Morgan Stanley

INSTITUTE FOR SUSTAINABLE INVESTING

Sustainable Reality

Sustainable funds outperformed Traditional peers in 1H 2026; flows positive but still lagging

Key Takeaways for 1H 2026

AUM in Sustainable funds grew to over $4 trillion

Assets under management (AUM) in Sustainable funds globally reached a new high of $4.24 trillion at the end of June 2026 according to Morningstar data. This was up 4.8% on December 2025, mostly driven by fund performance. Sustainable funds now make up 6.1% of total AUM, down from a high of 7.2% in December 2023 as Traditional funds have consistently recorded stronger net inflows over that period.

Sustainable funds outperformed Traditional peers, driven by strong equity fund performance

The median return for Sustainable funds was +4.9% for 1H 2026, outperforming Traditional funds at +4.0%. Greater exposure to equities was the key driver of outperformance: The median Sustainable equity fund return was +9.0% in the first half of the year, just ahead of +8.6% for Traditional peers, which more than offset -1.3% for Sustainable fixed income funds, underperforming Traditional fixed income funds at +1.3%. Sustainable funds had stronger median returns than Traditional peers in all four major regions, with outperformance greatest in Americas and APAC investment areas.

Inflows to Sustainable funds in 1H 2026, although still below the rate of Traditional funds

First half inflows to Sustainable funds were $37.7 billion, or +0.9% of prior year-end AUM, with momentum stronger in the first quarter and slowing in the second. By fund domicile, Europe funds drove the first quarter inflows. North America flows turned positive in the second quarter, but Asia recorded outflows in both quarters. Traditional funds continue to record stronger flows, at +2.5% of prior year-end AUM in 1H 2026.

About the Sustainable Reality Series

TRACKING AUM, FLOWS AND PERFORMANCE FOR SUSTAINABLE FUNDS

Sustainable Reality is a long running series from Morgan Stanley's Institute for Sustainable Investing. It uses Morningstar data to track AUM, flows and performance for Sustainable funds in comparison to Traditional funds across a universe of 99,000 global funds.

TERMINOLOGY

The analysis uses Morningstar's definitions of "Sustainable" and "Traditional" funds.

MEDIAN RETURNS

We refer to median return because of the very wide range of potential outcomes common for investment funds, but also to reflect the likelihood of an individual investor selecting a fund that achieves the return. Returns are shown in USD.

METHODOLOGY

For the full methodology, see page 17.

CONTACT US

For any questions related to the report, please reach out to the Institute for Sustainable Investing team at **globalsustainability@morganstanley.com**.

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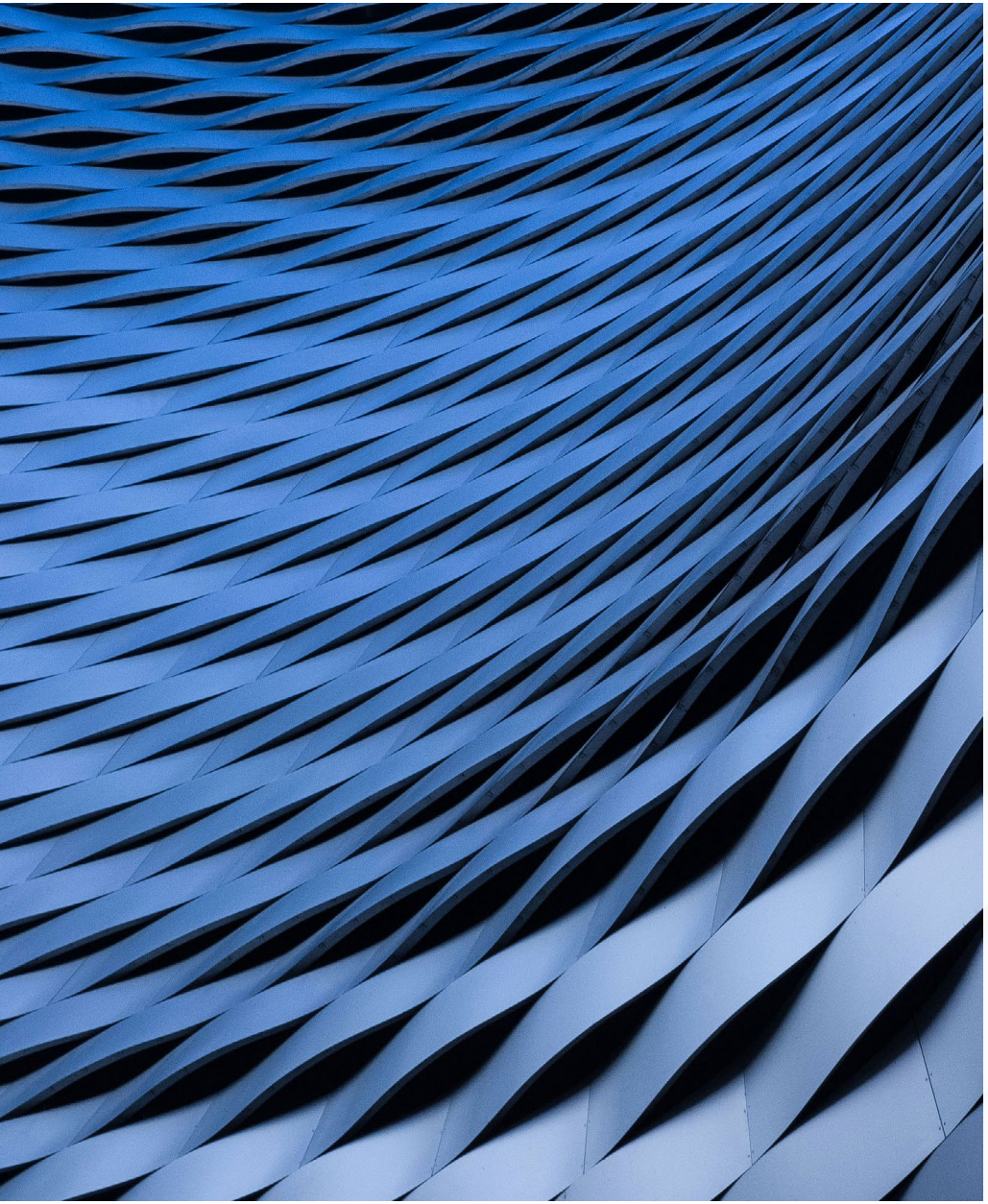

