# Gabelli ESG Fund, Inc.

## Shareholder Commentary
## June 30, 2018

**(Y)our Portfolio Management Team**

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**To Our Shareholders,**

For the quarter ended June 30, 2018, the net asset value ("NAV") per Class AAA Share of the Gabelli ESG Fund decreased 1.7% compared with increases of 3.4% and 3.9% for the Standard & Poor's ("S&P") 500 Index and the Russell 3000 Index, respectively. Other classes of shares are available. See page 2 for performance information for all classes.

### Environmental, Social, and Governance (ESG) Investing

Environmental, social and governance (ESG) refers to the three main areas of concern that have developed as central factors in measuring the sustainability and ethical impact of an investment in a business. Incorporating ESG factors into company research can help understand risks and opportunities that may otherwise have been overlooked, and improve the return profile of investment portfolios. ESG analysis differs from a traditional socially responsive investing (SRI) screen in that it does not apply a "negative screen", excluding companies that engage in specific unwanted activities (such as selling tobacco or weapons). Instead, it takes a holistic approach, evaluating a company's performance in a variety of areas, including carbon emissions, energy efficiency, water stress, human capital development, chemical safety, board independence, management pay practices, and business ethics.

### Politics, the Economy and the Markets

During the second quarter of 2018, markets recouped first quarter losses to finish the first half of the year modestly higher. Economic indicators, including the lowest unemployment rate since 2000, remain favorable. The Federal Reserve's program of interest rate normalization is on track after two hikes this year. While the market appears to be taking the strong trade rhetoric from the Trump administration in stride, this global game of chicken could get out of control, with significant consequences for consumer prices and employment. The mere threat of a trade war may have already had a deleterious impact on planned investment. Attacks on free

## Comparative Results

**Average Annual Returns through June 30, 2018 (a)(b)**

| | Quarter | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception (6/1/07) |
|---|---|---|---|---|---|---|
| **Class AAA (SRIGX)** | (1.69)% | (0.34)% | 4.11% | 7.05% | 8.42% | 5.69% |
| S&P 500 Index | 3.43 | 14.37 | 11.93 | 13.42 | 10.17 | 7.56 |
| Russell 3000 Index | 3.89 | 14.78 | 11.58 | 13.29 | 10.23 | 7.63 |
| **Class A (SRIAX)** | (1.70) | (0.41) | 4.09 | 7.05 | 8.43 | 5.69 |
| With sales charge (c) | (7.35) | (6.13) | 2.05 | 5.79 | 7.79 | 5.12 |
| **Class C (SRICX)** | (1.90) | (1.09) | 3.31 | 6.24 | 7.61 | 4.90 |
| With contingent deferred sales charge (d) | (2.88) | (2.08) | 3.31 | 6.24 | 7.61 | 4.90 |
| **Class I (SRIDX)** | (1.66) | (0.14) | 4.34 | 7.32 | 8.68 | 5.95 |

**In the current prospectuses dated July 28, 2018, the gross expense ratios for Class AAA, A, C, and I are 1.73%, 1.73%, 2.48%, and 1.48% respectively, and the net expense ratios for these share classes after contractual reimbursements by Gabelli Funds, LLC, (the "Adviser") are 1.25%, 1.25%, 2.00%, and 1.00% respectively. Class AAA and I Shares do not have a sales charge. The maximum sales charge for Class A Shares and Class C Shares is 5.75%, and 1.00%, respectively.**

(a) *Returns represent past performance and do not guarantee future results. Total returns and average annual returns reflect changes in share price, reinvestment of distributions, and are net of expenses. Investment returns and the principal value of an investment will fluctuate. When shares are redeemed, they may be worth more or less than their original cost. Current performance may be lower or higher than the performance data presented. Visit www.gabelli.com for performance information as of the most recent month end. Returns would have been lower had Gabelli Funds, LLC, the Adviser not reimbursed certain expenses of the Fund. The Fund imposes a 2% redemption fee on shares sold or exchanged within seven days of purchase. Performance returns for periods of less than one year are not annualized. Investors should carefully consider the investment objectives, risks, charges, and expenses of the Fund before investing. The prospectuses contain information about these and other matters and should be read carefully before investing. To obtain a prospectus, please visit our website at www.gabelli.com.* The S&P 500 Index is a market capitalization weighted index of 500 large capitalization stocks commonly used to represent the U.S. equity market. The Russell 3000 Index is an unmanaged indicator that measures the performance of the 3,000 largest U.S. traded stocks, in which the underlying companies are incorporated in the U.S. The MSCI AC World Index is an unmanaged market capitalization weighted index representing both developed and emerging markets. Dividends are considered reinvested. You cannot invest directly in an index.
(b) The Fund's fiscal year ends March 31.
(c) Performance results include the effect of the maximum 5.75% sales charge at the beginning of the period.
(d) Assuming payment of the 1% maximum contingent deferred sales charge imposed on redemptions made within one year of purchase.

