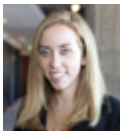
Brown ADVISORY
Thoughtful Investing.

MOVING FORWARD

2021 Sustainable Investing Perspectives

AUTHORS:

ERIKA PAGEL
CIO, Sustainable Investing



ELIZABETH HISS
Investment Analyst, Sustainable Investing

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INTRODUCTION

For several years, Brown Advisory has authored annual asset allocation publications, to share our firm's current perspectives on capital markets and our outlook for various asset classes. On the heels of our **2021 Outlook publication**, we are pleased to offer for the first time this supplemental report, focused on sustainable investing topics and trends that are shaping the work we do for clients.

As we write this introduction, several environmental and social factors are dominating much of the world's consciousness and establishing themselves as key investment considerations for the next several years. We are all still being heavily impacted by the global COVID-19 pandemic, but also hopeful that the world is emerging from this unprecedented period, and that a return to social normalcy will bring with it economic improvement as well. In the U.S. especially, a long-overdue reckoning over racial injustice has steadily gained momentum over the past year, and issues of justice, diversity and inclusion have become top priorities for companies and other entities in which we invest. Climate change remains an existential threat to our civilization, and the U.S. has rejoined the global governmental response to this threat with a transformational plan to cut carbon emissions by 50% over the next decade (vs. 2005 levels). Perhaps more importantly from an investment perspective, business segments like electric cars and renewable energy production have definitely moved from the fringes into the mainstream of their respective industry sectors, and the promise of these technologies to decarbonize our society offers real hope for the future. The title of this report, "Moving Forward," is a simple recognition of the transition and transformation we are witnessing—and a reminder of our primary purpose to guide our clients through challenge and uncertainty and toward their long-term objectives.

Sustainable investing is not an asset class, nor is it a portfolio "factor." We see it as a holistic approach to investing that takes into account a broad range of environmental, social and governance (ESG) matters as well as client-specific priorities. The theme of "moving forward" is highly relevant to sustainable investing; each year, more and more of our clients are choosing to embrace sustainable investing principles in their portfolio. Further, the field is evolving rapidly as dedicated, thoughtful investors all over the world develop new methods of integrating ESG considerations into their investment decisions. We seek to broadly incorporate ESG factors in our investment research and portfolio construction processes, because we believe that sustainable investing can enhance returns while driving better societal outcomes at the same time. This combination of benefits, in our view, offers a compelling value proposition to nearly any investor.

We often speak with clients about how sustainable investing can deliver results in three broad areas: it can improve and drive financial returns, it can align a portfolio with a set of mission-driven principles, and it can steer capital towards investments that generate positive societal impact. This report will focus almost entirely on the first of these benefits, in an effort to demonstrate how our sustainable investment research has contributed to our investment results by helping us identify material risks and opportunities that may not have revealed themselves otherwise.

Our goal in this report is to cover material ESG considerations that we believe are playing a meaningful role in the current investment landscape, and then discuss how those considerations play into our two- to three-year outlook for various asset classes. We hope you find this discussion informative and helpful and that it sparks conversations about your long-term investment plan.

BACKGROUND: THE EVOLUTION OF SUSTAINABLE INVESTING

This field of investing has evolved greatly over time—not just in scale, but in sophistication. The very early years of "SRI," or socially responsible investing, focused primarily on screening out or divesting from businesses viewed as objectionable by faith-based or other groups. This started hundreds of years ago with criteria for investing established by certain religious denominations, and in the modern era started with divesting from businesses providing munitions for the Vietnam War effort, and profiting from apartheid in South Africa. Over time, various other business segments (alcohol, tobacco, gambling and others) as well as corporate behaviors (such as poor labor treatment or pollution) were added to exclusion lists.

The evolution of sustainable investing has been a virtuous cycle; the advanced methodologies and widespread popularity of sustainable investing today rests squarely on the foundation built by early pioneers decades ago. Those early practitioners helped to gradually bring more and more attention to ESG considerations over time; as a result, we see customer populations who demand more responsible and sustainable products and practices, and we see a lack of tolerance for corporate environmental and social malfeasance.

Sustainable investing continues to gain traction and market share within the overall investment landscape. In 2020, US SIF found that more than $16 trillion in the U.S. was being managed under an ESG investment mandate—approximately one-third of all assets under professional management (see Figure 1 below for data on the size and growth of the SI market). US SIF's definition of sustainable investing is fairly broad, but the consistent growth of assets that qualify under its definition over the past 15 years is undeniable.

Today, sustainable investing has broadened its scope from its origins. While exclusionary or "screening" practices are still important to many investors, the focus of the industry has moved substantially toward positive inclusion—in other words, the pursuit of portfolio investments that are in whole or in part helping to address, mitigate or even solve some of the world's most pressing social and environmental challenges.

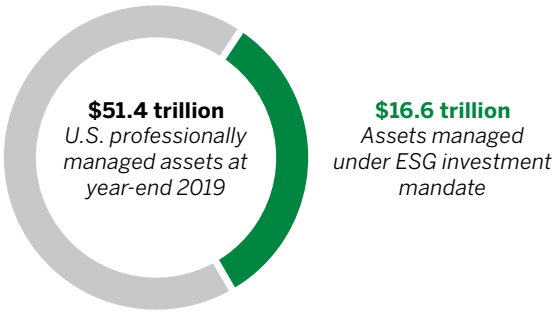
Environmental, social and governance matters need to be understood as potential risk factors in a portfolio, but it is equally if not more important to understand the sources of sustainable opportunity in our holdings. Such opportunities might stem from operational excellence that improves resource efficiency, or innovation that enables a company to transform its offerings and/or claim leadership in its markets.

The focus of sustainable investors on climate issues is a prime example. Many companies that are thinking ahead about climate risk are reducing their carbon footprint, which helps reduce future regulatory risk and helps to enhance their reputation among customers and shareholders as responsible managers. Some are going further and building entire businesses around solutions to mitigate the effects of climate change or to help customers adapt to it.

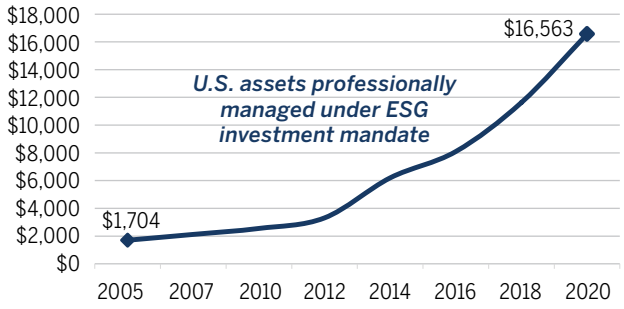
Environmental issues are often at the forefront of ESG discussions, but the events of the past year brought increased attention to social and governance matters, specifically in terms of racial justice, diversity, equity and inclusion, and worker safety. A wide range of indicators show how sustainable principles are influencing the business and investing communities (see "Staying Power" on page 5).

Figure 1: Sustainable Investing Market Size, Growth and Share of Overall U.S. Total
(data as of 12/31/19)

32% of all U.S. professionally managed assets follow an ESG investment mandate (12/31/19)



ESG-mandated U.S. managed assets grew nearly tenfold between 2005 and 2020



SOURCE: US SIF: THE FORUM FOR SUSTAINABLE AND RESPONSIBLE INVESTMENT, 2020 TRENDS REPORT. MOST RECENT DATA AVAILABLE AT TIME OF PUBLICATION. DATA REPRESENTS ASSETS DEFINED BY US SIF AS BEING MANAGED UNDER AN ESG MANDATE. PLEASE SEE THE END OF THE PUBLICATION FOR IMPORTANT DISCLOSURES.

We believe that many practitioners are becoming more intentional with their sustainable investing methods. More and more traditional asset managers are proactively incorporating ESG into their decision making, becoming more transparent about their ESG research, and pushing companies and bond issuers to similarly step up their ESG commitments. The end result, in our view, is a more attractive investment universe, as sustainable business concepts increasingly guide corporate executives and investment managers alike.

We have always sought to use a holistic approach in an effort to understand how companies broadly manage fundamental and ESG risks and opportunities; we believe that this mindset is gaining traction across the investment management industry. Environmental efficiency can materially reduce costs, and many companies have built meaningful competitive advantages by solving climate-related challenges for their customers. There are also linkages between social and governance excellence and financial outcomes; for example, companies that focus on attracting and retaining diverse talent and building inclusive cultures are likely to spend less over the long term on recruitment and training, and benefit from higher productivity due to higher employee retention. We look for companies that have not only been able to react to ESG issues, but those that are part of the solution. We expect these trends are here to stay and may well define the next decade of investing.

STAYING POWER

Recent evidence of the growing influence of sustainable principles in business and investing:

- Through the Net Zero Asset Managers Initiative, **money managers representing over $32 trillion in assets under management (as of 3/31/21) have committed to reducing their net portfolio carbon emissions to zero by 2050.**
- Corporate intention is shifting with regard to ESG. Many corporations now provide annual sustainable reports and many include ESG in their overall mission. **The Governance and Accounting Institute reported that 90% of S&P 500® Index companies published a sustainability report in 2019, up from 53% in 2012,** and Factset® reports that 79 S&P 500 companies discussed ESG on their earnings calls in Q3 2020, up from only five in the first quarter of 2018.
- **Investor support for environmental shareholder proposals increased by 33% in the first half of 2020** vs. the first half of 2019, according to Proxy Insight.
- Major global economic organizations and alliances are increasing focus on ESG metrics as a critical measure of a nation's success. The OECD adopted a Better Life Initiative which has 11 indicators to measure things that citizens care about such as work and life balance, housing, income and civil engagement. The World Bank and the International Monetary Fund are also paying greater attention to environment, inequality and sustainability of national economies.
- Board diversity is gradually gaining regulatory steam. **In 2018, California began requiring CA-headquartered firms to include a minimum number of women on their board; more than 10 other states have followed suit, either enacting or actively considering board diversity statutes.** At the end of 2020, NASDAQ filed a proposal with the SEC to require all NASDAQ-listed companies to have at least one female director and one from an underrepresented minority group.

