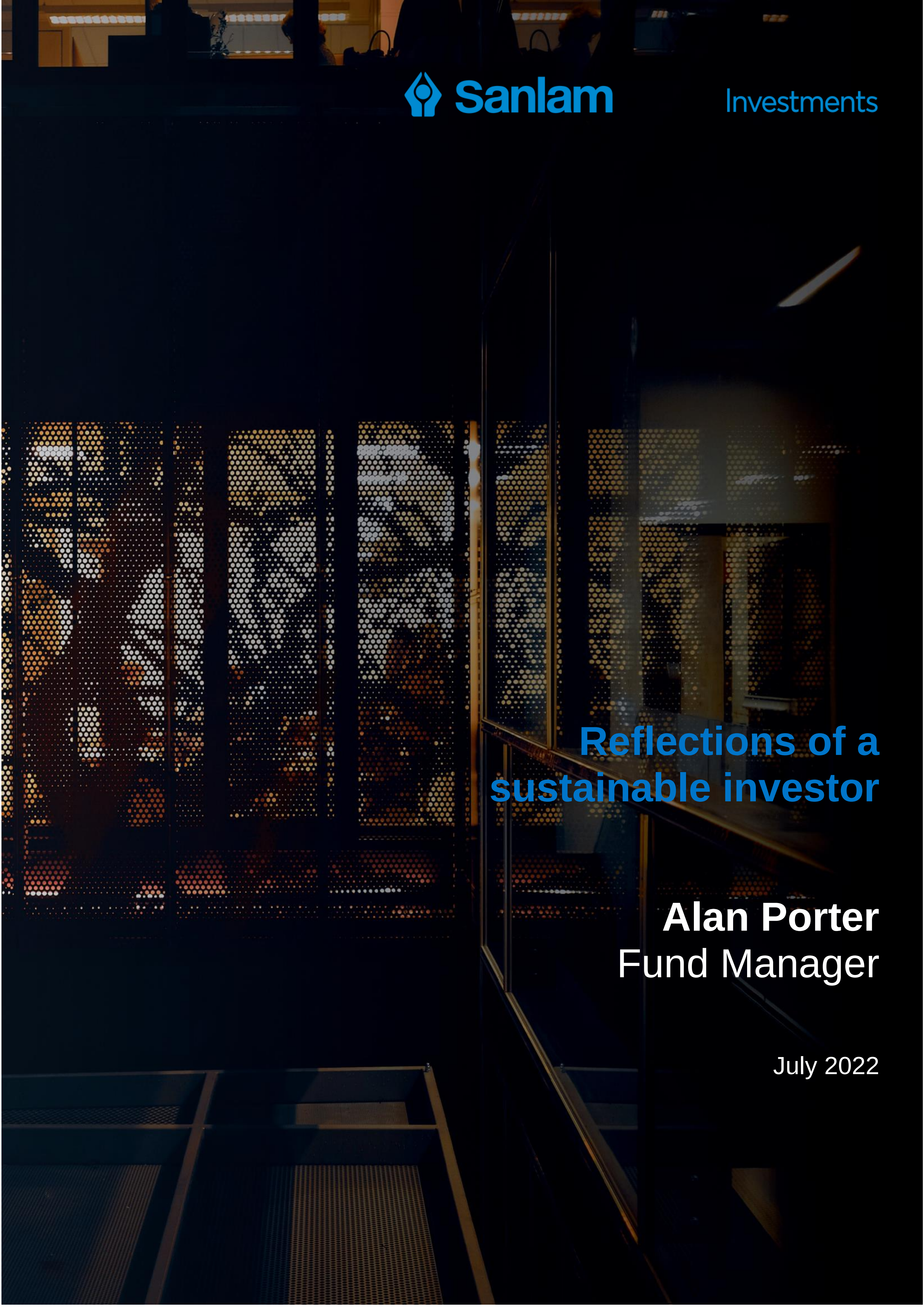

Sanlam Investments

Reflections of a sustainable investor

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Many things have stood out for the sustainable investor over the last twelve months, here we reflect on three: credibility; exclusions; and data.

Credibility

Credibility, the quality of being trusted and believed in, has become the byword for the sustainable investor.

