Sustainable Investments

Quarterly Newsletter of J. Safra Sarasin Asset Management
1st Quarter 2021

The Climate Transition: High noon for investors!

> „We only have 7 years left until global warming reaches 1.5°C.“

This is the sober, albeit abridged, conclusion of the scientific studies of the Intergovernmental Panel on Climate Change (IPCC). There is a direct link between the greenhouse gases emitted by humans and the rise in temperature compared to the pre-industrial era. If emissions rise, the temperature rises as well. If humankind wants to limit the temperature increase to 1.5°C, the IPCC estimates that we will only be able to emit a total of 300 gigatonnes (Gt) of CO_2e. This is the so-called carbon budget we have left. It implies that CO_2 emissions must be radically reduced. The less we emit today, the longer the budget will last in the future. But by 2050, humanity should aim for net-zero carbon emissions, which means that by then the same amount of carbon should be absorbed as emitted - a very ambitious plan!

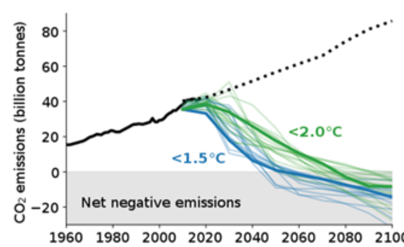
More and more countries are committed to the Paris Accord…

The good news is that more and more countries are committing themselves to this ambitious plan with concrete targets. A large number of countries announced over the last year that they would reduce greenhouse gas emissions to net-zero by 2050, including Japan, the UK and also Switzerland. Even China - one of the largest GHG emitters - is aiming to reach net-zero by 2060. The incoming US administration has announced that they will ratify the Paris Treaty immediately. The European Union had previously set itself the target of a 40% reduction in greenhouse gases by 2030 (versus 1990), but wants to raise this to 55%. We can assume that Germany will bring forward its planned exit from the climate killer coal by 2038. Political measures are set to increase sharply in the coming years.

…which increases the risk of the “carbon bubble” bursting

This is bad news for fossil energy companies. After all, existing fossil gas, oil and coal reserves far exceed the carbon budget. If we add to this the presumed but as yet untapped reserves, we arrive at an amount of almost 3000 gigatonnes of CO2e of potential emissions. If, however, only around 300 Gt can be emitted in line with the climate targets, the rest of the fossil reserves will become worthless in the near future. They will become stranded and along with them the power stations, ships, planes and trucks that burn them. The risk of "stranded assets" is a problem not only for companies but also for investors. Over the next few years these securities could be drastically devalued. CarbonTracker.org estimates that a total of USD 26 trillion in market capitalisation is at risk.

Emission reductions required for Paris



Source: “Mitigation pathways”, wikimedia commons

Climate change mitigation implies risks, but above all great opportunities

It is our fiduciary duty to avoid such risks. After signing the Paris Pledge for Action in 2015, we published a Climate Pledge in 2020 with the aim of reducing the CO_2 emissions embedded in our sustainably managed portfolios to net-zero by 2035. The aim is to reduce risks by avoiding companies with potentially stranded reserves and by gradually reducing the carbon footprint of our portfolios. At the same time, there are enormous opportunities if we focus on companies that are on a 1.5°C path or enable other companies to reduce emissions through green technologies. These will be the winners of tomorrow.

Best wishes,

Dr. Jan Amrit Poser
Chief Strategist & Head Sustainability

Three avenues of reflecting climate change in portfolios

Given the long-term economic impact, climate change is becoming recognized as a significant risk in investment portfolios. We provide a framework on how to integrate climate change into investment decisions.

Climate change has risen to the top of the political agenda
With the publication of the Stern Review on the Economics of Climate Change in 2006, a wider audience became aware of the economic consequences of climate change. The combined negative effects on the global economy are expected to be significant and most likely non-linear. Effects will be felt across a variety of primary and secondary impacts. The primary impacts include increased severity of droughts, rising sea levels, and higher incidence of natural catastrophes. However, it is the secondary effects such as increased migration and higher intra-regional conflicts, or more frequent disruptions to production infrastructure and supply chains which account for a larger part of the expected impact.

