J. STERN & CO.

The Value of Long-Term Investing

Investment Insight

SUSTAINABILITY ³ – REFLECTIONS ON A YEAR OF ESG IMPLEMENTATION

Last year we outlined our Roadmap to Sustainable Investing. It has been a tumultuous year for the global economy and the markets, but also a year in which our approach of investing in quality companies that have strong and sustainable competitive positions in good and growing markets, with strong managements and solid balance sheets, has been validated by the returns they have been able to generate.

The resilience of the companies we have invested in has also reinforced our conviction that sustainability, quality, and value are closely linked and that we should think about our investment approach in terms of triple sustainability, or even better Sustainability³ — a company that achieves a high level of ESG sustainability should strengthen the sustainability of its competitive position and improve its prospects for generating sustainable value over time. It is a concept that is integral to our investment approach and that we should perhaps seek to trademark…

During this last year we have put into practice the ESG process we have integrated into our investment analysis. We have worked to define and analyse in a much more detailed way the policies and practices of the companies we have invested in and have quantified a number of aggregate portfolio metrics to measure the overall ESG performance of our World Stars Global Equity strategy.

The starting point: Alignment with the UN SDGs

As we outlined in our roadmap in January 2020 our starting point is the UN's Sustainable Development Goals. These provide a blueprint for achieving a better and more sustainable future for all by addressing 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 that government, business and social actors are asked to commit to in order to deliver solutions.

World Stars Companies Alignment to the SDGs

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As a globally agreed sustainability framework, we believe that the UN Sustainable Development Goals (UN SDG) provide a clear and compelling framework for us to apply both to the companies we invest in and to our work as investors.

Looking at our World Stars holdings, 15 of our companies have a clear roadmap to addressing one or more of the 17 SDGs, with the majority focusing on seven or more goals. The most commonly focused targets are Climate Action, Responsible Consumption & Production, Decent Work & Economic Growth and Clean Water, followed by Equality, Good Health & Wellbeing and Quality Education. These are tangible areas in which corporates can work to make a difference, either through their products and services, through their role as employers or through social engagement programs, fostering better societal outcomes, tackling externalities and systemic issues. They represent both opportunities and risks.

But helping to create change goes beyond mere alignment. As signatories to the UN's Principles of Responsible Investment and the UK Stewardship Code, we are being called upon to seek tangible outcomes ourselves and demonstrate what our investee companies are doing to tackle common challenges. That is why we are increasingly focused on whether the companies we have invested in have specific targets in place to achieve those outcomes and how they measure them.

L'Oréal, the global leader in cosmetics, is a good example of a company whose sustainability strategy is outcome driven. The company formally aligns itself with 14 SDGs. Each of these alignments is accompanied by tangible commitments and specific targets. Plastics and packaging pose one of the key challenges for consumer goods companies and L'Oréal seeks to address that by identifying UN SDG 12, Responsible Production and Sustainable Consumption, as an area of focus. To achieve this the company has multiple quantitative and time-defined targets: L'Oréal has committed that 100% of its plastic packaging will be refillable, reusable or recyclable by 2025, that 100% of the plastics used in its packaging will be from recycled or bio-based sources by 2030, and that by the same date it will reduce its packaging intensity by 20% whilst sending zero waste to landfill.

Similarly, for our food & beverage companies the challenge is how to meet increased demand whilst preserving natural habitats. Pernod Ricard, the owner of iconic brands like Chivas Regal whiskey, Martell cognac and Absolut vodka, has placed a particular focus on UN SDG 15, Life on Land, which aims to focus on the sustainable use of terrestrial ecosystems, halting and reversing land degradation and biodiversity loss. Pernod has championed a targeted approach focused on fostering biodiversity, a reflection of its role as a business that sources ingredients from 250,000 hectares of land globally. The company is therefore targeting that by 2030, 100% of its affiliates will have a strategic biodiversity project, addressing the most pressing local issues. At the same time, the company is planning by 2025 to develop regenerative agriculture pilot schemes within its owned vineyards in eight wine regions, Argentina, California, Cognac, Champagne, Spain, Australia, New Zealand and China. These aim to mimic natural processes to improve the quality of topsoil, watersheds and ecosystems, with the target of then sharing these learnings with 5,000 farmers globally.

