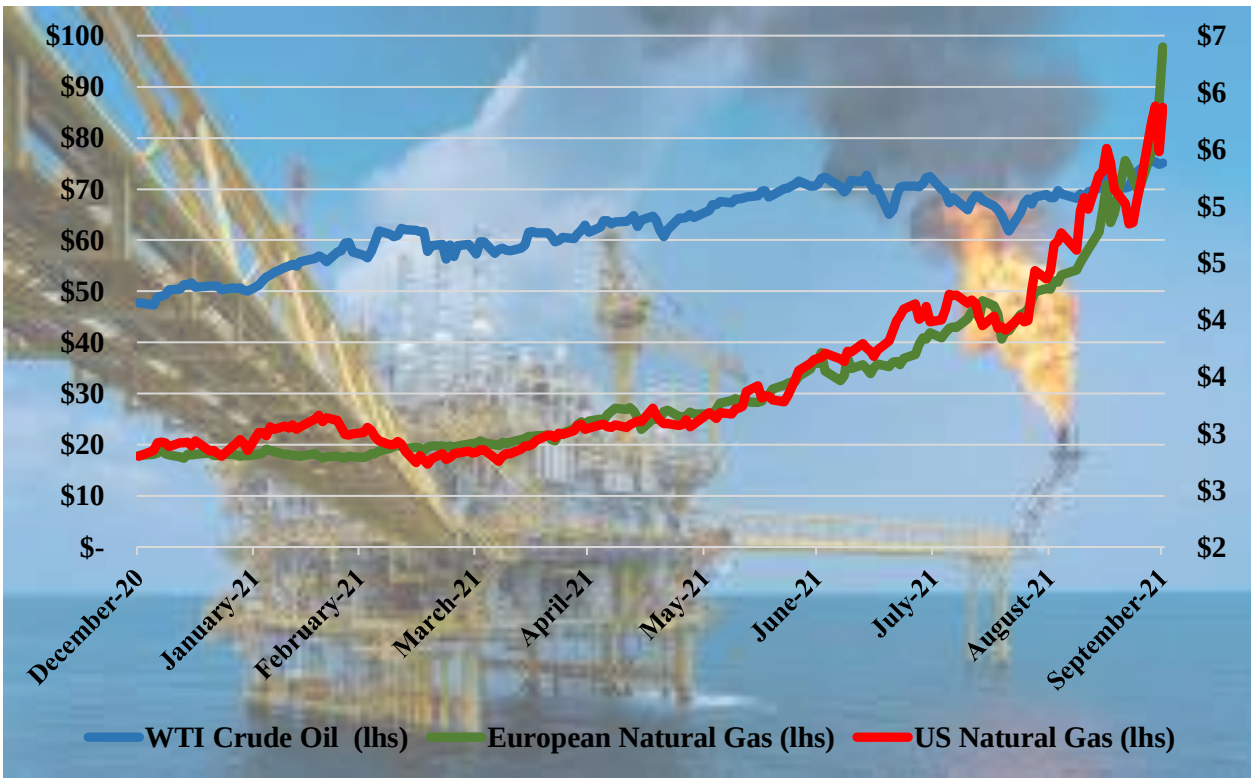
Quarterly Review and Strategy Update

September 30, 2021

Energy Prices



Source: Bloomberg

- **Economic growth slowing even as Covid-19 infections, hospitalizations and deaths decline**
- **Supply chain congestion and labor shortage put pressure on inflation**
- **Debt ceiling theater, China Evergrande disarray, and inflation concerns trap markets in sideways trading range**

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THE ECONOMIC ENVIRONMENT

On October 15th, President Biden signed a bill temporarily raising the nation's debt ceiling, kicking the can down the road until December 3, when the farce will be replayed to prevent the United States from defaulting on its obligations and triggering a financial catastrophe. While the financial markets have become somewhat immune to the partisan brinksmanship that accompanies each debt ceiling increase, this particular episode could not have come at a worse time. Three major sources of uncertainly have converged. First, Democrats are debating the size and scope of the proposed $1 trillion infrastructure package and the $3.5 trillion social policy and climate bill, which will in turn determine the magnitude of the corporate tax hike required to pay for them. Second, economic data continues to pile up suggesting that inflation may not be transitory. Finally, the collapse of Chinese property developer Evergrande threatens to destabilize the Chinese economy, with consequences for global economic growth.

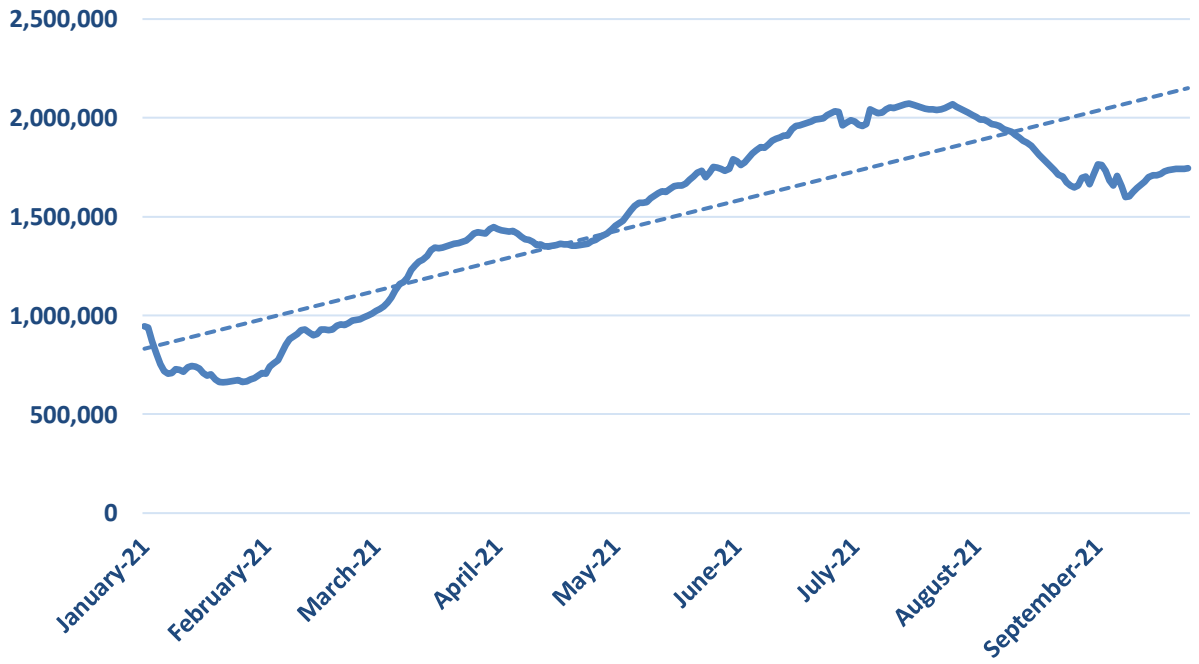
While economic news released in the third quarter confirmed the steady recovery of the American economy, obstacles to sustained growth are emerging. U.S. GDP grew 6.7% in the second quarter compared to the first, supported by higher personal spending, exports, and private business investment. The unemployment rate declined to 5.2% in August, continuing the steady decline since last May. However, the number of new jobs created over the past year have been erratic; while 943,000 new employees were hired in July, only 235,000 were hired in August and 194,000 in September. At the same time the Bureau of Labor Statistics reported new job openings increasing to a series high of 10.9 million positions, up from 6.7 million last July, and the number of Americans filing for unemployment benefits rose steadily throughout September, to 362,000 in the last week of the month. Although the overall unemployment rate declined to 4.8% in September, this seems to reflect the lower labor participation rate — people have elected to step aside from the workforce. Many employers have raised wages, but despite anecdotes about huge signing bonuses and salary increases, average hourly earnings are up only 4.3% compared to last year. The persistent gap between job vacancies and unemployment shows that the pandemic has prompted many workers to reassess their jobs as they grapple with career direction, work-from-home choices, and employer vaccination mandates.

