October 2018

Investment Advisory Committee: Summary minutes

Attendees:

Attendees:

Seb Beloe (Head of Research)
Ted Franks (Fund Manager)
George Latham (Managing Partner)

Clare Brook (Adviser)
Mike Clark (Adviser)
Geoff Hall (Chair)
Mark Lewis (Adviser)

Geoff Hall announced that Rachel Crossley had stepped down from the Committee and thanked Rachel for her participation and contributions over the past few years

1. Committee membership

Geoff Hall (GH) started the meeting by announcing that Rachel Crossley had stepped down from the Committee. On behalf of the Committee and of WHEB, GH thanked Rachel for her participation and contributions over the past few years. There then followed a brief discussion about potential new members and it was agreed that the Committee as a whole needs both sustainability skills and experience as well as investment expertise. All members should have some familiarity and interest in both of these areas and the Committee should also retain a good gender balance. Seb Beloe (SB) will seek to recruit additional members in the coming weeks to bring the Committee back to five independent members and a Chairman.

2. Business and market update

George Latham (GL) provided a brief update on WHEB's business and broader market developments. Among recent developments have been continued asset growth at the company to over £270m, as at the end of September. The 'B' share class has also been closed to new investors as this share class has now achieved its maximum number of investors. The strategy is also being sold into Australia as the Pengana WHEB Sustainable Impact Fund and was recently awarded the top 'Highly Recommended' rating by the investment consultant Lonsec.

3. Fund update – How does cyclical exposure relate to sustainability?

Ted Franks (ETF) provided a brief update on the fund's composition and performance over the last four months. There then ensued a high-level discussion about the relationship between sustainability-oriented businesses and the economic cycle.

Members argued that momentum in many jurisdictions around the world is strongly reactionary and increasingly aligned against further globalisation.

ETF commented that a significant proportion of environmentally-themed stocks sit within the industrial sector and are therefore exposed to the state of the economy. SB pointed to companies in WHEB's Sustainable Transport theme as an example. These companies are exposed to secular shifts towards electronic and automated vehicles. They are also, however, sensitive to the underlying cycle of the automotive sector. Similarly, companies involved in making manufacturing processes more efficient, are exposed to the underlying demand for capital goods. ETF also pointed out that many of these companies are global exporters. They sell their technology to markets around the world, and are therefore vulnerable to tariffs between different nations and regions.

Committee members pointed out that the underlying economics of many low carbon technologies has matured substantially in recent years. Pressure on fossil-fuelled based sectors and high energy users will persist, they said, providing underpinning demand for these technologies. Some members also argued that, in their view, momentum in many jurisdictions around the world is strongly reactionary and increasingly aligned against further globalisation. Such political head-winds may create challenges for companies that are exposed to global trade.

Committee members also explored the extent to which an impact strategy could be 'defensive' and would still attract support from asset owners. It was agreed by members that interest in positive impact sustainability strategies is a long-term secular trend that would likely persist through any economic downturn in the medium-term.

Interest in positive impact sustainability strategies is a long-term secular trend that would likely persist through any economic downturn in the medium-term.

3. Changes to the investment portfolio

Seb Beloe (SB) introduced one new holding that had been purchased for the fund in the previous period and one stock that had been sold from the portfolio.

Daikin Industries (Resource Efficiency) is a manufacturer of air conditioning systems and components. The company sells its equipment globally including into emerging markets where access to cooling is increasingly critical as climate change worsens. Air conditioning is however very power hungry and Daikin is widely recognised as developing the most efficient air conditioning systems and components on the market.

DAIKIN
AIR INTELLIGENCE™

The Committee had an extensive discussion about Daikin's suitability for the fund. There then followed a broader discussion about the overall positioning of the fund for anticipated worsening environmental trends. This further discussion is noted in the subsequent section.

Committee Members acknowledged that air conditioning is likely to play an critical role in helping communities in tropical and sub-tropical parts of the world adapt to a hotter climate. They expressed the concern, however, that air conditioning uses an enormous amount of power. This additional power demand and the consequent carbon emissions would in itself help accelerate climate change.

Air conditioning is likely to play an critical role in helping communities in tropical and sub-tropical parts of the world adapt to a hotter climate.