We have separated the portfolio managers' commentary from the financial statements and investment portfolio due to corporate governance regulations stipulated by the Sarbanes-Oxley Act of 2002. We have done this to ensure that the content of the portfolio managers' commentary is unrestricted. Both the commentary and the financial statements, including the portfolio of investments, are available on our website at www.gabelli.com.

trade by a U.S. president aren't novel, but the current tone is more strident than in the past; coming from the country that authored the systems governing post-WWII commerce, these attacks could have negative, albeit indeterminable, consequences for the market's confidence in the free market.

Whether the presidential candidacy of Sen. Bernie Sanders, the June election of Andrés Manuel Lopez Obrador as president of Mexico, the rise of democratic socialist Jeremy Corbyn in the U.K., or the primary defeat of a powerful Democratic congressman by democratic socialist Alexandra Ocasio-Cortez in New York's 14th congressional district, examples abound of dissatisfaction with the current state of affairs. Such tensions have likely been fueled by changing technology, demographics, and globalization. Capitalism has survived far worse. In fact, one of its beauties has been the ability to subsume these trends and ultimately raise the living standards of broad swaths of the population. We continue to closely monitor trade volleys, the rate cycle and the U.S. mid-term elections, while maintaining a diversified portfolio of strong companies trading at attractive discounts to their Private Market Values.

**The New "Nifty Fifty"?**

Market returns so far this year have been dominated by the "FANG" – Facebook, Amazon, Netflix, and Google (now Alphabet). These four stocks accounted for 1.6 percentage points of the S&P 500's 2.6% first half return; adding tech giants Apple and Microsoft (resulting in a group known by several acronyms, but we'll use FANGMA) brings the total to 2.5 percentage points, or virtually the entire positive performance of the index. More broadly, the top ten contributors to the S&P's return, which includes the six members of the FANGMA, accounted for over 3.1 percentage points, or 116% of the S&P's return. 2015 played out similarly, with the FANGMA returning 2.3% vs the S&P 500's 1.4% (172% of the total) and the top ten returning 3.3% or 244% of the S&P's return.

Much has been written about this apparent level of return concentration – but is it truly unusual? The answer, it turns out, is that while 2015 and the first half of 2018 are outliers, the level of concentration in most other recent years has been run-of-the-mill. Since 1988, the best performing ten and twenty stocks have accounted for approximately 40% and 60% of the total returns of the index. For 2014, 2016, and 2017, the top ten stocks accounted for 28%, 29%, and 31% of returns. This should not be surprising considering that the concept of contribution to return has two components: price appreciation for the year and the average weight of the stock in the index for the year, the result of which is that large companies that are up a little can contribute far more to returns than small companies that are up a lot. What makes the last few years seem different is that the same companies (i.e. the FANGMA) dominate the top contributors list more than any other group of stocks has in the last thirty years. In the six years since CNBC personality Jim Cramer coined the moniker FANG, Facebook, Amazon, Alphabet, and Apple have appeared four times (notably, Amazon was among the largest detractors from the S&P in 2014) – Microsoft, the grizzled technology veteran left out of the FANG, appeared all six times.

Adding to the attention given the FANG is the dominance and growth of their respective platforms and the above average valuations that they garner. This has drawn some comparisons to the tech bubble of the late 1990s, but that comparison understates the cash generating power and genuine competitive advantages of the FANG. A more apt, though still imperfect, analogy may be to compare the 1990s tech bubble to the fads and extreme optimism of the mid-1960s "Go-Go stocks" which crashed in the 1970 bear market, only to give way to the "Nifty Fifty" list of stocks compiled by Morgan Guaranty Trust for institutional clients in the early 1970s. Like today's FANGMA, this list included industry leaders with strong balance sheets and above average growth rates and P/E ratios (an average of 42x vs the S&P 500's 19x in 1972) such as Disney, McDonald's, and Xerox – one-decision stocks that should be bought and held forever. These stocks indeed led the market and were among the last to crash in the 1973-1974 bear market (one, incidentally, precipitated by the fall of the post-war monetary system and a U.S. president), but later ended up declining far more spectacularly than the S&P 500. In 1998, Wharton professor Jeremy Siegel showed that these Nifty Fifty stocks underperformed the S&P 500 in the subsequent 25 years, though the extent of the underperformance is up for methodological debate. Some of these stocks remain leaders today, while many were subsumed by others or ceased to exist. In any case, their times had passed and they turned out to be vulnerable.