Hiring challenges are just one faced by businesses. While the Institute for Supply Management's Purchasing Managers Index has reported steady improvement over the summer, with growth in new orders, production, inventories, and prices, businesses complained that they face an unprecedented number of hurdles to meet increasing demand. Manufacturers have been hit by record-long raw material lead times, shortages of critical materials, rising commodities prices, and transportation logjams. Supply chain problems appear to be particularly acute – as an example, the Port of Los Angeles reported a record backlog of 66 ships waiting at anchor to unload their cargo, as a shortage of dock workers, truck drivers, and outdated scheduling systems create weeklong delays. Before the pandemic, the ports typically saw an average of zero to one ship waiting to dock. "Our company's entire supply chain continues to have significant challenges getting manpower, which is impacting production of parts and ability to meet daily build schedules," complained one manufacturing manager. "Additionally, the logistics problems – especially port delays and a shortage of shipping containers – are significantly impacting inbound and

outbound shipments. Raw materials costs still are at record highs, and we have raised customer pricing, with additional increases in the near future due to labor costs going up."

Consumers, on the other hand, were clearly impacted by the emergence of the Delta variant of the Covid-19 virus. The University of Michigan's measure of consumer sentiment fell in late August to the lowest level in a decade, with Americans saying they are worried about the Delta variant and rising inflation. Consumer spending was mixed over the summer, with growth in June and August offset by declines in May and July. Movie theater visits fell by more than half at the end of August from a pandemic peak in mid-July, according to market research firm TOP. Airline passenger traffic, that had been rising steadily all year, peaked in July and has been declining as well. IHS Markit's Services Purchasing Managers Index fell to 54.4 in September of 2021 from 55.1 in August, pointing to the slowest growth in services activity since July of last year.

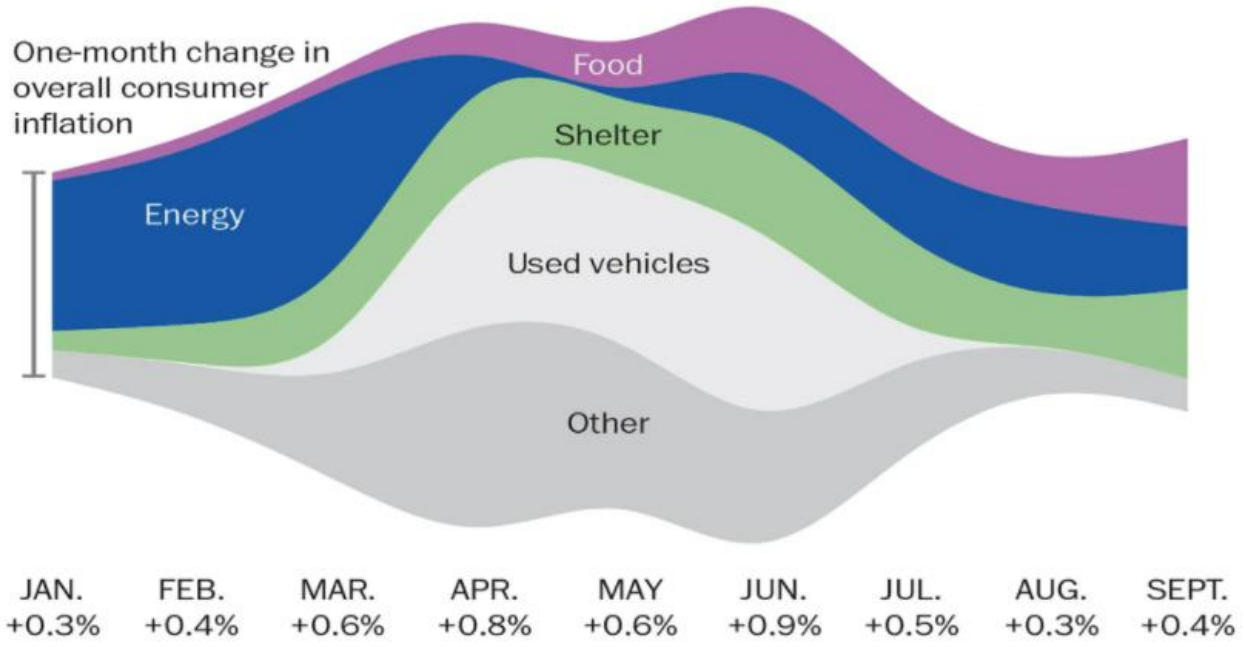
Daily U.S. Passenger Travel



Source: TSA

Inflation pressures continue to build. The annual inflation rate rose to 5.4% in September, a 13-year high. Prices of rent, food, new vehicles, energy, and medical care services have increased, while prices of used cars, transportation, and apparel declined. The price of energy is becoming a major concern. A combination of higher than expected economic growth, low inventories, and logistical disruptions have led to oil and gas shortages in many parts of the world, pushing crude oil over $80 a barrel (a 50% appreciation since the start of the year), resulting in power outages in China and gas stations in the UK running out of gasoline. At 419 million barrels, U.S. commercial crude oil inventories (excluding those in the Strategic Petroleum Reserve) fell to their lowest level in nearly three years and about 7% below the five-year average for this time of year. Since OPEC has refused to heed calls to increase production,