Given the long-term economic impact, it has been accepted that climate change needs to be accounted for in investment portfolios. However, given the complexity of the inter-linkages between climate change mitigation and other ESG objectives, many investors are overwhelmed. The following article provides a framework on how climate change can be integrated into the investment decision process, both as a source of potential risks as well as an investment opportunity.

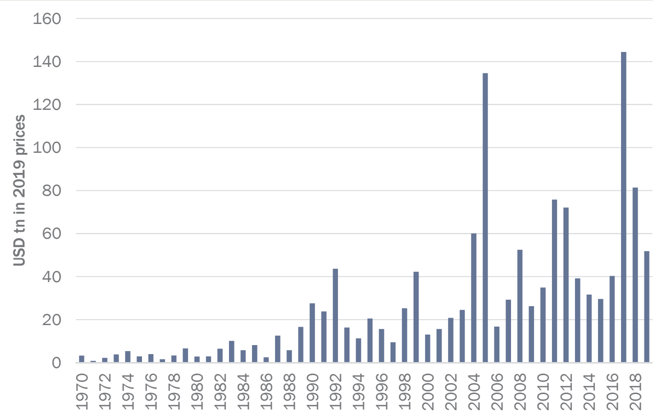
The Task Force on Climate-related Financial Disclosure (TCFD) defines two main categories of climate-related risks: physical risks and transition-related risks. The first describes the direct impacts from the changing climate, such as severe weather or floods. The second describes the risks which arise as companies fail to prepare for the transition to a low-carbon economy. Thirdly, climate change mitigation might open new opportunities in supporting the transition. This requires new product and services which facilitate an alignment with goals of the Paris Climate accord, and creates attractive space for companies and investors. In the following, we lay out how these three different dimensions can drive financial returns.

Physical risks: Climate change puts company assets at risk
The effects of climate change are evident around the world with more frequent heat waves, more hurricanes, more wild-fires, and more floods. As such, climate change creates tangible economic losses around the world. Five of top ten weather-related losses happened in the past ten years, which exemplifies the correlation between rising temperature levels and extreme weather.

But it is mostly the secondary effects which create the highest economic losses. The increased frequency of hurricane landfalls in Florida have severely reduced access to private insurance of facilities close to the coast, requiring the State of Florida to provide a backstop hurricane insurance. The heavy monsoons in 2011 in Southeast Asia wreaked havoc with the technology sector as most of the manufacturing of hard-disk drives was concentrated within an area that was flooded for weeks.

As such, climate change puts the physical assets and the production capacity of companies and its suppliers at a direct loss. Physical risk is the most direct result of climate change. While detailed modelling of physical risk has been a mainstay of insurance companies for decades, the detailed data is often inaccessible for investors. Fortunately, companies increasingly address the topic as part of their sustainability report. In addition, the process within companies to manage physical risks is being disclosed and can be assessed and discussed with management.

Insured Weather Catastrophe Losses



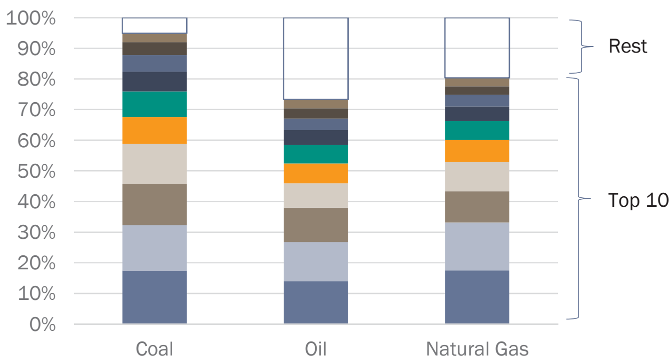
Source: SwissRe Institute, 01.10.2020

Transition risks: Climate change mitigation puts earnings at risk
As governments prepare the political measures and regulations for a low-carbon future, companies will experience both a push from increased carbon taxes and laws as well as a pull from changed customer preferences and behaviours. These changes will put business models at risk, and could represent a significant headwind to future profitability if not properly addressed.

