J. SAFRA SARASIN

Sustainable Swiss Private Banking since 1841

Sustainable Investments

Quarterly Newsletter of J. Safra Sarasin Asset Management | 2nd Quarter 2020

Editorial

Heading to Paris: net zero emissions by 2050!

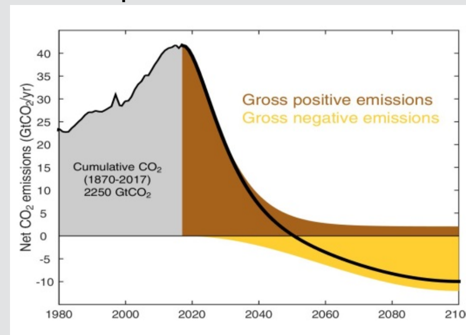
Dear Reader

Climate change has been a talking point ever since strikes by school pupils and mass demonstrations escalated the discussion onto the agenda of global summits of the EU, the G7 and the UN. Central banks and financial policymakers are pondering how to turn the ship around and move towards more sustainable practices. Captains of industry at the World Economic Forum and the World Business Council for Sustainable Development (WBCSD) are discussing how best to equip themselves to deal with the challenge of climate change. Large pension funds and insurance companies have joined forces to create the Net Zero Initiative, whose goal is to have an investment portfolio with net zero greenhouse gas emissions by 2050.

Why net zero?

The goal of the Paris Climate Accord to limit global warming to well below 2°C compared to pre-industrial levels is certainly a very ambitious target and it was hard to derive concrete measures for companies. It was therefore necessary to operationalise the goal by interpreting it as a path for reducing global CO_2 emissions. However, this reduction path shows the enormous challenge of the task: to achieve carbon neutrality, every tonne of greenhouse gases emitted after 2050 must be offset in some way, for example by planting trees. Sooner or later we will have to capture CO_2 from the atmosphere and store it.

Reduction path for CO_2 emissions



Source: Glen Peters, CICERO, Oslo

Preparing for the climate transition

This visualisation shows the huge challenge climate change presents for humanity. To achieve this goal, governments will have to pass more sweeping regulations into law. Consumers are likely to radically change their behaviour. Large asset owners and pension funds, too, are pledging to increasingly use their capital to encourage activities with a positive environmental impact. Companies that do not adequately prepare themselves for this future will come under pressure on all fronts: on the sales side, on the funding side and through taxes and possible sanctions from the state. Finally, the real estate sector, one of the biggest emitters of greenhouse gases, will also have to adapt to this reality.

Constructing future-proof portfolios

This makes it all the more important for investors to create future-proof portfolios. To mitigate risks and to enhance returns, it is imperative to bet on the winners in this climate transition, and to avoid the losers of climate change. Investors should therefore scrutinise the plans of each individual company for reducing greenhouse gas emissions. It is also important to review firms' credibility based on whether they have managed to achieve earlier sustainability targets. In this way it is possible to assess the progress of each portfolio company's carbon emissions reduction. This equally applies to property portfolios. Apart from determining their carbon footprint, measures for reducing future emissions are equally important. Ultimately, it should be possible to measure the average temperature that the portfolio is heading towards. We have calculated this temperature for the major benchmarks. The sobering – but hardly surprising – result: the world economy is only on track for a reduction down to four degrees. There's still plenty of work to do!

Best wishes,

Jan Amrit Poser

Chief Strategist and Head Sustainability

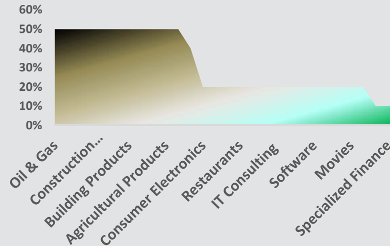
Where are corporates in the climate transition?

Corporates cannot ignore the effects of climate change on their business. Increasingly frequent extreme weather events are forcing politicians to think about what needs to be done to preserve our planet, the economy and the financial system. Companies must therefore rethink their strategy to adapt to the regulatory threats, challenges and opportunities related to Climate Change. Companies that do not take the issue seriously will soon be faced with major constraints that will directly undermine the viability of their activities. Corporate climate strategies should not be perceived as a constraint, but as one of the most important investment opportunities of the century.

How to reward the best students?

