J. SAFRA SARASIN
Sustainable Swiss Private Banking since 1841

Sustainable Investments

Quarterly Newsletter of J. Safra Sarasin Asset Management
October 2018

Editorial

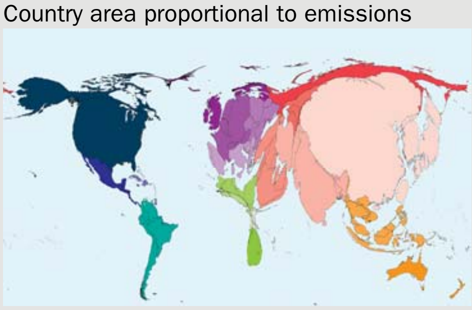
Global challenges and investment themes

Dear reader

The summer of 2018 has brought an unprecedented heatwave to the Northern hemisphere. Forest fires have raged from Sweden down to Greece, claiming the lives of many victims. Central Europe and the UK were gripped by a severe drought lasting several months that caused massive crop failures. As a consequence of the accumulated heat, heavy downpours caused flooding and transport chaos for a while. Meteorologists say that the past summer has shown a highly unusual weather pattern which they think is linked to man-made climate change.

While the harbingers of a dramatic climate change are giving clear signs, the political reactions are absent. America's unilateral declaration of a trade war brings back to life ageing and inefficient coal power stations in the USA. Germany is not progressing with the planned exit from coal. Subsidies for energy in many Emerging Markets are sustaining a rise in the use of fossil fuels. The following graph depicts the world map, representing the area of a country in proportion to its carbon dioxide emissions. The picture shows that emissions are currently primarily a problem for industrialised countries, but that the catch-up process of emerging countries, especially China, will massively exacerbate the problem in the next decade.

Carbon dioxide emissions 2015
Country area proportional to emissions



Source: Worldmapper.org

In October 2018 the Intergovernmental Panel on Climate Change (IPCC) will release a special report in preparation for December's climate conference COP24 in the Polish city of Katowice. It is high time that the international committee of experts warns politicians that achieving the set goal of limiting global warming to 1.5 degrees Celsius compared to pre-industrial levels is now virtually impossible.

Many recent studies have indeed concluded that achieving the Paris goal requires a net depletion of carbon dioxide from 2070 onwards, with a gross withdrawal of carbon dioxide starting already in 2030 on a massive scale. The longer politicians procrastinate, the more CO2 will need to be removed from the atmosphere later on.

Sustainable investments aim to identify the risks associated with global challenges and the measures necessary to redirect economic activity. We calculate the carbon footprint of each portfolio and its exposure to fossil fuels in order to be able to draw conclusions for portfolio construction and risk management.

But more importantly, global challenges also offer great opportunities for investors. One very promising theme is the need to provide clean water for industry and households and to use it more efficiently. A second theme is the technological revolution that is necessary to master the energy and transport transitions. A third theme is the necessitiy to meet the needs of Asia's rising middle classes in a sustainable way. A fourth theme is the re-orientation of global production and services towards the rapid ageing of our society. All these trends will bring significant growth to the companies positioning themselves in these fields. The main topic of this quarterly newsletter is sustainable thematic investing, with which investors can achieve positive performance from long-term trends and, at the same time, develop their impact. Let us inspire you!

Best wishes,
Jan Amrit Poser
Chief Strategist and Head Sustainability

Interview with Pierin Menzli, Head of Thematic Equities

Forward-looking thematic investment strategies offer opportunities and solutions

Many investors are interested in focusing on sustainable growth not only as a way of achieving positive returns, but also supporting new solutions that benefit society. The enormous environmental, political and social changes we are currently experiencing also bring new opportunities and risks for investors. Pierin Menzli, Head of Thematic Equities, explains some key aspects of sustainable thematic investment, with a particular emphasis on the escalating regional water crisis and potential solutions.

What investment themes are of interest to your clients?

