CAMRADATA

Sustainable Investing Whitepaper

Sponsored by AEGON Asset Management Kempen

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Welcome to CAMRADATA's Sustainable Investing Whitepaper

2020 was a critical year for sustainable investing after the global health emergency set alarm bells ringing for every facet of life – from supply chain risks to employee treatment and the continued straining of natural resources.

As Covid-19 brought the world to a standstill, the initial shock led to fears around the progress of sustainable investing, which was becoming increasingly mainstream. Those fears, however, were soon allayed as assets in sustainable funds hit a record high of $1.25 trillion (as of the end of September 2020), with Europe passing the $1 trillion milestone, according to Morningstar data.

In the world of asset management, the pandemic revealed the stark truth – that financial models have traditionally failed to adequately capture ESG risks and in turn, ESG issues will continue to drive future market trends.

What's certain is that ESG is here to stay – as evidenced by last year's inflows.

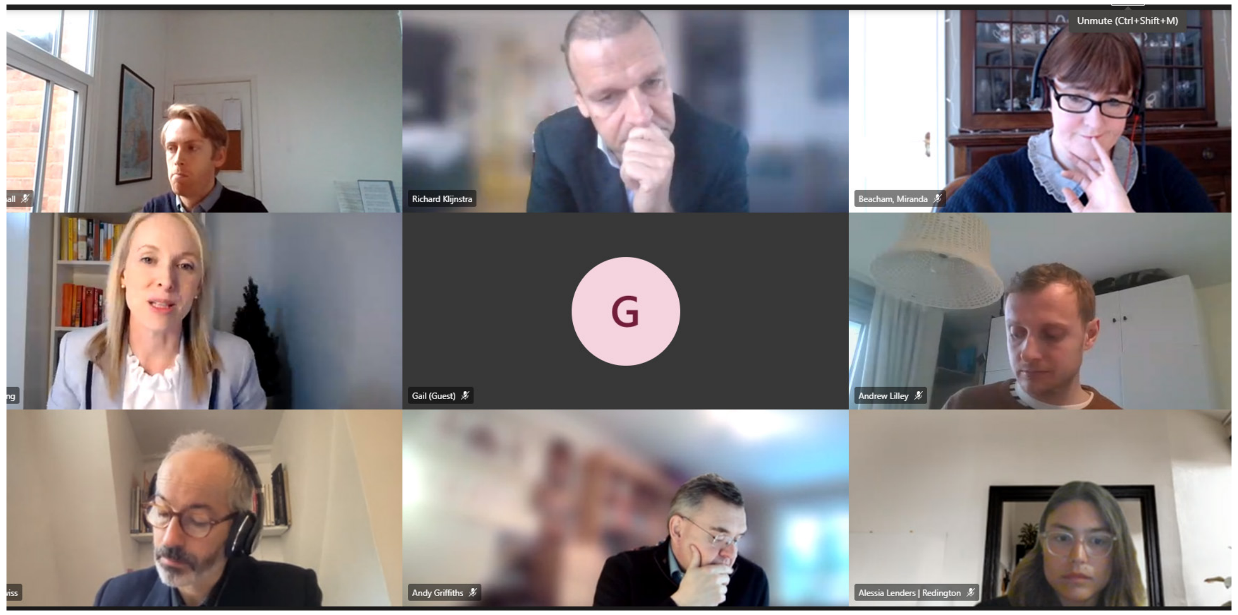
But beyond the inflows of 2020, what will be closely watched in 2021 is sustainable investing at the federal level. The Trump administration presided over the withdrawal of the Paris Agreement in June 2017 as well as the repeal of the Clean Power Plan in 2019. In other words, the enforcement of environmental protection hit a 30-year low.

In sharp contrast, President Joe Biden has committed to re-joining the Paris Agreement on his first day in office, which could cause a tipping point along with commitments by China, the EU, Japan and South Korea. But while the move is welcomed at a grassroots, municipal, state and international level, young people will be watching – and calling out – any violations.

In the first five months of the pandemic alone, there were more inflows into ESG funds than over the previous five years. With the biggest transfer of generational wealth in history (c.$60 trillion) taking place over the next couple of years, millennials will be watching – and deploying capital – accordingly. CAMRADATA's Sustainable Investing whitepaper seeks to discover where opportunities lie.

Sustainable Investing Roundtable

The CAMRADATA Sustainable Investing roundtable took place virtually in London on 27 January 2021.