We believe that a successful carbon transition can only be achieved if all sectors participate in the reduction of greenhouse gas emissions. In order to identify the companies which are best positioned for the carbon transition, we have created a carbon score. This key issue combines the exposure of each company to the risks associated with greenhouse gas emissions and the ability of its management to embed these threats in its strategy. The notion of carbon risk can be broken down into several dimensions. The fiscal risk related to tax increases, the physical risk related to the increase in extreme weather events and the risk of transitioning its business model to be in line with the Paris Agreement. We believe that the more a company is exposed to the challenge of reducing its CO_2 emissions, the more its management must do to take concrete steps to respond to the potential threats that may affect its industry in the years to come. This carbon score is a component of our final ESG (Environmental, Social and Governance) score. The more a company is exposed to the carbon threat, the higher this component is weighted in our final ESG score. This ESG score is then used to define our investment universe. Companies are not eligible for our sustainable investment universe should their score fall below a certain threshold. The threshold is more or less strict depending on the ESG risks and impacts of each industry. The following graph shows the contribution (in percent) of our carbon score to the final ESG score of selected industries. To understand the materiality of each of the key issues such as carbon emissions for each industry, we identify their relevance for investments, cost, and cost of capital. We then integrate these material impacts into our financial models. The combination of ESG and fundamental analysis allows us to more accurately quantify each company's potential future risks or opportunities facing the challenge of Climate Change.

Contribution of emissions in our ESG rating

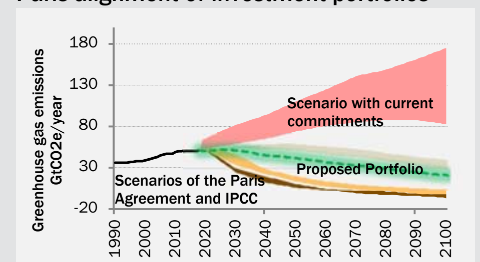


Source : Bank J. Safra Sarasin

Assessing climate scenarios for companies

As a next step, specialised data from climate analysis providers allow us to determine the percentage of greenhouse gas reduction efforts required for each company to be in line with a global warming path of 1.5°C, 2°C or 3°C by 2050. In this way, the alignment of each company with the Paris Agreement can be established. To determine whether a company is likely to make the required efforts towards the energy transition, we look at the carbon reduction targets published in the annual reports. However, having a numerical target is a necessary though not a sufficient condition to be credibly committed to emissions reductions. Many companies are doing "green washing", a practice that consists of paying lip service to improve their image and attract capital. To judge the credibility of the announced objectives, we analyse the trend of past efforts. If past reductions were in line with past objectives, we give credit to the future commitments, keeping in mind that these commitments must still be in line with the Paris Agreement. If they are not, we calculate the temperature scenario that would be achieved if the company stayed on its past reduction effort. We prefer to take a conservative approach because we are aware that the possible impact of a distorted rate on the scenario would be considerable if we overestimated a company's ability to reduce its carbon intensity. This methodology therefore allows us to select companies that have taken the step of introducing the climate dimension into their strategy and which, due to their past performance and future objectives, are in line with the Paris Agreement. We define the climate positioning of our final portfolio as the weighted average of the different climate scenarios of the companies in it.

Paris-alignment of investment portfolios



Source: http//climateactiontracker.org, J. Safra Sarasin

Green revenues Integration

In addition to this analysis, we are closely following the evolution of the European Union discussions on the Green Taxonomy and Ecolabels which will be awarded to investment funds that take into account in a structured way the energy transition, and in particular the integration of "green revenues". The latter represent the proportion of income linked to themes qualified as relevant to the fight against global warming. We take them into account in our final decision-making by favouring companies with significant green revenues and in our portfolio construction by overweighting companies with significant green revenues. We closely follow the climate and ESG evolution in our portfolio by offering an adapted reporting which is presented in the following section.

Robin Rouger
Sustainable Investment Research

Offering full transparency on Climate Investments

The banking sector plays a pivotal role in financing the carbon transition. Besides harnessing the opportunities and avoiding risks of the climate challenge, it supports companies that have integrated climate issues into their strategy by facilitating access to capital. In order to make the right decision, regulators and industry organisations are increasingly requiring companies and asset managers to offer more transparency to investors on ESG aspects such as the climate. As a pioneer in sustainable investments, Bank J. Safra Sarasin offers a comprehensive reporting that summarizes the ESG exposure of our funds. It also integrates the carbon positioning of investments under several dimensions.