THE SUSTAINABLE INVESTMENT LANDSCAPE

At the beginning of 2020, the most likely market outcome seemed to be slower growth in U.S. GDP. But in a short few weeks, a lot changed and equity markets experienced a sharp correction globally in the first quarter. The rebound in global equity markets has surprised many market observers. A combination of the Fed's action and fiscal stimulus underpinned a recovery in risk assets since the second quarter of last year. In 2020, the S&P 500® Index gained 18.4%—an outcome few would have predicted.

Throughout 2020, the market recovery had wide performance dispersion; strong performers included technology companies or those that benefited from the shift to a digital and work-from-home economy (home improvement is one example). Performance laggards were largely in economically sensitive areas and cyclically demand dependent companies.

Technology, growth and "stay-at-home" stocks drove the surprisingly strong performance of U.S. equities in 2020. As of this report's publication, valuations for many of these companies are lofty and, in some cases, extended. Some pockets of current enthusiasm, such as the resurgence of SPACs (special purpose acquisition companies), are reminiscent of the "irrational exuberance" of the 1999 technology/internet bubble. ESG investors have traditionally focused the lion's share of their attention on the large-cap equity market, but there are many other corners of the investment universe that, in our view, offer an attractive mix of risk and reward.

The sectors and segments which led the market in 2020 were a notable boon to many ESG strategies, which broadly speaking tend to lean into more innovative sectors such as technology and health care. As such, it is important for sustainable investors to understand the valuations in these sectors, and where there is risk of correction. Market concentration in technology and internet giants is a well-discussed market risk at this point; below, we will discuss a similar phenomenon occurring with certain companies appearing in a large majority of ESG fund portfolios. Importantly, the holdings in these funds still only represent a small percentage of most of these companies' overall market capitalization. They may pose a future concentration risk, but at present, we generally believe the opportunity in these names is attractive, and we are simply monitoring this potential to see how it evolves over time.

A key consideration on our minds, both last year and looking forward, is the rapid pace of change in renewable energy adoption. As barriers to entry continue to drop away in this industry, it has the potential to be a meaningfully disruptive force in many economic sectors.

We are seeing an increase in available ESG investment options in various regions globally. China, in particular, presents a unique opportunity with nearly as many public companies as the U.S., trading volumes similar to the U.S. and many quality growth companies in consumer, healthcare and technology. Sustainable investing is developing rapidly in Asia; China is a leading manufacturer of wind and solar components. Increasing international interest and rising awareness associated with climate change is helping to drive this growth. We are monitoring areas of potential concern such as transparency, labor, reliability of data and regulatory changes.

Further, Asia is home to one of the leading global green bond markets (as of the end of February 2021, Asia represented 17% of global cumulative labeled bond issuance to date, according to Bloomberg). This has played a critical role in financing renewable projects. In late 2020, Xi Jinping announced China's plan to become carbon neutral by 2060, and the country is a likely driver of global innovation.

Finally, we are finding value in several lesser-known pockets of the ESG universe such as collateralized loan markets and tax equity credits. These specific opportunities are supplemental to our core belief in the potential for active sustainable managers to make thoughtful decisions that differentiate their portfolios from passive ETFs. All of this increases our confidence that our sustainable investing approach has the potential to outperform over the long term.

Valuation Of the ESG-Darling "BANDMATE" Stocks

For several years, investors around the world have grown increasingly nervous about the concentration of market capitalization in just a few stocks in certain indices. Examples include the FAANG stocks (Facebook, Apple, Amazon, Netflix, Google/Alphabet), and the related "FAANGMT" stocks (adding Microsoft and Tesla to the list), which make up a meaningful portion of the S&P 500. The "BATS" stocks (Baidu, Alibaba, Tencent, Samsung) are becoming dominant drivers of Asian markets in a similar manner.

As the sustainable investment landscape has grown in scale, a handful of companies that appear across a broad swath of sustainable portfolios have been beneficiaries of capital flows to ESG funds and strategies. Due to their high scores and ratings from large ESG data providers and their low-carbon business models, these stocks have become the darlings of the ESG investment landscape: Ball Corp., Alphabet, Nvidia, Danaher, Microsoft, Apple, Tesla, and Ecolab, a group we have labeled as the "BANDMATE" stocks.

The ESG bonafides of these BANDMATE stocks have led many active managers to select them for portfolios, and they also sit atop the major market-cap weighted ESG ETFs and indices. These ESG funds have seen heavy inflows in recent years due to rising interest in sustainable investing; in 2020, $51 billion was added to sustainable funds in the U.S. according to Morningstar, $36 billion of which went to passive ETFs and index funds where there is no active manager to trim exposure to overvalued companies.

This scenario has been one reason that these stocks have become more expensive in recent years (see Figure 2 on page 7). Valuations for these companies have risen for other reasons, chief among them being that most have strong business models and promising prospects for the future, which has propelled their returns (also shown in Figure 2).

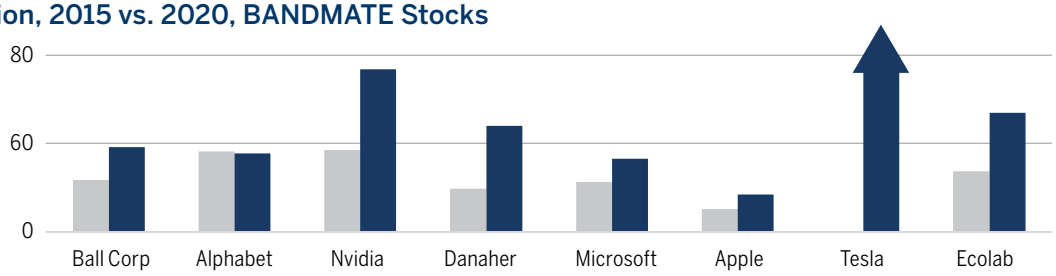
Figure 2: BANDMATE Stocks: Rising Valuations for ESG Darlings

The BANDMATE stocks make up a notable percentage of leading ESG funds and ETFs, and these funds have seen heavy inflows in recent years. This fact, alongside the generally robust business performance and prospects of these companies, have propelled the group's returns (see table at top of exhibit) and valuations (see chart at bottom).

	Average Weighting in 10 Largest ESG Funds and ETFs (as of 3/31/21)*	Average Weighting in S&P 500 Index (as of 3/31/21)		2020 Return (%)	2019 Return (%)	2018 Return (%)
Ball Corp	0.4%	0.1%		45.2	41.8	22.7
Alphabet	2.9%	3.6%		31.0	29.1	-1.0
Nvidia	0.7%	1.0%		122.3	76.9	-30.8
Danaher	1.7%	0.4%		45.3	49.6	11.8
Microsoft	4.7%	5.3%		42.5	57.6	20.8
Apple	3.9%	5.7%		82.3	89.0	-5.4
Tesla	0.8%	1.5%		743.4	25.7	6.9
Ecolab	1.0%	0.2%		13.2	32.3	11.1
BANDMATE Total	**16.1%**	**17.8%**	**Weighted Return***	**86.3**	**56.7**	**6.1**

*Reflects relative average weightings of each BANDMATE stock in the 10 largest ESG funds as of 3/31/21. Returns are expressed gross of any management fees.

Multiple Expansion, 2015 vs. 2020, BANDMATE Stocks



	Ball Corp	Alphabet	Nvidia	Danaher	Microsoft	Apple	Tesla	Ecolab
P/E Ratio, 12/31/2015	23.4	36.5	37.0	19.5	22.5	10.3	n/a	27.3
P/E Ratio, 12/31/2020	38.4	35.5	73.6	48.0	33.0	16.9	954.4	53.8

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Beyond their high scores from ESG ratings providers, we think the business models of these companies and their commitment to making sustainability endemic to their operations make them compelling investments over the long term. (No investment is perfect, of course, and issues such as the substantial carbon emissions produced by the IT giants' supply and distribution chains need to be considered as well.) Microsoft, for example, has been a leader in putting a price on carbon within its own operations. Management implemented a "carbon fee" (effectively a carbon tax) on every internal business line to drive company-wide accountability around carbon reduction. The fee functioned like a chargeback—reflecting the true cost of an airline ticket, for example (both the cost of the ticket and the price to offset carbon emissions associated with that flight). The carbon fee affects investment decisions by providing both an incentive and the financial justification for internal efficiency initiatives. It also helps to drive culture change by raising internal awareness of the environmental implications of our business and to establish a discipline at scale across the organization, guiding the energy and travel choices made both at corporate headquarters and through local subsidiaries.

Alphabet is one of the largest operators of data centers in the world. It has been a leader on conducting iterative land use and ecological impact assessment of planned data center developments. This helps them maximize use of renewable energy for power, and minimize other impacts to the surrounding ecosystem like water usage. Their efforts have tangible implications for lowering the carbon footprint of the IT industry (which contributes meaningfully to global carbon emissions).

The investment arguments for Microsoft, Apple and Alphabet are well known, and the rest of the names on the list all have long runways for growth, with various sustainable business strategies driving that growth. Additionally, a healthy amount of their multiple expansion is attributable to that of the overall market (the S&P 500 Index's earnings multiple has expanded by more than 60% over the past five years). Nonetheless, we are monitoring our exposure to these stocks in sustainable (and other) client portfolios carefully.