The 2021 CAMRADATA Sustainable Investing roundtable began by asking whether we have enough data at our fingertips for sustainable investing. According to Andrew Lilley, head of ESG Research at pension fund consultancy, Isio, it feels like there is a new ESG fund launched every day. But in spite of this increasing volume, Lilley was one of those on the panel who reckoned data to analyse sustainability remained inadequate. Others included Richard Klijnstra, head of sustainable equity at Kempen Capital Management, and Dr Bronwyn King, founder of Tobacco Free Portfolios.

One reason for their doubt may be that financiers are beginning to view portfolio companies more holistically. "So far, ESG has scrutinized companies' operations," said Klijnstra. "Going forward, it will be far more concentrated on the impact of their products and services."

Gaining further insights requires more not less data.

> *" What we need collectively is to get better on the voluntary disclosure and guidance frameworks that underpin ESG reporting "*

Alessia Lenders, responsible investment associate at Redington, noted that on biodiversity, 60% of wildlife has been lost in the last forty years. In spite of the best efforts of some NGOs, we still don't have sufficient data to measure the impact of this loss.

Other panellists, however, were worried about information overload. "There is so much data, but it is still a bit of a mess," said Miranda Beacham, head of UK responsible investment at Aegon Asset Management. "Larger companies have plenty of resources to produce the data. What we need collectively is to get better on the voluntary disclosure and guidance frameworks that underpin ESG reporting."

She gave the example of the Global Reporting Initiative (GRI) and the Sustainable Accounting Standards Board (SASB) working together on corporate reporting as one welcome step in this direction.

Andy Griffiths, founder of the Investor Forum, which co-ordinates shareholder concerns with listed UK companies, said a plethora of requests for enhanced data could be a red herring if it means investors are expecting "a right answer" from corporates. "I'm a big fan of purpose – companies that can articulate what they are about in simple fashion," he said.

Griffiths gave the example of Novo Nordisk. "Its purpose is driving change to defeat diabetes" - there are billions of dollars to be made in that fight," he said.

Of course, metrics help shareholders and analysts to understand how far a company adheres to its purpose. Griffiths' point, however, was that any metrics are subject to change. Investing is all about informed prediction. "It's difficult to have long-term confidence in earnings," he noted.

For companies and industries facing profound challenges to the sustainability of their business model, this problem is often confused, according to Griffiths, because what tends to happen is that management strives to maintain earnings while multiples reduce. "These are complex interlinked issues and by the time you have full disclosure, it may be too late."

Griffiths agreed with Beacham's point that the largest companies have the most resources to supply data on sustainability and that companies can "game" information (which can ultimately impact their attractiveness and sustainability as investments).

As an active investor, Beacham's remedy was to really know your holdings and targets and to engage to improve them. She gave the example of Plug Power, a US company that is leading the development of hydrogen fuel cell systems for electrically powered vehicles. "The company had a 'poison pill' clause in the case of a takeover which ignored the rights of shareholders. We liked the investment case, but not this clause. After engaging with management we persuaded them to remove it," said Beacham, who emphasised that Aegon AM was a minority shareholder.

> *" Lateral engagements mean that best practice can be disseminated throughout a sector, with greater results "*

Her second example was the Investor Forum collaboration with Climate Action 100+ to encourage Barclays to establish and disclose milestones on its transition away from funding fossil fuel extraction. This could not be an individual effort as the British bank is Europe's largest financier of fossil fuel projects. But the campaign organised around one-quarter of total shareholdings and achieved its goal.

Klijnstra noted that sometimes there are industry concerns where investors engage across the sector with large and small companies by theme. As part of its aim for a Living Wage for all those in the clothing trade, Kempen has engaged with the likes of Nike but also Coats, a much smaller UK company that supplies industrial threads. He noted that such lateral engagements mean that best practice can be disseminated throughout a sector, with greater results. If the leaders in a sector set an example, the rest will follow.

Baselines in place

King then suggested that there had to be baselines in investment and that they should precede decisions such as best-in-sector. Since 2018 Tobacco Free Portfolios has encouraged over 160 institutional investors worldwide to formally pledge to abandon their tobacco holdings. For King, engagement with companies in this sector is not an option. She noted that often human health is not a prime lens in ESG. "But if you look at the UN SDGs and consider the UN Tobacco Control Treaty – then it is," she said. "Asset owners and asset managers need a reset on human health ."

King pointed out that in 2020 tobacco-related illnesses killed four and a half times more people around the world than COVID. She made the distinction that tobacco-related illnesses are preventable and caused by products from companies, not a virus.

