

Investment Advisory Committee: Summary minutes

Information on new (and existing) committee members is available from the WHEB website.

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Attendees:

Seb Beloe (Head of Sustainability Research)
 Tim Dieppe (Fund Manager)
 Ted Franks (Associate Fund Manager)
 Hyewon Kong (Senior Analyst)
 Ty Lee (Senior Analyst)

Geoff Hall (Chair)
 Tristan Hilgarth (Adviser)
 David Lloyd-Owen (Adviser)
 Nick Robins (Adviser)
 Ebba Schmidt (Adviser)

Apologies: Ben Goldsmith (Internal Adviser)

A new look committee

This was our first meeting of the new committee and we started off by welcoming new member Tristan Hilgarth who joins Ebba Schmidt on the Committee along with David Lloyd-Owen and Nick Robins as the other two external committee members.

For further information on Ebba and Tristan's backgrounds see (<http://www.whebam.com/team/investment-committee->).

Ebba Schmidt: Investment Manager at the UK Pension Protection Fund (PPF)



Tristan Hilgarth: Former CEO Invesco Europe, and Head of Jupiter Private Clients

Exposure to contentious industries

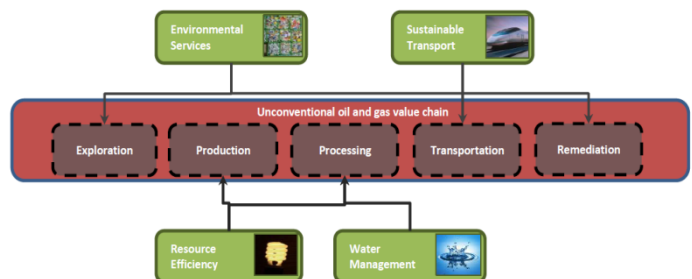
The investment team had prepared a discussion paper following the last committee meeting that set out their approach to limiting the fund's exposure to contentious industries. While all of the companies held in the fund are selected for their exposure to the fund's nine social and environmental investment themes, inevitably, some company revenue does not come from the themes – currently approximately 80% of combined revenues across the fund comes from the nine themes with the remaining 20% coming from other businesses.

Most of this 20% is not in contentious areas, but for a small number of companies, a proportion of their revenue comes from areas that are controversial, for example unconventional oil and gas (e.g. shale gas). The fund does not have any direct exposure to any oil and gas companies nor to companies whose primary business is in oil field services as these companies do not fit in the investment themes. However, some companies that are held in our resource efficiency, water management, environmental services and sustainable transport themes do provide products or services to the oil and gas industry. Unconventional oil and gas activity creates significant negative environmental impacts, and, because all the companies in the portfolio are focused on providing solutions to these and other impacts, the fund does have exposure to areas such as water treatment, environmental consulting, waste treatment and energy efficiency services to the oil and gas industry.

Any other exposure to oil and gas is very limited (in no case representing more than 10% of any individual company revenues) does not involve direct oil and gas exploration or production and is typically not specifically designed for the oil and gas industry but is standard technology that is used across a wide variety of other industries.

The committee suggested that it might be helpful to have an overall 'theme exposure' target for the fund, and an additional test should be that

Theme exposure to unconventional oil & gas activity



Global coal demand may well peak by as early as 2017 due in large part to Chinese policy constraining coal use in order to limit air pollution and carbon emissions.

The WHEB investment process utilises ESG data to identify well-managed companies that are likely to outperform the market over the long-term.

The committee welcomed the initiative and suggested that engagement should be focused on companies where there is a reasonable chance of success.

'more sustainability' (i.e. higher environmental standards etc.) should, as a general rule-of-thumb, benefit each individual company in the fund.

Macro-economics: the commodities super-cycle and prospects for a currency war

The committee was asked for their views on the nature of current commodity prices and whether Japanese monetary policy was likely to create a currency war. Key points made during the discussion were that:

- Commodities in general will continue to be cyclical but that certain commodities are facing long-term structural limits.
- Soft commodities in particular face long-term price inflation due to constrained supply and rising demand.
- Global coal demand may well peak by as early as 2017 due in large part to Chinese policy constraining coal use in order to limit air pollution and carbon emissions.
- High commodity prices are, in the long-term, supportive for the fund which includes companies that supply products and services aimed at increasing resource efficiency, but may also be a head-wind over the short term.
- Shale oil will add significantly to oil supply, but is not 'cheap' oil and this combined with effective supply management by OPEC will likely keep prices relatively high.
- Inflationary policies in Japan appear to have been effective in boosting the country's economy which offers a welcome addition to global growth. Potential negative impacts over the longer-term depend on how long the policy is maintained.