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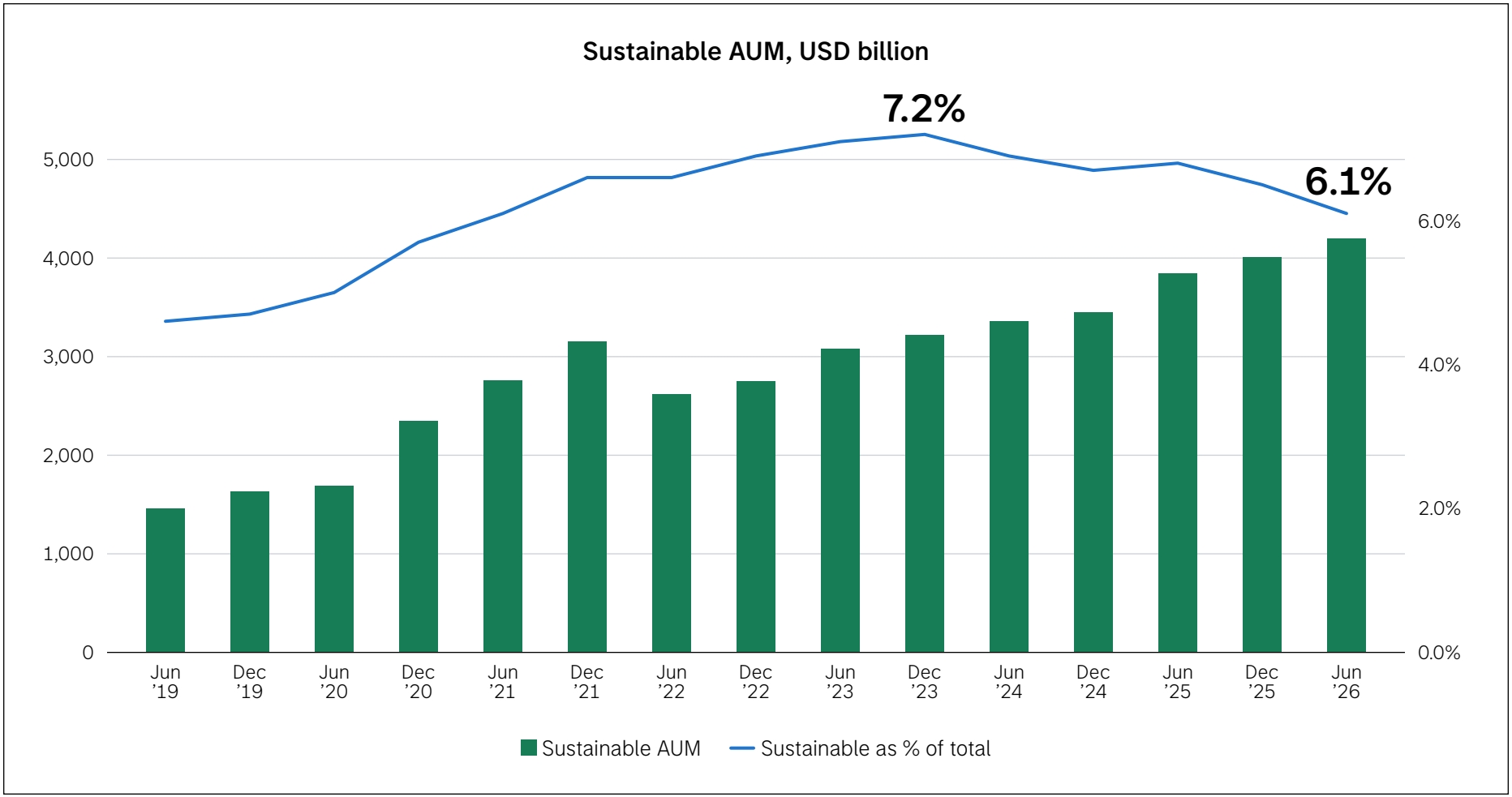
AUM in Sustainable funds grew to over $4 trillion

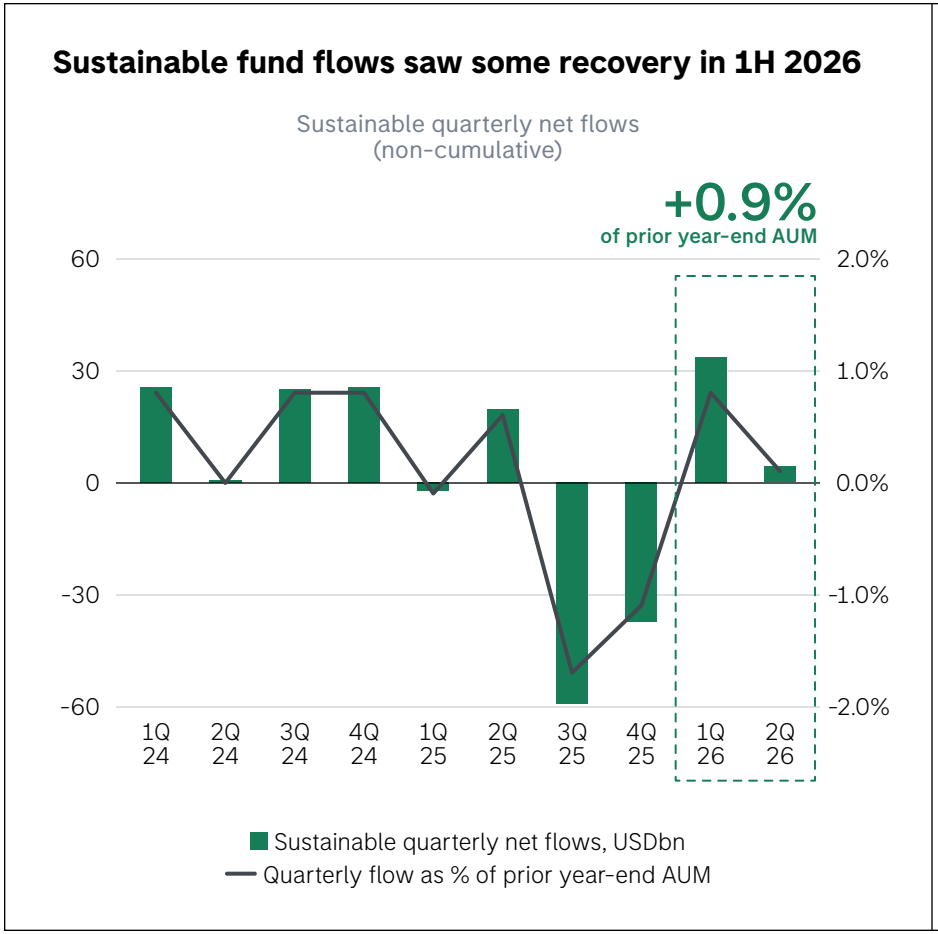
At the end of June 2026, Sustainable funds' AUM reached a new absolute high of $4.24 trillion, up 4.8% from the end of 2025. This represents 6.1% of total AUM, down from the peak of 7.2% at the end of December 2023. AUM in Sustainable funds has grown steadily in absolute terms since 2022, averaging a half-yearly growth rate of 6.2%. This was driven by both inflows and returns in 2022–2024 but more recently driven mostly by returns, with outflows in 2025 and small inflows in 1H 2026. The decline as a proportion of overall AUM since December 2023 reflects consistently stronger inflows to Traditional funds.

