Morgan Stanley
Institute for Sustainable Investing

Sustainable Signals:

The Individual Investor Perspective

Individual investors are clearly signaling that sustainable investing has a bright future, but only if investors see proof that pursuing positive impact and maintaining a profitable portfolio can be complementary goals. By identifying the key drivers of sustainable investing and addressing potential barriers, the Morgan Stanley Institute for Sustainable Investing aims to accelerate mainstream adoption of this dynamic investment approach.

This survey polled active individual investors to explore the following areas:

- Who is the sustainable investor?
- How are individual investors working sustainability into their investment decision-making?
- What are the barriers to greater adoption of sustainable investing?
- What are individual investors' expectations for the future of sustainable investing?

Key Findings

Individual investors have a positive, but conflicted, view of sustainable investing

- 71% of individual investors are interested in sustainable investing
- 54% believe choosing between sustainability and financial gains is a trade-off

Millennial investors are on the leading edge of adoption and females are substantially more likely than males to factor sustainability into their investment decision process

- Compared to the overall individual investor population, Millennial investors are nearly 2x more likely to invest in companies or funds that target specific social or environmental outcomes
- Female investors are nearly 2x as likely as male investors to consider both rate of return and positive impact when making an investment

Demand for sustainable investing is expected to increase

- 65% of individual investors expect sustainable investing to become more prevalent in the next five years

Executive Summary

The way we choose to allocate investments today can have great impact on the challenges of tomorrow. As the world's population continues to grow, becoming healthier and more connected, finite resources currently taken for granted will become increasingly constrained. Companies will need to integrate sustainability into their strategies and products and will need capital from investors to finance essential solutions capable of improving access to food, water and clean energy. By 2050, the business opportunities for sustainability-focused companies are expected to be between $3 trillion and $10 trillion annually, or up to 4.5 percent of global GDP.[1]

While the opportunity is clear, we wanted to better understand the investor perceptions and behaviors that currently inform the adoption of sustainable investing. To accomplish this, the Institute for Sustainable Investing initiated a two-part research study that explores the drivers, barriers and implications surrounding sustainable investing from the perspective of individual and professional investors. In order to accelerate mainstream adoption of sustainable investing approaches, it is critical to understand how all active market participants approach sustainable investing – regardless of the total amount of money under their control.

The survey uncovered four central themes that underpin individual investors' perceptions of sustainable investing:

1. **Underrealized Opportunity:** Individual investors are highly interested in sustainable investing and can identify advantages for companies that focus on sustainability. However, they have yet to fully translate corporate advantages into investment action, as more than half believe sustainability and financial returns imply a trade-off for investors.

2. **Millennial Movement:** Millennial investors are more focused on sustainability in their consumer behavior than the overall investor population, which is carrying over to a greater adoption of sustainable investing.

3. **Women Leading the Way:** Compared to male investors, female investors are more likely to factor sustainability into their investment decisions and are more likely to see the advantages of doing so.

4. **Bright Future:** Individual investors expect sustainable investing to become more prevalent over the next five years.

While it is encouraging that many individual investors are already focused on sustainable investing and realize the benefits of doing so, more work needs to be done to help educate investors that positive impact and the potential for market-rate financial returns can be pursued simultaneously.

Methodology

"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.

The sample size was n=800 individual investors, with an n=200 oversample of Millennials (aged 18 to 32).

Data was collected online through a 37-question survey conducted by the Brunswick Insight team.

This survey took place November 12-21, 2014.

This paper is published by the Morgan Stanley Institute for Sustainable Investing. The Morgan Stanley Institute for Sustainable Investing is dedicated to accelerating mainstream adoption of sustainable investing by developing innovative and scalable finance solutions to address global challenges—seeking both competitive financial returns and positive societal impact. The Institute is committed to industry-leading work that combines Morgan Stanley's history of excellence in client service with cutting-edge approaches to investment. For more information about the Morgan Stanley Institute for Sustainable Investing, visit http://www.morganstanley.com/sustainableinvesting.

Underrealized Opportunity

Individual investors are beginning to factor sustainability into their investment decisions, but there is room to grow.

There is a high degree of individual investor interest in sustainable investing; nearly three in four (71%) say that they are interested. More importantly, many see sustainability as an obligation, as more than half (58%) of individual investors see their responsibility as consisting of more than just profit maximization.

71% of individual investors are **interested** in sustainable investing

As a result, these investors place a premium on sustainability. When making an investment decision, sustainable business practices are seen as being as important as one-year financial performance, and more important than the announcement of new products or services.

