

Third Quarter 2018

**Quote of the Quarter:**

*"Let us put our minds together, to see what life we can build for our children"*

-Sitting Bull, 1876

## Taking That First Step

We strive to report on useful data and trends and to share ideas and experiences that are thought-provoking. This quarter we want to share an illustrative experience about an investor that recently made its first impact investment.

### Desire for impact

Family Office ABC ("ABC") wanted to make an impact investment but had been struggling for over two years to find the right place to begin. ABC had an experienced investment team and had researched many impact ideas, including venture capital, growth equity, infrastructure, green bond, organic/indoor farming, education, housing and jobs creation funds. ABC family members wanted to "do some good with their money" but, with hundreds of funds to choose from, they were suffering from analysis-paralysis. Further complicating their process was a lack of track record with respect to many of the subject funds, the amorphous nature of what "impact" meant to each family member, concerns about poor financial returns from 2005-8 funds, and disagreement as to whether financial return or impact was the primary goal. When ABC inquired about investing with us, they found comfort in our track record, our experience, our in-depth impact reporting and our willingness to answer their many questions and work collaboratively with them to evaluate, refine and quantify their investment goals. We were happy to be able to help them take that first step on their impact journey.

*The point of that story is so many investors are still waiting to take that first step with respect to impact investing. They are still gathering data and, in many cases, simply over-thinking it...or worse not really thinking seriously about it at all. So we encourage you to take that first step, even if it is a small one. If you have yet to make an impact investment, start somewhere, anywhere. Choose to partner with us or someone else as your guide. But stop waiting for the so-called perfect investment to arrive on your doorstep. Use that first impact investment to learn what other opportunities exist or may lay around the corner. Use it to refine what impact investing means for you. Use it to determine what is possible beyond mere financial gain. Then in 2019 make two impact investments and then do more the following year. You have an opportunity to positively impact this world. Engage. Get started, even if it is with a small dollar amount.*

## Terminology

In its 2018 Investor Watch, UBS recently cited terminology as a key impediment to wider investor adoption of sustainable investing with 72% of respondents finding the associated terms confusing.<sup>i</sup> We often use the term “impact investing” to broadly describe the investment strategy of using your capital for a dual-purpose: financial return + something good. The Global Impact Investing Network (“GIIN”) describes impact investments as investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return. Some industry participants may nitpick and try to narrowly define impact investing as being limited solely to private investments and use terms like Environmental, Social, and Governance (“ESG”) or Socially Responsible Investing (“SRI”) to cover public equity and public debt investments. We are going to use impact investing here as the umbrella term to cover your entire portfolio: stocks, bonds and alternatives.

## All or Just Part of Your Portfolio?

Many investors are unsure if impact investments should be in a separate “allocation bucket” or if impact investing principles should be applied to every investment in a portfolio. The answer can be different for everyone, but we suggest that impact investing should span your entire portfolio.

If you are new to impact investing, where do you start? The answer is wherever you want but don’t overthink it. There are hundreds and hundreds of options available to you today. If you want to promote sustainable business practices you might screen out of your public equity portfolio certain types of companies (e.g., fossil fuels or pesticide companies) and you might want to “screen in” companies that better implement sustainable business practices relative to their peers (e.g., those that have reduced the amount of energy and raw material inputs and/or decreased the amount of waste per a given measure of output). There are already a multitude of mutual funds and ETFs that will allow you to easily do this (see stock indices chart later in this commentary). Similarly, there are a lot of options for the bond or fixed income allocation within your portfolio: green bond funds, PACE bonds, micro-lending funds, low-income housing municipal bonds, mutual funds, etc. As for alternatives, this is where the real opportunity lies and represents the most effective means for creating a positive impact on the world around us. There are hundreds of choices separated by investment strategy (venture capital, growth equity, buyout, infrastructure and real assets) and focus (environment, jobs/poverty alleviation, gender diversity, housing, education, healthy living/aging, water, food/ag, energy, transportation, etc.). Sorting through it can be daunting but consultants, wealth management platforms and groups like us are ready to assist you.