There are several methods to assess the exposure of companies to the climate transition. The easiest to assess are risks to assets which have been explicitly valued by financial markets or accounting standards. As policies, technology, and markets changes, some assets are at a risk to be prematurely written down or devalued. These **stranded assets** will be no longer able to earn their cost of capital before the end of their economic life. For example, Bloomberg New Energy Finance, a leadings analytics company on the energy transition, estimates that between 2030 and 2035 it is likely to become economically viable to shut down a coal plant and replace it with an alternative energy source as carbon taxes rise and renewable production becomes more efficient and cheaper. Any coal plant with an economic life beyond that point might become obsolete. The same could happen to the drive train production of automotive manufacturers and their suppliers as battery-driven vehicles become more economically viable.

As part of the climate transition, the assets most at risk of becoming stranded are the fossil fuel reserves. Stranded assets in fossil fuels are concentrated within a few companies and sectors such as energy, materials, or utilities. The top 10 impacted companies account in general for more than 75% of total exposure. The following graph shows the top 10 emitters in colour.

Potential Carbon Emissions (MSCI World)



Source: CarbonDelta, MSCI, Bloomberg, Bank J. Safra Sarasin, 04.05.2020

To be sure, the analysis above shows only the direct exposure of companies to fossil fuel reserves. To assess the full extent of the exposure of companies, the entire value chain underlying these industries needs to be analysed. These include the suppliers, such as producers of compressors for the shale industry, service companies providing drilling rigs and crews, as well as mid- and downstream companies such as pipelines or trains used for transportation. In the end, as fossil fuel driven technologies become obsolete and will be overtaken by cleaner solutions, the current production capacities will need to be written down.

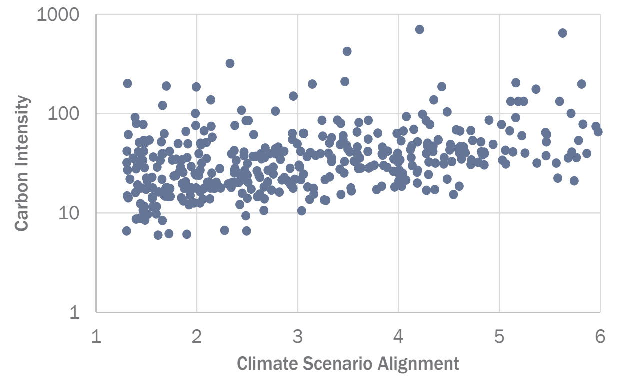
As a proxy for this exposure, we are using the **current carbon intensity** of a company. This measure takes the total greenhouse gas emissions (GHG) in tons of CO_2 equivalent and normalizes them by the invested capital of the company. It can be shown that it correlates with other measures of cost- and resource-intensity and can be used as a quality indicator. In addition, as regulation increasingly requires the societal costs of GHG emissions to be internalized through taxes, they are a risk of higher future costs. At this point, reliable data is available on so called scope 2 emissions which include direct emissions from the production or service-provision process as well as indirect emission from the externally produced energy consumption.

Forward-looking measures of Paris-alignment

In a more forward-looking perspective, we analyse the de-carbonization objectives companies have set for themselves. As economies align themselves with the goal of the Paris accord to limit global warming to well below 2°C, individual companies are being judged on their efforts to achieve these targets. The targets as well as their historical success in achieving carbon intensity reductions are used to calculate an alignment with a **climate temperature scenario path**. While still dependent on many modelling choices and assumption, it should provide a clearer perspective on companies' preparedness for the transition.

