Stewart Investors
Sustainable Funds Group

Stewart Investors Sustainable Funds Group

Quarterly Client Update

Q4

1 October - 31 December 2020 | For adviser use only

Image location:
Ram Jhula bridge, Rishikesh, India

Contents

Investment philosophy

We are stewards

Our role is to allocate society's capital to productive uses, in accordance with our Hippocratic Oath

We are long-term

Our time horizon is measured in years, not weeks, and we value companies accordingly

We invest only in companies contributing to a more sustainable future

We engage constructively as owners to help companies on their sustainability journeys

We invest only in high quality companies

We seek out companies with exceptional cultures, strong franchises and resilient financials

We believe capital preservation is important for capital growth

We define risk as the possibility of the permanent loss of client capital

Investment objective

To generate attractive long-term, risk-adjusted returns by investing in the shares of high quality companies that are particularly well positioned to benefit from, and contribute to sustainable development.

Investment terms

View our list of investment terms to help you understand the terminology within this document.

Human development pillars:

investing in companies contributing to and benefiting from sustainable development

Image location: Mumbai, India

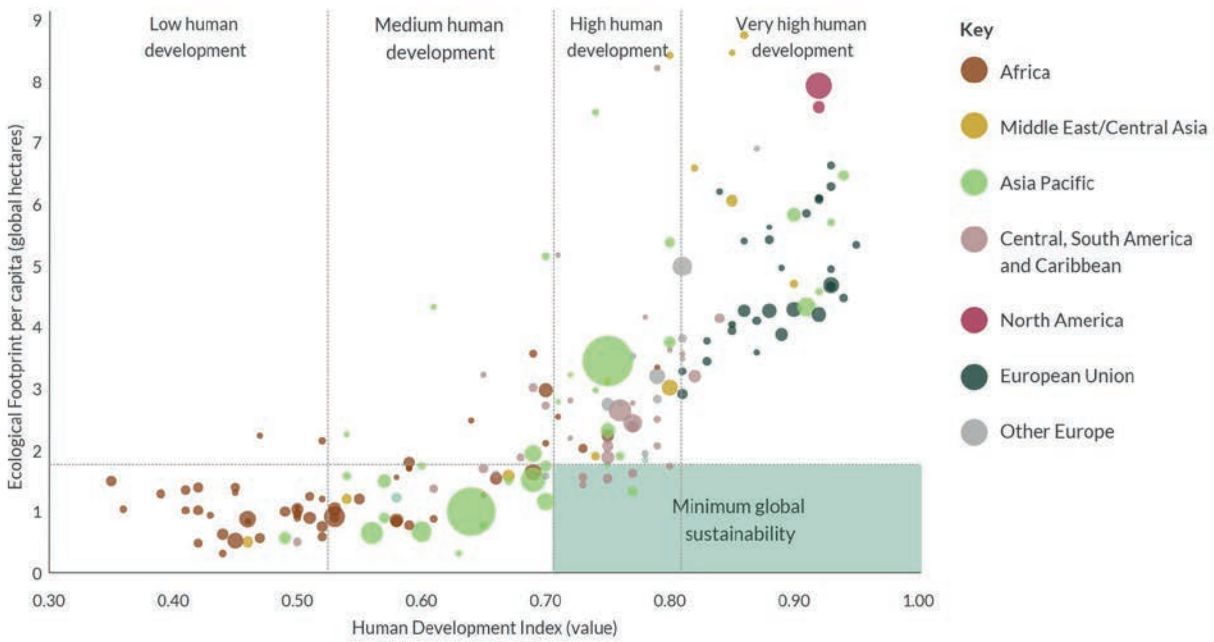
Since our first sustainable development-focused strategy launched in 2005, human development has been a key focus area given our long history of investing in Asia Pacific and emerging markets. Recently we have been expanding the way we assess and report on how our companies are contributing to various solutions to human development challenges. This builds upon our work mapping the contribution our companies are making to climate solutions featured in Project Drawdown.

The idea of 'sustainability' is simple and easy to understand. Yet at the same time, it is a concept which has spawned innumerable marginally different definitions. Each interpretation of the concept is inevitably imperfect and incomplete, and at the same time has something to offer. We do not presume that our own framework is the 'right' approach, let alone the only valid one.

How we think about sustainable development

Since 2012 we have used a framework developed by the Global Footprint Network for describing sustainability, which brings together the twin imperatives of human development and environmental sustainability. To us, combining these two high-level goals is a solid basis for understanding what sustainability is at its heart. This is a goal which economist Kate Raworth describes as providing "for every person's needs while safeguarding the living world on which we all depend."[1]

The graph below, from the Global Footprint Network encapsulates this.[2] On its vertical axis, the graph uses the concept of 'ecological footprint' to plot humanity's use of the Earth's regenerative and absorptive capacity in terms of water,



Source: Global Footprint Network, 2019 National Footprint Accounts www.footprintnetwork.org and data.footprintnetwork.org/#/sustainableDevelopment?cn=all&yr=2016&type=BCpc,EFCpc. Latest country data for the Ecological footprint is 2016.

land, food and other natural resources.[3] On its horizontal axis, the graph uses a broad measure of human development – the Human Development Index (HDI) developed for the UN by economist Amartya Sen, and which includes metrics related to income, education and health.[4]

The bottom right quadrant (coloured light sage green) is the area of global sustainability: the zone in which a society has delivered 'high human development' but still lives within its environmental means. Unfortunately it is quite a lonely part of the graph!

We use this framework to help think about the sustainability positioning of individual companies. Our aim is to find companies which are contributing to and benefiting from sustainable development. That means we look for business models which help move societies from north to south on the chart by reducing environmental impact, and from west to east by improving human development outcomes.

To deepen our understanding we recently evaluated companies on their contribution to environmental solutions using an external framework developed by Project Drawdown which identified 80 climate change solutions. We are continuing this work by doing the same for human development. However, a comparable framework to Project Drawdown does not exist and so we have instead expanded on the components of the HDI.

Deepening our understanding of human development

The HDI used in the chart works well as a high level measure. Countries which score well on it genuinely do tend to be delivering for their citizens, and vice versa. However, like all metrics it has its limitations. Many companies which we believe to be sustainable do not map directly to any of its constituent components – income, education and health – and so we have spent some time thinking about how we would expand this idea.

Taking inspiration from many different sources, we have determined 10 broad pillars which we believe encapsulate the essence of human development in a slightly more detailed way, and to which we could readily map companies. We believe that our investee companies should all be contributing in a tangible way to at least one of the ten pillars.

These pillars cover a range of areas which we believe to be central to the spirit of sustainable human development, and quality of life for people around the world, particularly in emerging markets. Most of them are self-explanatory and link back in clear ways to Sen's concept of 'development as freedom'[5] and the HDI.

10 pillars of human development

- Nutrition
- Health & wellbeing
- Water & sanitation
- Education
- Information & connectivity
- Energy & electricity
- Income & employment
- Financial inclusion
- Housing
- Standard of living

To elaborate on probably the least self-evident pillar and to illustrate our thinking more generally, our conception of 'Standard of living' is an idea inspired by the late Hans Rosling's work. It is approximated in the HDI as GDP per capita.

At its heart, it refers to people's ability, through the ownership of private goods, to attain a higher quality of life. As shown below, Rosling's exceptional book *Factfulness* illustrated this with reference to transport, cooking equipment and sleeping arrangements.[6] We could equally refer to ownership of air conditioning – which in many tropical emerging markets has clear links to educational attainment and labour productivity – or to family possession of white goods – which have been instrumental in allowing women to enter the workforce in many societies around the world.

Demonstrating positive impacts on human development

To test and demonstrate our approach, we have analysed the companies in our Global Emerging Markets Sustainability strategy against the pillars, and will soon roll this analysis out to other strategies as has previously been done for Project Drawdown solutions.

For clients in the Global Emerging Markets Sustainability strategy, for instance, we own shares in a Chinese provider of extractor fans and gas cooking hobs. In a Chinese context, these products have huge environmental and health benefits. Households switching from burning

Source: Gapminder and Dollar Street - Free material from www.gapminder.org, CC-by license.

solid fuel to using gas has been shown to be the single biggest contributor to improving air quality in China, preventing an incredible 400,000 premature deaths annually.[7] The company, in our view, maps clearly onto the 'Energy & electricity' pillar, since its business model is to provide people with a cleaner form of cooking fuel.

The strategy also has a position in a leading provider of medicines in Bangladesh. With over 700 drugs and the only truly nationwide distribution system, the company has a focus on anti-infectives, as well as treatments for the non-communicable diseases which are now the leading causes of illness in Bangladesh. In a country in which the annual medical spend was a paltry US$36 per person per year in 2017[8], the company is well-positioned to continue to deliver access to medicines in a society which desperately needs it. It maps neatly onto the 'Health & wellbeing' pillar.

These are just two of the many tangible and inspiring ways that each of our companies are contributing to solving the world's human development challenges.

When we group companies together by pillars, we begin to get a picture of where the investee companies of the Global Emerging Markets Sustainability Strategy are contributing most to human development in emerging markets.

We currently own shares on behalf of clients in companies in the portfolio which contribute meaningfully to all of the pillars except for one, 'Water & sanitation'.

The largest concentrations of contributions arise in three areas.

The first is 'Health & wellbeing', and includes companies which are manufacturing drugs and personal care goods, as well as pharmaceutical retailers and companies providing medical diagnostic services.