Components of Inflation in 2021

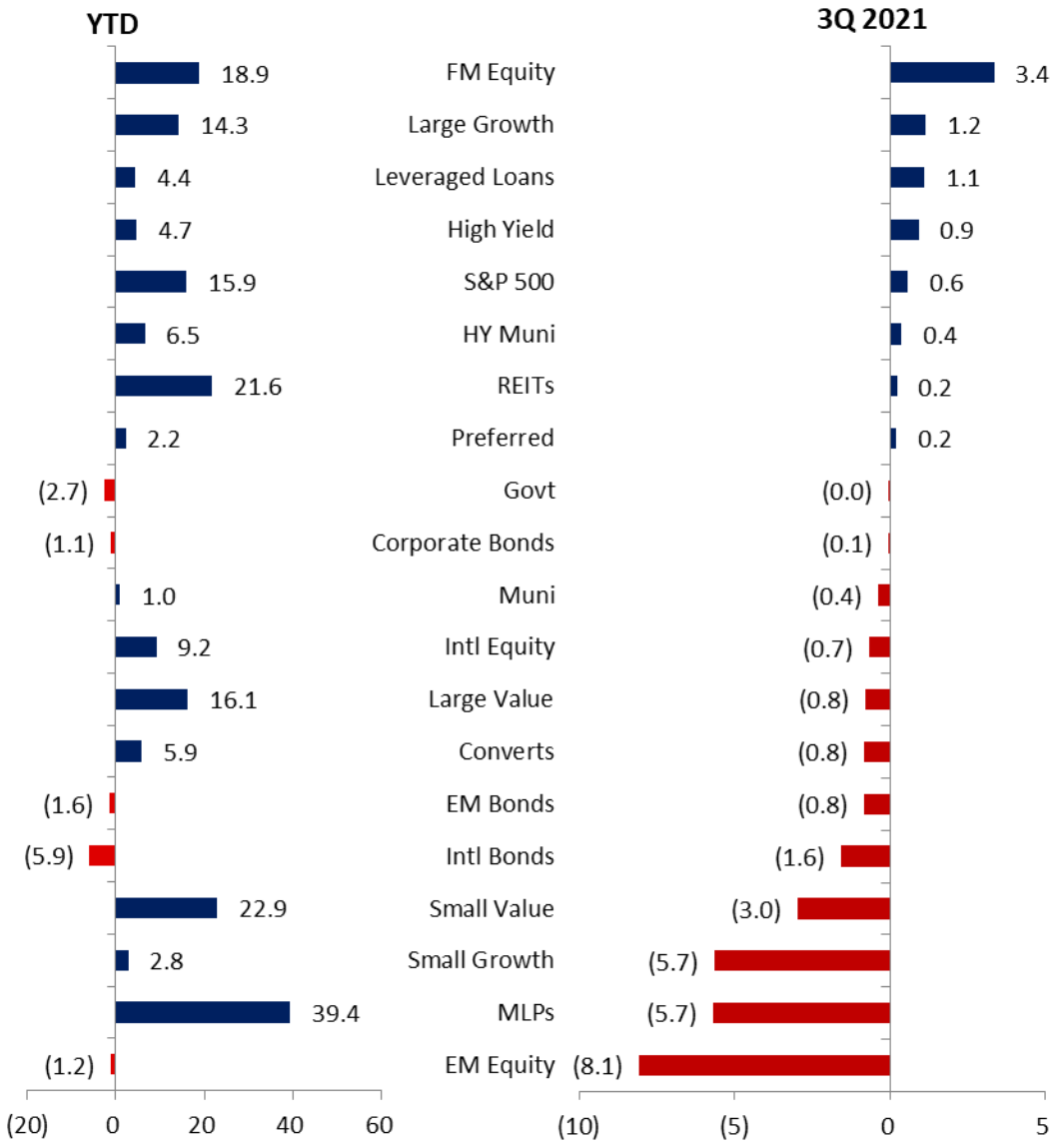


Source: The Detroit News, U.S. Labor Department

prices may head higher. The picture in natural gas is more severe, with prices in Europe and Asia surging over 6 times versus the same time last year. In the U.S., prices have doubled since the start of the year. Since more than half of all households use gas for home and water heating, a harsh winter could lead to shocking cost increases for some consumers. In the past, some industrial users had the ability to switch from natural gas to coal and vice versa if one fuel became too expensive; however, the sharp drop in coal production globally has eliminated this substitution option. In the short term, supply increases cannot be triggered quickly due to lack of capital and labor. While the transition from fossil fuels to renewable energy may be inevitable, it clearly needs to be managed cautiously to avoid self-inflicted energy crises.

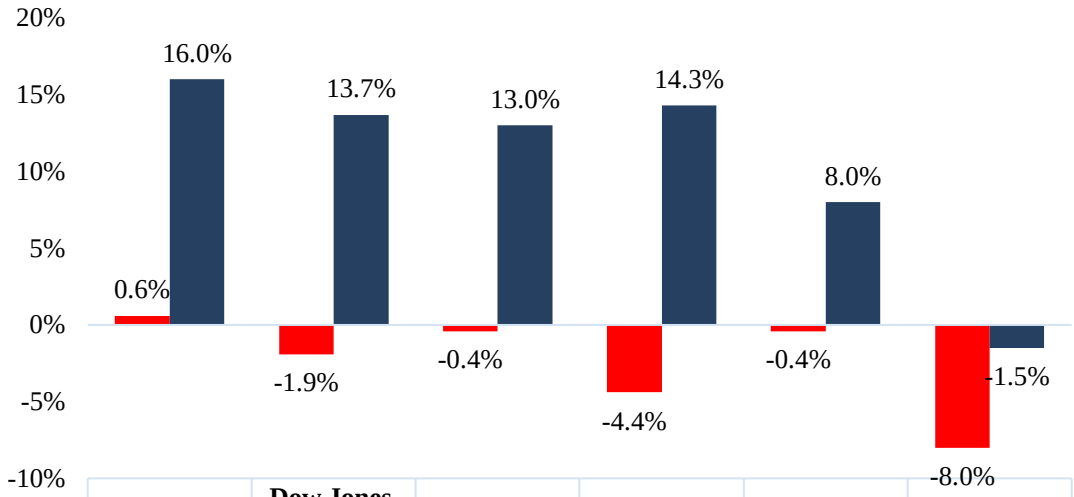
3rd QUARTER PERFORMANCE OF MAJOR ASSET CLASSES

Numbers represent percentage change



EQUITIES

Performance of Major Equity Indices



	S&P 500	Dow Jones Industrial Average	Nasdaq Composite	Russell 2000	MSCI EAFE	MSCI EM
Q3 Returns	0.6%	-1.9%	-0.4%	-4.4%	-0.4%	-8.0%
YTD Returns	16.0%	13.7%	13.0%	14.3%	8.0%	-1.5%

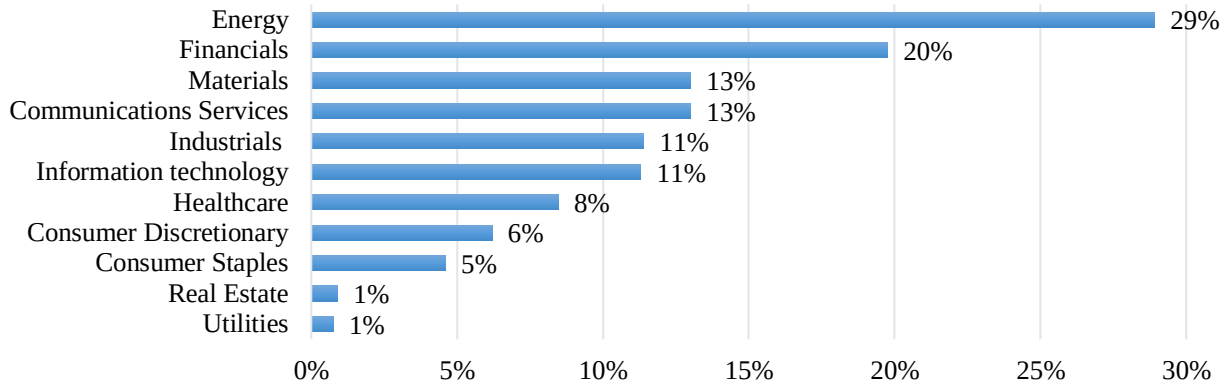
September has historically been the worst performing month for equity markets. This year was no different, with the month marking an end to 7 consecutive months of a winning streak, resulting in mixed outcomes for the equity indices in the third quarter. On a total return basis, the S&P 500 index etched a return of +0.6%, the Dow Jones Industrial Average was down -1.9%, and the NASDAQ was also down -0.4%. Internationally, most of the broad indices declined in the third quarter. Emerging markets dropped sharply while foreign developed markets had a modest fall. A coalition of macro headwinds which unfolded in the last couple of weeks of the quarter, such as China's Evergrande debt downgrade and the Federal Reserve's more "hawkish" stance, drove much of the market underperformance.