Both measures evaluate companies on their carbon emissions. However, given the backward- and forward-looking nature, the results are aligned, but give different perspectives. To understand the risk to a company, a more detailed analysis is required.

Measures of Carbon Exposures of Companies



Source: CarbonDelta, CarbonMetrics, MSCI, Bloomberg, Bank J. Safra Sarasin, 04.05.20

Green revenues: The carbon transition provides opportunities

A successful climate transition requires new solutions to provide low carbon replacements for existing needs. It provides new entrants with an opportunity to compete effectively with established players for new markets. This happens across a large cross-section of sectors. Tesla was founded only 17 years ago, but is already the largest seller of luxury cars in the US, ahead of over 100-year-old European stalwarts such as Daimler-Benz or Audi. GE's own onshore wind business generates similar revenues as its legacy gas turbine unit.

To ensure that capital is directed towards activities which have a significant impact, the European Union has defined 70 climate change mitigation and 68 climate change adaptation activities which should be considered as beneficial to combat climate change. The detailed regulations, known as **"EU Taxonomy for sustainable activities,"** measures the **green revenues** associated with these activities. High exposure should enable the respective companies to gain market share and grow faster than their competitors.

"One size fits all" does not work

Reflecting the complexities of climate change in investment portfolios is a daunting undertaking. It is upon asset managers and asset owners to decide how their portfolios should reflect the upcoming challenges. Starting from assessing the risk of physical asset destruction to measuring alignment with policy intentions to benefitting from new opportunities, investors have an increasing set of tools at their disposal. And given the stark consequences of climate change which await us, it has become a necessity to integrate these into portfolios.

Florian Esterer
Asset Manager Equities Core

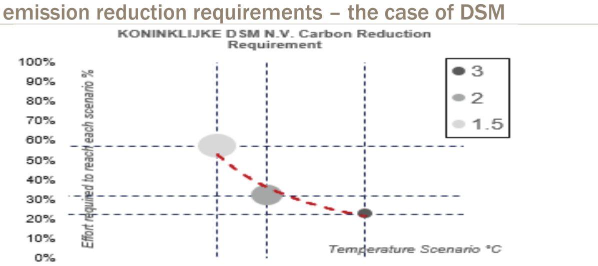
Assessing corporate alignment with the Paris Accord

The issue of global warming has a considerable risk implications for investments. We have developed a process that assigns a temperature path to each company.

Climate assessments need to be science-based

Ever since Mark Carney's speech in 2015 which introduced the notion climate-related risks, investors have scrambled to integrate this issue into their investment decisions. The big question is: how can companies and investors align with the Paris Climate Accord based on scientific considerations. The requirements and ability of companies to do that is dependent on scientific advances and government policies to manage the energy transition. Moreover there are a lot of assumptions to be made to calibrate their models. But in the end, investors need a compass to take climate considerations into account for two reasons. Firstly, the approach helps to identify weak companies, which are likely to be strongly affected by physical, regulatory or transition risks that will have a negative impact on their profits and cause assets to strand. Secondly, we can find opportunities among those companies that have already integrated the climate dimension in their business models in order to gain market share and be tomorrow's winners. Therefore, assigning a temperature path is crucial.

Carbon emission reduction requirements – the case of DSM



Source: J. Safra Sarasin, 08.12.2020

Carbon reduction efforts depend on the temperature goals

We believe that each sector has its role to play in the climate transition. But it depends on the nature of each business and its geographical location which carbon reductions efforts have to be undertaken to align with the Paris Accord. Our data providers supply the carbon reduction requirements that need to be made for each sector and countr depending on the temperature scenario.

DSM: strong management commitments

Scope 1+2 (market-based) DSM has released their new strategy in 2018: Purpose led, Performance driven. Part of this strategy includes an absolute reduction of 30 % of its scope 1+2 emissions versus 2016.