Why do individual investors place so much value on sustainable business practices? It is because they see clear competitive advantages for companies that adopt such practices.

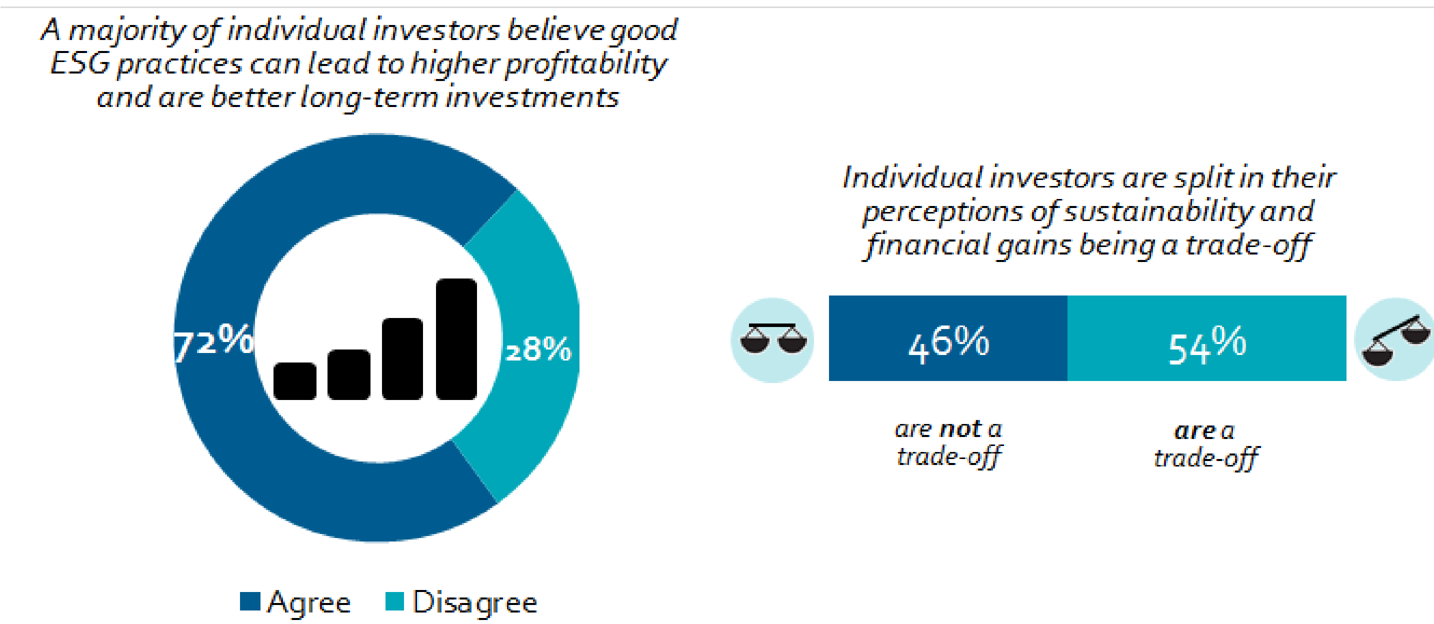
For example, nearly half (45%) of all individual investors believe sustainable companies are more innovative, and one in three (30%) individual investors believe that companies focused on sustainability attract better talent. Compare this to less than 10% of individual investors who say a sustainability focus makes companies less innovative or less desirable employers.

Additionally, nearly three quarters (72%) of individual investors surveyed believe that companies with good ESG practices can achieve higher profitability and are better long-term investments (see Figure 1).

While individual investors recognize clear business advantages for companies with a focus on sustainability, they do not fully translate this into advantages for investors. Individual investors are divided over perceptions of sustainability and financial gains being a trade-off (54% vs. 46%).

Overcoming this perception gap and demonstrating to individual investors that it is possible to achieve positive impact and profit and that sustainability can be a potential advantage, will be critical for the future of sustainable investing.

Figure 1 - Perceptions of Sustainable Investing Profitability



Millennial Movement

Millennial investors are substantially more focused on sustainability than other generations.

Millennials investors are not only the most interested in sustainable investing (84% are interested); they are also more likely to factor sustainability into their daily lives.

