

THE HUB

Market Insights

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS

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Environment, Social and Governance (ESG) considerations are key metrics of long-term investors' investment decisions

Key takeaways:

- Mirova sees four major transitions (demographic, environmental, technological and governance) having an enormous impact on the way companies do their business.
- Mirova believes that adhering to positive ESG policies and generating solutions for some of the megatrends our planet and our society is exposed to can create long-term value for investors.
- Many institutional investors have signed the UN Principles of Responsible Investment and/or adhered to the Montreal Pledge, leading to investors publishing the carbon footprint of their portfolios. Some countries have introduced or are in the process of introducing regulation for institutional investors.

An interview with Mirova's CIO

Sustainable investing specialists at Mirova have been providing global investors with diverse solutions for years. Jens Peers, CFA®, Chief Investment Officer, explains Mirova's distinct approach to delivering returns with impact, mega-trends reshaping the world and the investment opportunities that coincide with these trends.



Jens Peers, CFA®

Chief Investment Officer & Portfolio Manager

Mirova

What would you say is the Mirova difference?

Mirova has specialized in sustainable investing for over 30 years. It's in our DNA. For those who don't know exactly what sustainable investing is, we see it as a long-term approach to investing that incorporates Environmental, Social and Governance considerations into the investment process. Our philosophy is grounded in the belief that businesses which adhere to positive ESG policies and which generate solutions for some of the megatrends our planet and our society is exposed to, can create long-term value for investors. We are not your traditional SRI (Socially Responsible Investing) investor who takes a relatively simple exclusionary approach – not investing in companies that have a negative impact on society,

such as tobacco, alcohol or firearms companies. We take a thematic approach to investing, which we think could lead to very good long-term performance. We believe that focusing on trends that will change the world can help investors avoid companies that may look good on paper, but may actually be in secular decline.

Why do you think integrating ESG throughout your process offers you stronger results?

In order to generate sustainable performance, it is important to identify the right opportunities and also to manage risks properly. We strongly believe that companies who offer solutions for some of the bigger problems our world is facing, are well

positioned to generate superior growth and returns. Also, many investors don't believe ESG risks are financial risks and are therefore not properly pricing in those risks when valuing investment opportunities. That this could be a costly mistake has been proven many times in the past. Recent examples of how poor ESG practices could lead to significant losses are for instance BP and Volkswagen. Our process is based on deep fundamental research and frequent interactions and engagement with the companies we invest in. Contrary to most other investors, Mirova uses a large in-house team of analysts, each specialized in one or more ESG themes. They assist the portfolio managers to make better financial decisions by providing ESG specific information so they can identify opportunities and risks the market may overlook, and by engaging with companies in order to improve their behavior and performance. We know for instance that board composition, employee diversity and incentive schemes can have a big impact on performance and find it important to use our power as an investor in debt or equity to move companies in the right direction.

Can you explain the role of global mega-trends in your portfolios?

Our philosophy is based on the fact that the world is changing – and the world as we know it today will look quite different in ten years' time. Our current life styles, combined with the fact that the world still has to deal with population growth for the foreseeable future, means that we see four major transitions happening: demographic, environmental, technological and governance. These transitions are slow and constant and heavily influenced by almost unstoppable megatrends. In terms of demographics, an aging population and the fact that millennials and women play a much more important role in our economy than

ever before, mean that companies have to rethink how they do business and what products they want to bring to the market. Urbanization and a rising middleclass in emerging countries are other important trends creating both opportunities and risks as they have an impact on our demographic transition. We are also convinced that natural resource depletion and climate change will force us into an environmental transition towards lower carbon energy sources and more sustainable ways of dealing with precious natural resources such as water and food. The technological transition is probably the most visible at this stage as technological advancements are impacting all aspects of our lives, from energy to retail, healthcare, education etc. We also see a transition in terms of governance short term profit maximization is no longer tolerated in the context of systemic risk (think about the subprime crisis). Topics such as gender equality, corporate compensation and fair tax payments are also popular topics on social media, forcing companies to adjust their policies in these fields. We believe those transitions are real and important and think as a results that companies who are taking those already into account will fare better than those who don't.

How does a mega-trend lead to an investment idea in Mirova's process?

Maybe it's better to explain this with an example. Think about an aging population, for instance. When people get older their eyes deteriorate. So we believe a lot more people will need reading glasses, especially as the massive Baby Boomer generation gets older. One example of an investment idea would be a high-quality, well-run company that is a leader in the production of lenses for reading glasses.

