Investment Advisory Committee: Summary minutes

WHEB is launching a new Ireland-based fund for EU-based investors.

Companies need to have at least 50% of revenues from sustainability themes to qualify for investment by the WHEB strategy.

Attendees:

Attendees:

Seb Beloe (Head of Research)
Ted Franks (Fund Manager)
George Latham (Managing Partner)
Kingsmill Bond (Member)
Kelly Clark (Member)
Carole Ferguson (Member)

Apologies:

Geoff Hall (Chair)
Mike Clark (Member)

1. Business update

George Latham chaired the meeting in Geoff Hall's absence and kicked off with a brief update on WHEB's business. Assets under Management in mid-February reached £470m supported by strong in-flows from the UK market. George also commented on the increasing competition that WHEB is seeing as mainstream asset management firms launch new strategies in response to growing investor interest in sustainability (see below).

WHEB has also launched a process to establish a new fund structure based within the European Union. This fund will cater for EU-based investors that will no longer have access to the UK fund following Brexit. WHEB will also be recruiting a new member to WHEB's business development team. Based within the EU, the new employee will support the development of this business. WHEB is also recruiting two new business development team members for the UK business including maternity leave cover for Libby Stanley.

2. Investment process enhancements

Committee members were updated on changes that have now been formally made to the investment process. As discussed at the previous October meeting, WHEB has increased the threshold for inclusion in WHEB's investment universe. Previously, companies had needed at least 30% of company revenues to come from products or services that qualified within the strategy's nine investment themes. At the end of 2019 this minimum threshold was increased to 50% of revenues.

The change was made for two reasons. Firstly, it reflects the growth that WHEB has observed in the proportion of business that many companies now derive from end markets that are connected with sustainability solutions. Secondly, it also demonstrates WHEB's renewed conviction that companies with this level of exposure represent a purer realisation of the strategy's investment philosophy. In practise most holdings in the strategy are 100% exposed to the themes. The weighted average thematic exposure across the strategy is over 80%.

In addition, the range of companies held in the portfolio has been reduced from 50-70 to 40-60. This reflects WHEB's ambition to hold a tighter range of companies, with greater depth of understanding and conviction.

Committee members were interested to understand whether these changes had had any impact on the range of investment opportunities or on the strategy's volatility compared to the MSCI World. Ted Franks confirmed that approximately ten stocks had been deleted from the investment universe (out of 950) and that the strategy's volatility had not significantly changed even with the lower number of positions. It was confirmed that the Committee will continue to play its role in reviewing investments in the strategy including considering the appropriate level of thematic exposure.

Several changes have been made to portfolio holdings to increase exposure to companies with higher impact ratings.

3. Top ten holdings and strategy changes

Seb Beloe introduced WHEB's 'impact engine' at the last Committee meeting. Ted Franks explained how, in the previous period, several changes have been made to portfolio holdings in order to increase exposure to companies with higher impact ratings based on the impact engine methodology.

AMS AG (Resource Efficiency) was sold because it has refocused its business on lower impact products related to smartphones. Acuity Brands (Resource Efficiency) was also sold as it has shifted its strategy away from high impact LED lighting applications, and towards lower impact exposure to building automation. National Instruments (Resource Efficiency), ICU Medical (Health) and Johnson Controls (Resource Efficiency) were also sold in the period due to lower conviction in the investment case of each business. Companies that were bought in the period included:

Hikma Pharmaceuticals (Health) which manufactures non-branded generic and licensed pharmaceutical products. The company offers a range of therapies including anti-infectives, pain management, central nervous system and oncology. The products are sold at affordable prices across a wide range of developed and developing markets.

Advanced Drainage Systems (Water Management) manufactures systems that capture, store and treat storm water in communities in the US. The systems are used to create greater resilience to more extreme weather particularly in the southern states and are largely made from recycled plastic.

Infineon AG (Sustainable Transport) is a power semi-conductor manufacturer with a strong position in sensing and micro-controllers. These products are critical components in managing power distribution in electric and autonomous vehicles as well as in enabling the 'internet of things'.

Arcadis NV (Environmental Services) is a design and consulting firm that provides engineering and environmental services particularly focused on buildings, infrastructure and water businesses. The company is particularly focused on assisting municipal authorities and private clients in integrating climate resilience into design and engineering projects.

