Sustainable Investments

The Sustainability Newsletter of J. Safra Sarasin Asset Management

July 2016

Editorial

Sustainable themes after the climate summit

Dear Reader

Last year there was a whole series of UN conferences which will subsequently be seen as an important historical landmark, if not to say, a “Bretton Woods” for sustainability. Sustainability was certainly last year’s hot topic: starting with the UN Conference on Disaster Risk Reduction Conference in Sendai, Japan, followed by the Third International Conference on Financing for Development in Addis Ababa, Ethiopia, and the UN Post-2015 Development Agenda in New York, and finally the United Nations Climate Change Conference in Paris in December 2015. Participants discussed, planned and argued about which sustainable development goals humanity should set itself, how the achievement of these goals should be financed, and which countries should contribute how much.

Sustainability roadmap up to 2030

The results are clear to see! A total of 188 countries have now signed up to these ambitious sustainability goals, thus allowing the Paris agreement to be ratified. The 17 Sustainable Development Goals cover all areas and aspects of our well-being, while the subsidiary targets for each goal set out a concrete roadmap for political decision-makers worldwide for the next 15 years. It presents a very full agenda for promoting sustainable development that affects all of us, from combating poverty and hunger, to creating a more inclusive, egalitarian and peaceful society, ensuring access to clean water and renewable energies, and improving health.

UN Sustainable Development Goals

Source: United Nations, 2015

Opportunities for people and business

At the same time, these new goals stake out the increased opportunities available to people, businesses and investors. In order to meet the climate targets, novel, efficient means of energy generation and storage need to be introduced and energy-saving methods developed. The need for decent access to clean water will be a boon to many companies, such as water utilities, as well as manufacturers of water treatment plants and water meters. In future, the emphasis will be not on breakneck expansion, but rather on a pace of growth that preserves resources. Companies active in this area could well be tomorrow’s winners.

Thematic investment approach

Identifying these opportunities is the main objective of thematic investments. This discipline aims to spot at an early stage those trends that will attract capital and demand over the coming years and therefore promise a dynamic rate of growth. In the thematic approach, the region or sector that a company belongs to is not as important as whether its revenues will be affected by a future investment theme, and to what extent. Because if the prediction of the theme materialises, all the selected companies will achieve superior growth rates, which should in turn generate a decent investment return.

Insights into investment themes

Our quarterly newsletter is dedicated to thematic investment and is designed to give an insight into all its aspects, ranging from Green Bonds to renewable energy, sustainable consumption and the theme of water. All these trends will benefit significantly from international efforts to foster sustainable development across the planet. It is no longer possible to turn back the clock. Dramatic changes are ahead that will not only benefit individual investors, but also each one of us personally.

Best wishes,
Jan Amrit Poser
Head Asset Management

Thematic investment in solutions to meet the challenges of the 21st century

Shortage of resources, population growth and climate change are all global trends that threaten sustainable development. Companies that face up to these challenges – and are even able to find solutions to them – will be better equipped than their peers for achieving sustainable growth over the long term. Investors capable of identifying winning themes can potentially achieve higher returns

Sustainable megatrends create opportunities

The investment philosophy of our Thematic team is based on a successful combination of attractive sustainability themes that are set to play a pivotal role in the 21st century. These themes are based on global trends such as climate change, demographic shifts, shortage of resources, technological progress and the growing importance of corporate responsibility. Although these trends may unsettle many investors, for companies they mainly create opportunities as well. As these companies are extremely well positioned, they offer exciting chances for investors as well.

Rigorous company research is key

We believe that in-depth analysis of the company is the only way to provide an answer to the question as to how sustainable its business model is, and that active portfolio management is thus required. The first step taken by our Thematic team is therefore to select a number of future macro themes. It only considers those themes with convincing potential and strong growth prospects, specifically targeting the shares of those companies that have found a solution to the challenges faced. These companies have adapted their business models to the changes and are in a position to benefit from these global trends.

Sustainable themes of the future

Advanced Materials	Changing Consumer	Energy & Climate	Finance Future
Health Systems	Mobility	Technical Disruptors	Water

Source: BJSS

Health: People are living much longer and want to keep healthy. To do so, they need high-quality products which are also as competitively priced as possible. Access to medicines is a major issue – particularly for developing and newly industrialised countries.

