The case for

IMPACT THROUGH PUBLIC EQUITIES

BY TIMOTHY P. DUNN

The world's public equity markets are the largest and most free-flowing pool of capital with over $80 Trillion of value in the hands of pensions, endowments, foundations, and individuals. The flows in the public equity markets bring essential funding for emerging businesses, reward winners, and hasten the decline of sunset companies and industries.

Large investment institutions (e.g., Fidelity, BlackRock) have been tasked with stewarding assets for or on behalf of individuals and entities around the world. The professional managers of these large pools of money are almost universally rewarded on one simple measure – did they "beat the market" this quarter and/or this year? They typically do not consider the impacts their investment decisions might have on society and our environment because they have not been asked to make such considerations. This unidimensional and short-term perspective is a primary contributor to the capital markets' systematic failure to account for the impact our economy has on the environment and humanity.

Fortunately, there is a growing, though still small, number of investment firms that are working to truly innovate the analysis and decision-making process used by professional investment managers to incorporate environmental and societal factors. This work is being greatly assisted by the excellent work of non-profits like the Sustainability Accounting Standards Board, CDP (formerly the Carbon Disclosure Project), and the UN's Principles for Responsible Investing. Increasingly leading academics are building a body of work that shows the benefit of integrating Environmental, Social, and Governance (ESG) factors into the investment process. Yet, it is estimated that only about $600 Billion of the $80 Trillion properly assesses potential impacts of a business on society or the environment before investing in that company.

There are also hundreds of large corporations that are on the path to significantly reducing their impact on and use of natural resources. These range from Unilever (a leading global food company) to Microsoft (a global software and data center services company). 129 major companies (including Apple and Alphabet) have pledged to be using 100% renewable energy by 2020. 106 companies (including General Mills and L'Oreal) have already set science-based targets for corporate Greenhouse Gas Emissions that would support global goals to limit the impact of climate change. These companies are at the vanguard of doing the right thing for their investors, customers, employees, and society writ-large. Though currently, most investment firms fail to reward such thoughtful long-term efforts.

Our advocacy investment firm seeks to demonstrate that businesses which are working to better manage their use and impact on our planet's finite natural resources (clean air, clean water, raw materials, forests, and soil) will generate better financial returns and be better long-term investments. We deploy our Environmental Productivity™ analysis to identify the most natural resource efficient companies in every sector of the economy. Further we test business models to identify the most fundamentally sustainable businesses for the 21st century. We consider this a needed improvement on existing active equity management.

Our investment process is built with deep understanding of traditional fundamental analysis and the value of growing datasets on environmental, social, and governance factors reported by companies. It begins with an inclusionary screening based on natural resource efficiency, moves on to deep fundamental research, and ends with security valuation.

Terra Alpha's Investment Process

Data Collection Process

- Identify companies that disclose key environmental data (carbon emissions, water, and waste)
- We believe that if you measure it, you will manage it

Inclusionary Screening Process

- Identify companies with best-in-class natural resource efficiency as compared to industry peers
- We believe that in a resourced constrained world, high Environmental Productivity yields better returns

Fundamental Assessment Process

- Identify sustainable business models over the next 5+ years
- We want to own businesses that will thrive, even in a changing world

Security Valuation Process

- Find the most attractively valued companies that we have found to have sustainable businesses and high Environmental Productivity
- Don't overpay, even for quality

We also track specific work companies are doing to drive their long-term success through innovation. A few examples of leaders in corporate environmental productivity are provided below.

ADIDAS: The German-based sporting goods and apparel company is now selling three new editions of its UltraBoost shoe, all made from plastic debris found in the ocean. Each pair of shoes reuses 11 plastic bottles, on average, and feature laces, heel lining and sock liner covers that are made from recycled materials. Adidas has a goal to create one million pairs of these shoes. With a retail price of $200 per pair, UltraBoosts are on par with higher-end athletic shoes. This initiative is not only good for the planet, but provides a meaningful contribution to the company's revenue figure on an annual basis. Initiatives such as these are microcosms of our investment and advocacy philosophies at Terra Alpha.

XYLEM: The U.S.-based water technology company is a true global leader in its operations and reporting. One of the standouts in how the company incorporates EP processes and technologies is an innovative energy, emissions, and water-saving heat pump system installed at one of its largest manufacturing facilities. The Emmaboda plant makes 2/3 of all Flygt pumps, and has an innovative heat recovery project (starting in 2009) that reduced the plant's energy use by 75%; this alone is expected to drive a 20% reduction in company-wide water use by 2019.

The success of Terra Alpha's investment thesis will not only provide our investors with a better way to invest their assets, it will help drive change in how all investors consider the use of environmental and societal impacts in their own decision making.

The public equities market is a powerful force that impacts all of society. Left unchecked, it will continue to drive our economy in the wrong direction. Asset owners must ask more of those they have entrusted to manage their hard earned assets. A shift in the decision-making process by investment professionals to incorporate environmental and societal impacts will not only drive better risk-adjusted returns for asset owners, it will help shift how our economy functions so that it delivers a better outcome for society.

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Tim has over 30 years of professional investment experience. He spent 19 years at Capital Research/American Funds as one of the lead portfolio managers of The Growth Fund of America, Capital World Growth and Income Fund, and EuroPacific Growth Fund. He holds a BA in International Relations from The College of William and Mary and a MBA in Finance from Northeastern University.