Management Target	
Objective Based Year	2016
Objective Target Year	2030
% Carbon Reduction Target	30%

Source: J. Safra Sarasin, 08.12.2020

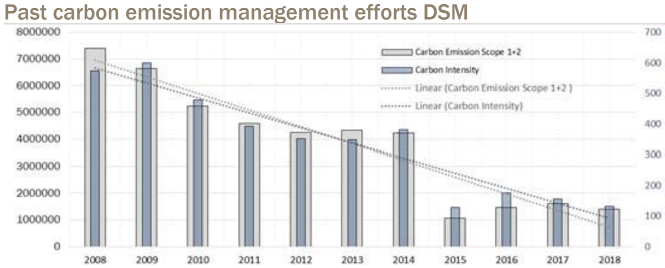
Checking companies' carbon reduction objectives

In a second step, we anaylse the carbon reduction objectives formulated by the management of each company. These targets are then compared with the requirements under each temperature scenario. Such we can assess whether the objectives are ambitious enough to align with the Paris Accord or whether they fall short with these.

Carbon emission past practices

Having ambitious objectives is a necessary, but not a sufficient condition. This is why we need to confirm the ambitious target by comparing them with the results that were achieved in the past. So it is important to assess the trend of each company's past emissions. Climate change is not a new issue, so a company with a responsible climate policy should have been setting up strategic directions years ago. Past observations allow us to see whether the current carbon management objectives are realistic and align with a consistent trajectory pathway and a temperature scenario. The progress will of course be monitored over time and the model needs to be updated over time.

Past carbon emission management efforts DSM



Source: J. Safra Sarasin, 08.12.2020

What do clients get?

Of course it is not with perfect certainty that we can estimate a company's climate trajectory over the next few years. But we can certainly confirm that we have taken into account all the necessary ingredients to mitigate the risks stemming from the climate transition. We believe that a company that (a) has proven that it is capable of reducing carbon emissions over time, (b) is displaying in its strategy a real commitment to continue on this transition pathway, and (c) that is in line with the efforts to be made to comply with the Paris Accord, is likely to be better positioned for a low-carbon future. Once we have done this quantitative assessment, an in-depth fundamental analysis is advised to understand the company's strategic thinking in relation to the energy transition. Finally, this analysis needs to be complemented with an assessment of its ability to generate future cash flows needs to be carried out to select the future leaders of tomorrow.

Robin Rouger
Sustainable Investment Analyst

Sustainable Investment Research

”Green Revenues” are opportunities for investors

Political pressure and the demand for solutions to the enormous ecological problems are steadily growing. We see “green revenues” as opportunities to invest in and incorporate them systemically into our investment process.

Solutions from the private sector are needed

Overuse of resources, pollution, climate change and deforestation are taking their toll. This has an impact not only on our society, but increasingly directly on the economy. It is estimated that over 50% of the world's economic output is directly dependent on nature. Companies are mainly perceived as the cause of the problems. For example, risk-based ESG analysis examines CO_2 emissions or water pollution among other risk factors. The focus here is on the operational level. However, companies usually have a greater impact through their products and services. They do not always have a negative footprint, but increasingly offer solutions to environmental and social problems. In fact, achieving global climate targets depends heavily on an increased number of companies offering green solutions. This is where the strengths of private sector come into play: speed, flexibility, innovation and scalability. The larger and more tangible ecological problems become, the greater the social and political pressure and the higher the demand for solutions will be. Companies that offer products that contribute to solving environmental problems have a competitive advantage. We try to identify these companies at an early stage and take advantage of the opportunities.

A clear definition of “green solutions” is the foundation

What are green products and services? And how do they contribute to solving environmental problems? These trivial-sounding questions are anything but clear in practice. For example, should transitional technologies such as gas be considered as green? What about products and services that may well be an efficient solution to one specific problem (e.g. CO_2 emissions), but have negative consequences in another area (e.g. biodiversity)? Until now, there has been little guidance and each financial institution has had to answer these questions for themselves. This has inevitably led to certain technologies and products being presented as greener than they actually are.

