Wescott's Environmental, Social and Governance (ESG) + Impact Offering Annual Report 2019

Wescott Financial Advisory Group LLC

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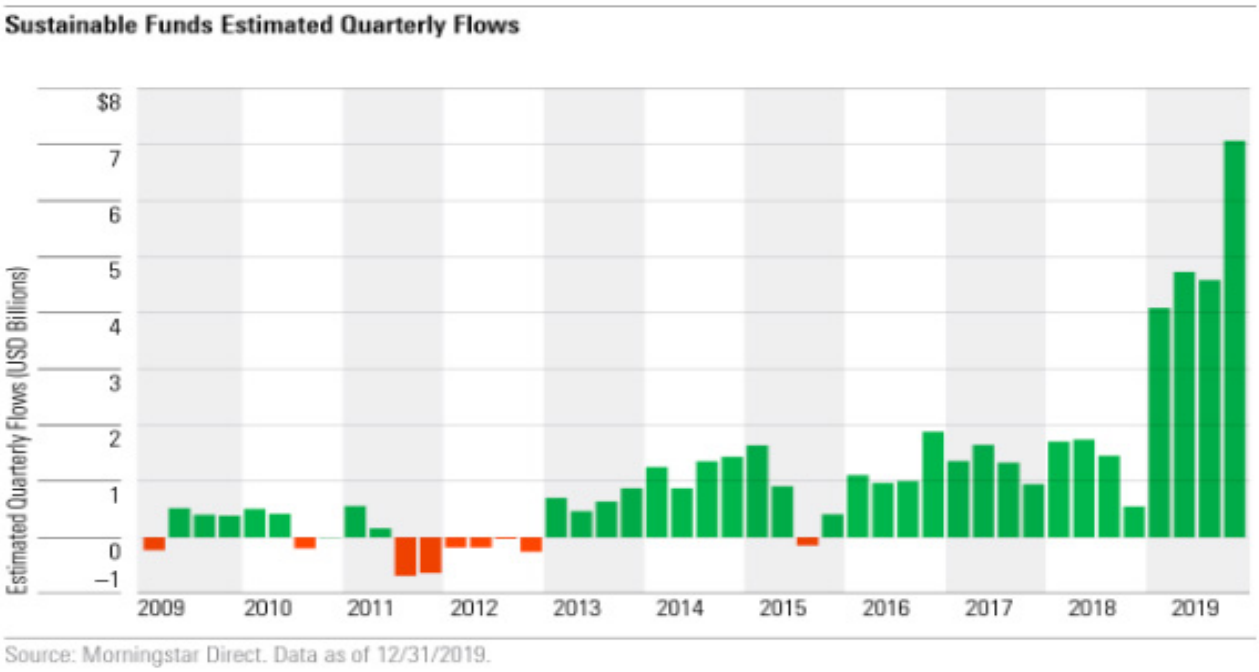
The demand for investment solutions that address clients' environmental, social and governance (ESG) preferences has been growing in recent years. The asset management industry has responded with products and services that seek to avoid certain companies and industries (i.e. no fossil fuels) using a customized screening approach. More recently, active managers have incorporated environmental, social and governance research into their security selection criteria and proxy voting procedures, allowing them to take more of a positive approach to ESG in their implementation.

According to data from Morningstar, flows into sustainable funds increased dramatically in 2019, underscoring the growing demand in the market. It is clear from fund flows and news headlines that sustainable investing is top of mind for many investors, corporations and asset management companies. As advisors to individual and family clients, endowments and foundation and pension funds, Wescott's ESG + Impact offering offers our clients an opportunity to seek a financial return with a sustainable focus.