Aegon AM has signed the Tobacco Free Finance Pledge. Kempen's portfolios are tobacco free. Interestingly, both firms trace their sustainability credentials back to the launch of specialist ethical products (starting in 1989 for Aegon). Klijnstra recalled that Kempen began with strategic exclusions but now has progressed to alignment with SDGs, becoming more sustainable over time.

"We are a long-term investor, looking decades into the future," he said. "Tobacco? Society is against it. Fossil fuel? Society is more and more against it. Alcohol? Society is more and more recognizing the negative effects of using the product. You find over the long term that the sustainability considerations will impact the financials."

For Michael Marshall, Head of Sustainable Ownership at RPMI Railpen, in-house investment manager for the UK's Railways Pension Scheme, ethical factors and ESG factors are distinct concepts that might or might not coincide. He said that ethical is often linked to reputation, whilst ESG is about the extent to which financial outcomes can be shaped by governance and sustainability.

“ We prefer to make a difference through what we do own rather than worry about what we don’t own ”

"I would compare [Dr King's] baselines to the foundations of a house," he said. "What you find unethical and unengageable you exclude, then on top of that you build your processes and systems to identify and price ESG risk. On top of that you come to questions of impact. The data question is: which data do we need for each floor?"

The Railway Pension Scheme Trustee Board believes that ESG correlates with long-term financial returns. "We have to match our investment processes with this investment belief," Marshall told the CAMRADATA panel. One of the more straightforward ways of so doing is in private holdings. "Real Assets are directly linked to making a difference to the real economy. We typically own much more of a privately held asset than we own of a listed security," said Marshall. "In addition, property and real assets have Railpen's longest holding periods; it's decades for real estate and infrastructure versus five to seven years on average for our fundamental equities."

One of Railpen's main themes is climate transition and decarbonisation. "We prefer to make a difference through what we do own rather than worry about what we don't own."

For example, one-third of Railpen's infrastructure portfolio is renewable energy. Marshall said deployment in renewables is easier said than done, as you need supportive energy policy and pricing environments, and the market is increasingly crowded.

In real estate, all of Railpen's properties are supplied by renewable energy. Furthermore, there are energy-saving plans in place and Railpen's property team effectively offer free consultancy to tenants on energy and price efficiencies. Marshall added that Railpen has started taking on development risk as "the best way to ensure we have net zero-aligned building stock."

Consultants' wishlist

The consultants at the CAMRADATA roundtable were then asked what gives an asset manager an edge in sustainability. Lenders said that at the highest level, the make-or-break question is why a manager chooses to invest clients' money this way. She said that the answer had to come from the ultimate decision-owner, the portfolio manager. "Redington wants to hear how ESG information affects or influences decisions materially. Do you have a process in place?"

The second high-level question relates to that asset manager's pioneering spirit. Redington wanted to hire those firms genuinely thinking outside of the box from those who were just part of the general movement towards sustainability.

Lilley said he liked to see consistency and coherence. "Good managers articulate clear firmwide ESG goals and then apply them consistently across their entire fund range," he said. "I would expect these ESG goals to be focussed. Realistically, a single manager cannot tackle all 17 of the UN SDGs, but instead should focus on a few core priority areas and implement them across all asset classes and sectors where it is practical to do so."

Lilley continued: "This consistency of approach is so often lost in large asset managers. They cannot explain how all of their funds relate to their core firmwide ESG objectives."

He added that passive equity providers could be equally culpable. "If you are not engaging with the majority of your portfolio holdings in line with your ESG objectives, then you are not doing your job," he said.

Although Marshall said RPMI Railpen doesn't use many external managers, he agreed with the consultants. "We want to see ESG at the heart of a manager's process. And they need to be just as clear about the 'what' as the 'why' they are doing ESG in the first place." he said.

As evidence of best practice, Lilley suggested that working on communication is key. "If a portfolio manager can't explain how their fund's ESG integration fits into their firmwide objectives and stewardship priorities, then the fund will not receive a good ESG rating. This is where some managers fall down even if they have a good ESG approach: they aren't able to explain it coherently"

Beacham then responded that there are more and more questionnaires coming from investment consultants on sustainability. In the last year, Aegon AM has been updating its systems to make it easier to extract proof-points for clients and advisers. She nevertheless suggested that this was another case where the answer is not more data, but better frameworks to streamline the flow of ESG information.