84% of Millennial investors are **interested** in sustainable investing

As workers and consumers, the behavior of Millennial investors stands out from the rest of the individual investor population. Millennial investors are:

Nearly three times more likely to seek employment with a company because of its stance on social and/or environmental issues (14% of Millennial investors, compared to 5% of the total individual investor population).

Nearly twice as likely to purchase from a brand because of the company's social and/or environmental impact (15% of Millennial investors, compared to 7% of the total individual investor population).

Nearly twice as likely to check product packaging to ensure sustainability (40% of Millennial investors, compared to 22% of the total individual investor population).

This emphasis on sustainability in the employment and consumption decisions of Millennial investors is carrying over to their investment decisions. Compared to the overall individual investor population, Millennial investors are:

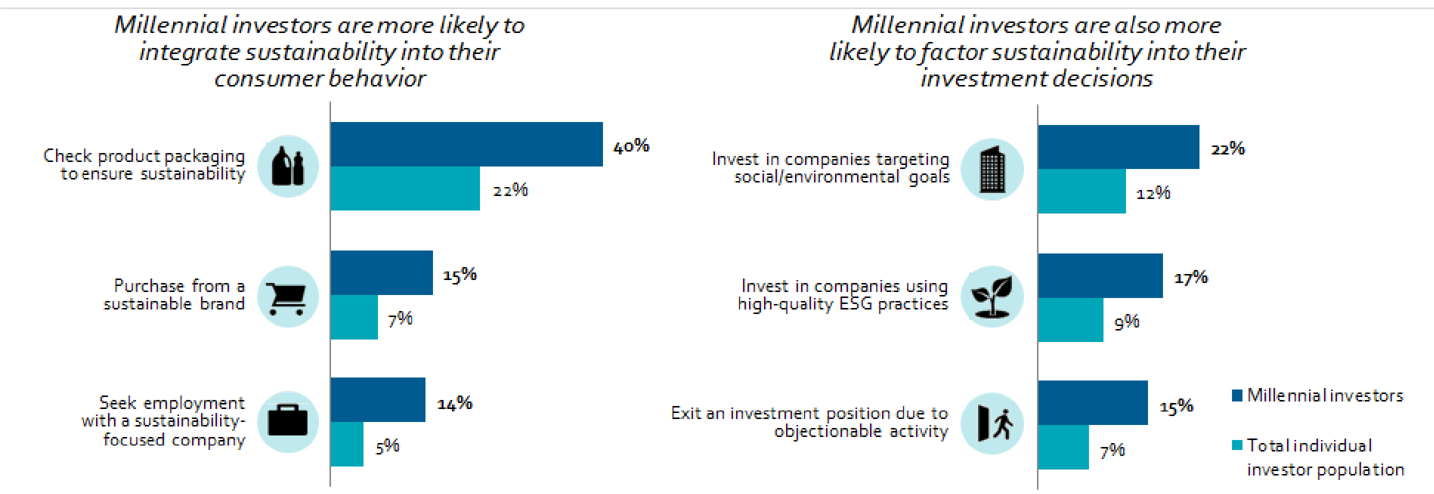
Nearly twice as likely to invest in companies or funds that target specific social or environmental outcomes (22% of Millennial investors, compared to 12% of the total individual investor population).

Nearly twice as likely to invest in companies or funds that aim to use environmental, social or governance practices to create a value differentiator (17% of Millennial investors, compared to 9% of the total individual investor population).

Over twice as likely to exit an investment position because of objectionable corporate activity (15% of Millennial investors, compared to 7% of the total individual investor population).

Demographic trends signal that Millennial investors are likely to drive demand for sustainable investing well into the future. According to a study conducted by Nielsen, half of the most sustainability-focused consumers globally are Millennials.[2] This matters because by 2020, one in three U.S. adults will be a Millennial.[3] As Millennials begin to accumulate more wealth and invest accordingly, their perceptions of sustainability are likely to have a significant impact on the financial services sector. Asset managers creating investment products for individual investors cannot ignore these trends.

Figure 2 – Millennials Are Bringing Sustainability into Consumer and Investment Behavior



Women Leading the Way

In addition to Millennial investors, female investors are also on the leading edge of adoption of sustainable investing. They are more likely than their male counterparts to factor sustainability into investment decisions, and see the benefits of doing so.

Female investors are more interested in sustainable investing than male investors (76% vs. 62%) and are more likely to consider sustainability in their consumer behavior (48% of female investors have done one or more sustainable consumer actions – such as checked product packaging to ensure sustainability, compared to 32% for male investors).

