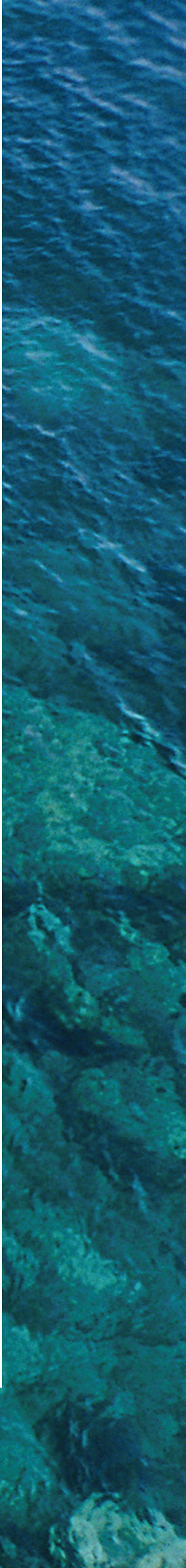
Indeed, U.S. sustainable, responsible and impact investing spiked between 2014 and 2016, growing at a rate of more than 33%, bringing it from $6.57 trillion to $8.72 trillion.[2]

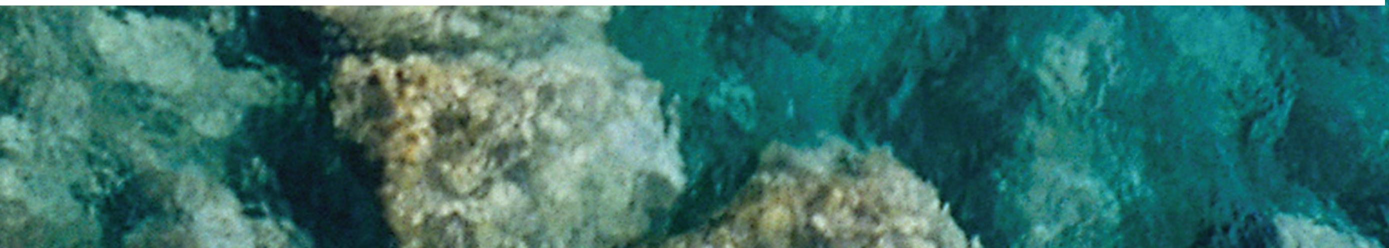
What's more, investors have sharpened their interest in customizing investments to their own social and environmental priorities. Broad, one-size-fits-all approaches held less appeal than those that could be tailored to personal preferences. And investors, particularly Millennials, believe that their investment decisions can influence the issues they care about.

Perceptions of a trade-off between sustainable investing and financial gain have proven stubborn, despite mounting evidence to the contrary. But our 2017 survey also revealed something encouraging within this fact: For all the tenacity of this perception, it hasn't slowed the growth of interest in sustainable investing.

Among Individual Investors...

75%	71%	80%
are interested in sustainable investing. 86% of Millennials are interested.	believe companies with leading sustainability practices may be better long-term investments.	are interested in sustainable investments that can be customized to meet their interests and goals.





Key Insights

Our Findings Uncovered Five Central Themes:

Interest Still Strong

Interest in sustainable investing has held steady—and on some fronts has grown. Individual investors, led by Millennials, increasingly see this as a normal and desirable element of any portfolio.

- **Sustained Interest:** Three-quarters of investors, and 86% of Millennials are interested in sustainable investing, a rise from the previous survey. Millennials in particular are more intensely interested than in 2015 (38% report feeling "very" interested, up from 28%).
- **Increased Adoption:** Investors report an uptick in sustainability-minded investment decisions since 2015 (38%, up from 32%).

Consumer Preferences Become Investor Preferences

Consciousness around sustainability has leapt from the consumer space to the investment space. According to the latest survey, investor attention to sustainability factors is now growing faster than consumer attention.

- **Customization is King:** Investors are more likely to adopt sustainable investments if they can tailor those investments to their own impact interests (80%).
- **Values Matter:** Millennial investors are nearly twice as likely as the general pool of investors to have made a purchase because of a brand's environmental or social impact, and three times more likely to work at or apply to a company because of its stance on issues.