Interest in impact investing is increasing, but money is slow to move. Some recent data points:

- 60% of family offices surveyed recently by Global Impact Investing Network (GIIN) are either still developing an impact investing strategy or just starting to consider impact investments.<sup>ii</sup>
- Nine out of ten asset managers are familiar with sustainable investing, but only half implement ESG or Impact Investing approaches to investing activities.<sup>iii</sup>
- Three-quarters of individual investors surveyed by Morgan Stanley in 2017 are interested in sustainable investing, but only 38% are making sustainability-minded investment decisions.<sup>iv</sup>

Progress is being made but we have a long way to go. Investor's growing familiarity with impact investing and some emerging standards and standard bearers help. In 2015, the United Nations created the Sustainable Development Goals (the "SDGs"), a list of 17 investment categories that are becoming the industry standards to measure and track an investment's impact. For illustrative purposes, below is a heat map of our first impact secondaries fund with respect to the SDGs.

### SDG Map for our Clean Growth III Fund



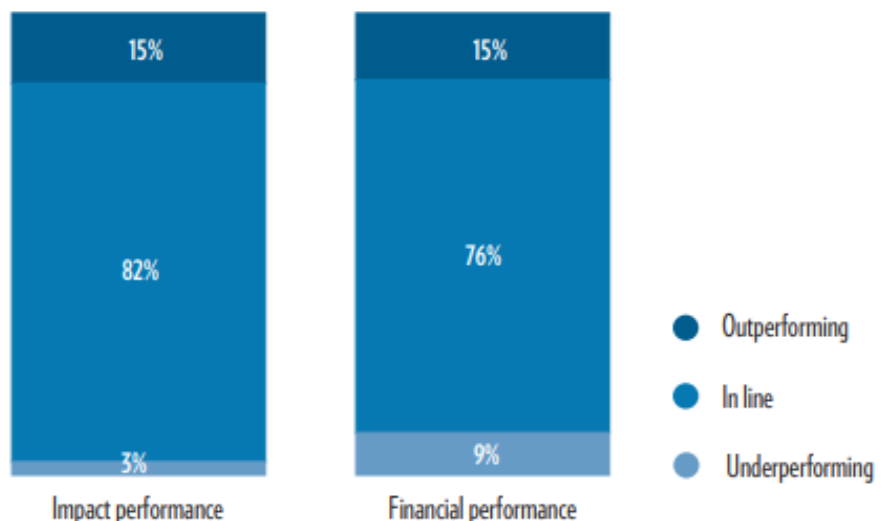
Three prominent standard bearers provide additional guidance, and we encourage you to visit their websites for information:

- **[Principles for Responsible Investment](#):** The Principles for Responsible Investment (PRI) works to help incorporate environmental, social and governance (ESG) factors into investment and ownership decisions. It is an independent organization that is supported by, but not part of, the United Nations. There are over 1,900 signatories with a combined \$70 trillion assets under management. The organization has developed six Principles for Responsible Investment that encourage ESG incorporation within the investment industry.<sup>v</sup>
- **[Global Impact Investing Network](#):** GIIN is a nonprofit organization focused on increasing the scale and effectiveness of impact investing. GIIN defines impact investments as investments made with the intention to generate social and environmental impact alongside a financial return, which is the standard definition today.<sup>vi</sup>
- **[The Forum for Sustainable and Responsible Investment](#):** The Forum for Sustainable and Responsible Investment (US SIF) is shifting investment practices towards sustainability, focusing on long-term investment and the generation of positive social and environmental impacts. The organization serves as a non-profit hub for the sustainable, responsible and impact investment sector in the United States and offers a variety of resources and information. Its members represent more than \$3 trillion in assets under management.<sup>vii</sup>

Another challenge impact investing faces is the widespread (and incorrect) idea that investors must give up financial performance if they want to invest responsibly.

- 53% of investors surveyed by Morgan Stanley still believe investing sustainably requires a financial trade-off.<sup>viii</sup>
- When polling investors that are already making impact investments, though, we see that impact investments are overwhelmingly meeting or outperforming initial expectations (see chart below).

