Investment Advisory Committee: Summary minutes

October 2020

Attendees:

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Geoff Hall (Chair)
Seb Beloe (Head of Research)
Ted Franks (Fund Manager)
George Latham (Managing Partner)
Kingsmill Bond (Member)
Mike Clark (Member)
Ray Dhirani (Member)
Carole Ferguson (Member)

1. Business update

George Latham provided an update to the Committee on significant business developments since the last Committee meeting in June. The strategy has continued to attract new assets and has grown from £500m of assets under management (AuM) at the last meeting to over £700m in AuM at the end of September. This is approximately 80% higher than the figure reported at the October 2019 Committee meeting. George also reported that the team have visibility on a further £200m which is expected to be invested before the end of 2020.

WHEB have appointed a new Business Development Director who will be based in Amsterdam.

As reported at the June meeting, WHEB continues to make progress with the launch of a new Irish-domiciled fund that will be open to clients based in European Union countries. These clients will no longer be able to access the UK OEIC fund structure after the first of January 2021. This new fund is expected to be launched before the end of the year.

WHEB have also now appointed a new Business Development Director who will be based in Amsterdam and will be responsible for looking after EU-based clients. The appointment will be announced at the beginning of November.

Alongside the new Business Development Director, WHEB is also recruiting a new Business Development Associate and a new Investment Team Analyst both of whom will be based in the London office.

2. Overall fund performance and composition

The FP WHEB Sustainability Fund has enjoyed a strong period of outperformance throughout 2020.

Ted Franks introduced the top ten holdings in the fund and reported that the flagship FP WHEB Sustainability Fund has enjoyed a strong period of outperformance throughout 2020. For the twelve months through to the end of September, the fund had outperformed the MSCI World by nearly 10% (see figure 1 overleaf).

Since June, markets have been rather buoyant, driven by optimism among investors that a vaccine would be successfully trialed and launched early in 2021. This has in turn caused investors to become more optimistic about the prospects for cyclical and industrial businesses. This optimism was reinforced in those parts of the economy that were able to demonstrate a rapid recovery following the lock-down earlier in the year. For example, data showing that sales of battery-electric vehicles (BEVs) were approaching 10% of all vehicles sold in European markets supported the share prices of companies exposed to this part of the market.

Overall, Ted argued that the period during which COVID-19 has had an impact on the market, has served to validate a lot of the business models pursued by companies in the portfolio. These models are characterized by companies with resilient businesses and strong competitive positions. They are also typically in critical markets that have continued to operate throughout the period of the pandemic.

Figure 1: FP WHEB Sustainability Fund - Absolute performance (total return)[1]

	12m to 30/09/20	12m to 30/09/19	12m to 30/09/18	12m to 30/09/17	12m to 30/09/16	12m to 30/09/15	12m to 30/09/14
FP WHEB Sustainability	15.07%	1.87%	11.55%	14.87%	31.25%	0.60%	10.23%
MSCI World	5.24%	7.76%	14.44%	14.41%	29.85%	1.58%	12.08%
IA Global Median	7.19%	5.98%	11.63%	14.92%	26.15%	-1.36%	7.87%

As interest in sustainability has grown, so clients have become more discerning in their assessment of different investment strategies.

Evolving client needs and increasing role of regulation

Ted also commented on the increasing level of client demand for sustainability-oriented investment funds and a parallel trend in the sophistication of fund analysis. As interest in sustainability has grown, so clients have become more discerning in their assessment of different investment strategies. WHEB has, we believe, innovated ahead of this demand most notably through the development of the ‘impact engine’. This helps to direct – and document – the investment team’s activities in identifying increasingly impactful companies as candidates for inclusion in the strategy.

At the same time, new frameworks for categorizing assets and asset manager activities are being developed by regulators at both EU and UK level. These are not always consistent or necessarily even coherent and put additional reporting demands on the business, in WHEB’s view.

Anti-globalization and impact

Committee members were interested to understand what impact efforts to roll-back globalized supply-chains and business activities have had on the WHEB portfolio. Ted reported that the trade wars between the US and other regions including China had been a painful experience for the strategy particularly in 2018 and 2019.

In response to these pressures, many companies have begun to adapt through more regional sourcing models. There remains, however, significant supply-chain exposure to China in many businesses across several industrial markets. Ted’s view is that these tensions will persist whatever the outcome of the US election. This ‘scaling back’ of globalization will result in fundamental changes in how businesses operate and will be a key focus for WHEB’s investment team in the coming years.

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The ESG stampede and stock valuations

Committee member were also interested to understand WHEB’s view on the valuations that some ‘ESG champion’ companies are now trading at. Ted argued that many of our stocks are still reasonably differentiated and operate in niches as well as in social themes. These are not always the ‘obvious’ ESG champions that, in some cases, have become expensive relative to their own history.