Many clients are currently interested in new technologies in the areas of artificial intelligence, driverless vehicles and robotics. That's perfectly understandable, as we are confronted daily with these themes in the media and also in our private and personal lives.

Other themes that come and go in waves over the years include climate change, which people are becoming increasingly aware of as a result of heat waves and other natural catastrophes. Water – and its availability and quality – has obviously been another hot topic for some years.

Many investors are also interested in social themes, such as healthcare, demographic change and consumer habits of the millennials (20-35-year-olds).

What are the objectives of thematic investments?

The purpose of thematic investment strategies is to identify business models and industries that stand to benefit from one or more growth trends while at the same time offering solutions to social challenges in areas such as technological change or resource shortage. Our main priority is to be able to offer forward-looking, distinctive portfolios built with a high level of conviction.

What does that mean in concrete terms?

We believe our choice of investment themes, coupled with our in-depth analysis of companies and their sustainability credentials, enables us to identify the most forward-thinking companies. We lay a solid foundation for these "High Conviction" portfolios by constructing concentrated – and at the same time adequately diversified – investment portfolios containing around 30-40 positions spread across different regions, sectors and sub-themes. Our investment strategies are not geared towards a specific stock market index, but to the quality of the business models. On top of that, it is the financial figures that define the quality of our investments rather than their inclusion or weighting in a benchmark index. Our approach is therefore very different from passive, backward-looking investment instruments based on market capitalisation.

What new developments can you tell investors about?

There is plenty to tell in areas such as investment processes, new portfolio positions and industry awards. Perhaps the most interesting news for clients is that we now offer all investors several thematic investment strategies in the areas of new technologies and lifestyle brands in UCITS-compliant investment vehicles domiciled in Luxembourg. In the past, these were only available as specialised investment vehicles for individual investors.

In addition, we have revised and improved the existing JSS water investment strategies. The progressive technologisation of the water value chain and the launch of the UN's Sustainable Development Goals (SDGs) – specifically Goal 6 (access to clean drinking water for all) – prompted us to take this step.

Which aspects of the JSS water strategy are new?

We still place a strong emphasis on conventional water products in the water infrastructure, such as pipes, pumps and valves. However, we complement these more established products with a greater focus on technology (see figure below). Here we also invest in software firms offering 3D water modelling for modern cities or simulations of dams bursting. These ground-breaking innovations have massive potential and a very strong positive impact. The second new area involves companies that manage existing water resources responsibly, also referred to as good "water stewardship" (see figure). These companies are role models for their competitors and all their stakeholders. Furthermore, this strategic approach to water management also gives companies a competitive advantage in the form of lower operating costs and fewer reputation risks. We therefore believe that they make a positive impact.

JSS water investment strategy

Source: Bank J. Safra Sarasin

Which aspects do investors need to be particularly aware of?

In my opinion, active management is necessary because the themes can change dramatically and develop in different directions. So it's no use to "keep betting" on industries or companies that are more geared to the past. In addition, investors also need to analyse previous periods with temporary corrections. How does the portfolio behave when markets turn negative? And how does the portfolio manager respond? Ultimately it's a question of trust whether to invest in the expertise of an investment team that is not only able to tell positive individual stories but has also established a systematic and professional investment process.

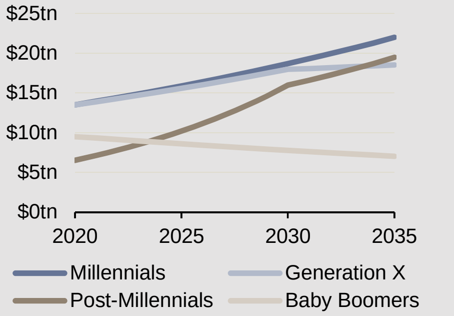
Millennials are the world's most powerful consumers

Millennials – aged between 15 and 34 – outnumber all other generations and have the strongest impact on consumer trends. They reach their prime working age now and their spending power is already higher than any other age group. The «connected» generation shops anytime and anywhere, across online and offline channels, with less brand loyalty than previous generations. They have different lifestyles, eat differently, and are more environmentally conscious than their parents.