SB acknowledged that this is a critical issue. He also argued that air conditioning is an increasingly essential technology for many parts of the world where temperatures are already hazardous for vulnerable communities. And this is a trend that is only going to get worse. We agreed that it is essential that Daikin's equipment is substituting for lower efficiency alternatives. The positive impact of this improved efficiency helps to offset additional demand from new systems. The WHEB team agreed to contact the company to determine the extent to which offsetting is achieved through substituting to Daikin systems. It was also noted that as power grids reduce their carbon intensity (through higher levels of renewables) the negative carbon impact of air conditioning will decline.

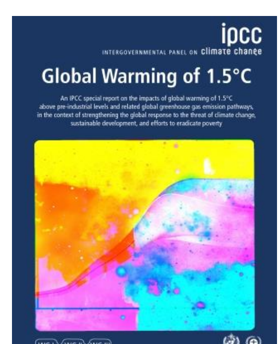
DASSAULT SYSTEMES

Dassault Systèmes (Resource Efficiency)

The one company that was sold during the period was Dassault Systèmes. Dassault supplies computer aided design (CAD) and other software products that are used to make a range of manufacturing and logistics processes more efficient. The company had performed very strongly as growing numbers of companies have sought to streamline the efficiency of their manufacturing processes. The company was sold on valuation grounds and we would hope to buy back into the company if the valuation reaches a more attractive level.

4. Is the WHEB fund positioned for climate break-down?

Prompted by the discussion about Daikin Industries (see above) as well as the latest report from the Intergovernmental Panel on Climate Change (IPCC)[1], the Committee then had a debate about the overall positioning of the fund for dramatic climate change. The IPCC's Special Report on Global Warming of 1.5°C was published at the beginning of October and provided extremely sobering analysis of the risks of climate change. Committee members were concerned that the current holdings in the fund are not delivering significant enough carbon reductions to ensure that the world's economy will realign with a 1.5°-2°C pathway in the next decade.



The Committee had a debate about the overall positioning of the fund for dramatic climate change

[1] – IPCC Special Report on Global Warming of 1.5˚C, October 2018

Overall, the net positive climate impact of the WHEB portfolio means that the strategy is clearly aligned with a scenario that would see 1.5°C or even less of warming.

The team agreed that the IPCC analysis makes for extremely challenging reading. The WHEB investment strategy is intended to provide investors with as pure an exposure as possible to listed companies that are enabling and benefiting from a progressive shift to a lower carbon more sustainable economy. Every company in the portfolio is judged to have a product portfolio which is making a positive contribution and improving social and environmental outcomes.

A proportion of these businesses offer 'breakthrough' levels of positive environmental impact. These are businesses that are reducing carbon emissions or other resource use by more than 50%, or leading to significantly better social outcomes. Breakthrough businesses represent approximately c.25% of the fund. The remainder of the portfolio is invested in companies which have a positive impact, but typically this is more modest (on average offering a 20-25% improvement in impact). Overall, the net positive climate impact of the WHEB portfolio means that the strategy is clearly aligned with a scenario that would see 1.5°C or even less of warming[2].

The WHEB team is constantly looking for opportunities to invest in positive impact companies that also meet our investment return objectives. While this is clearly possible in many areas (such as electric vehicles or renewable energy), there are sustainability issues where there are not yet many opportunities available in listed markets, such as genuinely sustainable food production.

As one Committee member asked, "is it actually possible to invest in listed equities in a way that is commensurate with the scale of the environmental challenge?"

WHEB believe that their approach is as focused on positive impact as it is possible to be in listed markets. But as one Committee member asked, is it actually possible to invest in listed equities in a way that is commensurate with the scale of the environmental challenge? This question was largely left unresolved at the meeting. It is possible – even probable – that without more concerted and urgent action at all levels of society, and across asset classes, the pace of change will prove insufficient to keep at bay the devastating impact of climate breakdown.

6. Any Other Business

The next meeting is scheduled for February 2019 at WHEB's offices at 7 Cavendish Square. We plan to consider how the strategy addresses Sustainable Development Goal 14 – 'Life Below Water'. SB will liaise with Members to finalise the agenda in advance of the meeting.

[2] – See for example pp 26-28 of WHEB's 2016 Annual Impact Report for further discussion on this point.

Investment Advisory Committee Members

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

Clare Brook:
CEO, Blue Marine Foundation

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

Mark Lewis:
Global Head of Research, Carbon Tracker Initiative