Millennials More Engaged, More Skeptical

This generation continues to lead the charge when it comes to sustainable investing. While interest grew, the new numbers also show a creeping skepticism. Between those realities exist opportunities for greater adoption.

- **Influence and Impact:** Substantial majorities of Millennial investors believe that their own investment decisions can influence climate change (75%) and alleviate poverty (84%).
- **Retirement on the Horizon:** Nearly all Millennial investors (90%) expressed interest in pursuing sustainable investments as part of their 401(k) portfolios.

Gender Gap Present but Narrowing

As with Millennials, women stand at the forefront of the movement. While women show higher interest, men's actions show signs of catching up.

- **Narrowing Gender Gap:** While women still lead men in their interest in sustainable investing, the gap in action is narrowing. In 2017, women and men have a statistically equal likelihood of having integrated sustainability into their investment decisions (40% and 36% respectively).

Challenges Remain

Sustained interest in sustainable investing is matched by an equally enduring belief that such investing involves a financial trade-off. The challenge, as in 2015, is to continue marshaling the evidence that dispels this belief.

- **Trade-off Myth:** A majority of investors (53%) still believe that investing sustainably requires a financial trade-off.
- **More Skeptical Millennials:** Millennials believe the trade-off myth to a greater degree than the general pool (59%). More than half believe that an investor's sole responsibility should be maximizing profit (54% vs. 47% in 2015).

The Survey Took Aim at a Variety of Topics

Our 2017 survey explored the sustainable investing terrain with greater depth, and included new questions reflecting surging growth in the space. We asked:

- What issue-areas/themes are investors most interested in investing in?
- To what extent are investors interested in investing locally vs. nationally vs. globally?
- Is it an investor's responsibility to do anything other than maximize profits?
- Do investors prefer sustainable investments that have an overall positive impact on social and environmental issues or those that are customized to their own interests and goals?
- To what extent do investors believe that sustainability and financial gains are a trade-off?

A Note on Context

From Brexit to the 2016 U.S. election, the two years after our initial survey were tumultuous ones on the global stage. Indeed, this survey was conducted less than a month after the inauguration of President Donald Trump.

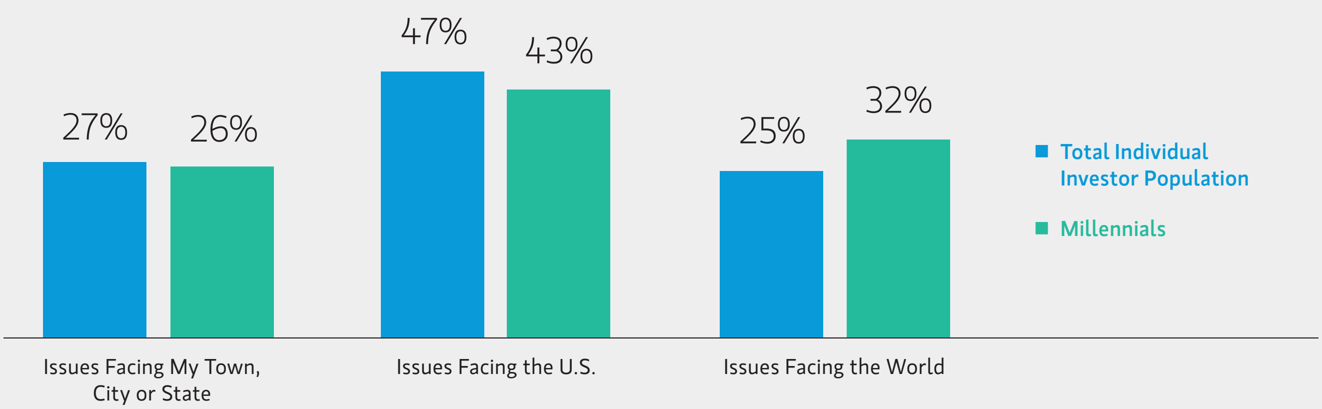
This context makes the clarity of our findings all the more striking. Even in a time of change, interest in sustainable investing appears unflappable. In fact, it's stronger than ever.