Humans make sense of the present and seek insight into the future by examining the past. Fact patterns and outcomes may differ, but the Nifty Fifty episode offers some lessons. First, there are no such things as "can't miss" stocks. Habits evolve, technologies change, and companies mature. It's a cycle as old as capitalism itself. Wal-Mart encroaches upon Sears and Amazon attacks Wal-Mart. Some companies manage to cheat death, but the Apple story, for example, could have been much different if not for the return of Steve Jobs, and these nuances can be difficult to predict. Which brings us to the second point: valuation (and by extension, stock picking) matters. A company may have a very bright future, but the stock won't shine if it already discounts that growth. And, in our view, the higher the growth rate, the less predictable/the higher the variability around that growth rate tends to be. Thus, we would require a greater discount to our appraisal of value to make that investment in growth.

At the moment, (y)our Fund has no exposure to certain members of the FANGMA, not because we are skeptical of their businesses or because we are allergic to owning growth companies, but because in general they have either not met our valuation criteria or they are outside our areas of core competency. Valuations and outlooks change, however, and given the likely staying power of many of these enterprises, they may become more prominent in (y)our portfolio. In the meantime, we have owned many other regular top contributors to S&P returns (e.g. Comcast 2.0% of net assets as of June 30, 2018), and are always on the lookout for the stocks that will outstrip the FANGMA.

**Deals, Deals & More Deals**

In the first half of 2018, global deal making hit a record $2.5 trillion (+61% year-on-year), including a record $1 trillion (+79%) of activity in the U.S. The underpinnings for industry consolidation remain strong: historically low interest rates, improving business confidence, and scarce organic growth opportunities. Countervailing these dynamics are the prospects for a more assertive Department of Justice and heightened trade tensions. During the quarter, however, the Department of Justice was dealt a setback when U.S. District Court Judge Richard Leon rejected the government's challenge to the AT&T/Time Warner merger, allowing that deal to close and easing the way for other vertical mergers. Elongated merger approvals by the Chinese government and collateral damage from the aforementioned trade war, are likely the main uncertainties going forward.

(Y)our portfolio benefited from several announcements. Vodafone (1.3% of net assets as of June 30, 2018) agreed to acquire Liberty Global's (2.1%) German and Eastern European assets for an attractive 11x+ EBITDA, leaving Liberty a little less global, but with enough cash to significantly shrink its market capitalization after closing next year. In addition, ConAgra (4.6%) agreed to acquire Pinnacle Foods, a company Conagra CEO Sean Connolly targeted in his prior role at Hillshire Brands; the combination would strengthen its already significant presence the growing frozen foods category.

## Investment Scorecard

Lamb Weston (3.2% of net assets as of June 30, 2018) (+18%) was the largest contributor to returns as the company reported yet another outstanding quarter, with net sales up 12% and adjusted EBITDA up 25% as it is benefiting from its capacity expansion amid continued favorable supply/demand dynamics for potatoes. Food company Post Holdings (1.9%) (+14%) also rose, as it posted strong results following the close of its acquisition of Bob Evans, and continues to make progress towards either selling or taking public its private label food business. Finally in food, Kraft Heinz (1.7%) (+8%) rose amid speculation that it was considering an acquisition of Campbell Soup and a general rebound in valuations in the sector. Macquarie Infrastructure (1.9%) (+17%) partially recovered from the steep fall precipitated in February by a cut in its dividend; during the third quarter we expect the company to report continued progress in repurposing its liquid storage tanks and finding partners for its power generation assets. Other contributors to return included Liberty Sirius (2.1%) (+11%) which tracks the strong subscriber results of Sirius XM and ServiceMaster (1.4%) (+17%) which nears the spin-off of its American Home Shield warranty business.

After strong performances in 2017, several industrial companies including Xylem (5.0%) (-12%), Tenneco (2.0%) (-19%) and CNH Industrial (1.6%) (-14%) retreated on fears of a maturing economic cycle compounded by concerns about the impact of a trade war, including higher input costs. As discussed above, Liberty Global (2.1%) (-13%) agreed to sell its German and Eastern European operations to Vodafone which became a “sell the news” event for the stock. Finally, Hewlett-Packard Enterprise (1.9%) (-16%), which completed two spin-offs in 2017, was pressured by stiff competition and waning structural growth in the computer server area.