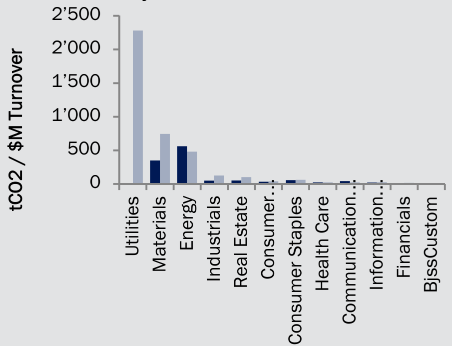
Reporting needs to be comprehensive

We think climate-related challenges should be firmly embedded in overall ESG considerations. While not neglecting governance and social components, a company must propose a thorough energy transition strategy. Therefore, we believe that a company's awareness of climate issues needs to be integrated into our overall ESG rating. Of course, climate considerations are more or less relevant depending on each company's industry. This also reflects the considerable efforts required for different sectors to achieve a successful transition. In addition, we are analysing each company's impact on the UN's Sustainable Development Goals (SDGs), with a focus on those tied to the energy transition. Finally, we evaluate companies' alignment with the goals of the Paris Agreement in terms of the global warming path.

Total carbon transparency in our investments

We integrate the carbon dimension into our reporting in several ways to allow our investors to understand exactly how their portfolio is exposed when compared to the benchmark. As a sustainable asset manager, we attach great importance to this positioning and have therefore been offering this service to our clients for several years now.

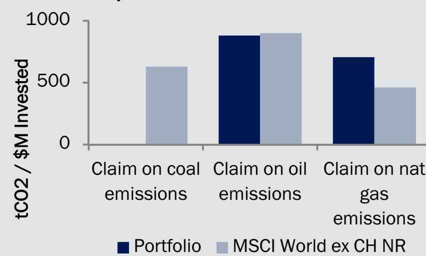
Carbon Intensity: Fund vs Benchmark



Source: J. Safra Sarasin

We pay particular attention to the distribution of carbon intensity by sector in the portfolio against the benchmark. Given our focus on climate issues, we strive for a better positioning, i.e. a lower carbon intensity, than the index on all sectors. In order to reduce the total portfolio intensity, some investors simply eliminate the most energy-intensive industries. However, we follow a best-in-class approach because we believe that all sectors have to contribute to the carbon transition. Therefore, we pick those companies that are most aligned with the goals of the Paris Agreement.

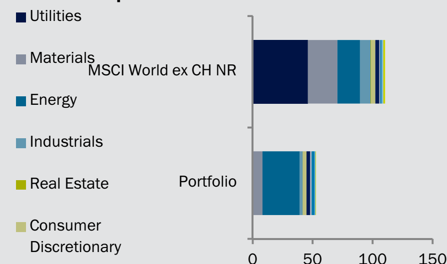
Carbon Footprint: Fund vs Benchmark



Source: J. Safra Sarasin

We also report the contribution of the ten largest positions to the portfolio's total carbon footprint and show their positioning within their respective sectors. Owning a company with a high carbon footprint is not necessarily a risky investment as long as it is better positioned than other players in its industry. We pay particular attention to the transition dynamics of these companies.

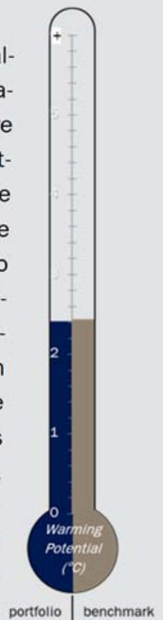
Carbon Footprint Fund vs Portfolio



Source: J. Safra Sarasin

Furthermore, we show the fund's exposure to stranded assets against its benchmark. We strive for a lower or even zero exposure to companies with potentially stranded assets as this issue represents a significant risk. Indeed, this topic is widely discussed today and we believe that new legislation will be introduced that will impact fossil energy stocks.

Climate-Alignment Test



With regard to the climate challenge, we have set up a mechanism that allows us to compare the climate alignment of our portfolios with the objectives of the Paris Agreement. Knowing the contribution of each company to the final scenario, we can extrapolate to break down the exposure of each sector and each country to the final scenario. We then compare these measures with the portfolio's benchmark. Further, we plan to integrate a specific in-house classification by grouping companies into different buckets: leaders that have fully integrated climate issues into their strategic decisions and transitioners that still have work to do. We monitor their progress closely to ensure that they continue their transformation process. In the meantime, the enablers are proposing innovative solutions that can help other companies reduce their energy consumption.

Targeting the SDGs

In addition to the above, we are closely following the efforts carried out by the European Union on the definition of green and brown revenues of companies. However, we put in place a process that already allows us to quantify the positive impact (in USD) of the energy transition for every million invested (see last issue on SDGs). Our ESG and Climate reporting, combined with financial reporting provides a comprehensive view of our investments and gives new meaning to our savings.