Our findings also indicate enthusiasm for funneling private capital toward domestic impact. Nearly three-quarters of investors polled noted a preference for sustainable investments at the U.S. or local levels, while one-quarter preferred global impact.

Investors Showed a Preference for Sustainable Investments That Make a Positive Impact in the United States.

FIGURE 1

If you had the opportunity to participate in a sustainable investment opportunity that was focused on making a positive impact on social and environmental issues facing either the world, the U.S. or your town, city or state, which ONE would you be most interested in pursuing?



Methodology

Data was collected online through a 51-question survey, conducted by Brunswick Insight. The sample size was n=800 U.S. individual investors, and an n=200 oversample of Millennials (aged 18 to 35). This survey took place February 17-22, 2017.

"Sustainable investing" was defined in the survey as 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.

"Active individual investors" were defined as individual investors that actively trade stocks, mutual funds, bonds, etc., outside of retirement funds or real estate investments, and who play an active role in decision-making about their investments.

Detailed Findings

Interest Holding Steady

Interest in sustainable investing remains as high as it was in 2015. Now, 75% of individual investors and 86% of Millennial investors are either "somewhat" or "very" interested in the concept, compared to 71% and 84% in 2015, respectively.

While those changes are statistically insignificant, the number of Millennials with the strongest interest in sustainable investing has risen, from 28% to 38%.

This occurred despite a heightened sense of market volatility. The numbers of investors, Millennial and otherwise, who believed the economy would stay the same over the next year fell markedly since 2015. There was a 20 percentage point rise among Millennials who thought it would worsen in that time, while among investors as a whole there were both more optimists and more pessimists.

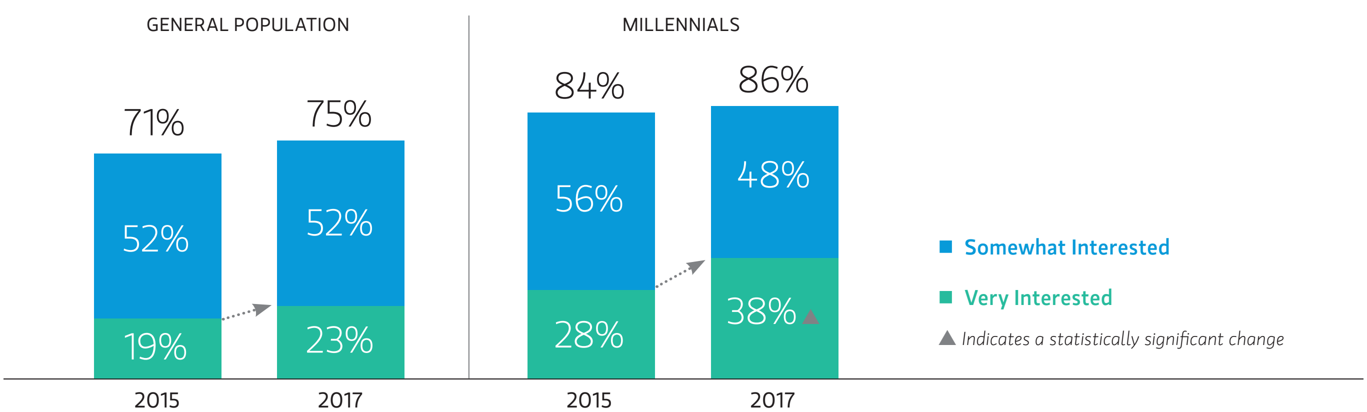
In uncertain times, perhaps, companies and funds with sustainable attributes may be viewed as more stable in the long run. Seventy-one percent of investors polled agreed that leading social, environmental and governance practices can potentially lead to higher profitability and may be better long-term investments.

In light of uncertainty around the economy, this continued interest in sustainable investing suggests a growing acceptance of the concept.

While Overall Interest in Sustainable Investing Grew Slightly, Millennial Intensity Continued to Build.

FIGURE 2

How interested are you in sustainable 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?



