MARKETS IN FOCUS | Election 2020

ESG Investing:
Built to Last No Matter Who Wins

CARILLON TOWER ADVISERS

Not a fad. A mindset change.

In an election marked by strong policy differences on climate change, energy production, and environmental regulation, you might expect results at the polls to have consequences for environmental, social, and governance (ESG) practices in corporate management and investing.

But that is not likely to happen regardless of who wins, according to Sheila King, CFA, and Jason Wulff, CFA, each a co-manager for separate ESG portfolios at Eagle Asset Management, an affiliate of Carillon Tower Advisers. Instead, they said ESG corporate governance and investing has grown to the point and is focused enough on long-term outcomes that one election probably won't have more than a marginal impact on its continued use, scope, or momentum.

"My opinion is that these things will continue to evolve despite who is in the White House, but maybe the pace goes a little bit faster with one versus another," said King, Portfolio Co-Manager for Eagle's ESG-Focused Fixed Income Strategy. "I don't think ESG is a fad. I think it's a mindset change."

For example, she said, many corporations that do business around the world have stayed committed to the Paris Agreement on climate change even as the Trump administration has begun the process to withdraw the United States from the accord. Over the long term, she said she expects corporations to continue to factor ESG-related risk and opportunity analyses into their business plans and decisions.

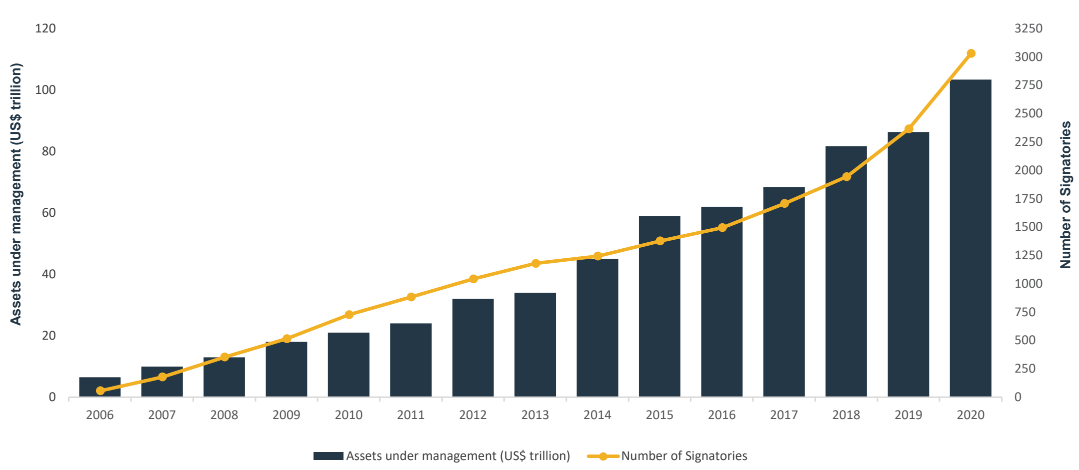
As of March 2020, more than 3,000 businesses and organizations that manage over $100 trillion in assets across more than 60 countries had signed the charter document of the United Nations-supported Principles for Responsible Investment (PRI). Nearly 20 percent of PRI signatories are U.S.-based, according to the organization's 2018 annual report.

The principles call on signatories to incorporate ESG issues into investment analysis, decision-making, and ownership policies and practices, as well as to demand information on ESG issues from the entities in which they invest and the financial industry generally. In practice, ESG corporate policies focus on areas ranging from minimizing pollution and energy use to promoting gender equality to supporting the development of sustainable communities.

Thinking about ESG considerations does not mean sacrificing results, the Eagle portfolio managers say.

"Companies that are well-run from an ESG risk and opportunity standpoint can equal or exceed traditional benchmarks as far as

Figure 1: Growth in participation in the Principles for Responsible Investment, 2006-2020



Source: Principles for Responsible Investment as of 3/20/20.

performance is concerned," King said. Contrary to an earlier emphasis on simply avoiding "sin stocks," she said, socially responsible investing has evolved into something much greater through the use of positive screening of potential investments for ESG-related benefits. At Eagle, King's investment team builds on its traditional fundamental research by integrating ESG research and analysis of risks and opportunities into decisions whether to buy, sell, or hold an investment.