A rise in COVID-19 cases due to the emergence of the Delta variant and inflationary fears led to investors favoring large-cap names over small this year. This was driven by profit taking in some small-cap names that had seen a strong rally early in the year in the wake of economic reopening as well as worries that profit margins of smaller companies might take a hit in an inflationary environment. Eight out of eleven industry sectors ended the quarter in positive territory, although the magnitude of returns was much smaller than in previous quarters. Industrials and materials lagged the most, stemming from a possibility of weakness in demand from China. Energy and Financials continued to be leaders among sectors.

Growth stocks outperformed Value stocks for the quarter, thanks to their strong July and August returns, but this trend reversed following the Federal Reserve's Federal Open Market Committee meeting on

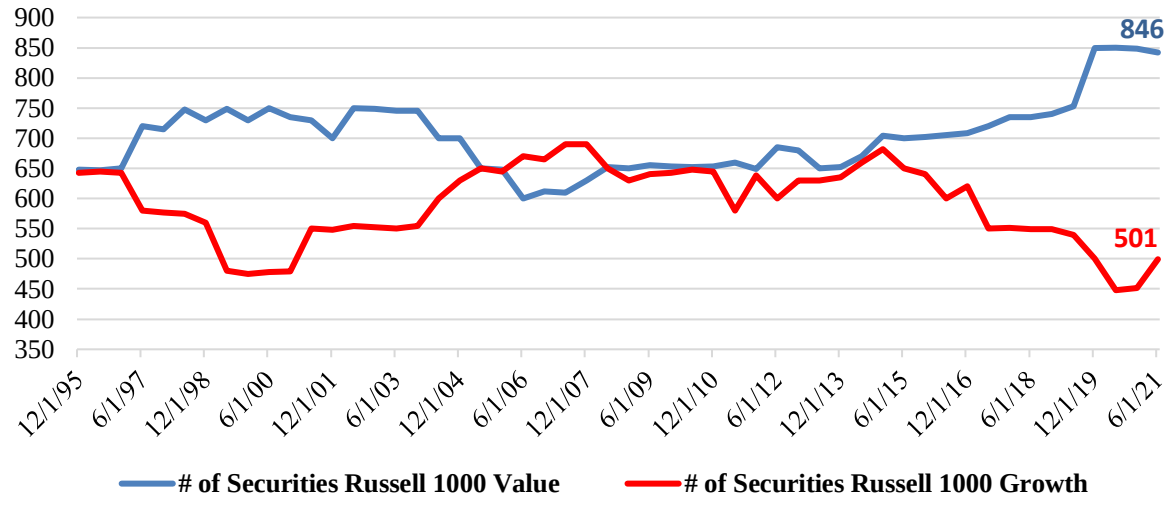
September 22nd when discussions about the taper of the Fed's bond buying program focused attention back to the possibility of rising interest rates.

Industry Sector Performance



This year Growth and Value style investing seem to be playing a tug of war, as uncertainties related to global growth have waxed and waned. Value stocks, which usually trade cheaper than their historical multiples, surged in the early part of the year as economies reopened, but their performance against their Growth counterparts faded in favor of names which did well during peak pandemic fears in 2020. More recently however, growing inflationary concerns have led to yet another round of outperformance by Value stocks. Year to date, the Russell 1000 Growth is up +14.3% whereas the Russell 1000 Value is up +16.1%.

Number of Names in Russell 1000 Growth and Russell 1000 Value



Conventional wisdom says Growth and Value styles of investing have unique characteristics, so the stocks in mutual funds or ETFs that adhere to the styles should be unique as well. Broadly speaking, Value stocks are categorized by low price-to-earnings (P/E), low price-to-book (P/B) ratios, and may have strong fundamentals that are unrecognized by the market, while Growth stocks generally have higher P/E and high P/B ratios that are justified by their higher future growth rates. But many stocks have a mix of both characteristics, and a subset of stocks which

represents the overlap of these characteristics end up in the lists of both Growth and Value managers. As an example, the Russell 1000 Value and Growth indices currently have 846 and 501 names respectively, but just over 300 stocks are in both benchmarks. Historically, roughly 30% of companies in the Russell 1000 on average are in this overlap region and appear in both the Growth and Value indexes, while the remaining 70% are assigned exclusively to be in one or the other. Why are there fewer stocks in the Growth Index? Since the indices are weighted on a market capitalization basis, the run-up of Growth stocks has led to a reduction in their number in the index, and the overlap has increased.

The idiosyncrasies of the Russell index construction poses challenges for both asset managers and investors. Active managers pursuing what they believe are "pure" Growth or Value strategies may find their performance diverging from these benchmarks. If the Russell Value Index increases the number of its stocks with Growth characteristics, would a Value manager be tempted to stray from her espoused discipline and buy more Growth stocks in order to not underperform the Value index? An investor in both Russell Growth and Value ETFs who is under the impression that the two provide risk diversification might be unpleasantly surprised by the significant position overlap. According to FTSE Russell, about $10.6 trillion in investor assets were benchmarked to Russell's U.S. indices as of the end of 2020. Approximately $465 billion of that amount was in passive investment products using the index benchmarks. While index funds may appear straightforward on the surface, sometimes their technical construction details may hide considerable risks.

BONDS

Fixed income markets experienced a relatively benign quarter from a return perspective as rates stuttered amid speculation around the U.S. debt ceiling and the Evergrande debacle in China. Credit-risk assets performed best, with leveraged loans and high yield leading the way at +1.1% and +0.9%, respectively. Broadly, U.S. Treasuries and corporate bonds were more or less flat – although the 10-year UST experienced some volatility, declining from a yield of 1.48% to a low of 1.17% before rebounding back to 1.53% by the end of the quarter. Municipals came in at -40bps. Overseas, both emerging market bonds and international corporate bonds saw minor losses of -0.8% and -1.6%, respectively. Spreads remain tight, and enticing yields prompt skepticism.

Evergrande Balance Sheet

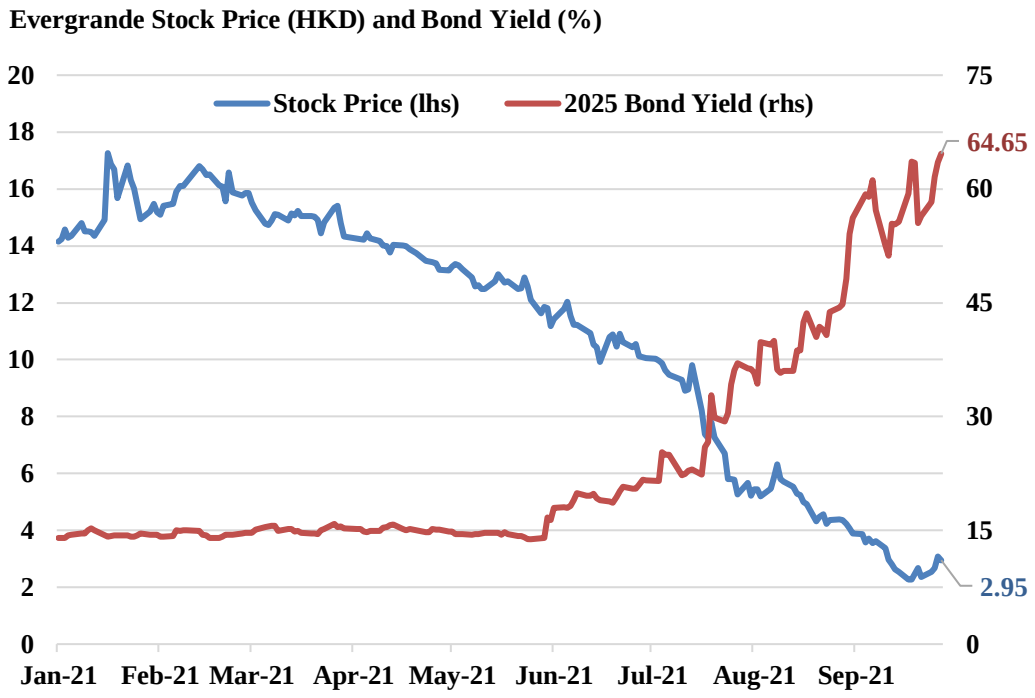
	USD billion	
Total Assets	$	369.9
Total Liabilities	$	306.0
Borrowings		89.0
Trade and other payables		149.8
Contract Liabilities		33.6
Other		33.6
Total Equity	$	63.9