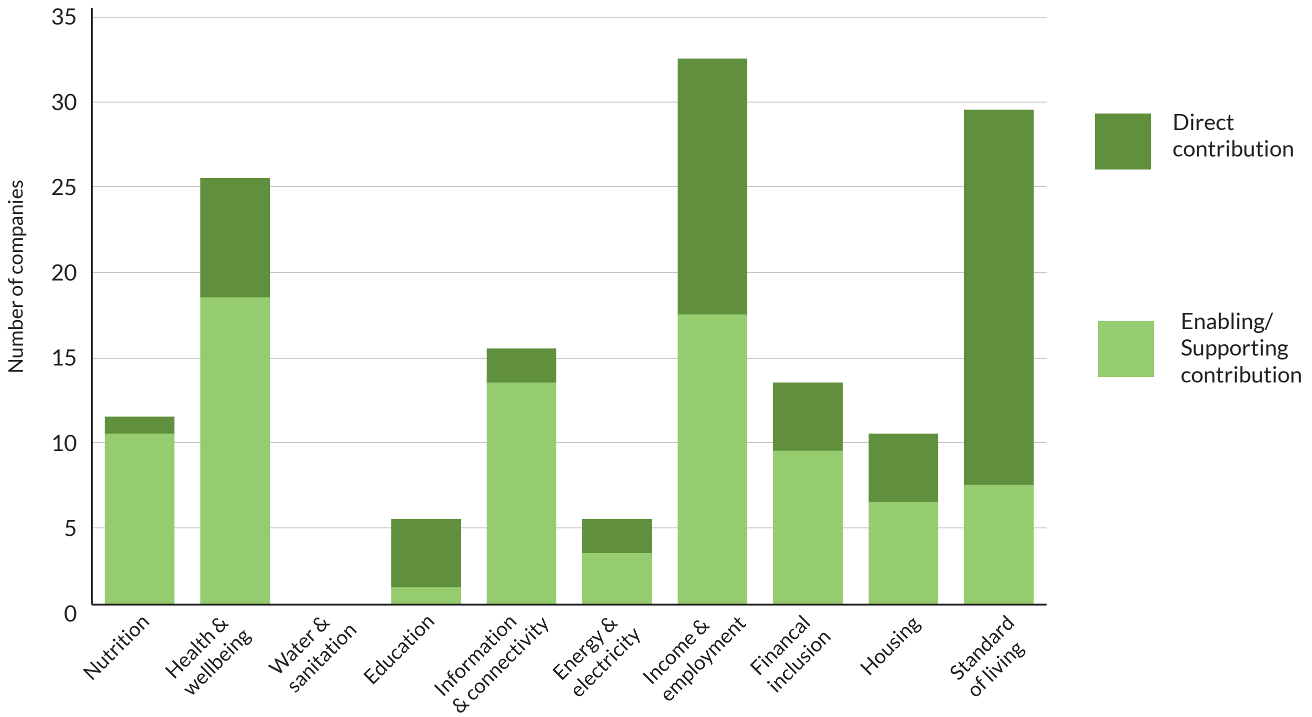
The second is 'Income & employment', where a good example would be a company in Brazil which provides enterprise resource planning (ERP) software to half the country's small and medium sized enterprises, thereby supporting the jobs of millions of Brazilians.

And the third concentration of company contributions is in 'Information & connectivity', and includes businesses like a Czech software company, which provides internet security software to 400m consumers.[9]

When we think about the solutions holistically, we also begin to see how our investee companies' contributions are complementary in their impact on human development.

Take the example of 'Housing'. Population growth and rapid urbanisation has put huge strain on infrastructure and housing stocks in emerging

HDI Pillars



Source: Stewart Investors, November 2020.

markets cities, and today approximately 880m people globally are classified as slum-dwellers.[10] This is a tragedy, not just for the quality of life for those millions of people, but for society: the ability to get an education, to access employment and to deliver social justice is tightly linked to adequate housing.

We mapped six existing Global Emerging Markets Sustainability strategy holdings onto the 'Housing pillar'.

They included companies providing mortgage financing, one being a company which since 1977 has financed an incredible 7.8m housing units in India, with an average loan size of US$35,700. Last year, 37% of their loans by volume were in the affordable housing segment, with an average loan size of just $15,000[11] – loans aimed at helping people upgrade their quality of housing at the bottom of the pyramid (poorest part of society).

The companies mapped onto 'Housing' also included companies providing building materials which are central to the construction of safe dwellings. An excellent example is an Indian decorative paint company. In a country where 90% of paint does not comply with regulations on lead content, a company like the one we own shares in for clients – which sells water-based, lead-free and low VOC[12] decorative paint – is well positioned to grow its sales more quickly as a result of its leading position on these issues, as well as save lives in the process.[13] In the developed world, paint is primarily an aesthetic consideration, but in the humid climate of South Asia, paint plays a crucial role in preventing damp and mould, aiding waterproofing and ensuring buildings last longer. Without high quality, non-toxic paint, housing units in tropical climates quickly become unfit for human habitation.

Sustainable investing as an enabler of human development

Many of the contributions which our companies are making to sustainable human development are not ground-breaking. Most are not eye-catching or headline-grabbing. But they are no less powerful or important for that.

It is the essential medicines in Bangladesh, the first time mortgages in India, the gas cookers in rural China and the safe, low-toxicity paint in India that are helping and will continue to help hundreds of millions of people in emerging markets to live longer, better and healthier lives.

We continue to believe that the best way to allocate capital responsibly and productively over the long term is to find companies which are contributing to and benefiting from sustainable development. With our new frameworks, we have powerful tools to analyse and find such companies, and to communicate their contributions to clients.

We look forward to continuing to do so in coming months and years.

[1] Raworth, Kate. Doughnut Economics: Seven Ways to Think Like a 21st-Century Economist. Chelsea Green Publishing, 2017.

[2] Global Footprint Network, 2019 National Footprint Accounts www.footprintnetwork.org and data.footprintnetwork.org/#sustainableDevelopment?cn=all&yr=2016&type=BCpc,EFCpc. Latest country data for the Ecological footprint is 2016.

[3] Source: https://www.footprintnetwork.org/our-work/ecological-footprint/

[4] Source: http://hdr.undp.org/en/content/human-development-index-hdi

[5] According to 1998 Nobel prize winner, Amartya Sen, freedom is both the primary objective of development, and the principal means of development.

[6] Hans Rosling, Factfulness: Ten Reasons We're Wrong About The World - And Why Things Are Better Than You Think.

[7] Source: https://www.pnas.org/content/115/49/12401

[8] Figure as of 2017. Source: https://www.theglobaleconomy.com/Bangladesh/health_spending_per_capita/

[9] Source: company data.

[10] Source: https://oxfordbusinessgroup.com/overview/urban-adaptation-rapid-urbanisation-and-young-growing-populations-put-pressure-emerging-2

[11] Source: company data.

[12] VOC stands for volatile organic compound. VOCs are solvents that get released into the air as paint dries.

[13] Ambit Capital Research, Bright shades all priced in, Research tender, November 2020.

Source for company information: Stewart Investors investment team and company data. This stock information does not constitute any offer or inducement to enter into any investment activity.

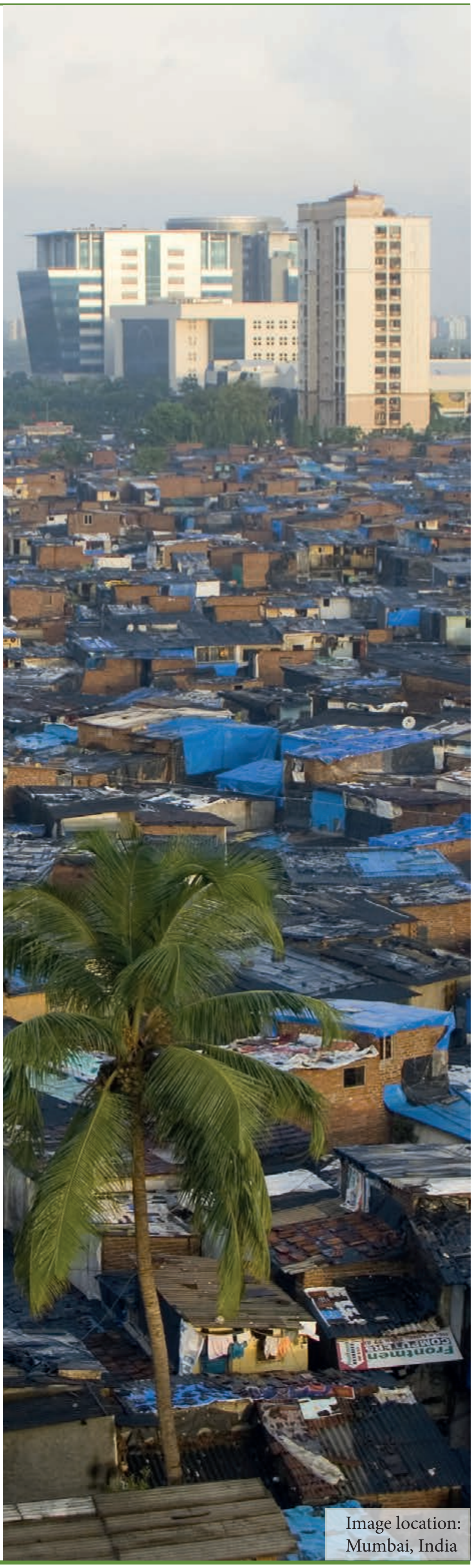


Image location: Mumbai, India

Significant portfolio changes

Image location: Auckland, New Zealand

Worldwide

During 2020 we focused, as we always do, on investing in high-quality companies that are well-positioned for sustainable development and run by trustworthy stewards. Our aim is always to preserve capital in times of market volatility, but this does not mean standing still. Portfolio turnover was unusually high in 2020.

The global health crisis meant many previously expensive companies became less expensive. We were afforded a rare opportunity to undertake the most significant portfolio adjustment since inception of the strategy in late-2012.

We invested in 22 new companies and divested 18 during the year. We did so in order to improve the quality and resilience of the portfolio for the decade ahead. We made some mistakes in the process, and ideally would have liked to have made a few more changes. But we believe the companies we introduced can take opportunities and weather the storms a post-pandemic world will bring, while making the world a better place.

We spent much of the final quarter consolidating positions and divesting from a handful of companies that fit less well with our longer-term plans, or that have become too expensive for the growth they might achieve in the years ahead. We added two new holdings: New Zealand-based Fisher & Paykel Healthcare and the Dutch company Philips.