	Bloomberg Barclays MSCI US Corporate Year ESG Focus Index	Bloomberg Barclays US Corporate Bond Index
3 Year Total Return	21.19%	20.61%
5 Year Total Return	35.63%	35.06%

Source: Bloomberg. Cumulative returns as of 8/31/20.

Reducing risk is a common goal in ESG investing, according to a survey of institutional investors sponsored by Carillon Tower Advisers and Investment & Pensions Europe at IPE's Summer Pensions Congress 2020.* When asked how they evaluate ESG investing, 59% of survey participants said they see it as a form of risk reduction, while about 27% said it is a way to enhance returns. Another 12% considered ESG investing to be a marketing term, and 2% said they didn't use ESG considerations while investing.

Because there is less public data available on sustainable practices in the small- to mid-cap space, Eagle Asset's Vermont Investment Team talks with companies' management to understand how ESG issues could affect those businesses.

"It's not political," said Wulff, Portfolio Co-Manager for Eagle Vermont's SMID Cap ESG Select Strategy. "We tend to be very clear about that. It's about running your business well and being a good asset manager."

At one manufacturer, managers initially pushed back on the idea that ESG considerations had anything to do with their business. The conversation continued and the reactions began to shift as Wulff and his colleagues asked what management was doing to improve the efficiency of its factories, reduce waste, and treat its employees well. Six months later, the firm, one of the strategy's holdings, came out with a corporate responsibility report that detailed its efforts in those areas.

A means to improve investment results

ESG investing has not emerged as an issue in the presidential campaign, but that's not to say that there are no differences between the nominees on ESG-related issues. For one thing, the election's outcome could decide the fate of two proposed U.S. Department of Labor rules on ESG investing and proxy voting.

If enacted, the first rule would affect 401(k) and other pension plans regulated by the Employee Retirement Income Security Act of 1974 (ERISA). Specifically, it seeks to ban those plans' fiduciaries from investing in ESG products that reduce returns or increase risk in pursuit of non-financial objectives. "Private employer-sponsored retirement plans are not vehicles for furthering social goals or policy objectives that are not in the financial interest of the plan," U.S. Secretary of Labor Eugene Scalia said in announcing the proposed rule on June 23. "Rather, ERISA plans should be managed with unwavering focus on a single, very important social goal: providing for the retirement security of American workers."

The second rule, proposed on August 31, would impose a similar restriction on plan fiduciaries and investment managers to whom they delegate to exercise proxy voting rights.

ESG considerations, Wulff said, are not separate from returns. Rather, the two are intertwined because investing in companies that can avoid resource, supply chain, governance, and other problems in the future can benefit investors in the long run.

> "It's about running **your business well** and being a **good asset manager**."
>
> —Jason Wulff, Portfolio Co-Manager for Eagle Vermont's SMID Cap ESG Select Strategy

*Read more about the survey at IPE's Summer Pensions Congress 2020.

> “**Fundamentals** are fundamentals, and that’s **what the market reacts to.**”
>
> —Sheila King, Portfolio Co-Manager for Eagle’s ESG-Focused Fixed Income Strategy.

“Where ESG investing helps us is identifying these organizations that are most durable, most adaptable, most agile,” Wulff said. He said he would not expect the proposed Department of Labor fiduciary rule, if implemented, to have much of an effect on ESG investing. Rather, he thinks the use of ESG considerations as a means to improve investment results, an approach the Eagle Vermont investment team employs, will become a more mainstream practice over time.

Apart from the proposed regulatory changes, Democratic presidential nominee Joe Biden has outlined a $2 trillion infrastructure and clean energy plan that has generated news coverage and commentary about its potential to benefit companies with ESG-focused policies and business models.† The plan outlines support for, among other things, increased development of electric vehicles and a goal of producing electricity free of carbon emissions by 2035.

Still, there’s evidence that an administration’s regulatory and fiscal actions may have little impact on steering the future of industries where other, more long-term forces are already at work. The Trump administration has strongly supported traditional forms of energy production. That, however, hasn’t stopped alternative energy from outperforming fossil fuels over the last five years.

