J. STERN & CO.

The Value of Long-Term investing

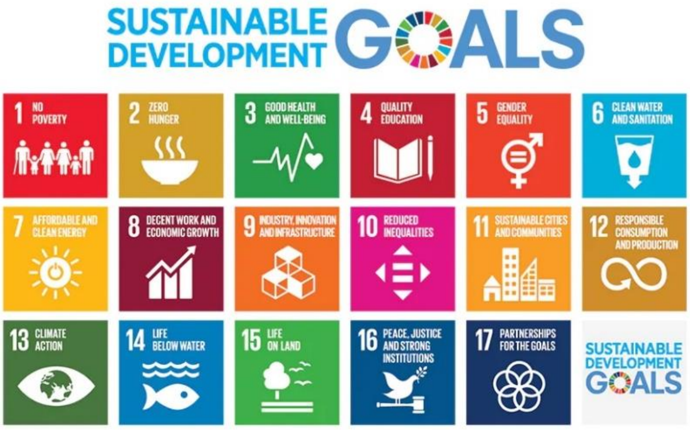
Insight

Quality and Sustainability as Drivers of Long-Term Returns:

OUR ROADMAP FOR SUSTAINABLE INVESTING

Our investment philosophy at J Stern & Co. builds on the tradition of the Stern family and its 60-year, multi-generational track record of investing for the long term. The family's guiding principle as we have always highlighted is investing in quality and value, seeking long term real returns across economic and market cycles, based on our own in-house, independent research. Quality is the foremost requirement for the companies we invest in.

We define quality as investing in companies that participate in attractive industries, which hold leadership positions in those industries, and that have a strong and sustainable competitive advantage or a deep and enduring moat as Warren Buffett would say. Governance forms part of that definition. We look for strong management teams with a proven track record, engaged, independent boards and oversight structures that ensure shareholder interests are protected.



At the same time, we have always recognised that companies do not exist in a vacuum but are part of a nexus of environmental and social influences that mean that they are subject to a social licence to operate. We believe that it is critical for us to understand and incorporate this broader perspective in our analysis. Investing for the long term and across generations makes a social licence particularly important because it is founded in structural influences and regulatory and reputational risks that a more conventional financial analysis would not capture.

Sustainability and Investing for the Long-Term

The clue is in the name, as it were. In order to have a sustainable competitive advantage, companies have to operate in a sustainable way. This has always been our approach, but over the last few years we have seen issues of sustainability, transparency and accountability grow in importance, with the broader investment community being asked by both clients and other stakeholders to better understand what outcomes companies are delivering for broader society.

Climate change and the existential challenges it poses has been one of the primary drivers of this higher awareness. The use of plastics, especially single-use, and the degradation of our oceans has been another visible case in point of the failure to properly control externalities. Fair treatment of employees, suppliers and customers and transparent and sustainable sourcing of raw materials all form part of the sustainability of a business.

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At the same time, high profile cases of companies prioritising the bottom line and failing to make the investments needed to ensure their long-term sustainability are adding to the pressure. Californian utility PG&E and its failure to properly maintain equipment such as power lines led to a series of wildfires in 2017-18, claiming lives, destroying property and devastating the local habitat. It led to over $15bn in settlement payments to victims and regulators, and the eventual bankruptcy of the company itself.

UN Sustainable Development Goals

The United Nations have worked to establish goals for global sustainable development that provide a blueprint to achieve a better and more sustainable future for all. These goals address global challenges, including poverty, inequality, climate change, environmental issues, peace and justice. They constitute agreed principles that aim to tackle global challenges and issues by 2030 and provide a roadmap for government, business and social actors to commit in delivering solutions. As a globally agreed sustainability framework, we believe that the UN Sustainable Development Goals (UNSDG) provide the clearest framework for us to apply both to the companies we invest and to our work as investors.

The crucial question we must answer is whether the companies we invest in are working to advance the UNSDG and what we can do as investors to assess a company's Environmental, Social & Governance (ESG) performance, understand the engagement and commitment in tackling ESG-related issues and to encourage them to address issues in a timely and determined way.