Real Engagement for Climate Change Mitigation

A growing number of investors are undertaking company engagement and are exercising their rights as shareholders to influence corporate behaviour. Over the last three to four years, the global investment community has elevated its engagement practices in various forms and shapes, attaching an "engagement toolset" to its core offering, its products or just using engagement as tool to obtain recognition in the market. Whatever the motivation is, engagement is here to stay and will continue to be one of the core elements used by investors to obtain more information on how investee corporates improve their performance in various ESG aspects.

Engaging effectively "on the ground"...

One of the emerging engagement themes is Climate Change-related interactions with corporates: ranging from energy efficiency, CO_2 emission reductions and more climate-friendly product lines. But the big question remains unanswered: when can engagement with corporates make a real difference and how do you as investor evaluate progress? The traditional approach involving phone calls with management, letters and joint statements with other investors are a good start, but my experience related to real and tangible engagement driven change comes from the field, from the dust and mud of Eastern Europe, from the dirt roads in Africa and the plains of Asia. Engaging on climate-related issues on the ground is one of the most effective ways of obtaining information you as investor usually do not have and addresses issues with corporates you otherwise would never be able to address.

Source: Sasja Beslik

...requires to spot a case, review the facts...

A couple of years ago I came across an international steel-producing company in Eastern Europe operating a sizable plant in Central Bosnia employing some 3'000 people in a town of 200'000 people, where most inhabitants were unemployed. On an aggregate level, ESG and environmental scores in particular were average in peer comparisons and on aggregate climate-related emissions were slowly improving. From the onset it all looked acceptable, but a closer look at specific operations made me wonder how things were really developing. We started by looking at health records in the town. Moreover, I looked at a number of complaints to local authorities regarding pollution caused by the company. Complaints are quite usual in the developing world, but in this case, the numbers were terrifying. Then we assessed regulatory requirements regarding steel-producing companies and emission controls related to them, as well as permits and control frequencies. Clearly, authorities had a very lax approach to corporate responsibility as well as to the companies' pollution issues. The steel plant was positioned in a narrow valley where wind brought heavy Sulfur oxide emissions straight to this town of 200'000 people every day. CO_2 emissions due to heavy use of coal were increasing over the last three years and this section of the company was a drop in the ocean of a huge international corporation.

Source: Sasja Beslik

...and confront the local management...

After initial requests to visit the company on the ground via its Investor Relations team, a permit was issued and we were on the ground in Bosnia. During those two days, we met local management, employees, local authorities, doctors and groups of impacted people. After two days on the ground, the conclusions were very clear. The situation was very bad, but all parties were interested in improving it. The devil was in the detail, as always: short- versus long-term improvements, structural versus surgical interventions, etc. Our discussion with the management was open and transparent. We had only a small, marginal stake in the company that gave us very little leverage to push for faster and more radical improvement. But the fact that we had spent time on the ground and truly engaged with local management created an understanding from both sides on what should be done first. Capturing Sulfur oxide emissions at the moment where heated steel is poured over from huge ovens is the moment when emissions were highest. Investing in closed-systems and quadrupling ventilation capacity would lead to an immediate improvement. Management agreed and a deadline was set. We could make a difference on the ground for many people in that town and our bare presence in the factory created an atmosphere of importance for local management and for employees.

Source: Sasja Beslik

...in order to make a real difference!

Investors can make a difference engaging companies on environmental and climate issues, but that engagement cannot be reserved only for meetings in offices in London, Paris, New York or Zurich. The real change and the real engagement will always be best when done on the ground with people responsible for running business and people impacted by that business.

Sasja Beslik
Head of Sustainable
Finance Development

Real Estate: riding the wave towards net zero

Going forward, Climate Action (SDG 13) needs to be at the forefront of sustainable real estate. It is the responsibility of asset owners and managers alike to respond in a two-tiered approach. First, aligning their real estate portfolio to a 1.5-degree scenario by setting an ambitious target. Second, a pathway to net zero with transparent reporting and rapid implementation of decarbonisation measures.

SDG 13: Climate Action
Take urgent action to combat Climate Change and its impacts.