Water: Demand for water is constantly rising, but there is a growing shortage of clean water in many parts of the world. Water is a key input factor for both industry and agriculture.

Consumer behaviour: Consumers want to be sure about quality (e.g. toxic substances in clothing and food) and are increasingly demanding more environmentally friendly and socially responsible forms of production.

Energy & climate: The world is currently in the process of switching from finite to renewable sources of energy. Another important and often neglected area here is energy efficiency.

Mobility: Demand for mobility is continuously growing, and with it the need for transport concepts that are sustainable in the long run.

Modern materials: Thanks to stricter regulations, there is growing demand for materials that reduce resource consumption in buildings and vehicles. The key issues here include heat insulation, stability and lightweight construction, to name a few.

Technological innovation: The IT sector is home to many innovations that are dramatically transforming our economy. We conduct in-depth analysis of themes such as the Internet of Things, cloud computing and driverless vehicles, and screen them rigorously to see if they are equipped for the future.

Sustainable finance: Here the focus is on financial service providers that promote more sustainable development (e.g. renewable energies) or offer socially responsible products (insurance policies, etc.).

Selecting tomorrow's winners

When analysing companies, we extend the traditional financial criteria to include three other dimensions: Environment, Society and Corporate Governance (ESG). This analysis is performed by the Sustainable Investment Research team at Bank J. Safra Sarasin. Our bank has been a pioneer in this field since 1989. One of the tasks of sustainability analysis is to identify how well the companies perform compared with their peers when measured against ESG criteria.

Comprehensive company analysis

Source: BJSS

The thematic approach is global and considers not just large, but also small and medium-sized companies which are future-oriented. However, companies engaged in business activities at odds with ethical and environmental criteria are excluded from the selection process. These include nuclear energy, armaments, genetically modified seeds and tobacco.

A portfolio with a sustainable future

By investing in themes, investors have the opportunity to participate in the potential success of sustainability leaders. With their products and services, there are able to address the themes of the future and make a positive contribution towards sustainable development, creating value for shareholders in the process.

Andreas Holzer
Product specialist for the JSS Oekosar Equity Multi-thematic Fund

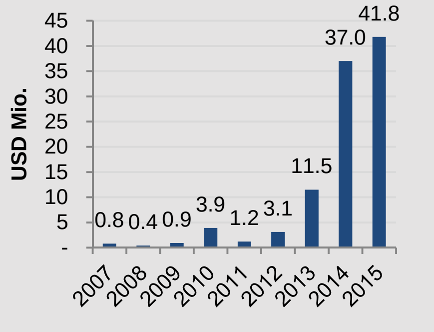
Green Bonds – a growing market with a promising future

"Green Bonds" have become increasingly popular over the past five years and are now available to a much wider public. Investors looking to put their capital towards supporting sustainable development can therefore get directly involved. So what is the difference between Green Bonds and conventional bonds, and what drives the market in this segment?

Green Bonds come of age

Green Bonds essentially have the same structure as traditional bonds: an issuer borrows money from an investor, and in return makes regular interest payments (in the form of coupons) and also repays the capital at the end of the term (redemption). The difference between Green Bonds and conventional bonds is the way in which the capital raised is subsequently used. While the proceeds of a traditional bond issue can be used to fund practically any project, the proceeds raised by Green Bonds are tied to projects that provide environmental or social benefit. They therefore finance a broad spectrum of investments, ranging from renewable energies and reduction of greenhouse gases to forestry projects and the construction of social housing. Since Green Bonds are mainly associated with environmental objectives at present, social themes are not discussed here.

Annual volume of Green Bond issues (USD)



Source: Climate Bonds Initiative

Flagship projects

There are many high-profile examples of projects financed by Green Bonds. The Australian bank NAB, for example, raised around USD 250 million in 2014 and used the money to finance loans for electricity generation for farmers using wind and solar power. The consumer products giant Unilever also raised GBP 250 million in 2014 which it used to introduce more environmentally friendly production methods in six global locations, including projects to reduce greenhouse gases, water consumption and waste volumes. The South Korean car manufacturer Hyundai issued bonds to the value of USD 500 million this year exclusively to finance consumer loans for hybrid vehicles. In the public sector, government agencies and supranational organisations such as the World Bank, the KfW Group and the European Investment Bank (EIB) have issued Green Bonds since the turn of the millennium to raise capital specifically intended for green development aid, sustainable housebuilding and also climate protection.