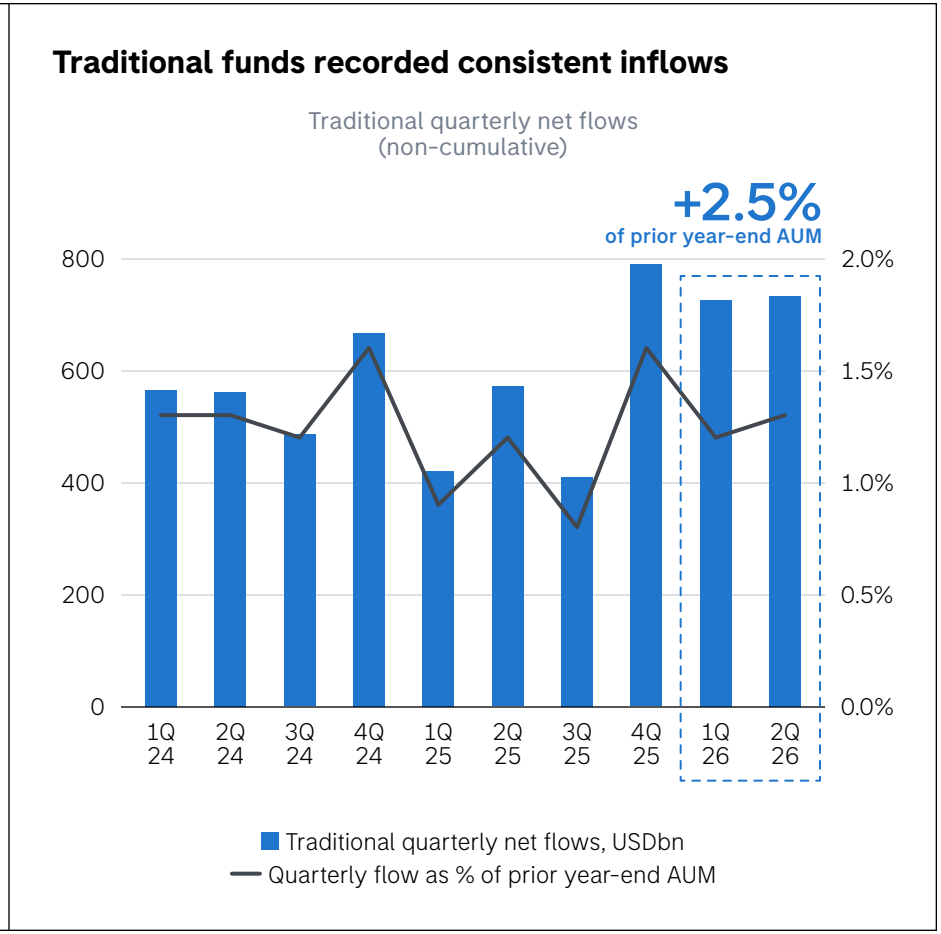


Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026.

Sustainable funds recorded inflows in 1H 2026, although momentum slowed in the second quarter

Sustainable funds reported inflows of $37.7 billion during 1H 2026, or +0.9% of prior year-end AUM. Inflows rebounded to $33.5 billion in the first quarter, up from outflows of $37.5 billion in the last quarter of 2025. However, this momentum moderated in the second quarter of 2026, with only slight inflows of $4.2 billion. Traditional fund flows continue to outpace those for Sustainable funds, with 1H 2026 inflows at +2.5% of prior year-end AUM.





Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026.

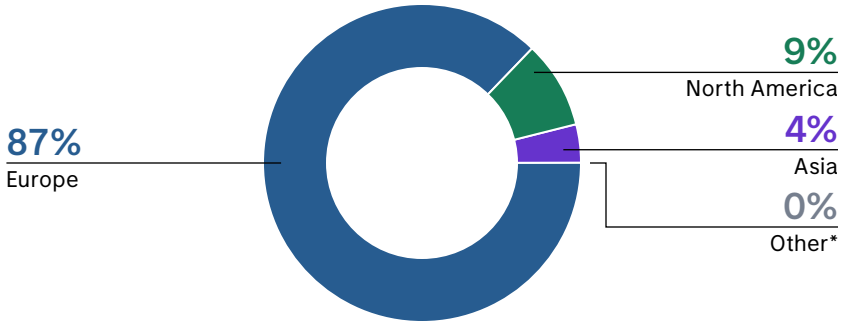
Sustainable fund inflows in Europe and North America, but below rates for Traditional funds in each region

Europe-domiciled Sustainable funds, which account for 87% of Sustainable AUM, recorded $43.9 billion inflows in 1H 2026. This is +1.2% of prior year-end AUM, with almost all inflows in 1Q 2026 and a slower 2Q 2026.

Sustainable funds in North America had inflows of $3.1 billion in 2Q 2026, ending more than three years of outflows. Net inflows for the first half were +0.4% of prior year-end AUM (with 1Q still slightly negative), still weaker than Traditional peers.

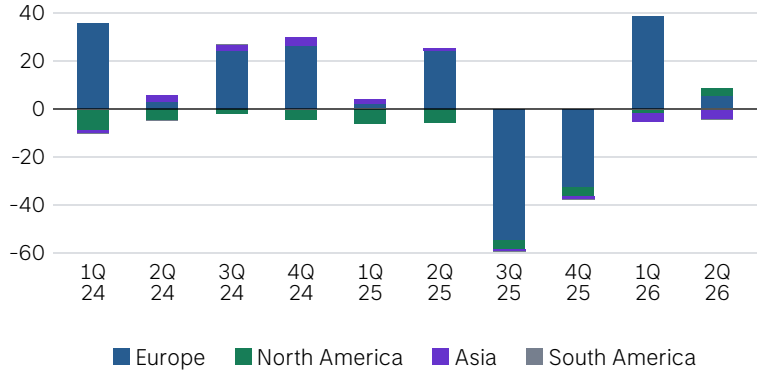
Asia-domiciled Sustainable funds lagged other regions in 1H 2026, with outflows of -$7.5 billion, or -5.5% of prior year-end AUM.

Sustainable AUM by domicile, June 2026



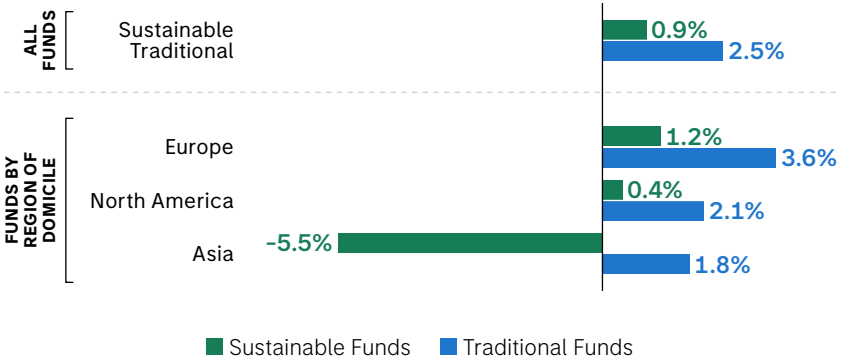
Europe funds saw inflows in 1H 2026

Sustainable fund quarterly net flow by region of domicile, USDbn



Asia flows were weakest relative to AUM

1H 2026 net flows as a % of prior year-end AUM



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026.