Understanding millennials is essential to recognising future consumer trends

The Millennial generation is the largest in history and as they reach their prime working and spending years, their impact on the economy is going to be substantial.

Global millennial spending power to exceed all other generations



Source: Financial Times, World Data Lab, 2018

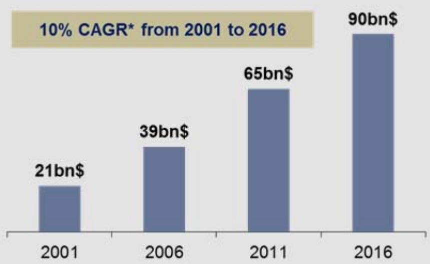
Additionally, millennials have come of age during a time of technological change, globalisation and economic growth. The following characteristics typify millennials:

- The percentage of young people married has dropped by more than 50% since the 1960s. Millennials are waiting longer to have children. This is supported by a more advanced health care system. As a consequence, more discretionary income is available for consumption, for longer.
- Millennials show different attitudes to ownership that have helped to develop the so-called «sharing economy» or «collaborative consumption». Experiences are valued more than acquiring products, as they are mostly unique and readily sharable. Renting is a very viable option compared to buying, also from a sustainable point of view. Millennials have been reluctant to buy items such as cars or a house. Instead, they are turning to a new set of services that provide access to products without the burdens of ownership.
- Millennials' affinity for technology is reshaping many economic sectors, particularly the retail space. With product information, reviews and price comparisons at their fingertips, millennials are turning to brands that can offer maximum convenience at the lowest cost.
- They are dedicated to wellness, devoting time and money to exercising and eating right. Their active lifestyle influences trends in everything from food and drink to fashion.

Millennials eat differently

The lifestyle of millennials varies considerably from the one of their parents. As they have chosen to live in bigger cities, they are suffering the negative effect of urbanization i.e. traffic and daily commutes. Millennials are also more active, spend less time at home and are more health conscious when it comes to what comes on their plates. Those developments have had a particular effect on breakfast occasions. It appears that this generation is either skipping breakfast or buying food-to-go on their way to their workplace. This has caused structural shifts in the growth of certain food categories, like breakfast cereals to more healthy alternatives, such as fruit snacks or organic products as the following illustration shows.

Global organic food and drinks sales, 2001 - 2016



Source: FiBL & IFOAM, Ecovia Intelligence, 2018

The new apparel retail model

Millennial consumers' lives are centered on digital discoveries on social media via influencers and experiences. Therefore, styles and fashion trends change much faster than in the past which means that the design, sourcing and flow of goods to consumer and wholesale channels has to be much quicker as well. Additionally, the rise of social platforms brings down barriers to entry in retail and is redefining relationships between brands and retailers. For brands, no longer is it enough to put a logo on every product. Even performance attributes in fabrics have not become a differentiating factor. Going forward, we believe brands need to provide added value in the form of an emotional experience.

Investment conclusions

We believe that the retail apparel and footwear retail market has shifted from a push- to a pull-model. Apparel retailers have to rethink how they can engage with their millennial customers to create a longer lasting emotional connection, based on experiences and supported by influencers.

We also expect to see further disruptions in grocery stores, with traditional processed food losing shelf space to healthier and organic products, which resonate more with Millennials' aspirations.