Seb Beloe commented that ‘green hydrogen’ stocks have been particularly vogueish. This is, in our view, partly due to these companies being heavily promoted by erstwhile oil and gas analysts looking to expand their franchises into adjacent industries such as hydrogen. WHEB has remained sceptical of these stocks’ valuations, which we believe incorporate overly optimistic assumptions about the pace of transition to green hydrogen.

1 - Total return in GBP with dividends reinvested net of tax. Periods ending 30/09/2020. Source: Bloomberg, FE Analytics.

3. Buys and sells in the period

There have been relatively few changes to the portfolio over the previous four months. Just two new businesses were bought for the fund including Vestas Wind Systems and Sonova AG.

Vestas Wind Systems (Cleaner energy) is the world's largest designer and manufacturer of wind turbines. The company is headquartered in Denmark and has operations around the world manufacturing onshore and offshore wind turbines. The company also provides operation and maintenance services for wind turbines.

Sonova (Wellbeing) develops, manufactures and services a variety of hearing care solutions. Their products include hearing instruments and aids as well as cochlear implants.

Committee members all agreed that these two businesses were clearly investable within the policies and philosophy of the investment strategy.

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Ted also discussed three companies that were sold from the strategy during the period. These included both Norma Group and Spectris plc which were both judged by the investment team to have relatively low impact intensity.

The third company, Varian Medical Systems, was sold as it was acquired by Siemens Healthineers. Varian had been in the strategy since 2013. Following the sale of its imaging business, the company focused exclusively on the diagnosis and treatment of cancer. Varian has been a strong performer during our investment period and had also become one of our highest impact intensity stocks. The company's singular focus on oncology and its expanding range of treatments gave the company a strong impact profile. This impact was further enhanced by their efforts to develop and sell radiotherapy machines specifically for developing countries.

4. WHEB's approach to net zero carbon commitments

Seb Beloe introduced a discussion paper on WHEB's approach to net zero carbon (NZC) commitments. The paper was drafted in response to the enormous growth that WHEB has seen from clients, asset owners, consultants and NGOs in NZC commitments from asset managers and other financial institutions.

WHEB has committed to becoming a NZC business in our own operations (covering scope 1, 2 and 3 emissions) by 2025. However, as provided for in guidance to asset managers[2], this does not include the investments made through our investment strategies which is subject to a separate decision-making process as part of WHEB's investment strategy.

WHEB has made public commitments to engage with companies held in our investment strategy to encourage them to accelerate their efforts to achieve NZC emissions by 2030.