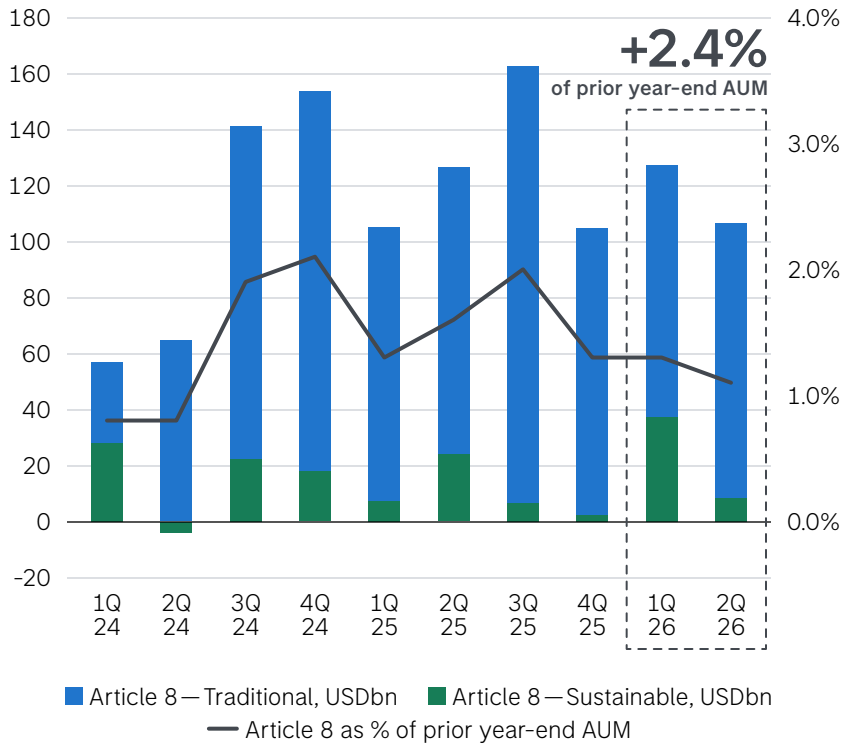
* Other includes South America and Africa, which account for 0.09%/0.01% of AUM respectively. Note that a fund can be domiciled in one region but invest globally or in other regions. Investment area refers to the latter.

Article 9 funds stable in 1H 2026, after prolonged outflows

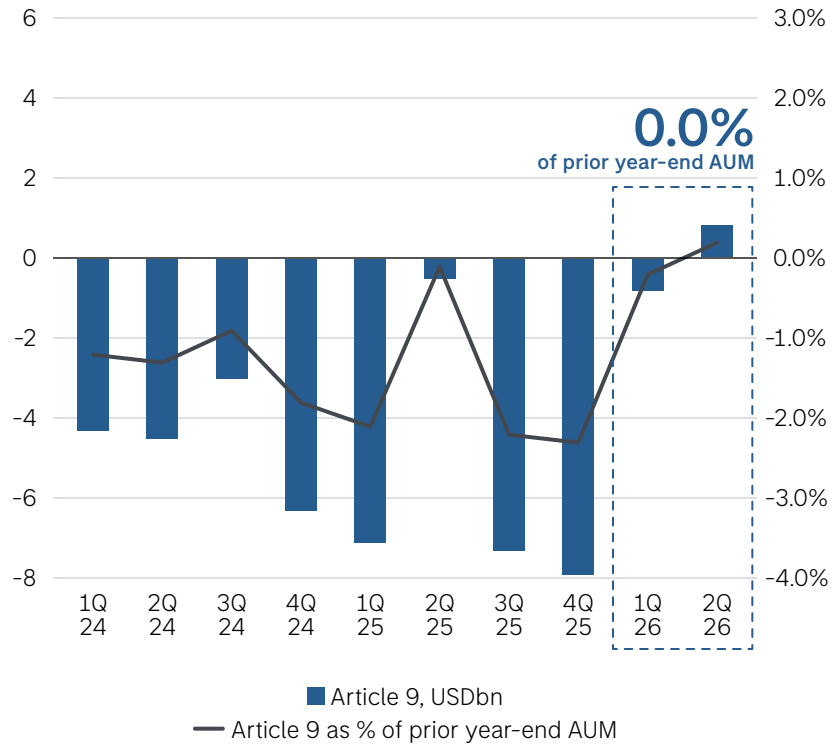
Article 8 funds saw inflows of $242.2 billion during 1H 2026, or +2.4% of prior year-end AUM. These flows were mostly driven by Article 8 funds classified as Traditional by Morningstar—Article 8 funds classified as Sustainable account for $45.8 billion (or 19%) of the total (+1.8% of prior year-end AUM).

Article 9 funds recorded small inflows in the second quarter of 2026, at $0.8 billion. This follows a ten-quarter run of outflows stretching back to 4Q 2023. With small outflows in 1Q 2026, flows for 1H 2026 were around zero.

Article 8 quarterly net flows (non-cumulative)



Article 9 quarterly net flows (non-cumulative)



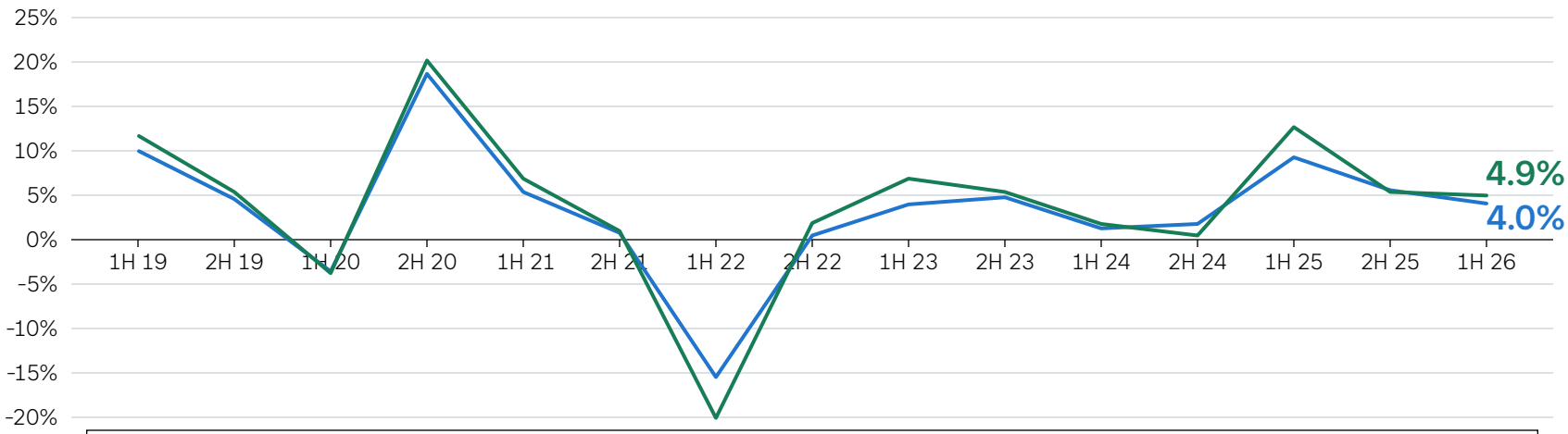
Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026.

Sustainable funds outperformed Traditional funds with median return of +4.9%

The median Sustainable fund returned +4.9% in 1H 2026, almost a percentage point ahead of the median Traditional fund at +4.0%. This was driven by larger representation of equity funds in the Sustainable universe, compared to the Traditional universe, equities the best-performing asset class in both sets of funds. Sustainable funds outperformed in all four regions.

Sustainable funds outperformed Traditional peers in 1H 2026

Median return—Sustainable vs Traditional funds



	1H 19	2H 19	1H 20	2H 20	1H 21	2H 21	1H 22	2H 22	1H 23	2H 23	1H 24	2H 24	1H 25	2H 25	1H 26
Sustainable Funds	11.6%	5.3%	-3.7%	20.1%	6.8%	0.9%	-20.0%	1.8%	6.8%	5.3%	1.7%	0.4%	12.6%	5.3%	4.9%
Traditional Funds	9.9%	4.5%	-3.5%	18.6%	5.3%	0.7%	-15.4%	0.4%	3.9%	4.7%	1.2%	1.7%	9.2%	5.5%	4.0%
Sustainable vs Traditional (bps)	163 bps	80 bps	-19 bps	152 bps	151 bps	28 bps	-463 bps	141 bps	294 bps	65 bps	52 bps	-131 bps	336 bps	-23 bps	91 bps

Sustainable Funds — Traditional Funds — Sustainable vs Traditional (bps)

Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026. Note: bps stands for basis points; 10 bps is 0.1%.