$11.2 trillion in assets **controlled by women** in the U.S.
(Source: Center for Talent Innovation, 2014)

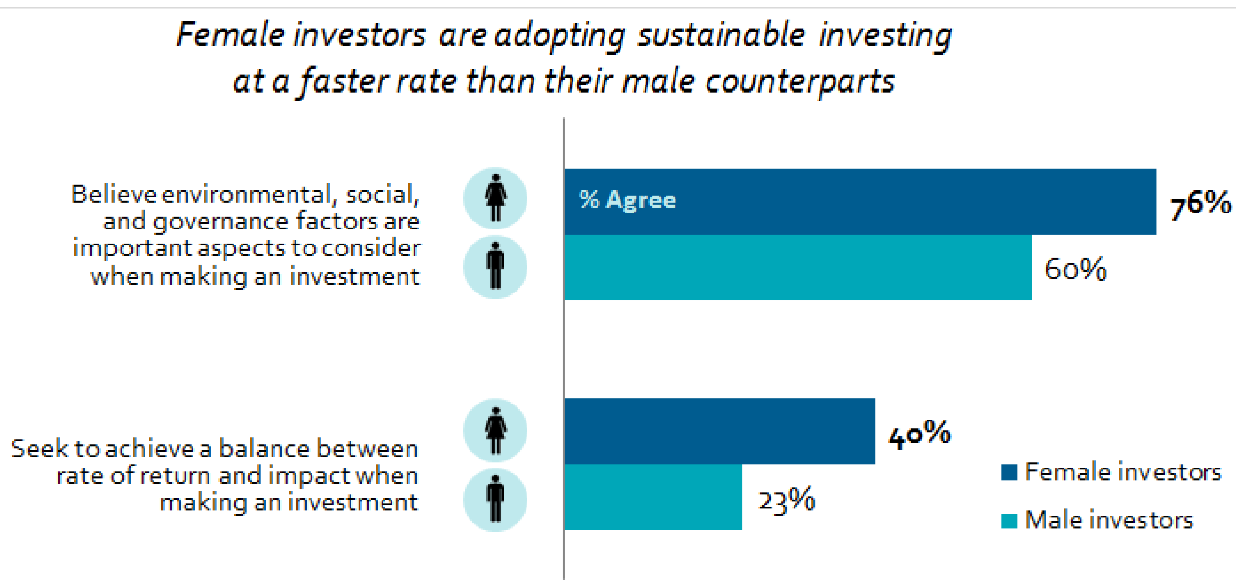
Like Millennial investors, female investors' greater focus on sustainability generally seems to be shaping their approach to investment decisions. Female investors are nearly twice as likely as male investors to consider rate of return as well as the impact of their investment when making an investment decision (40% vs. 23%). Additionally, female investors are more likely to believe environmental, social, and governance factors are important aspects to consider when making an investment (76% vs. 60%).

One driver of these perceptions is likely a greater realization of the benefits that sustainable business practices can produce. For example, female investors surveyed are more likely than male investors to believe that good ESG practices can lead to higher profitability and better long-term investments (77% vs. 61%).

Female investors' support for sustainable investing is likely to have a noticeable impact on the broader business and investment environments, as women are playing an increasingly central role in both. Women are earning more college degrees than men.[4] More than half (52%) of all managerial and professional jobs in the US are now held by women.[5] And, American women control $11.2 trillion in investable assets, which is 39% of the nation's total investable assets.[6]

As the influence of women in business and investing continues to grow, sustainable investing is likely to continue moving into the mainstream.

Figure 3 - Female Investor Adoption of Sustainable Investing



Bright Future

Individual investors do not expect sustainable investing to fade away as a short-term trend or investment theme that will expire in six months. Rather, sustainable investing is an investment approach that is expected to become much more widespread, transcending market conditions and economic outlook.

Individual investors say that on average 46% of their total portfolio should be invested sustainably. This belief aligns with their outlook on the future of the trend – two in three (65%) individual investors believe that sustainable investing will become more prevalent in the next five years.