Source: China Evergrande Group

In late August of this year, a letter circulated in which Evergrande, a Chinese real estate conglomerate, informed the Guangdong government it was at risk of running out of cash. While Evergrande has called the letter a fabrication, the speculation of such an event roiled debt and equity markets worldwide but especially so in Asia. The company has more than 2 trillion RMB of debt, roughly equivalent to $310 billion U.S. Dollars. Its creditors include thousands of retail investors, banks, suppliers, and foreign investors. It has expanded aggressively over the last several years, with forays into non-real estate areas such as electric vehicles, theme parks, energy, and sports.

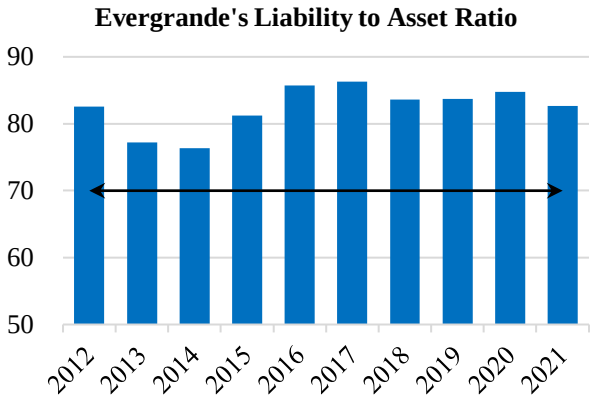
Since the letter circulated, Evergrande has met one interest payment of $84 million but has missed two subsequent payments on September 23 and September 29, resulting in a 30-day grace period before default. The company's equity shares are down ~80% year to date, and its debt has been trading around $0.25 on the dollar, indicating a suspected imminent default. Speculation over Evergrande's insolvency dates back to at least 2012 after Andrew Left, a famous short-seller, released a scathing report on the company, which ultimately led him to be suspended in 2016 from trading Chinese markets for five years. About a year ago in an attempt to rein in property developers' leverage, the Chinese government set out rules, known as the "three red lines." These balance sheet metrics are: (1) a ratio of liabilities to assets, (2) net debt to equity, and (3) cash to short-term borrowings. Nearly half of China's 30 biggest real estate

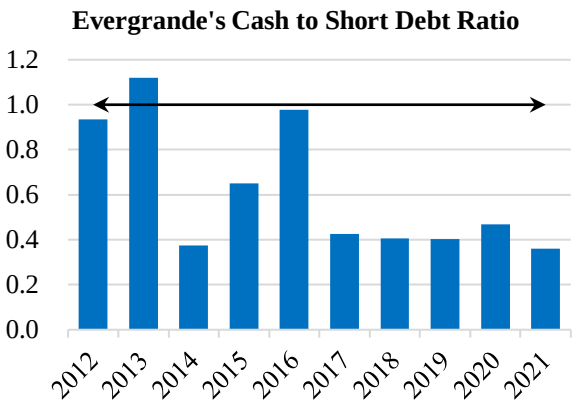
developers were in breach of at least one of these rules. The liabilities to assets ratio is the most commonly tripped "red line," demonstrating the indebtedness not just to lenders but also their business partners.



Source: China Evergrande Group

Evergrande Balance Sheet





Source: Bloomberg

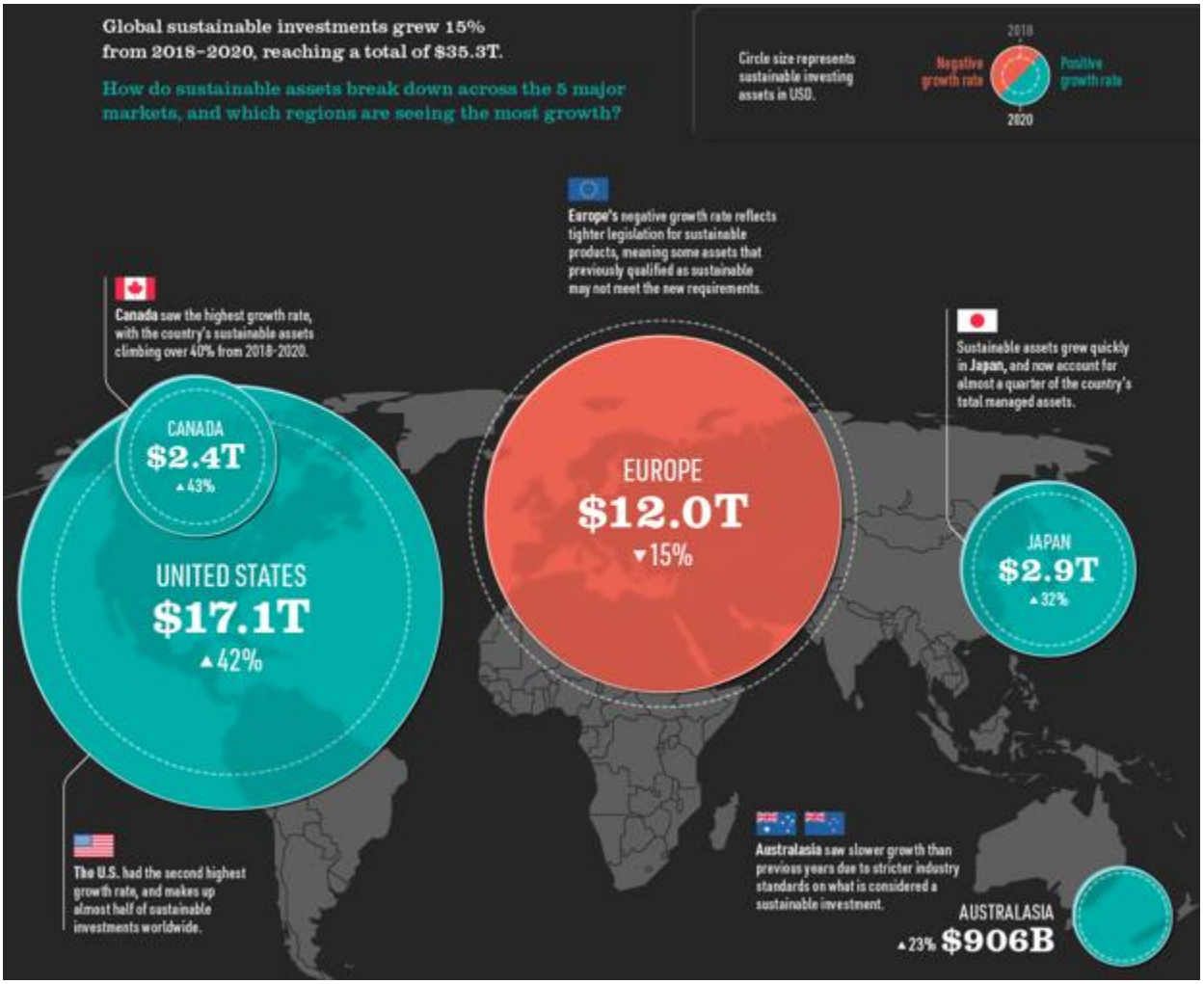
There are potential negative implications for the global economy if there is a Lehman Brothers-style collapse. Real estate accounts for nearly 30% of Chinese GDP. Evergrande is the second largest developer in China by sales and is part of the Global 500, one of the largest companies in the world by revenue. It employs nearly 200,000 people directly and is indirectly responsible for more than 3.8 million jobs. Trade and other payables account for nearly half of Evergrande's debt, revealing the potential

contagion. In fact, there have already been some repercussions in area markets, as Chinese Estates Holding, a Hong Kong-based property group, is attempting to go private amid its own share price losses due to its Evergrande exposure.

