

Responsible Investing



Responsible investing, sustainability, and ESG are terms that mean something different to everyone. Each of these expressions rose to prominence as events such as the global financial crisis and the COVID-19 pandemic provided frequent reminders of the interdependence between societies, economies, and financial markets. However, in recent years, scrutiny around responsible investing and the consideration of ESG factors has grown, with some investment firms even abandoning the term ESG to avoid controversy. In large part, the problem relates to responsible investing being misunderstood and poorly defined, and phrases such as “doing well by doing good” have increased skepticism. Regardless of the future of responsible investing, Vaughan Nelson believes its recent evolution holds lasting lessons that can be implemented and utilized.

As client interest has increased and the responsible investing landscape has evolved, asset managers have developed various methods of incorporating sustainability into an investment process. Examples of commonly utilized strategies include ESG screening, thematic investing, and impact investing. The approach utilized by Vaughan Nelson is known as ESG integration, which is defined as using financially material information related to ESG risks and opportunities to support the pursuit of delivering attractive risk adjusted returns. From an investment perspective, our intent is to understand how ESG risks and opportunities can affect the financial performance of the issuers in which we are invested. Importantly, our framing recognizes that issuers across all sectors and geographies may be affected by ESG factors, but in different ways. While ESG information does not typically drive our investment decisions, we believe it can contribute to more informed investment decisions.

One of Vaughan Nelson’s fundamental strengths is an ability to align internal resources and capabilities with evolving industry dynamics. Therefore, as the relevance of sustainability related factors have become increasingly apparent in recent years, in some cases driving business decisions across issuers, thoughtful enhancements across our responsible investing toolkit expanded our ability to evaluate ESG factors. While our overall philosophy and approach remain largely unchanged, a responsible investing framework supported with step-by-step tools assists investment professionals in considering ESG risks and opportunities. Vaughan Nelson’s responsible investing framework can be distilled into three key steps.

1. **IDENTIFY** a company’s exposure to financially material ESG themes.
2. **ANALYZE** a company’s ESG risks and opportunities based on their unique business model.
3. **INTEGRATE** relevant findings into the investment thesis.

A valid critique of many responsible investing approaches is that they inadvertently prioritize a social agenda, which may or may not align with client interests. Rather than embedding values, beliefs, or other non-financial factors in investment decisions, Vaughan Nelson’s approach is based squarely on financial materiality. We seek to identify how sustainability factors may impact a company’s financial performance and only attempt to understand the negative externalities of a company’s operations if it may hurt their

financial positioning. Our approach is based on “value” rather than “values,” and investment outcomes rather than societal outcomes.

While the spectrum of responsible investing approaches is wide ranging, perhaps more confusion exists around what indicators should be used to measure ESG risks and opportunities. ESG factors are inherently multifaceted and nuanced, so it is not surprising that the assessment of ESG factors requires a suite of methods. Unfortunately, readily available and easily quantifiable figures are often poor measures of future risks and opportunities. Each company has a unique intersection with sustainability issues, so focusing on a single metric, such as carbon emissions, may lead to false conclusions or distract from other pressing issues. Additionally, the indicators used to measure a company’s direct operational exposure may vary from the material, yet often overlooked, indirect exposure they experience through their supply chain and customer base. As with any form of financial analysis, it’s the combination of metrics that tell the full picture and help form an investment thesis.

The climate transition is an example of an environmental theme where company specific factors play a significant role, often in non-transparent ways. Climate transition risks and opportunities refer to the disruptions in policies, technologies, market dynamics, and societal expectations faced by companies due to the global shift toward a more sustainable economy. Since the nature, speed, and scale of these changes result in varying levels of vulnerability, a wholistic perspective of a company’s value chain is required. For example, a manufacturing-oriented company may have the greatest exposure to transition risks through regulatory changes or advancements in clean technologies, while a service-oriented company may have the greatest exposure to transition risks through changing demand dynamics or evolving consumer sustainability preferences. Since ESG risks and opportunities vary based on company-specific characteristics, Vaughan Nelson evaluates ESG factors based on a company’s business model and value drivers.

While responsible investing often focuses on downside risks, Vaughan Nelson is equally focused on the growth opportunities that will emerge. As society transitions to a more sustainable future, system level changes will disrupt industries and present opportunities for investors. Companies positioned to embrace change, capitalize on sustainable opportunities, and align their strategy with evolving trends can help shape the future. From a governance perspective, companies with effective oversight structures will be better suited to navigate change and maintain resilience in an unpredictable world.

Vaughan Nelson is not an ESG focused firm and does not prioritize ESG factors in investment decisions. However, by observing industry-wide trends and responsible investing methods, we have carefully incorporated useful elements into our investment process. While confusion and uncertainty around responsible investing persists, Vaughan Nelson’s approach will continue to be grounded in the pursuit of delivering attractive investment returns for clients.

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The information contained in this document is intended to describe how the use of financially material information related to ESG risks and opportunities can be used to support the pursuit of delivering attractive risk adjusted returns. It is not intended to describe the firm's offerings related to Socially Responsible Investing (SRI), in which clients can opt into exclusionary screening criteria based on client driven values and beliefs.

ABOUT US

Vaughan Nelson is a \$16.1 billion (as of 9/30/25), Houston-based investment manager focused on U.S. and International equity strategies. Vaughan Nelson constructs fundamentally driven, high active share, factor diversified portfolios with a targeted return philosophy seeking investments positioned to compound at double-digit rates annually. For additional information, please contact Mark Farrell at mefarrell@vaughannelson.com.