71% of investors polled agreed that leading social, environmental and governance practices can potentially lead to higher profitability and may be better long-term investments.

Acting Sustainably: The Total Investor Pool has Made Appreciable Gains in Adopting Sustainable Behaviors, but Millennials Still Lead.

FIGURE 3

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

Millennials purchased from a sustainable brand 2X more often than the total individual investor population

Millennials were 3X more likely to have sought employment with a sustainably-minded company

Millennials invested in companies targeting social/environmental goals 2X more often than the total individual investor population

From Consumer Preference to Investment Preferences

Widespread interest in sustainability surely helped whet appetites for sustainable investing—and now momentum behind sustainable investment appears to be catching up to other facets of sustainability.

Consumer behavior (checking product packaging for sustainability characteristics, purchasing from a sustainable brand or seeking employment with a sustainably-focused company) remained consistent with 2015 levels in the new survey.

At the same time, the number of individual investors factoring sustainability issues into their investment decisions has increased. This includes screening investments for alignment with their personal values and interests, investing in companies targeting social or environmental goals, and exiting investments associated with perceived objectionable activity.

Millennials (82%), Generation Xers (67%) and women (59%) are more likely than average (54%) to take at least one of the consumer and investor actions explored in the survey.

Sustainable Investing in the Workplace: A Method for Attracting Millennial Talent?

Millennials are projected to make up 75% of the American workforce by 2025.[3] And while just 31% have a 401(k), this is expected to rise as they advance in their careers.[4] Given Millennial investors' support for sustainability in consumer behaviors and their intense interest in sustainable investing, it is likely they will seek to bring their investments into alignment with their values. Our results imply that offering sustainable investment funds as 401(k) options may be an additional way for companies to attract and retain Millennial talent in competitive job markets.

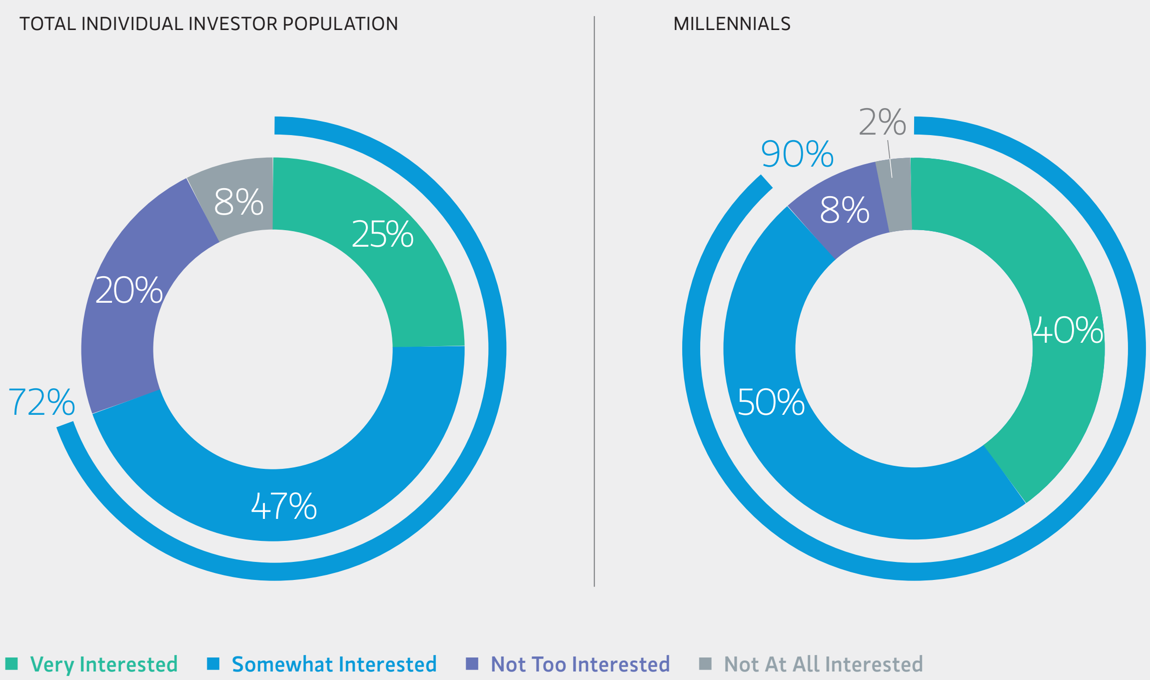
The 2017 survey revealed more than half of Millennial investors believe that companies with a focus on social or environmental performance are more innovative and roughly half believed that they attract higher quality talent (40% for environmental focus and 52% for social focus).