Semiconductors are another sector of note. Semiconductor firms have become a core constituent of many sustainable portfolios recently, which is mildly surprising given that such portfolios have generally de-emphasized capital-intensive businesses in the past

due to inherent environmental footprint. However, companies like Taiwan Semiconductor (TSMC), Analog Devices and Nvidia have become popular with active sustainable managers; they play a leading role in enabling the electrification of vehicles, smart grid technology, and pushing the limits of power efficiency on small chipsets used in smartphones and other smaller devices. Moreover, firms like TSMC are investing in efficient foundries that harness renewable energy, and are thus helping to reduce the high carbon emissions of the sector overall.

The sustainable business potential in the semiconductor sector may not be fully recognized by traditional investors, and while many of the sustainable managers we recommend to clients are seeing the value embedded in these companies, many passive ESG funds remain focused on their capital and carbon intensity and continue to exclude them. This is one of many examples where, in our view, active fundamental and sustainable research can lead to investment allocations that are meaningfully different from passive funds. If we do our jobs well, that differentiation has the potential to produce outperformance.

Renewable Energy: Back in the Spotlight

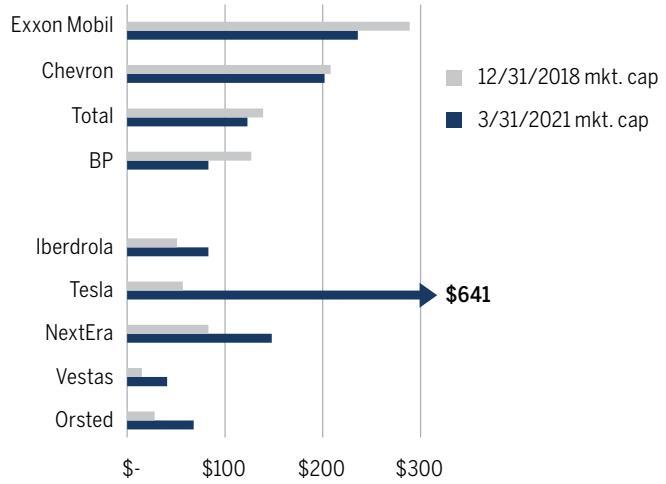
Clean energy indexes were runaway performers in 2020. The Nasdaq Clean Edge Green Energy Total Return Index (limited to U.S. listed, "pure play" clean energy firms) returned 184% in 2020. The Wilderhill Clean Energy Index (inclusive of companies listed across global markets) generated an even more impressive 207% return.

While we have seen a blistering pace for renewable energy deployment over the past decade, this success was not paralleled in the pure-play renewable stock indexes, which underperformed the broader market consistently between 2011 and 2018. Returns in this space started to pick up in 2019 and took off in 2020.

Some clean energy leaders such as Tesla and Nextera now have greater market capitalizations than the oil majors that have dominated the sector for decades (see Figure 3 below)—a strong indication of the sea change occurring in global energy markets.

Figure 3: Changing of the Guard

Market capitalization of leading renewable energy companies is starting to surpass that of the oil majors.



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LEGACY ENERGY IN TRANSITION

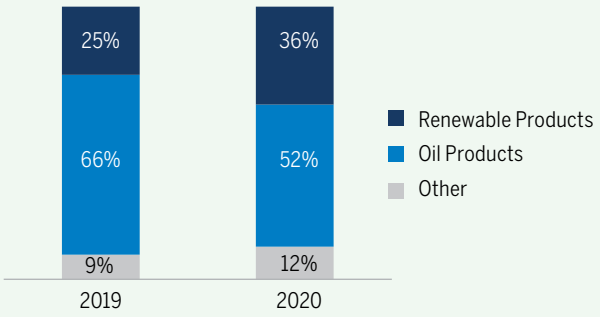
The push to decarbonize the energy grid will require commitments from the largest incumbent energy companies. Some of our sustainable managers have found compelling opportunities, in terms of alpha generation and carbon emissions reduction, in state-owned oil gas producers that have shifted focus to renewables.

Orsted was once Denmark's largest producer of oil and gas, but is now the largest producer of renewable wind energy in the world. Over the past decade, it completely transformed its power generation mix to focus on offshore wind development; it has reported divesting from fossil fuels since the early 2000s, with full divestment in 2017. It is now a leader in the global renewable energy industry with wind assets across North America, Europe, and Asia.

Neste is the state-owned energy company of Finland, a country known for its fossil fuel assets and energy production. In the late 2000s, it began to diversify its portfolio away from oil refining, and focused on biofuel production. Neste's biofuels use a patented technology to leverage waste and residue streams to produce diesel and aviation fuel. Today, it is the world's largest producer of biofuels, accounting for 40% of overall production globally. As biofuel becomes a larger driver of its overall revenue, Neste reports deploying more capital into its clean energy capabilities (69.4% of capital investments in 2020). Ultimately, it aims to exit the fossil fuels business entirely.

Shifting from Oil to Renewables:

Neste Revenue Mix, 2020 vs. 2019



SOURCE: NESTE.

Some of the major oil companies are actively trying to adapt, by altering their business models and acquiring renewable energy businesses. Examples include the French oil major Total, which owns a majority stake in SunPower. We view Orsted and Neste as great example of companies in active transition to lower-carbon business models *(see "Legacy Energy In Transition" exhibit on page 8).*

This shift coincides with the global movement to divest from fossil fuels. An undeniably divisive strategy in the broader movement to encourage lower-carbon investing, fossil fuel divestment has many adherents and just as many opponents. But adherents are growing in number: According to 350.org, asset owners representing nearly $14 trillion—1,192 institutions and 58,000 individuals—have either begun or are committed to divestment from fossil fuels as of April 2021, a staggering increase from the roughly $50 billion in global assets that had divested from fossil fuels as of 2014.

Decisions to divest from fossil fuels have generally not hurt index investors in U.S. and global markets in recent years, and during many years the decision was a mild benefit to returns *(see Figure 4 at right).* Overall, divestment does not carry the same investment risk vs. broad-market indexes that it once did, because the energy sector is a much smaller segment of broad-market indexes today. For example, energy represented more than 15% of the S&P 500 Index (as defined by GICS) in the early 1990s; today, they make up less than 3%.

Investors are gravitating to renewable energy for many reasons: attractive advances in technology, improving economics for solar generation (now cost-competitive with other electricity sources in many markets), and the powerful draw of finding (or not missing out on) the next Tesla. Further, green stimulus plans across the world are attractive long-term tailwinds for the sector. In addition to Asian and European support programs, the Biden administration recently announced its ambitious plan to cut U.S. greenhouse gas emissions by 50% before 2030 (from 2005 levels). Further, Treasury Secretary Janet Yellen co-authored a publication recently with former Bank of England Governor Mark Carney, laying out the need for a comprehensive decarbonization framework to address climate change, including the implementation of carbon taxes alongside heavy capital investment in clean energy infrastructure.

The infrastructure buildout to enable the decarbonization of electricity markets will require large scale investment from public and private sources. Some of the players poised to benefit are utilities, power generators, battery developers and transmission line construction companies, and companies from all of these industries are finding their way into the portfolios of sustainable managers we recommend.

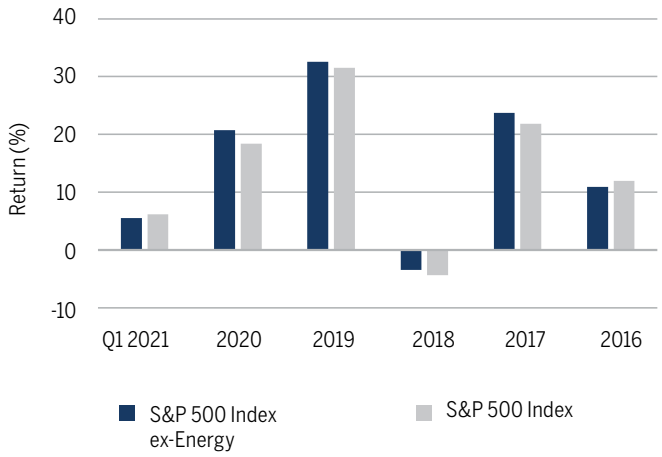
A transition to a net-zero-emissions economy is a massive undertaking—a shift of that scale in energy production mix will take time, and the transition will produce environmental impacts of its own along the way (displacement of current infrastructure, land use change, and new pollution sources are only some of the derivative effects). While the opportunity set for this shift of capital is substantial there are also risks that companies will need to reckon with. Companies without the ability to replace carbon as a key input will face existential risks if they cannot develop a transition plan.

Figure 4: Fossil Fuel Divestment Results

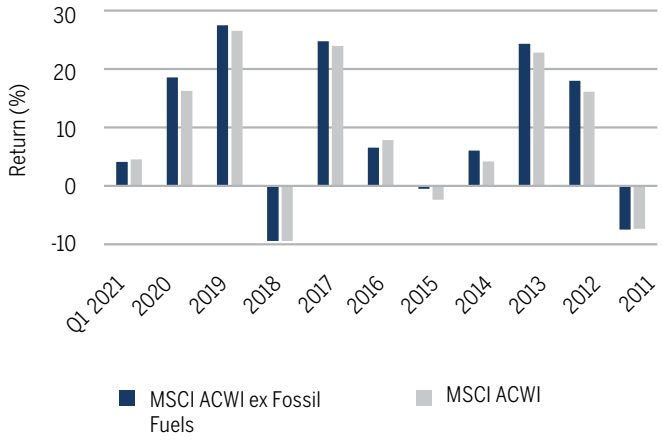
The MSCI ACWI ex Fossil Fuels Index has mildly outpaced the MSCI ACWI nine out of 10 years since 2011, and results have been similar for the S&P 500 Index since 2016 (earliest available data provided for both indexes).

