Rising to Meet the Climate Challenge

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Our society is in a race against time to decarbonize. As such, we spend a great deal of time studying how public policy intersects with the actions of the corporate sector to drive the necessary evolution of the global economy. Together with our deep industry knowledge and the bottom-up fundamental insights that emerge from our in-depth research on individual companies, we believe we are able to identify companies that have the potential to catalyze positive change.

Weighing Sustainability and Investment Return Considerations in a Dedicated Sustainability Strategy

Seeking to drive superior investment returns will always be the core of what we do. We believe in making investment decisions based on the durability of a company's business model, operations, and value chain, and the valuation of the security.

Every company in our U.S. Equity Sustainability strategy has both an investment and sustainability thesis, and they are often tightly linked. The sustainability thesis outlines what makes the company a Sustainability Champion, Enabler, or Improver, and tracks key details of the unique sustainability characteristics of the company over time.

The Impact of Enablers

A Sustainability Enabler is a company whose products or services help improve environmental, social, and governance (ESG) standards or outcomes in society. These companies influence the future state of sustainability for an industry or advance a sustainability theme. The impact they have is in that influence.

Our approach is to understand the enabling role that the company plays, develop a sustainability thesis that outlines that role, and link it to the company's strategy, operations, business model, value chain, or industry. Sometimes the thesis begins qualitatively, and as we track
progress and continue to engage with the company, the quantitative opportunity becomes clearer.

An example of an enabler of the transition to a low-carbon economy would be an integrated circuit manufacturer whose products are used in consumer and industrial electronic devices, such as cell phone battery chargers and household appliances on the consumer side, or internet of things (IoT) devices on the industrial side. The company's products enable the optimization of power consumption during AC/DC conversion or voltage fluctuations. For example, during a light load, power would be reduced to an amount necessary to run the device efficiently, and during standby, or no-load, power is effectively shut down.

It is estimated that in the United States alone, roughly 10% of energy use is a function of standby power consumption. The sustainability thesis for this company would center on the cumulative energy saved by installing its chips in a wide variety of products, which could be further converted to avoided greenhouse gas emissions.

Improvers to Champions

A Sustainability Champion is a company with leading sustainability standards and practices, and a Sustainability Improver is a company with scope for significant improvements in both of these areas that has made a commitment to implement such initiatives. These designations are based on peer comparisons to allow for variety in progress toward sustainability standards across sectors and market capitalizations.

Champions have an impact by setting a high bar for sustainability practices among industry peers, while Improvers have an impact through the rapid and progressive enhancement of sustainability practices, as well as improving disclosure.

A building materials company, for example, could be considered a Champion given its long history of managing and disclosing material sustainability issues in its operations and value chain. The company's industrial processes require intense heat and were historically powered by fossil fuels, including coal.

Recognizing that having high carbon-emissions intensity was a material risk for the company in an environment where policy to mitigate emissions was becoming more stringent, the company invested in replacing equipment to reduce its Scope 1 and 2 carbon emissions.

The new equipment was more efficient and could be powered by alternative energy sources. The company also developed a vendor sustainability program and worked with partners along its value chain to set emissions reduction targets, which helped the company reduce its Scope 3 emissions.

When the climate policies in certain high-risk jurisdictions changed, the company was already well positioned to minimize penalties for high carbon emissions. The company could be seen by others as a model for transforming operations to minimize transition risks. So not only are its reduced operational and value-chain emissions a key driver of its impact, but by setting a high bar on best practices, the company is also positively influencing developments across its entire industry.

When this building materials company began its sustainability journey, taking steps to reduce its emissions, it could have been considered an Improver. Though the company would have started out with small goals, our focus is on positive change and whether a company is committed to, and capable of, delivering best-in-class reductions in emissions over time. Not all Improvers become Champions, but there is the potential for them to do so.

Conclusion

Increased societal awareness around sustainability, combined with ever-evolving expectations and demands from stakeholders, is creating structural changes in society. Our U.S. Equity Sustainability strategy aims to identify the companies that are in front of the curve
in responding to these changes, and that see their own internal actions as drivers of sustainable competitive advantage and thus long-term value. These companies implicitly recognize the value in leading the climate transition, both from a societal and shareholder value point of view.

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