Global Emerging Market Equities

In the emerging market equities team, we use a combination of top-down country and bottom-up stock analysis in our investment process. ESG considerations are integrated at all stages.

In their bottom-up research, analysts complete a mandatory written ESG review for each company they cover. Reviews may result in adjustments to the cost of capital, provisions or cash flows. Where an explicit adjustment is not possible, ESG concerns will be reflected in a discount/premium applied to the initial fair value estimate. Significant ESG concerns will also affect the analyst's conviction in their recommendation.

Engagement is a natural part of our investment process. We engage with companies to seek improvement in ESG performance and processes; to monitor developments in ESG practices, business strategy, and financial performance; and to enhance our analysis of risks and opportunities.

Schroders' sustainable investment team supports the investment team in this area.

The portfolio managers formally review portfolio-level ESG characteristics at a monthly sustainability risk meeting. This review includes two proprietary measures of sustainability risk, Carbon VaR and SustainEx™, as well as MSCI and Sustainalytics scores.

CASE STUDY: SELLING NORILSK NICKEL ON ESG CONCERNS

Schroders' data insights unit (DIU) supports the emerging market equities team with ESG analysis on a project basis. For instance, geospatial and meteorological analysis by the DIU helped the investment team gain a better understanding of Russian assets in the Arctic circle and their vulnerability to climate change.

In May 2020, an ageing fuel tank at one of Norilsk Nickel's power plants in the Arctic circle collapsed, leaking 21,000 tons of diesel fuel into two Siberian rivers. The government declared a state of emergency and ordered an investigation.

In early July, the national environmental watchdog imposed a record $2.1 billion fine on the company. The analyst had previously applied an additional 2% cost of equity to his valuation model to account for the elevated environmental and governance risks at the company. He now includes the additional cost of the $2.1 billion fine in the valuation, and has raised the cost of equity premium to 2.5%.

We held a small position in Norilsk in our core emerging market portfolios, which we sold in early June on learning of the diesel spill. The fund manager decided to sell the stock given the increased ESG concerns.

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