The former grew out of the appliance manufacturing company that also carries the Fisher & Paykel name. It built its first humidifiers 52 years ago using jam jars. It is now a global leader in humidification for respiratory systems in hospitals and home care settings. Their products help keep patients out of intensive care wards, reducing pressures and costs to health systems.

The company responded swiftly and well to COVID-19. We believe it is well placed to pull forward future demand for consumables, an important contributor to overall revenue, notwithstanding shorter-term pressures as health care systems adjust to post-pandemic realities.

Philips has evolved significantly over the years. It is now a focused provider of health care technologies, with a goal to improve the lives of 3bn people by 2030, including 400m people[1] in underserved communities. This ambition is supported by a track record of innovation and a holistic view of health care based on the powerful idea that prevention is better than cure.

Operating across personal health care, diagnostics, and connected care (e.g. internet of things), Phillips is well positioned to improve lives and reduce overall health system costs, amid strong competition from some formidable peers.

We sold Brambles, Novo Nordisk, Pigeon, Varian Medical Systems and Cerner, based on our bottom-up analysis and the specific circumstances of each company. We think Novo Nordisk could face growing regulatory headwinds and Pigeon increasing product competition. We have concerns about changes in the financial quality and stewardship of Cerner. The management of Brambles have executed their strategy very well, but we are uncertain what level of returns are possible from here. And we chose to sell Varian following its takeover by Siemens Healthineers.

Please visit our website to listen to Pablo Berrutti's latest webcast on the strategy portfolio and performance, along with an overview of how the team are working to improve transparency for clients via our dedicated microsite.

https://www.stewartinvestors.com/au/en/adviser/sustainable-funds-group/strategies-and-funds/strategy-updates/worldwide-sustainability-webcast.html

Worldwide Leaders

This quarter we made fewer changes to the overall portfolio following a period of high turnover earlier in the year.

We initiated a position in Copart, which is a leading online vehicle auction company. It is a critical enabler of the global re-use and recycling of vehicles, parts and raw materials. Founder Willis Johnson is still one of the largest shareholders and executive chairman, with a long-tenured management team that stewards a net cash balance sheet. The company has evolved well from dismantling vehicles and selling parts, to buying up an auction house, with its first website in 1995, and fully transitioning to an internet only auction business in 2004. Unlike other asset light marketplace businesses, it also enjoys a significant competitive barrier in its ownership of large tracts of land near metropolitan centres, which enables quick and efficient recovery, storage and salvage operations. The company also plays a critical role in the aftermath of a natural disaster by contributing to recovery and resilience in the communities they serve, best evidenced most recently in the wake of Hurricane Harvey in Texas in the summer of 2017. Copart is a market leader in the US, and has also successfully established its model in the UK, and is now planting the seeds for further growth elsewhere in Europe.

During the quarter, we sold our holding in Beiersdorf. We have long admired the long-term investment horizon of the Herz family behind the company with its affordable skin care brands, and the net cash balance sheet. This should have given plenty of options to invest in higher areas of growth. However, we were disappointed by recent decisions in capital allocation, and found better options in other areas of consumer products and healthcare to make additional investments, like Edwards Lifesciences, Coloplast, bioMérieux, Halma, Novozymes and Nestlé.

We made small trims to our holding in Sysmex and Tata Consultancy Services on valuation concerns.

Finally, we also sold out of Varian Medical Systems completely, following its takeover by Siemens Healthineers.

Global Emerging Markets

We exited three positions during the quarter: WEG, Foshan Haitian Flavouring and Colgate-Palmolive.

All of these companies benefited in 2020 from powerful tailwinds aiding their growth, and have been able to deliver fantastic financial results even during a very difficult 2020. As a consequence, each of these companies' shares have reached all-time highs[2], and valuations at which we struggle to maintain positions.

We try to hold on to our favourite companies for as long as possible, but our valuation discipline means there is a point at which we are forced to exit. Our disposals this quarter are an attempt to reduce risk prudently in the context of soaring markets.

We have exited companies where we feel valuations implied everything had to go right in order to generate an attractive return. In turn, we have allocated that capital to quality companies where we feel valuations mean there is a more attractive risk-reward profile.

This included initiating two new positions during the quarter, in Natura & Co and SPAR Group.

Natura & Co is a Brazilian home and personal care company which we have invested in for long periods in the past. We have always loved Natura's leadership on sustainability issues – ranging from living wages to engagement with smallholder suppliers. The company has made a number of acquisitions; over the next few years, we believe earnings should grow healthily as various synergies come through and this doesn't appear to be fully incorporated into valuations.

SPAR Group is a wholesaler group supplying thousands of independently-owned retail stores. The group derives around a third of its revenue from Europe, where it has undertaken successful acquisitions in the last few years, and has recently entered Poland. SPAR is very reasonably valued in our view, particularly in light of zero profit today from their new Polish operations which could, in five years, be making a meaningful contribution to earnings.

We also increased our exposure to Samsung Electronics. The South Korean company derives most of its profits from its memory chip business, which is benefiting from structural tailwinds arising from cloud infrastructure investment. Samsung shares have traded on a very modest multiple of its cash flow, and the company has USD85bn in cash on the balance sheet. The shares appeared reasonably valued.

Asia Pacific Leaders

Asian equity returns were strong in the fourth quarter and for the year as a whole. In many areas valuation is the biggest challenge. For the first time in recent memory we sold an entire position in one company across all Asian strategies, purely because of valuation. This company was Nippon Paint, the Japanese-listed paint company, as strong share price performance ran far ahead of the underlying fundamentals and brought valuations to extreme levels. We owned Nippon Paint for its leadership in China's underpenetrated decorative paint market, as well the stewardship of the high quality Goh family. However, enthusiasm around a recovery in the Chinese housing market, as well as confirmation of a long-awaited corporate restructuring, pushed Nippon's price-earnings ratio (P/E) multiple above 100x: a valuation that we believe makes it very difficult to earn an attractive long-term return from.

During the quarter we sold President Chain Store, the Taiwanese operator of 7-Eleven convenience stores. After numerous engagements, over a number of years, regarding the poor sustainability positioning of their product portfolio, particularly in relation to the distribution of tobacco and products rich in sugar, we felt that management's actions were trailing their commitments. While we have a great respect for the Lo family, the slow pace of change meant that we were becoming increasingly misaligned, in terms of our perception of the risks that challenge the franchise and threaten the cash-flows.

We also sold out of the remainder of our long-term holding in Brambles, the Australian-listed global logistics business. We have a deep admiration for the sustainability strengths of this circular business model, however we were concerned that debt was on the rise, once again, at a time when the franchise could face mounting headwinds from lower global growth.

Valuation also explains small reductions in Xero, Centre Testing International, Shenzhen Inovance, Hualan Biological and Tech Mahindra.

Fortunately, our conviction has risen in the quality of the franchise and the scale of the opportunity at Techtronic Industries, the Hong-Kong listed manufacturer of power tools. We were able to add to Techtronic Industries after a call with management highlighted the strength of their brands, their ability to take market share and the long-term opportunity from China, where the substitution of capital for labour in the construction sector is underway.

We added to Tata Consumer Products after engagement with the Chairman of Tata Group underlined the focus and commitment to the success of this consumer franchise. In the case of Naver we have increasing conviction in the strength of the franchise to challenge the Chinese internet behemoths in other countries across Asia. We were also able to add to our position in CSL which has been slightly out of favour but where quality is undiminished.

We are excited with the introduction of two new franchises to the portfolio: Infosys and HDFC Life. India is blessed with a number of world class software service franchises. We have owned Infosys, a leading Indian global consulting and IT services company, before and have always had a great admiration for the quality of the franchise. In recent years we have been dissuaded from ownership as stewardship hiccups accompanied

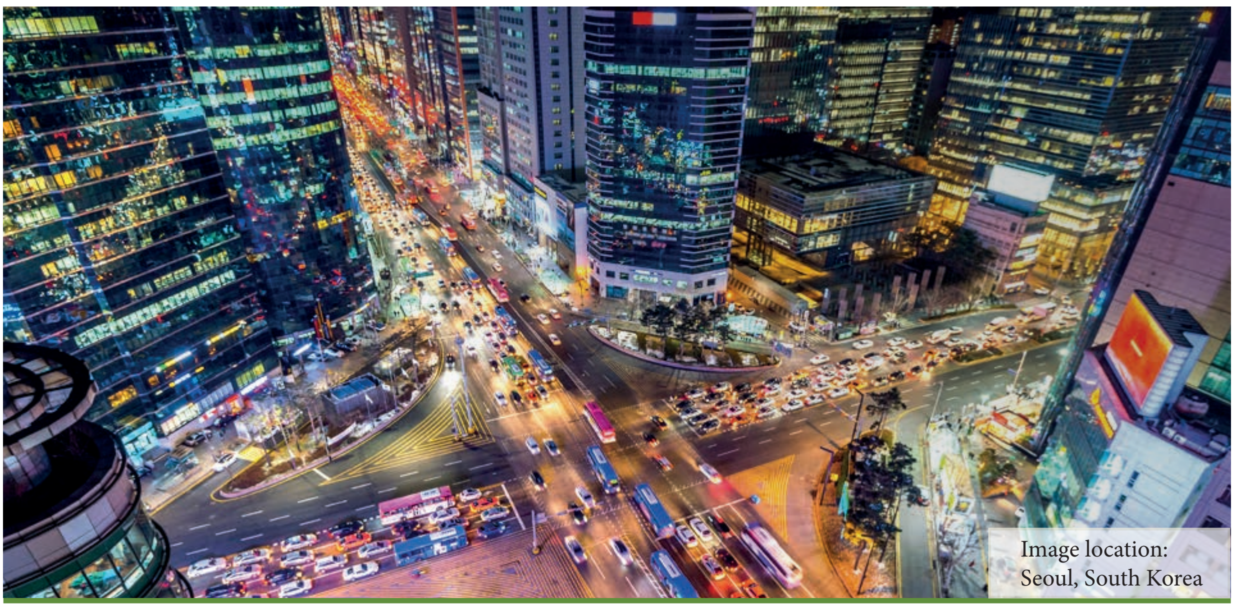


Image location:
Seoul, South Korea

an intra-generational transition in management. We have kept close contact with the company and now feel that stewardship has returned to the high standards we expect from Infosys. In the case of HDFC Life, we have the upmost respect for the culture of excellence and probity within the HDFC group and we have been long-term supporters of HDFC – the high-quality mortgage provider and majority owner of HDFC Life.