Strong equity fund performance drove overall Sustainable fund outperformance

Asset allocation was a significant contributor to Sustainable funds' relative performance in 1H 2026. Sustainable funds have a higher weighting to equities (56% of the universe, vs 41% for Traditional funds), which generated the strongest median returns across asset classes.

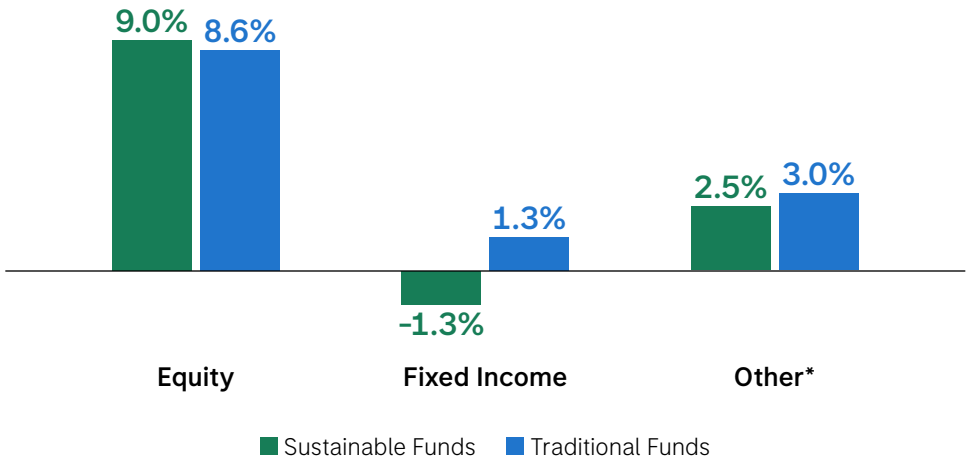
Equities: Sustainable funds recorded a median return of +9.0%, 40bps ahead of Traditional peers at +8.6%.

Fixed income: Sustainable funds' median return of -1.3% was more than 250bps below Traditional fixed income funds at +1.3%. Here, geographical exposure was a factor: Both Sustainable and Traditional fixed income funds had negative median returns in Global and Europe investment areas, and these regions account for 80% of Sustainable fixed income funds but only 39% of Traditional peers.

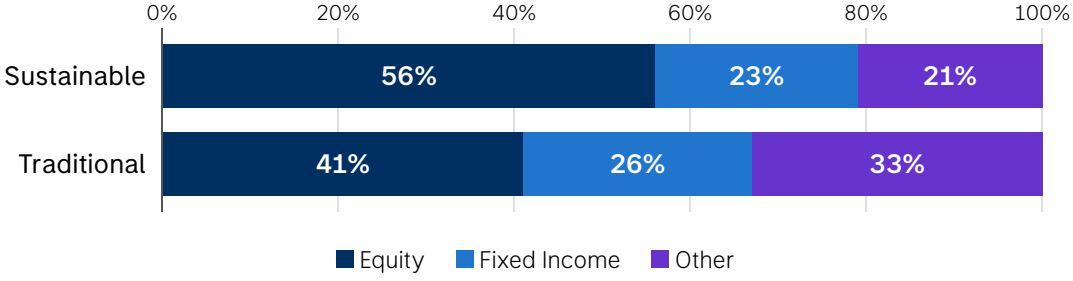
Other*: Sustainable funds had a median return of +2.5%, behind Traditional peers at +3.0%.

Sustainable funds saw strongest performance in equities

1H 2026 median return by asset type



Split of fund count by asset class, June 2026



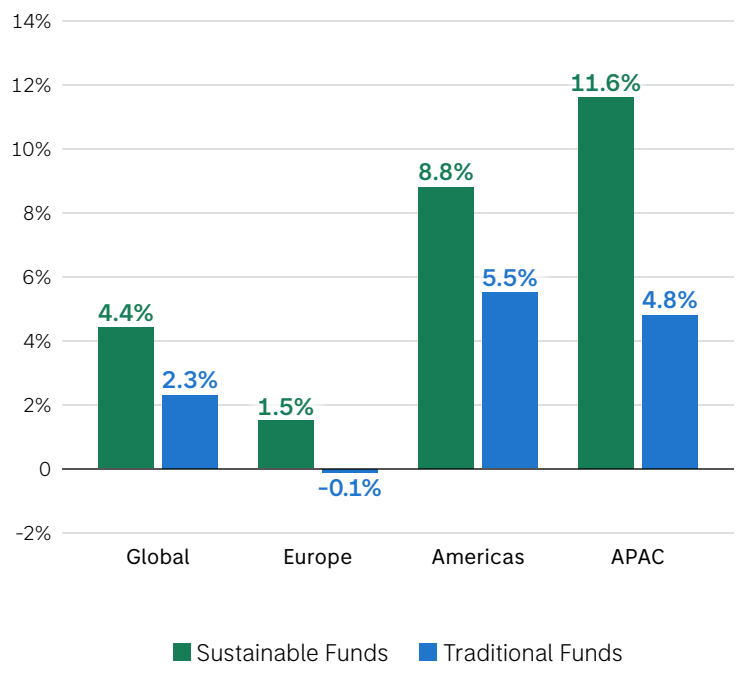
Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026. Note: bps stands for basis points; 10 bps is 0.1%.
*Other includes multi-asset, property, commodities and alternative fund types.

Sustainable funds outperformed in all geographies in 1H 2026, with particular strength in Americas and APAC

Strong relative performance in the Americas and APAC drove overall outperformance by Sustainable funds, outweighing the impact of their larger allocation to Global and Europe investment areas. While Global and Europe posted weaker median returns, Sustainable funds still outperformed Traditional funds in both regions. This contrasts with prior periods, when Sustainable funds' heavier exposure to Global and Europe—69% of Sustainable funds, versus 39% for Traditional—was a key driver of relative underperformance.

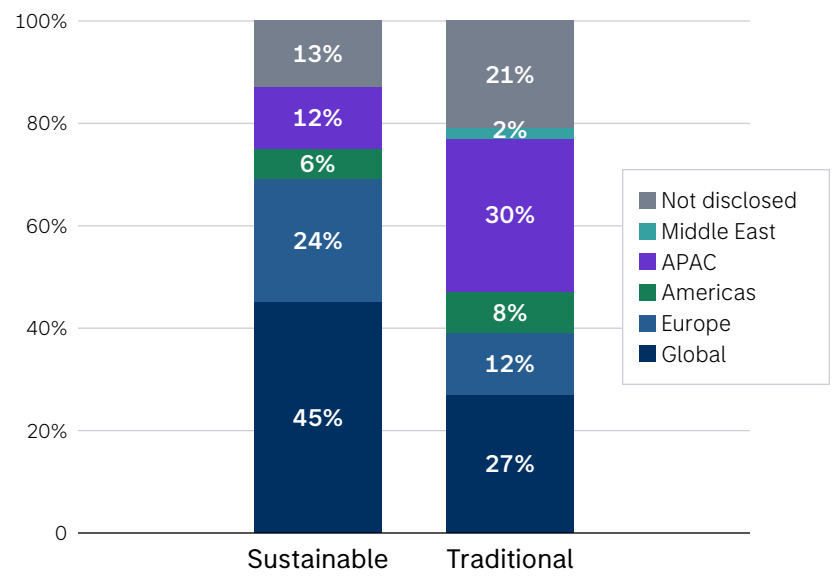
Americas and APAC saw the strongest median returns

