OWL ESG

THE UNEXPECTED INTERSECTION OF SUSTAINABILITY AND DIVIDENDS

WITHOUT FINANCIAL RETURNS, SUSTAINABLE INVESTING IS FUTILE

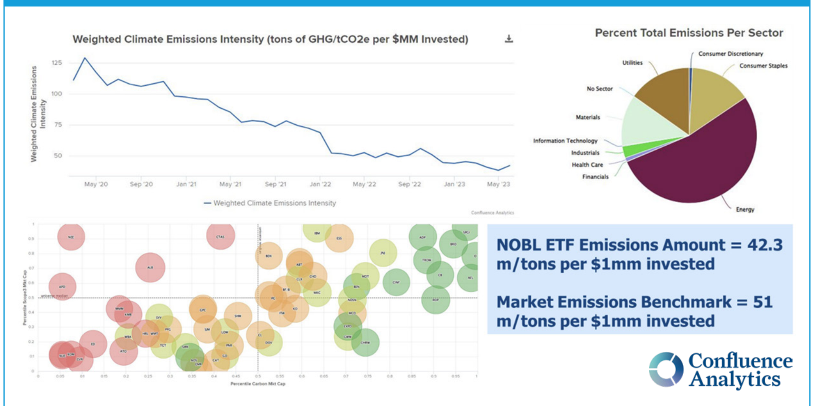
Sustainable investing and long-term investing share significant overlap. Investors use both approaches to seek specific positive change over broad periods of time. Without financial returns, sustainable investing is futile, and blue-chip, dividend paying stocks are a critical component of many successful long-term investment strategies. These established companies tend to be more carbon-intensive for a number of reasons, seemingly creating conflict between the two investment approaches. But there are ways to include stable, blue-chip companies in a sustainable portfolio, even with some names that might seem counterintuitive, by looking at dividends and the “climate-adjusted yield.”

By Rob Yates

To compare portfolio companies’ effectiveness in their implementation of sustainability strategies, such as greenhouse gas (GHG) emissions reduction measures, a standard cost of doing business is necessary. Establishing a baseline makes it possible. For example, to price carbon in a market setting, confirm the efficacy of offsets, and evaluate investment decisions in terms of risk and return.

Once a baseline is established, the market can reliably evaluate a company’s impact, positive and negative, against an expected return on investment. Of course, yield and return are complicated and difficult to predict, even for the most sophisticated institutional investors. Stable stocks that so many investors crave lose some luster when non-financial objectives complicate the equation, potentially reducing returns substantially. In other words, fossil fuel companies would not deliver the same returns if they stopped using fossil fuels.

NOBL COST OF EMMISIONS



This concern holds true to an even greater extent for income investors, who tend to be resolute in investments, which they view as long-term relationships, and predict their yield relative to returns over time. Blue-chip companies with extensive histories of reliable dividend payments fit this description perfectly, but this creates a conflict for sustainability-focused investors, though, as these companies are often significantly more emissions-intensive, for several reasons. Sustainable investors potentially face a choice between stable, predictable returns or low-emission companies.

This is a false dichotomy, though. With an established price of carbon, investors can commit their dollars to these stalwart companies, even those which are not usually associated with being "green." By multiplying the cost of carbon by total emissions, and then dividing that number by a company's market cap, investors can calculate a straightforward "cost of carbon metric," expressed in basis points. Subtracting that from the dividend percentage yield ends with a "Net Zero Yield," which is the cost-of-carbon adjusted return from the company's paid dividends.

SELECT NET ZERO YIELDS

	3M	EMERSON	Johnson & Johnson	P&G
Dividend[1]	5.89%	2.42%	2.95%	2.57%
Scope 1&2[2]	3.9m	.80M	.80M	2.3M
Net Zero Yield Expense[3]	0.16%	0.04%	0.00%	0.02%
Net Zero Yield[4]	5.73%	2.38%	2.95%	2.55%

Notes:

1.) As of 6/13/2013

2.) Scope 1&2 GHGs for 2022 from Companies

3.) Assumes average carbon price of $23 per m/ton of GHG over market cap

4.) Current Yield - Net Zero Expense = Net Zero Yield

Confluence Analytics

Not only does this give sustainable investors a clear path to simultaneously being income investors, it creates a language for companies and investors alike to discuss the cost – and return – of making huge adjustments to a company's net carbon impact through offsets. As the first table above shows, companies like ExxonMobil should be viewed not only as tolerable for sustainable investors, but possibly even preferable, as they have a powerful market incentive to address their carbon-emissions challenge.