## Conclusion

We continue to believe we are well positioned for almost any economic backdrop by focusing on companies possessing pricing power, skilled management, and flexible balance sheets that trade at meaningful discounts to their Private Market Values. Our investment environment remains catalyst rich with financial engineering, and still low borrowing costs driving acquisition activity.

July 27, 2018

**Top Ten Holdings** **(Percent of Net Assets)**
**June 30, 2018**

| | | | |
|---|---|---|---|
| Xylem Inc. | 5.0% | PayPal Holdings Inc. | 3.1% |
| Conagra Brands Inc. | 4.6% | Sony Corp. | 3.0% |
| Mondelez International Inc. | 4.5% | Johnson Controls International | 3.0% |
| Danone SA | 4.1% | Watts Water Technologies Inc. | 2.9% |
| Lamb Weston Holdings Inc. | 3.2% | American Express Co. | 2.5% |

**Note**: The views expressed in this Shareholder Commentary reflect those of the Portfolio Managers only through the end of the period stated in this Shareholder Commentary. The Portfolio Managers' views are subject to change at any time based on market and other conditions. The information in this Shareholder Commentary represents the opinions of the Portfolio Managers and is not intended to be a forecast of future events, a guarantee of future results, or investment advice. Views expressed are those of the Portfolio Managers and may differ from those of other portfolio managers or of the Firm as a whole. This Shareholder Commentary does not constitute an offer of any transaction in any securities. Any recommendation contained herein may not be suitable for all investors. Information contained in this Shareholder Commentary has been obtained from sources we believe to be reliable, but cannot be guaranteed.

**Minimum Initial Investment – $1,000**

The Fund's minimum initial investment for regular accounts is $1,000. There are no subsequent investment minimums. No initial minimum is required for those establishing an Automatic Investment Plan. Additionally, the Fund and other Gabelli/GAMCO Funds are available through the no-transaction fee programs at many major brokerage firms. The Fund imposes a 2% redemption fee on shares sold or exchanged within seven days after the date of purchase. See the prospectuses for more details.

**www.gabelli.com**

Please visit us on the Internet. Our homepage at www.gabelli.com contains information about GAMCO Investors, Inc., the Gabelli/GAMCO Mutual Funds, IRAs, 401(k)s, current and historical quarterly reports, closing prices, and other current news. We welcome your comments and questions via e-mail at info@gabelli.com.

The Fund's daily NAVs are available in the financial press and each evening after 7:00 PM (Eastern Time) by calling 800-GABELLI (800-422-3554). Please call us during the business day, between 8:00 AM – 7:00 PM (Eastern Time), for further information.

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**e-delivery**

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**Multi-Class Shares**

Class AAA Shares are no-load shares offered directly through selected broker/dealers. Class A and Class C Shares are targeted to the needs of investors who seek advice through financial consultants. Class I Shares are available directly through the Fund's distributor or brokers that have entered into selling agreements specifically with respect to Class I Shares. The Board of Directors determined that expanding the types of Fund shares available through various distribution options would enhance the ability of the Fund to attract additional investors.

# GABELLI ESG FUND, INC.
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## Portfolio Management Team Biographies

**Christopher C. Desmarais** joined GAMCO Investors, Inc. in 1993. Currently he is a Managing Director of GAMCO Asset Management Company, a portfolio manager of Gabelli Funds, LLC, as well as the Director of Socially Responsive Investments. His responsibilities also include marketing and client service of GAMCO's Value, Growth, and International capabilities for institutional, endowment, and family office clients as well as direct oversight of all of the Firm's SRI equity products. He is a graduate of Fairfield University with a B.A. in Economics.

**Kevin V. Dreyer** joined Gabelli in 2005 as a research analyst covering companies within the consumer sector. Currently he is a Managing Director and Co-Chief Investment Officer for GAMCO Investors, Inc.'s Value team. In addition, he serves as a portfolio manager of Gabelli Funds, LLC and manages several funds within the Gabelli/GAMCO Funds Complex. Mr. Dreyer received a B.S.E. from the University of Pennsylvania and an MBA from Columbia Business School.

**Christopher J. Marangi** joined Gabelli in 2003 as a research analyst. Currently he is a Managing Director and Co-Chief Investment Officer for GAMCO Investors, Inc.'s Value team. In addition, he serves as a portfolio manager of Gabelli Funds, LLC and manages several funds within the Gabelli/GAMCO Funds Complex. Mr. Marangi graduated magna cum laude and Phi Beta Kappa with a B.A. in Political Economy from Williams College and holds an MBA with honors from Columbia Business School.

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