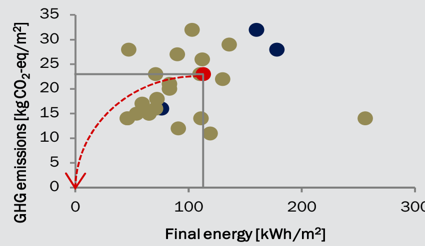
Real estate is a key driver

Real Estate and the buildings sector are a chief contributor to Climate Change. In 2018 the global buildings sector accounted for 28% of the global energy-related greenhouse gas (GHG) emissions. This is mainly due to the operational energy consumption of buildings. However, the environmental impact increases over the life cycle of buildings. Including construction materials and processes, the sector accounts for 39% of the global GHG emissions. The emissions from construction materials and construction processes, called embodied carbon, are irreversibly emitted before a building enters operation - or upfront. Furthermore, the real estate and buildings sectors are one of the main sectors exposed to adverse effects of Climate Change. Consequently, real estate is a primary target for CO_2-related regulations and taxes.

Environmental Management System (EMS)

In 2017, Bank J. Safra Sarasin developed an EMS to complement our award-winning real estate sustainability strategy. The EMS collects consumption data for energy and water of every property in the portfolio as well as on-site production of renewable energy. We calculate the resulting GHG emissions with location-based emission factors and classify them based on the GHG Protocol. Direct emissions (Scope 1): Generation of electricity, heating and cooling. Indirect emissions (Scope 2): Purchased or acquired electricity, heating and cooling. The following graph shows the most recent EMS reporting of our Swiss real estate portfolio with the intensities of GHG emissions and final energy based on 2018 data. The EMS enables us to monitor the portfolio based on key sustainability indicators, benchmark the performance and define measures to improve sustainability. Consequently, the EMS is the foundation for developing a reduction pathway and thus the transition towards net zero.

EMS 2018 reporting

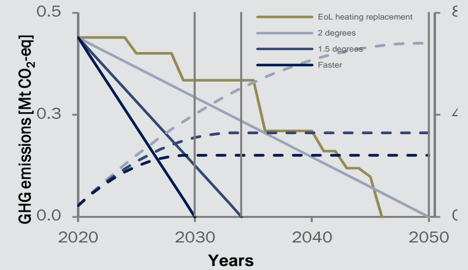


Source: Bank J. Safra Sarasin Research 2020

Reduction of GHG emissions

The graph below shows the theoretical reduction pathway scenarios based on the EMS for GHG emissions (Scopes 1 and 2) from fossil heating systems considering their lifecycles: A 2-degree (~3%/a) and 1.5-degree (~7%/a) aligned pathways and rapid reduction (~10%/a). They reach carbon neutrality by 2050, 2035 and 2030 respectively. Although the portfolio is currently at 77% renewable energy, the various scenarios reach significant cumulative GHG emissions that only flatten after an assumed carbon neutrality. Not considered is the energy-mix, which is not decarbonized yet. Therefore, a relevant measure is the provision of renewable energy for the properties. Additionally, on-site generation of solar electricity (e.g. roof top PV systems) further decreases GHG emissions. Furthermore, they enable addressing Scope 3 emissions. The purchased electricity by tenants can be decarbonised through self-consumption organisations. This creates an opportunity for stakeholder engagement, thereby including the tenant on the journey towards net-zero. Other aspects of Scope 3 include embodied carbon and calls for engaging the upstream value chain and enable it to Climate Change mitigation by focusing on low carbon materials and construction process.

Reduction pathway scenarios



Source: Bank J. Safra Sarasin Research 2020

Asset managers have a role to play

Considering the financial aspects of the transition, asset managers have to consider inflation-adjusted investments and future portfolio growth. Therefore, both absolute and intensity targets to reduce GHG emissions are crucial. Hence, the investment process and its objectives need to align with the Paris Accord and resulting acquisitions or retrofitting have to contribute to the Climate strategy. Portfolios need to prepare for sweeping decarbonisation measures aiming for Carbon Neutrality latest by 2050. Going forward, asset owners and asset managers should both communicate transparently the methodologies used to define targets for carbon neutrality and report on the progress of the GHG reductions. The question is not whether to aim at such a goal, but rather how fast it can be achieved. The decarbonisation measures are readily available, but need implementation.