While Evergrande has managed to sell some assets, the capital from those sales is dwarfed by the size of the debt. Its sale of a $1.5 billion USD stake in a regional bank will likely go directly to the bank in question to settle its accounts there. Likewise, Evergrande is mulling over a sale of its property services subsidiary, which has a market value of $7 billion USD. Neither would have a material impact on the company's overall leverage levels. Since missing the payments, the company has not issued guidance and has not meaningfully engaged with investors. Evergrande has subsequently hired Houlihan Lokey to advise on the situation. It is expected Evergrande will require a restructuring, as analysts believe the company is "too big to fail." Some speculate the Chinese government will have to intervene to limit the fallout. Despite its desire to prevent moral hazard, Beijing will need to protect its citizens who have bought unfinished apartments, construction workers, suppliers, and small investors to prevent social unrest. Likewise, they will need to act to prevent contagion and successive failed companies. One option includes the effective nationalization of the company, leading to a restructuring and subsequent backing by state owned enterprises. Many believe this is the best option available to Beijing and investors, but this will certainly be a challenge as it seeks to avoid dilution of its leverage message.

If Evergrande is allowed to default on its obligations, there will undoubtedly be negative consequences for its investors and counterparties, resulting in a further deterioration of foreign investor confidence and capital flows. However, its lasting effect on the global economy will likely be much less impactful than the Lehman Brothers capitulation. For starters, Evergrande's liabilities are fairly straight forward, and its assets have a much higher recovery value – even in the event of bankruptcy – than Lehman's portfolio of sub-prime loans. Similarly, the contagion from Lehman's collapse stemmed from highly complex derivatives that spanned not just the whole U.S. financial system but beyond. In fact, even though Evergrande is the second largest developer by sales, the Chinese residential market is highly fragmented, with Evergrande accounting for only 3.2% of property sales in 2020. And yes, while Evergrande has a debt load of $310 billion U.S. Dollars, it only accounts for approximately 1% of Chinese banks' loan portfolio. That level of exposure is unlikely to result in a systemic problem. However, the situation is still unfolding, and investors will likely be wary of the space until the uncertainty is resolved.

Sustainable Investments Worldwide

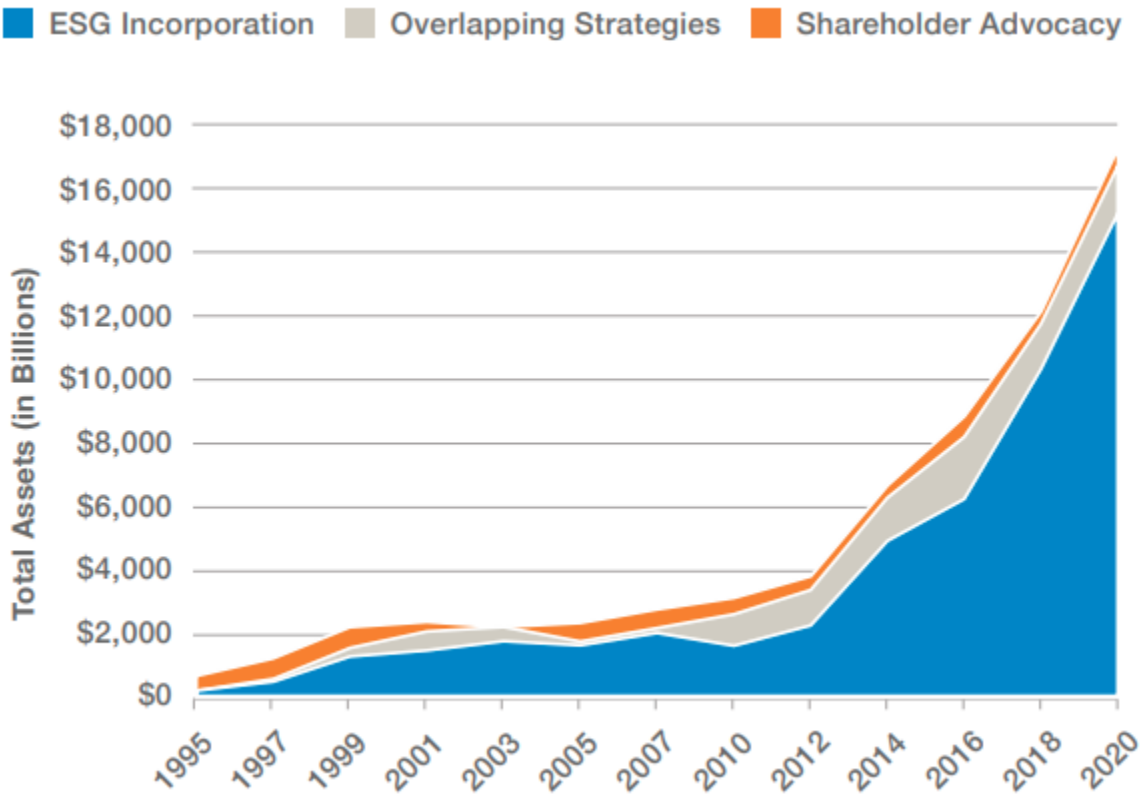


Source: Visual Capitalist

On March 11, 2021, Desiree Fixler, the Group Sustainability Officer at DWS, the asset management arm of Germany's Deutsche Bank, was fired from her position the day before the company released its annual report. In the report, the asset manager claimed that it applied a process called "ESG Integration" to evaluate investments for environmental, social, and governance risk factors for more than half of its $540 billion assets under management. Fixler, who had only been hired last August to help the firm develop its ESG capabilities, claimed that DWS was misrepresenting its ESG credentials. In her assessment "only a small fraction of the investment platform applies ESG integration," adding there was no quantifiable or verifiable ESG-integration for key asset classes at DWS. "As chief sustainability officer, as a proponent of ESG, how could I not speak up on wrongdoing," Fixler insisted. "Posturing with big statements on climate action and inclusion without the goods to back it up is really quite harmful as it prevents money and action from flowing to the right place." Her claims contradicted DWS' boasts in the annual report

that "as a firm, we have placed ESG at the heart of everything that we do." Fixler has filed an unfair dismissal case against DWS in a labor court in Germany. BaFin, the German financial regulator, as well as the SEC and the Justice Department, are now investigating DWS for potentially misleading claims.