The takeaway, in our view, is the minimal dispersion in results, rather than an absolute "winner" or "loser." Fossil fuel divestment simply no longer has the impact it once did on returns, due to the smaller weighting of fossil fuel industries in broad-market indexes.

Fossil Fuel Divestment Results: S&P 500 Index
(as of 3/31/21)



Fossil Fuel Divestment Results: MSCI ACWI Index
(as of 3/31/21)



SOURCE: BLOOMBERG. PLEASE SEE THE END OF THE PRESENTATION FOR A COMPLETE LIST OF INDEX DEFINITIONS. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

The SPAC Surge

There is an extremely important caveat to the recent returns of renewable energy stocks. Much of the strong performance in this sector over the past year has been driven by a proliferation of initial public offerings, many of which garnered rich valuations despite being pre-revenue, pre-production, or exhibiting negative cash flow. Many of these IPOs fall in the category of Special Purpose Acquisition Companies, or SPACs. We discussed the SPAC phenomenon in our firm's 2021 Outlook publication earlier this year; simply put, SPACs are established as public vehicles to collect capital, which is then used later to acquire a private company or companies to take public.

About $80 billion was raised in more than 230 SPAC offerings in 2020—a four-fold increase in deal count vs. 2019 *(All SPAC data was collected from Bloomberg.)* SPACs have become a potentially galvanizing means of raising capital to deploy into systemic climate change mitigation technology and solutions. About two dozen of the SPACs launched in 2020 were in clean energy, transportation or mobilization. According to Bloomberg, the electric vehicle space alone produced 20 different SPAC deals across many verticals including electric, battery and hydrogen.

Since the start of 2019, we identified 43 SPAC deals that are still trading at time of publication, with what we consider to be a dedicated focus on ESG initiatives. Most of these have raised capital to deploy in clean energy infrastructure or other climate change mitigation technology, with a few seeking other ESG-related objectives, such as promoting racial equity and inclusion in their target company acquisitions. Approximately $13 billion has been raised over the past two-plus years through these ESG SPACs (see Figure 5 at right). The excitement in the market can be seen in the dislocation between this SPAC basket's market cap vs. the dry powder raised (as of 4/29/21, this group's collective market cap was more than $49 billion, even after a meaningful drop in SPAC prices in late April); we see this as both a positive indicator of this channel's viability as a funding source for innovative new ideas, and a signal of caution for investors considering investment in some of these SPACs at current prices.

Companies and governments alike are pursuing increasingly aggressive emission reduction goals for power plants, factories and vehicle fleets all over the world, so the demand for clean technology is growing rapidly. Last year's SPAC activity may be just the beginning of a larger wave of capital pouring into the early-stage clean tech arena.

Of course, the appetite for these SPAC deals is favorable to those who sponsor and underwrite them, but those who are snapping up shares after these offerings at lofty prices face real risks. Not all SPACs will be able to successfully implement their business plans, and the flood of SPACs with dry powder to spend may lead to a run-up in early-stage renewables startups. The air has come out of the tires for certain SPAC stock prices recently, and we anticipate continued price volatility. When investing in this space, deep due diligence is essential to understanding whether the future value of the investment can justify its current price.

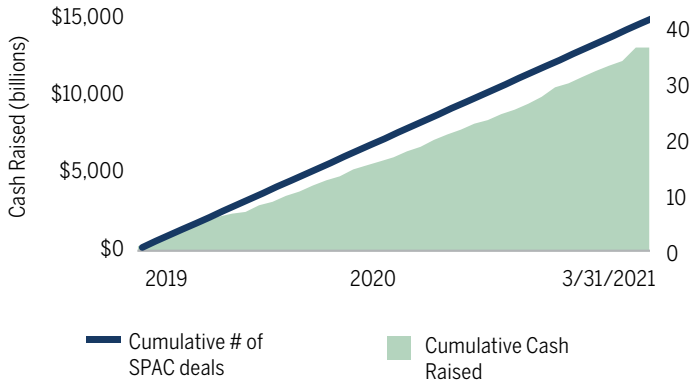
ESG Opportunities in Credit Markets

Bond markets dwarf stock markets in terms of scale, and yet bonds have not received nearly as much attention as stocks have from ESG investors and researchers.

Figure 5: SPACs As Funding Channel for ESG and Climate-related Business

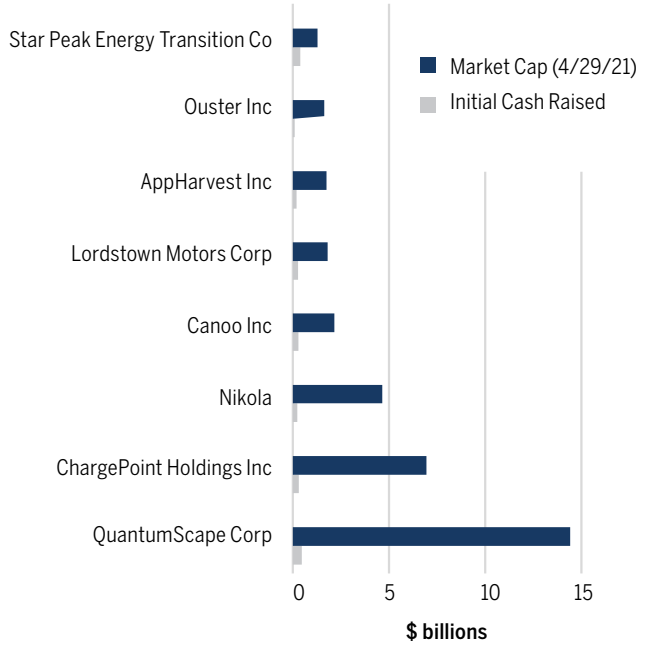
More than $13 billion was raised in 40 ESG-related SPAC deals in 2019, 2020 and early 2021.

Dry Powder Raised in 43 ESG SPACs, 2019-2021
(Data as of 4/29/2021)



While SPACs offer a new financing path for innovative businesses, popularity with investors has led to high current valuations relative to cash raised in a number of SPACs.

Market Cap as of 4/29/2021 vs. Initial Cash Raised, Selected ESG SPACs



SOURCE: BLOOMBERG. The information provided in this material is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell, or hold any of the securities mentioned. It should not be assumed that investments in such securities have been or will be profitable. To the extent specific securities are mentioned, they have been selected by the author on an objective basis to illustrate views expressed in the commentary and do not represent all of the securities purchased, sold or recommended for advisory clients. Past performance is not indicative of future results.

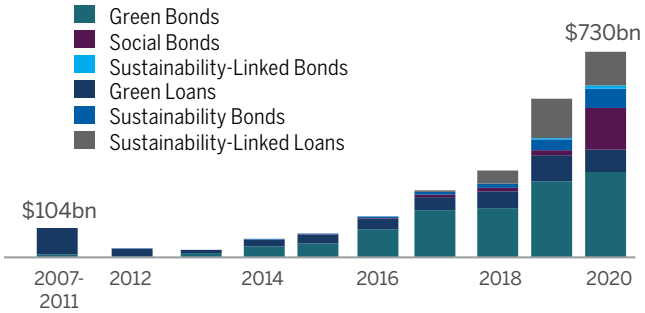
The term "labeled bonds" serves as an umbrella for a variety of different green, social and sustainability bond and loan structures, all of which certify their proceeds are being used for positive social and environmental purposes. Our internal fixed income researchers, as well as the teams of third-party bond managers we recommend to clients, view this space as an attractive source of excellent investment ideas, issued by companies, municipalities and other entities with a healthy long-term perspective on risk management.

Broadly, green bonds just surpassed $1 trillion in cumulative historical issuance in 2020, and total cumulative labeled issuance surpassed $2 trillion, according to Bloomberg New Energy Finance (see Figure 5 below). While the space has seen rapid growth, cumulative global issuance still represents just a fraction of the $17 trillion in U.S. sustainably managed assets, suggesting that there is opportunity for growth in labeled bond issuance in the coming years.

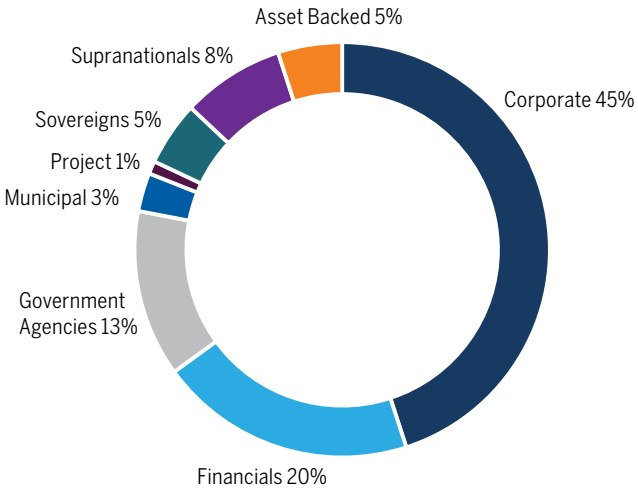
Figure 6: Labeled Bonds Taking Off

Labeled bond issuance has grown rapidly in recent years. In 2020, the market surpassed $2 trillion in cumulative global issuance. The bulk of activity to date has been in investment-grade securities; other opportunities across the credit spectrum remain largely untapped.

