UBAM - POSITIVE IMPACT EQUITY

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws.

Sustainability & Market Review

- Q2 2020 will be forever remembered as the first entire quarter that so many of us spent every working away from the office and yet in this strange environment the impact team is surviving, and even flourishing. Like many we have been given a first-hand micro insight into a macro event, in every way as confusing and disorientating as some of the dark days of the Global Financial Crisis. The whole of UBP hopes that you, our supporters, have navigated this period with good health and an absence of significant disruption.

- The growing prominence of the S within ESG during the slow march of the pandemic has been notable. According to the FT, employee health & safety and labour practices have been the most frequently discussed ESG topics in the press during Q2. Pre-crisis, 33% of workers in the US did not have any form of sick pay in place from their employers. As the world attempts to 'build back better', the crisis is likely to alter the engagement priorities between all stakeholders on employment practices, remuneration, supply chains and dividend payouts – to name a few. As George Soros recently commented:

  We missed the opportunity to create a more just economy after the financial crisis of 2008 and provide a social safety net for the workers who are at the heart of our societies. Today we must change direction and ask ourselves 'what kind of world will emerge from this catastrophe and what can we do to make it a better one?

- The Sustainable agenda came under challenge in favour of economic intensive care measures. Indeed, as an illustration of the change in priorities, the convention centre due to host the COP26 (UN Climate Talks) in Glasgow in November was converted into an emergency Covid-19 hospital. Some important elements of the global sustainability agenda have indeed been delayed. However, one of the key highlights for Q2 2020 was the launch of the EU Green Deal at the end of May. The €750bn recovery plan of grants and loans for green projects is a credible financial initiative intended to see through many of the aspects of the powerful movement.

- The inclusion of transitioning 'dirty' companies within the scope is clearly aimed in part to win over challenged countries like Poland, but it also wisely recognises that major protagonists need to be included as part of the solution rather than ostracising them as part of the problem. This spirit of engagement makes it much easier for companies like BP to chart a course of fundamental change. Indeed Bernard Looney, the new CEO of BP put it well when he was recently quoted in the FT saying:

  We said that by 2050 we would have that (hydrocarbons burned by our customers) equivalent at zero. If every energy producer did something similar, the world's problem from an emissions perspective from the energy sector would be solved.

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

- The EU followed up its Green Deal with the other major development of Q2, the publication of the EU Taxonomy in mid-June. The taxonomy will supply a common language for investors on climate and the environment, creating the world's first-ever “green list” – a classification system for sustainable economic activities that have a substantial positive impact on the climate and the environment. We are sometimes challenged on our belief that Europe and its companies lead the world for impact candidates, however, these political moves illustrate why Europe remains so far ahead of most other large countries in legislative terms. That said, it is encouraging to witness the Japan Climate Leaders’ Partnership (JCLP), a coalition of more than 140 companies, demanding that the Japanese government make decarbonisation a part of its pandemic recovery plan in an initiative at the end of the quarter.

- The change in agenda is well aligned with what is happening at the corporate level. For example, forecast expenditure on renewable power is set to overtake oil and gas drilling for the first-time next year. Goldman Sachs estimates renewables (including biofuels) will account for about 25% of all energy spending in 2021, up from 15% in 2014.

- Corporate commitments to a better world have also continued to multiply in lockdown. In June the UN launched its Race to Zero, a global campaign focused on a healthy, resilient, zero carbon recovery, which ‘creates jobs, unlocks inclusive, sustainable growth and reduces the risk of future shocks’. There are now more than 1,000 associated companies that have committed to net zero by 2050 using both reduction and offsets.

- In our last quarterly report, we highlighted the reduction of emissions in urban areas. Flight Radar data shows that the 31% drop in emissions in March from the aviation industry resulted in a saving of 28m tonnes of CO_2, or the equivalent of 6m cars off the road for a whole year. These environmental benefits are still being accrued in many parts of the world and we await longer run findings which will be published in the coming quarters. Whilst this unexpected ‘free pass’ on emissions will help those countries like the US and Australia that had fallen well off the flight path of their own targets, it was sobering to witness that the CO_2 particle concentrations registered a new all-time peak at the longest running survey site in Hawaii.