Search for standards for Green Bonds

The market for Green Bonds was estimated to be worth around USD 400 million in 2008, but since then, interest in this sustainable asset class has been steadily rising every year. At the same time, however, calls have increased for a uniform definition and clearly defined processes as part of the overall financing package. This has resulted in two standards being established: on the one hand the Green Bond Principles from the International Capital Market Association (ICMA). These principles include a framework for good practice when issuing bonds, especially the intended purpose, the choice of project, the management of the proceeds raised and reporting requirements. This standard is currently applied by over 50 globally active financial institutions. However, there is no obligation for supervision by independent third parties. The second standard is the Climate Bonds Standard set by the non-profit organisation Climate Bonds Initiative. In contrast to the Green Bond Principles, this second standard involves certification, which allows issuers to use the label "Green Bond". At the moment, however, the standard currently only includes criteria for project-financing relating to energy and greenhouse gases.

Drivers of the Green Bond market

In addition to these two standards, a number of market players have developed similar definitions. This has led to a situation where the amount of new Green Bonds issued up to the end of 2015 soared to more than USD 40 billion. While the Green Bond market still mainly comprised only the bonds of government-related issuers five years ago, the proportion of Green Bonds from corporate issuers has since risen sharply thanks to the introduction of the new standards. One reason has been the greatly enhanced transparency and standardised procedure for sustainable project financing. Green corporate bonds now account for more than a third of all Green Bond issues and are expected to make up an even greater share of the sustainable bond market in future. In summary, not only the size but also the make-up of the Green Bond market has radically changed over the years. In contrast to traditional bonds, the funds raised by Green Bonds are used in a systematic and value-oriented way to promote sustainable development for the future.

Claudio Paonessa
Asset Management
Bonds/Absolute Return

Water – elixir for life and for performance

Bank J. Safra Sarasin's Water Investment Theme helps investors to benefit from increasing competition for scarce freshwater resources and stricter regulation of wastewater treatment while providing solutions for a sustainable future

Aging infrastructure is a chronic problem

On May 25, 2016, a water pipe leak in Florence, Italy, caused the road along the Arno River near Ponte Vecchio to collapse, creating a 200m long ditch full of parked cars and water. Fortunately, no one was hurt and the only people who remember the accident are the residents of Florence whose water supply was cut, and the equity analysts who have been seeing the tremendous investment opportunities in the Italian water sector for years. Indeed, aging water infrastructure is a chronic problem across most European and North American cities. The reason is simple – investments in water infrastructure need to be compensated by higher water tariffs, which is a politically difficult step.

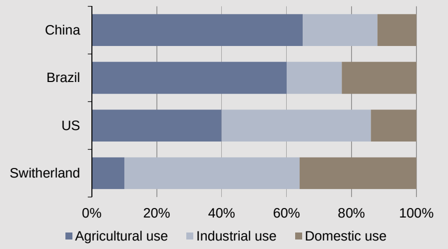
The glass is half-full

If raising water prices is a problem in the developed world, then one can imagine just how sensitive the issue is in the developing world. According to Global Water Intelligence (GWI), India and the Middle East have some of the lowest water tariffs in the world, despite being generally water scarce regions where a lot of investment is needed. Thus, though there are plenty of opportunities for water investment, very few have been realized because water users are reluctant to pay a price corresponding to the value they receive. Several factors are changing this gridlock:

1) **Distress**: Extreme droughts (such as those in California and Brazil) and incidents that harm human life (such as the lead contamination of water in Flint, Michigan) lead to public acceptance that clean water does not come for free.

2) **Economics**: Industry accounts for 20% of freshwater withdrawals globally and over 50% in the developed world. Industrial clients are driven by economic considerations and their water needs are growing due to expansion in water-stressed regions and the necessity to use "difficult" saline or brackish water. The industrial water market is expected to grow annually by 8% from \$20bln in 2016 to over \$27bln in 2020 according to the GWI.