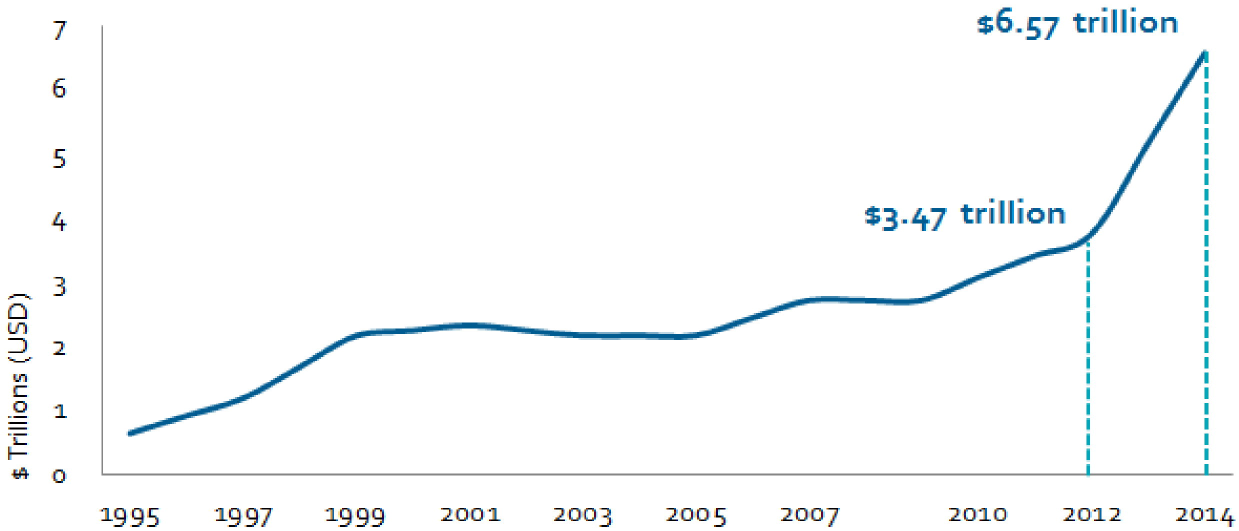
The attention sustainable investing has received from the media and investors seems to support this view. In the media, sustainable investing has gained wider traction, with the number of media mentions doubling since 2010.[7] In the investment management sector, assets utilizing sustainable investing criteria have grown 76% in the last two years to $6.57 trillion, now accounting for more than one out of every six dollars under professional management in the United States.[8]

65%

two in three individual investors believe sustainable investing will become more prevalent in the next five years

Figure 4 - Professionally Managed US Assets Utilizing Sustainable Investment Criteria

Total volume of sustainable investments nearly doubled from 2012 to 2014



Source: USSIF: "US Sustainable, Responsible and Impact Investing Trends 2014," November 2014.

Conclusion

Individual investors are sending signals that display clear interest in integrating sustainability into their personal investment portfolios. Driven by rising demand and deeper engagement from Millennial and female investors, active individual investors expect sustainable investing to accelerate in the near future.

However, there are also clear barriers to broader adoption. In the survey, the majority of individual investors participating did not connect the positive impact of their investments to evidence of positive returns. For this investment approach to reach its full potential, the financial services industry must not only create investment products, but also equip individual investors with the tools and resources needed to properly evaluate and compare sustainable investments across asset classes. As sustainable investing scales from what has traditionally been perceived as a niche opportunity to a mainstream investment approach, these resources will become all the more critical in helping investors of all sizes make informed decisions.

The *Sustainable Signals* series is designed to connect the perspectives of both individual and institutional investors. The second part of this study will focus on understanding how professional investors approach sustainable investing and the evolution of their efforts to integrate ESG and positive impact into their investment selection process. The combined insights from each survey can be used to track the evolution of sustainable investing across the capital markets ecosystem.

As the Morgan Stanley Institute for Sustainable Investing builds awareness and identifies narratives that help prove investing with impact and maintaining a potentially profitable portfolio can be complementary goals, we aim to create new dimensions of value for our clients and society at large.

Notes:

[1] World Businesss Council for Sustainable Investment, "Vision 2050: The New Agenda for Business," 2010.

[2] Nielsen, "Global Survey on Corporate Social Responsibility," 2014.

[3] New York Times, "Marketers Are Sizing Up Millennials," Aug. 21, 2014.

[4] Bureau of Labor Statistics, 2014.

[5] Forbes, "The Future of Work: A Golden Age For Working Women," Aug. 24, 2012.

[6] Center for Talent Innovation, "Harnessing the Power of the Purse: Female Investors and Global Opportunities for Growth," May, 2014.

[7] Factiva Search Result – Accessed on Dec. 9, 2014.

[8] US Forum for Sustainable and Responsible Investment, "US Sustainable, Responsible, and Impact Investing Trends 2014," November 2014.

Disclosures

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