MASECO ASIA

Our approach to sustainable investing

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Executive summary

In an interconnected global economy with rising population and consumption, it is increasingly important that investors, businesses, governments, and societies recognize and factor in the costs of externalities (costs incurred by environmentally damaging business activities) to companies, that can in turn result in un-priced consequences on the environment, society and ultimately, financial performance.

As an investor, you can factor in the costs of externalities by looking at investments that are specifically designed to create environmental and social impact across your investment portfolio. MASECO Asia offers a strategy to implement values-based investing from sustainability and socially responsible mutual funds. Investments are evaluated carefully and approached with the same financial analytical rigor as any other investment to identify suitable opportunities that aim to deliver impact as well as performance.

Sustainable investing uses markets to reallocate capital to companies that are integrating responsible corporate behavior and sustainable outcomes into their business and industries. Capitalism is an efficient way to allocate resources and wealth. Sustainable capitalism is investing for blended value. It is the idea that capitalism can maximize long-term economic value creation by reforming markets to address real needs while considering all costs and integrating environmental issues, social and governance (ESG) metrics into the decision-making process. It applies to the entire investment value chain from entrepreneurial ventures to publicly traded large cap companies. Investing with future generations in mind will help transition economies to sustainable substitutes.

Your wealth, your values. Your future

Defining Sustainable Investing

Sustainability investing as an investment philosophy has evolved over several decades. While concrete definitions are difficult to pin down, there are three identifiable strands:

- Ethical investing – identifying companies that share your values and morals and investing in them exclusively.
- Socially responsible investing (SRI) – typically avoiding companies that violate human rights or social criteria and/or that produce or distribute specific products such as armaments, tobacco, alcohol, gambling, pornography.
- Sustainable investing – focuses on environmental, social and governance (ESG) issues. Screening results in investing more in companies that are actively changing their corporate behaviour and products or services to achieve environmentally and socially sustainable outcomes.

Sustainability investing is one approach within the broader Socially Responsible Investing (SRI) universe. While "sustainability" may have different meanings to different people, the term is often associated with general concern for the environment. The United Nations describes sustainable development as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs"(Bruntland Commission, 1987). With this framework in mind, business practices that exhaust resources or cause irreversible changes to the earth's climate are considered unsustainable.

Sustainable Methodology

Many SRI approaches involve the use of positive or negative screening. The criteria forming these screens are based on subjective standards that may be difficult to measure. Additionally, the screening methods are typically applied to business practices in absolute (or binary) terms, which result in a company stock being either included or excluded.

This all-or-nothing approach may result in reduced diversification and a smaller investment opportunity set. Companies with strong environmental policies might be excluded because of a single detail, or an entire category of firms might be deemed ineligible because of an industry's environmental reputation. Since companies have varying degrees of environmental commitment, their business practices are better characterised along a spectrum. An investment methodology that reflects this spectrum may better serve investors.

MASECO Asia's approach looks at all major sectors, emphasising investment in companies with high environmental sustainability scores and minimising or excluding investment in companies with low scores. This inclusive approach progressively weights companies according to their degree of sustainability commitment, resulting in a larger investible universe, broader diversification across industries and a more robust application of environmental values in a portfolio. The step-by-step process is illustrated in the table below.

The combined approach gives investors a way to reinforce environmentally sustainable business practices while pursuing their long-term investment goals through a broadly diversified strategy.

Many approaches to sustainability investing either exclude or include certain businesses or entire sectors on the basis of a measure of their sustainability. The price investors pay for these absolute and binary screens creates a bias towards certain sectors of the market, which may or may not be rewarded. Investors are therefore entitled to ask whether adopting a sustainable investment philosophy enhances or detracts from investment performance.

Making market portfolios sustainable

Starts with a core market portfolio to capture the return of equities. Then increases exposure to companies that have high ratings for sustainability practices, and reduces or eliminates exposure to companies with low ratings.

Companies are broadly rated using three key criteria, each of which will receive roughly the same weighting:

1. Climate change – 30%

Considers a company's carbon emissions per dollar of revenue. The analysis evaluates the thoroughness and

transparency of carbon reporting by companies participating in the Carbon Disclosure Project, an organisation that works with companies to measure and disclose their greenhouse gas emissions. It also takes into account a company's use or production of clean energy and alternative fuels, energy-efficient programs and the production of goods promoting energy efficiency.