There are many industry organizations, rating agencies and other institutions that are part of an important, dynamic but disparate effort at creating and implementing criteria and frameworks for sustainable investing. We believe that the discourse about sustainable investing will increasingly focus on the UNSDG and we will be called on to answer the challenge they pose: What are companies and investors doing to achieve a better and more sustainable future for all?

UN Principles of Responsible Investing

The global investment management industry has translated this call to action into a new framework of investment analysis that not only incorporates financial metrics but also embeds ESG factors in this analysis. Indeed, since the establishment of the UN Global Compact in 2005 and the release of the Principles of Responsible Investing in 2006 (UNPRI), ESG integration has become an integral part of the investment industry, with 1,900 firms managing over $89 trillion in assets joining the signatories, recognising that ESG issues can affect the performance of investment portfolios.

As part of this recognition the investment industry has also seen a progressive change in the way ESG is being implemented as part of the investment processes. Historically ESG was applied through the utilisation of exclusion criteria, where certain sectors or companies seen as not desirable from an ESG perspective were simply excluded from the investable universe. Increasingly however it is being recognised that ESG issues affect companies across sectors and industries and require a more differentiated approach. As global issues challenge business models across the global economy, it is necessary to progressively integrate ESG factors into fundamental financial analysis. We strongly believe in this approach. ESG analysis and integration is about identifying and quantifying risks, engaging with companies to address and redress them, but it is also about articulating potential opportunities.

Material ESG Factors

An important part of our ESG analysis is to use a structured approach which is compatible with global best practice and broadly based on an industry-leading framework. Having studied different options, we chose the Sustainability Accounting Standards Board (SASB) criteria. SASB is a non-profit organisation founded in 2011 and supported by some of the largest asset owners and managers to develop industry-specific reporting standards across environmental, social and governance topics. It uses an objective, verifiable and comparable set of criteria to identify material issues for each industry which we complement with our own judgements. With this process we identify risks and opportunities and assess how effectively they are being managed by the boards of the companies in which we invest.

SASB focuses on issues that have the potential to affect corporate value, are reflective of broader stakeholder consensus, are industry specific and are actionable by companies. These issues or 'dimensions' are mapped across major industry groups in a materiality map. The issues encompass five broad areas:

- Environmental - This dimension looks at the use of non-renewable resources as inputs to the production process and at harmful externalities to air, land, and water resources. It includes issues related to greenhouse gas emissions, air quality, energy management, water and waste management as well as biodiversity impacts.

- Social Capital - This dimension relates to the expectation that a business will contribute to society in return for a social license to operate. It addresses the management of relationships with key stakeholders, such as customers, local communities and the government. It includes issues related to human rights and community relations, access and affordability, customer welfare, data security, privacy, fair disclosure and labelling, as well as fair marketing practices.

- Human Capital - This dimension addresses the management of a company's human resources as a key asset to delivering long-term value. It includes issues that affect the productivity of employees, such as diversity and inclusion, compensation and benefits, as well as recruitment and retention in industries which are highly competitive for specific talent or skills. It also addresses working conditions, the management of labour relations in industries that rely on economies of scale and in industries with legacy pension liabilities. Finally, it includes the management of the health and safety of employees especially for companies that operate in dangerous working environments.

- Business Model & Innovation - This dimension addresses the impact of sustainability issues on innovation and business models. It addresses the integration of environmental, human, and social issues in a company's value-creation process, including resource recovery, product or production innovation, and efficiency and responsibility in the design, use and disposal of products.

- Leadership & Governance - This involves the management of issues that are inherent to the business model in an industry and that are in potential conflict with the interests of broader stakeholder groups, and therefore can create a potential liability, a limitation or even a removal of a license to operate. This includes regulatory compliance or political influence. It also includes systemic risk management, safety management, supply-chain management and materials sourcing, conflicts of interest, anti-competitive behaviour, corruption and bribery.

In addition to this framework and to have a more specific focus on an issue we think is of great importance to us as investors, we use an additional J. Stern & Co. proprietary Corporate Governance dimension focusing on the principal-agent relationship, and how the rights of shareholders as stakeholders are protected. As part of this analysis we look at board structure, management oversight, separation of CEO and Chairman roles, executive compensation and shareholder voting rights amongst other factors.

