

# FINANCIAL PLANNING NOTES

## CLIENT NEWSLETTER

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#### ESG INVESTING: WHAT YOU NEED TO KNOW

If you pay attention to the headlines, then you've probably heard of ESG investing. With ESG funds capturing \$51.1 billion<sup>1</sup> of investors' net new money in 2020, the headlines are pretty hard to ignore. But what is ESG investing, and is it right for you? Read this article for help in answering those questions.

#### The ABC of ESG

The term ESG stands for environmental, social, and governance. It is similar to socially responsible investing (SRI) in that you can use it to align your investments with your values. But there are some differences.

While SRI uses screens to include or exclude companies based on an individual investor's preferences, ESG provides a broader focus based on how a company's practices in the ESG framework affect that investment.

A number of research groups and companies, including Bloomberg, MSCI, and Refinitiv, provide ESG ratings based on such criteria as:

- **Environmental:** Examples include energy consumption, use of green technology, and animal welfare.
- **Social:** Examples include diversity and inclusion policies in hiring, community contributions, and human rights.

- **Governance:** Examples include board independence, executive compensation, and transparency.

If these issues are important to you, you may want to explore ESG investing. But you should first be aware of potential ESG issues.

#### Possible ESG Risks and Downsides

Before you dive headfirst into the ESG investing world, you'll want to consider the potential drawbacks.

Perhaps the most well-known downside is the lack of any set standards for evaluating companies' ESG practices. As "What Is ESG Investing?"<sup>2</sup> states:

*"While this opens the playing field for many interesting approaches to doing good while generating a solid investment performance, it also increases the possibility that some investment firms will use the veneer of being ESG-focused to acquire new clients without employing disciplined ESG investment strategies."*

It also means that some mutual funds or exchange-traded funds may include a company like Chevron for its environmental record. Others may exclude it since it is in the business of oil and gas, both nonrenewable energy sources.

Or a fund or ETF might include a cellphone provider for its social or governance policies. Yet the company may contribute to environmental degradation through its



use of non-biodegradable materials, as the *Forbes* article “Pros and Cons of ESG Funds”<sup>3</sup> points out.

This lack of widely used standards makes it important to do your research to ensure that your investments align with your values.

You should also be mindful of diversification when investing in an ESG mutual fund or exchange-traded fund. Some funds may be concentrated in industries such as technology. And while owning the FAANG stocks (Facebook, Amazon, Apple, Netflix, and Google) can be a boon for your short-term market returns, holding too much of any sector can place your returns at risk. Consider how you are going to offset any concentration so that you maintain a diversified portfolio.

Finally, expense ratios for ESG funds tend to be higher than for other funds. You may think this takes a back seat to aligning your portfolio with your principles. However, it’s essential to keep the cost over time in mind. As *Forbes* points out, “higher expenses ratios that aren’t associated with at least slightly higher performance may reduce your long-term returns.”<sup>4</sup>

### What About ESG Investment Performance?

ESG investments made headlines over the past year, including triple-digit performances for some funds. Yet, as “Keeping ESG Investment Performance in Perspective”<sup>5</sup> points out, some top-performing funds started to decline in February 2021 even as the S&P 500 climbed.

Perhaps the decline was a natural correction to the

exuberance of the prior year. It’s too soon to tell, but the surge in popularity did prompt the Securities and Exchange Commission to issue a Risk Alert about problematic ESG practices<sup>6</sup> of some investment advisors, Registered Investment Advisors, and private funds offering ESG products.

Recent ESG financial performance also brings up the often-repeated mantra of investing:

*Past performance is no guarantee of future results.*

ESG investing holds promise, especially for people who want their money to positively impact this world. But we would caution against making any investment because of hype. Your investment decisions should align with your long-term goals, and your portfolio should appropriately balance the risk you take with your return needs. A portfolio with ESG investments can be part of that decision-making process and a tool for people who want to reward companies for good behavior.

Sources:

<sup>1</sup> Iacurci, Greg, “Money Invested in ESG Funds More Than Doubles in a Year,” CNBC.com, February 11, 2021.

<sup>2</sup> Rotonti, John, and Alyce Lomax, “What Is ESG Investing?” Motley Fool, March 11, 2021.

<sup>3</sup> Ashford, Kate, “Pros and Cons of ESG Investing,” Forbes.com, April 10, 2019.

<sup>4</sup> Napoletano, E., and Benjamin Curry, “Environmental, Social and Governance: What Is ESG Investing?” Forbes.com, updated March 1, 2021.

<sup>5</sup> Benjamin, Jeff, “Keeping ESG Investment Performance in Perspective,” *InvestmentNews*, April 22, 2021.

<sup>6</sup> <https://www.sec.gov/files/esg-risk-alert.pdf>, April 9, 2021.

## EXECUTOR CHALLENGE

Yet another eerie side effect of the COVID pandemic has been a surge in estate planning activity. It seems a lot of folks decided it might be a good idea to write their will, just in case. And as a result of that activity, a lot of family members and friends have found themselves designated as the administrator, or executor, of someone's estate.

If you're thinking about creating or updating your estate plan, you have some very important things you should discuss with the person who has agreed to be your executor.<sup>1</sup> Even if your estate plan is up to date, it's essential to give your executor all the information they need to carry out your final wishes.

**1. Where is the original will?** Your executor will need to know exactly how to get ahold of the original will so it can be filed with the probate court upon your death. If an estate planning attorney drafted it and has the original, provide the attorney's contact information to your executor. Or specify where in the house you keep the will. A safe deposit box is

not a good place to keep it unless your executor is an owner of the box.

- 2. Your passwords.** Your executor may need to access your email, accounts, and social media, as well as phones and other devices. If you don't want them to have all that information while you're alive, then tell them how they can access a consolidated password file on your computer, and keep that file up to date!
- 3. A final letter.** You may want to write a personalized letter to some or all of your loved ones. Your executor is a good person to entrust with that letter, or tell them where to find it. This will be especially important if there will be "surprises" in your will, such as excluded children or the inclusion of lovers, past or present. Such bombshells could set the whole family fighting and result in litigation. A final, informal letter may be your best and only opportunity to explain your decisions.
- 4. The little things.** Your will should be as specific as possible about the disposition of financial assets: real



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estate, investment accounts, cars, jewelry, artwork. But you may have things that aren't financial assets that you want someone in particular to have—maybe photos or other mementos you want to go to a child or grandchild. Tell your executor about those items.

- 5. The burn box.** If you have skeletons in the closet and you want them to stay there, you want to have someone you trust to dispose of them after you pass. Whether it's letters from past or current lovers, embarrassing photos, or worse, the unfinished vampire musical you were writing for the last 20 years, tell your executor where that stuff is, with specific instructions to destroy it.

Your goal in all of this is to facilitate an easy and complete dissolution of the estate. The easier you make the job for your executor, the more likely you'll accomplish that goal, without setting your family members at each other's throats or ending up with legal battles that go on for years and consume the entire estate.

— *Steve Tepper*

Sources:

<sup>1</sup> Waters, Sharon, "How to Be a Good Executor," AARP Bulletin, May 2021.

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