Growth of ESG Assets



Source: SIF Foundation

ESG investing has become a rapidly growing business for asset managers. According to the Forum for Sustainable and Responsible Investment, $17 trillion – roughly one-third of all assets under professional management in the U.S. – was being managed in some type of sustainable-investment strategy, representing a 42% increase from two years earlier and a nearly fourfold increase over the past decade. The number of U.S. open-ended funds and ETFs with sustainability objectives grew by 30% in 2020 from the year before. Bloomberg forecasts ESG assets globally could exceed $53 trillion by 2025, representing more than a third of the $140 trillion in projected total assets under management. This would make ESG investing the most significant trend in investing since the advent of indexation.

This growth, however, poses enormous challenges for companies, asset managers, and investors. In response to pressure from regulators, asset managers, and investors, 90% of S&P 500 companies had published some kind of ESG report in 2020, up from 86% the prior year. While carbon footprint dominates ESG reporting, there is increasing demand for data related to employee diversity and inclusion in the aftermath of the emergence of the Black Lives Matter movement. A plethora of organizations, including the Global Reporting Initiative, the Sustainability Accounting Standards Board, the Carbon

Disclosure Standards Board, and the Task Force on Climate-related Financial Disclosure, are all demanding data from companies while competing with each other to establish a dominant reporting standard. The International Financial Reporting Standards Foundation, whose accounting standards are adopted by 120 countries, is developing its own ESG standards, making it more than likely that these countries will endorse and require companies to use their framework. The European Union has proposed that starting in 2024 nearly 50,000 publicly traded and large, private companies will have to report standardized data on various ESG metrics. In the U.S., the SEC has also begun to debate how companies should disclose ESG metrics, and in June, the House of Representatives passed the "ESG Disclosure Simplification Act," which, if enacted, would require companies to report ESG data in their SEC filings. Until legislatures and financial regulators around the world can agree on common standards, however, companies are likely to selectively disclose information that will make them look good – rather than what is material – knowing that what they report is rarely subject to a rigorous audit by a third party.

This in turn makes it extremely difficult for asset managers to compare one company to another on ESG performance. Not surprisingly, a number of ESG rating agencies have emerged, offering to compile data to distill it into a score, much like a bond credit rating assessed by Standard and Poor's or Moody's. So, an equity analyst for an ESG fund could presumably pick a company with an "A" ESG rating in preference to an industry competitor that only has a "C". However, in a study of ESG ratings conducted by MIT professors Florian Berg, Julian F. Koelbel, and Roberto Rigobon, the trio found that there was significant divergence amongst the ratings of prominent ESG raters. One service might rate Apple an "A", while another might rate it a "C". Companies on which the 6 major rating agencies disagreed the most include Intel, AT&T, Johnson & Johnson, and Philip Morris – all large-cap companies with considerable troves of publicly available data. The MIT team discovered that the inconsistencies amongst rating agencies stemmed from differences in the attributes they measure (one rater might measure a company's carbon emissions, another political lobbying); the metrics examined for the same attribute (one might track employee lawsuits while another might track staff turnover to measure the quality of a company's "employee satisfaction"); and finally, the weights assigned to each of the E, S, and G factors. So, it is possible for an ESG rating agency to assign a coal mining company a high overall ESG score if its employee and community engagement and its governance polices are good enough to overcome a poor environmental score. The correlation among these agencies' ESG ratings was on average only 0.61; by comparison, credit ratings from Moody's and Standard & Poor's have 0.92 correlation, meaning that they rarely disagree about a company's default prospects.

While this ambiguity around ESG ratings may sow confusion, does it matter? After all, no institutional-grade bond investor would just rely on credit ratings to pick bonds, right? The problem is that asset managers have no standards or guidelines themselves to define what constitutes an ESG investment process or ESG fund. Long before ESG became a widespread term many investors were practicing ethical or "socially responsible" investing, which applied negative screens to exclude certain "sin" industries like tobacco, alcohol, gambling, and arms manufacturing from portfolios. While such "negative screening" approaches are easier to understand and implement, actively incorporating ESG metrics into a security selection process is a more difficult and ambiguous task. Is it sufficient for an analyst to simply acknowledge a company's ESG risks to be ESG compliant? Or does the analyst need to incorporate, as an example, the potential costs of a company's carbon emissions into forecasts of its revenues and costs?

Ultimately, how much weight should ESG factors have relative to traditional financial metrics like profitability or leverage? For a fund to be a legitimate ESG product, does the investment process need to prioritize ESG factors in security selection?

These methodological challenges have not stopped asset managers from emphasizing their sustainability credentials in their marketing or from launching a tsunami of ESG products. In 2006, when the United Nations-backed Principles for Responsible Investment was launched, 63 investment companies with $6.5 trillion in assets under management signed a commitment to incorporate ESG issues into their investment decisions. In 2021, the number of signatories has grown to 3,826 and represented $121 trillion in assets. Critics argue that the asset management industry is embarking on a cynical attempt to capture investor enthusiasm for ESG. According to Morningstar, asset managers repurposed or rebranded 256 funds as "sustainable" in 2020, up from 179 the year before. In the first quarter of this year alone, a 127 existing funds decided to include ESG in their name. Many of these funds were underperforming or had suffered significant investor redemptions. For example, the USAA World Growth Fund, which changed its name to the USAA Sustainable World Fund last October, had seen $315 million in net outflows since 2011. Perhaps the fund's marketing department had forgotten to inform the portfolio managers of the change — even though the fund's marketing materials claim it now integrates "sustainable investing, responsible investing, or environmental, social, and governance analysis," it still owns nearly $100 million in shares of 47 fossil-fuel companies, as well as companies like British American Tobacco and notorious Brazilian miner Vale, whose atrocious neglect of its mines killed 270 people in 2019 alone.

Such blatantly cynical steps prompted Tariq Fancy, who served as the Chief Investment Officer for Sustainable Investing at Blackrock, the world's largest asset manager, to resign and publish a 40-page whistleblower essay in which he lambasted ESG investing as doing more harm than good. "There is no evidence," he raged, "that any ESG exchange traded fund has any positive social impact that I have seen." Fancy believes that investors allocate to ESG funds to feel good about themselves but are deluded if they believe such actions result in companies taking meaningful action. He describes ESG investing as analogous to giving "wheat grass to a cancer patient" – it is not only ineffective but dangerous as it delays real solutions to the world's major problems. He argues that firms like BlackRock – whatever their public statements about social responsibility – have gleefully welcomed the surge of ESG interest as a money-making bonanza. He points out that it is no coincidence that ESG-labeled funds charge investors fees that are on average 42% higher than traditional funds.

So, what should financial advisors do to help clients interested in ESG? A survey by the CFA Institute reported that while 69% of retail investors are interested in ESG, only 10% actually invested in products that incorporate ESG factors. Unsurprisingly, interest in ESG increases the younger the investor. However, a financial advisor's job isn't to simply serve what clients want – indeed, it is the advisor's responsibility to steer clients away from misguided investment strategies and fleeting fads. And by the way, do ESG products even perform?