These plans are selective, they do not solve all problems and they leave much work to be done. However, they are part of an important overall commitment to the SDGs, they constitute a credible contribution to the global effort of addressing some of the world's common challenges and they illustrate the vital role that businesses can play in the process.

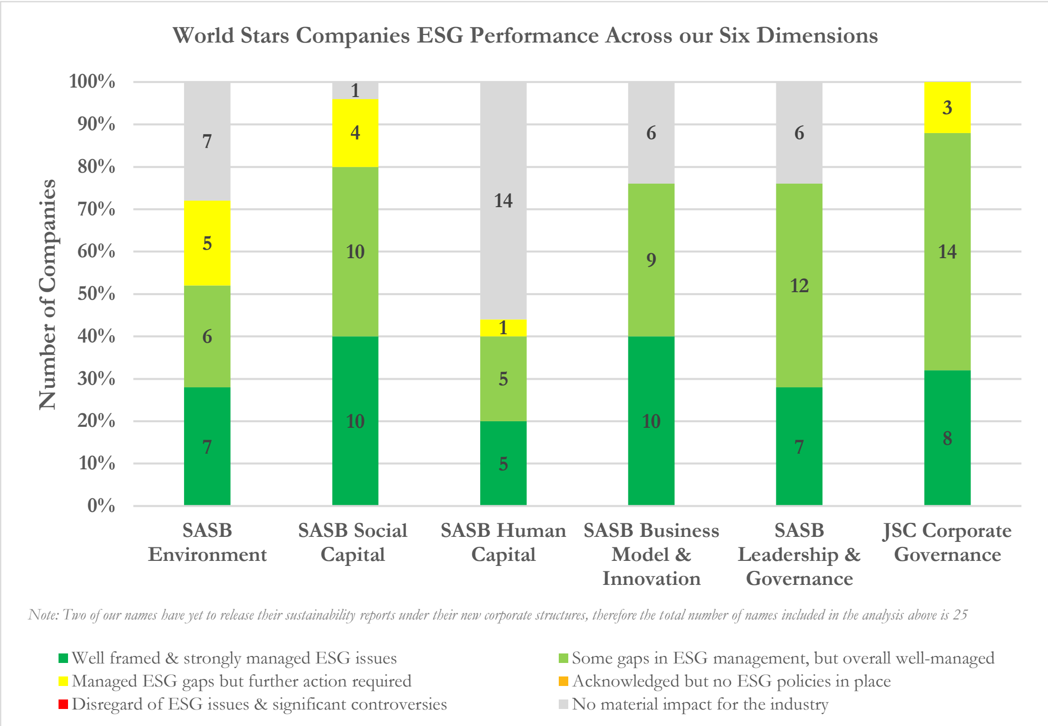
Beyond the UN SDGs: Materiality in Environment, Social and Governance issues

The next level of our investment analysis centres around understating more deeply the effect of ESG factors on the revenues, costs and valuation of our holdings. As we outlined last year, we have chosen to base our in-house analysis on the Sustainability Accounting Standards Board's (SASB) materiality framework. SASB is a non-profit organisation, supported by some of the largest asset owners and managers globally, that is seeking to develop best practice in sustainability reporting. It uses an objective, verifiable and comparable set of criteria to identify material issues for each industry. These are aggregated in five areas or dimensions, Environmental, Social Capital, Human Capital, Business Model & Innovation and Leadership & Governance.

SASB ALLIANCE
ORGANIZATIONAL MEMBER

SASB excludes traditional corporate governance from its Leadership & Governance dimension because it does not want to duplicate the significant body of standards that exists for this factor. In order to include traditional corporate governance in our ESG process and the ESG reports we produce, we complement these with 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, an area of special importance for us as investors.