A better framework is likely to emerge in this field thanks to the creation last year of the Investment Consultants' Sustainability Working Group, which includes Isio, Redington and 10 other consultancies active in the UK market. The Group's purpose is to reduce unnecessary fragmentation within the general transitioning of long-term capital away from fossil fuels and degradation of the natural world.

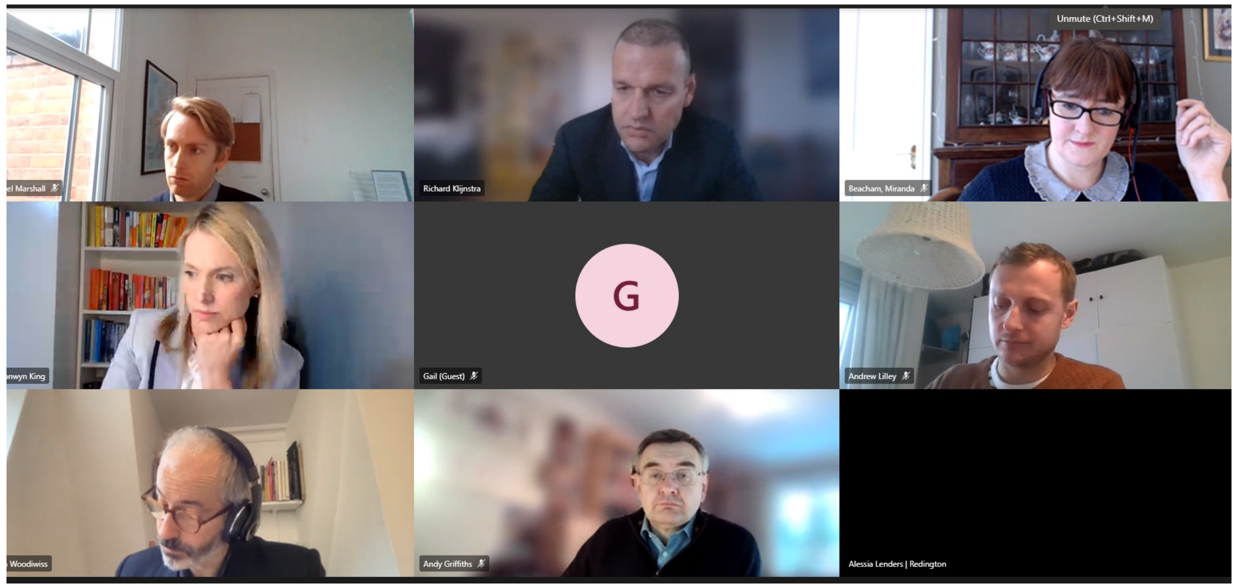
“ A better framework is likely to emerge in this field thanks to the creation last year of the Investment Consultants’ Sustainability Working Group ”

The year ahead

For Aegon AM, 2021 will continue to see a focus on social justice. "It's a topic we've had challenges with when engaging with some US holdings," admitted Beacham. "Black Lives Matter last summer has changed that." She expects better disclosures from companies this year on Equal Employment Opportunities. "If a company says that it embraces diversity in all its forms, that is not really possible or credible," she said. "We want companies to be honest about their priorities and the choices they are making."

For Kempen, being a sustainable investor in 2021 means continuing to assess how far investee companies' products and services align with the UN SDGs, and in what way the capital expenditures and R&D of a company point to further alignment.

For Redington, 2021 is all about stewardship, as client UK pension funds have to report under the new Stewardship Code. "Where can we



have the biggest impact for clients?" says Lenders. "This has to be all along the investment value chain." With one asset owner, Redington is currently looking at decarbonisation of its portfolio: which monitoring criteria to employ and the consequences for the managers looking after the assets.

Isio is embarking on their 2021 training programme and is rolling out training workshops for client-facing consultants on all matters ESG. The ESG team at Isio run these workshops regularly and they also feature external speakers. "However proactive an ESG research team may be, if our consultants don't believe in the ESG story, then ESG strategy ideas won't be implemented in client portfolios. Regular training is essential to translate big ideas into action." he said.

King said Tobacco Free Portfolios will advocate to make sure products labelled ESG or SDG-aligned or 'net-zero' are explicitly tobacco-free; and will encourage the mainstream finance sector to make tobacco exclusion holistic, across insurance, lending and investment.

Finally, she encouraged asset owners, beneficiaries and assets manager to understand the UN Tobacco Control Treaty, signed and ratified by 180 countries. She recommended portfolios align with the tenets of the Treaty.