Asia Pacific

During the quarter we sold three companies from the strategy and were able to initiate positions in two new franchises.

We sold out of President Chain Store, the Taiwanese operator of 7-Eleven convenience stores; Nippon Paint, the Japanese-listed paint company; and Brambles, the Australian-listed global logistics business. Further information on each company is referenced above in the Asia Pacific Leaders update.

We reduced the position size of Tech Mahindra and Shenzhen Inovance, as a rapid rise in their share prices had run ahead of their underlying qualities.

Despite these sales, cash did not rise meaningfully as we were able to make additions to a number of existing holdings and purchase two new franchises.

We initiated positions in two larger companies: HDFC Life, an Indian private sector life insurance company and Infosys, an Indian global consulting and IT services company. Further information on each company is referenced in the Asia Pacific Leaders strategy update.

Over the period we added to Naver, Vinda, Syngene, Tube Investments, AK Medical, Tata Consumer Products, CSL and Techtronic Industries. There is no commonality here in terms of sector or country. The similarity is that they are high-quality franchises, stewarded by high quality people, which is reflected in high-quality financial statements. For each company we have deepening conviction in their qualities and, alongside consideration of their valuation, felt they deserved to be a bigger portion of the strategy.

Asia Pacific and Japan

Over the period we exited four companies and used the proceeds to acquire two companies that we believe offer higher quality growth and more reasonable valuations.

We sold out of President Chain Store, the Taiwanese operator of 7-Eleven convenience stores; and Nippon Paint, the Japanese-listed

paint company. Further information on each company is referenced above in the Asia Pacific Leaders strategy update. We also sold our small position in Youngone Holdings, a Korean company involved in the manufacturing of garments for global brands, as we failed to gain conviction in the long-term quality of the franchise; and Metropolis Healthcare, an Indian diagnostic company which we recently added, having failed to build a meaningful position in the company.

In terms of purchases, we initiated positions in Tube Investments, which specialises in engineering, bicycles, metal-formed products and chains in India and internationally; and Infosys, an Indian global consulting and IT services company.

In Tube Investments we are backing a new management team, within a fourth-generation family-owned company, to build a leading industrial conglomerate in India. On top of an impressive track record, we are very impressed by this team's desire to learn from, and eventually emulate, world-class industrial companies in Europe and the US. Further information on Infosys is referenced above in the Asia Pacific Leaders strategy update.

India

During the quarter we initiated positions in HDFC Life, Bosch India, Infosys and CG Power.

HDFC Life Insurance is India's leading private sector life insurance company. Life insurance has always played a pivotal role in providing protection and acting as a social security net in India. Both these factors are key to the sustainable development of economies. Majority owned by the high quality HDFC group, the company's culture, competence and long-term stewardship are outstanding. The life insurance sector is well positioned for strong growth in the coming decades, given the twin inflexion points of rising incomes and more efficient technology-led distribution. We are particularly excited about HDFC Life's aspiration to reach the bottom of the pyramid with more affordable products which, if successful, could be life changing for these communities. Poor underwriting and chasing growth for growth's sake are key risks to watch out for.

Bosch India has over the last century become the most trusted provider of mobility solutions in the country and is the only listed entity in Robert Bosch's (Germany) eco-system. The parent is owned by a foundation which has the time horizons of decades not years. Its early investment into cleaner technologies will help Bosch India emerge as a key participant in India's transition to more stringent emissions standards and electrification across the automotive spectrum. India's air quality is possibly amongst the worst globally[3] and a shift to cleaner technologies is essential. More competition in newer technologies is a key risk.

Infosys, a leading Indian IT services provider, has spent the best part of the last decade trying to get management succession right. The appointment of Salil Parekh a few years ago ushered in much needed stability in leadership. With a founder-stewarded board and a quality professional management team, Infosys is now well positioned to return to its former glory days of being a technology bellwether. Infosys' contribution to sustainable development of economies it operates in is exemplary. We are particularly excited by its aspiration to train 10 million individuals with digital skills in the coming decade. Slowdown in technology spend is a key risk for the company.

CG Power is a leading maker of motors and transmission equipment. The company was driven to bankruptcy by its previous owners due to poor governance. The company is now well placed to return to its former glory under the quality stewardship of its new owners Tube Investments (a long-term holding across many of our strategies). A long overdue revival in India's industrial cycle could potentially fast track this turnaround. CG Power's products are crucial to the building and maintenance of key sustainable infrastructure in the subcontinent.

We exited Mahindra Finance and Astral Poly Technik. While Mahindra Finance is well positioned for a cyclical revival in rural India, its track record of managing credit quality has been patchy. We sold out as there were many higher quality investment ideas that were becoming available to the portfolio. Astral is a high quality company led by a competent entrepreneur with strong prospects for the coming decade. We sold as valuations were discounting much of this potential.

[1] Source: https://www.philips.com/a-w/about/news/archive/standard/news/press/2019/20190328-philips-re-aligns-its-lives-improved-target-with-the-un-2030-sustainable-development-agenda.html

[2] Source: FactSet. Past performance is not a reliable indicator of future results.

[3] Source: https://www.iqair.com/us/world-air-quality

Source for company information: Stewart Investors investment team and company data. Data shown is for a representative Stewart Investors account of each strategy shown above. It is not a recommendation or solicitation to purchase or invest in any fund. Some of these strategies are not available for distribution in the Adviser market and this material is provided for information purposes only and does not constitute a recommendation, a solicitation, an offer, an advice or an invitation to purchase or sell any fund and should in no case be interpreted as such. Differences between the representative account-specific constraints, currency or fees and those of a similarly managed fund or mandate would affect results. This stock information does not constitute any offer or inducement to enter into any investment activity.

Techtronic Industries

Country	Hong Kong
Company size	USD28bn market capitalisation
Shareholders since	March 2020
Strategies held in	Asia Pacific, Asia Pacific and Japan, Asia Pacific Leaders
Description	Techtronic designs, manufactures and markets power tools, outdoor power equipment, accessories, hand tools, layout and measuring tools and floor-care appliances
Stewardship	Pudwill family own 23%

Relevant Sustainable Development Goals:

SDG 8: Decent Work & Economic Growth

- Employs 34,000 people

SDG 13: Climate Action

- No emission cordless drills. 39% reduction in product packaging
- +200% increase in battery collection for recycling

Areas for engagement:

> Gender diversity

> Colbalt in the supply chain

Rationale:

Techtronic is dominant internationally in an array of power, hand, measuring and trade tools for both home and commercial use. They have ownership of strong brands in consolidated areas which results in pricing power. We believe they are in a good position to grow organically and by acquisition. We believe risks to the company include lower cost competition from China and economic cyclicality.

Source for company information: Stewart Investors investment team and company data. The Stewart Investors Sustainable Funds Group supports the Sustainable Development Goals (SDGs). The full list of SDGs can be found on the United Nations website. This stock information does not constitute any offer or inducement to enter into any investment activity.

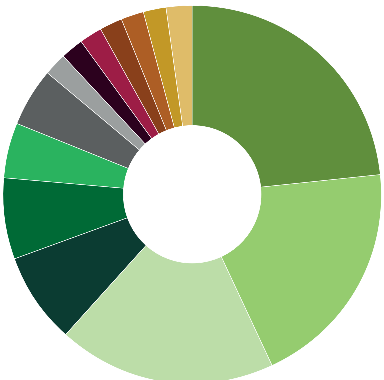
Image location: Hong Kong

During the quarter there were 191 company resolutions to vote on. On behalf of clients, we voted against nine resolutions relating to corporate structure.

- We voted against the election of two directors at **Brambles** as we are not convinced about the calibre and experience of both directors; and feel Brambles have squandered an opportunity to improve Board diversity. (two resolutions)
- We voted against the equity-based remuneration of the CEO at **CSL**. We have engaged with CSL over a number of years on remuneration and while we appreciate and acknowledge the changes they have made to their remuneration structure, our concerns remain about the absolute level of CEO pay and the gap between median pay. (one resolution)
- We voted against the election of a director to the Board of **Centre Testing International** as we do not believe the director is truly independent to sit on the audit committee. (one resolution)
- We voted against the acquisition of **Varian Medical Systems** by Siemens Healthineers. We believe there is a risk that its absorption into Siemens Healthineers could undermine its capacity to continue innovating and providing leading cancer treatment technologies and systems. We also voted against the Board's request to delay the meeting should they be unsuccessful in gaining the support required for the acquisition, as well as the executive golden parachute arrangements connected to this transaction. We sold out Varian following its takeover by Siemens Healthineers. (three resolutions)
- We voted against the executive compensation package at **Microsoft** as it is simply too high and short term. We believe how companies such as Microsoft pay does set the stage for others to emulate and copy, and this proposal increases the pressure on other boards to increase CEO pay. (one resolution)
- We voted against **Jack Henry & Associates'** request to remove the supermajority vote requirement related to approving a sale or acquisition of the Company. We consider ourselves active shareholders and prefer to vote on such matters at the AGM. (one resolution)

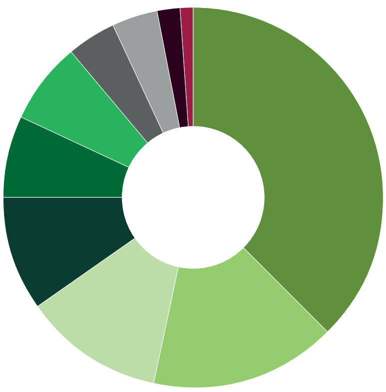
Should any client like a full list of all proxy voting for the companies held in the strategies, please contact us directly.