Philipp Mettler
Investment Analyst,
Consumer Discretionary

Stéphane Destraz
Portfolio Manager

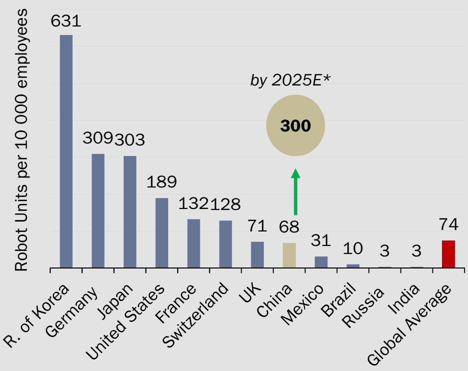
Living among robots

Technological progress and economic growth have triggered an unprecedented expansion phase of robotics adoption and applications across sectors. Continuous innovation in automation, big data and software analytics will strengthen the case for robotics and open new business perspectives. Fears of mass unemployment are overdone, but sustainability challenges exist and have material implications for the value and potential of technology enablers and adopters.

Robots are moving beyond manufacturing
By 2025 the global market for robotic systems is expected to reach USD 87bn (BCG), with a similar amount coming from Artificial Intelligence-based analytics, sensors and lasers as well as from vision, control and communication systems. The main adoption and growth drivers are falling prices, wage inflation and continuous technological improvements. Robots will not only be used in the traditional industrial sector, which was the earliest adopter of robotics technologies, but increasingly in new areas across the consumer and commercial space.

Industrial robot density is rising globally
The global average robot units per 10,000 employees is reaching new highs every year.

Industrial robots – 74 units is the new record-high robot density average

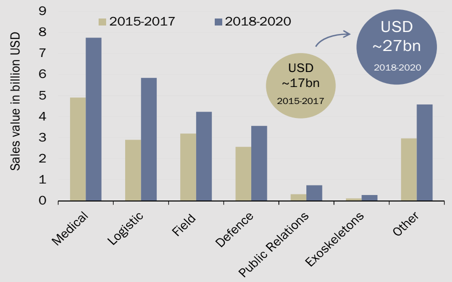


Source: Bank J. Safra Sarasin, IFR, 2018

China, currently the world's largest market for industrial robots with around 30% of global demand but only 23rd in terms of robot density, will be the leading growth driver for this market (chart above). In 2015 the State Council launched its "Made in China 2025" strategy, aiming to upgrade the manufacturing industry, focusing on technology and in-novation with an emphasis on quality over quantity.

Service robots are booming and expected to outgrow industrial robots
Robots are not only gaining ground in the manufacturing sector, but also in other environments from healthcare, logistics or agriculture through to households and entertainment (chart below).

Adoption of professional service robots across the board



Source: Bank J. Safra Sarasin, IFR, 2018

Medical robotics and computer-assisted surgery systems will reduce the variability in surgeons' skills, improve patient outcomes and minimise invasive procedures. Similar meaningful impacts can be expected in other fields. In bionics, promising developments are being made with smart prostheses and exoskeletons reinforcing human capabilities. In logistics, advanced robots have entered warehouses and logistics centres with capabilities in sorting, picking and packaging, thereby increasing efficiency, accuracy and safety. New generations of autonomous robots are also being introduced in the agricultural sector with capabilities ranging from precision crop seeding, weeding and spraying to fruit harvesting, "milkbots" and self-driving tractors.

Robocalypse or cyberparadise?
Historical evidence dismisses both technological dreams and nightmares. Over 250 years of technological (r)evolutions, unemployment has indeed remained stable and around 5%. According to the International Labor Organization, 30% of jobs created since the 1990s were profiles that did not previously exist (software development, IT admin, etc.). Furthermore, not all approaches to harness the potential of automation are effective. Current experiments in the automotive sector demonstrate, for example, that full automation of production is not the best avenue to achieve a mix of cost and quality objectives, despite using the very latest technology. Automation is actually more likely to support specific tasks within a work stream or job, thereby changing the nature of human intervention and freeing up time to pursue other objectives. This is already visible in the restaurant industry, where companies invest in automated ordering and cooking, and redeploy their workforce to enhance service quality and customer experience. Societal challenges must also be addressed by companies sooner rather than later, as this influences the related political agenda and (re)defines the framework in which businesses operate. Today's public discussions are reminiscent of the past, with topics such as the appropriate way of sharing the technological dividend. South Korea is experimenting with the idea of a tax on robots. New ethical dilemmas emerge, for instance in the case of death caused by a self-driving car or around cyber security and privacy on the back of power-grid hacks and fake news. Of course, this does not undermine the potential of new technologies for society at large. Indeed, 2.8 million lives are currently lost every year in hazardous occupations. These jobs could be replaced or made safer by technological solutions. On a bigger scale, the rise of robots may also ease the pressure on labour and economic structures caused by demographic shifts that are slowly flipping the age pyramid on its head.