" Civil society, NGOs and even politicians sometimes question whether engagement works – we will be putting the case that it does "

As a fitting end to a discussion on sustainability, Griffiths said that the Investor Forum was looking to make the case for the merits of engagement. He hoped that enhanced stewardship disclosures in 2021 would provide much more transparency on both the scale of, and impact from, engagement. "Its values are not always understood. Civil society, NGOs and even politicians sometimes question whether engagement works – we will be putting the case that it does."

Roundtable Sponsor

Miranda Beacham, Head of ESG – Equity & MAG

Personal Profile

Miranda is a member of Aegon Asset Management's Responsible investment Team, where she is responsible for ESG integration, voting and engagement. Her role involves overseeing the environmental, social and governance screening process for ethical and sustainable funds. She also provides corporate governance screening and research for all equity investments across the group and conducts research into wider ESG issues.

Miranda is responsible for the monitoring and engagement of the ESG approaches and performance of investee companies in line with our responsible investment policies. She leads engagement activities with public policy makers and investee companies on issues such as board structure, remuneration, environmental impact and social practice. Miranda joined in 1994 as a research assistant in the UK equity team and has 26 years' industry experience. She studied Chemistry at Napier University in Edinburgh and has the IMC professional qualification.

AEGON Asset Management

Aegon Asset Management

Company Profile

Aegon Asset Management is an active global investor. Our 380 investment professionals manage and advise on assets of £331 billion for a global client-base of pension schemes, public funds, insurance companies, banks, wealth managers, family offices and foundations. We organize our investment capabilities around four focused investment platforms where we have deep asset-class expertise: fixed income, real assets, equities, and multi-asset & solutions. Across these platforms we share a common belief in fundamental, research-driven active management, underpinned by effective risk management and a commitment to responsible investment.

Aegon Asset Management strives to be a global leader in responsible investing. Our 14-strong Global Responsible Investment team supports ESG integration by our research and investment teams, leads our active ownership activities, develops innovative products and promotes responsible investing best practices across the organization.

Source for data: Aegon Asset Management. As at 30 June 2020.

Roundtable Sponsor

Richard Klijnstra, Head of Sustainable Equity

Personal Profile

Richard Klijnstra is head of Sustainable equity at Kempen Capital Management. He has been working in the financial industry since 1996.

Richard Klijnstra joined Kempen in July 2006, as head of the Credit team. During his 10 years at the helm of the team the credit franchise was successfully built to full capacity, which included the launch of the Kempen sustainable credit fund in 2013. He started the Sustainable Equity team in 2016. Investing for the long term in high quality sustainable companies is his passion. Prior to joining Kempen, he worked for 8 years as a Portfolio Manager at Fortis Investments focusing on CDOs and credit portfolios.

He is a Certified European Financial Analyst (CEFA).

Kempen Capital Management

Company Profile

Kempen Capital Management is a specialist asset manager with a focused approach and a clear investment philosophy. We believe in long-term stewardship for our clients and other stakeholders. Kempen provides sustainable returns, fiduciary management services, manager selection, portfolio construction and monitoring, alongside a number of actively-managed investment strategies.

Kempen Capital Management, part of Van Lanschot Kempen Wealth Management NV, is a specialist and independent wealth manager. Kempen Capital Management NV is licensed as a manager of various UCITS and AIFs and authorized to provide investment services and as such is subject to supervision by the Netherlands Authority for the Financial Markets.

Roundtable Participants

Andy Griffiths

Executive Director

Andy has over 25 years of international investment experience. Before setting up the Investor Forum in 2014, Andy was a senior investment professional at Capital Group and M&G. Throughout his career, Andy has been responsible for financial sector investments and has consistently been ranked among leading equity investors in Europe. Andy was also an Operating Partner with Corsair Capital.

Andy is a former Fulbright Commissioner, sits on the UnLtd Ventures Advisory Board and is a trustee of MoE.

Andy Lilley, CFA

Head of ESG Research

Andrew manages the ESG research team and is responsible for setting ESG policy across all asset classes and investment funds and integrating ESG-centric strategies across Isio's client base.

He has been at Isio (formerly KPMG Investment Advisory) for all of his career to date, having joined at graduate level in 2012. Andrew was made head of the ESG Research Team from the inception of Isio, in March 2020, and oversees ESG implementation across a variety of client types including defined benefit and defined contribution pension schemes, fiduciary managers and foundations.