Proxy voting by country of origin



- 24% India
- 20% Australia
- 19% China
- 8% United States
- 7% United Kingdom
- 5% Bangladesh
- 5% Denmark
- 2% Nigeria
- 2% South Africa
- 2% Jersey
- 2% Portugal
- 2% Sweden
- 2% Japan
- 2% Brazil

Proxy voting by proposal categories



- 38% Board related
- 16% Compensation
- 12% Capital management
- 10% Audit/financials
- 7% Changes to company statutes
- 7% Merger & acquisition
- 4% Other
- 4% Meeting administration
- 2% SHP: Governance
- 1% SHP: Environment

Source for company information: Stewart Investors investment team and company data. Numbers may not add to 100 due to rounding. This stock information does not constitute any offer or inducement to enter into any investment activity. SHP means: Shareholder Proposal.

Why sustainable development and returns can be achieved in emerging markets

Image location: Zambia

In late 2013, we wrote a company report on Zanaco. The company had a customer base of around 650,000 people, made up of consumers, farmers and small and medium enterprises. Banking penetration in Zambia at the time was especially low; only 18% of adults had bank accounts, compared to 65% in Nigeria and Kenya.[1] In that context, we were excited by the prospect of a company well-positioned to extend financial inclusion at primarily the bottom of the pyramid in Zambia and benefit from that tailwind.

The bank certainly appeared to have the quality to take advantage of this opportunity. Its largest shareholder was Rabobank, a Dutch co-operative focused on rural and sustainable banking. In financial terms, the bank was well-capitalised, producing attractive returns on equity and growing earnings at 25% a year. The recommendation was a BUY.

That was seven years ago. Thankfully, following team discussion and further reflection we did not purchase shares in the company. Since then, the share price has fallen 92% in US$ terms.[2] The company's market capitalisation has collapsed from US$467m in 2013 to just US$36m today.[2]

What went wrong?

There are some contextual factors that are important: namely that banking is a fragile and cyclical business model, and that the initial valuation of 3.6x price to book left plenty of room for a decline in the share price.

These, though, are necessary rather than sufficient conditions for 92% value destruction in seven years.

The main cause of such a calamitous result is the fact that banks tend to be 'warrants on the economy.' That is to say, it is almost impossible for a bank to thrive in an environment of economic crisis.

And since 2013 that is, unfortunately, exactly what has happened to Zambia. The local economy has been the victim of a lethal cocktail of climate change, macroeconomic turbulence and institutional weakness.

	Dec 2013	Nov 2020
Price ZMW	1.8	0.5
P/Bk	3.6	0.8
ZMW/USD	5.5	20
Price USD	0.33	0.025
Mkt cap USD	467	36

Source: S&P Capital IQ as of November 2020.

In recent years, Southern Africa has warmed around twice as fast as the global average;[3] rainfall has become more extreme and less reliable. From 2017 to 2019, an unprecedented multi-year drought imposed development setbacks upon millions of people: crop failure, food insecurity, increased disease and crime, and reduced educational attendance were amongst the many social impacts.

In terms of macroeconomics, the primary effect was inflation; food is 70% of the consumer price index and what most Zambians spend a majority of their income on.[4] Shortages naturally mean higher prices. Moreover, since over 80% of Zambia's electricity generation is from hydropower[5], the severe lack of rain also resulted in rolling 18-hour blackouts and a doubling in the price of electricity in January 2020.[6]

Zambia is a very narrow and therefore fragile economy. Around 75% of the country's exports are copper,[7] leaving foreign earnings highly dependent on the price of the metal.

This left Zambia unable to deal with the twin shocks of weak copper demand and drought, and the economy has been caught in a classic emerging markets trap.

An external shock results in currency weakness. Devaluation fuels inflation and prevents authorities from cutting interest rates, guaranteeing recession. International investors' nervousness becomes self-fulfilling: Moody's and Fitch both downgraded Zambia's debt in April 2020 and triggered another round of devaluation. The yield on the Zambian government's ten year bonds is now an eye-watering 38%.[8]

The economy's near-term prospects look bleak. No wonder, in this environment, as a warrant on the economy, Zanaco's share price has fallen over 90% in US dollar terms.

The sustainable investment dilemma in emerging markets outside of Asia

Zambia is an extreme example of what has afflicted many developing countries in the last decade, particularly outside of the Asia Pacific region, in an environment of more subdued resource demand.

The structural role in the global economy of emerging markets outside of Asia is as a source of raw materials. Iron ore, wheat, beef, copper, coffee and oil flows from Africa, Latin America and the Middle East to the three industrialised regions of the world economy: North America, Europe and East Asia.

This has been the case for decades and in some cases centuries. It is a reality which makes it difficult for economies in these regions to grow quickly, alleviate poverty and not come under structural macroeconomic pressure during times of resource price weakness, like that which we have seen since 2014.

During that period, Brazil and South Africa suffered a similar combination of corruption scandals, power shortages and drought. Nigeria and Egypt were forced to abandon currency pegs in the wake of falling commodity prices. Argentina and Turkey have persisted with poor policy choices which have led to high inflation and risk of debt defaults. Russia entered a deep recession following the oil price crash.

Long before COVID-19, almost all major emerging markets outside of Asia had experienced recession in the last five years as a consequence of commodity price falls.

US $1	Dec 2013	Nov 2020	%
Zambian kwacha	5.5	20	264
South African rand	10.3	16.3	58
Nigerian naira	158	381	141
Egyptian pound	6.9	15.7	128
Brazilian real	2.3	5.7	148
Argentinian peso	6.3	78.3	1143
Mexican peso	12.9	21.1	64
Russian rouble	33	77.8	136

Source: S&P Capital IQ as of November 2020.

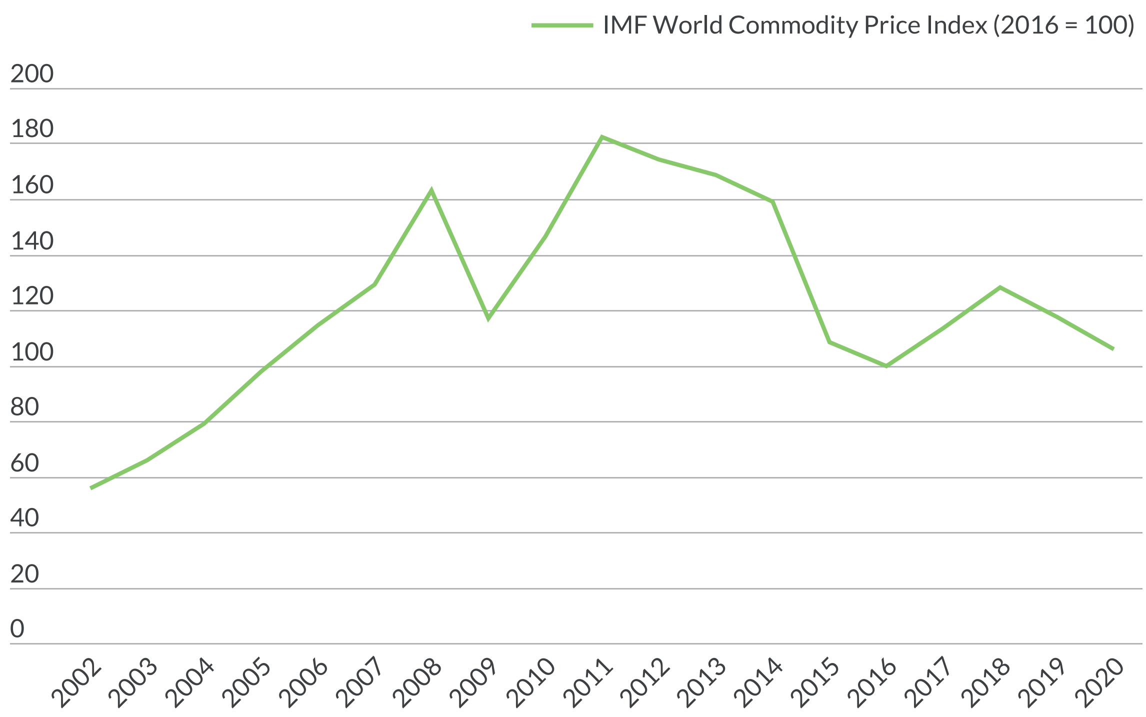
And in almost all cases, the release valve for these macroeconomic pressures has been through their currencies. Significant devaluation has been widespread outside of Asia, making attractive equity returns for hard currency investors tough to come by. The scale of these slides have meant that in many cases foreign investors have had to make well over 10% a year in local currency before breaking even in US dollars.

This creates an apparent dilemma for us as emerging markets investors who are passionate about sustainable development.

We view our role as helping to responsibly allocate the savings of the developed world, where our clients are located, to those economies that need it most - an act of diligently moving capital from where it is abundant, and therefore earns a low return, to where it is scarcer and therefore earns a higher return.

We believe such capital flows can simultaneously deliver attractive long-term returns to clients while at the same time benefiting the societies in which we invest. We seek to provide capital to companies which are involved in providing poverty-alleviating goods and services – financial inclusion, access to medicine or essential everyday goods, like soap and shampoo – because we feel they should offer the most attractive long-term, risk-adjusted returns.

The tension arises from the fact that it is those countries with the greatest need for capital and where allocating that capital might have the



Source: IMF Data as of June 2020.

greatest impact on sustainable development, like Zambia, which simultaneously are the riskiest for our clients' capital to be invested in. The markets which dominate benchmarks – China, South Korea and Taiwan – are lower risk, have the lowest costs of capital and have the least need for foreign capital to aid development.