Jann Breitenmoser, CIIA
Investment Analyst,
Industrials

Guillaume Krepper
Sustainable
Investment Analyst,
ESG integration

Selected sustainability profiles and ratings in the third quarter of 2018

China Conch Venture – looking at business through a green lens

China Conch Venture is an industrial company. Its products and services portfolio revolves around renewable energy, efficiency, pollution prevention and green buildings and is backed by a targeted cleantech innovation strategy. By putting environmental solutions at the core of its business, the company is well positioned to benefit from long term sustainability trends globally as well as a strong domestic momentum on the back of China's ambitious green economy plan. Moreover, production processes bear environmental risks which the company is adequately mitigating based on a comprehensive environmental management system and regular audits. The board structure however creates potential limitations for shareholders to effectively oversee and influence the company's development. On a relative basis, China Conch Venture displays an above average sustainability profile and is therefore eligible to the sustainable investment universe.

Sainsbury's – seizing the rising demand for eco-friendly and healthier products

The company has a comprehensive sustainability plan with ambitious targets. Within the food retailer sub-industry Sainsbury is among the clear leaders when it comes to the sustainable sourcing of raw materials (e.g. seafood, palm oil, beef or dairy) and puts a focus on building reliable supply chains. The retailer also has one of the highest rates of sustainably-certified products and reformulated items in its offering, which means that the company is well positioned to take advantage of opportunities in this relatively fast-growing market. On the labour side, recent acquisitions, such as Home Retail Group, pose integration challenges and may affect staff morale and productivity. Sainsbury undertakes considerable efforts to mitigate such risks. Coupled with an overall sound corporate governance set-up, this leaves Sainsbury in a good position to tackle existing business and sustainability challenges.

Roche – building its license to operate in emerging markets

Roche is a Swiss pharmaceutical company with high exposure to emerging markets (around 30% of revenues). Indeed, the company has developed a broad access-to-healthcare strategy to contribute to and benefit from the improvement of healthcare in developing countries, notably through differential pricing for low income patients and development of drugs addressing orphan diseases. Besides, Roche comprehensively addresses typical challenges in its industry to which it is highly exposed given its global scale. In particular, corruption risks associated with business development in emerging economies are mitigated through adequate measures. On the manufacturing side the picture is, however, mixed with convincing means addressing environmental issues while product safety and quality remains a field of progress despite efforts to reduce related operational, business and legal risks. Overall and on a relative basis, Roche displays an above average management of sustainability issues and is therefore eligible to the sustainable investment universe.

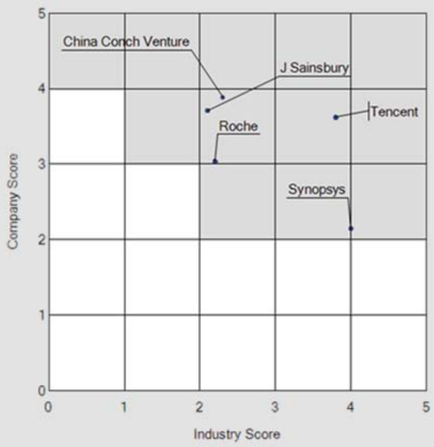
Synopsys – addressing supply chain risks proactively

Synopsys is the leading company by sales in Electronic Design Automation (EDA) which is a category of software tools for designing and testing microchips. As a software company, the ability to attract, retain, and develop human capital is key. Synopsys offers a comprehensive approach in this regard. While being primarily a software company, Synopsis also offers a limited number of semiconductor products. It proactively addresses the ESG issues common to this business namely: responsible sourcing of minerals and transparency in the supply chain. Synopsys supports the Responsible Business Alliance (RBA), which has established supply chain standards to promote social, ethical, and environmental responsibility. The company fully complies with Section 1502 – disclosure of the use of conflict minerals – of the Dodd-Frank Act and in 2017 has implemented policies to mitigate the risk of slavery and human trafficking in the supply chain. Compared to its peers Synopsis displays an average sustainability rating.

