WELLINGTON MANAGEMENT®

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About the authors

Eric is the architect of Wellington Management's social impact strategy. He manages our flagship Global Impact Portfolio and is a thought leader for the development of social impact and other thematic investment ideas that support the firm's portfolio managers and analysts.

Quyen partners with industry practitioners, academia, and other organizations to develop thought leadership and strategy on impact investing and measurement. She has provided strategic guidance for the development of Wellington's Global Impact strategy and serves investment teams in a consultative role.

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Listed equities: Aiming to fill a void in the impact ecosystem

KEY POINTS

- We believe public equities are the key to democratizing impact investing and expanding the impact ecosystem.
- Impact investing must center on intentionality, centrality, and additionality.
- Many impact companies are rapid growers with innovative approaches and immense end markets.

Impact investing harnesses the power of finance in an effort to address the world's most challenging problems, including:

- Providing clean water, affordable housing, and health care;
- Facilitating sustainable agriculture and nutrition;
- Offering access to education, financial services, and the Internet; and
- Promoting clean energy and resource efficiency.

Addressing such issues on a global scale is recognized by many as being vital to our future, yet it has long proven intractable for public and philanthropic institutions to solve these problems alone. This is due in part to a lack of available capital. We believe that tackling these problems will require the involvement of the entire impact investing ecosystem, from angel investors to private equity and public market participants. The nascent growth in public-market impact funds is, in our view, a necessary step toward democratizing impact investing and increasing the capital available.

Democratizing impact investing

For decades, impact investing has been the domain of private market investments such as venture capital, private equity, and microlending. Despite important progress, these private investments remain limited in scope and challenging to access for most investors, given large investment minimums, stringent eligibility requirements, concentration risk, difficulty sourcing deal-flow, the need for extensive research, and the volatile early-stage nature of the businesses. Private investing also presents liquidity challenges, limited transparency, and a dearth of options along the risk-tolerance spectrum.

For us, authentic impact investing is a core value and the guiding principle of our investment framework.

We believe that public equities are the key to democratizing impact investing and expanding the ecosystem. By enabling a much larger set of asset owners to align their values with their investment objectives, public market funds can increase the capital available to solve these enormous challenges. A complement to private equity, public funds are typically easier to access and offer daily liquidity and transparency. They can invest across a range of sectors, regions, impact themes, and market capitalizations, enabling participants to diversify quickly at a much lower cost. And we know from experience that public-equity impact investments can deliver competitive, market-beating returns by pairing disciplined fundamental research with an understanding of the impact case for each investment.

What is impact investing?

Impact investing differs from other values-based or socially responsible investment approaches. All have merit, but for impact investors to attract and deploy the necessary capital, we believe three key characteristics must hold: intentionality, centrality, and additionality.

Intentionality: The definition of an impact investment begins with the critical concept of intentionality. An investor chooses to make an investment with the explicit intent of generating a targeted and positive societal or environmental outcome.

Centrality: A company's core product or service must advance one or more of the investor's impact goals, with business units and product lines geared toward impact. Impact-oriented products and services must comprise the majority of a company's business activity; otherwise, it is often too easy for a company to evolve away from the investor's impact objectives.

Additionality: A company's efforts must fill unmet needs that are not easily filled by other means or agents such as competitor products and services, philanthropic goods, or government aid. We also look at whether the company aims to improve the lives of a particular underserved demographic, such as women, the indigent, the sick, or the elderly.

While we hope and expect more mainstream managers will embrace impact investing and expand the impact ecosystem, we appreciate concerns about impact dilution or "greenwashing." Mislabeling and rebranding of existing funds are common worries. We believe this underscores the importance of authenticity from asset managers and due diligence from prospective investors. For us, authentic impact investing is a core value and the guiding principle of our investment framework. Investors entrust us with their assets to align their values with their investment objectives. A thoughtfully constructed public-market impact universe allows us to do that for a growing number of people around the world.

Identifying themes, measuring impact

For the Wellington Global Impact approach, we have identified 11 themes that we believe frame the world's great social and environmental challenges, and notably those for which there are sufficient listed companies in which to invest.

LIFE ESSENTIALS	HUMAN EMPOWERMENT	ENVIRONMENT
Affordable housing	Education and job training	Alternative energy
Clean water and sanitation	Digital divide	Resource efficiency
Sustainable agriculture and nutrition	Financial inclusion	Resource stewardship
Health	Safety and security	

We began investing in our themes in 2014 and have continually worked to match them to the impact investing opportunity. When the United Nations (UN) adopted its Sustainable Development Goals (SDGs) in late-2015, this confirmed that the themes we generated were consistent with these universal goals. While impact investing was not the intended application of the SDGs, today these goals are increasingly used by investment managers to define impact objectives. Our approach is closely aligned, addressing all but two of the UN's goals for a sustainable future (**Figure 1**).