2014 annual freshwater withdrawals



Source: The World Bank

3) **Tighter regulation and stricter enforcement**: Regulation of wastewater treatment and reuse is becoming more stringent as competition for freshwater resources between the three main user groups intensifies. Specifically, China has pushed forward with its war on air and water pollution despite its economic slowdown. In the West, the implementation of the Ballast Water Management Convention will require the treatment of ballast water in over 60'000 ships until 2020.

"Water, water, everywhere, nor any drop to drink." Coleridge, The Rime of the Ancient Mariner

In summary, a successful investor in the water sector needs to understand how long-term growth drivers work alongside the short-term industry-specific and business cycle dynamics to influence corporate earnings quarter after quarter. After all, the investment performance of any thematic portfolio reflects both long-term trends and solid industry and equity analysis.

The ebbs and flows of water investing

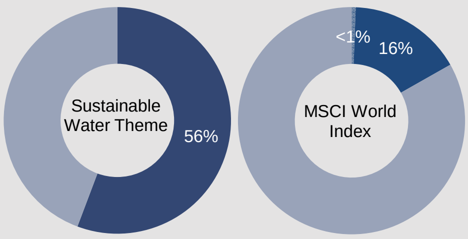
The Water Investment Theme captures investment opportunities along the full water value chain from treatment, infrastructure and supply to efficient use.

JSS Water Investment Themes

Source: Bank J. Safra Sarasin

The Water Treatment investment theme includes companies in the water analysis, filter technology and chemicals industries. The companies of the Water Infrastructure theme are suppliers of pipes, pumps, plumbing and related products and engineering and construction firms, which work with utilities involved in Water Supply and wastewater treatment. Lastly, the theme of Efficient Use of Water includes companies from a host of industries, which help their clients save water, such as precision agriculture equipment supplier Lindsay or water heater company A.O. Smith.

Revenue exposure to water



Source: Bank J. Safra Sarasin

According to GWI, the water market will reach \$256bln in 2016 and grow to \$319bln by 2020. In order to benefit from this growth, Water investment portfolios should contain only companies with a certain water revenue exposure. We estimate that the water exposure of the companies in the water fund is on average 56% while the water exposure of the MSCI World Index is less than 1%. Even when we consider only the water companies from the index, the exposure amounts only to 16%. We believe that a focused and actively managed portfolio can help investors take advantage of the growth in the water sector while at the same time fostering sustainable development in the broader economy.

Viara Nedeva Thompson
Sustainable Investment Analyst for the Water Investment Theme

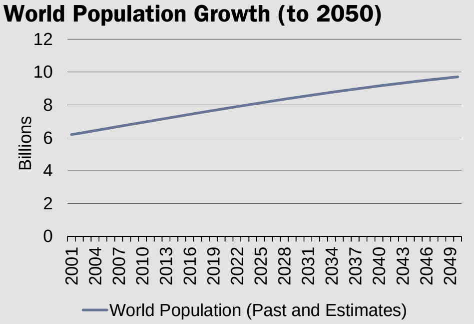
New Power: The future of energy yields investment opportunities

There is change in the air for the energy sector as we speak. Driverless electric cars are populating US highways but in the meantime the oil crash has allowed people to drive more for less money with their gasoline-powered cars. The future certainly looks different and the energy transition will bring many investment opportunities for the sustainable investor.

The rising hunger for energy

Our society is facing growing demand for energy in the face of an increasing population. The World Bank expects world population to grow by around 32% from 7.3bn people today to 9.7bn by 2050. The energy intensity per capita is also increasing as more people own cars, use connected devices and also live longer.

World Population Growth (to 2050)



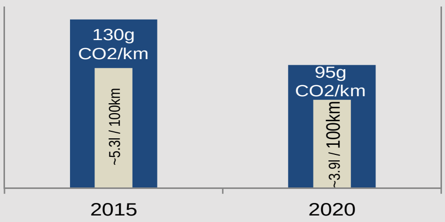
Source: World Bank, 2016

As a result, the demand for energy is expected to increase 70% by 2035. Such a surging demand will need to be met by rising fuel and electricity output. However, it is all too clear that the future energy output will have to be renewable and clean in order to contain greenhouse gas emissions. Moreover, an untapped potential lies in solutions that help to raise energy efficiency.