So at first glance, there appears to be a trade-off between the extent to which we can adhere to the twin imperatives of, on one hand, being conservative and focused on preserving clients' capital and, on the other, allocating that capital in the most socially-useful way.

In practice, we would argue that there is a simple way to overcome this apparent quandry - through being highly selective on quality.

Changing the frame: sustainability as a driver of individual company returns

We do not own 'South African stocks' - we own two companies which we believe are the best in the country. We do not own 'Brazil' - we own four companies there, which we believe are the highest quality ones we can find. We do not own anything in Russia, or Saudi Arabia, or Mexico – because we do not think we have found the right quality companies at the right valuation. Our clients do not own 'emerging markets' - they own shares in what we believe are the best companies in that universe.

Being extremely selective on quality is especially well suited to the highly volatile emerging markets of Africa, Latin America and the Middle East. In our stock picking over the last five years, we have been especially aware of the difficult environments these companies operate in and the risks of currency weakness. We have tried not to own 'warrants on economies'.

We have instead primarily focused on owning for clients companies that fall into one of two categories, each of which contain only a very small fraction of the listed universe.

The first is those companies that are globally competitive. These are exporters which compete successfully with firms from the US, Western Europe and Asia. They are a rare occurrence in Latin America, Africa and the Middle East, but they exist. For example, WEG's electric motors are amongst the world's most efficient, while two IT service companies, EPAM and Globant, are the global leaders in 'digital transformation' services.

Company	Country	Industry	CFPS CAGR 2013-2020
EPAM Systems	Belarus	IT services	29%
WEG	Brazil	Electric motors	11%
Globant	Argentina	IT services	78%

Source: S&P capital IQ as of November 2020.

The focus for these kinds of companies is on innovation and technology. They typically spend a sizable portion of revenue on research and development. Having such companies based in emerging markets can mean a build-up of much-needed human capital in those countries and skilled employment for engineers.

In many cases they manage to derive a sizeable portion of their earnings from the US and Europe, and therefore earn hard currency. They also often choose to list in developed markets. These characteristics help them sidestep the headwinds of devaluation in local currencies discussed above.

The second type of company we have focused on are those that are domestically-focused, but which are able to grow earnings per share consistently, even during recessions. Such a feat requires a powerful combination of strong growth and high calibre management. In practice, we find many of these companies are amongst the best positioned for sustainable development: often, their rapid growth is fuelled by business models delivering socially-useful, valued goods to consumers.

Integrated Diagonstics is a great example. Last year it delivered 30 million medical diagnostic tests, at an average cost of US$4.60, to underserved populations in Egypt, Jordan, Sudan and Nigeria. The demand for affordable, reliable medical tests in those countries gives the company a fantastic tailwind.

In all of these cases, the sustainability of the company's business model is central to our long-term investment thesis. Being convinced that a company is contributing to and benefiting from sustainable development is an absolute prerequisite for us to allocate capital.

In the end, rather than there being a dilemma between allocating capital in a socially-productive way and preserving clients' capital, the two ends are actually perfectly aligned.

It is precisely those companies that are benefiting from sustainability tailwinds that are the ones that are able to survive and thrive, even in tough macroeconomic environments, and thereby ensure clients' capital is safe.

We believe that a highly selective method and a twin focus on quality and sustainability is the most fruitful approach, for us, to tackle the challenge of allocating capital in emerging markets outside of Asia.

[1] Source: https://www.theglobaleconomy.com/zambia/bank_accounts/

[2] Source: S&P Capital IQ as of November 2020.

[3] Source: https://qz.com/africa/1420245/life-in-southern-africa-is-going-to-become-untenable-as-temperatures-keep-rising/

[4] Source: https://www.unece.org/fileadmin/DAM/stats/documents/ece/ces/ge.22/2012/Zambia_REVISED_CONSUMER_PRICE_INDEX.pdf

[5] Source: https://www.se4all-africa.org/seforall-in-africa/country-data/zambia/

[6] Source: https://www.aljazeera.com/economy/2019/12/27/price-of-electricity-for-zambians-will-double-next-month#:~:text=Zambia's%20state%20power%20firm,to%20the%20country's%20energy%20regulator.

[7] Source: https://oec.world/en/profile/country/zmb/

[8] Source: http://www.worldgovernmentbonds.com/country/zambia/ as of 23 November 2020.

Source for company information: Stewart Investors investment team and company data. This stock information does not constitute any offer or inducement to enter into any investment activity.

Asia: Playing the Long Game

Image location: Hong Kong

Time-horizons matter. In a world beset by an ever-expanding list of developmental, environmental and economic challenges, a long-term mind-set is crucial if companies are to not only survive, but contribute and benefit from the necessary changes required over the coming decades. But with the average tenure of a CEO now close to five years[1], and the average holding period for a stock less than six months[2], time horizons are collapsing when they should be expanding. In 2020, lockdowns, loose monetary policy by central banks and stock market euphoria combined to create an environment plagued with short-term pressures. We believe being able to think and act for the long-term is one of the strongest, and rarest, assets a company can have today.

In the two hundred or so corporate meetings we conducted this year we focused more than ever on understanding where management teams were making long-term decisions that required sacrificing near-term profitability in order to improve value-creating opportunities in the years to come. These decisions tend to reflect time-horizon and sense of purpose, especially at a time of crisis. If time horizon is short and sense of purpose ambiguous then such tough, long-term decisions are near impossible to make and long-term success, and survival, is compromised.

It is for that reason that we believe, over the long term, stock prices closely match growth in underlying business value, and, over that time frame, it is the quality of the people that influence whether value is created or destroyed. Brand strength, technological lead or the attractiveness of a platform are essential but not sufficient ingredients of long-term success. For even unique assets that are not nurtured and invested in, will succumb to deterioration and see any associated excess profitability competed away.

In 2020, companies capable of looking through next quarter's expectations and next year's results, and continued making long-term decisions, have been able to compound their competitiveness relative to peers. We have seen many of our companies gain market share, launch new products and partake in opportunistic mergers and acquisitions (M&A).

The value of a long-term approach

Techtronic Industries provides an example of the benefits of being able to play the Long Game. We own the Hong-Kong listed manufacturer of power tools as we like their collection of brands, proven track record of innovation and leadership in an industry well-placed to deliver attractive long-term growth. The power tool market is relatively consolidated with Techtronic's major competitor being a large US company (known for their black and yellow tools). Unlike Techtronic, which is majority owned by the Pudwill family, their US competitor has no long-term owner, or discernible culture, and so serves at the pleasure of short-term shareholders. Watching how these companies have managed themselves through 2020 provides a great insight into the outcomes of time-horizon and, in our eyes, quality.

During the depths of the COVID-induced panic, in line with their historic behaviour and true to their goal of achieving global leadership, Techtronic's management made some important long-term decisions (see quote below).

In contrast, their competitor announced an 'initiative' to cut USD1bn in costs.[4] Any business with that kind of excess has either been materially mismanaged or is cutting into muscle rather than fat. While the long-term impact on their brand and innovation capabilities are unquantifiable there is little doubt that key assets are being under-invested in to save this

> "We invested more in manufacturing capacity. We also invested aggressively in even more product development. We wanted to accelerate product development because we felt there were so many opportunities for us to capture market share and to increase the pace in which we are achieving global leadership in the tool market. And we also decided to invest heavily in rolling out more salespeople. We wanted - we felt strongly that if our customers, if our retail partners and our distributors were open for business during the virus, then we had to be in those stores, in those showrooms, helping our customers sell through their products and helping the end users select the right tools."

Techtronic CEO, August 2020.[3]

year's bonus. Such behaviour tends to be the rule rather than the exception for companies with no mission, overriding purpose or long-term destination in mind.

We have since seen Techtronic continue to gain market share - a trend that is likely to continue as they remain focused on building long-term assets while peers focus on preserving their bottom-line. Another tangible outcome of Techtronic's divergent approach, and a major reason why we like the company, is their unassailable leadership in battery technology. A relentless focus on research and development (R&D), where they spend twice as much as a percentage of sales versus competitors, has steadily compounded to a point where Techtronic are now one of the largest manufacturers of batteries globally. Their leading battery-powered range has improved safety and environmental outcomes for consumers, as well as improving franchise strength by locking users onto their platform, helping to ensure repeat purchases. The strength of their battery ecosystem and the attractive positioning of the franchise for sustainable development are outcomes of numerous decisions to forgo short-term profitability in order to build something great, and enduring, in the long-term.

We believe Techtronic's long-term mind-set, innovative culture and competent management will continue to deliver long-term success. These enduring factors will not be evidenced in ESG scores or fit conveniently into a model but continues to be key to our conversations and analysis.

Culture as a competitive advantage

In our March letter – COVID-19 and Investment returns in Asia - we highlighted that our Indian IT companies had frustratingly failed to protect capital during the market sell-off. Tech Mahindra, Tata Consultancy Services (TCS), Cyient and Infosys all help corporates across the world to evolve and enhance their business models through the use of technology. These companies saw large portions of their market capitalisations wiped away in short order as the market assumed pressure exerted by large-scale lockdowns would force corporates to curtail investments and consequently reduce the Indian IT companies' cash flows. We spoke with each of these companies throughout the depths of the sell-off. Like us, they had little idea of what lay ahead. All they could point to was the resilience and adaptability of their cultures as well as their determination to be reliable partners to customers.

We have watched these companies adapt and maintain their relevance to customers through many economic and technological cycles but it is only in the depths of a crisis where great cultures can truly be appreciated. Within a couple of weeks these companies had reengineered themselves from centralised structures housed in vast campuses to a form of extreme decentralisation, with hundreds of thousands of engineers not only working from home, but continuing to support customers' mission-critical activities. Such change would have been impossible without cultures that empower employees and are genuinely focused on delighting customers.