Finally, we look at adherence to international norms, like the UN Global Compact or the recommendations of the Task Force for Climate-related Financial Disclosures (TCFD). Our aim is to identify risks and opportunities and assess how effectively these are being managed by the boards and managements of the companies in which we invest.



We base our assessment primarily on our own internal analysis, leveraging our research team's breadth of experience and in-depth industry understanding. 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.

Over the last year, we have used this framework to map out material issues for our World Stars holdings, analysing what each company does to manage the risks and then conclude 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.

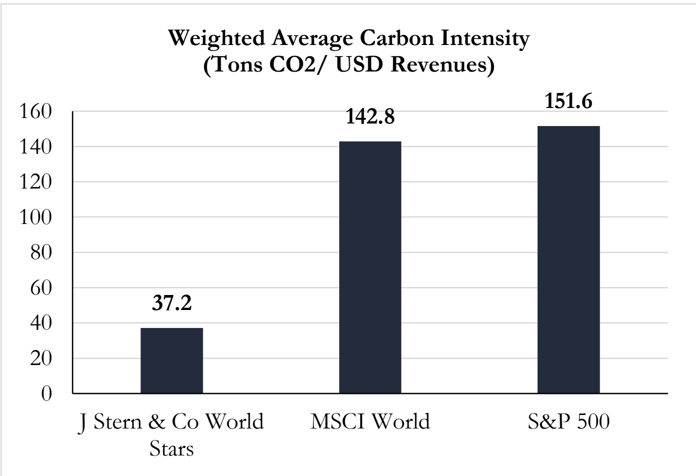
The output of our analysis is a traffic light matrix for the six overarching dimensions, highlighting achievements and opportunities as well as risks and areas for improvement for our holdings.

We are encouraged that our analysis has concluded that our companies, to a large extent, have identified sustainability risks appropriately and have implemented policies and practices to mitigate risks and take advantage of opportunities. A detailed review of every factor and every company would be outside the scope of this insight, so in the following sections we focus on two issues, Carbon Emissions and Diversity & Inclusion practices. These showcase the outcome of our analysis and illustrate how we have leveraged on this research to push our investee companies for better outcomes where needed.

Quantifying ESG Issues: Environmental Factors and Carbon Emissions

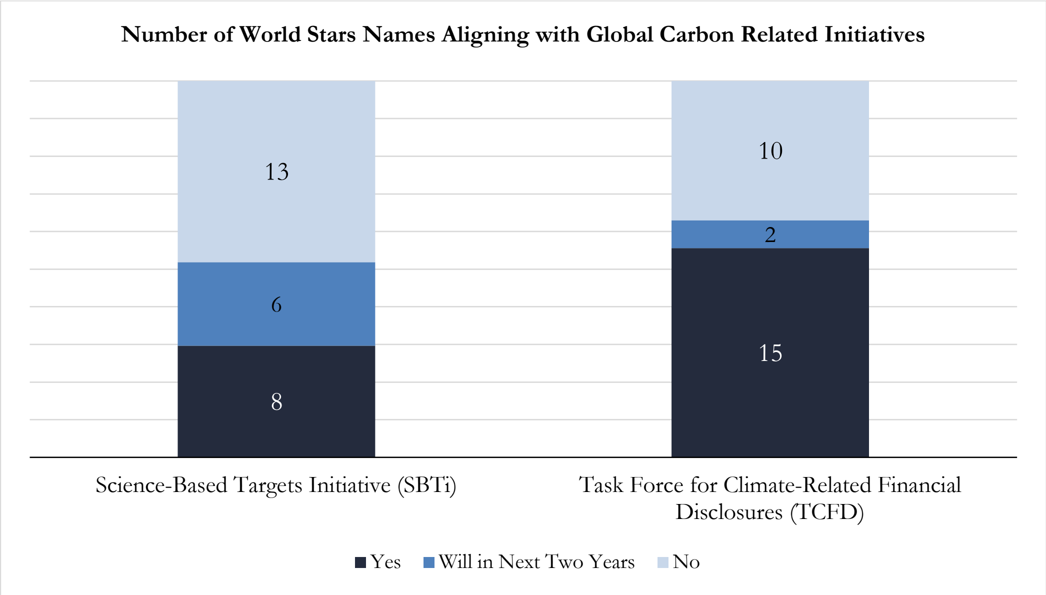
Of course, the biggest challenge of our generation is climate change. The challenge is clear not only for the planet but also for corporates that are increasingly called upon to implement both mitigation and adaptation measures to tackle climate change and deal with ever more complex regulatory requirements. These initiatives increase costs for the businesses but future-proofs them for the decades ahead, reducing the risk of reputational damage, consumer backlash or financial sanctions.