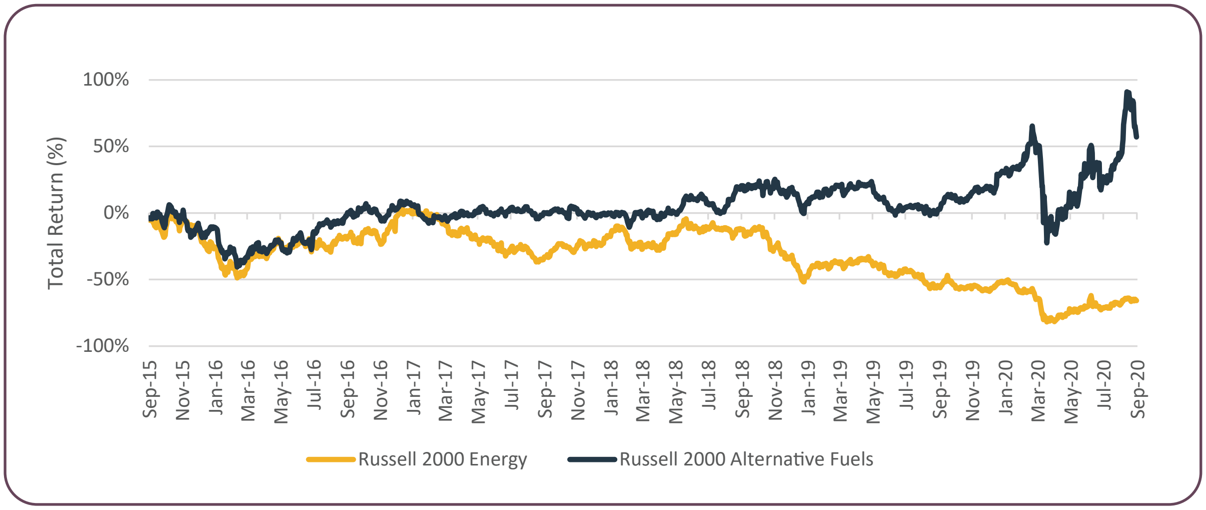
“You would have thought that oil and gas would have done well, and alternative energy would have done poorly and that, therefore, maybe ESG-oriented portfolios would do worse,” Wulff said. But he said being overweight to energy would have been a major headwind to performance during this period, while being overweight to alternatives would have been a tailwind.

Long-term horizons

The focus on long-term trends, risks, and outcomes is both what makes ESG investing useful, Eagle portfolio managers say, and is also why they expect it to be, at most, marginally affected by the November 3 election.

“Fundamentals are fundamentals, and that’s what the market reacts to,” King said. “You can have certain road blocks an administration puts in the way, or you can have some barriers taken down by an administration, but I think in the end the evolution of corporations is based on what they think is best, and they’re learning that a focus on climate change and ESG aspects is actually good for business.”

Figure 2: 5-year Returns: Russell 2000 Energy Sector vs. Russell 2000 Alternative Fuels Subsector



Source: Bloomberg, as of 8/31/20.

† Source: The Biden Plan to Build a Modern, Sustainable Infrastructure and an Equitable Clean Energy Future (2020)

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Carillon Tower Advisers is a global asset management company that combines the exceptional insight and agility of individual investment teams with the strength and stability of a full-service firm. Together with our partner affiliates – ClariVest Asset Management, Cougar Global Investments, Eagle Asset Management, Reams Asset Management (a division of Scout Investments), and Scout Investments – we offer a range of investment strategies and asset classes, each with a focus on risk-adjusted returns and alpha generation. Carillon Tower Advisers believes providing a lineup of institutional-class portfolio managers – spanning a wide range of disciplines and investing vehicles – is the best way to help investors seek their long-term financial goals.

About Eagle Asset Management

Eagle Asset Management is built on the cornerstones of intelligence, experience, and conviction, driven by research and active portfolio managers. Our long-tenured investment teams manage a diverse suite of fundamental equity and fixed income strategies designed to meet the long-term goals of institutional and individual investors. Our teams have the autonomy to pursue investment decisions guided by their individual philosophies and strategies.

Risk Considerations

Investing involves risk, including risk of loss.