### Performance Relative to Expectations (Source: 2018 GIIN survey<sup>ix</sup>)



On top of meeting investors' expectations, there is a growing body of research that indicates impact investments achieve comparable or even better financial returns than conventional investments. <sup>x</sup> A 2017 study from Nuveen TIAA Investments compared five widely known U.S. equity Responsible Investment indices (indices that are comprised of securities that meet certain environmental and social sustainability criteria) with track records of at least 10 years to two broad market benchmarks, the Russell 3000 and S&P 500. The analysis found no statistical difference in the Responsible Investment returns compared to the two broad market benchmarks.

## Responsible Investment Indices



Data through 12/31/2016. Series indexed to 100, inception dates: S&P 500, Russell 3000, and MSCI KLD 400 Social, 5/4/1990; DJSI U.S., 1/1/1999; Calvert U.S. Large Cap Core Responsible, 4/28/2000; MSCI USA IMI ESG Leaders, 12/22/2000; and FTSE4Good US, 1/3/2003. MSCI indexes include aggregated, multisource histories prior to acquisition on 9/1/2010.

It is not possible to invest in an index. Performance for indices does not reflect investment fees or transactions costs.

Sources: FactSet Research Systems Inc., Morningstar, Inc., MSCI Inc., and TIAA

As you can see, the responsible investment indices achieved comparable performance over the long term despite using a smaller universe of securities meeting specific ESG criteria.

When assessing impact investment managers, sample questions you might use are the following (hat tip to Walden Asset Management):

- Do you have an ESG/responsible investment policy?
- Is your firm a signatory to the UN Principles for Responsible Investment?
- What other sustainable investment initiatives do you participate in?
- How do you integrate ESG factors into your investment philosophy and decision-making process? At what point do you evaluate a potential investment's alignment with your philosophy?
- How long have you been researching and making impact investments?
- What improvements do you anticipate making regarding your ESG/impact objectives in the upcoming year?

## Upcoming Events

We are regular speakers and attendees at key industry conferences. We hope to see you at these upcoming events:

October 4-5	<b>Total Impact Boston</b> , Boston, MA <a href="http://totalimpactconference.com">totalimpactconference.com</a>
October 14-17	<b>IFEBP Annual Conference</b> , New Orleans, LA <a href="http://ifebp.org">ifebp.org</a>
October 23-24	<b>FOX Fall Forum</b> , Chicago, IL <a href="http://familyoffice.com">familyoffice.com</a>
November 1-4	<b>The SRI Conference</b> , Colorado Springs, CO <a href="http://sriconference.com">sriconference.com</a>
December 9	<b>FOX Advisor Briefing</b> , Seattle, WA <a href="http://familyoffice.com">familyoffice.com</a>

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i <https://www.ubs.com/content/dam/ubs/microsites/ubs-investor-watch/IW-09-2018/return-on-value-global-report-final.pdf>

ii [https://thegiin.org/assets/GIIN\\_AnnualImpactInvestorSurvey\\_2017\\_Web\\_Final.pdf](https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf)

iii [http://www.morganstanley.com/content/dam/msdotcom/en/assets/pdfs/Morgan\\_Stanley\\_ISI\\_Sustainable\\_Signals.pdf](http://www.morganstanley.com/content/dam/msdotcom/en/assets/pdfs/Morgan_Stanley_ISI_Sustainable_Signals.pdf)

iv [http://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable\\_Signals\\_Whitepaper.pdf](http://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable_Signals_Whitepaper.pdf)

v <https://www.unpri.org/about-the-pri>

vi <https://thegiin.org/about/>

vii <https://www.ussif.org/about>

viii [http://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable\\_Signals\\_Whitepaper.pdf](http://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable_Signals_Whitepaper.pdf)

ix [https://thegiin.org/assets/2018\\_GIIN\\_Annual\\_Impact\\_Investor\\_Survey\\_webfile.pdf](https://thegiin.org/assets/2018_GIIN_Annual_Impact_Investor_Survey_webfile.pdf)

x US SIF Foundation's Money Manager Roadmap