- Another aspect for impact investment focuses on investment performance. The Morningstar report entitled ‘Do Sustainable Funds Beat their Rivals’, published in June, provided a convincing analysis by assessing nearly 4,900 funds including 745 labelled as Sustainable. The rating agency found that the majority of sustainable funds generated higher returns than traditional alternatives over 1, 3, 5 and 10 years. Perhaps even more significant, there is a far higher survivor bias, with 77% of ESG funds still available 10 years after launch versus 46% for traditional funds. It is therefore little surprise that Impact Investing AUMs have continued to grow to $715bn at the end of 2019 up from $502bn in April 2019 (according to GIIN), an annual growth rate of 17%.

- During the quarter, the UBP Impact team has stayed active researching many exciting new stock ideas and working with companies to better define the positive impact they have on the planet. We also took part in the Investment Leaders Group initiative on the Financial Risks associated with Biodiversity Loss and Land Degradation which will publish its findings later this year. This was also one of the key topics at our bi-annual Impact Advisory Board meeting held successfully in June. The minutes of this will be published on the UBP website shortly.

Markets

- As the previous quarter ended with the global economy on idle, the slow reopening of countries allowed by a relative containment of the virus propagation led to a strong second quarter for equity markets. This was also supported by central banks around the globe, which ensured that they would continue to provide the necessary firepower to keep government and corporate borrowing costs low.
- Reflective of the sharp rebound, equities display strong positive performance across the board. It is important to note that this was supported by normalizing levels of volatility throughout the quarter as the indicator remained in the 25-35 region compared to the 70+ highs observed during Q1.
- The S&P 500 index returned +20.5% during the quarter despite still high levels of unemployment, while the MSCI Europe returned +15.1%. Emerging markets recovered strongly too, with the MSCI EM index displaying 18.2%. (all local currency and MSCI EM in USD).
- It must be noted that underneath the index performance numbers, the sector returns are more differentiated. Unsurprisingly, the areas most affected by the virus such as hotels, airlines and banks have lagged the rally since late March. Similarly, while food retailers and supermarkets are the best performing sectors year-to-date, they have also lagged for most of the rally. Overall, value stocks are down -17% while growth stocks are up +6%.
- Despite a seemingly positive evolution, it must not be forgotten that to date, the virus has still not been fully contained and no vaccine has been approved. While some economies are reopening thanks to low levels of new infections, the US, Latin America and some emerging countries have been unable to control its spread.
- Moreover, a long duration of the current environment would lead to new risks as central banks have indicated that they are lending rather than spending, meaning that they address liquidity over solvency. Similarly, governments have issued stimulus cheques and generous unemployment benefits, but these are supposed to expire in July for the US and in October for the UK. This could lead to lower incomes for many people and have an impact on consumption.
- Overall, an undeniably strong quarter across markets stimulated by an improving global environment and renewed investor optimism. Nonetheless, the second half of the year remains uncertain and infection rates will continue to be closely monitored.

Performance Review

- Global markets managed to navigate Q2 2020 in an optimistic mood. Whilst the newsflow in April was still dominated by rising casualty figures and differing approaches to containment, investors focused on the sovereignisation of the financial effects of the global pandemic. In a world that has been desensitised to higher levels of national debt, the huge stimulus packages were met with unbridled optimism and growth companies powered the market upwards.
- For impact strategies this was broadly good news. The market’s preference for ignoring near term challenges to profitability and focusing on long term growth potential plays into the strategic framework through which we select our holdings.

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

- Over the quarter as a whole, the UBAM - Positive Impact Equity fund returned 20.8% (Net of fees, IC EUR share class). This figure compares well versus a range of broad indices, for example the MSCI ACWI NR (EUR) up 16.7% and the MSCI Europe NR (EUR) up 12.8%. As readers will know we do not construct our portfolio with reference to any benchmark, but we do firmly believe that our companies have the ability to generate superior returns when compared to general equity benchmarks over the long term; Q2 2020 convincingly demonstrated this point.