THE INVESTOR FORUM

isio.

Roundtable Participants

Alessia Lenders

Responsible Investment Associate

Alessia is an associate on Redington's Manager Research Team. She leads the team's research efforts around Sustainable and Impact Investing through the sourcing and due diligence of implementable solutions for clients across a variety of asset classes. Prior to Redington, Alessia spent 3 years at J.P. Morgan where she contributed to the development of the bank's first sustainable investing products for private wealth clients.

Alessia completed a dual-degree program at the University of Pennsylvania with a Bachelor of Science from the Wharton School and a Bachelor of Arts in International Studies from the College of Arts & Science.

REDINGTON

Michael Marshall

Head of Sustainable Ownership

Michael Marshall is Head of Sustainable Ownership at RPMI Railpen ("Railpen"). As a member of Railpen's Fiduciary Leadership Team, Michael is accountable for the integration of environmental, social, and corporate governance (ESG) factors into the fiduciary and investment management functions, in order to support the scheme's mission to pay pensions securely, affordably, and sustainably.

Prior to joining Railpen Michael held a variety of senior roles in pensions, asset management and ESG advisory. He is a member of advisory groups at the British Venture Capital and Private Equity Association (BVCA), the Financial Reporting Council (FRC), the Principles for Responsible Investment (PRI), and the Institutional Investors Group on Climate Change (IIGCC). He studied economics at Bristol University.

RPMI RAILPEN

Dr. Bronwyn King AO, MBBS, FRANZCR

Founder, CEO and Director

Dr Bronwyn King AO is a social entrepreneur, movement maker, company director, medical specialist and humanitarian on a mission to inspire and transform organisations into purpose driven, sustainable businesses. She is the Founder and CEO of Tobacco Free Portfolios, an NGO she established after her uncomfortable discovery that her own hospital's pension plan was investing her money in Big Tobacco. Alongside an accomplished team of medical doctors, ethics experts and sustainable finance professionals, her engagement across the global corporate, finance, health and diplomatic sectors led to the launch of the Tobacco-Free Finance Pledge at United Nations' Headquarters in 2018. This initiative - backed by President Macron and former Australian Prime Minister Turnbull - now has 145 Signatories with combined AUM of US$10.9 trillion. Dr King's 2017 TEDx Sydney talk has been viewed more than 3 million times.

A former elite swimmer who represented Australia and for ten years worked as Team Doctor for the Australian Swimming Team, Dr King is also an Australia Day Ambassador and an Ambassador for Big Brothers Big Sisters Australia. In 2019 Dr King was awarded an Order of Australia (AO) for distinguished service to community health. She is the reigning Melburnian of the Year, an award bestowed by the City of Melbourne.

TOBACCO FREE Portfolios

Moderator

Brendan Maton

Freelance Jounalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.
Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.
Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

How useful are the SDGs?

The Sustainable Development Goals (SDGs) were adopted by all United Nations Member States in 2015 as a universal call-to-action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030. This is a noble purpose, but how have the SDGs become the hot topic in responsible investment? And how useful are they?

The 17 SDGs provide a framework for identifying sustainable themes and initiatives to help to solve the many and varied sustainability challenges facing the world.

For countries and governments to achieve the SDG goals they will need the support of the private sector. While the SDGs are a useful tool to help identify sustainable initiatives, we believe they are not the best way to think about sustainability impacts at the individual company level. Rather, the nature of the goals is to spur governments into making policy changes.

Looking at things from a micro rather than macro perspective, the picture becomes less clear. When analysing and investing in companies, it is easy to map certain investments to some of the goals. For example, an electric car manufacturer will sit comfortably in SDG 13 (Climate action). But what about the other end of the value chain? The lithium miner is an essential piece of the puzzle in creating those cars.

No third-party screening tool will give any credit to this activity because the direct impact of the company is less favourable. But no lithium miner means no electric vehicle. This means the SDGs become an imprecise tool to describe the sustainability impacts of a portfolio of listed equities.

The other issue with SDG's is that there is a lot subjectivity involved from a corporate and investment perspective. The goals were written for governments and the targets attached reflect that. So, if a company is claiming to align with the goals, they should be aligning with the targets. Some of these targets translate to the private sector more easily than others, as illustrated in the two examples below.

With SDG 7 (Affordable Clean Energy) the target is better infrastructure for renewables. This is an easy theme to invest in.

In contrast SDG 3 (Health and Well-being) has targets based on factors such as infant mortality, which is difficult to align with the activities of many healthcare companies.