Additionally, Millennial investors remain three times as likely as the general investor population to have worked at or applied to a company because of its stance on social or environmental issues (19% compared to 6%). Given that Millennials are almost universally interested (90%) in pursuing sustainable investments as part of their 401(k)s, companies able to provide Millennials with 401(k) options that can better align their portfolios and careers with their values could be at a competitive advantage.

Nearly all Millennial Investors Surveyed Expressed an Interest in Pursuing Sustainable Investments as a 401(k) Option.

FIGURE 4

How interested would you be in pursuing sustainable investments if they were an option in your 401(k)?



Millennials: More Engaged, More Skeptical, More Opportunities

Nearly nine in 10 Millennials (86%) are interested in sustainable investing. This is significantly higher than individual investors overall (75%).

This heightened interest by Millennials is likely tied to their strong belief that they can make a positive difference with their own investments:

- 75% agree that it is possible for “my investment decisions to influence the amount of climate change caused by human activities,” compared with 58% of the total individual investor population.
- 84% agree that it is possible for “my investment decisions to create economic growth that lifts people out of poverty,” compared with 79% of the total individual investor population surveyed.

But the Millennial story isn’t a simple one. Alongside this interest in sustainable investing is a strain of cautiousness: 59% of Millennials polled believe sustainable investing necessarily involves a financial trade-off. More Millennials now believe it goes against an investor’s responsibility to do anything other than maximize profits. Fifteen percent strongly agree with this, up from 8% in the previous survey. Those Millennials disagreeing with this statement, meanwhile, fell by 8%.

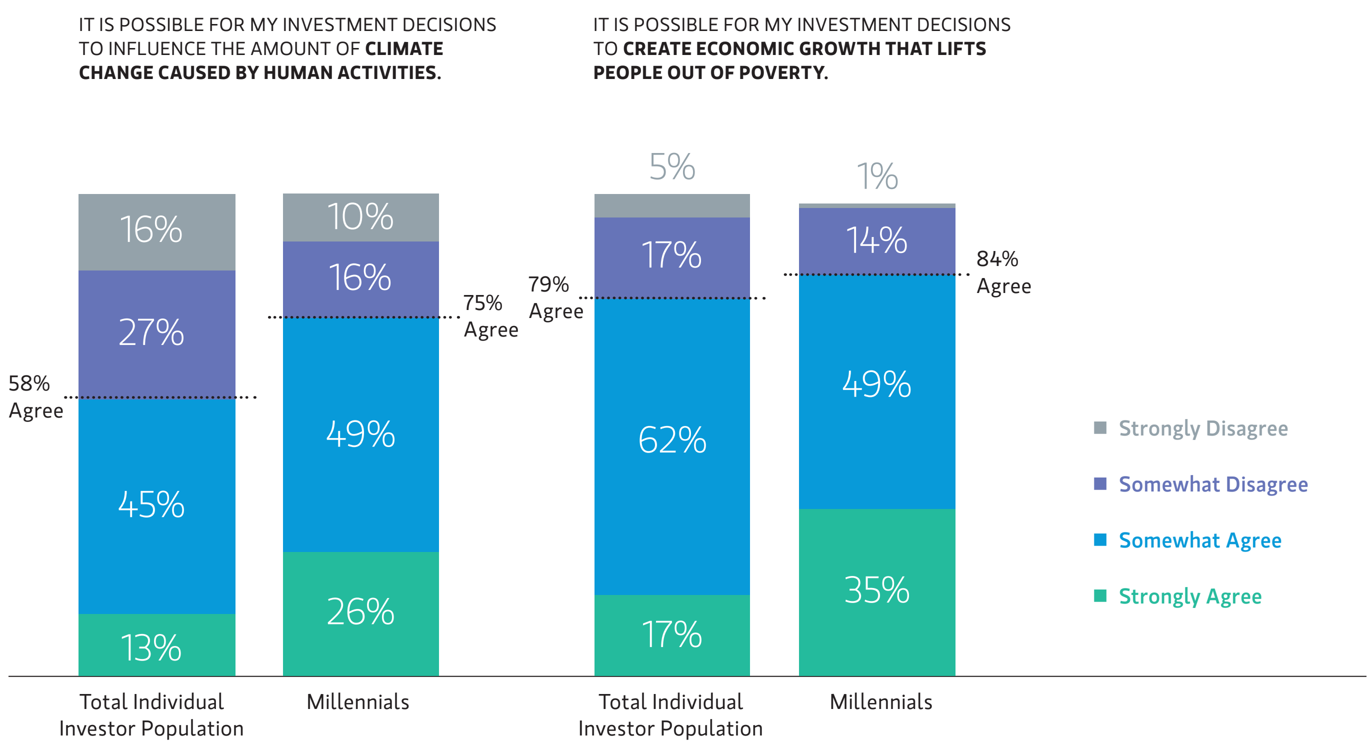
Interestingly, these signs of cautiousness aren’t dampening Millennials’ interest in sustainable investing. On the contrary, that interest is stronger than ever. The picture emerging here is one of a nuanced approach to the market. Millennials want strong returns and they want their money to have a positive impact. In other words, they’re well-positioned to absorb the growing evidence that both are possible.