- We find that the most useful way to cover performance is to focus on the themes and on the companies that are held within them. We observe some dispersion in return across themes, but all finished the quarter with strong double-digit performance. Health & Wellbeing and Climate Stability were the strongest performers due to the current focus on healthiness and the growing interest for alternative energy sources. Basic Needs displays the lowest theme performance, due in part to the exposure to Education.

Investment Theme	Average Theme Q2 Performance
Basic Needs	**17.65%**
Health & Wellbeing	**39.07%**
Inclusive & Fair Economies	**32.73%**
Healthy Ecosystems	**20.11%**
Sustainable Communities	**20.06%**
Climate Stability	**42.36%**

- Only a handful of portfolio companies recorded a share price fall in Q2. Within these Laureate Education Inc. is the most notable. The company was blindsided by the global pandemic in the midst of a process of rationalisation, intending to focus down its portfolio on a streamlined number of countries for higher education provision. Furthermore, the need to convert its pupil base from on site to remote learning was a challenge. In our call with the management on the 20th May, we were reassured that whilst challenging, the current environment was under control.

- Hoffman Green Cement Tech SAS also fell 14% in Q2 although we do not believe this was anything more than a thin market in the shares, as the investment story of their deployment of green cement remains in place.

- The portfolio sported 5 stocks that rose more than 50% during Q2. Of these it was reassuring to see quality companies, that were badly disrupted by the pandemic, find strong investor support. Here we would highlight both BasicFit NV and Valeo SA. Genmab A/S was our strongest contributor, rising 61% followed by Hexagon Composites ASA which has seen a lot of interest on the back of the wider new energy theme and in particular the successful IPO of Nikola Motor Company in the US.

Portfolio Activity

- Q2 turned out to be a fertile research period for the team. There is general agreement that the freedom from interruptions and the availability of investor relations teams makes up for the unreliable internet signals at home and lack of spontaneous investment chatter of a typical office environment.

- As featured later in the report, we started a position in US-listed Ecolab Inc., a leader in water purification and sanitation. In contrast, we also included the Finnish healthy foods company, Raisio OJY in the portfolio for the first time. This small cap company has a strong focus on oat-based foodstuffs, including the brands Benecol and Elovena, as well as on healthy ingredients in particular for the fish feed industry.

- Finally, we started a holding in TPI Composites Inc, a US based wind turbine blade manufacturer with a 14% market share of the onshore turbine market. This move builds on our holding in Siemens Gamesa Renewable Energy SA and reflects an intent to move up the value chain in the renewable power generation market at a time when we expect demand to accelerate. This trend was recently supported in a Goldman Sachs note which forecasted that within the energy space, renewables investment will make up the largest share of expenditure for the first time in 2021, surpassing investment in fossil energy.

- During the quarter, we also sold our positions in MOWI ASA (formerly known as Marine Harvest ASA) and Tianneng Power. The decision to sell out of MOWI is best explained by competition for capital within the fund and our view that Raisio offers our investors a better impact investment opportunity at this time. In the case of Tianneng, the shares have enjoyed a huge run in 2020, moving up from a low of HK$4 to over HK$10. We took the view that the valuation was now quite full and indeed mindful that the shares are powerfully influenced by the Chinese retail investor, so we opted to sell out of our holding.

- We also made a number of adjustments during the quarter. We reduced our holding in Genmab, which had become very large thanks to the strong performance of the shares. We also reduced our holding in Kerry Group as we re-allocated capital to stronger ideas. One such name was Laureate Education with whom we had a conference call in May to update ourselves on how well the higher education provider was coping with the stresses of the pandemic. On the strength of that call with the CEO we took the opportunity to increase our holding

Quarterly Thematic Focus:

Basic Needs – Raisio OYJ

- Considering the influence of the Covid-19 crisis on the first half of this year, it feels appropriate to focus on another one of our societal themes – Basic Needs. Linked to the SDGs 1 (“No Poverty”), 2 (“Zero Hunger”), 4 (“Quality Education”) and 6 (“Clean Water and Sanitation”), it addresses a number of areas which constitute the minimum elements individuals necessitate to achieve well-being in the modern world.