Figure 1
Alignment with Sustainable Development Goals

Wellington Management supports the SDGs | Sources: Wellington Management, United Nations

We believe that measuring the impact of each investment is crucial for holding ourselves and the companies we invest in to high standards of accountability. Tracking and reporting impact is an industry best practice that is, in our view, another key to expanding the ecosystem. Our team develops custom key performance indicators (KPIs) using a structured,

"We find that impact companies, on average, can have several advantages relative to non-impact companies including potentially faster growth, innovative approaches, and immense end markets."

replicable research methodology in an attempt to track each company's progress toward effecting positive social and environmental change. Ultimately, the purpose of measuring impact is to:

- Bring awareness of the core impact case of an investment
- Increase accountability and encourage improvement over time
- Deepen our engagement with the companies in our portfolio
- Inform, affirm, and strengthen values alignment for our clients

Potential benefits of public market investments for social enterprises

Companies working to deliver social and environmental solutions can benefit from the steady stream of capital from public market funds, as well as guidance and engagement from dedicated impact investors.

- **Critical support:** Public market impact investments can help social enterprises stay true to their objectives as they grow. Many high-quality companies get stuck at a suboptimal size, struggling to attain enough funding to expand. The dearth of public-market impact investors signals an unwillingness to invest in private impact companies or new initial public offerings (IPOs); their innovative business models, untested technologies, and relatively long payoffs can render them uninvestable. Without this crucial source of capital, founders may be forced to sell a promising enterprise, losing control of its impact potential.
- **Broader financial resources:** Public-market impact investors also enlarge the pool of potential investors after an IPO. Given a tendency among impact investors toward patience and longer time horizons, this capital may help reduce stock-price volatility, improving a company's ability to raise additional equity, issue debt, borrow from banks, pay employees, and ultimately reinvest to scale its impact mission.
- **Guidance and engagement:** Impact investors can encourage companies to communicate their social impact footprint, track and measure their progress, and consider listing on a social stock exchange. This may help them attract lower-cost funding, expand their customer base, and can strengthen their impact and brand.
- **Visibility and awareness:** Whereas the visibility of successful social enterprises is opaque in a private equity setting, a vibrant public equity market can highlight success stories, attracting new investors and, in our opinion, other aspiring social enterprises. Impact asset managers can help dispel misperceptions and attract more mainstream capital.

The investment case for public-equity impact strategies

While some skeptics may argue that impact investments are destined to deliver concessionary, or below-market, returns, we respectfully disagree. We find that impact companies, on average, can have several advantages relative to non-impact companies including potentially faster growth, innovative approaches, and immense end markets. The proprietary universe for Wellington's Global Impact approach consists of companies with strong growth profiles.[1] The historical three-year revenue-growth rate of companies in our universe is almost triple that of the broad market,[2] reflecting strong demand and, in our view, supporting the long-term investment case.

[1]The Global Impact opportunity set is proprietary and reflects Wellington Management's fundamental research on individual companies.

[2]As defined by the MSCI ACWI

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Notably, the set of publicly listed companies that meet our impact criteria is expanding.

This universe of listed impact companies has also historically had higher financial return dispersion than the overall market.[3] Dispersion often results from misperceptions about a stock's investment merits, which, in the case of impact companies, can stem from limited analyst coverage, unconventional business models, short operating history, and a broad range of potential outcomes. Yet for dedicated public-market impact investors, such factors look more like investment opportunities than obstacles, as dispersion helps active managers distinguish potential top and bottom performers.

Impact investing is not without risks and challenges. The investment horizons of companies in our universe tend to be longer (it is impossible to change the world quickly), and their return volatility can be above average, given uneven growth paths and reliance on disruptive business models and technologies. For these reasons, we believe deliberate portfolio construction policies and careful risk management are particularly important elements of the strategy.

Notably, the set of publicly listed companies that meet our impact criteria is expanding. Companies are leveraging technology to develop and seek to deliver innovative solutions across our target themes. Many disruptive companies are attracting capital, enabling them to strengthen financial fundamentals while also expanding their positive reach. Finally, large addressable end markets and alignment with megatrends like aging demographics and sustainability should provide enduring tailwinds for competitive growth.

RISKS

Capital – Investment markets are subject to economic, regulatory, market sentiment and political risks. All investors should consider the risks that may impact their capital, before investing. The value of your investment may become worth more or less than at the time of the original investment. The Fund may experience a high volatility from time to time.

Concentration – Concentration of investments within securities, sectors or industries, or geographical regions may impact performance.

Currency – The value of the Fund may be affected by changes in currency exchange rates. Unhedged currency risk may subject the Fund to significant volatility.

Emerging markets – Emerging markets may be subject to custodial and political risks, and volatility. Investment in foreign currency entails exchange risks.

Equities – Investments may be volatile and may fluctuate according to market conditions, the performance of individual companies and that of the broader equity market.

Hedging – Any hedging strategy using derivatives may not achieve a perfect hedge.

Small and mid-cap company – Small and mid-cap companies' valuations may be more volatile than those of large cap companies. They may also be less liquid.

PLEASE REFER TO THE PROSPECTUS AND KEY INVESTOR INFORMATION DOCUMENT (KIID) FOR FURTHER RISK FACTORS.

[3]Dispersion of the Wellington proprietary Global Impact universe versus the MSCI ACWI was measured over a period of December 2013 – December 2018. Dispersion represents a 12-month average of the mean trailing one-year standard deviation of stock returns. Updated annually. **PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE RESULTS AND AN INVESTMENT CAN LOSE VALUE** | Sources: Wellington Management, FactSet

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