1H 2026 median return by investment region



69% of Sustainable funds invest in Global and Europe

1H 2026 split of fund count by investment region



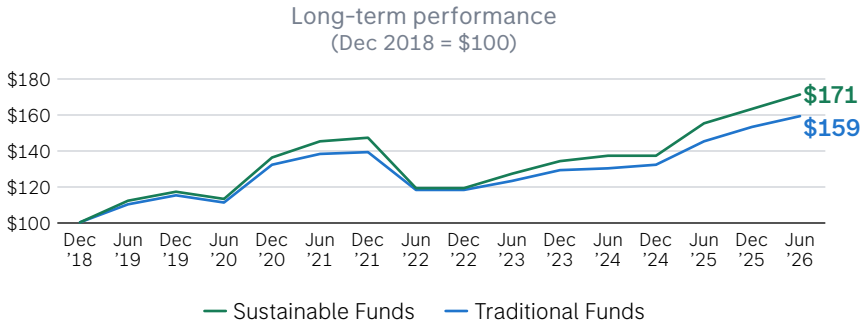
Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026. The Sustainable Reality series shows returns in U.S. dollar terms.

Long-term returns and downside deviation

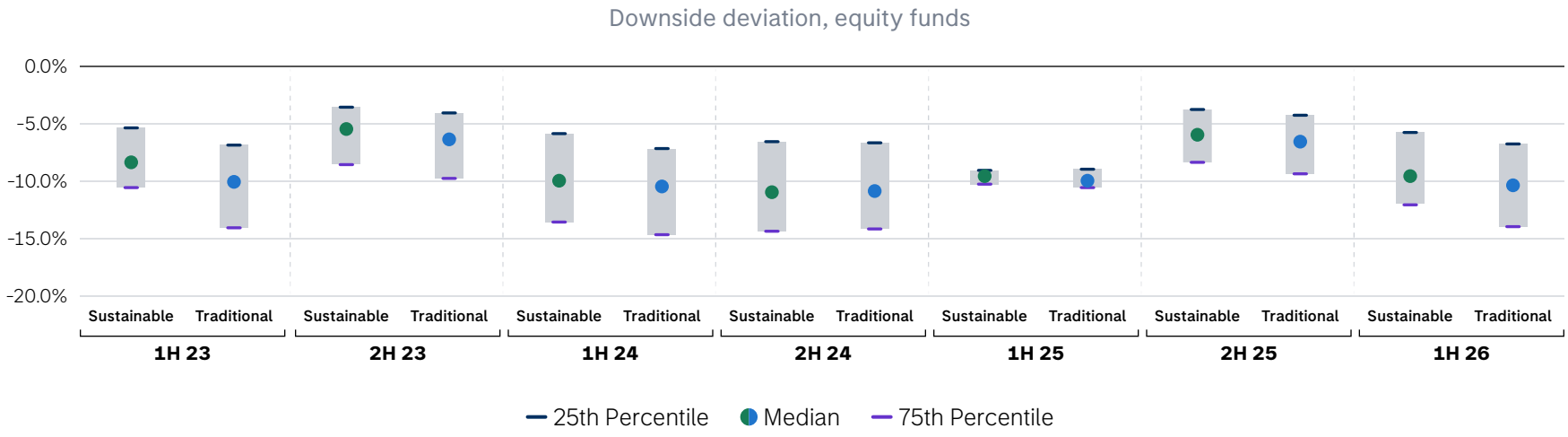
A hypothetical $100 investment into a Sustainable fund in December 2018 would have grown to $171 by the end of June 2026, assuming median returns were achieved in each period, compared to $159 for a Traditional fund.

For 1H 2026, downside deviation was -9.5% for Sustainable equity funds and -10.3% for Traditional equity funds, meaning that Traditional funds had greater potential for relative losses. Downside deviation measures the likelihood of negative returns in a set of funds against a chosen benchmark.

$100 invested in December 2018 would be $171 today, at median Sustainable fund returns*



Downside deviation measures the likelihood of negative returns against a chosen benchmark, here the S&P 500



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026.

*Past performance is no guarantee of future results. December 2018 is the start point as Morningstar's sustainable fund classification started in January 2019. This chart applies the median fund return for the full universe of Sustainable and Traditional funds (as shown on page 9) in each half-year period to a hypothetical $100 investment starting in December 2018.

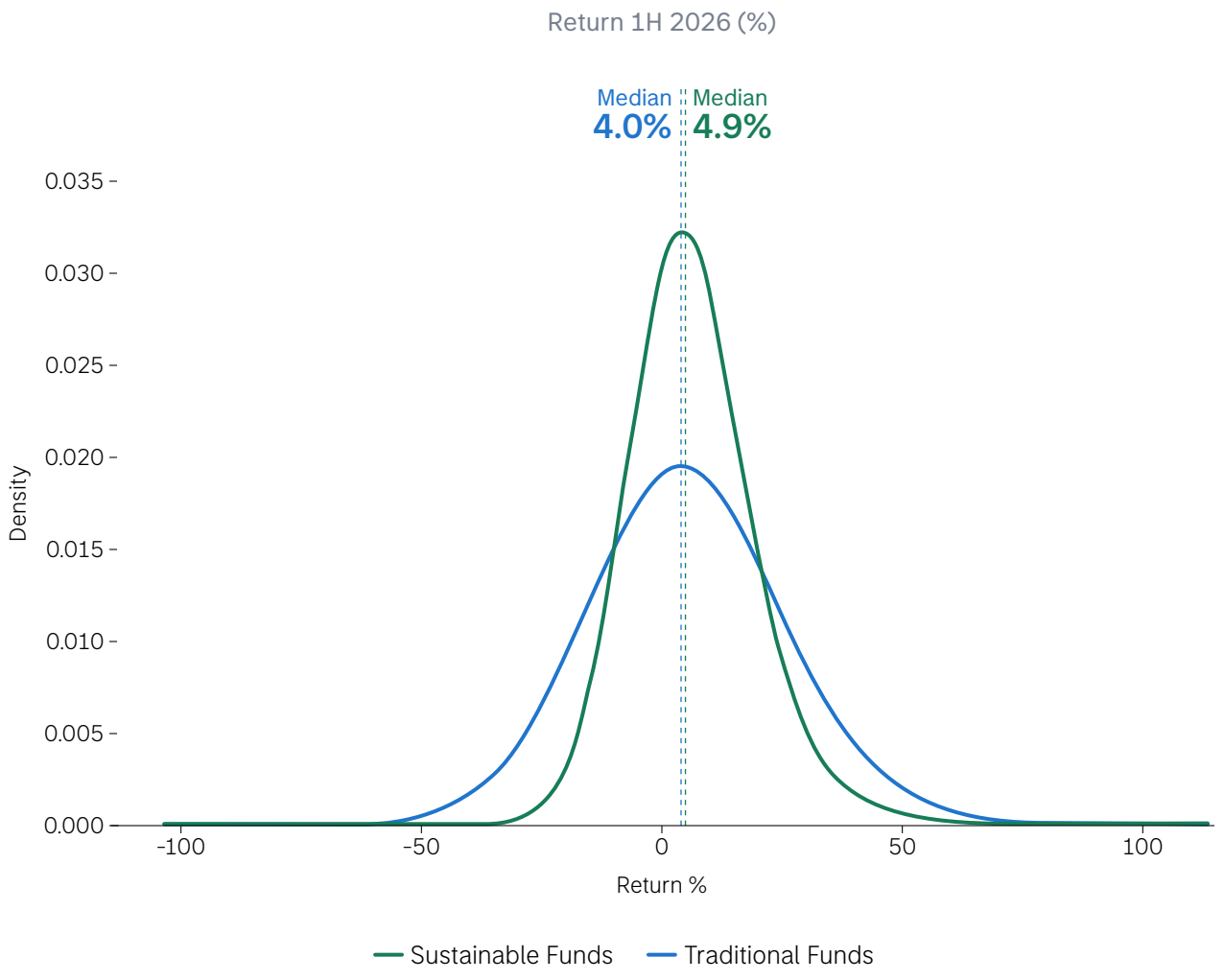
72% of Sustainable funds had positive returns in 1H 2026