Tencent Holdings – leader in human capital development

The Chinese internet giant Tencent handles vast amounts of personal data from a huge number of user accounts. The data stems from its digital platforms, such as messaging services QQ and WeChat. While the company has adopted privacy policies and internal data security controls, it continues to lag global leaders in this area. Overall the policies in this area have to be considered as moderate. However, Tencent ranks at the top quartile when it comes to recruitment, retention, and employee productivity. Being among the most profitable internet companies in China, Tencent indeed offers strong employee benefit packages. Additionally, the company has implemented cutting edge employee engagement & survey programs to keep track of employee satisfaction and stay ahead of possible morale issues. The two aspects of medium data management and leading human capital management leave Tencent with an above average sustainability rating.

Sarasin Sustainability-Matrix®



Sustainable Investment Universe

Source: Bank J. Safra Sarasin, selected issuers, these non-exhaustive examples are provided for illustrative purposes only; ratings as of August 2018

Sustainable Investment Research

UNGC: The Power of Principles

Bank J. Safra Sarasin is a member of the UN Global Compact with a commitment to fulfil its Ten Principles. The Swiss branch of this Initiative launched the "Tour de Suisse" documentary to promote Corporate Responsibility and the Sustainable Development Goals (SDGs) in Switzerland. Bank J. Safra Sarasin participates in this film to showcase how "Sustainable Business is Smart Business". This short movie explores how our commitment to sustainable operations can create opportunities for innovation and valuable business models while mitigating risks and overcoming challenges.

The United Nations Global Compact (UNGC) is the world's largest corporate sustainability initiative. The former UN Secretary General Kofi Annan announced it at the World Economic Forum in Davos in 1999. One year later it was launched in New York. Its objective is to encourage businesses all over the world to adopt sustainable and socially responsible policies, and to report on their implementation.

The United Nations Global Compact initiative is a principles-based framework for businesses, stating **ten principles** in the areas of **human rights**, **labour, the environment** and **anti-corruption** as shown in the illustration below. Every member commits to fulfill these principles, and report annually on its commitment in this regard.

Today, the UNGC has more than 9500 members in over 160 countries, both developed and developing. According to the UNGC the members represent nearly every sector and company size.
In 2015, 193 member states of the United Nations adopted the **17 Sustainable Development Goals (SGDs)**. These principles lay out a path until 2030 to end extreme poverty, fight inequality and injustice, and foster environmental protection. The UNGC "is committed to be a leading catalyst" in identifying new markets and opportunities for companies resulting thereof. This implies for example that the UNGC provides tools to businesses to turn the goals and principles into concrete actions.

"Tour de Suisse" on Sustainable Business: Bank J. Safra Sarasin in focus

This year, the Swiss network of the UNGC has launched the "Tour de Suisse on Responsible Business". For this Tour, the network has produced the movie "A journey through sustainable Swiss business" showcasing best practices in four Swiss companies. Bank J. Safra Sarasin and three other leading Swiss sustainable companies – Firmenich, Caran d'Ache and Nestlé Waters – are put in the spotlight in a documentary. This short movie explores how the companies' commitment to sustainable operationscan create opportunities for innovation and valuable business models while mitigating risks and overcoming challenges.

The 10 Global Compact Principles

Human Rights

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
Principle 2: make sure that they are not complicit in human rights abuses.