- Due to the diversity of goals this theme encapsulates, the constituent companies come from a range of industries. This includes an affordable housing provider like Countryside Properties PLC, entities that improve accessibility to education like Laureate Education but also water infrastructure builders and nutrition focused food producers. While most of these notions may be taken for granted in the developed world, especially in comparison to developing countries, this does not mean that the ideal result has been achieved in those countries and that the goals are fulfilled. Indeed, hunger in the developed countries is limited – food is abundantly available at an affordable cost, making it strongly accessible. Nonetheless, the pursuit for cheaper and easily manufactured ingredients has favoured the growth of unhealthy foods, replacing minerals and vitamins by sugars and fats. Consumer consciousness has increased over the years and the demand for better, healthier and more sustainable foods has grown with it.

- This is an opportunity for us to introduce one of the latest additions to the fund – Raisio Oyj which develops and produces healthy foods and ingredients with a specialisation on plant-based nutrition. Through its products, Raisio seeks to generate benefits for its consumers on 3 levels: (1) overall health and well-being thanks to natural and nutritious foods/ingredients, (2) controlled cholesterol levels for lower heart diseases thanks to innovative ingredients and (3) the planet through environmentally friendly packaging and carbon aware operations.

Source: Raisio's Sustainability report

- Generating such benefits through its products while developing sustainable brands with transparent production chains positions Raisio well to supply a growing demand. For example, Benecol is Raisio's most international brand and is known as the reference for cholesterol-lowering foods. Proven to be safe and effective, it is sold in food products and as an ingredient in yoghurts, butter-like spreads and snack bars. Similarly, the company has strong expertise and knowledge of the use of oats which allow naturally healthy products such as wheat-free snack biscuits and has recently invested in a new production facility for plant-based products. This will allow the company to respond to the rapidly growing demand for such foods and alternatives in Europe.

- In addition to generating revenues from sustainable and beneficial products, Raisio displays a strong intention of running its operations in an equally sustainable way. Although too small to be listed on MSCI, its ambitious efforts are displayed in its 'Good Food Plan 2019-23' which targets: no plastic packaging and 100% recyclability, 100% carbon neutral production, 80% of products to be healthy alternatives and more. Such strong credentials have given Raisio an IMAP score of 17, reflecting best in class intentionality and materiality.

- Raisio directly responds to the sub-goals of SDG 2 concerning agricultural productivity and sustainable food production systems, making it a welcomed addition to the Basic Needs theme.

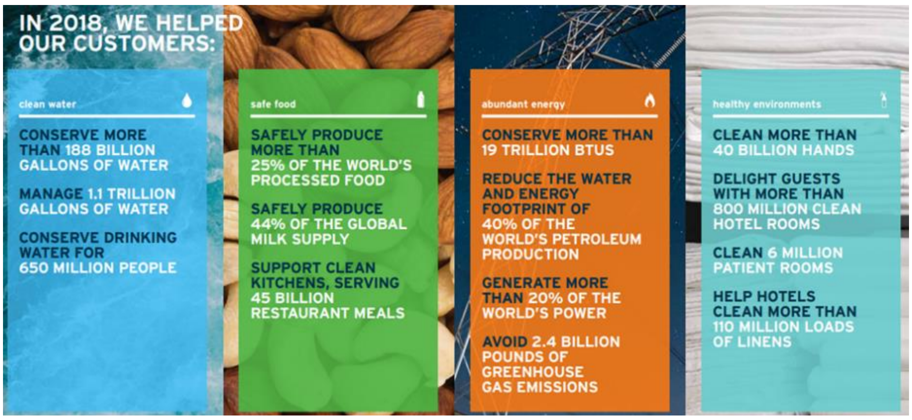
Engagement Focus

- During Q2, the Impact team continued to pursue a busy agenda of engagement with both portfolio companies and new prospects. One company engagement that really stood out to us took the form of two conference calls with Ecolab. During Q2 we completed the IMAP research relating to Ecolab and due to the company's openness to engagement on non-financial topics we found that the time from idea origination to inclusion in the portfolio was notably rapid.