Annual Labeled Bond Issuance By Category
(as of 2/28/21)



Cumulative Labeled Bond Issuance By Bond Type
(as of 2/28/21)



SOURCE: BLOOMBERG NEW ENERGY FINANCE

The rapid growth in this space has led to increased concerns about greenwashing. While issuers need to conform to a variety of standards to earn a certified label, an issuer may define positive impact differently than a buyer. Countries may issue debt to fund green projects, while their overall policies are doing notable environmental or social harm; the same can be true of companies. Investors also need to be wary of first-time labeled issuers, as there is no track record in place regarding successful implementation of social or environmental projects, or on providing promised reporting and transparency regarding results. Investors need to be the gatekeeper to ensure these bonds fit their framework and not take the label at face value. This is a key reason why we consider it so important for bond managers to conduct in-depth due diligence on any bond promising to use proceeds for projects that will generate positive societal impact.

As discussed earlier, many observers foresee that corporations and governments will seek to raise immense amounts of capital to support decarbonization of the economy, as well as other technology and infrastructure needed to address the effects of climate change. Fixed income markets—across the entire credit spectrum—can be a fruitful resource for raising that capital, but most of this activity has been concentrated in investment-grade issuance to date, with other segments of the market largely untapped. While we believe the labeled bond market is providing a growing and more transparent opportunity set, the current labeled market is still not highly diversified, and there are also ample opportunities outside of labeled bonds.

Another area where we see meaningful opportunity is in collateralized loan obligation (CLO) issuance that incorporates ESG factors in the underwriting process. According to our research, labeled bonds account for only 0.25% of the Bloomberg Barclays U.S Corporate High Yield Index, and 0.1% of the LSTA[1] /S&P Leveraged Loan 100 Index; time will tell if issuers expand ESG-related activity and begin to grow those percentages. CLO managers require diversified collateral and will need to create robust ESG frameworks of evaluating their underlying portfolio companies. On the plus side, they rely extensively on corporate disclosure of data to price risk effectively, and with the SEC and other regulators starting to ramp up ESG data disclosure requirements, these managers may soon have a broader ESG tool kit available to them for their research.

Opportunities in Tax Credits

Tax credits, and the programs they support, are a lesser-known area of opportunity for sustainable investors. Tax credit programs serve as government incentives to encourage investment in areas like renewable energy, workforce housing and community development. This can be a mechanism for corporations to manage federal tax liability, but only if they purchase credits that provide capital to projects that benefit the community and environment.

The Investment Tax Credit (ITC) and Low-Income Housing Tax Credit (LIHTC) programs have played important roles in U.S. solar power and affordable housing, respectively. The ITC has supported the explosive growth of U.S. solar power capacity over the past decade, while also helping to bring down the effective cost of deployment. The ITC allows for a 26% tax credit for certain residential and commercial

[1]Loan Syndication and Trading Association

solar systems. Currently, this is scheduled to drop to 22% in 2023, with the residential credit expiring in 2024 while the commercial/utility credit will remain permanently at 10% (the program could be extended further depending on what happens with the Biden administration's infrastructure package). The LIHTC program reports that it has supported the development of more than 47,500 projects and 3 million affordable housing units since 1986.

We believe that tax credits will be another driver of increased investor interest in real assets over the next several years. For example, investors can invest capital in a solar project, in exchange for receiving the tax credit benefits associated with the project. Importantly, we do not look at these opportunities primarily as tax strategies, rather, they can be a way to redirect dollars to projects that meet a company's ESG goals. We help clients think through these investments, with various private market funds providing several options for clients.

An example is a private real estate fund investing mostly in subsidized affordable housing and/or rent-restricted properties due to LIHTC regulations. The fund's focus is on properties affordable for low-income residents and/or located close to employment or mass transit options. Many LIHTC assets are in need of renovation and are committed to affordability restrictions beyond initial tax credit compliance periods; this fund aims to acquire these assets and finance a comprehensive green retrofit with LIHTC and bond financing.

Developed economies have a growing list of ESG-adjacent tax incentive programs, and the rules governing these programs are not standardized. Better reporting metrics and standardization would benefit this market; returns from these investments can vary meaningfully based on the effective tax rate of the company sponsoring the underlying project. The World Economic Forum released metrics in 2020 and we anticipate standardization to be a focus in 2021.

A Note on Active vs. Passive Investment

We believe the sustainable investing universe represents a particularly favorable environment for active managers and for fundamental, bottom-up due diligence aimed at building a differentiated view about a company's intrinsic value relative to its current price. The wide dispersion in ESG ratings assigned by third-party research firms, and the lack of clear and standardized disclosure from companies and bond issuers, creates an opportunity for well-armed investors to unlock hidden value in sustainable business models that the market has not yet discovered.

However, we are not surprised that the popularity of passive investing has extended into the sustainable investing space. Major institutional asset managers have launched "sustainable" or "ESG" versions of their broad-market index funds, as a way to capture the inflows pouring into ESG investments. Typically, these passive funds use an ESG ratings data provider to assign quality ratings to the constituents of a broad-market index; while they build the fund's market-cap-weighted portfolio, the fund sponsor will generally exclude or underweight any holding that falls below a certain rating, while seeking to minimize tracking error vs. the unscreened index.

Importantly, we believe that this process does not discern the relative quality of sustainability ratings, nor does it account for nuances that require active, thoughtful consideration. A poor ESG rating may be offset by marked recent improvement in ESG performance, or the success of a new sustainable business initiative. A strong ESG rating may not yet capture a recent egregious violation of environmental regulations or ethical principles. Additionally, we believe there is a place in portfolios for ESG "improvers"—companies exhibiting marked ESG progress and tangible positive outcomes over time—as long as the criteria and goals/targets for these companies are clearly defined by portfolio managers and understood by investors. None of this is likely to be captured by the methods used to manage passive ESG funds.

ESG "improvers" may appear in various portfolios that we recommend. A number of managers (Brown Advisory among them) believe that these improvers are attractive sources of potential alpha, as improvements to operations and business strategy are reflected in a company's results over time. Here are two examples:

- **Nordson** is a long-term holding of one of our recommended large-cap managers. Several ESG data providers rate it poorly due to concerns over raw material use in its products, but the manager who owns the stock notes that Nordson already deploys advanced material recycling methods, and a plastics-reducing design process. These initiatives have not been well communicated to the market; the manager is encouraging Nordson to improve its disclosure so the company can be more accurately judged by ESG ratings providers.
- **Trex** is a decking material company held by one of our recommended small-cap managers. It has received low marks from ESG data providers due to concerns about its manufacturing process, but the manager's research reveals that Trex has invested meaningfully in more resilient and efficient processes in recent years, included implementation of a closed-loop water system that saves 160 million gallons of water per year, and establishing distributed manufacturing sites to reduce distribution-related emissions and costs.

The discernment benefits of good active management need to be weighed against the perceived cost and tracking error benefits of passive investing; investors will view these factors differently according to their circumstances.

OUR CURRENT STANCE IN SUSTAINABLE PORTFOLIOS

Over the past year we have made meaningful shifts to client portfolios to respond to the low interest rate environment, unattractive long-term returns in bonds, the uncertainties borne of the current pandemic, and dislocations in performance and valuations between some market segments (notably between growth and value in equity markets).

Typical valuation metrics such as PE, EV/EBITDA, and cyclically adjusted PE suggest U.S. stocks are more expensive today than at any point since 1999. However, relative to current interest rates, valuations are much more in line with historical norms. Given the wide range of potential outcomes for markets over the next several years, we believe it is important to maintain balance in portfolios, which we are expressing with a combination of short-duration and core fixed income holdings, a mix of global equities that balances growth, quality, dividend income and value, and investment in private markets and lower-beta diversifying assets.

Fixed Income

We view bond allocations as important elements of most balanced portfolios, helping to provide income as well as ballast against market volatility. However, low interest rates limit expected returns and yields for bond markets over the next few years, and the environment also creates risks for longer-duration investments that may be more sensitive to a future rise in rates. In response, we have shifted many portfolios to allocations that place greater emphasis on quality, short-duration holdings that can help to increase liquidity and reduce credit risk.

Sustainable opportunities in fixed income markets expand every year, and we anticipate a robust flow of fundamentally solid new issues that also have the potential to produce positive impact through the use of bond proceeds on activities with social and environmental merit. This extends to the short-duration segment of the market, where we have identified several investment opportunities with strong sustainable characteristics.

- *One example is a short-duration strategy focused on GNMA mortgages. Ginnie Mae has been a critical part of government programs to support home ownership for low- and moderate-income households, and this strategy invests in mortgages that are explicitly guaranteed by the federal government and made through government agencies such as the Federal Housing Authority and Department of Veterans Affairs.*

Equities

Shift from U.S. to Global. This shift has been characterized by more emphasis on global managers with greater regional flexibility, which has generally increased our non-U.S. exposure.