Figure 1: Sustainable Fund Asset Flows Gain Momentum in 2019



Measuring Sustainability Risks

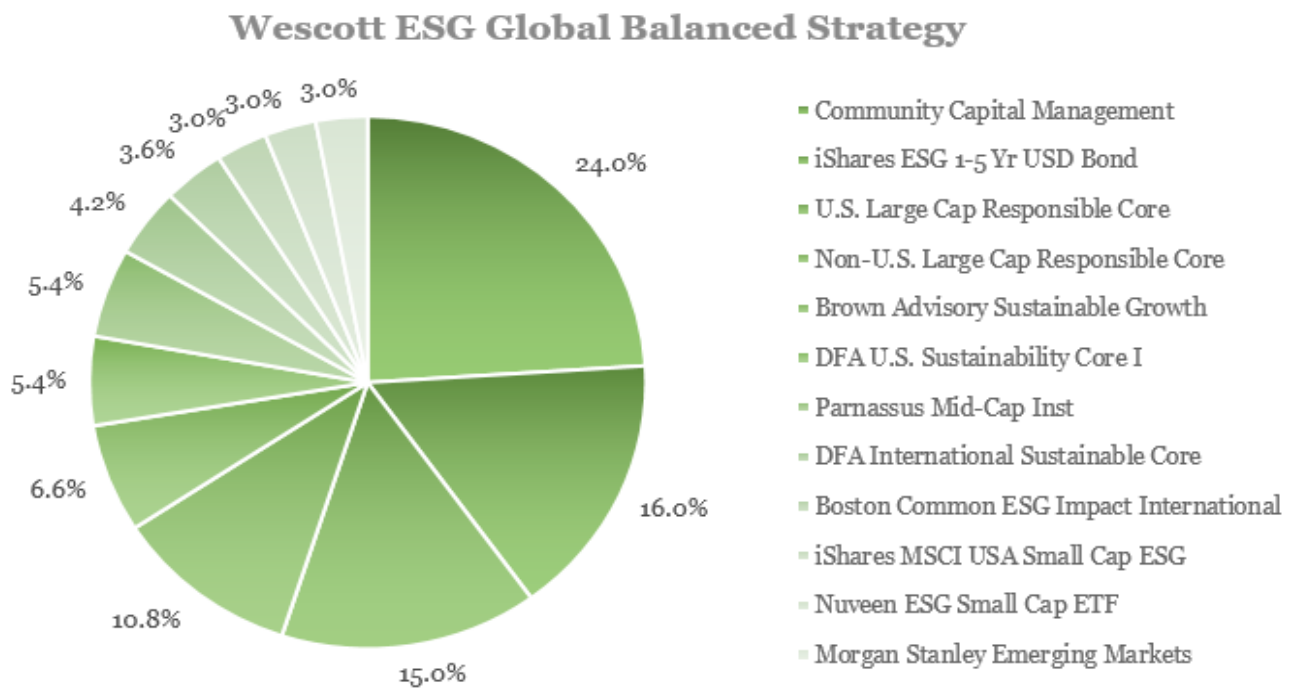
As interest grows, so too has the ability to measure the environmental, social or governance (ESG) impact of a given investment or strategy. Morningstar, a provider of investment analytics, has introduced a sustainability rating to complement their risk, style and return data. The Morningstar Sustainability Rating is a measure of the financially material environmental, social and governance, or ESG, risks in a portfolio relative to a peer group. The rating is an historical holdings-based calculation using the company-level ESG Risk Rating from Sustainalytics, a leading global and independent provider of ESG research.

The Sustainalytics ESG Risk Rating is rendered on a 0-100 scale. Lower is better, with zero indicating that a company has no unmanaged ESG risk and 100 indicating the highest level of ESG risk. In practice, most scores range from 0-50. ESG Risk Ratings are aggregated to a Portfolio Sustainability Score on a monthly basis, using an asset-weighted average of all covered securities. Covered securities include equity and fixed income securities issued by companies that have ESG Risk Ratings. To receive a Portfolio Sustainability Score, at least 67% of a portfolio's assets under management must have a company ESG Risk Rating from Sustainalytics.

Wescott's ESG + Impact Platform

One of the primary challenges facing both advisors and asset managers is the fact that no single solution can successfully meet the demands of such a wide range of client preferences. What is important to one client may not be to another. As a result, Wescott's solution in this area consists of a range of strategies; both active and passive, separately managed and pooled designed to meet our clients' diverse objectives.

Wescott offers a number of approved investment strategies with clear ESG + Impact objectives. In addition, Wescott has constructed an ESG + Impact balanced target portfolio designed to produce attractive long term returns via capital appreciation and income generation, while also maintaining lower exposures to ESG risks. Within the U.S. Large Cap Core and the non-U.S. Large Cap Core mandates, eligible Wescott clients can choose to implement their own strategy via customized separately managed accounts that meet specific ESG criteria.