The fact that the goals were designed for governments hasn't stopped companies aligning themselves with SDG badges. But there is no body assigned to verify these badges and to call-out the worryingly rampant practice of 'rainbow-washing', where a vast range of SDGs, many rather tenuous, are linked to a company. We have discovered many examples of companies making ludicrous claims, such as a tobacco company claiming to align with nine of the SDGs, including Health & Wellbeing.

" Such a framework requires diligent bottom-up analysis and a willingness to look beyond the obvious impacts "

We also find the kind of companies that typically make these claims are those that are larger and have the resources to commit to disclosure around how they align. This adds further to our concern around the large-cap, developed-market bias that is so prevalent in systems designed to quantify the world of sustainable investment.

Summary: A useful if flawed tool

The SDGs provide a valuable tool for identifying themes and initiatives for sustainable investment. But they do have significant limitations, which investors should understand. We have built our own framework to identify second and third-order impacts, such as the contribution of lithium miners to clean transport. We believe this is a better way of identifying sustainable companies. Such a framework requires diligent bottom-up analysis and a willingness to look beyond the obvious impacts. But it is worth it, as it leads to stronger and more sustainable portfolios.

Miranda Beacham
Head of UK Responsible Investment

The importance of active management in sustainable investing

What is the added value of active management in sustainable investing? Generally, in large-cap equities the debate has been focused on financial returns - whether active management actually leads to investment alpha. Passive investing will probably soon become more prevalent than active (based on the value of assets under management), a trend driven by low costs and broad diversification. In sustainable investing, investment alpha remains important but in the context of the outcomes for all stakeholders: the continuous dialogue active managers have with companies on long-term strategy and in particular ESG is to the ultimate benefit of all stakeholders.

What is sustainable investing?

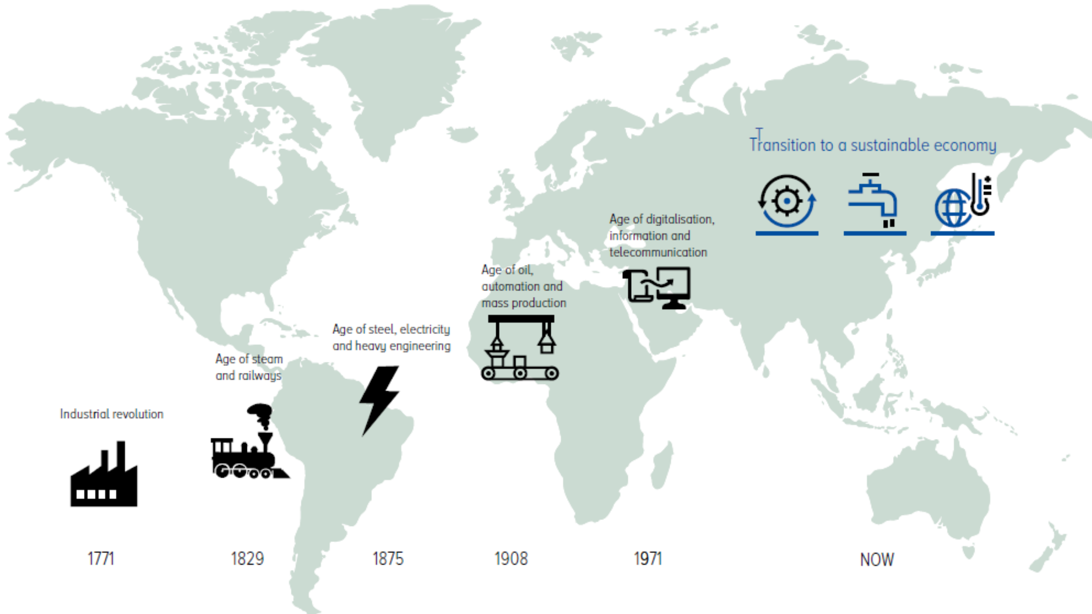
Our definition is allocating capital to companies run on sustainable business principles. We see it as the synthesis between traditional long-term investing and ESG integration. This way of investing enables the transition to a more sustainable economy; an economy consistent with a low-carbon, prosperous, equitable, healthy and safe society. The strategy of sustainable investing is well-positioned for achieving attractive long-term returns with interests of all stakeholders at heart.