Within this nuanced relationship to investing lies opportunity. The 2017 survey revealed unambiguous enthusiasm for the inclusion of sustainable investments in 401(k) plans (90% interested, compared with 72% of the overall investor population).

Millennials Are More Likely to Think They Can Make a Difference With Their Investment Decisions.

FIGURE 5

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



Relatedly, the poll showed a strong desire for the ability to customize sustainable investments. Eighty-nine percent of Millennials said they were likely to invest in a fund they could tailor to their personal interests and goals, compared with 80% of the overall population.

Millennials showed the greatest interest in all three investment themes explored in the survey (climate change, gender diversity and religious values), with 82%, 69% and 50% reporting interest in thematic investments, compared with 68%, 51% and 45% of all investors, respectively.

The past decade has seen a rise in personalized consumer products, from retail apparel to food and beverage to technology, and the survey suggests that sustainable investing could follow suit. In the current environment, creating thematic and regional portfolio options may help drive engagement with sustainable investing.

While hurdles might still exist for this generation of investors, identifying untapped opportunities—retirement accounts, customizable funds—seems to offer a clear way forward.

89% of Millennials said they were likely to invest in a fund they could tailor to their personal interests and goals, compared with 80% of the overall population.

A Narrowing Gender Divide

Women again show greater receptivity to sustainable investing than men (84% women compared with 67% men). They are more likely than men to report focusing on positive social and/or environmental impact alongside rates of return when investing, as opposed to a strict focus on the rate of return. Fifty-six percent of women focus at least partially on making a positive impact with their investments, compared with 45% of men.

But where men might voice less enthusiasm for sustainable investing, their actions signal otherwise. Women (40%) and men (36%) have a statistically equal likelihood of having integrated sustainability into their investment decisions.

