Swell

Swell Investing's Impact Approach
Investing for Progress and Performance

"If everyone puts a portion of their investment dollars to work toward impact and they come away satisfied with the impact -- and financial return -- they achieve, we will have changed the expectations of the financial system forever. Because if you could make things happen that you believe in and get a financial return, why would you ever want just financial returns again?"
Cathy Clark, Duke Fuqua School of Business

“Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society.”
Larry Fink, CEO of BlackRock

“A new generation of consumers is demanding greener and more ethical products. Businesses and investors alert to this shift will reap the benefits, and will be engines of change.”
Al Gore and David Blood, Generation Investment Management

What Is Impact Investing?

Impact investing refers to investments "made into companies with the intention to generate a measurable, beneficial, social or environmental impact alongside a financial return."

One of the key components of impact investing is intentionality, or the intention of an investor to have a positive social or environmental impact through their investments.

Unlike broad SRI or ESG approaches, Swell focuses not just on how a company conducts its business, it focuses on what that business is. Impact investing aims to generate value that extends beyond the financial bottom line, which is what distinguishes it from other approaches.

	Swell	Environmental, Social & Governance (ESG)	Socially Responsible Investing (SRI)
Screens out destructive and exploitative industries	✓	✗	✓
Encourages transparency and disclosure	✓	✓	✗
Picks best companies based revenue alignment	✓	✗	✗
Addresses social or environmental issues	✓	✗	✓

Capturing Social Alpha

Social alpha is the idea that companies embracing the core tenets of sustainability and social responsibility while practicing them transparently mitigate certain market, regulatory, public opinion and environmental risks to their top and bottom lines. Economic growth and sustainability are interdependent. Great company leadership knows it's impossible to have sustained economic prosperity without efficient management of natural resources.

Thankfully, we already have many of the tools necessary to solve some of the seemingly insurmountable economic and environmental challenges we face. There exist technologies that will go a long way towards resolving our need for energy, food, water, infrastructure, security, and jobs. In fact, the market continues to develop and improve products and services that replace existing processes with less polluting alternatives, promote industrial resource efficiency and promote resource conservation.

A Shifting Economy Introduces Opportunities

The world's economy is on the cusp of a massive shift in the way that capital is allocated and investors are at the forefront. At Swell, we believe that every dollar invested can--and should--have a positive impact on the world.

We're not alone in this conviction. Seven in ten Americans think it's important that their values align with their decisions around investing and more than one in five dollars under professional management is invested in ethical strategies, with that figure projected to grow to one-third of invested assets by 2025.

Impact investing isn't just a feel-good movement, it's a smart investment strategy. Wise investors know that in this age of finite natural resources, ballooning population growth (9 billion by 2050), increased urbanization, and aging and inadequate infrastructure, we cannot continue to support the status quo. Long-term shareholder value has always been found in companies which are able to effectively adapt their business models to the world as it changes around them. Moreover, those who are first to innovate in response to those changes tend to reap larger benefits.

INVEST IN PROGRESS

For many decades, impact investing was only available to institutions and very high net worth individuals. Swell believes that every investor should have the opportunity to invest with intention, which is why we created a platform and product that makes true impact investing widely available.

The Swell Difference

- **High Impact** - Each company in Swell's portfolios derives revenue from its impact theme. We focus not just on how a company conducts its business but what that business is.

- **United Nations Sustainable Development Goals (SDG)** - Each Swell portfolio tracks to the 17 UN SDG's, representing the greatest challenges facing our world today.

- **Curation** - Separately Managed Account (SMA) structure allows deselection of companies from Swell "mix" that don't align with investors' values.

- **Tax Optimization** - Swell automatically uses tax-intelligent lot ordering behind the scenes to reduce taxable gains during a rebalance and when an investor sells out of a portfolio. Tax lot ordering sells shares with the largest losses first and largest gains last.

- **Thematic Options** - In building its thematic portfolios, Swell identifies growing areas of the markets that are likely to outperform over the long-term.

Defining the Market Opportunity

Does impact investing mean accepting lower returns? The short answer is no. While the notion that profit and social good are fundamentally at odds is extremely common, it has also been soundly refuted.

ESG Factors Outperform

Swell's approach includes screening companies for their environmental, social and governance (ESG) factors. That means only companies which treat their employees well, take into account the environmental impact of their business practices, and show dedication to strong governance and disclosure practices are considered for a Swell portfolio.

These practices benefit companies over the long term. In a free and competitive market where consumers have choices, they often choose to buy from and work for companies with good reputations. In its annual survey of 25,000 American consumers, GfK found that 56% of consumers not only preferred "green" products, they were willing to pay more for them. A separate study by McKinsey finds that over half of consumers in the US and UK are willing to pay a "green premium" of 10% on everything from electronics to building materials and automobiles. This is important because consumer spending drives 83% of economic growth.