Sustainable investing is about identifying companies that integrate ESG risks and opportunities into their long-term strategy. They can create value by leading the transition to a sustainable economy while mitigating downside risks. As an investment team we call these companies sustainable leaders and we consider them as strong candidates for our portfolio. A company can lead the transition for example by being vocal, participating in industry groups, setting an example or by developing and offering products and services that have impact. One way to measure impact is by analysing the contribution of products and services of a company to achieve the Sustainable Development Goals (SDGs).

> *"Sustainable investing is about identifying companies that integrate ESG risks and opportunities into their long-term strategy"*

Transition to a sustainable economy

Figure 1: Next wave of innovation



Source: Kempen

Since the late 18th century the world has seen five waves of innovation. In our opinion the next wave is the transition to a sustainable economy.

Innovations like clean technology, gene and cell therapy, artificial intelligence and green chemistry are enabling this transition and are changing society. Also new concepts like the access economy transform the economic environment. In this model a product is temporarily accessed instead of owned, so can be more efficiently used, while the manufacturer is more incentivised to come with an enduring product

Integration of ESG

ESG analysis is an indispensable tool to evaluate capital generation. A company generates financial capital by creating future business with attached cash flows to pay shareholders, employees, suppliers, governments etc. But for the long-term investor it's not only financial capital that is important. Manufactured, intellectual, natural and social capital are also relevant. Buildings, facilities and products are examples of manufactured capital. And intellectual capital comes in the form of patents, data and innovations. When it comes to natural capital, we're talking about climate change, water use and pollution. While a license to operate, human rights and social ties are examples of social capital. Finally, human capital concerns the health, training, job satisfaction and labour productivity of the workforce.
To combine financial analysis with ESG considerations, a passive investor can rely on the market in pricing shares and using ESG ratings. Active managers make an integrated analysis of financial and ESG data. If seeking outperformance, investors should select active managers in asset classes with high dispersion and low efficiency. Passive investing is useful if they seek low costs and broad diversification. To have impact as a shareholder by engaging with companies to improve sustainability, an active approach is the logical proposition.
As we view it, there are three arguments that support an active approach to sustainable investing:

" When times are changing investors and companies cannot be passive and stand on the sidelines, but rather be part of a change for good "

Dispersion of leaders and laggards

The transition to a sustainable economy can be only partially made by existing products and services. This offers companies growth opportunities, but with a high risk of disruption. The dispersion between leaders and laggards will be significant. In a period of high dispersion, following the broad market in a passive solution is perhaps not the optimal strategy. Active managers with a sustainability focus and expertise better understand the dynamics of the transition.

ESG: Data inefficient

We don't think ESG is already priced efficiently in the market. Although much ESG data is disclosed publicly, often it can be difficult to identify and assess which aspect is most useful for making financially-related decisions. For efficiency broad accessibility, standardisation and transparency of information are needed. As for climate change, the Task Force on Climate Related Financial Disclosures (TCFD) reported that although most reviewed companies disclosed some relevant data, few companies disclose the financial implications or describe their resilience under different climate-related scenarios. For measuring the contribution of companies to the SDGs much more detailed disclosure is needed to make a proper assessment.
ESG ratings still have shortcomings. A lack of disclosure, limited communication between providers and companies and rating frameworks that are not tested over a long period of time are some of the limitations, in addition to not being forward looking enough. Additionally ratings show a relative high dispersion between agencies. Active credit investors can outperform market benchmarks over the long-term based on these credit ratings. We believe active managers have a similar role in sustainable investing.

Active ownership is rewarded

To identify and support sustainable leaders we believe active ownership is key. The purpose of active ownership is twofold: impact and insight. Impact to support and influence management, insight to understand the long-term prospects of the company.

Richard Klijnstra
Head of Sustainable Equity

Conclusion

The transition to a sustainable economy will be an important driver for equity returns. We expect a large dispersion between the leaders and laggards. As ESG is not efficiently priced in the market, an active approach is recommended to add investment alpha.
In addition, in the transition to a sustainable economy, active managers have an important contribution by having a continuous dialogue with companies on long-term strategy and in particular ESG. This engagement benefits all stakeholders and cannot be made through passive management.
When times are changing investors and companies cannot be passive and stand on the sidelines, but rather be part of a change for good.

Meet the Team!

Sean Thompson

Managing Director

Natasha Silva

Managing Director, Client Relations

Amy Richardson

Senior Director, Business Development

Natasha Fletcher

Senior Associate, Client Relations and Business Development

Yasmin McKeon

Associate, Marketing and Events Co-ordinator

Mithursha Kesavan

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