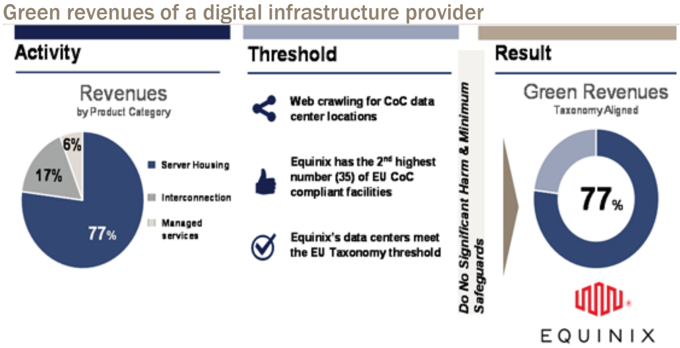
The EU Taxonomy provides a guide to “green” activities

The European Union's Taxonomy for the identification of green economic actvities is a tool to help the real and financial economy alike to make the transition to a climate-friendly, resource-efficient and resilient economy. It is the foundation of the EU Action Plan for financing sustainable growth. The Taxonomy sets performance thresholds for economic activities which a) make a substantial contribution to at least one of six defined ecological obejctives, b) do not cause significant harm to the other five objectives (Do no harm principle) and c) meet minimum social safeguards. The EU has set the following six environmental objectives: Climate change mitigation, climate change adaptation, protection of water and marine resources, transition to a circular economy, prevention and control of pollution, protection and restoration of biodiversity and ecosystems. Until now, the detailed technical criteria have only been defined for the two objectives climate of change mitigation and climate change adaptation. The other four objectives are to be covered in the next two to three years. The new EU regulation further lays out that large European companies and financial institutions will have to report their financial and ESG data in a Taxonomy-aligned format in the coming years.

How do we already measure green revenues today?

In order to be able to take advantage of the opportunities offered by green solutions and at the same time to anticipate upcoming regulations, our assessment of green revenues is already takes the EU Taxonomy into account. In doing so, we map corporate revenue data to the environmental objectives of the Taxonomy. Through our proprietary Sustainability Matrix© we ensure that we do not invest in companies that cause significant harm to other environmental objectives. Our standard exclusion criteria fulfil the minimum social safeguards required.

Green revenues of a digital infrastructure provider



Source: J. Safra Sarasin, December 2020

In addition to collecting and importing external data, we also perform proprietary analyses. After considerable desk and data research, the second step is to exchange information with the companies in order to obtain as granular a picture of the green revenues as possible. On the basis of the technical criteria of the EU Taxonomy, we then investigate what proportion of sales is based on green solutions. These are then incorporated into our measurement and can thus be aggregated and optimised at portfolio level. Through this qualitative process we strive to create sustainable and financial value for investors.

Nico Frey
Sustainable Investment Analyst

Sustainability Rating Reviews of Green Champions and Climate Pledgers in the 4th Quarter 2020

Kingspan – it is all about insulation

Green Champions

Kingspan Group is an Irish company that produces insulation and building envelope solutions. The company's segments include Insulated Panels, Insulation Boards, Light & Air, Water & Energy and Data & Flooring. The Insulated Panels segment is engaged in manufacturing insulated panels, structural framing and metal façades. Kingspan's thermal insulation products significantly improve the energy efficiency of buildings, which are one of the largest energy consuming sectors in the EU and represent 36% of the total carbon emissions. 84% of the company's revenue come from the Insulation panels & boards segment, of which 71% (and 60% in total) align with the EU Taxonomy's low thermal conductivity and heat loss criteria. Hence, Kingspan classifies as a Green Leader in our climate fund. Furthermore, the company has good ESG scores and is hence part of our best-in-class sustainable investment universe.