Analysing these issues has been a key area of focus for us during the last year. We have researched the carbon footprint of our holdings, targets for greenhouse gas emissions and the policies they have put in place to achieve those targets. It also includes their alignment with emerging international norms, in particular the Task Force for Climate-related Financial Disclosures (TCFD) and the Science-Based Targets Initiative (SBTi). The TCFD has been established under the direction of the Financial Stability Board to develop



Source: JSC World Stars Bloomberg Scope 1&2 Emissions; MSCI World & S&P 500 BlackRock iShares recommendations for more effective climate-related disclosures. Its recommendations are structured around four key pillars, governance, strategy, risk management and metrics & targets. The SBTi brings together the UN Global Compact, the World Resources Institute, the CDP (formerly the Carbon Disclosure Project) and other parties to promote best practice in emission reductions and net-zero targets.

The results of our analysis are encouraging. Reflecting strong performance in environmental practices but also our focus on asset light, intellectual-capital rich companies, the carbon footprint of our World Stars strategy is significantly lower than that of the broader market. It is also encouraging to see that 15 of our holdings have already aligned themselves with the TCFD recommendations, whilst eight of our holdings already have Science-Based Targets in place and another six are looking into doing so in the next two years.

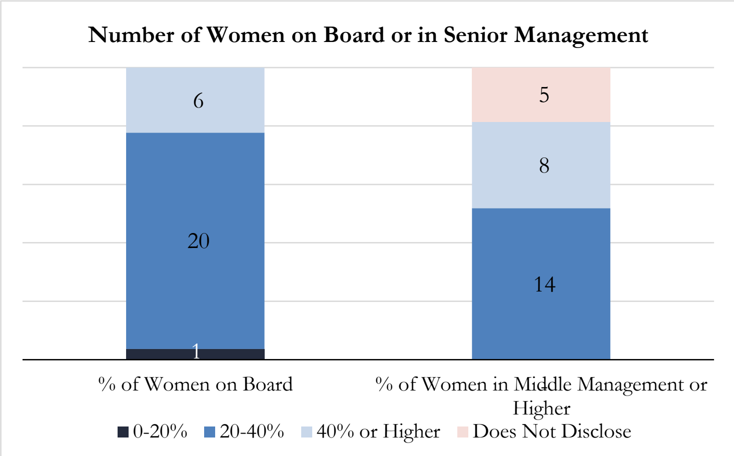


We have seen determined actions to drive better environmental outcomes. Alphabet is a case in point. The company's growth is contingent on an extensive global network of data centres with ever-increasing energy demands. Alphabet has proactively sought to tackle the energy and greenhouse gas implications. It became carbon neutral in 2007 and was the first company of its size to match 100% of its electricity consumption with renewable energy in 2017. Today, Alphabet is the world's largest corporate purchaser of renewable energy. It intends to fully decarbonize its electricity supply and operate on 24/7 carbon-free energy by 2030.