It has been widely reported that a financial advisory firm, after an extensive review, culled more than 1,200 funds with combined assets of $1.4 trillion from its European sustainable fund list earlier this year. This cull represents around 40% of the assets under management that the company had considered sustainable at the end of September 2021. Our response? Too right!

Most of the funds rejected were classified as Article 8 funds under the Sustainable Finance Disclosure Regulation (SFDR). SFDR sets out the mandatory ESG disclosure obligations for asset managers and aims to bring in a level playing field for financial market participants and provide transparency in relation to sustainability risks. As managers of the Sanlam Sustainable Global Dividend Fund, an 'Article 8' fund, we know how important the external validation of sustainability credentials is.

We are surprised at how many funds have managed to be classified as 'Article 8' funds. Any action by research and data providers to raise the hurdle and help ensure greenwashing is eradicated should be applauded.

At Sanlam, we believe several things are key to help ensure credibility in sustainable investing. In addition to negative screening, where certain subsectors are excluded, sustainability analysis must be embedded in the research process for choosing which companies to invest in. A clear test of this is that you can demonstrate that companies that fail your sustainability analysis will not be invested in. In the same way that you wouldn't invest in companies that you felt had weak business models or were expensive. We employ a sustainability scorecard as the first part of any company analysis. If a company scores negatively we will not proceed.

Engagement with companies is also an important part of sustainable investing. Voting is key here as it allows for scrutiny of a board's actions. We vote on all items and proposals on behalf of our clients. When we vote against management proposals, we let the company know why we have voted the way we have. This naturally leads, in most cases, to engagement and we can then further assess the responses we are given.

We believe external validation of sustainability credentials by the likes of Morningstar and MSCI is key as is having targets for portfolios related to such bodies. We target an MSCI ESG rating of AA or AAA, the top two ratings, for our fund, always.

Exclusions

Exclusions, companies removed from consideration in a portfolio, have become a hot topic in sustainable investing this year.

Most sustainability funds apply at least one exclusion criterion where they exclude certain companies from investment. Controversial weapons are the most excluded category followed by tobacco and thermal coal. The Sanlam Sustainable Global Dividend Fund excludes companies that derive more than 10% of their revenues from tobacco, alcohol, gambling, adult entertainment, weapons, and fossil fuel extraction. There are debates surrounding the use of exclusions that are worth considering.

Some argue that exclusions are costly to investors because of the performance missed out on by not owing certain areas of the market. The only evidence we have seen that supports this is based on analysis covering the last 20 years. We would argue that the growth of sustainability funds that use exclusions has only taken off in the last few years. Using 3, 5 and even 10 years of history would show that sectors like tobacco and integrated oil & gas have performed poorly.

Others argue about the effectiveness of exclusions on changing behaviours. They state that regulation is the bigger driver in the reduction of say, controversial weapons or tobacco consumption. We would argue that timeframes are important. Many of the key regulations such as the UN Convention on Cluster Munitions (in force in 2010) or the World Health Organisation Framework Convention on Tobacco Control (in force in 2005) pre-date the growth of sustainability funds.

We believe exclusions have several clear positives. One of the criticisms of many funds that claim to take environmental, social and governance (ESG) issues seriously is that it is hard for investors to see the evidence of this. We have always felt that one sure way to evidence the integration of ESG is to show that stocks are not invested in because of ESG issues. There are two ways to do this, one is to exclude companies the other is to demonstrate a research process where stocks fail because of rigorous ESG analysis. We do both, we exclude certain sectors and if a company fails our sustainability analysis we will not invest. Indeed, sustainability analysis is the first part of our company analysis.

The use of exclusions also has an indirect impact by raising public awareness of environmental and social issues. Funds that employ exclusions tend to state this up front and visibly to investors which helps with raising this awareness. But for us the most important positive is client choice. Clients want the option of investing in funds that exclude areas of the market that they are uncomfortable investing in. Who are we to disagree?

Data

Data, facts, and statistics collected for reference or analysis, is a key issue for the sustainable investor.

As managers of a strategy that invests in companies that combine strong sustainability and dividend credentials, we often get asked about the quality of sustainability data and reporting. Sustainability reporting has improved over recent years and this needs to continue to allow investors to make informed decisions over how to allocate their clients' capital. However, we believe that perfect sustainability data should not be the enemy of good data, that is, investors should focus on companies with data and reporting goals that are directionally improving.