DIVIDEND YIELD NET OF EMISSIONS

- **Examine the ProShares S&P 500 Dividend Aristocats ETF (NOBL) first to compute the Net Zero Cost of the ETF**
- **NOBL ETF selects companies with a 25+ consecutive years of paying dividends**
- **We illustrate the concept of net zero cost of emissions with some of NOBL largest sector emittors**

	ADM	NEXTera ENERGY	ExxonMobil
Dividend[1]	2.48%	2.52%	3.42%
Scope 1&2[2]	15.2M	46.6M	117M
Net Zero Yield Expense[3]	0.88%	0.71%	0.61%
Net Zero Yield[4]	1.61%	1.81%	2.81%

Notes:

1.) As of 6/13/2013

2.) Scope 1&2 GHGs for 2022 from Companies

3.) Assumes average carbon price of $23 per m/ton of GHG over market cap

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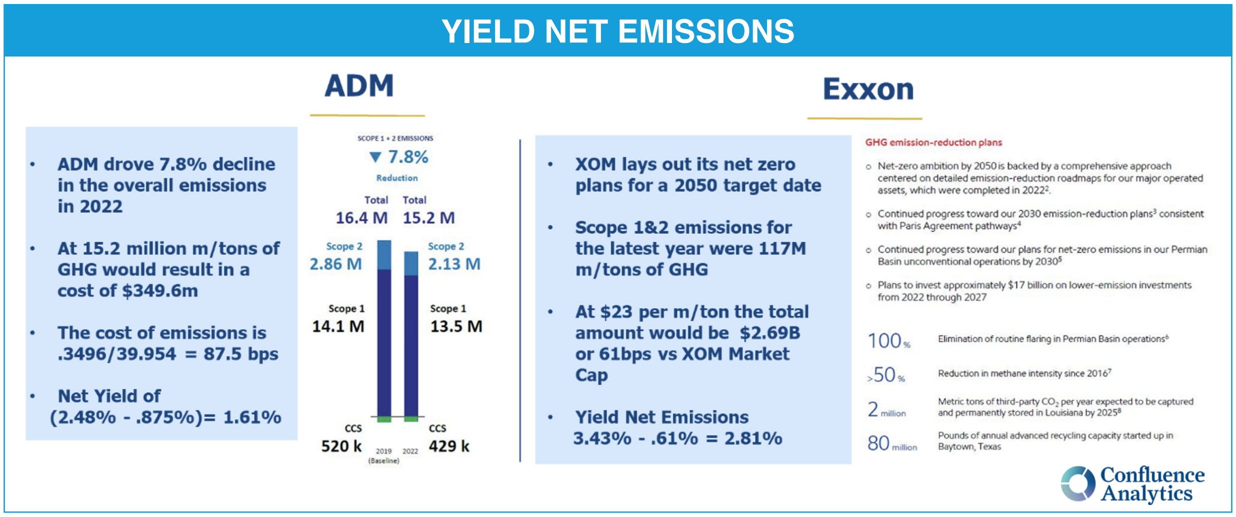
Confluence Analytics

In fact, the impact of a sustainable investment dollar is greater at bigger companies with more market cap, where yield is diminished less per ton of offset carbon. The market has provided a clear way to make investments that are both sustainable and provide the stability of dividends. It is surprisingly affordable to have your sustainability cake and eat your financial returns too. The GHG externality translates to a real input in the equation as part of a predictable return, through yield.



Companies that fail to boost investor bottom lines will quickly whither without the requisite financing, regardless of how “green” they might be. For example, to a portfolio manager who is seeking reduced GHG emissions impact in a portfolio, evaluating both overall returns and “climate-adjusted yield” as accurately as possible is paramount to selecting companies that are sustainable financially and environmentally. As sustainable investments deliver repeated financial successes, positive change accelerates in non-financial categories, like emissions reduction, with market forces as an engine.

If market forces are the engine of change, yield is the fuel that makes that change meaningful. Higher and more predictable yields are attractive to nearly all institutional investors, regardless of the degree to which sustainability might influence them. For investors focused on sustainability, the only distinction is that they see yield in terms of return on their investment in both progress and dollars. Beyond that, sustainable investment includes the same considerations inherent to any other investment strategy, and portfolio companies are selected based on predicted returns against peers, the market, expectations, and a host of other factors.