Investing in the energy transition

The energy transition from a fossil fuel powered society to a renewable energy powered society will not be easy. Foremost, the energy transition calls for lower consumption. This requires the involvement of different technologies and solutions energy efficiency to reduce the demand for energy and to reduce the cost of energy and the cost for the environment. We have identified several interesting investment opportunities in efficient lighting (LED), efficient mobility (electric cars, lighter materials, downsized engines) and efficient buildings (insulation, smart materials). Particularly large energy savings are possible in the transportation sector. As an example, the European Commission ruled that the carbon intensity of newly produced vehicles will have to be as low as 95g of CO_2/km (3.9l of fuel/100km) by 2020. This implies a 26% decrease in fuel consumption (from 5.3l of fuel/100km) which can only be achieved by increasing energy efficiency.

CO_2 & fuel efficiency targets (EU)

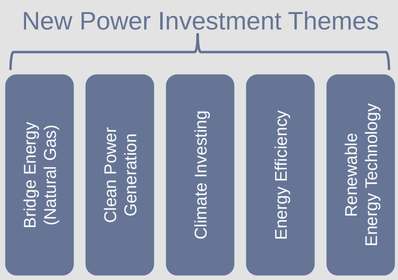


Source: European Commission, 2015

New Power: a comprehensive theme

This means that decreasing our consumption of fossil fuels (oil, coal, and natural gas) is complimentary to the switch to renewable energy. Both are needed to meet energy demand and reduce its societal and environmental impact. In our New Power Investment Theme, we have implemented five relevant themes that we invest in and offer the interesting investment opportunities: bridge energy (natural gas preference over coal and oil), renewable energy technology (solar, wind), energy efficiency (building, mobility, lighting), clean power generation (clean utilities) and climate investing (financing and insurance of sustainable projects).

New Power Investment Themes

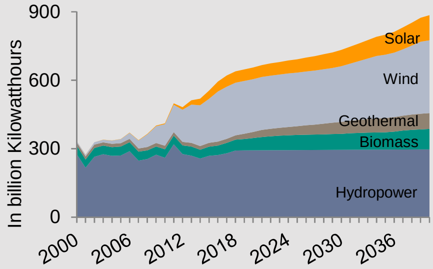


Source: Sustainable Investment Research, 2016

Strong trends in renewable energies

The renewable energy sector is likely to offer strong growth in the upcoming years. With the cost of solar (price of polysilicon and solar modules) and wind coming down, these sources of energy are increasingly competitive against natural gas and coal fired utilities. The shift in market shares that we have recently observed is set to continue and will bolster earnings growth for the companies which are active in the sector.

Growth in renewables (USA, 2000–2040E)



Source: US EIA, Annual Energy Outlook, 2015

The New Power Investment Theme captures promising aspects of the energy transition and includes the entire value chain of the energy production. This makes it both a focused as well as a diversified investment solution.

Stéphane Destraz
Sustainable Investment Analyst for the New Power Investment Theme

Interview with Michele Coco, Asset Manager of the sustainable lifestyle brands investment strategy

The power of sustainable lifestyle brands

Brands are valuable to companies today because they attract consumers and foster their loyalty. Moreover, brands are counted among the intangible assets on the balance sheets of companies. But in order to reap long-term benefits, companies have to make sure that the lifestyle the brand is catering to is sustainable.

Why are brands important for companies?
Branding is one of the most critical parts of a marketing strategy of a successful business. A strong brand goes far beyond its visual logo or a catchy name. It is the entire set of connotations that a consumer has in relation with a particular product. A strong brand identity can create an emotional relationship of trust, credibility and quality that wields immense power. With the global business world online and an increase in worldwide competition from emerging markets, strong brand identity is more important than ever before. A consistent, well thought through branding strategy must be at the heart of successful product development. It has never been more important to get branding right and brand management should be a core topic when teaching about business administration and strategy.