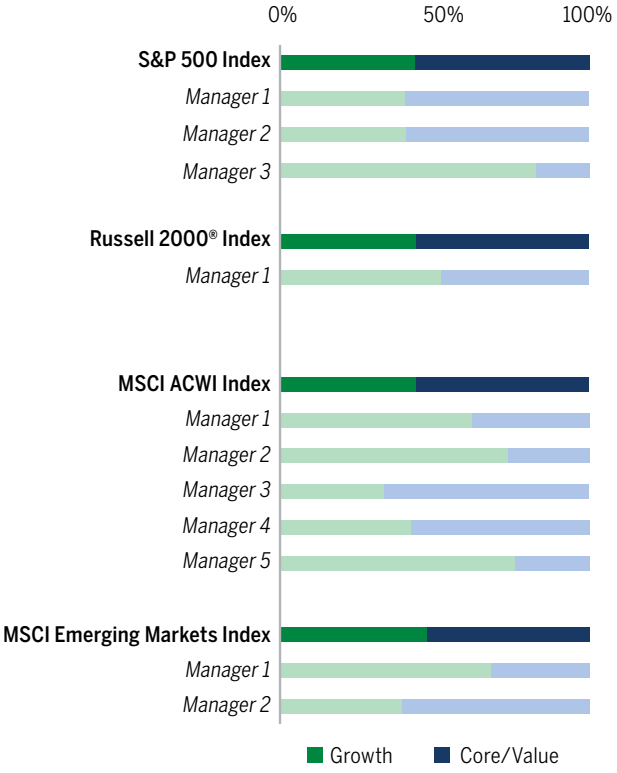
In sustainable portfolios, our recommended managers include:

- *A concentrated global equity strategy focused on financials, technology, industrials and health care. The manager has a "soft activism" approach geared toward helping portfolio companies improve their sustainability profile. The portfolio structurally seeks to avoid the fossil fuel and energy sectors and has never held companies in those sectors since inception.*
- *A concentrated global equity strategy that seeks out holdings exhibiting "future contingent assets" that the market may not be pricing in today. They engage with every company in their portfolio, seeking to unlock sustainability improvements in operations, human capital management, and other areas with direct linkages to financial outcomes.*

We have also added specialists to augment our Asia allocations across all market caps. We are attracted to Asian opportunities for several reasons. Asian equities currently trade at a broad discount to U.S. stocks; Asia has fared better during the pandemic than other regions; and, central banks in Asia have ample leeway to support economic stability and growth. The growth of the Asian middle-class consumer is well-documented at this point, and that trend is supporting explosive growth in a variety of sectors and diversifying the economy away from large state-owned enterprises. Many sustainable finance markets in Asia

Figure 7: Healthy Growth/Value Mix Among Recommended Sustainable Managers

Sustainable investing options have a reputation for being biased toward growth, but many of our recommended ESG managers offer a growth/value style mix similar to that of their relevant core benchmarks.



SOURCE: MORNINGSTAR AS OF 3/31/21. PLEASE THE END OF THE PRESENTATION FOR A COMPLETE LIST OF INDEX DEFINITIONS.

are still in their infancy, and the shift in both government focus and investor appetite on ESG matters are, in our view, likely to catalyze a meaningful expansion of quality investment opportunities. We believe that there is a large role that Asia can play in not only reducing carbon footprints, improving governance and transparency but also catalyzing opportunities and leading innovation.

- *Our platform includes a global emerging-markets ESG equity strategy, with a portfolio emphasis on Asia ex. Japan. The manager believes that the essential drivers of value creation for companies are opportunity for growth, competitive advantage and a strong sustainability profile.*

Shift from Growth, to Value and Dividend Growth. With economies set to fully re-open in 2021, we will likely see a meaningful boom in purchasing for many services, experiences and products that were unavailable or put on hold during the pandemic. Cyclical stocks, particularly those hit hard by COVID, are prime potential beneficiaries, and we are seeking increased exposure to these companies through value and dividend-growth allocations, in order to capture what we see as a compelling combination of currently attractive valuations and favorable earnings comparisons in coming quarters.

As mentioned earlier, sustainable managers often have a growth bias, due to traditionally strong ESG profiles in sectors like technology and healthcare, and avoidance of sectors such as energy and utilities. While value and dividend strategies are less common in the sustainable manager universe, our active search for sustainable managers with a core approach that blends growth and value has yielded some promising results. Many of our approved public equity investment strategies have a good combination of growth, core and value exposure in their portfolios (as defined by Morningstar), and this diversity can help these strategies weather a variety of market conditions (see Figure 7.)

Managers in this asset class with a good mix of growth and value include:

- *A liquid ESG EAFE strategy with a "governance-first" lens for evaluating potential holdings. The strategy has not held fossil fuel companies since inception, and structurally seeks to avoid energy, tobacco and weapons. It has a growth bias, but its industrial and consumer staples exposure diversifies the portfolio into more defensive and cyclical sectors.*
- *A recently launched concentrated strategy that focuses on ESG leaders. The manager seeks a portfolio of compelling equity securities with strong ESG profiles and attractive dividend yields.*

Add to U.S. Small Cap: Last year, U.S. small cap companies were impacted by lockdowns and the effects of social distancing. Further, small-cap growth stocks were trading at a historically high premium to value counterparts in early 2021. These conditions have created an opportunity for us to add exposure to quality small-cap managers that emphasize holdings withe growing cash flow and/or market share.

- *One example is a U.S. small-cap strategy focused on a mix of growth and value companies. The manager seeks to pair fundamental and ESG research to identify entrenched, durable, and scalable franchises benefiting from structural growth, trading at reasonable valuations.*

Continue to encourage ESG activism and engagement by sustainable and traditional managers: We have seen a notable uptick in active, ESG-oriented engagement from our managers with companies in their portfolios across a number of issue areas from carbon emissions disclosure to diversity, equity, and inclusion issues. We think direct engagement between managers and their portfolio companies is an important and critical tool to move the needle on ESG issues, and we are pleased to see traditional managers without concrete sustainable mandates become more active in engagement efforts as well.

- *One of our traditional global equity investment managers outlined a new ESG policy for the firm which pertained in particular to how the investment team would begin holding companies more accountable for their management of ESG risks, GHG emissions disclosure, and strategic planning for operating their businesses in a low-carbon world.*

Diversity, Equity and Inclusion (DEI) Focus

We are firmly committed to increasing the representation of diverse managers across our investment platform, addressing any unintentional bias in our investment selection process, and expanding investments that drive positive change with regard to gender and racial equity.

We work with many clients to add manager diversity to their portfolios. Our process generally involves a discovery phase to understand the client's perspectives on diverse manager representation, and to set goals that meet the client's specific needs. This involves helping each client set criteria for what defines a "diverse manager," and developing a transition plan to add those managers into their portfolio over time. A recent example resulted in a client aiming to move 10% of portfolio assets to managers with >50% women and/or minority ownership, a goal that was surpassed within 12-18 months.

We also seek out funds and managers whose investment approach contributes positively to equity and justice. One of our venture capital managers, for example, has an investment team almost entirely staffed by women and/or persons of color; it does not have a specific DEI investment mandate, but its approach and its team's wide-ranging perspectives have led to a diverse portfolio—more than half of company founders in its funds identify as women and/or persons of color. It created a dedicated fund recently that seeks to enhance diversity of shareholders, board members and leaders of late-stage companies preparing to go public, and its investment team has committed personal capital to this strategy.

Between our search for managers with this kind of DEI impact, and our internal investment team's ongoing review of the DEI merits of potential equity and fixed income investments, we are confident that our focus on this issue will continue to sharpen in the coming years.

Private Markets*

Private market investments can offer investors an opportunity to put capital to work in return-focused strategies tailored toward intentional impact goals. Unlike managed public-market strategies, private investments are often laser-focused on specific impact goals, and opportunities that may seem compelling to one investor may not interest another. Our private market platform seeks to match clients with the opportunities that reflect their mission, values and priorities.

For example, we have invested in a private real estate fund with a sustainable focus; specifically, the manager targets stable, cash-flow-positive investments in green, multifamily housing throughout the U.S. that is 100% affordable, mixed-income, rent-stabilized or rent-controlled; additionally, the fund seeks out "smart planning" housing investments where residents can connect easily to jobs, schools or other essential retail establishments by mass transit or on foot.

Some other examples of investments made by some of our recommended private managers include:

- *A company that manufactures and sells environmentally friendly shoes. The company measures the emissions of its entire supply chain, reduces environmental impacts through the use of sustainable materials, and offsets residual emissions to neutralize its carbon footprint.*
- *A robotic surgery firm that helps enable more effective diagnostic and therapeutic procedures for the treatment of lung cancer.*
- *A mobile fintech company that provides instant credit scoring, lending and other financial services to customers in underrepresented markets, including Kenya, Tanzania, India and the Philippines.*

In renewable energy, we have made several private investments that involve the purchase or management of the real renewable asset (e.g., solar projects, wind farms, etc.). Lower- and middle-market renewable energy investments can offer relatively attractive deal valuations, given the lack of subscription interest from larger players. One manager we recommend is dedicated to renewable energy infrastructure, and provides secured loans to small and mid-sized solar developers that have limited lending alternatives given their smaller size. It has identified a mismatch in supply and demand for non-dilutive capital at the pre-construction phase. As a result, the firm can generate an attractive yield on senior loans that are backed by strong collateral. Projects in its most recent fund have offset approx. 500 metric tons of GHG emissions.

It is important to call out two distinct categories of private impact investment: "***return-first" strategies*** that seek competitive performance commensurate with their asset-class peers, and "***impact-first" strategies*** that mix philanthropic and financial considerations in a vehicle that may seek different risk/reward objectives when compared to a traditional private investment. Nonprofit endowments and foundations are often especially interested in these distinctions, as they need to consider various guidelines that govern whether investments can be considered mission-related investments (MRIs) or program-related investments (PRIs).

Our asset allocation model focuses exclusively on the first category of return-focused strategies. We also work with some clients to identify compelling impact-oriented investments, typically isolating a pool of assets that can be evaluated according to different criteria than the client's core portfolio.

*PRIVATE AND ALTERNATIVE INVESTMENTS MAY BE AVAILABLE TO QUALIFIED PURCHASES AND ACCREDITED INVESTORS ONLY.