- Ecolab is focused on the industrial segments of Safe Food, Clean Water and Healthy Environments – for example, their products are used at installations responsible for the processing of 45% of the world's milk supply.

- Ecolab's financial performance is reason enough to include the stock in most portfolios. The company has consistently generated a CFROI (CS Holt) well above the cost of capital through financial discipline and a business model that focuses on selling to customers an opportunity to generate a substantial eROI (exponential return on investment) from deploying Ecolab in their facilities.

- What impressed us most was that a near $60bn market cap US company was not only prepared to take the time to carefully explain the nuances of its business model but then also agreed to a follow-on call with their Chief Sustainability Officer. It is no surprise to us on the basis of these engagements that Ecolab produces non-financial disclosure of a quality that we have not identified within our impact universe so far. For example, in Ecolab's Sustainability Report, the company quantify the GHG emissions saved, the litres of water saved and the foodborne diseases avoided for their entire customer base. These may seem like relatively simple outcomes but they are highly complex to aggregate in practice. Ecolab is capable of producing impressive case studies, for example a contract with Archer Daniels which saved the client $28m after Ecolab's fees as well as saving 2.3bn litres of water, a figure greater than Ecolab's own annual water consumption. But the key skill at the corporate level is to be able to translate this into group measurements (extract from sustainability report below). In Ecolab's case saving the equivalent drinking water of 712 million people for its clients in 2019 is a stark metric, and one along the lines we would like to see other companies attempt to calculate.



Source: Ecolab's Sustainability report

Outlook

- As we enter the summer season the markets are entering a new phase reflecting the evolving economic experience around the globe. The initial shockwave of witnessing the pandemic entering and building in any specific country has passed. The novelty shock won't be replicated. However, in its place we have the subsequent infection spikes caused by deconfinement. This is likely to become the new normal for the foreseeable future as Covid-19 responses move from the national level to the regional or even the local level.

- The US Fed has recently warned that the early optimism of economic recovery may now plateau as this rolling programme of localised lockdowns sets in. This will no doubt be the experience for many other countries too. For example, Spain has isolated parts of Catalonia and Galicia in response to new spikes.

- The implication for the stock market is that we should not expect companies to return to full capacity utilisation or profitability until a vaccine is found and proven to be effective. The investment case for our positive impact fund is supported by this general recognition that social and environmental practices will need to adapt. Therefore, providing the investment team can reach a level of comfort that our companies are suitably capitalised to weather these rough patches, the portfolio is set up to navigate these strange times as recent performance illustrates.

Recommended Reads

Reads:

- **How South Korea Is Composting Its Way to Sustainability:** Automated bins, rooftop farms, and underground mushroom-growing help clean up the mess. From: <https://www.newyorker.com/magazine/2020/03/09/how-south-korea-is-composting-its-way-to-sustainability>

- **"Altered Ocean" by Mandy Barker** is a photography book and exhibition which raises awareness about plastic pollution in the world's ocean. A powerful contrast between the colourful patterns of objects which is visually pleasing and the human origin of the items which highlights the effect on marine life.

Podcasts:

- **"Invest like the best"** is a podcast series that I sometimes listen to (without any discernible effect thus far) but they have one episode with Jeremy Grantham that covers asset allocation for the first 30 minutes and then a fascinating climate change / finite resources discussion. From: http://investorfieldguide.com/jeremy-grantham-an-uncertain-crisis-invest-like-the-best-ep-177/

Watch:

- A great interview from somebody who tracks SDG progress at the top-down level (Guillaume Lafortune, SDG Index Manager of the UN Sustainable Development Solutions Network). From: https://www.youtube.com/watch?v=CDMTuxFPPzA

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