Another mega-trend is the depletion of natural resources. Can you speak about the importance of sustainable water solutions?

Our water and food resources are two daily essentials for which you don't really have an alternative. We need them to survive. And what I don't understand is the little exposure people generally have in their portfolios to sustainable water and food investments. By the way, historically, those two themes have had good performance. But because water and food are not really present in the major indices, investors generally don't have much exposure to these areas. On top of that, water is becoming increasingly important. For example, in the United States roughly 14% of all water flowing through pipes is leaked out. The quality of pipe systems is really bad. So, we believe, this presents an investment opportunity because there is a very strong need – and also because there is no alternative to resources like water.

How might your ESG investing approach uncover opportunities and risks others overlook?

A lot of traditional asset managers start with the benchmark when they construct a portfolio. Traditionally, benchmarks are heavily biased towards companies and sectors which benefited from historic economic success. They have built their wealth on this historic success, while companies whose underlying market drivers historically have been less economically important, represent lower weights in benchmarks and consequently also in most investment portfolios. Our ESG Research Group allows us to go beyond this approach. As social and environmental problems become more visible and need more urgent and sustainable solutions, the economics for

companies presenting such solutions become more attractive, which we believe will lead to outperformance and a resulting higher weight in traditional benchmarks. We believe our ESG research gives us an edge in identifying those opportunities. Simultaneously, we also believe that the four major transitions we talked about before will have an enormous impact on the way companies do their business and companies who do not take this properly into account will underperform in our opinion, some slowly, as those transitions become more visible, some in a more abrupt way when their ESG risk taking turns into financial disasters, as was the case with for instance Volkswagen and BP.

What might a Mirova Global Sustainable Equity strategy look like?

The basic principles are the same as for any other well-constructed investment portfolio : diversification and a focus on undervalued securities. We seek to manage relatively concentrated portfolio, with a high active share and also relatively low turnover. We can invest in global companies of any size that we think may profit from long-term global trends. Overall, our ESG research and investment management groups identify and invest in companies we believe may play a role in the transition towards the world as we will know it in ten years' time, a transition driven by demographics, environmental considerations, technological changes and a higher focus on governance. For example, our strategy may have virtually no exposure to traditional energy sources, based on our belief that fossil fuels will eventually be replaced by a combination of new technologies.

How do you see the appetite of institutional investors for ESG investing? Has it evolved over the last few years?

Many institutional investors have signed the UN Principles of Responsible Investment. Other voluntary initiatives such as the Montreal Pledge, leading to investors publishing the carbon footprint of their portfolios are also attracting a lot of institutional investors. Some countries have introduced or are in the process of introducing regulation for institutional investors. In the UK for instance, the comply or explain approach from the Stewardship Code, makes institutional investors rethink their voting behavior while in France The Energy Transition Law asks for institutional investors to explain how they integrate ESG and how their investments help the fight against climate change and promote the transition towards a less carbon intensive economic model. Green bond investing has taken off as a result, appetite for sustainable infrastructure investing is growing and demand for ESG integration in equity investing is growing.

Are there different appetites within institutional investors around the world?

Historically there have been differences in approach to sustainable investment in different regions in the world, mainly because of historic reasons. A best-in-class approach was more popular in Europe, while a traditional exclusionary approach was more popular in the US. Asian demand has lagged but is now also rapidly increasing. In all parts of the world we see demand converging towards a more positive approach to ESG: How can ESG research not only

help us to define what we do not want to invest in, but more importantly, how can doing good (create positive impact) be combined with doing well (create good financial performance). Recent election results seem to have accelerated this trend.

It meets the increasing transparency need. Where do we stand today and how do you see the outlook on integrating ESG considerations in investment?

Investors are more and more aware that investing in a financial asset also means financing a specific activity and those activities have impacts on our lives, positive and negative. Evolutions in data provisioning and gathering are leading to more and better opportunities to analyze the impact of portfolios. Creating ESG profiles for portfolios and indices has become easier and better quality, but at the same time investors need to be aware of the differences in methodologies. Too often investors are happy to outsource the ESG profiling of their portfolio to a major ESG rating provider without being aware of the differences between provider's methodologies and the resulting differences in their ratings. One very positive evolution is the increasing quality of data for carbon footprinting of portfolios and the ability to translate the carbon footprint of a portfolio into a global warming scenario. This approach may visualize the impact of portfolios in a more realistic way and may make it easier to understand what impact financing the right or wrong activities may have. Ultimately, I believe that such impact reporting may affect the way people construct their portfolios

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