Investing in Environmental Protection

April 2021

Investing Through an Environmental Protection Lens

Since 1970, April 22nd has been a day of supporting environmental protection. As we embrace this day focused on sustainability, it is appropriate to highlight how investors can align their environmental values and investment objectives.

Interest in ESG portfolios is growing. Last year, U.S. sustainable fund flows totaled $51.2B, more than double the 2019 figure and ten times larger than 2018. Additionally, a recent global survey on ESG initiatives stated that 88% of respondents ranked Environment as their top priority.[1]

Today, companies and industries vary in how they recognize, address, and report on environmental-based risks. Given these differences, there are many avenues for expressing "environmental protection" in an investment portfolio. This piece details just one of these approaches.

Building an Environmental Protection Model

ESG portfolios are typically built using three core levers, which are highlighted below:

1) **Exclusions**
2) **Tilts**
3) **Active Ownership**

The environmental protection model incorporates **all three**: it overweights companies with strong emphasis on issues like climate change, pushes poor scoring companies to change through proxy voting, and completely divests when the misalignment in values is too large.

Exclusions: The model excludes companies with business ties to operations that negatively impact the environment: **Oil & Gas, Oil Sands, Nuclear, Arctic Oil & Gas Exploration, Shale Energy, Thermal Coal, and companies with high carbon intensity.** It also divests from companies involved in any severe environmental related controversies.

[1] https://www.blackrock.com/corporate/literature/publication/blackrock-sustainability-survey.pdf

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Companies were excluded from the MSCI AC World Index.

Examples:

Duke Energy

- Consistently ranks high in carbon emissions. High carbon footprint is partly due to their larger reliance on coal-based energy than their peers.

Shell

- Ongoing environmental controversies and a pattern of operational oil/waste spills. Furthermore, ongoing litigation against the company could further expose company to material financial risks.

Tilts: After these exclusions, we "score" our investible universe on environmental protection metrics and overweight stronger-scoring companies, while underweighting and/or removing lower-scoring ones. We use proprietary data, our ESG scoring convention, and our risk-optimization engine to score and construct ESG portfolios. Our scoring framework incorporates the themes below:

- Carbon Footprint & Climate Change
- Carbon Intensity
- Pollution & Waste Management
- Water Stress
- Resource Use
- Deforestation & Biodiversity
- Environmental Impact of Products & Services

Tilt Towards

1. Carbon Footprint & Climate Change:

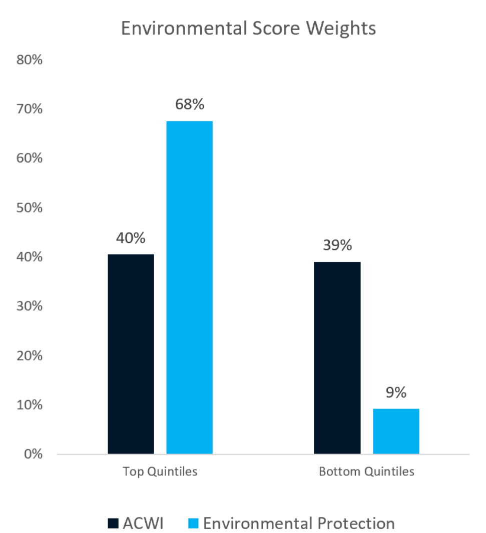
Dell

- Reduced carbon intensity by 35%, increased renewable energy use by 50%, and ties compensation to environmental goals.

2. Environmental Impact of Products:

Vestas

- Manufacturer, seller, installer, and servicer of wind turbines creating renewable energy.



Tilt Away

1. Deforestation and Biodiversity:

Cargill

- Facing ongoing criticism regarding deforestation in its supply chain.

2. Carbon Intensity & Waste/Pollution:

Southern Company

- High Carbon intensity versus peers and involved in multiple controversies regarding pollution.

Past performance is no guarantee of future results.

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After completely removing the lowest scoring "environmental protection" companies, we increased the environmental protection score of the top quintile of companies by 28% and decreased the bottom quintile of companies by 30% – all while maintaining the efficacy of the underlying investment model.[2] Advisors have the flexibility to increase/decrease the "tilt level" to control for tracking error.

Active Ownership: Owning public equities provides the opportunity to vote on shareholder issues. Adding environmentally responsible proxy voting enables an active ownership approach for further influencing portfolio companies. Specific to the environmental protection model, we proxy vote in a way that promotes mitigation of climate risks, plans for more renewable energy use, and yields additional transparency on environmental initiatives like current emissions and/or renewable energy targets.

Returns & Risk

In addition to maximizing exposure to companies most aligned with environmental protection values, advisors often want return characteristics to closely match their firms high-conviction investment model. In other words, we find their most common goal to be significantly improving the pro-environmental protection exposure in the new model while maintaining the efficacy of their legacy investment model. We strive to be the platform where advisors can offer custom, values-based portfolios with unrivaled specificity – in this case, controlling for tracking error to marry risk-adjusted return and environmental-based goals.

Encourage Your Clients to Make it Their Own

There is no single way to address environmental values in a portfolio. Most of our clients use a combination of exclusions, tilts, and proxy voting, but every portfolio is truly unique. This fits our belief that values-based investing is never one-size-fits-all and is better accomplished through a customizable, separately managed account. For advisors interested in portfolios with an environmental focus, within our Canvas platform, you can access the above model, build a variation of it, or create something entirely new. Our mission is to precisely match unique values and investment objectives. **Happy Earth Day and make it a point to get outside today!**

If you are an advisor and have an ESG model or mandate in mind, we would love to talk: esg@osam.com.

[2] As of December 2020.

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- Composite Performance Summary

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For the full composite performance summary of this strategy. please follow this link: http://www.osam.com

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The risk-free rate used in the calculation of Sortino, Sharpe, and Treynor ratios is 5%, consistently applied across time.

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