Sasha Cisar
Sustainability Research
Real Estate

Sustainable Investment Research

Sustainability Rating Reviews of Companies on Track for a Paris-Aligned Scenario

ABB – industrial company on a 2 degree path with high exposure to green revenues

ABB is a Swiss power and automation technologies company operating in approximately 100 countries. It operates through the four divisions Electrification Products, Robotics and Discrete Automation, Industrial Automation and Motion. ABB is one of the top European clean tech players. Its strategic commitment to clean technologies is reflected in the integrated product and services offering in charging infrastructure for electric vehicles and its diversified product portfolio in renewable energies, power management, fuel efficiency, industrial automation and water treatment. Even though, ABB sold its Power Grid division, its clean tech positioning remains strong and continues to account for a significant share of the revenues. Bank J. Safra Sarasin's forward-looking climate alignment approach indicates that ABB is one of only a few industrial companies that has put in place emissions reductions targets which are consistent with a path to 2 degrees warming.

City Developments Limited – Asian leader for green buildings

The World Economic Forum (WEF) estimates that global real estate consumes 40% of global energy annually and accounts for more than 20% of international carbon emissions. Therefore, the sector is increasingly subject to global regulatory action related to reducing building energy use. City Developments Limited (CDL), a Singapore listed global real estate operating company active in 29 countries is a sustainability leader in this sector. The company's focus lies on value creation through strategic sustainability integration. The high sustainability rating is defined by strong green building credentials and high health & safety standards. Energy efficiency activities and the adoption of a new sourcing strategy for renewable energy in 2018 are central parts of CDL's environmental strategy. The company also expresses a clear ambition to align its business activities with a 1.5°C future and became a signatory of the science-based targets initiative (SBTi) in 2018. Through a dedicated "Green Lease Partnership Program", CDL also encourages tenants to manage and reduce their own energy consumption and therefore brings them along the "Paris agreement" of 1.5 degrees.

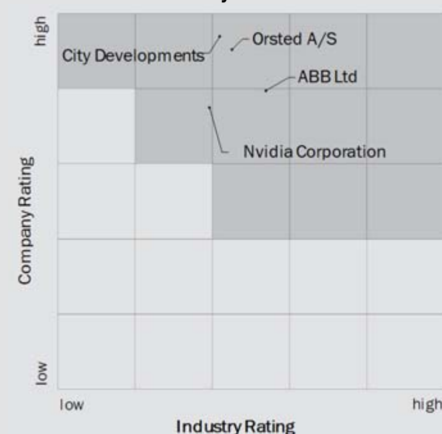
Orsted – A remarkable transition from brown to green energy

Formerly an oil and natural gas company, Orsted is Denmark's largest power producer and the world's largest offshore wind farm operator. With local Danish market shares of 49% for electricity production and 35% for heat production, Orsted's markets encompass mainly Northwestern European countries. Despite its start as a fossil-fuel-based company, the company is firmly preparing for the carbon transition by actively promoting and creating sustainable solution. It operates through three core segments: Wind Power which develops, constructs and operates wind farms; Bioenergy & Thermal Power which generates electricity and heat from thermal power stations and Distribution & Customer Solutions which purchases, sells and distributes clean energy. Thereby, the company's core activities consist of the development and construction of assets, the operations and maintenance, as well as the sales and optimization of the energy commodities portfolio. The company screens in line with a 1.5°C Paris Agreement scenario. More than 60% of their revenue are classified as green, meaning they are already well positioned for the climate transition due to their wind farming business.

Nvidia – Playing energy efficiency in the near and long term future

Reducing the energy consumption of company data centers is high on every CEO's agenda. While this was historically driven by cost considerations, it is bound to accelerate once the carbon transition picks up pace. Nvidia, a US-based Technology company, focuses on GPUs (Graphical Processing Units). These GPUs are inherently more energy-efficient than other ways of computation. They are optimized for throughput and performance per watt. Not only does the company beat the conventional CPU on energy efficiency, Nvidia also seems to have gained an advantage against its main competitor AMD. The fact that today 8 out of 10 of the world's most energy-efficient supercomputers are run on Nvidia chips illustrates their dominance in this area. The company displays an above-average sustainability rating and hence is part of Bank J. Safra Sarasin's Sustainable Investment Universe. Our forward-looking climate assessment puts the company on a 1.5 degree warming path, which is much better than the average of global peers.

Sarasin Sustainability-Matrix®



Sustainable Investment Universe

Source: Bank J. Safra Sarasin, Information on companies is shown for illustrative purposes only and does not constitute an offer, solicitation or recommendation to buy, hold or sell investments and does not consider the circumstances of any individual investor. The information shown may change without notice. Information containing forecasts are intended for information purpose only and are neither projections nor guarantees for future results and could differ significantly for various reasons from actual performance.

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Sustainability Rating Methodology

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.

Key issues

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.

Controversial activities (exclusions)

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.

Data sources

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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