Sustainable Investing: Too important to ignore

November 2019
Sustainability
A perfect storm

Accelerating change
Average tenure in the S&P 500 has dropped from 50 years to under 15 years over the last five decades

Regulatory scrutiny
Sustainable finance at the forefront of policymakers’ agenda

Global challenges
Require finance’s involvement to solve

Client pressure
Savers are increasingly focused on sustainability-related issues

Source: Schroders
Sustainable investing is no longer niche
Interest, demand and sophistication are on the rise

Indexed, 2007 to 2017 average = 100

Limited industry penetration ➔ Rapid rise in awareness, limited differentiation ➔ Ubiquitous recognition, focus on differentiating strategies

European responsible AUM

Global CSR reports

Sustainable investing news

PRI signatories

Source: Hightail (news search for articles containing ‘sustainable investing’ relative to all articles referring to ‘investing’, Principles for responsible investment (number of signatories) and EuroSIF (combined AUM invested in different ESG strategies, adjusted for double-counting).
Sustainable investing growing in influence

Sustainability set to play greater role over next five years

More important

75%
Global

70%
North America

70%
Latin America

84%
Europe

67%
Asia-Pacific

Source: Schroders Institutional Investor Study 2019. How do you expect the role of sustainable investments to change in the next five years?
Social impacts are becoming financial costs

As their role has expanded, large businesses face growing pressures

Large companies have become 20–30% more important to economies and societies over last 20y

Growing pressures to contribute to societies; irresponsible behaviour is becoming a liability

Source: Fortune, IMF, OECD, BEA, Gulling et al., OECD tax database, General Social Survey, American Action Forum, Heritage Foundation, Schroders calculations and estimates. Note: data from Fortune is not available prior to the 1990s; we have estimated the equivalent values, using data from Thomson Reuters.
The risks are real
Companies are facing significant headwinds

- Companies are facing growing social and regulatory headwinds
- The scale of the externalities companies impose has grown so large that in many industries, those costs exceed their total earnings.
- Earnings listed companies generate for shareholders currently total US$4.1 trillion, which would fall by 55% to US$1.9 trillion if those social impacts crystallized as financial costs.
- One third of companies would become loss-making. The risk to profit pools and competitive positions is clear.

Source: Schroders, SustainEx
But why is sustainability so difficult?

- Variety of definitions
- Off the shelf solutions have not added alpha
- Complex issues covered
- Low transparency
- Limited understanding of risk around issues like climate

Source: Schroders.
The broad spectrum of sustainability and ESG

Not all sustainability is the same

Financial benefits

- Integrated
  - ESG research
  - Voting
  - Engagement

- Responsible
  - Best in class
  - Controversy avoidance

- Screened
  - Excluding companies involved with certain activities or industries

Social benefits

- Impact
  - Specific social benefit
  - Potential for financial return

- Philanthropy
  - Address societal challenge(s)
  - No financial return for investors
ESG analysis: the need for a proprietary approach

Third party ratings are backwards-looking, opaque and inconsistent

**Poor predictor of controversies**

Average rating pre and post controversy:

- **3.69**
- **+1.06**
- **4.76**

**Correlation between scores**

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<th>Environmental</th>
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<th>Governance</th>
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</table>

**Passive ESG has a poor track record**

Performance of common ESG indices relative to conventional equivalent

Indexed, latest – 100

**Ratings are opaque and inconsistent**

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

1Source: Thomson Reuters, Schroders calculations. 2Source: Thomson Datastream, as at 1 November 2018.
The proof

Performance of 11,000 mutual funds 2004 - 2018

Key findings

- No consistent and statistically significant difference in total returns
- Sustainable funds experienced a 20% smaller downside deviation than traditional funds

Reporting

Portfolio level reporting with different sustainability lenses

Source: Schroders for illustrative purposes only.
We seek to integrate ESG factors into our research and investment decisions across asset classes. We actively engage with companies on material ESG issues to enhance our analysis or to seek improvements in performance. We assess resolutions and apply our voting policy and guidelines as outlined in our ESG policy. We develop proprietary tools to help translate structural trends into actionable investment implications.

17 dedicated ESG specialists
With
>150 years¹ combined investment experience

2,200+ Engagements
Across
50 countries globally

5,227 company meetings voted
99% valid resolutions voted

Source: Schroders, as at 30 June 2019 unless otherwise stated. ¹As at 4 March 2019. ²PRI, 2015, 2016, 2017, 2018 and 2019 Assessment Reports.
Sustainability at Schroders
The journey to be a market leader

Issues such as climate change, resource scarcity, population growth and corporate failure have put responsible investment at the forefront of investors’ minds. We believe that companies with a strong environmental, social and governance ethos tend to deliver better results for our clients.

Peter Harrison, Group Chief Executive, Schroders plc

Source: Schroders, as at 30 July 2019. A+ based on PRI Assessment. Not all strategies are available to US investors.

'Sustainable Multi-Factor Equity'
Climate change: a holistic approach

Climate Progress Dashboard
- Analysis of future temperature changes given the current rate of progress across policy, finance, innovation and incumbent industry.

Engagement
- Pressure on companies to raise transparency, adopt TCFD and have scenario planning.
- Member of the Climate Action 100, Powering Past Coal Alliance.
- Non-executive director education.

Carbon VAR
- Systematic analysis of transition risk assuming a $100 carbon price.
- Allows for better like for like comparisons given supply chain analysis.

Physical Risk
- Forecasts of medium term exposure to climate reacted weather events.

Reporting and Transparency
- Firm-wide TCFD commitment.
- Reporting tool with >50 environmental indicators.

Future Areas of Research
- Climate growth exposure.
- Fossil fuel company exposure.
- Tying it all together.

Source: Schroders
The benefits of a sustainable approach

Investment insight
A deeper understanding of how the world is changing that can evolve over time

Delivering alpha
A forward looking approach to sustainability that reflects economic evidence

Better stewardship
Active ownership to mitigate the risks that can not be eliminated

Investment focused
Products that meet beneficiary expectations in performance and sustainability terms

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Schroders Institutional Investor Study 2018 was conducted between 1 – 30 June 2018. This study was commissioned by Schroders and undertaken by an independent research agency, CoreData Research, to study institutional investors across North America, Europe, Latin America and Asia to analyze their attitudes towards sustainable investments, investment objectives and risk. Respondents represent a variety of institutions, including pension funds, foundations, endowments and sovereign wealth funds. The 650 institutional respondents were sourced from 15 different countries and were split as follows: 175 in North America, 250 in Europe, 175 in Asia and 50 in Latin America.

Schroders Global Investor Study was conducted between 20 March – 23 April 2018. Schroders commissioned Research Plus Ltd to conduct an independent online study of over 22,000 people in 30 countries around the world, including Australia, Brazil, Canada, China, France, Germany, India, Italy, Japan, the Netherlands, Spain, UAE, the UK and the US. This research defines ‘people’ as those who will be investing at least €10,000 (or the equivalent) in the next 12 months and who have made changes to their investments within the last 10 years.

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