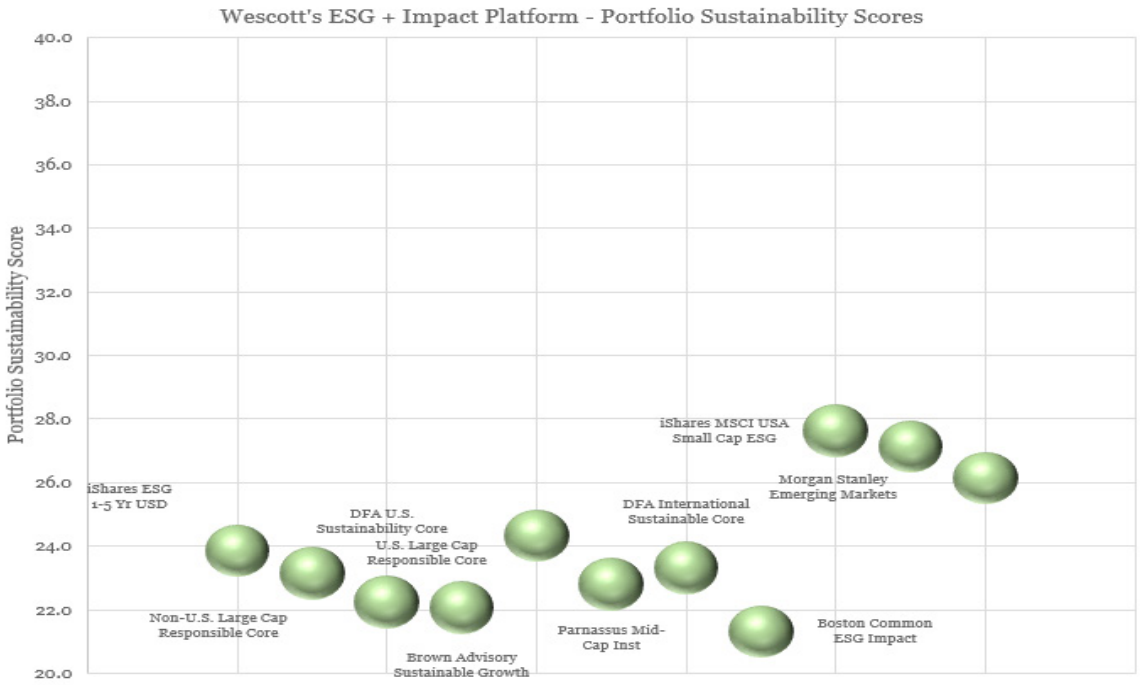


Source: Wescott Financial Advisory Group, LLC

Wescott's selection of ESG + Impact Managers

Each manager included in the Wescott ESG + Impact target portfolio underwent extensive due diligence by *Wescott's Investment Research Group* and was ultimately approved by *Wescott's Investment Committee* based on minimum fundamental, quantitative and ESG criteria. For each manager selected, sustainable investing had to be an integral part of the investment process employed in the strategy's mandate and the fund in most cases designated as a sustainable fund by prospectus. Even funds that are not designated as a sustainable fund should exhibit characteristics consistent with lowering risks related to an environmental, a social or a governance issue.

Wescott, using tools provided by Morningstar based on scores from Sustainalytics, measures each fund's exposures on an annual basis. In the chart below, we graph each manager's Sustainability Score compared to the Global Equity Benchmark. A lower Portfolio Sustainability Score indicates less risk while a higher score indicates more risk. In all but three cases, the equity managers selected for Wescott's ESG + Impact platform have lower risk scores than the global equity benchmark of 25.0. The asset classes with scores above the global large cap benchmark include U.S. small cap and emerging markets, which tend to have higher exposures to companies with more ESG risks. In the three cases where the scores are above the benchmark, all three score lower than their peers which range from 28.0-30.0 on this scale.



Source: Morningstar Direct, Wescott Financial Advisory Group, LLC. *Current Sustainability Score based on 99% of AUM | Global Category: Global Equity Large Cap | Sustainability Score as of Nov 30, 2019. Sustainability Rating as of Nov 30, 2019. Sustainalytics provides company-level ESG Risk analysis used in the calculation of Morningstar's Sustainability Score. Sustainability Mandate information is derived from the fund prospectus.*

Wescott's ESG + Impact Manager Highlights

Brown Advisory Sustainable Growth

The Fund's investing approach focuses on finding a concentrated portfolio of companies whose internal sustainability practices help generate tangible business benefits, in the form of revenue growth, cost improvement or enhanced franchise value. This may include products that have a competitive advantage as a result of sustainability drivers such as resource efficient design or manufacturing or products and services that offer solutions to long-term sustainability challenges.

We consider Brown Advisory to be one of the leading managers deeply committed to the sustainable and impact investing space. They wholeheartedly support sustainable investment principles and are one of the few firms that provides quarterly and annual impacting reporting. Their Annual Impact Report (Brown Advisory 3Q 2019 Sustainability Report) includes a detailed review of how they invest using innovative ESG and sustainable research, discussions of the positive environmental and social outcomes being created by their portfolio companies, and a look at how they engage with portfolio companies as well as with the broader sustainable investing community.