OUR SUSTAINABLE MODEL AND INVESTMENT PROCESS

There are numerous factors we consider when constructing sustainable multiasset portfolios. As with every portfolio, we need to answer balancing questions around growth, risk, income, liquidity and stability. As noted throughout this report, we believe that a primary benefit of ESG research is that it can help us make smarter investment decisions, and select managers with a greater probability of generating attractive long-term risk-adjusted returns.

Additionally, we need to think about client-specific factors—for example, a nonprofit's mission, and how to align its portfolio with that mission; or, a family's shared values and priorities, and how to reflect those values when selecting investments.

Our experience has shown us that we can accomplish all of these intersecting goals with a thoughtfully constructed portfolio. These portfolios may exhibit some mild investment-related differences from "non-sustainable" counterparts. One example mentioned in this report is the tendency for sustainable portfolios and managers to exhibit a growth bias. Another example is in hedged equity; we do not currently recommend hedged equity strategies as part of our sustainable manager platform. This is partly because of a dearth of current options (our search effort in this space are ongoing), and partly because we have not yet become comfortable with shorting companies in a sustainability-focused portfolio.

However, all Brown Advisory client portfolios are constructed using the same asset allocation methodology; the managers we recommend to clients are subjected to the same level of rigorous fundamental and operational due diligence, and overall, we are committed to delivering the same financial outcomes to our clients regardless of how they incorporate sustainable considerations in their long-term plans.

Asset Allocation

We believe in a bottom-up approach to building sustainable client portfolios. Our allocation decisions are influenced by a combination of asset-class analysis and manager-specific conviction—in other words, we may invest more in an asset class where our outlook is mixed, if we have an especially high degree of confidence and enthusiasm in a manager within that asset class. Further, most of our recommended, actively-managed sustainable strategies run concentrated portfolios; we believe that concentrated strategies are much more capable of maximizing the value created by a strong manager's research, insight and decision making.

Our general asset allocation views are expressed with a model portfolio we maintain, constructed from recommended sustainable managers in various asset classes. This model serves as a starting point from which we can tailor a portfolio to fit the needs of a specific client; few, if any, of our clients' portfolios mirror this model exactly.

In addition to traditional metrics such as portfolio risk, liquidity and expected returns, we think about broad exposure to various ESG risks, as well as the potentially positive impact generated by the portfolio's holdings across various social and environmental categories. Analysis to uncover these factors is conducted at the individual manager/strategy level, as well as for full, multiasset portfolios. A key challenge with this work is generating "look-through" data across dozens of managers, to identify the security-specific ESG and impact characteristics of each manager's underlying portfolio. Without a technology-based solution, this work involves an untenable time commitment in terms of manual data collection and collation.

To address this challenge, we developed a proprietary in-house system called ARIS Analytics. This system ("ARIS" is an acronym for Alignment, Risk, Impact and Sustainability) can cross-reference Brown Advisory's primary ESG research and third-party ESG data sources against the holdings data for hundreds of managers in our approved and recommended list. This allows us to generate detailed ESG and impact analysis for any managed fund in the system, or for a multiasset portfolio constructed from those funds. The system is useful during initial discovery and planning with clients as we look at their current holdings and make proposals for new portfolio allocation; it is equally useful for monitoring and reporting on progress once a new portfolio has been implemented.

In the exhibits on pages 17 and 18, we share information about our sustainable model portfolio as of Dec. 31, 2020. In addition to providing a traditional asset allocation view, we provide several views of the portfolio generated from ARIS Analytics, including portfolio exposure to what we deem to be ESG controversies, carbon footprint, and exposure to holdings that our in-house research team believes are generating positive societal impact.

Manager Research and Selection

Our team has conducted due diligence on hundreds of managers that describe themselves as "sustainable." Each one has been subjected to the same level of scrutiny we apply to any manager, and additionally we have sought to ensure that these managers truly integrate ESG research into their investment processes. This vetting process has resulted in a set of approved and recommended managers, from which we have constructed our fully sustainable model portfolio.

The universe of sustainable managers is expanding rapidly; in 2020 alone, Morningstar reported approximately 700 new sustainable equity and fixed income fund launches. This trend is welcome—a larger universe of managers should lead to a larger number of managers that can beat their benchmarks—but it also makes our work more challenging, because there is a huge variance across these funds in terms of how the manager defines sustainability, the criteria they use for security selection, the extent to which they integrate ESG research in their process, and so forth.

It is more important than ever for us to stay focused on deep due diligence, so we can cut through what managers say about sustainability in an effort to learn what they really do. For us to recommend a

BROWN ADVISORY SUSTAINABLE MODEL PORTFOLIO

The following charts and tables provide information on our sustainable model portfolio as of 12/31/2020. In addition to baseline asset allocation, we provide data on fossil fuel exposure, exposure to selected ESG criteria, and finally exposure to what we view as positive social and environmental impact themes, calculated and presented using our proprietary ARIS Analytics system.

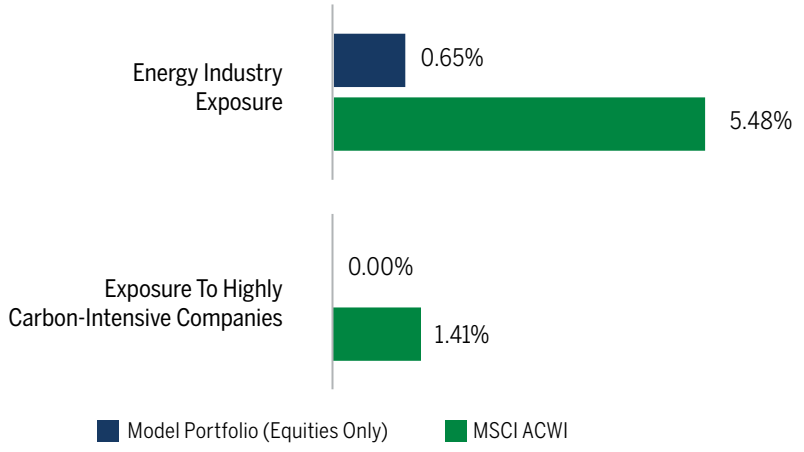
Our model for sustainable portfolios is maintained as a starting point for constructing actual portfolios for clients. It represents our "pure" thinking with regard to asset allocation, sustainable manager selection and ESG-related criteria, without factoring in any considerations for a specific client; as a result, few if any of our clients' portfolios will actually mirror this model exactly.

Brown Advisory Sustainable Model Portfolio for Qualified Purchasers as of 12/31/2020

Portfolio Risk Category	Asset Class	External SI Strategies Recommended	Internal SI Strategies Offered	Portfolio Weight
Stability Assets	Cash & Equivalents	N/A	N/A	3%
	Fixed Income	Yes	Yes	26%
Steady Growth Assets	Real Estate	Yes	No	3%
	Private Credit	Yes	No	2%
Moderate Growth Assets	U.S. Large/All Cap	Yes	Yes	20%
	Global Large Cap	Yes	Yes	16%
	EAFE	Yes	No	8%
High Growth Assets	U.S. Small Cap	Yes	Yes	8%
	Emerging Markets	Yes	No	8%
	Private Equity	Yes	No	6%

Source: Brown Advisory. The table above represents a hypothetical asset allocation. It is not representative of an actual portfolio. Asset allocation could change depending on risk tolerance, investment objective and assets available for investment. The portfolio management team will customize portfolios to meet the guidelines, requirements, and risk tolerance of each client. The information provided in this is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular investment strategy, including whether or not to buy, sell or hold investments in any asset class mentioned. It should not be assumed that investments in such asset classes have been or will be profitable. Many alternative investments by regulation may only be sold to Accredited Investors and Qualified Purchasers.

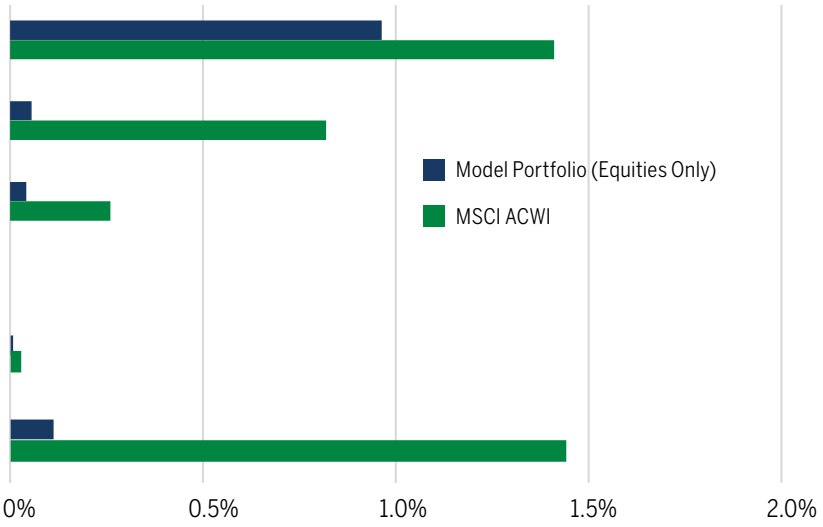
Climate/Carbon Exposure, Sustainable Model Portfolio vs. MSCI ACWI as of 12/31/2020



Source: ARIS Analytics/Brown Advisory, MSCI. Companies are flagged for energy/fossil fuel exposure according to GICS industry classification, and/or ownership of fossil fuel reserves. Companies are flagged as highly carbon intensive based on size of fossil fuel reserves or documented carbon emissions; these are generally considered the companies with the largest ongoing contribution to climate change. The information provided in this material is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell, or hold any of the securities mentioned. It should not be assumed that investments in such securities have been or will be profitable. To the extent specific securities are mentioned, they have been selected by the author on an objective basis to illustrate views expressed in the commentary and do not represent all of the securities purchased, sold or recommended for advisory clients. The information contained herein has been prepared from sources believed reliable but is not guaranteed by us as to its timeliness or accuracy, and is not a complete summary or statement of all available data. This piece is intended solely for our clients and prospective clients, is forinformational purposes only, and is not individually tailored for or directed to any particular client or prospective client.