Diversification does not ensure a profit or guarantee against loss.

Regarding the Eagle Vermont SMID Cap ESG Select Strategy: Investing in small- and mid-sized companies is based on the premise that relatively small companies will increase their earnings and grow into larger, more valuable companies. However, as with all equity investing, there is the risk that a company will not achieve its expected earnings results, or that an unexpected change in the market or within the company will occur, both of which may adversely affect investment results. Historically, small- and mid-cap stocks have experienced greater volatility than other equity asset classes, and they may be less liquid than larger-cap stocks. Thus, relative to larger, more liquid stocks, investing in small- and mid-cap stocks involves potentially greater volatility and risk. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

Regarding the Eagle ESG-Focused Fixed Income Strategy: Historically, bonds have provided less volatility and less risk of loss of capital than has equity investing. However, there are many factors which may affect the risk and return profile of a fixed-income portfolio. The two most prominent factors are interest-rate movements and the creditworthiness of the bond issuer. The risk of a change in the market value of the investment due to changes in interest rates is known as interest-rate risk. Interest-rate risk is subject to many variables but may be analyzed based on various data (e.g., effective duration). The risk that the issuer may default on interest and/or principal payments is often referred to as credit risk. Credit risk is typically measured by ratings issued by ratings agencies such as Moody's and Standard & Poor's®. Bonds issued by the U.S. Government have significantly less risk of default than those issued by corporations and municipalities. However, the overall return on government bonds tends to be less than these other types of fixed-income securities. Finally, reinvestment risk is the possibility that the proceeds of a maturing investment must be invested in a lower yielding security, all other things held constant, due to changes in the interest-rate environment. Investors should pay careful attention to the types of fixed-income securities that comprise their portfolio, and remember that, as with all investments, there is the risk of the loss of capital.

Income earned from investments in municipal bonds, while exempt from federal taxes, may be subject to state and local income taxes. All capital gains, as well as income earned from other sources, are subject to taxation. Income from municipal securities may also be subject to the Alternative Minimum Tax. Municipal securities typically provide a lower yield than comparably rated taxable investments in consideration of their tax-advantaged status. Investments in municipal securities may not be appropriate for all investors, particularly those who do not stand to benefit from the tax status of the investment. Please consult an income-tax professional to assess the impact of holding such securities on your tax liability.

ESG refers to Environmental, Social, and Governance factors used in measuring the sustainability and societal impact of an investment in a company or business. An ESG investment strategy will include only holdings deemed consistent with the applicable ESG guidelines. As a result, the universe of investments available to the strategy will be more limited than strategies not applying such guidelines, which may cause it to perform differently than similar portfolios that do not have such a policy.

Disclosures

Index or benchmark performance presented in this document does not reflect the deduction of advisory fees, transaction charges, or other expenses, which would reduce performance. Indexes are unmanaged. It is not possible to invest directly in an index. Any investor who attempts to mimic the performance of an index would incur fees and expenses that would reduce return.

The indexes referred to here are not used as benchmarks for the Eagle ESG-Focused Fixed Income Strategy or the Eagle Vermont SMID Cap ESG Select Strategy and are not representative of the strategies' returns.

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The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility, and financial issuers.

The Bloomberg Barclays MSCI US Corporate Year ESG Focus Index measures investment grade, fixed-rate, taxable corporate bonds, and is optimized to maximize exposure to positive environmental, social, and governance (ESG) factors. The index aims to preserve the overall risk characteristics of the Bloomberg Barclays US Corporate Index while targeting issuers with the highest MSCI ESG Ratings in each sector.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index. It represents approximately 8 percent of the total market capitalization of the Russell 3000® Index.

The Russell 2000 Energy Sector is a subset of the Russell 2000 Index consisting of small-cap energy companies across a range of specialized industries, including oil well equipment and services and crude oil producers.

The Russell 2000 Alternative Fuels Subsector is a subset of the Russell 2000 Index consisting of small-cap companies that produce alternative fuels such as ethanol, methanol, hydrogen, and bio-fuels that are mainly used to power vehicles, as well as companies that are involved in the production of vehicle fuel cells and/or the development of alternative fuel systems infrastructure.

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