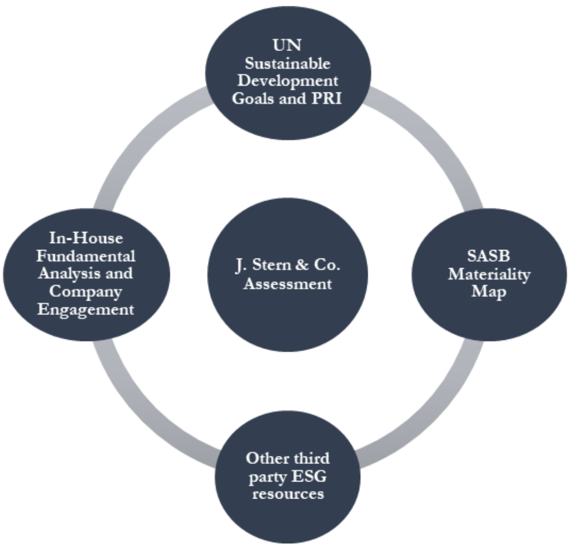
We believe that using the SASB materiality map as framework for our own fundamental assessment allows us to have a consistent approach to our analysis across different industries and geographies as well as across different sustainability issues. It also allows us to refer to other third party ESG resources that follow the SASB materiality map.

Corporate Commitments

Also important for us is whether our companies have made public commitments in terms of ESG and whether they are signatories to key international initiatives. Specifically, we look at whether our companies are signatories to the UN Global Compact and whether they have aligned their strategy with the UNSDG. The UN Global Compact is a commitment for companies to operate in ways that meet fundamental responsibilities in the areas of human rights, labour, environment and anti-corruption. Over the long-term it invariably means companies working to achieve the goals of the UNSDG not just in strategy but in outcome as we have discussed.

Tangible Outcomes

We look to identify the most material issues for each industry we invest in and have completed stock-specific analysis for each of our holdings. We map material issues, analyse what each company does to manage those risks and then come to a conclusion as to whether these constitute an opportunity or a risk that can affect the company's performance and value in the short, medium and long-term.



We base our assessment primarily on our own internal analysis, leveraging our research team's breadth of experience and in-depth industry understanding whilst consulting third party ESG providers where appropriate to complement our views. In doing so we focus our analysis particularly on those ESG issues that we believe are likely to have the most significant impact on the companies' operational and financial performance.

Direct engagement with company managements is a core part of this process. Having identified those ESG issues most relevant to a company's success, we raise them where appropriate with the management. As with our engagement on other strategic, operational and financial issues, this allows us to gain a better understanding of company initiatives whilst providing management with feedback where we think there is scope for improvement.

The output of our analysis is a traffic light matrix for the six overarching themes, highlighting achievements and opportunities as well as risks and areas for improvement for our holdings. We use materiality to measure the impact on the strategic, operational or financial performance of a company. The final category 'Not Material' does not imply that issues affecting a given criteria are not important to the industry, company or to the stakeholders involved. Rather it means that in our assessment it is not one of the critical issues and therefore does not need to be analysed through our own in-depth research.

Well framed and strongly managed ESG issues	
Some gaps in ESG management, but overall well managed	
Managed ESG gaps but further action required	
Acknowledged but no ESG policies in place	
Disregard of ESG issues & significant controversies	
Not material for the industry	

Company Examples

The best way to illustrate our process is through specific stock examples.

Nestlé has been a core holding in our portfolios over decades. The company's strong level of ESG engagement has been reflected in its LEAD status as a highly engaged participant of the UN Global Compact. The company is recognizing and managing issues that could materially affect the business and is part of numerous organisations that aim to enhance the protection of natural resources, including the Alliance for Water Stewardship and the Responsible Palm Oil Roundtable. Notably it also has numerous initiatives in place to enhance consumer welfare, improve nutrition (including its pioneering Nestlé Health Science business) and raise awareness on health and wellness.