Pushing for Broader Representation: Diversity & Inclusion as Aspect of Human Capital & Governance

Diversity & Inclusion has been another area of key focus for us. This reflects our belief in the particular importance that talent management constitutes for knowledge-based, intellectual capital-rich industries where the bulk of our investments lie. But it also reflects the fact that the ability of a company to meet the challenges posed by a global multi-cultural business environment and client base pose, is contingent on the ability to leverage talent from all parts of the organisation, including gender, nationality and other factors.

We are encouraged that within our World Stars portfolio, 33% of board members are women, ranging from 57% at L'Oréal to 12% at Sika. This is better than the 28% level for the S&P 500, though more in line with the FTSE 100 at 33% level. Female representation at middle or higher management is at a 38% level in the World Stars, providing a good basis in terms of talent pipeline, though clearly with room for improvement. Although gender is only one aspect of diversity, it is one of the more widely disclosed metrics, and we are buoyed by progress in this area. We are also encouraged that our holdings have well-articulated targets in this area. For example, Pernod Ricard and Givaudan are targeting gender-balanced senior management teams by 2030. Nestlé is increasing the proportion of women in the group's top 200 senior executive positions from around 20% currently to 30% by 2022. And Medtronic has moved closer to its 2020 "40-30-20" target, having 40% women in global leadership positions, 30% women at manager level in research and development globally, and 20% ethnically diverse managers in the US.



Not all industries do well in D&I metrics however. The technology industry has faced particular challenges in the area. This is despite the sector's shortage of technically qualified employees, in particular software engineers, who are essential to companies' success. At the same time, the sector faces significant issues of representation at senior management level. We believe strongly that recruiting from and developing diverse talent pools will serve to address some of the talent shortage in the sector, whilst fostering innovation and helping companies understand the needs of their ever-diverse global customer base.

Active Engagement in ESG Issues

Of course actions like those we have described do not mean there is room for complacency. We engage actively with the companies we have invested in and where we believe our companies should take more aggressive action to address some of these challenges, we raise our voice to encourage change. We see this as an integral part of our role as stewards of our clients' capital. Maintaining a constant dialogue with company management is key to how we discharge our stewardship responsibilities and we believe it as a way to maximise shareholder value over the long-term.

In 2020, we engaged with our investee companies on 66 occasions to discuss topics pertaining to their capital structure, strategy, operational performance, and ESG matters, across all levels of management. One notable example related to environmental performance is American Tower, one of the leading global providers of wireless communications infrastructure with a presence in the US and major emerging markets. Our internal carbon footprint analysis flagged American Tower as having a particularly high carbon profile due to the need have diesel generators as backup in locations where the local power grid is unstable, most notably in emerging markets. The issue is an example of the direct clash of multiple SDGs around economic and social development and access to infrastructure and communication, and environmental and climate concerns. Following up on these findings, we discussed the company's recent investments in renewable energy and battery storage during two meetings with its senior management where we gained a better insight in the company's efforts to reduce its carbon footprint without compromising its industry leading return profile.

Where required we will use our voting voice to raise concerns and drive change. In 2020, we voted on a total of 415 resolutions at the AGMs of 22 companies. We voted against the companies' Board of Directors recommendation in seven instances, in line with our voting principles. Five of those instances were related to issues around Diversity & Inclusion, where we voted in support of shareholder proposals for increased disclosure around D&I metrics. Given our strong conviction in the importance of digital transformation as a driver of global growth and our long-term ownerships of several of the largest digital platforms, our votes against the board recommendations of Amazon, Facebook and Adobe were particularly notable. We voted in favour of shareholder proposals requesting better reporting on promotion-related data as well as additional reporting on gender and racial pay levels and will keep pushing for change in our engagements with these companies.

In summary, for us it has been a year of putting our sustainability roadmap into practice, engaging with our investee companies and pushing for change where needed, This work has allowed us to recognize the importance of Sustainability[3], the interaction of the sustainability of ESG policies and practices, competitive position, and prospects for long-term value generation for our investment approach and our ability to generate long-term returns for our investors.

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