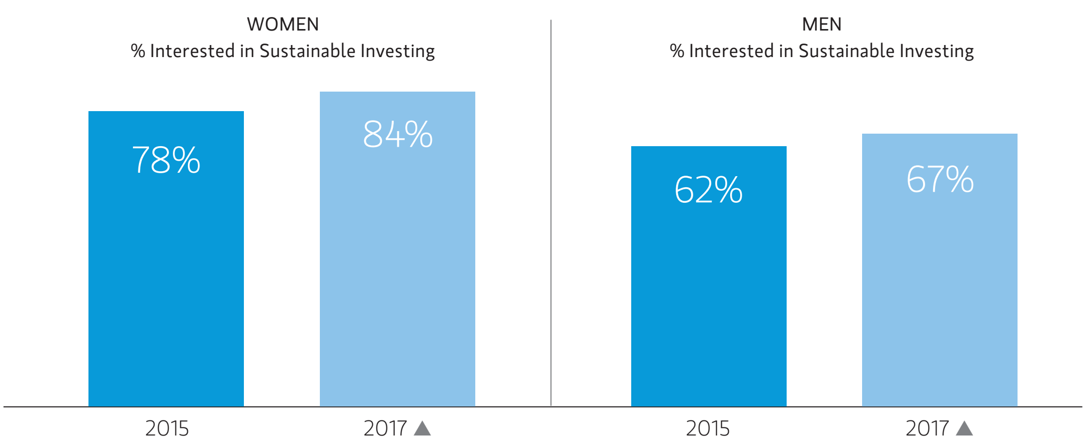
Men appear to be closing the gap on another front, as well. In 2015, women reported that 37% of their portfolios were invested in sustainable investments, compared to 30% for men. Just two years later, men are more or less on par with women (43% vs. 40% for women and men, respectively).

As sustainable investing matures and a new generation of individual investors rises to the fore, it can be expected that the gender gap will continue to diminish. Among Millennial investors, 89% of women and 81% of men expressed interest in sustainable investing, a significantly smaller divide than among all investors polled.

Women Continue to Express a Greater Interest in Sustainable Investing.

FIGURE 6

How interested are you in sustainable investing, which is the practice of making investments in companies or funds that aim to achieve market rate financial returns while pursuing positive social and/or environmental impact?"



▲ *Indicates a statistically significant change*

The Stubborn Trade-Off Perception

Leading-edge advocates and early adopters of sustainable investing have made their enthusiasm clear. But among the broader population of investors, the perception of a financial trade-off represents one of the most pressing hurdles to mainstreaming the movement.

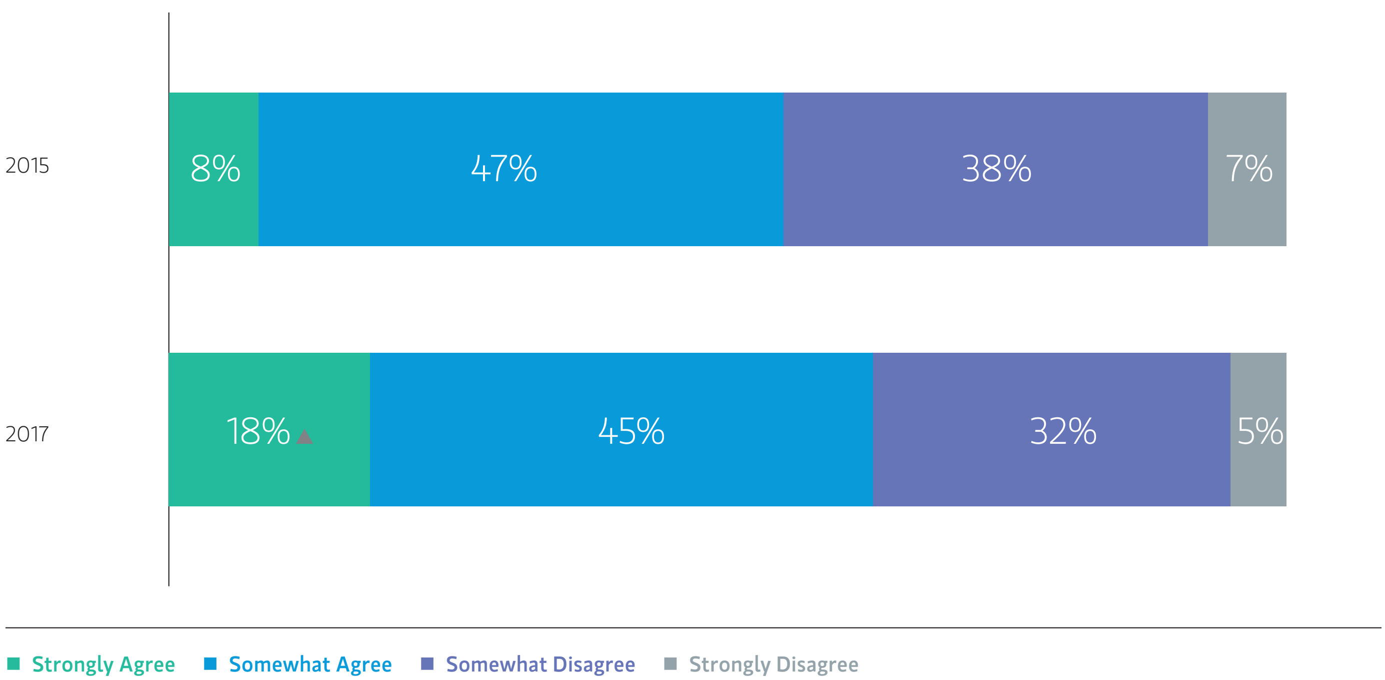
While beliefs about this trade-off remained more or less unchanged on most counts since 2015, there was a marked change among Millennials: The number who strongly agreed that sustainability and financial gains are a trade-off grew from 8% to 18%.