72% of Sustainable funds had positive returns in the first half of 2026, versus 67% for Traditional funds.

Both curves have long tails, resulting in a very wide range of fund performance outcomes. Using mean, or simple average, returns would be disproportionately affected by these long tails and not represent the likelihood of achieving that return across a selection of funds.

The "Sustainable Reality" series uses median fund returns as the primary metric without any weighting to account for different fund sizes. Median is the more appropriate return value given the non-normal distribution of the entire universe of fund return. The median value also better represents the likelihood of an investor selecting a fund and achieving that specific return value.

Density chart of Sustainable and Traditional fund returns



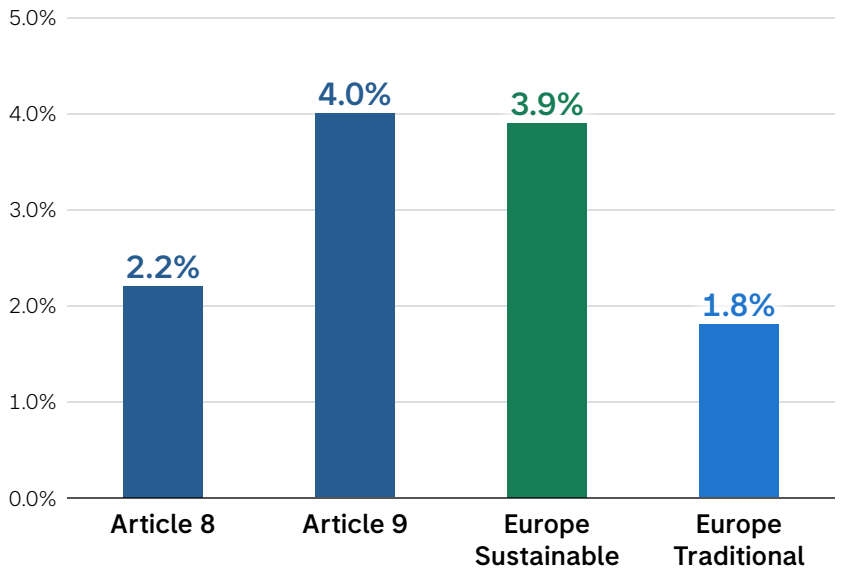
Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026.

Analyzing performance for Europe-domiciled funds

Europe-domiciled Sustainable funds outperformed Traditional peers in the first half of 2026, delivering median returns of +3.9% against Traditional funds at +1.8%. Article 8 funds (which include some Traditional funds) generated median returns of +2.2%, while Article 9 recorded median returns of +4.0%.

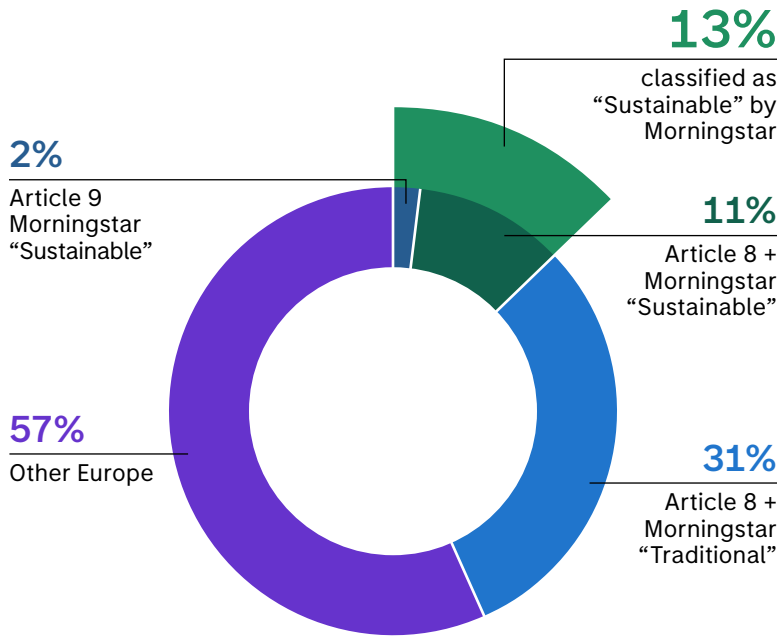
Close to half of Europe-domiciled AUM is classified as Article 8 (42% of total Europe AUM) or Article 9 (2% of total), with the remainder sitting under Article 6. Morningstar classifies all Article 9 AUM and 11% of Article 8 AUM as "Sustainable," or 13% of Europe-domiciled AUM in total.

1H 2026 median return by SFDR classification



The EU's Sustainable Finance Disclosure Regulation (SFDR) sets out mandatory ESG disclosure requirements for asset managers with the goal of creating more transparency about Sustainable investment strategies. According to the SFDR's classification system, which went into full effect on Jan. 1, 2023, a fund is either classified as Article 6 (funds without a sustainability scope), Article 8 (funds that promote environmental or social characteristics) or Article 9 (funds with Sustainable investment as their primary objective).