We could also point to TCS's industry-leading attrition levels as evidence of their quality: an outcome of loyal and empowered engineers. Such an employee base tends to be cheaper to maintain, more productive and capable of preserving long-term relationships with customers. We think it comes as no surprise that TCS can maintain industry-leading margins while also being voted one of the best places to work in both the US and India.[5]

Thanks to what they have learned this year, TCS has committed to a '25-by-25' strategy which aims for only 25% of its workforce to be in an office by 2025. This model will likely prove both lucrative to margins and improve TCS's access to a greater pool of high-quality talent with more working mothers able to enter, and remain in, the workforce. We hope to see more women enter the higher echelons of these businesses: a topic we continue to engage them on.

Rather than the envisioned pain, COVID-19 served as a catalyst in increasing the appreciation and urgency for all businesses to have technology at their core. We believe this has the potential to start a multi-year technology investment cycle of which Tech Mahindra, TCS and Infosys should be leaders, and major beneficiaries. Despite strong recoveries in share prices, we believe these businesses continue to be attractively valued for their quality and growth opportunities.

Time is on the side of our financial companies

With lockdowns destroying economic activity and central bankers holding rates low, now is certainly not a boon time for banks. With that, many of our financial holdings were detractors to performance last year. However, as with previous crises, we are seeing high quality financial institutions prosper and position themselves favourably for the eventual recovery.

Our four largest financial holdings HDFC, Kotak Mahindra, Bank Central Asia (BCA) and Sundaram Finance, have a cumulative two hundred years' of experience under their belt. Surviving this long in such a cyclical, heavily-leveraged, industry is no easy feat and entirely the result of the quality of people.

Each of them continually sits in the highest ranks for asset quality – a function of patience and discipline. But despite the quality of underwriting, these lenders continually choose to hold more capital and build provisions far earlier and more aggressively than their peers. Such conservatism supresses short-term profitability but promotes long-term survival. Decisions like these can only be made with a mind-set that is intent on playing the Long Game.

Their hard-earned reputations for strength at time of crisis does not go unnoticed by depositors who race to hand over hard-earned savings at the expense of lower quality peers who consequently face capital withdrawals and see borrowing costs rise. Kotak, HDFC, BCA and Sundaram now sit on strong, low cost capital bases, and have improved their already strong relative competitiveness at the bottom of the cycle: a behaviour we have seen time and time again. We believe each of them should be able to compound at an attractive rate from here as they benefit from industry consolidation as well as the growing penetration of financial products in their respective economies.

Looking forward

2020 has proven that forecasting, especially over the short-term, is of little use and time is best spent on factors we can control. Growing political and environmental risks, combined with accelerating technological and consumption trends, mean time-horizons matter more than ever. We continue to allocate our clients' capital to companies where we trust high-quality, aligned, long-term stewards to build enduring franchises capable of generating attractive amounts of cash-flow over the years, decades and generations to come.

[1] Source: https://www.pwc.com/gx/en/news-room/press-releases/2019/ceo-turnover-record-high.html#:~:text=The%20study%2C%20which%20analyzed%20CEO,over%20the%20time%20period%20analyzed

[2] Source: https://www.reuters.com/article/us-health-coronavirus-short-termism-anal/buy-sell-repeat-no-room-for-hold-in-whipsawing-markets-idUSKBN24Z0XZ

[3] Source: S&P Capital IQ. Q2 2020 Techtronic Industries earnings call script 13 August 2020.

[4] Source: Company data: Q1 2020 financial results.

[5] Source: https://www.tcs.com/tcs-recognized-as-number-one-top-employer-in-the-united-states-2020 and https://www.top-employers.com/en-GB/companyprofiles/in/tata-consultancy-services-india/

Diversity: An indicator of distinctive cultures

One of the key tenets of our investment philosophy has long been a focus on the cultures and people behind businesses. We believe that franchises that are successful over the long term are built on the backs of unique cultures that have the wherewithal to resist short-term pressure in favour of nurturing a sustainable business over decades, have the ability to think diversely about the opportunities ahead and the risks they might face, and the operational focus to deliver on their strategies year after year.

In the process of analysing companies and meeting with management teams, we spend a lot of time looking out for these markers of distinctive cultures. This takes the form of studying histories, understanding how succession has evolved over time, and looking at remuneration structures amongst many other things.

Why do we think about diversity?

Considering diversity within organisations is also a key part of understanding cultures better. For us, the willingness of founders and managers to go out of their way to foster an inclusive environment, seeking a diverse range of viewpoints, is suggestive of a culture where leaders are open to being challenged, are always on the lookout for new perspectives, and are planning for their next decade of growth when the profile of incoming talent will continue to evolve.

This diversity of thought comes in many different forms. Some examples of areas we focus on include the range of experiences on the Board, management or Board members from different countries as companies expand operations across new geographies, and gender diversity within the organisation.

Why and how we are engaging on gender diversity?

We believe we invest in some of the highest quality companies in our Asia Pacific, Emerging Markets, and Worldwide universes. Even with these companies, gender diversity remains a work in progress, especially on senior management teams and the Board. This is a topic that is relevant to companies across our investment universe, and in our minds, a first step towards thinking about diversity of thought more broadly.

We are by no means experts on this topic, particularly from within the glass houses of the investment industry. As such, we worked with the University of Technology in Sydney to commission a report on policies and tools around the recruitment and retention of women through their careers to compile a set of ideas that have had clear cases of success. We went on to share this research with some of the companies we invest in, on behalf of clients, and continue to have conversations on where they might be following different strategies and areas of improvement.

Learning from companies we invest in

As much as we engage with companies we invest in, we also continue to learn from the successes they have had. Halma is one such example, where the company has been able to see tangible changes in gender diversity across the organisation in a fairly short period of time. We had a dialogue with Jennifer Ward, the Group Talent and Communications Director at the company, who helped us better understand their views and the policies implemented to improve diversity within the company.

Operating with a decentralised model with 44 subsidiaries across 20 countries, diversity is key competitive advantage for the group. Creating an environment that is inclusive of unique viewpoints, under an overarching shared purpose, allows managers on the ground to take decisions and act quickly, which is critical to the success of a decentralised operation.

Six years ago, Halma had 18% women on the Board and the executive team did not have any women. With strong leadership from CEO Andrew Williams and buy-in from the organisation as a whole, Halma today has 40% women on its Board, 58% on the Executive Board, and 50% amongst its divisional CEOs.[1] Alongside commitment from senior managers, they have achieved this through active management of recruiters, focusing on IQ and learning agility rather than just the relevant job experience (particularly on the Board), and implementing practical, behaviour-based learnings. As a decentralised organisation, Halma is very careful about the balance of the relationship it maintains with operating subsidiaries. The first global policy they implemented across the organisation was a parental leave policy for both parents, highlighting the importance of inclusion in the culture of the organisation.

You can watch our interview with Jennifer here.

Next steps

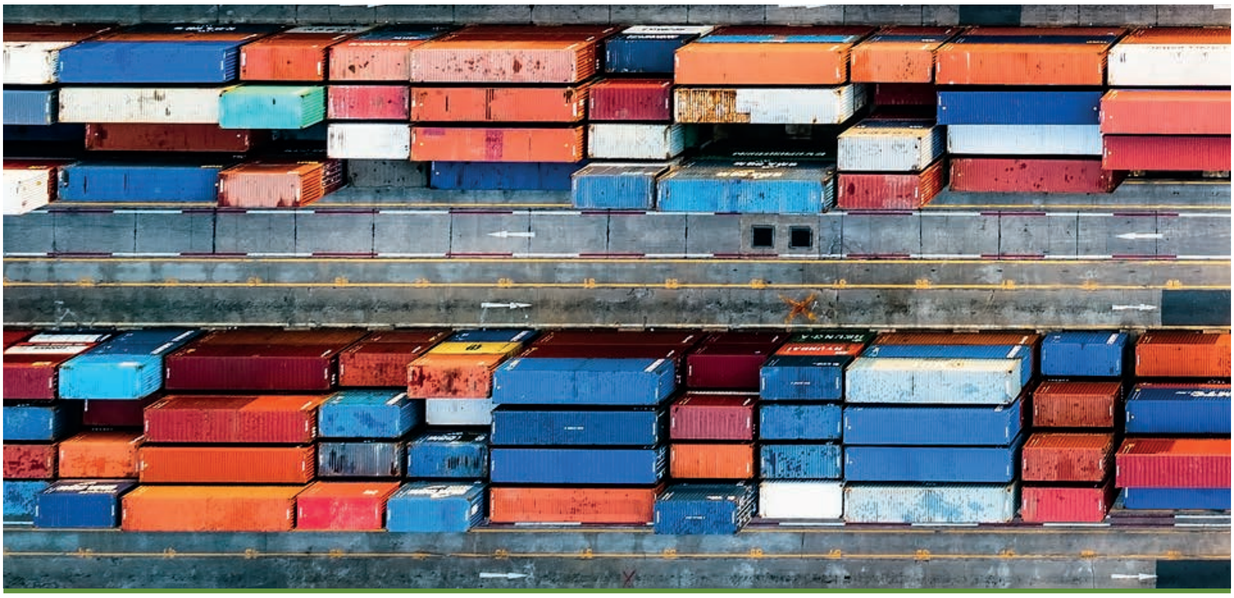
Given our focus on cultures and people behind businesses, gender diversity continues to be an area of engagement for us with many of the companies we invest in. The solutions to bring about change are long term and require incremental changes to deliver tangible outcomes. We expect to continue having these conversations with companies over the next few years, and to continue learning from their successes ourselves.

Insights from Halma's approach to diversity

- Senior leadership commitment
- Shared purpose and mindset
- Inclusion comes first, no point having more diversity if it isn't heard
- Focus on IQ and learning agility in recruitment, not having done a specific role for x number years
- Manage recruiters very actively
- Practical, behaviour based learning - just highlighting bias doesn't change it
- Breakdown gender role norms - e.g. parental leave and flexibility
- Continuously monitor both the types of roles and career progression to manage pay gap

[1] Source: Halma company data.