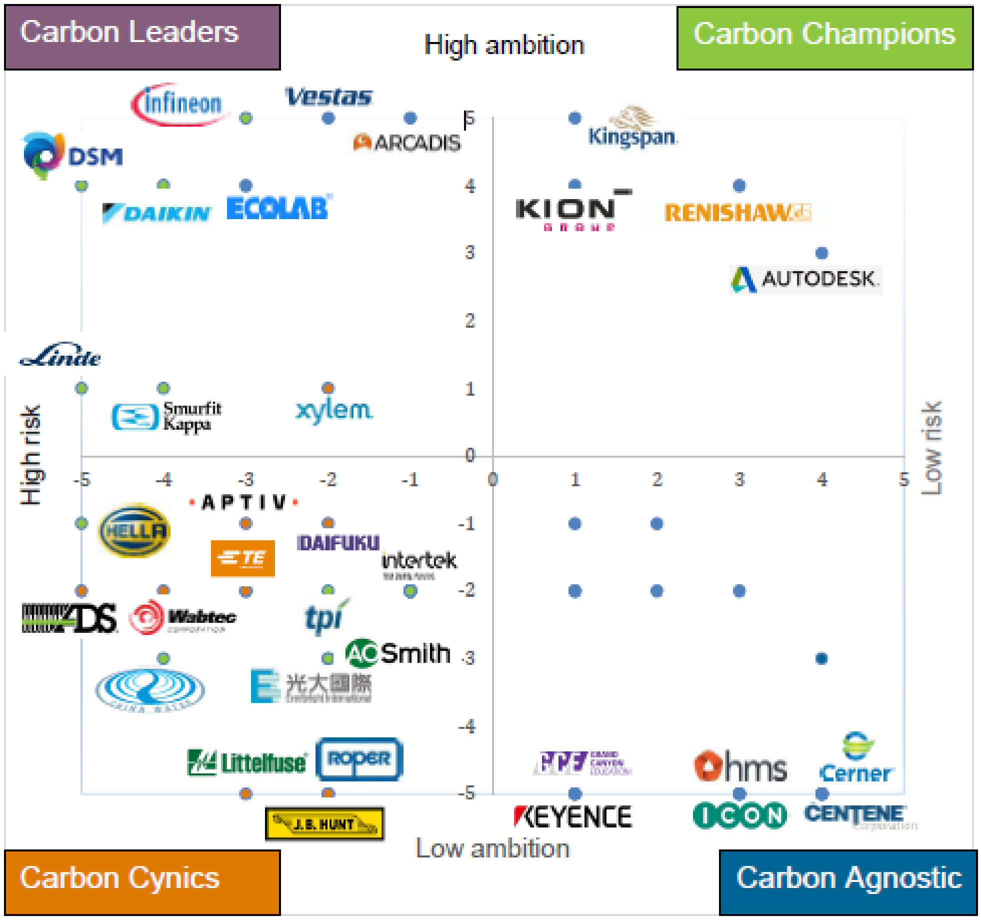
Portfolio-level NZC targets

Nevertheless, WHEB has made public commitments to 'engage with companies held in our investment strategies to encourage them to accelerate their efforts to achieve NZC emissions by 2030'[3]. Seb reported to the committee that the team has done a considerable amount of work engaging with companies held in the portfolio to encourage them to adopt demanding NZC targets. As of the end of September, approximately 5% of the portfolio had set NZC targets by 2030 at the latest. 12% have already set NZC targets to be achieved by no later than 2050, and a further 6% have committed to but have not yet published NZC targets. Based on these commitments, WHEB expects that within the next two years, over 20% of the existing portfolio will be committed to being NZC businesses by 2050 at the latest.

Figure 2 overleaf provides a mapping of the carbon risk exposure and levels of ambition displayed by key holdings in the WHEB portfolio. The risk exposure is based on scope 1, 2 and 3 emission levels (reported and estimated) and the ambition level is based on the existence and nature of any NZC targets.

2- Greenhouse Gas Protocol, Corporate Value Chain (Scope 3) Accounting and Reporting Standard, WRI/WBCSD
3 – Net Zero Carbon Initiative - https://www.whebgroup.com/wheb-commits-to-net-zero-carbon-standard/

Figure 2: Mapping of carbon risk exposure and ambition of WHEB portfolio companies



Member discussion

Committee members then had a robust discussion on the role and value of NZC targets. Members were overall broadly supportive of WHEB's approach in engaging with portfolio companies to push for aggressive reductions in absolute emission levels. However, an initial point made by members was on the importance of WHEB's focus on companies providing solutions to climate change and other social and environmental issues. This focus, so essential to the WHEB strategy, is not reflected in the mapping set out in figure 2. Committee members were adamant that this 'solutions-focus' is a critical part of the WHEB proposition and is missing from this analysis.

Committee members advised caution on the role and value of NZC targets particularly at portfolio level.

Beyond this, members advised caution on the role and value of NZC targets particularly at portfolio level. A blanket commitment to NZC, for example, fails to recognise the very different context of different businesses. For some, NZC emissions will be a massive undertaking with clear implications for greenhouse gas emissions. For others, achieving NZC ambitions would be immaterial to their business and to the climate. Treating them equally would, in the Committee's view, be deeply flawed.

It was stressed that even accurate measures of scope 1, 2 and 3 emissions would not fully capture the complexity of climate impacts.

Furthermore, it was stressed that even accurate measures of scope 1, 2 and 3 emissions would not fully capture the complexity of climate impacts. Members gave the example of an investment in housing in Aberdeen. An investment that might itself have low scope 1-3 emissions but would nonetheless be highly vulnerable to transition risks associated with the local (currently oil and gas based) economy.

Equally, companies that manufacture climate solutions, might have significant operational emissions and appear 'high risk' from a carbon exposure point of view. In practice, this risk would be heavily mitigated by the role of the product in enabling a transition to a zero carbon economy.

Members expressed concern that clients are looking for simple solutions that reduce a highly complex and dynamic aspect of investment management down to a single number or 'temperature rating'.

Members were also sceptical about the robustness of NZC targets from companies. Members advised that WHEB should undertake a deeper analysis of the strategies being used to deliver these targets, and, not least, the extent to which carbon offsets are being used.

Ultimately, members expressed concern that asset owners, clients and other groups are looking for simple solutions that reduce a highly complex and dynamic aspect of investment management down to a single number or 'temperature rating'.

These ratings are not only likely to be based on inaccurate data, but ultimately confer a false sense of accuracy on the approach and value of a particular investment strategy. They are aggregated to a level that is largely meaningless in the view of Committee members. It was also pointed out that climate change is just one issue, albeit a very important one. Ultimately, sustainability is about much more than just climate change, they said.

5. Any other business

The shift to lower impact food and agriculture is expected to play a critical role in reducing greenhouse gas emissions and reducing pressures to convert land into agricultural production. Committee members expressed an interest in understanding how the WHEB investment strategy is positioned to take advantage of the growth in demand for alternative protein food products. WHEB agreed to address this topic at the next Committee meeting in February 2021.

Investment Advisory Committee Members

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

Kingsmill Bond:
New Energy Strategist, Carbon Tracker

Ray Dhirani:
Head of Sustainable Finance, WWF-UK

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

Carole Ferguson:
Head of Investor Research, CDP