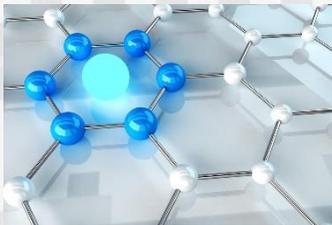


Flagship Report

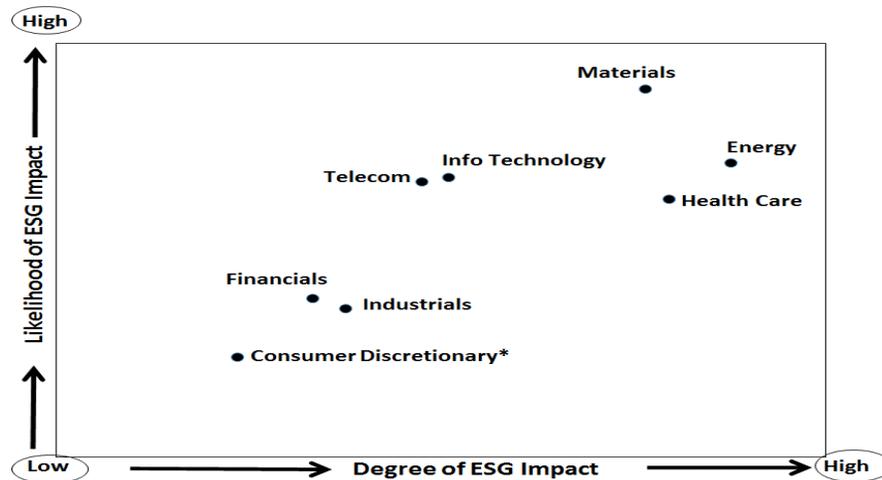
ESG in Sector Strategy: What's Material?



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- **How Much Does ESG Matter?** — As equity investors struggle with the extent to which ESG factors are relevant, we examine the issue from a quantitative perspective.
- **An ESG Materiality Matrix** — For eight of the ten MSCI ACWI GICS we plot the likelihood that a material sustainability issue will occur against the potential financial impact of an ESG event.
- **Relative ESG Risks and Opportunities** — The ESG Materiality Matrix can be used to identify relative ESG risks or opportunities at the sector or industry level. In this report, our focus is on relative ESG *risks* at the *sector* level.
- **Sector Overweights that Entail Relatively High ESG Risks** — Overweights of the Materials, Energy and Health Care sectors create relatively high ESG risks. For Materials and Energy, environmental risks are foremost. In Health Care, the sustainability issue with the greatest likelihood of having a material impact is “business model and innovation” (e.g., product quality and safety).
- **A Relatively Less Risky Sector Overweight** — In contrast to Materials, Energy and Health Care, in the Information Technology sector there are *a number* of ESG issues that could potentially be material, although it’s estimated their financial impact would be less significant than in the other three sectors.

Figure 1: ESG Materiality Matrix for Eight MSCI GICS



Source: Cornerstone Capital Group

Executive Summary

- While our prior investigations of the significance of certain ESG factors in sector strategy yielded some interesting insights, they were somewhat limited in scope. In this report, we attempt to more thoroughly identify sustainability issues that are material for sector strategy.
- The Sustainability Accounting Standards Board (SASB) has been steadily creating sustainability accounting standards on an industry-by-industry basis for the entire U.S. economy. SASB creates unique “Materiality Maps”™ for dozens of industries. In these maps, sustainability issues are assigned scores based primarily upon (i) evidence of interest and (ii) evidence of financial impact.
- Separately, RobecoSAM adopted a two-step approach to help identify the financial materiality of sustainability issues in 59 different industries. In the first step, the most important intangible factors were identified for each industry. In the second step, the factors were prioritized according to (i) their expected magnitude (i.e. degree of impact) and (ii) the likelihood of their impact.
- Leveraging the approaches of SASB and RobecoSAM, we create a two dimensional materiality matrix for eight of the ten MSCI GICS. While our “ESG Materiality Matrix” can be used to identify relative ESG risks or opportunities at the sector or industry level, in this report our focus is on relative ESG *risks* at the *sector* level.
- The ESG Materiality Matrix reveals that overweights of the Materials, Energy and Health Care sectors create relatively high ESG risks. For Materials and Energy, environmental risks are foremost. In Health Care, the sustainability issue with the greatest likelihood of having a material impact is “business model and innovation” (e.g., product quality and safety).
- In contrast to Materials, Energy and Health Care, in the Information Technology sector there are a number of ESG issues that could potentially be material, although it’s estimated their financial impact would be less significant than in the other three sectors. Consequently, an overweight of the Information Technology sector would seem less risky from an ESG perspective than an overweight of the Materials, Energy or Health Care sectors.



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Important Disclosures:

Erika Karp, CEO of Cornerstone Capital Inc., is a member of the Board of Directors of the Sustainability Accounting Standards Board.

Michael Baldinger, CEO of RobecoSAM, is a member of the Board of Directors of Cornerstone Capital Inc.

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