Cerner – supporting clinics with very low carbon footprint

Climate Pledgers

Cerner Corporation (Cerner) is a supplier of healthcare information technology (HCIT). The Company offers a range of intelligent solutions and services that support the clinical, financial and operational needs of organizations of all sizes. Given the nature of the business, they are not heavy emitters and therefore do not have a significant CO_2 reduction effort to accomplish to respect the Paris goals. The company has significantly decreased its carbon intensity over the last 10 years and is on a below 1.5° trajectory. Cerners MSCI carbon management score also sits in the first quintile and company even owns patents directly linked to low-carbon technologies. Moreover, Cerner is providing solutions to our SDG category " Basic Needs". Next to a solid governance score, Cerner shows a relative strength in managing Privacy and Data Security, which is one of most material key issues in the industry given the sensitivity of the data. From an ESG perspective, Cerner outperformance most its peers and is hence part of our best-in-class sustainable investment universe.

Shimano – green, healthy and efficient mobility

Green Champions

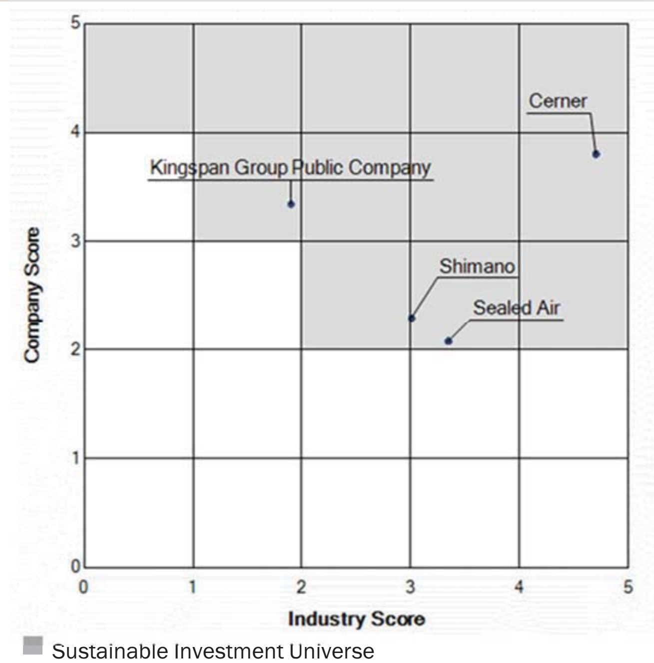
16% of the world's greenhouse gas emissions are connected to transport, 12% to road transport of which 60% come from passenger travel. Bicycles do offer many advantages for short-distance mobility: e.g. no carbon or other air pollution, no noise emissions, efficient usage especially in cities and positive health effects. Since years, bicycle transport within cities is growing steadily. The COVID19-crisis accelerated this development further. SHIMANO INC., a Japanese company with a very long history in manufacturing bicycle components, is at the heart of this sustainable trend. 80% of the revenue comes from its bicycle segment, the rest from fishing equipment and rowing related products. Counting only the cycling business as low carbon, the company is a clear Green Leader in our investment universe with 80% green revenues. Shimano convinces furthermore with solid ESG scores, which places the company within our best-in-class sustainable investment universe.

Sealed Air – producing packaging in a climate-friendly way

Climate Pledgers

Sealed Air Corporation is a provider of packaging solutions for the food, e-Commerce, electronics and industrial markets. The Company serves a range of markets including food and beverage processing, food service, retail, commercial and consumer applications, by providing food safety and security, product protection and equipment. The company made a strong commitment in 2012 to reduce its carbon emissions. The objectives have been achieved this year and new targets are expected. Over the last 6 years, the company managed not only to substantially reduce its carbon intensity but also its overall carbon emissions (scope 1 & 2) which shows their real desire to take carbon emission problematic within their strategical decisions. The company is hence a Climate Pledger with a temperature trajectory of below 2°. From a broader ESG perspective, Sealed Air shows a relative strength in nearly all environmental key issues while social key issues such as Labor Management and Chemical Safety ask for more attention. A solid overall ESG score makes the company part of our sustainable investment universe.

Sarasin Sustainability-Matrix®



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.

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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 inhouse 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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