» Carbon intensity (CO2 emissions/$revenue) - 20%
Own emissions and emissions from purchased energy normalised by revenue. Sector-average given to non-Carbon Disclosure Project (CDP) companies.

» Climate change solution users - 5%
Use or production of clean energy, alternative fuels, energy efficient programs, sale of goods promoting energy efficiency.

» Climate change reporting - 5%
Thoroughness and transparency of carbon reporting.

2. Environmental vulnerability – 35%

Focuses on a company's environmental impact, particularly where that impact is causing harm. This includes issues with hazardous waste, substantial fines or penalties stemming from environmental law violations, and other concerns, including damage to natural resources and environmental controversies with an impact on communities.

» Hazardous waste - 10%
Accrued environmental remediation liabilities normalised by revenue.

» Environmental regulatory problems - 10%
Substantial fines, civil penalties, settlements and controversies involving air, water, and other environmental regulations.

» Substantial (toxic chemical) emissions - 5%
Toxics Release Inventory (TRI) data for air, water, ground, and injection wells, normalised by revenue.

» Environmental controversy - 5%
Damage to natural resources that may not be regulated, such as the gasoline additive methyl tert-butyl ether (MTBE), cutting old-growth forests, mountain-top mining, asbestos contamination.

» Environmental negative economic impact - 5%
Involvement in environmental controversies that have negatively affected communities.

3. Environmental strength – 35%

Examines a company's processes and systems for managing and reducing overall impact on the environment. The analysis considers systems that track resource use and waste production, pollution prevention (including clearly defined goals) and regular progress reports. Scoring also reflects other initiatives, such as the substantial use of recycled materials or revenue derived from products and services with environmental benefits.

» Environmental management systems - 7%
Commitment to environmental management systems such as ISO14001 and other programmes such as the Environmental Protection Agency's Performance Track and Responsible Care programmes.

» Pollution prevention - 7%
Clearly defined goals in the reduction of the use and production of hazardous or toxic materials accompanied by systematic reports on progress toward those goals.

» Recycling - 7%
Substantial users of recycled material or firms in the recycling industry.

» Environmental initiatives - 7%
Noteworthy acts of environmental protection, partnerships with non-profit organizations or noteworthy operational practices to minimise resource use.

» Beneficial proucts and services - 7%
  Revenue derived from innovative products with environmental benefits such as remediation and environmental services.

Companies with the lowest ratings are given a multiplier of zero, which eliminates them from eligibility; the highest-rated companies receive a gradually increasing positive weight in the portfolio. In this way, the strategy emphasises investment in companies with a high sustainability score. By applying this approach within industries, the strategy maintains broad diversification and avoids elimination of entire industries or sectors.

Analysis across sectors and different company sizes

The methodology is consistently applied to all companies and within each industry sector. This approach prevents the elimination of an industry sector that may be seen as less environmentally friendly than others—while acknowledging that companies within a sector may engage in differing levels of sustainable business practices. This approach ensures that the portfolio remains highly diversified across industries. The approach has the added benefit of rewarding companies within each industry that are doing better than their peers from a sustainability standpoint and penalising companies that are doing worse than their peers. The weighting scheme creates a tilt towards sustainable companies, and because the overlay is applied at the industry level, it avoids industry bias.

Company size can significantly affect scoring in absolute terms. A large company, even operating at maximum efficiency, will have much higher total emissions than a small company in the same industry.

Some variables in the climate change and environmental vulnerability analyses, therefore, are weighted by revenue. Additionally, some environmental strength variables are measured in comparison to similar-sized firms, because large companies may have more resources than small companies to pursue environmentally beneficial initiatives.

MASECO Asia's BlendedValuesFramework in practice

Until recently, it seems it was generally assumed investors may need to be prepared to accept lower returns if they invested according to their 'values'. This perception likely stems from ethical investing and some forms of socially responsible investing that typically exclude entire industries from their portfolios.

MASECO Asia has chosen an integrated approach to sustainable investing so that it can look to deliver similar diversification and therefore similar returns to those of the more 'traditional' investments.

Risk Warnings

You should remember that the value of an investment and the income from it could go down as well as up. The return at the end of the investment period is not guaranteed and you may get back less than you originally invested.

About MASECO Asia

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