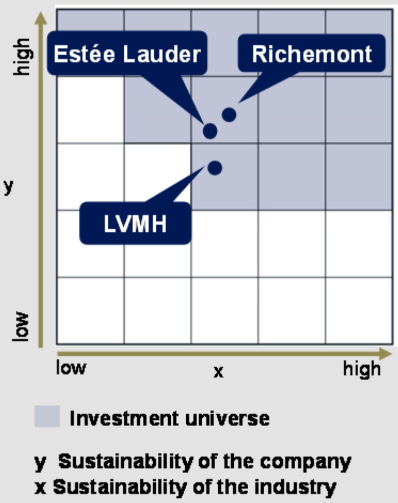
What is the role of the media?
Lifestyles include how people eat, dress, and communicate. With the rise of the media age, changes in lifestyles have accelerated. Media like movies, magazines, television shows, and more recently, the Internet (i.e. self-written blogs and popular websites) are the main sources influencing lifestyles around the world. Lifestyle trends have always been influenced by the wealthy and famous, whether they are spotted at leisure or in a paid advertisement. Celebrity endorsements are a common feature. But the internet has arguably become the most powerful medium for spotting and influencing trends. Since the rise of the intranet, not just celebrities have been able to influence lifestyle changes, but average persons if they have managed to voice opinions that went viral in social networks. The computer era has definitely changed the way people obtain their news, perspectives and communication.

How can we understand branding in the age of social media?
In the era of Facebook and YouTube, brand building has become a formidable challenge. As a centerpiece of their digital strategy, companies made huge bets on what is often called branded as content. Social media now allows companies to leapfrog traditional media and forge relationships directly with costumers. If you manage to tell costumers exciting stories and to connect with them in real time, your brand would become a hub for a community of consumers. Given that identity in a postmodern society is a work in constant progress, adopting new brands (trends) can help define an ever-evolving self-image, thereby providing a sense of personal direction for the future. Aesthetic appeal and symbolism are central in this regard: individuals use both to construct their sense of self.

Quelle: iStock

How do sustainability considerations affect the brand value of lifestyle companies?
Sustainability is important for society as a whole; this also applies for the lifestyle industry. Product quality issues, campaigns against poor supply chain labour practices or involvement in controversial businesses may seriously damage brands of companies. However, the consideration of sustainability criteria not only lowers reputational risks and helps to protect the brand value, but also creates business opportunities. The demand from LOHAS ("lifestyle of health and sustainability") clients for sustainable products is growing. Today 55% of online consumers are willing to pay more for products with a positive social and environmental impact (Nielsen Market Research, 2014). For example, Estée Lauder's AVEDA hair products have a cradle-to-cradle certification, Richemont started to measure the carbon footprint for different jewellery products and LVMH reports less issues with Asian suppliers to only name a few positive examples. All in all, linking lifestyle brands and their sustainability credentials is a progressive combination for investments.

Sustainability Matrix



Source: J.Safra Sarasin Ltd

How can investors benefit from sustainable lifestyle brands?
The Sustainable Lifestyle Brand Theme offers investors the possibility to invest in promising lifestyle brands. Lifestyle brands are present in many different sub-themes such as Accessories & Fashion or Apparel & Sports, Discretionary Consumption & Healthy Living or Entertainment, Mobility or Travel. Therefore the lifestyle brands philosophy can be implemented in a widely diversified portfolio.

Michele Coco
Asset Manager Equities of the Sustainable Lifestyle Brands Theme

Selected sustainability profiles and ratings in the second quarter of 2016

Georg Fischer: Sustainability as a Strategy Driver
Georg Fischer is a Swiss industrial company predominantly involved in supplying the automotive industry and the water industries. The company has a comprehensive sustainability strategy in place and considers it as integral to its business model. Hence, both operations and business benefit from a sustainability approach enabling better risk management and a good positioning towards clean technologies. Clear targets are set to improve the Environment, Social and Governance performance and strong management systems are in place to monitor progress, notably on emissions and waste issues. Furthermore sustainability contributes to building the company's product differentiation for example through light weight components improving fuel efficiency in vehicles, or their production of advanced control systems within water distribution infrastructure. Georg Fischer's sustainability rating is **above average**.

