

RIVER AND MERCANTILE GLOBAL SUSTAINABLE OPPORTUNITIES STRATEGY

INVESTING IN THE JOURNEY AWAY FROM POLLUTION

As interest in all things ESG has increased significantly over the past few years, some of the more high-profile, low carbon companies have seen their stock market valuations soar. As **valuation conscious**, often **contrarian investors**, we look at some of the well-known 'ESG darling' stocks with amazement.

Carbon **avoidance is not the investment solution** to the environmental issues we face. If society is to hit its climate targets, there is **an unequivocal need to decarbonise polluting sectors** and activities. The bill for doing this is a vast \$6 trillion per annum. Spending on renewable energy, for example, has been growing for decades (unsurprisingly leading to the elevated valuations we encounter), yet in dozens of other sectors and industries it's just about to start. This is our broad investment opportunity then: an **opportunity to make the returns we want** for our investors, and the investment that is going to allow society to **hit its climate targets**.

Put another way, is it better to invest in a company with a low carbon footprint because it is capital light, or does it do **more actual good** for the environment to, for example, invest and support a steel manufacturer with the technology to **halve the carbon intensity** of its products or its customers' products? The ESG investment industry has tried the former for many years, and yet we have undeniably failed to produce a reduction in carbon emissions we so desperately need to achieve, as we show in figure 1, overleaf.

Approach that is aligned with contrarianism and value-driven investments

This new strategy is **focused on opportunities** created by this generational shift within a number of unloved areas of the market, which are likely to see a far better cycle than they have over the last decade. We call companies with these transitional characteristics '**improvers**' and '**enablers**'. Our approach is a happy confluence of having a positive impact on the world and operating in line with our valuation-disciplined philosophy, exposing the strategy to **re-rating potential**. Investing in sustainability in this way is very aligned with a contrarian, valuation-conscious mindset.

In short, this is a much wider opportunity than wind farms and Tesla!

KEY FACTS

A **truly differentiated approach** to sustainability investing

A global equity strategy which combines **valuation discipline** and **contrarian thinking** with **sustainability** integration (meeting **SFDR Article 8** standards)

Focused on **under-appreciated** sustainability **improvers and enablers**, leading to "off the beaten track" ESG investments...

... with **re-rating potential** and an actual **real-world positive impact** on the environment

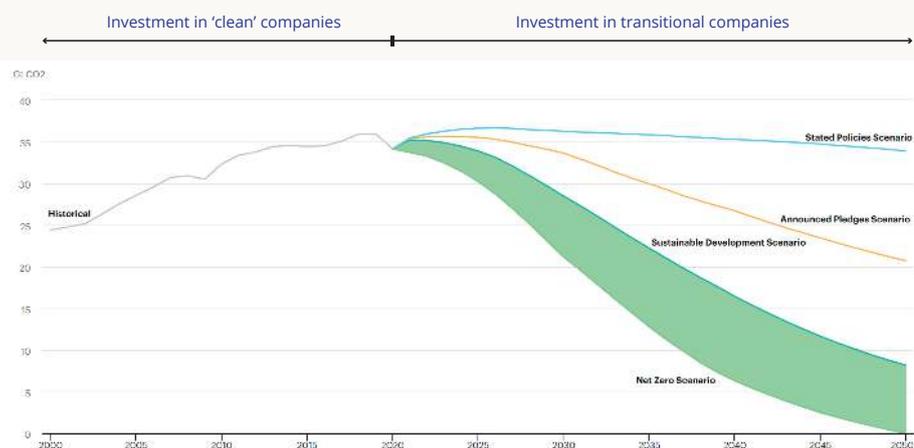
An **active stewardship** approach helps accelerate improvement where necessary

A **great diversifier for clients** over-exposed to the same narrow set of ESG growth stocks.

Run by experienced global equities managers, **William Lough** and **Hugh Sergeant**



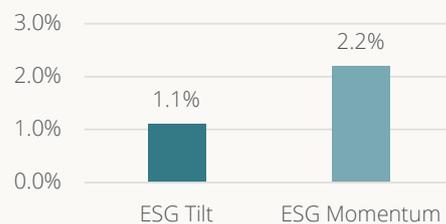
Figure 1. Investment in 'clean' versus 'transitional' companies.



Source: IEA, CO2 emissions in the WEO-2021 scenarios, 2000-2050, IEA, Paris <https://www.iea.org/data-and-statistics/charts/co2-emissions-in-the-weo-2021-scenarios-2000-2050>

Figure 2. Difference between investing in ESG Clean companies and ESG Improvers.

MSCI Study – Active Return of ESG Tilt and Momentum Strategies (Annualised, Feb-07 to Mar-15)



Source Bernstein. Published April 2021.

Proprietary ESG scoring and active stewardship

Within our investment team we have developed a **philosophy and process which integrates sustainability** at its core, and which we apply to every company we look at to produce our proprietary scores and analysis. Some common approaches to sustainability issues can be reactive or backwards looking and stagnant. We are **resolutely forward-looking**, seeking the **future winners** from emerging ESG leaders, companies driving significant improvements in their own sustainability credentials, and the companies whose products or services enable that improvement. Our **active stewardship** approach, with voting and focused engagement done by the investment team, means that client capital is also **supporting acceleration of change** where we see it as necessary or an opportunity to enhance returns. Using the MSCI scores as a proxy, this all suggests more potential for alpha generation (figure 2).

This strategy is a **concentrated, multi-cap** strategy. With ESG investing having become very concentrated in the highest valued, most crowded growth stocks, our approach offers the opportunity to **diversify valuation-risk** while enhancing the ESG contribution of the portfolio, as well as being an **exciting alpha opportunity** in its own right. We are investing in the sustainable opportunities of tomorrow, at the valuations of yesterday.

RIVER AND MERCANTILE

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