Strong ESG performance doesn't just help attract customers and command a price premium, it also helps companies attract and retain talent. In a 2016 study by researchers at Harvard, Columbia, and NYU they found that companies whose employees believe that their work has meaning — which the paper notes is often characterized by the positive impact on social and environmental issues — are more productive. Labor productivity is a key driver of a company's financial performance.

What's more, the MSCI KLD 400 index, which uses inclusion criteria based exclusively on ESG factors, has outperformed both the S&P 500 and the Russell 3000 on an actual and risk-adjusted basis for the past 25 years.

Risk Mitigation

Factors such as water use, carbon emissions, labor and supply chain management as well as governance concerns such as board composition can have an impact on a company's valuation. These so-called "extra-financial" concerns have clear financial consequences as barometers for efficiency in operations and management efficacy. How a firm is able to adapt and manage these issues is crucial when determining a company's ability to create long-term growth for investors. Identifying risk is crucial, particularly in areas that until now were considered immaterial to business activities.

Swell's impact investing approach acknowledges that superior long-term performance requires a complete risk assessment, efficient resource use (including human capital), equitable compensation incentives for management that are tied to company's long-term performance, and strong corporate governance. These are key indicators of how a company will perform in the long-term.

At Swell, we work to identify those management teams that embrace the idea of sustainability – using it to lower their costs, increase their revenues, improve their brand, reduce their risk, and attract talented people. These firms have been shown to exhibit lower risk of suffering volatility in their earnings. Research has also shown that ESG factors can mitigate bankruptcy risk by up to 90%.

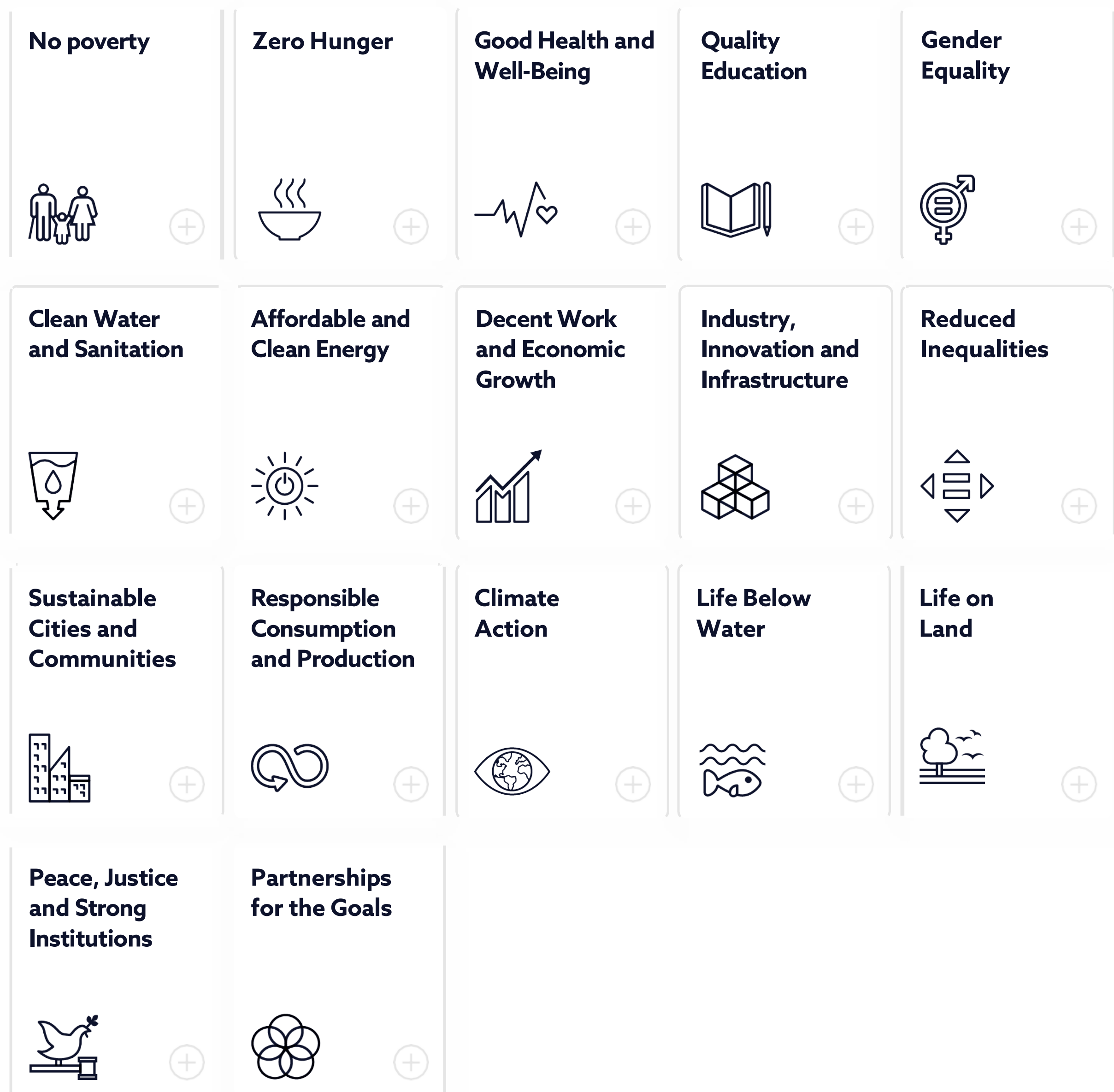
Additionally, the weighted average cost of capital for companies that do not integrate appropriate sustainability initiatives is higher than for those that have more robust environmental, social, and governance (ESG) practices.