The preponderance of academic research, at least, suggests that companies with superior ESG metrics outperform their peers. A study by Harvard Business School's George Serafeim found that companies that measured, managed, and communicated ESG metrics in the early 1990s outperformed a control group

over the next 18 years. A 2017 study by Nordea Equity Research, the largest financial services group in the Nordic region, reported that from 2012 to 2015, the companies with the highest ESG ratings outperformed the lowest-rated firms by as much as 40%. A comprehensive survey conducted by NYU Stern Center for Sustainable Business and Rockefeller Asset Management of over 1,000 ESG studies found that 58% of them showed a positive correlation between ESG and corporate financial metrics such as Return on Equity, Return on Assets, and stock price. As for ESG funds, a study by Morningstar examining the long-term performance of a sample of 745 Europe-based funds showed that the majority have done better than non-ESG funds over one, three, five, and ten years. "The findings debunk the myth that there is a performance penalty associated with ESG investing," said Hortense Bioy, director of passive strategies and sustainability research at Morningstar.

Nevertheless, it is clear that allocators need to dig deep beneath the PR onslaught to identify funds that truly add value through ESG integration. Louisiana Salge, Senior Sustainability Specialist at EQ Investors, a British sustainability-focused asset manager, argues that "fund titles mean next to nothing" because EQ's own research has revealed some funds without any ESG branding having better ESG integration than some specifically marketed as such. "It is crucial to cut across messaging and analyze the fund investment process, the team's philosophy, its resources and oversight and also dig into underlying holdings to really get security over a fund's objectives regarding sustainability. One needs to be extremely thorough through extensive qualitative analysis to ensure philosophy of the fund does match up with the mandate. We would need to see evidence of experience within the team, depth of research, authenticity and understanding of the complex subject matter to consider a fund."

Many ESG funds have generated outperformance recently simply by tilting industry sector weighting emphasizing technology at the expense of energy, at a time when the latter sector was dragging down the market. Although most ESG driven allocators believe that asset managers need to engage with company managements to exert pressure for change, many do not even bother. According to the research and advisory firm Institutional Shareholder Services, the number of ESG-related corporate resolutions have exploded: two-thirds of the 429 filings in 2020 addressed climate change, political spending, and treatment of women on boards and in the workplace. Yet while sustainable funds were significantly more likely than conventional funds to support such shareholder resolutions (sustainable funds supported these resolutions 68% of the time compared with 37% for other funds), a distressing number of ESG funds only supported a fraction of these resolutions. Corporate engagement matters – earlier this year Engine No.1, a tiny hedge fund managing just $240 million, defeated a full-court-press campaign by Exxon to place 3 directors on its board as it demanded that the company move faster to tackle climate change. In a similar vein, capital allocators need to demand greater transparency, more rigorous integration of ESG factors into the investment process, and above all, a truly genuine and authentic embrace of sustainable investing from their ESG asset managers.

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Glossary and Index Definition

•Alerian MLP Index (MLP) - The Alerian MLP Index is a composite of the 50 most prominent energy master limited partnerships calculated by Standard & Poor's using a float-adjusted market capitalization methodology. The index is disseminated by the New York Stock Exchange real-time on a price return basis (NYSE: AMZ). The corresponding total return index is calculated and disseminated daily through ticker AMZX.

•Barclays Capital U.S. Municipal Index – The U.S. Municipal Index covers the USD-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligations, revenue bonds, insured bonds, and prefunded bonds. Many of the sub-indices of the Municipal Index have historical data to January 1980. In addition, several subindices based on maturity and revenue source have been created, some with inception dates after January 1980 but no later than July 1, 1993. In January 1996, Barclays Capital also began publishing a non-investment grade municipal bond index and "enhanced" state specific indices for Arizona, Connecticut, Maryland, Massachusetts, Minnesota, and Ohio. These indices are published separately from the Barclays Capital Municipal Bond Index.

•BofA Merrill Lynch Convertible Bond Index (Convertibles) - The BofA Merrill Lynch Convertible Bond Index tracks the performance of US dollar denominated convertible bonds issued in the US domestic market. In addition, qualifying securities must have at least one-year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of $100 million.

•BofA Merrill Lynch Perpetual Preferred Securities Index (Preferred) - The BofA Merrill Lynch Fixed Rate Preferred Securities Index tracks the performance of US dollar denominated preferred securities issued in the US domestic market. Qualifying securities must be rated investment grade (based on an average of Moody's, S&P and Fitch) and must have an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

•BofA Merrill Lynch US High Yield Master II Index – This index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

•BofA Merrill Lynch EM External Debt Sovereign Index – This index tracks the performance of US dollar-denominated debt issued by sovereign issuers in countries belonging to emerging markets.

•BofA Merrill Lynch Mortgage Master Index – This index tracks the performance of US dollar-denominated mortgage securities.

•BofA Merrill Lynch Municipal Bond Index – This index tracks the performance of US dollar-denominated investment grade tax-exempt bonds.

•Credit Suisse Leveraged Loan Index – This index tracks the investable market of the U.S. dollar denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.

•JP Morgan Emerging Market Bond Index (EMBI+) - The Emerging Markets Bond Index Plus tracks total returns for traded external debt instruments in the emerging markets. The instruments include external-currency-denominated Brady bonds, loans and Eurobonds, as well as U.S. dollar local markets instruments. The EMBI+ is concentrated in instruments from the three major Latin American countries (Argentina, Brazil, and Mexico), reflecting the size and liquidity of these external debt markets. The non-Latin countries are represented in the index by Bulgaria, Morocco, Nigeria, the Philippines, Poland, Russia, and South Africa.

•MSCI Emerging Market Index (Emerging Market Equities) - The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of March 2015, the MSCI Emerging Markets Index consisted of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey, and United Arab Emirates.

•MSCI Frontier Market Index – The MSCI Frontier Market Index is a free float-adjusted market capitalization index designed to measure equity market performance of the frontier markets. As of March 2015, the MSCI Frontier Markets Index consists of the following 24 frontier market country indices: Argentina, Bahrain, Bangladesh, Bulgaria, Croatia, Estonia, Jordan, Kenya, Kuwait, Lebanon, Lithuania, Kazakhstan, Mauritius, Morocco, Nigeria, Oman, Pakistan, Romania, Serbia, Slovenia, Sri Lanka, Tunisia, Ukraine, and Vietnam.

•Russell 2000 Index (TR) - The best-known of a series of market-value weighted indices published by the Frank Russell Company. The index measures the performance of the smallest 2,000 companies in the Russell 3000 Index of the 3,000 largest U.S. companies in terms of market capitalization.

•Russell 1000 Index (TR) –A market-value weighted indices published by the Frank Russell Company. The index measures the performance of the largest 1,000 companies in the Russell 3000 Index of the 3,000 largest U.S. companies in terms of market capitalization.

•S&P 500 Index (TR) -Widely regarded as the best single gauge of the U.S. equities market, this world-renowned index includes 500 leading companies in leading industries of the U.S. economy. S&P 500 is a core component of the U.S. indices that could be used as building blocks for portfolio construction. It is also the U.S. component of S&P Global 1200. Total return (TR) provides investors with a price-plus-gross cash dividend return. Gross cash dividends are applied on the ex-date of the dividend.

•FTSE NAREIT US Real Estate Index Series – The FTSE NAREIT US Real Estate Index Series is designed to present investors with a comprehensive family of REIT performance indexes that span the commercial real estate space across the US economy, offering exposure to all investment and property sectors. In addition, the more narrowly focused property sector and sub-sector indexes provide the facility to concentrate commercial real estate exposure in more selected markets.

Data Sources: Bloomberg, L.P., JPMorgan, BofA Merrill Lynch, Standard and Poors, Barclays Capital, Alerian, Morningstar Direct, MSCI, HFR, Goldman Sachs, Trading Economics, HIS Markit, Eurostat, Eaton Vance.