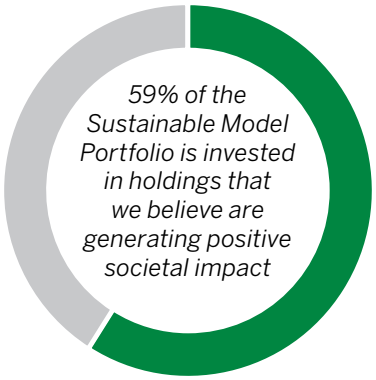
Exposure To Selected ESG Criteria, Sustainable Model Portfolio vs. MSCI ACWI as of 12/31/2020

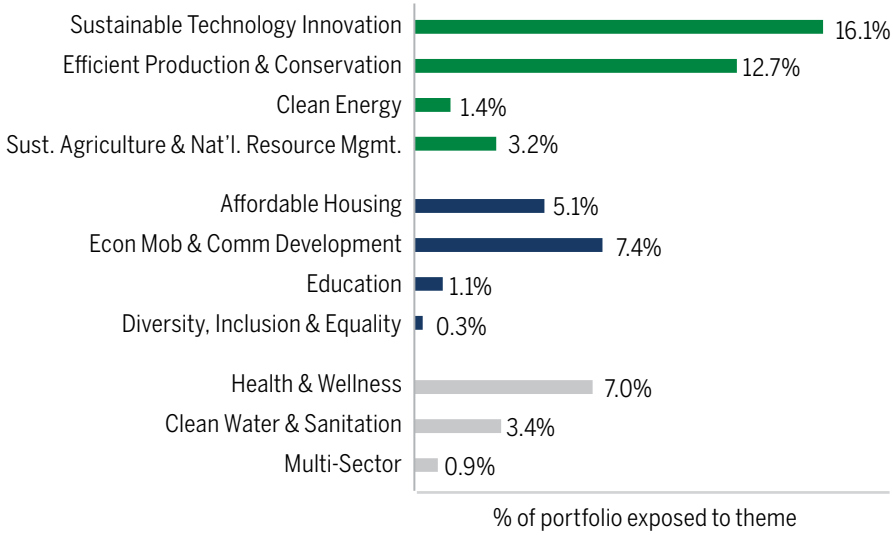
Business Practice	Threshold
Alcohol	<5% of Revenue
Tobacco	<5% of Revenue
Gambling	<5% of Revenue
Adult Entertainment	<5% of Revenue
Private Prisons	Any owner or operator
U.N. Global Compact	Compliance Failure



Source: ARIS Analytics/Brown Advisory, MSCI. Analysis covers the public equity portion of the model portfolio.

Exposure To Positive Impact Themes, Sustainable Model Portfolio vs. MSCI ACWI as of 12/31/2020





Investments are assigned an impact theme by meeting one of the following criteria:

1. Our ESG research team finds that sustainability is a core element of the investment's make-up—specifically, that a primary product or service generates a tangible positive environmental or social impact; or that sustainability is heavily embedded in operations in a manner that meaningfully reduces negative environmental and social impacts.
2. Our ESG research team has identified compelling sustainable opportunities or prospects for the investment—specifically, an ongoing transition or transformation that is driving positive progress with regard to sustainable activities, products or services.
3. As measured by MSCI, a company ranks in the top 25% of its industry within an impactful category and passes a proprietary ESG screen.

Investments not assigned to one of the themes above may have positive sustainability attributes, but have not met the above criteria.

Source: ARIS Analytics/Brown Advisory, MSCI. Companies are flagged for energy/fossil fuel exposure according to GICS industry classification, and/or ownership of fossil fuel reserves. Companies are flagged as highly carbon intensive based on size of fossil fuel reserves or documented carbon emissions; these are generally considered the companies with the largest ongoing contribution to climate change. The information provided in this material is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell, or hold any of the securities mentioned. It should not be assumed that investments in such securities have been or will be profitable. To the extent specific securities are mentioned, they have been selected by the author on an objective basis to illustrate views expressed in the commentary and do not represent all of the securities purchased, sold or recommended for advisory clients. The information contained herein has been prepared from sources believed reliable but is not guaranteed by us as to its timeliness or accuracy, and is not a complete summary or statement of all available data. This piece is intended solely for our clients and prospective clients, is forinformational purposes only, and is not individually tailored for or directed to any particular client or prospective client.

Sustainable Manager Evaluation Framework

We seek to conduct rigorous due diligence on every manager we consider for client portfolios, and sustainable managers are no exception. Our evaluation framework equally weights fund-level and firm-level criteria, as outlined below.

Firm-Level Criteria
50% of overall evaluation

Firm alignment with sustainable mandate of fund being evaluated	25%
Firm reputation and governance	15%
Firm operational characteristics	25%
Transparency and disclosure	25%
Investment terms and fees	10%
	100%

Fund-Level Criteria
50% of overall evaluation

Integration of ESG/sustainable research within process	20%
Integration framework	15%
Data sourcing/quality	20%
Engagement efforts	15%
Impact/sustainability outcomes	10%
Impact/sustainability reporting	10%
Fund track record/team track record in sustainable investing	10%
	100%

Source: Brown Advisory

sustainable manager, we need confidence that their ESG integration is real; that it adds material value to their investment decisions (e.g., helps them value future cash flows more effectively, manage tail risks of climate change, etc.); and, that the strategy meets the same investment and operational standards as any other manager on our platform.

Evaluation matrix for sustainable managers: We always seek out investment managers with well-honed, repeatable investment processes and strong commitment to fundamental, bottom-up research and long-term thinking. Our evaluation of sustainable managers is merely an extension of this process that aims to test each manager's ability to execute an integrated, sustainable investment process. As shown in the exhibit above, we evaluate sustainable managers on a variety of measurable criteria, seeking to place equal weight on the merits of the specific strategy being considered, and on the manager's overall operations and philosophical approach to investing.

We believe this rigorous approach is essential to separating the wheat from the chaff in an increasingly crowded market. Greenwashing is becoming more prevalent as demand for sustainable investments grows and companies seek to capture some of those assets. We are seeing traditional managers pivot their message or strategy label, and/or add references to ESG research in their prospectus, without making any measurable or meaningful change in their process or underwriting. On the other hand, firms are pursuing strategy transitions with far more authenticity. This is yet another reason why careful manager due diligence is so important when recommending sustainable managers for clients.

Conclusion

We live in volatile times. Investors often look for "inflection points," or turning points that indicate a major shift in business conditions, cultural preferences or the economic environment; we could argue that the past decade or more has been characterized by a near-constant stream of inflection points. Change and transformation has become the rule, not the exception—a scenario that is both exciting and unnerving for investors.

Certainly the common theme of this report is transformation—in cultural awareness of racial justice issues, in the economy's energy mix, and in the way investment results are measured by broader societal outcomes as well as financial returns. Our sustainable investing efforts on behalf of clients are constantly evolving, in an effort to stay ahead of shifts in the investment landscape, to respond quickly to our clients' needs, and to effectively integrate ESG research into our investment process in a manner that can improve returns over time.

However, the pace of change in society and in the sustainable investing field makes it that much more important to remain true to the fundamental investment principles that have guided our firm for many years—intense focus on bottom-up fundamental research, commitment to long-term thinking, and increasingly, dedication to using ESG research and a sustainable mindset to enhance our asset allocation, manager selection and investment decision-making. We need that firm foundation beneath us, to ensure that we can help our clients successfully move forward toward their long-term goals.

The S&P 500 Index represents the large-cap segment of the U.S. equity market and consists of approximately 500 leading companies in leading industries of the U.S. economy. An index constituent must also be considered a U.S. company. **The S&P 500 ex-Energy Index** is based on its parent index, the S&P 500 Index, and excludes constituent companies that are classified within the GICS energy sector. **The MSCI All-Country World Index (ACWI)** measures the global equity market, and includes large and mid-cap stocks across 23 developed market countries and 27 emerging market countries. **The MSCI ACWI ex-Fossil Fuels** is based on its parent index, the MSCI ACWI, and excludes companies that own oil, gas and coal reserves. **The MSCI Emerging Markets Index** captures large- and mid-cap representation across 27 emerging markets countries. **The Bloomberg Barclays U.S. Corporate High Yield Index** measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded. **The LSTA/S&P Leveraged Loan 100 Index** measure the performance of the U.S. leveraged loan market based upon market weightings, spreads, and interest payments. **The Russell 2000 Index** is a market-capitalization weighted equity index that provides exposure to the small-cap segment of the U.S. stock market. It tracks the performance of the 2,000 smallest U.S.-traded stocks. The **NASDAQ Clean Edge Green Energy Total Return Index** is deisgned to track the performance of a set of clean energy companies. The **Wilderhill Clean Energy Index** seeks to track the clean energy sector.

Market Capitalization is the market value of a publicly traded company's outstanding shares. **Price-Earnings Ratio (P/E Ratio)** is the ratio of the share of a company's stock compared to its per-share earnings. **Cyclically adjusted P/E ratio** (CAPE Ratio or Shiller Cyclical P/E) is a P/E ratio variant that uses a trailing, inflation-adjusted long-term average (typically 10 years) as its earnings figure. **EV/EBITDA** is a valuation metric that expresses a company's enterprise value as a multiple of its earnings before interest expense, taxes, depreciation and amortization.

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