Encouraging better environmental, social and governance (ESG) disclosure

Following discussion at the last committee meeting, the investment team had prepared a second paper setting out their approach to encouraging better ESG disclosure by companies held in the portfolio.

The paper stressed the importance of good ESG disclosure for the WHEB investment process which utilises ESG data to identify well-managed companies that are likely to outperform the market over the long-term.

The team works with other investors including through support for the CDP's efforts to improve corporate reporting on carbon emissions and water risk, by supporting the work of the Sustainable Stock-Exchanges initiative to develop more demanding listing rules and through participation in an investor expert network supporting the development of integrated reporting embracing financial as well as broader ESG information.

Beyond this, the team has also worked bilaterally with individual companies to encourage improved disclosure – work that is detailed in the Quarterly Voting and Engagement reports. However, this has tended to be ad hoc and this year the team plans to develop a systematic approach to encouraging better disclosure across the fund portfolio.

Based on Bloomberg data, the average quality of ESG disclosure is relatively good in the fund (compared to the wider universe) but ranges in individual cases from very good to poor. The proposal is to prioritise companies for engagement where 1) risks associated with environmental and social impact are relatively high, 2) the size of the company (based on market capitalisation) and 3) the quality of ESG disclosure at the company. Where 1) and 2) are high and 3) is low, the company will be considered a priority for engagement. Eight companies in the portfolio met these criteria.

The committee welcomed the initiative and suggested that engagement should focus on companies where there is a reasonable chance of success (eg. UK companies) even where disclosure is reasonable, and should also focus on encouraging better disclosure and performance on key material issues. The committee also suggested that the investment team should be willing to vote against acceptance of a company's annual report and accounts where ESG disclosure is poor. It was also noted that companies with higher activity in contentious sectors such as oil and gas (see previous section) also seemed to have poorer ESG disclosure scores.



The packaging industry plays a key role in both reusing waste materials and in reducing the environmental impacts of logistics.

The committee reviewed other new portfolio holdings, and agreed that these were suitable investments for the fund.

Theme reviews and portfolio holdings

The Committee heard summaries of two recent theme reviews that the investment team has completed since the previous meeting namely on Chinese wind-farms and on the packaging sector which fits in the Environmental Services theme. The committee were interested to hear the rationale for packaging being included as an investable sub-theme. The team acknowledged the controversial nature of packaging, but emphasised that parts of the industry play a key role in both reusing waste materials, and in reducing the environmental impacts associated with logistics of products, particularly in the food and beverage sector. The team had highlighted recycled cardboard as a packaging material that is benefitting from a greater focus on sustainability by retailers and other consumer goods manufacturers. Cardboard is recycled in large quantities, thus avoiding landfill or incineration, is lightweight, substituting for other heavier materials and reducing carbon in transport, and is increasingly available as 'retail-ready' packaging helping to reduce overall packaging use in the supply-chain.

On the basis of this analysis as well as a wider review of the sector, the team started a position in the Irish cardboard packaging company Smurfit Kappa, which recycles over 70% of its cardboard from waste streams in Europe and North America.

The second theme review focused on Chinese wind farmers which fit in the Cleaner Energy theme. China has great ambition for domestic renewable energy generation and four listed wind farm operators have emerged to deliver this ambition. All are growing quickly and have varying degrees of exposure to wind energy. The other challenge, highlighted by the committee, is the relatively poor quality of governance at these Chinese businesses. The investment team elected to invest in China Longyuan Power as the largest, best governed and, in the investment team's view, the highest quality company in the sector. The committee reviewed other new portfolio holdings including Air Methods Corp., Dialight and Nitto Dinko and agreed that these were suitable investments for the fund.



Any other Business

The committee reviewed the Quarterly Voting & Engagement report and applauded the new format and the strength of the commitment to write to every company that the team votes against at company meetings – a policy that few, if any, other asset managers have implemented. The committee recommended a clearer focus in the report on engagement that has generated clear results as the area of most interest to clients.

The next Committee meeting will take place in October which will include an update on the work undertaken during the quarter including on the engagement work being done on risks associated with low corporate tax rates and the team's view on whether the fund should have an overall theme exposure target.

Investment Advisory Committee Members



Ben Goldsmith:
Co-founder of WHEB Group



Nick Robins:
Head of HSBC's Climate Change Centre of Excellence



Geoff Hall:
Chairman of WHEB Asset Management. Former Chief Investment Officer at Allianz Insurance Plc



Ebba Schmidt: Investment Manager at the UK Pension Protection Fund (PPF)



Tristan Hillgarth:
Former CEO Invesco Europe, and Head of Jupiter Private Clients



David Lloyd Owen:
Waster and Water Industry Expert