Other items we could have discussed: voting; engagement; executive remuneration; and carbon pricing. One thing we are sure of, sustainable investing will only gain in importance whatever the discussion points.

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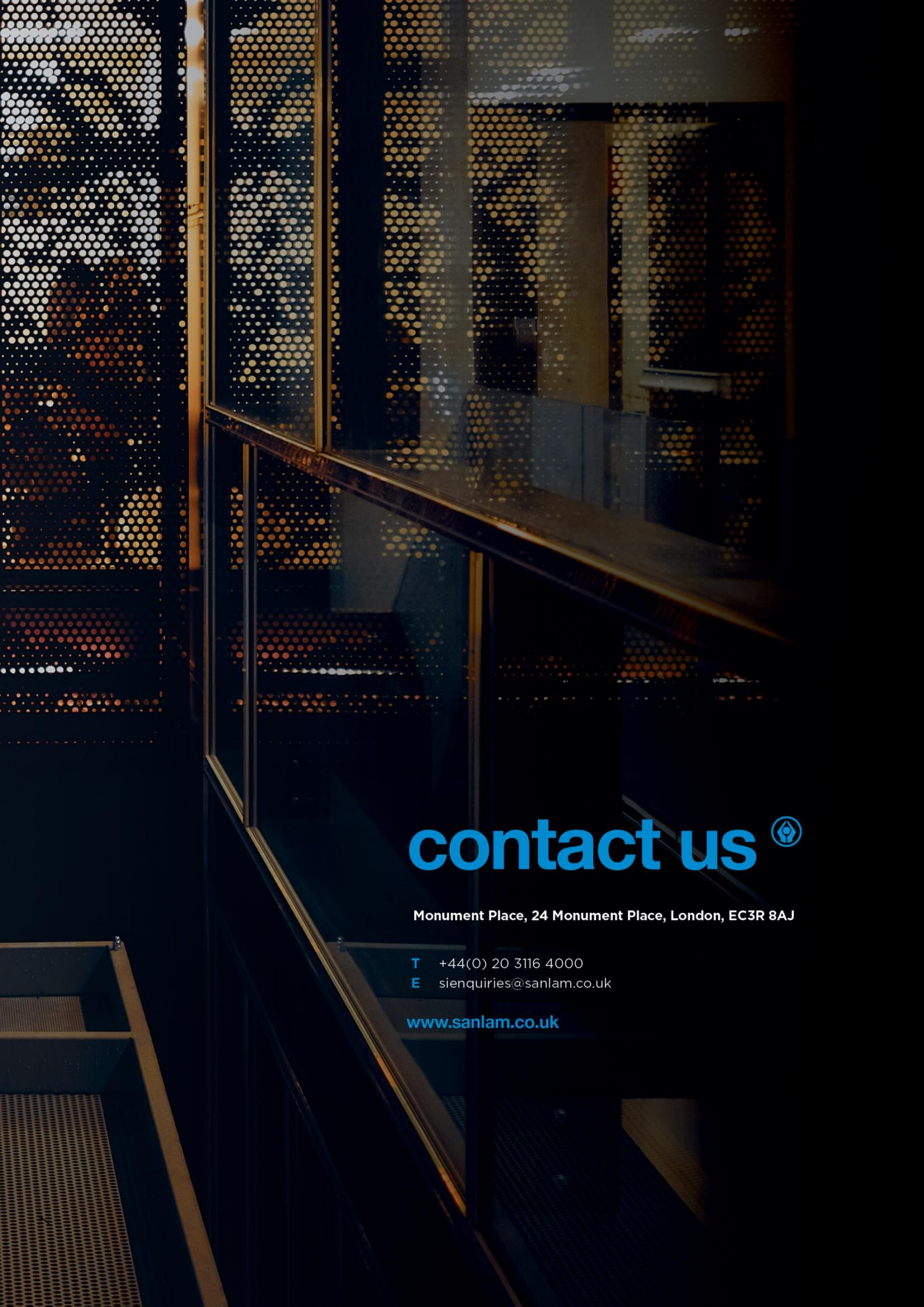

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