However, it is not without its controversies. In Nestlé Waters the company has to resolve critical issues such as the management of water resources and the depletion of local reservoirs. And across most of Nestlé's business, the effects of plastic packaging on the environment is of great importance both in terms of environmental impact, consumer perception and brand value. As part of its effort in tackling these issues we are encouraged to see the company has created the Nestlé Institute of Packaging Sciences with the aim of achieving 100% recyclable or reusable packaging by 2025 and the announcement of a concrete CHF 2 billion of investment to achieve that target. Plastic packaging is a topic that requires urgent action that resonates with consumers and has real risks for Nestlé and its brands, which is why we monitor it closely.

Environment	Social Capital	Human Capital
Business Model & Innovation	Leadership & Governance	JSC Corporate Governance

Amazon has been a flagship investment in our portfolios. It is the leader in e-commerce and cloud computing. Both industries also are subject to significant ESG considerations and it is important that as the industry leader, Amazon takes responsible action. In e-commerce, Amazon has created initiatives such as Frustration-Free Packaging in order to reduce packaging waste and materials. The company also joined the Sustainable Packaging Coalition for a more robust environmental vision for packaging.

Amazon has set its own sustainability goals through its Climate Pledge as it aims to meet the Paris Agreement 10 years early. Of note, the company aims to be net zero carbon across its business by 2040 and to be 100% supplied by renewable energy by 2030. However, Amazon has faced criticism, especially for the working conditions in its fulfilment centres and labour practices. The company is addressing these with initiatives to promote a fairer wage, safer workplaces and to promote diversity amongst employees. We will continue to track Amazon's progress in improving the working environment for its employees.

Environment	Social Capital	Human Capital
Business Model & Innovation	Leadership & Governance	JSC Corporate Governance

EssilorLuxottica is another core investment in our portfolios. It is the global leader in the design, manufacture and distribution of ophthalmic lenses, frames and sunglasses. It was formed in 2018 by the merger between Essilor and Luxottica. The company is putting ESG matters at the heart of its operations. It is actively promoting access to healthcare through many initiatives to disadvantaged and low-income groups.

In 2018, it joined the Vision Catalyst Fund which aims to provide sustainable solutions for eye health and has donated 200 million pairs of lenses since joining. In terms of environmental footprint, Essilor has reduced its water intensity by 21% and energy intensity by 7% from its 2015 baseline. The company is now included in several ESG indices such as the MSCI World ESG Index, MSCI Europe ESG Index and FTSE4Good Index.

Environment	Social Capital	Human Capital
Business Model & Innovation	Leadership & Governance	JSC Corporate Governance

However, the company has had ESG issues in the past. Last year, the very public dispute between the Executive Chairman Leonardo Del Vecchio and Executive Vice-Chairman Hubert Sagnieres resulted in a negative share price reaction. We have reached out to other shareholders and people close to the company to discuss our views. The issue is being addressed by the board and contained in a way that has allowed the company to focus on its business even if it is not yet fully resolved given the succession issues that are at its core. Although an agreement has been reached to resolve the dispute, we are continuing to monitor the company in terms of governance.

Part of the Global Investment Community

We believe that we are most effective when we act alongside our peers to push through change in the industry by echoing a collective voice and commitment. Our process is consistent with emerging best practice codes, including the UNPRI and the UK Stewardship Code, and we have signed up our firm to both initiatives.

The UN is a leading proponent of responsible investment. It has adapted the UNSDG to the investment management industry, created a common definition of understanding of ESG factors that have implications for investment, and provides support to its network of investor signatories in incorporating these factors into their investment and stewardship decisions. The 2012 UK Stewardship Code aims to enhance the quality of engagement between investors and companies by setting out a number of principles of effective stewardship for institutional investors.

And as part of our collaboration with the Sustainability Accounting Standards Board, we are also in the process of joining the SASB Alliance to formally engage in the development of best practices in integrating sustainability information into investment processes. Like other members of the Alliance we share the belief that today's capital markets need standardized sustainability disclosure and effective ESG integration into investment practices, for the benefit of issuers, investors and society at large.

Pathway Ahead

In summary, we are proud to join a wider community of institutional investors in articulating our commitment to environmental, social and broader governance factors. Indeed, as part of this journey, we look forward to broadening our scope and building on our approach in the year ahead ensuring that our clients' wealth and society's resources prosper for the next generations.

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