ESG Integration

Why do we incorporate ESG research in our investment approach?

We analyze environmental, social, and governance (ESG) factors at all levels of our investment process to give us insights into potential risks and opportunities at the regional, country, industry, and company levels and to help us build portfolios with lower risk profiles. We believe that analyzing this information helps to create a more complete understanding of our investments than what is captured by traditional financial analysis. In combination with fundamental analysis, ESG analysis can give us clues into the likely long-term performance of a company and can sometimes flag risks and opportunities before they are recognized by markets. But beyond the simple protection of investment gains, we think that uncovering ESG issues can help us invest in a more ethical or socially responsible way.

We do not believe that simply using insights from ESG analysis to help construct an investment portfolio creates social or environmental impact. However, our ESG analysis can strengthen our advocacy and active engagement activities and can result in tangible corporate changes and broader social impact.

How do we analyze ESG considerations?

Over the last two decades we have been analyzing companies according to their many interdependent relationships, including those with investors, employees, customers, suppliers, communities, and the natural environment, and preferring those that engage positively with their stakeholders. We are helped in this effort by third-party data providers such as Sustainalytics and Bloomberg. It is important to us to use our own networks and primary research because we have found that the mere scoring of companies does not provide the level of insight we are looking for. We believe that while some ESG issues can have a quantifiable impact on a company's financials, at other times, a qualitative or subjective approach is more useful to ascertain whether a company is behaving responsibly.

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Generally, we find the issues that are found in the Sustainability Accounting Standards Board's (SASB) Industry Research Briefs to be accurate representations of industry-specific sustainability issues that we consider in our analysis. For example, without strong governance fundamentals, improvements in social or environmental issues are not necessarily sustainable. Board structure and record of oversight are important indicators that we evaluate in all companies regardless of industry, as are executive compensation and business ethics.

All businesses are exposed to risks and opportunities arising from how they interact with their employees. How does a company attract and retain talent? What are its compensation practices at both the top and bottom levels? How stable and diverse is the management team? How widespread are stock ownership plans and decision-making authority? How comprehensive are policies regarding sick leave, parental leave, and retirement benefits? What are the labor standards in the supply chain? The answers can have an impact on a company's long-term financial performance.

Climate change and water scarcity are other issues that affect all companies, although some industries have greater exposure than others. We are interested in companies' carbon footprints including exposure to renewables, energy efficiency programs and products, and corporate preparations for a future price on carbon, as well as water conservation practices

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and emissions. How companies address these issues can indicate a long-term perspective as well as prudent business planning.

We have established minimum standards for some ESG criteria. For example, we will exclude companies that repeatedly violate labor laws or that are assessed large environmental fines. In addition, we screen out company activities we consider intrinsically destructive. These are detailed in a separate document. In essence, we are trying to balance the "good" things that a company does, in terms of societal or environmental well-being, against any negative impacts its products and practices may have.

We also use ESG analysis to identify particular trends that may be profitable investment themes. For example, companies that generate clean energy or manufacture equipment to reduce energy consumption should benefit from increasing regulation and awareness of the need to reduce energy use and cut greenhouse gas emissions.

How do we incorporate ESG analysis in our investment process?

The investment team employs a multidisciplinary approach that combines a rigorous top-down methodology with experienced fundamental research alongside our ESG analysis. Our scenario forecasting approach helps us to identify sources of opportunity and risk around the world. The process can help us think about long-term ESG issues at a sector or country level, although these are not incorporated into our quantitative framework because of differences in time horizon.

We are mindful of ESG factors when analyzing stocks but they neither guarantee nor prevent successful investment results. For example, our ESG analysis may uncover risks where there is a low probability of occurrence but a potentially high negative impact. At other times, we may discover slow improvements or disintegration that can play out over a long period

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of time at the country, sector, or company level. While ESG factors can certainly dramatically affect the prices of securities in the short term, at other times ESG information might only affect stock prices over the longer term, if at all, because of the short-term orientation of markets as well as the complexity in how ESG issues interact with other factors that drive stock prices.

As part of our "buy discipline," ESG information is compiled, analyzed, and shared, first with our securities analysts who incorporate this information into their analysis and look to quantify potential risks, and then with the broader investment team. Borderline cases are discussed in depth in investment committee meetings and with clients. ESG performance is monitored for portfolio companies and if a material deterioration is noted, a company is earmarked for closer scrutiny, dialogue, and potentially sale.

Reporting

For interested clients, we can produce a snapshot of their portfolios' ESG metrics. Key metrics typically include carbon footprint, workplace safety incidents, waste generation, water and air emissions, and employee diversity, as well as board diversity, tenure, and independence. We are also able to share summaries of key ESG considerations of portfolio companies as well as any specific corporate engagements upon request.

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