Boston Common ESG Impact International

Boston Common's mission reflects the commitment to their clients, their team, and to the universal commons. They analyze investment risks and opportunities from a broader perspective, because they believe understanding environmental, social, and governance (ESG) factors is fundamental to valuing a company. The firm strives to be responsible stewards of their clients' assets by seeking competitive investment returns from portfolios of companies that can contribute to and benefit from sustainable, global growth. Boston Common also uses their voice as shareowners to improve companies' practices and to advance the global dialogue toward a sustainable economy as evidenced by their latest Boston Common Active Investor Social Update 3Q 2019.

We consider Boston Common to be a true leader in the Environmental, Social, and Governance (ESG) space and believe that the firm, as well as its professionals, are dedicated to being a driving force of positive change by implementing sustainable practices in their portfolios and in their company's culture. The firm is recognized for its diversity, as women comprise approximately 60% of Boston Common's total staff, Board of Directors, and senior management, and racial diversity accounts for over 25% of total staff and senior management.

In 2016, the firm became a Certified B Corporation, which consists of a community of 2,500 businesses that meet the highest standards of verified social and environmental performance, public transparency, and legal accountability. In 2018, it was honored in the "Best for the World" list, which includes global businesses that earned scores in the top 10% of more than 2,500 Certified B corporations across all categories on the "B Impact Assessment". The B Impact Assessment evaluates a company's environmental performance, employee relationships, diversity, involvement in the local community, the impact a company's product or service has on those it serves, and more.

Community Capital Management – CRA Qualified Investment Fund (Fixed Income)

Community Capital believes that a fully integrated portfolio, one that includes environmental, social and governance (ESG) factors and is fossil fuel free, can deliver strong financial performance while simultaneously having positive long-term economic and sustainable impact. The firm looks to invest in high quality, well-researched securities that have positive societal impacts, while requiring transparency into the specific use of proceeds and measurement of their anticipated corresponding impact.

Community Capital actively manages its portfolios in order to take advantage of opportunities and reduce unnecessary risks. The team strives to keep risks lower, income higher, and provide diversification benefits similar to the broad investment-grade bond market.

The firm incorporates the environmental and social aspects of ESG investing into its investment philosophy by proactively seeking market-rate bonds that positively contribute to economic and sustainable impact. This includes a variety of impact initiatives such as affordable housing, small business development, gender lens, renewable energy, fossil fuel free, and many more. A benefit of the strategy is the ability for institutional shareholders to customize their investments to support specific geographies or impact initiatives, and to receive detailed quarterly reports on impact metrics and outcomes as illustrated in their CCM Impact Summary Report 4Q 2019.

Parametric Portfolio Associates

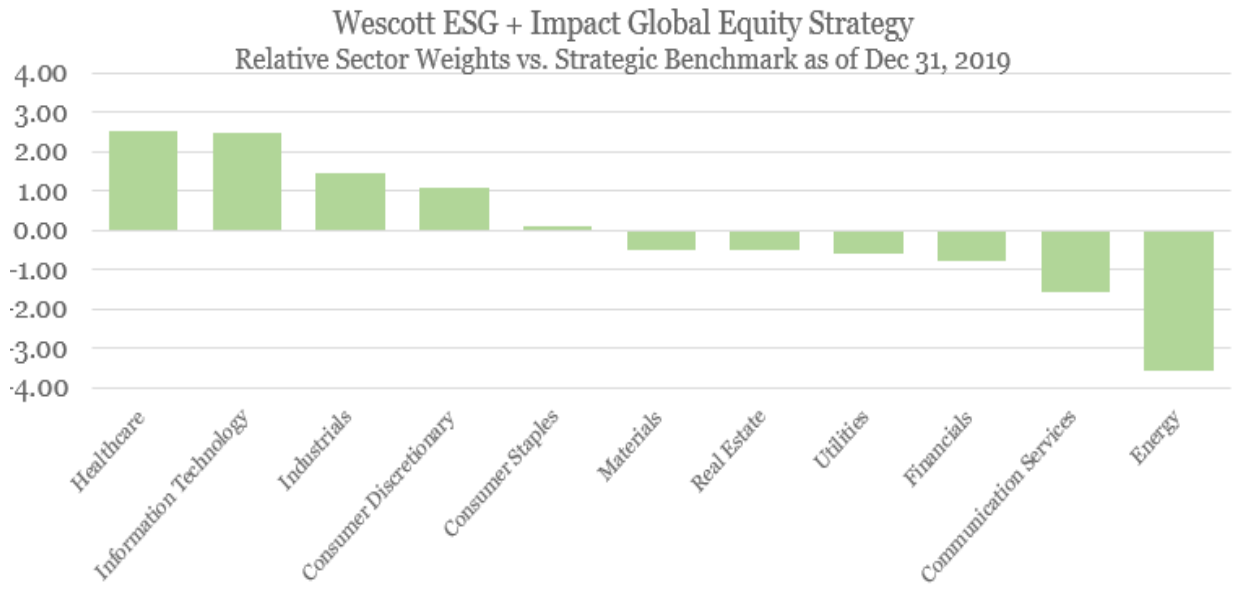
Customized Core Separately Managed Accounts and subadvisor to Calvert Responsible Indices