Committee Members did not have questions about the new holdings and viewed them as consistent with the strategy's underlying philosophy and policies.

Committee Members did not have questions about the new holdings and viewed them as consistent with the strategy's underlying philosophy and policies.

4. Investment strategy performance and positioning

Ted Franks updated the Committee on the performance and positioning of the strategy. From October until mid-February the strategy's absolute performance was positive and slightly ahead of the IA Global benchmark. Over the past two years the strategy has also delivered positive absolute performance. However, over this period the strategy has lagged behind the MSCI World benchmark. Key contributors to this underperformance have been the strong returns from mega-cap technology stocks (the 'FAANGs') which we do not consider to be investable stocks and the underperformance of mid-sized businesses.

In recent months a relatively small number of companies with strong positive impact credentials have seen a marked rerating.

At the same time, a relatively small number of companies with strong positive impact credentials have seen a marked rerating. Tesla is the best known of these, but other companies including Kingspan, Orsted, Tomra and Xylem have all seen their share prices appreciate dramatically (see below). The strategy is invested in some of these companies but has avoided many (such as Tesla) due to concerns about valuations.

In late February, concerns about the coronavirus also hit financial markets. This has been particularly acute in international trade-related companies which feature strongly in environmental investment themes. Ted indicated that he is broadly happy with the strategy's current positioning, but is keen to continue to transition towards higher impact stocks. Recent set-backs may provide opportunities to buy these companies on more attractive valuations.

5. The ‘ESG[1] stampede’

Ted Franks introduced a general discussion around what he has described as the ‘ESG stampede’. This is a phenomenon that WHEB has recognised in the market relating to the massively increased attention being given to the ‘ESG’ agenda generally, and to specific ‘ESG champion’ companies. The growing desire among investors to understand the impacts of their investments (both positive and negative) alongside a perception among asset managers that ‘ESG’ is one of the few remaining ways to maintain higher management fees, has super-charged interest in ‘ESG’ as an investment approach.

Several members believe that ‘ESG’ as a term is rapidly becoming meaningless as it is being used to cover such a wide range of investment styles and approaches.

During the ensuing conversation, some key points were made by Committee members. Several members believe that ‘ESG’ as a term is rapidly becoming meaningless as it is used to cover such a wide range of investment styles and approaches. Furthermore, members suggested, in many cases very little attempt has been made to identify and understand the underlying ideas behind the labels. Members also argued that the market is in the early stages of a ‘hype cycle’. For some investors, interest is driven by the recognition that climate change will (and is) having a significant impact on markets. For others, ‘ESG’ is simply a ‘momentum trade’ with a lot of money now being ‘flung at the energy transition’. In WHEB’s view, this is leading to share price anomalies emerging in some limited parts of the market (see earlier). It was also mooted, during the meeting, that support for businesses with a strong ‘ESG’ position or impact may in fact reflect a more profound structural shift in the way that younger investors see the world. Ascribing more value to these characteristics, it was suggested, may underpin a long-term re-rating for these companies.

All members agreed however that momentum around ‘ESG’ investing has a long way to run and that the enhanced focus on ESG is good news given the limited time left to shift capital away from polluting businesses and in to companies providing climate solutions. Committee Members highlighted a number of NGO campaigns targeting passive funds and aimed at encouraging investors to ‘make their money matter’ in supporting action on climate change and sustainability more broadly.

Members questioned what the right framing for WHEB should be and whether ‘impact’ or ‘sustainability’ or even ‘circularity’ is the right label. Ultimately, the Committee broadly agreed that the market is now beginning to see capital move towards higher performing ‘ESG’ companies. This is however being done, in some Members view, primarily for reputational reasons. The next stage, which may still be some time, will likely focus more acutely on data and investment analysis.

Investment Advisory Committee Members

Geoff Hall:
Chairman of WHEB Asset Management. Former CIO at Allianz Insurance Plc

Kingsmill Bond:
New Energy Strategist, Carbon Tracker

Kelly Clark:
Director of the Finance Dialogue and advisor to Carbon Tracker and the Ashden Trust

Mike Clark:
Founder, Ario Advisory & Advisor at Oxford Smith School. Formerly Director, Responsible Investment at Russell Investments

Carole Ferguson:
Head of Investor Research, CDP

1- ESG – Environmental, Social and Governance