Labour Standards

Principle3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
Principle 4: the elimination of all forms of forced and compulsory labour;
Principle 5: the effective abolition of child labour; and
Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

Principle 7: Businesses should support a precautionary approach to environmental challenges;
Principle 8: undertake initiatives to promote greater environmental responsibility; and
Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Art-Corruption

Principle 10: Businesses should work against corruption in all its forms, including extortion

Source: UN Global Compact 2018

Our Corporate Sustainability Strategy awarded with the ISS-oekom Prime Rating

Corporate Responsibility Prime
rated by ISS-oekom

Once again this year, the Bank was awarded with the **ISS-oekom Prime Status**. The sustainability rating agency ISS-oekom assesses the companies' responsibility towards persons affected by corporate activities and the natural environment. ISS-oekom awards Prime Status only to those companies that are among the leaders in their industry and which meet industry specific minimum requirements.
For Bank J. Safra Sarasin, Corporate Sustainability means responsible and proactive governance, considering and integrating the interests of all the Group's stakeholders into its decision-making process.

Focusing on its clients, while balancing the needs of its employees as well as the requirements of the society for long-term prosperity and the integrity of the environment, is paramount for the long-term strategy of the Group.
From this basis, Bank J. Safra Sarasin has developed **five core strategic Corporate Sustainability objectives** that determine all our activities in this regard.

1. We embed sustainability in our corporate strategy and governance
2. We incorporate sustainability considerations in our core investment offering
3. We live a sustainable corporate culture
4. We are part of the society
5. We manage resources efficiently

The "Tour de Suisse" from the Global Compact Network Switzerland

Source: UN Global Compact Network Switzerland, 2018

In the documentary, Bank J. Safra Sarasin experts and management demonstrate their commitment to sustainability, explain the "why" behind the Bank's leadership in sustainable investing over the past 30 years and illustrate the "how" of the Bank's techniques and tools to deliver sustainable investments for clients.

Bank J. Safar Sarasin, a strong leader in the sustainability field

The membership of the UNGC with the commitment to the Ten Principles and the participation of the Bank in the documentary about "Sustainable Business is Smart Business" demonstrate the strong conviction of the Bank towards continuous commitment to sustainable investing and the way the Bank runs its own business. Indeed, the Group operates with the same qualities and strengths which have ensured its longevity and performance across many generations: stable family ownership, exceptional financial strength, conservative risk management and deep personal client relationships.

Agnes Neher
Corporate Sustainability Manager

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The environmental, social and governance (ESG) analysis of companies is based on a proprietary assessment methodology developed by the Sustainable Investment Research Department of BJSS. All ratings are conducted by in-house sustainability analysts. The sustainability rating incorporates two dimensions which are combined in the Sarasin Sustainability-Matrix® :

Sector Rating: Comparative assessment of industries based upon their impacts on environment and society.

Company Rating: Comparative assessment of companies within their industry based upon their performance to manage their environmental, social and governance risks and opportunities.

Investment Universe: Only companies with a sufficiently high Company Rating (shaded area) qualify for Bank J. Safra Sarasin sustainability funds.

<u>Key issues</u>

When doing a sustainability rating, the analysts in the Sustainable Investment Research Department assess how well companies manage their main stakeholders' expectations (e.g. employees, suppliers, customers) and how well they manage related general and industry-specific environmental, social and governance risks and opportunities. The company's management quality with respect to ESG risks and opportunities is compared with its industry peers.

<u>Controversial activities (exclusions)</u>

Certain business activities which are not deemed to be compatible with sustainable development (e.g. armaments, nuclear power, tobacco, pornography) can lead to the exclusion of companies from the Bank J. Safra Sarasin sustainable investment universe.

<u>Data sources</u>

The Sustainable Investment Research Department uses a variety of data sources which are publicly available (e.g. company reports, press, internet search) and data/information provided by service providers which are collecting financial, environmental, social, governance and reputational risk data on behalf of the Sustainable Investment Research Department.

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