Parametric Portfolio Associates partners with firms like Wescott to build portfolios focused on what is most important to our clients. Parametric is a leader in custom solutions and has over $250 billion in assets under management, with over $22 billion in customized responsible investing mandates. Eligible Wescott clients can tailor portfolios to align to their values. Parametric provides detailed research on how they approach responsible investing in their Parametric Guide to Responsible Investing. In addition to setting screens aligned with values, our clients can determine what types of companies they want to own and through a proxy voting process, influence company behavior as active owners. Parametric's risk management and portfolio construction capabilities allow for full customization and reporting at the account level.

For clients that do not opt for a separately managed account, Parametric's responsible investing capability is available via a Calvert Responsible Index Fund, for which Parametric is the subadvisor. In their regularly published Calvert Impact Blog 2020, Calvert provides insight and analysis on the major ESG issues facing companies and shareholders.

Wescott ESG + Impact Emphasis on Reducing Fossil Fuel Involvement*

While there are many specific objectives that clients have when investing sustainability, Wescott's portfolio has been constructed in an effort to reduce exposure to fossil fuels. To that end, we have identified managers and funds that exclude or at a minimum, limit exposures to oil and gas companies that own and operate reserves. This results in an equity strategy that has a low **carbon risk score** and limited **fossil fuel involvement.** In addition, most funds in the strategy have a **low carbon designation** and a significant underweight to the energy sector.



Source: Wescott, Morningstar Direct

The Morningstar Sustainability Rating is a measure of how well the portfolio holdings are managing their ESG Risk relative to the portfolio's Global Category peer group.

The Morningstar Historical Sustainability Score is a weighted average of the trailing 12 months of Morningstar Portfolio Sustainability Scores. Historical portfolio scores are not equal-weighted; rather, more-recent portfolios are weighted more heavily than older portfolios. Based on their Morningstar Historical Sustainability Score, funds are assigned absolute category and percent ranks within their Morningstar Global Categories. A fund's Morningstar Sustainability Rating (Globe Rating) is its normally distributed ordinal score and descriptive rank relative to the fund's global category. Lower ratings are better and indicate that a fund has, on average, less of its assets invested in companies that have higher ESG risk as characterized by Sustainalytics.

Morningstar carbon metrics are asset-weighted portfolio calculations based on Sustainalytics company carbon-risk research. Based on two of these metrics—Carbon Risk Score and Fossil Fuel Involvement %—funds may receive the Low Carbon designation, which allows investors to easily identify low-carbon funds within the global universe.

To receive the **Low Carbon designation**, a fund must have a 12-month average **Portfolio Carbon Risk Score below 10 and a 12-month average Fossil Fuel Involvement % of less than 7%** of assets. For these metrics to be calculated, at least 67% of a portfolio's assets must be covered by Sustainalytics company carbon-risk research. All Morningstar carbon metrics are calculated quarterly.

Fossil Fuel Involvement % is the portfolio's asset-weighted percentage exposure to fossil fuels, averaged over the trailing 12 months. Companies with fossil fuel involvement are defined as those in the following subindustries: Thermal Coal Extraction, Thermal Coal Power Generation, Oil & Gas Production, Oil & Gas Power Generation, and Oil and Gas Products and Services.

The portfolio Carbon Risk Score is displayed as a number between 0 and 100 (a lower score is better). A portfolio's Carbon Risk Score is the asset-weighted sum of the carbon risk scores of its holdings, averaged over the trailing 12 months. The carbon risk of a company is Sustainalytics' evaluation of the degree to which a firm's activities and products are aligned with the transition to a low-carbon economy. The assessment includes carbon intensity, fossil fuel involvement, stranded assets exposure, mitigation strategies, and green product solutions.