Source for company information: Stewart Investors investment team and company data. This stock information does not constitute any offer or inducement to enter into any investment activity.



A regulatory update

2020 saw regulatory developments in sustainable finance reach new levels globally, but particularly in Europe. These developments, combined with a global pandemic, unprecedented wildfires, and a renewed focus on social movements like Black Lives Matter, put sustainable finance under the spotlight more than ever.

ESG and sustainability now form a central plank of the European approach to financial regulation. The intention is that financial services firms, particularly asset managers, play a key role in the allocation of capital to businesses that will drive the transition to a low carbon and more sustainable economy.

The policy agenda, known as the EU Sustainable Finance Action Plan, includes mandatory reporting and disclosure regulations in the form of the Sustainable Finance Disclosure Regulations (SFDR). This set of regulations has been an important focus for the Sustainable Funds Group over the last several months. The SFDR establishes a hierarchy of self-assigning fund categories based on investment focus. Two categories in the product hierarchy are relevant here.

- **Article 8** funds are those that promote environmental or social benefits, among other things, but whose core objective is not to achieve specific ESG impacts. Article 8 funds will have to state in fund documentation, including the prospectus, that they do not have a sustainability objective.

- **Article 9** funds are those with a clear sustainable investment objective, incorporating both environmental and social aims, and that also meet various sustainability-related disclosure and reporting requirements.

The consultation on the legislation only closed last September. The technical guidance on implementation is only expected in the early part of 2021. Yet the EU Commission have made March 2021 the deadline for pre contractual (Level 1) disclosures regarding sustainability.

We are working to ensure all existing and planned funds in our vehicle for European clients are Article 9 compliant by the deadline. This does not require any change to our investment approach, but it does require us to change the way we explain and illustrate the sustainable development benefits of our approach. Examples of steps we have taken include our work on Project Drawdown, Human Development Indicators and our interactive map which provides information on the investment rationale for every company we invest in, the contribution it makes to sustainable development, key risks and engagement topics.

What does Article 9 require us to do?

We do not need to change our Investment Objective in the prospectus, but we will add to the descriptions of our Investment Policy and Strategy:

- A description of the sustainable investment objective

- An explanation of how the investments we make do not significantly harm the sustainable investment objectives. We refer to our Position Statement on harmful and controversial products and services which we published last year, in which we define the harmful business activities we avoid as a result of our bottom-up investment process.

- A list of sustainability indicators we will report against (these include carbon emissions, CEO pay ratios, board gender diversity and employee engagement). Our initial choice of indicators was based on relevance, data availability, and alignment with the core metrics we had already decided to start reporting against.

From January 2022 it will be mandatory to start periodic reporting on how Article 9 funds meet their sustainability objective (Level 2 disclosures).

We have updated and filed our European prospectus and will make further refinements if necessary when the SFDR legislation is finalised.

How does SFDR align with other ESG and sustainability regulatory developments?

We are very supportive of regulators addressing sustainability issues. We think they have a vital role to play in creating greater clarity for investors and encouraging more capital to flow towards sustainable investment. But without closer international collaboration and better integration of regulatory initiatives, the main outcome will be a simple proliferation of regimes, rules, definitions and acronyms.

A current example of the need for closer regulatory integration is the contradiction between the SFDR and the Hong Kong ESG regulation. Green or ESG funds authorised by the Securities and Futures Commission of Hong Kong must have as their key investment focus one or more of the globally recognised ESG frameworks or principles, such as the UN Global Compact and UN Sustainable Development Goals (SDGs), and these must be reflected in their name and investment objective or strategy. While we report against a number of these principles and frameworks, the results are very much an outcome of our investment approach rather than a key investment focus.

Our more eagle-eyed clients may notice that we have opted to include a statement in our European client vehicle prospectus that we do not meet the requirements for ESG status in Hong Kong. The reason for this is that we think sustainability investing is bigger and broader than just ESG investing as it is currently defined by the Hong Kong regulator. This may cause some confusion given our (hopefully) concurrent Article 9 status confirming we have social and environmental investment objectives at the heart of our investment approach.

The Hong Kong regulator acknowledges that their regulation is a first step to enhance disclosure standards, and that they want to be mindful of various local and international regulatory developments. We hope that their approach and that of the European Commission will converge, so that things become clearer and more consistent for clients and all other stakeholders.

What about Brexit and the UK?

In 2019 the UK government published its Green Finance Strategy, which declares the UK's intention to match the ambitions of the EU's Action Plan. Detailed initiatives have yet to be disclosed and we do not expect the SFDR regulation to be implemented prior to 2022. As a result, we expect there will be a temporary misalignment in the investment policy and strategy between our UK and European product platforms. This is not ideal, but we want to be as proactive as we can on every regulatory front, even if this risks the appearance of uneven progress and temporary variations in our messaging across different product platforms.

How does SFDR relate to the Green Taxonomy?

The Green Taxonomy regulation forms part of the disclosure requirements of the EU Sustainable Action Plan, but it is not the same thing. The EU Taxonomy Regulation is a unified classification system for business activities that can credibly be called 'green' or 'sustainable' without doing any significant harm or breaching minimum social safeguards. We hope to have Article 9 funds that are contributing to environmental objectives and from January 2022 we will also need to disclose whether they are contributing to climate change mitigation and adaptation according to the taxonomy, and the extent to which the underlying investments comply with the taxonomy.

The activities that count as contributing to climate change mitigation and adaptation comprise a very small proportion of many sustainable funds. As mentioned in our Project Drawdown article, the MSCI analysis of our Worldwide Sustainability strategy and its green/unsustainable revenue split found that we have zero exposure to unsustainable revenues but only 2.5% exposure to 'green' revenues; the only plausible explanation for this very low number is an extremely narrow definition of what counts as 'green'.

In summary, we are very supportive of the ambitious European strategy to direct more capital to sustainable investment, and of the steps being taken to improve transparency around how funds disclose their sustainability characteristics. However, as mentioned in our response to the European Sustainable Finance Consultation last summer, we cannot iterate enough the importance of a coordinated global approach based on principles, rather than a prescriptive legislative framework.

We believe a combination of clear principles and sufficient room for diverse approaches is the best way to encourage innovation. It might also lead to improved transparency and more rigour around sustainability claims, which would be beneficial for the industry and the long-term future of sustainable investing.

Team update

We are delighted to welcome two new investment analysts to the Sustainable Funds Group.

In November 2020, Hanna Ranstrand joined the team based in Sydney. Hanna holds an MCom with Excellence in Global Sustainability and Social Enterprise from the University of New South Wales and a BCom in Finance from McGill University. Hanna had previously gained internship experience with the Sustainable Funds Group in Singapore, Edinburgh, London and Sydney. She also completed an internship with Jiarong Technology, a Chinese company that develops membranes for wastewater treatment.

In January 2021, Anya Prakash joined the team based in Edinburgh (albeit remotely due to current circumstances). Anya gained internship experience with Stewart Investors in 2018. She holds a BA in Philosophy from Wellesley College, Massachusetts, and a Graduate Diploma in Law from City University of London. She also completed an internship with asset management firm Grantham Mayo Van Otterloo & Co. in September 2016 and has gained professional experience working for law firms in Singapore and London.

Both Hanna and Anya are responsible for generating investment ideas for the sustainability strategies across all sectors in both emerging and developed markets.

New Morningstar Environmental Social and Governance (ESG) Commitment Level – Stewart Investors awarded their top accolade of ‘Leader’

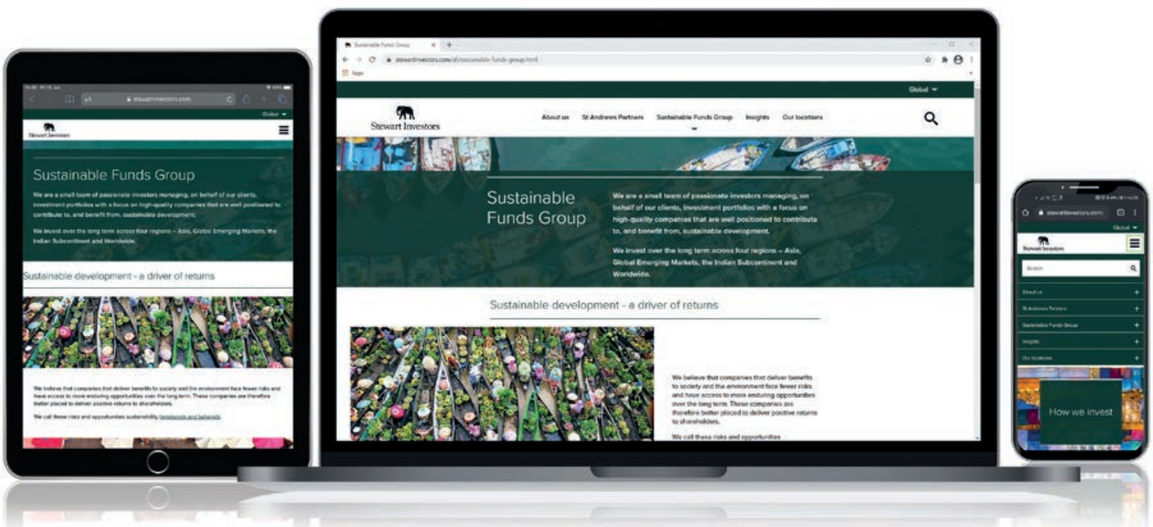
We are pleased to share that Morningstar, the independent financial research and ratings firm, has awarded Stewart Investors the top accolade of ‘Leader’ for their new ESG Commitment Level.

Morningstar assessed 100 plus strategies and 40 asset managers to analyse how they incorporated ESG factors into their investment processes and organisations. We are delighted to see the emergence of a more qualitative approach when considering the ESG credentials of asset managers and their investment strategies.

New Stewart Investors website

During the year we have been upgrading our website. These changes went live in December and we hope provide an improved and more interactive experience for you.

https://www.stewartinvestors.com/



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