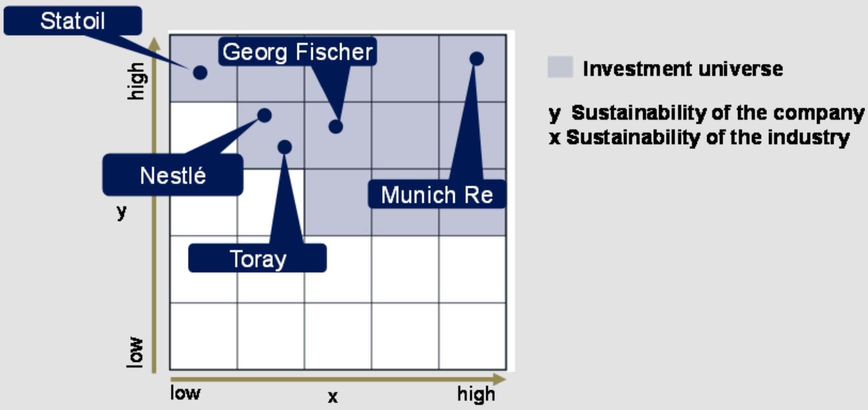
Nestlé: Progress in supplier monitoring
Nestlé has one of the most transparent and advanced sustainability strategies and reporting frameworks in the consumer goods industry. Nevertheless, it has been in the spotlight for a range of criticisms related to unsustainable raw material sourcing and supply chain labour practices, which weigh on the sustainability rating. The sheer scale and breadth of its supply-chain operations make controls harder to implement. Despite this, Nestlé has developed strong sustainability-related policies and systems and made progress especially with regards to supplier monitoring (cocoa, tea and coffee). Relative to peers, Nestlé's products have a significantly lower carbon and water footprint. In 2015, 6'174 environmental product assessments were conducted. All in all, this results in an **above average** sustainability rating for Nestlé.

Statoil: The leader in the energy sector
Statoil is an energy company that is involved in the exploration, production, transportation, refining, and marketing of petroleum and petroleum derived products in Norway and internationally. The company has an industry leadership position in managing environmental and social risks (e.g. lowest spills intensity compared to its peers). Statoil has a strong carbon emissions management and ambitious emissions reduction targets. The company ranks very strongly compared to peers with regard to carbon emissions intensity on a per-sales basis. Furthermore, the ownership structure does not include any indicators of major governance risks, and shareholder rights are generally strong and well-aligned relative to global peers. Overall, the company scores **above average** in the sustainability matrix.

Toray: The Clean Tech Chemical Company
Toray Industries is a chemical group with Japan and Asia as core markets (80% of turnover). Its major businesses are fibers & textile, plastic and chemicals. The company displays a strong management of key environmental and social issues related to the chemical business. The company therefore mitigates legal and operational risks associated to pollution and health issues that are typical to the sector and can prove costly. Moreover, Toray has put a strategic emphasis on green products of which it derives around 30% of revenues and dedicates half of its R&D (research & development) budget. The company is therefore well positioned to benefit from opportunities in clean technologies. Examples of such products include carbon fiber components for the automotive and aerospace industry, enhancing fuel efficiency, energy storage solutions and bioplastics. Toray's sustainability rating is **above average**.

Munich Re: The largest reinsurer actively addresses climate change challenges
Munich Re has interesting product offerings that relate to insuring against climate change risk, e.g. flood and crop insurance or discounted premiums for low carbon cars. "NatCatService" is a risk modelling tool that helps clients to identify natural hazard risks. Munich Re has a strong human capital development approach, good benefit packages and education initiatives are complemented by strategic senior management succession planning. The comparably low turnover rate is a good indication for the success of these efforts. These initiatives and other similar efforts of the company to improve the long-term resilience and thrive from ESG megatrends result in Munich Re being one of the ESG leaders in the reinsurance sub-industry with a **high** sustainability rating.

Sarasin Sustainability-Matrix®



Examples on sustainability profiles are only for illustrative purposes and do not take into account other factors, including but not limited to, economic factors. They do not constitute a request or offer, solicitation or recommendation to buy or sell investments or other specific financial instruments, products or services.

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