UN Sustainable Development Goals

In 2015, 193 world leaders adopted a plan for achieving a better future for all — laying out 17 Sustainable Development Goals (SDGs) which provide a path over the next 15 years to end extreme poverty, fight inequality and injustice, and protect our planet.

Achieving the Global Goals opens up $12 trillion of market opportunities as governments and private industries alike move towards achieving them. As of 2015, one in three companies reported they were likely to use the SDGs as a guide for setting corporate objectives.

INVEST IN PROGRESS



These aren’t just image-oriented initiatives, they’re good business. If private industries fail to work towards a positive future, lagging healthcare and education will impact their workforces. Environmental deterioration could cause political instability that creates business risk and impacts their bottom line, as well as rising input costs as more expensive substitutions becomes required.

Businesses that align with the UN SDGs are also aware that the social and environmental challenges we face today are creating a new degree of accountability in business.

Companies and even entire industries are likely to increasingly be held responsible for their externalities--the costs of doing business that are pushed off of their balance sheets and into society.

An example lies in California's implementation of the Low Carbon Fuel Standard and the pressures this and other regulations in the state have placed on the automotive industry. With full implementation of California's regulations around transportation alone, the state is set to benefit from reduced social costs of carbon valued at $10.4 billion by 2020 and $23.1 billion by 2025. In human terms, that translates to lower rates of heart attacks and nearly 75,000 lost days of work.

According to some estimates, electric vehicles are expected to be 35% of the new car market by 2040. This growth represents, 41 million cars, compared to less than 500,000 in 2015 and less than 1 million in 2016. The companies that adapt to these changes to meet consumer demand are likely to outperform for investors over the long-term. That's impact investing in action.

Swell's Approach

Swell's research is driven by the world's biggest problems, and its biggest solutions. We evaluate thousands of companies and build diversified, solutions-focused portfolios. We do the heavy lifting so our investors don't have to. With regular rebalances, we make sure our portfolios continue to be optimized for risk, reward, and impact.

Top Down

Guided by the seventeen UN Sustainable Development Goals, the Swell impact team evaluates the world's greatest risks to humanity along broad, thematic categories. By identifying the macro-level risks humans pose to themselves, Swell can create portfolios that benefit from significant regulatory and consumer sentiment driven tailwinds, over time.

Bottom-Up and Portfolio Construction

Once companies are deemed as impact eligible, they are analyzed along multiple financial metrics including liquidity, debt ratios, and volatility. Portfolios construction criteria are proprietary, but all portfolios are built with a firm focus on optimizing risk and return profiles amongst the holdings on the basis of market capitalization, volatility, and liquidity factors.

Assess Impact

We look at thousands of companies and assess them for positive impact. The companies we include derive revenue from the environmental or social impact part of their business and must be able to align that revenue to one or (in many cases) more of the seventeen UN Sustainable Development Goals. This process is conducted by the Swell impact research team on a per company basis throughout the calendar year, with existing holdings being reviewed annually along with new universe constituents.

In order to supplement proprietary qualitative research on a per company basis, Swell incorporates multiple third-party ESG scoring systems. This allows the Swell impact team to bolster conclusions, uncover latent issues and controversies, as well as evaluate disclosure and governance issues within industries. Even the absence of an ESG score for a company can be a good indicator that more research is required, and therefore part of the Swell research process.

Our Mission

At Swell, we're on a mission to ensure every dollar invested has a positive impact on the world. We believe today's greatest challenges represent tomorrow's biggest market opportunities and we want to help every investor take advantage and have a hand in building a better future.