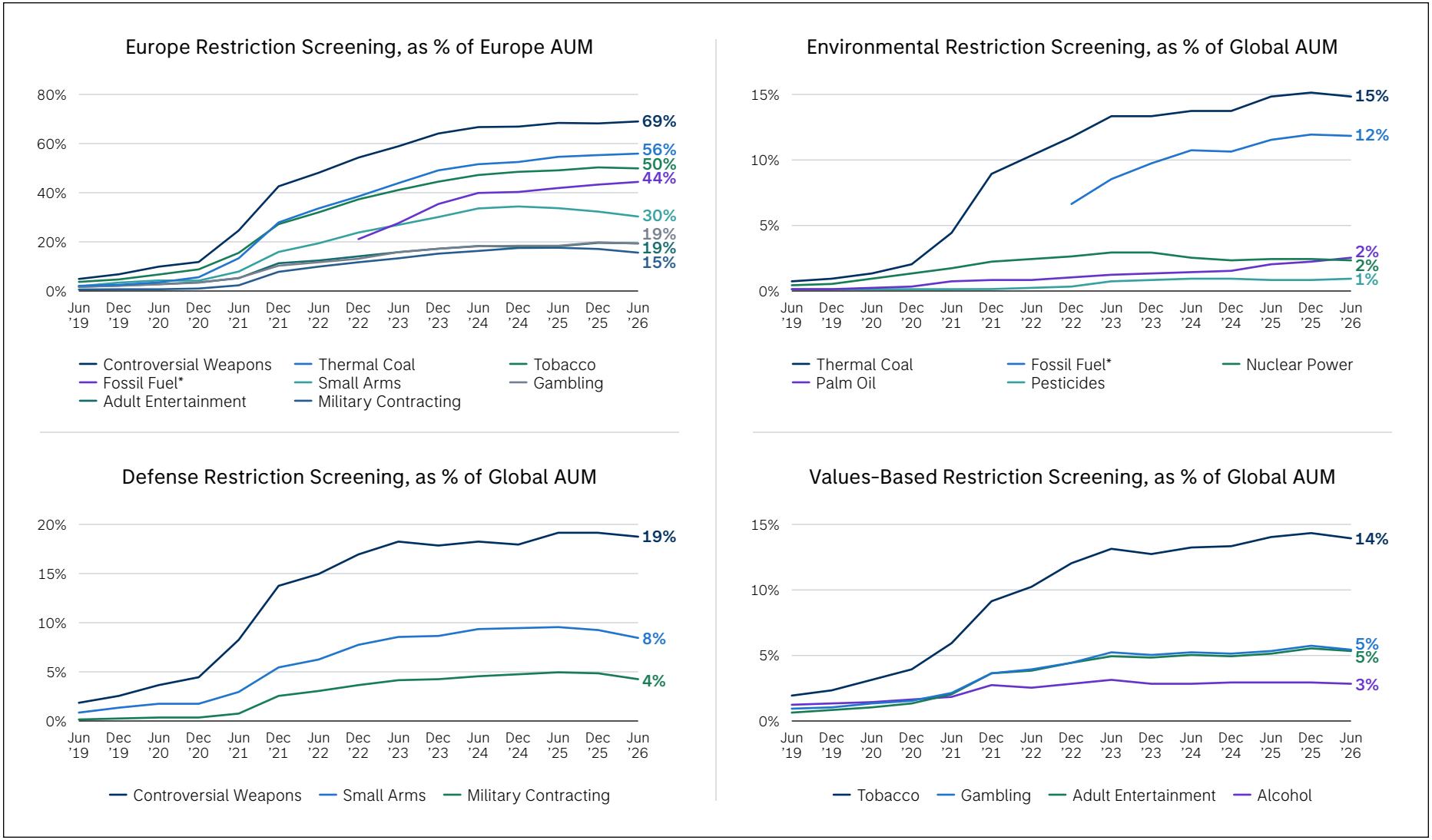
Europe domiciled AUM, June 2026



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026.

Restriction screening over time

Some defense restriction screens decreased slightly in 1H 2026, while environmental screens increased modestly.



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026.
*Fossil fuel was introduced as a separate category starting in December 2022.

Restriction screening

Europe-domiciled funds are far more likely to have restrictions applied than those in North America or Asia.

RESTRICTION SCREENING AT JUNE 2026	GLOBAL AUM, $bn	% Global AUM	EUROPE-DOMICILED AUM, $bn	% Europe AUM	NORTH AMERICA-DOMICILED AUM, $bn	% North America AUM	ASIA-DOMICILED AUM, $bn	% Asia AUM
Controversial Weapons	**15,050**	**18.7%**	**14,262**	**68.8%**	**417**	**0.9%**	**368**	**3.5%**
Thermal Coal	**11,919**	**14.8%**	**11,552**	**55.7%**	**249**	**0.5%**	**117**	**1.1%**
Tobacco	**11,163**	**13.9%**	**10,308**	**49.7%**	**443**	**0.9%**	**408**	**3.9%**
Other*	10,172	12.6%	9,582	46.2%	386	0.8%	200	1.9%
Fossil Fuel**	9,511	11.8%	9,164	44.2%	260	0.6%	87	0.8%
Small Arms	6,783	8.4%	6,230	30.1%	354	0.8%	199	1.9%
Gambling	4,351	5.4%	3,952	19.1%	260	0.6%	136	1.3%
Adult Entertainment	4,283	5.3%	3,975	19.2%	179	0.4%	128	1.2%
Military Contracting	3,419	4.2%	3,182	15.4%	164	0.4%	74	0.7%
Alcohol	2,234	2.8%	1,866	9.0%	254	0.5%	109	1.1%
Nuclear Power	1,851	2.3%	1,689	8.1%	122	0.3%	41	0.4%
Palm Oil	1,975	2.5%	1,924	9.3%	29	0.1%	22	0.2%
Genetically Modified Organisms	742	0.9%	721	3.5%	17	0.0%	4	0.0%
Pesticides	688	0.9%	684	3.3%	4	0.0%	0	0.0%
Animal Testing	364	0.5%	304	1.5%	41	0.1%	18	0.2%
Fur and Specialty Leather	253	0.3%	246	1.2%	3	0.0%	3	0.0%
Abortion	178	0.2%	99	0.5%	77	0.2%	2	0.0%

Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data as of August 8, 2026.
*Other includes any factors not covered by the named exclusions, for example companies with operations in countries whose governments pose human rights concerns.
**Fossil fuel was introduced as a separate category starting in December 2022.

Methodology

This report is part of the Morgan Stanley Institute for Sustainable Investing's 'Sustainable Reality' series, which assesses the historical performance of Sustainable funds against Traditional funds over a specific timeframe using Morningstar data. This report analyzes performance for January 1, 2026 – June 30, 2026.

The fund universe for this analysis includes closed-end funds, exchange-traded funds and open-end funds, taking the oldest share class, and excludes feeder funds, funds of funds and money market funds. In total, this analysis covered approximately 99,000 funds globally. This analysis takes each fund's sustainability classification as of June 30 (for 1H editions) or December 31 (for full year editions). While the parameters for including a fund do not change, taking the fund's classification at the most recent date means that universe of funds can change for each edition. All historical datapoints are restated based on the current period classification.

Morningstar classifies a fund as Sustainable if "...in the prospectus or other regulatory filings it is described as focusing on sustainability, impact investing, or environmental, social or governance (ESG) factors. Funds must claim to have a sustainability objective, and/or use binding ESG criteria for their investment selection. Funds that employ only limited exclusions or only consider ESG factors in a non-binding way are not considered to be a Sustainable investment product."

Sustainable funds are those classified 'Sustainable' by Morningstar, which can differ from the newer, and still broad, European Sustainable Finance Disclosure Regulation (SFDR) Article 8 and Article 9 definitions. Over 99% of Article 9 funds are also classified as Sustainable by Morningstar, while this only applies for around 30% of Article 8 funds. Traditional funds are those classified as 'Not Sustainable' by Morningstar.

Morningstar's calculation of total return is expressed in percentage terms and is determined each month by taking the change in monthly net asset value, reinvesting all income and capital-gains distributions during that month and dividing by the starting net asset value (NAV). All returns figures refer to median returns, as in prior Sustainable Reality iterations, and are shown in US dollar terms.

There can be a time lag of weeks or months in funds reporting data to Morningstar, notably for Asia-domiciled funds. Some figures from prior periods are revised to reflect the latest disclosures. Where this is material to prior analysis, the impact is noted in the text. Prior period figures could also be subject to modest revisions in the future. Data in this report were collected on August 8, 2026. Older editions of Sustainable Reality have looked at regional data based on the fund's domicile. Starting with the February 2024 edition, this the series now retains this breakdown and separately adds data based on a fund's investment area. For example, a fund could be domiciled in Europe but invest in global assets.

Disclosures

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