Interestingly, those who strongly agree that there exists a trade-off between sustainability and financial gains are actually more likely to have taken a sustainability-oriented action. For instance, 25% of those who strongly agree that there is a trade-off have also exited an objectionable investment, compared with just 11% of the total individual investor population. The same pattern is seen directionally with Millennials, where 32% of these strong believers exited an objectionable investment, compared with 19% of the total Millennial population. This suggests that even while the misconception of a trade-off persists, for some investors, the importance of social impact cannot be understated.

Millennials: More Skeptical? They're Now Twice as Likely to Strongly Agree That Sustainability and Financial Gains Are a Trade-Off Than in 2015.

FIGURE 7

Please indicate if you agree or disagree with each of the statements below: Sustainability and financial gains are a trade-off. Investors must choose between investing in companies or funds that choose to make a positive impact but have a lower rate of return, or companies or funds that are profitable but do not have sustainability as a primary focus.



▲ *Indicates a statistically significant change*

Conclusion

Over the last two years, interest in sustainable investing has grown. The idea continues to draw strong support. The key seems to be investors' belief that their portfolios can have substantive social and environmental impact. As long as the need for such impact remains, it is likely that investor interest will keep rising.

Abutting this momentum is the persistent perception that there must be a trade-off between performance and sustainability. This might explain the gap between adoption and expressed interest—while 75% report an interest in aligning their portfolios with their values, 38% have moved to do so. Not surprisingly, similar challenges emerged in a survey of investment professionals in the asset management industry (see **Sustainable Signals: The Asset Manager Perspective**).

Despite these hurdles, this survey made it clear that demand for sustainable investment options will likely swell in the years ahead. As such options grow in size, sophistication and customizability, a broad swath of individual investors could be inclined to allocate their investments accordingly. For this to happen, investors must be shown that maintaining a profitable portfolio and investing for a positive impact can be achieved simultaneously.

Notes

1 "Sustainable Signals: The Individual Investor Perspective," Morgan Stanley Institute for Sustainable Investing, 2015 (https://www.morganstanley.com/sustainableinvesting/pdf/Sustainable_Signals.pdf; accessed on June 14, 2017).

2 "U.S. Sustainable, Responsible and Impact Investing Trends 2016," U.S. SIF, 2016 (http://www.ussif.org/trends accessed on April 12, 2017).

3 "Workforce 2020: What You Need to Know Now," Debra Donston-Miller, Forbes, May 2016, (https://www.forbes.com/sites/workday/2016/05/05/workforce-2020-what-you-need-to-know-now/#1ad3a93d2d63; accessed April 12, 2017).

4 "Retirement Plan Access and Participation Across Generations," Pew Charitable Trusts, February 2017, (http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/02/retirement-plan-access-and-participation-across-generations; accessed April 12, 2017.)

Disclosures

For more information about the Morgan Stanley Institute for Sustainable Investing, visit www.morganstanley.com/sustainableinvesting.

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