Schroders

Schroder QEP Global ESG

Strategy Overview

What is QEP Global ESG?

Schroder QEP Global ESG[1] is an index-unconstrained strategy investing in stocks on the basis of valuations, business quality and ESG considerations. Analyzing a broad universe of ESG-rated stocks across developed and emerging countries, the team constructs highly diversified portfolios without sacrificing conviction. This strategy is based on our long-running Global Blend offering and the objective of QEP Global ESG is in line with that.

The strategy aims to outperform the MSCI AC World Index (NDR) by 3%[2] p.a. gross of fees over a full market cycle – we do not believe that ESG integration means that investors should have to compromise on returns.

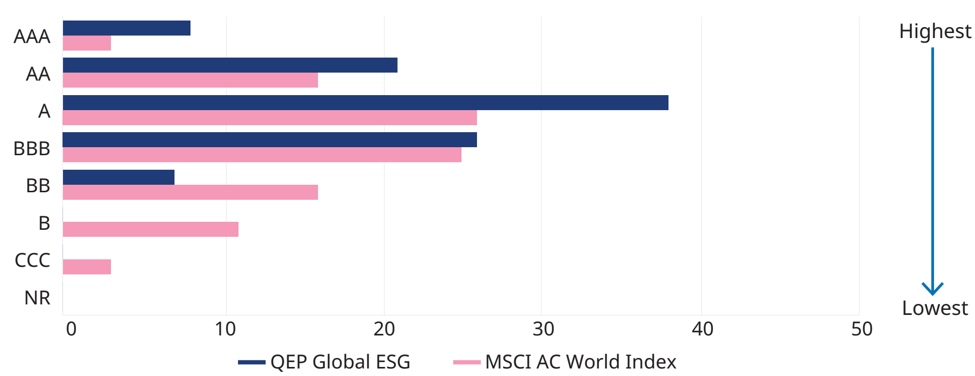
[1] Environmental, Social and Governance is referred to as ESG throughout the presentation.

[2] There can be no guarantee that any investor objective or outcome can be achieved.

Strong ESG profile

Through our comprehensive ESG integration, portfolios in the strategy will generally be tilted towards stocks with a higher ESG rating and away from those with a lower one, relative to the reference index.

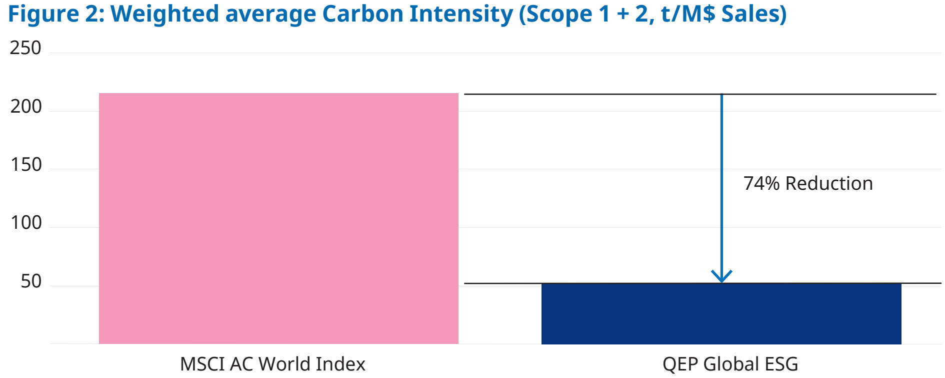
Figure 1: Positioning by MSCI ESG rating



Source: Schroders, as of December 31, 2018, based on a representative account within the QEP Global ESG strategy. For illustrative purposes only.

In addition, as we carefully manage the environmental risks associated with companies that have large carbon footprints, the portfolio has a much lower carbon intensity than the constituents of the reference index.

Figure 2: Weighted average Carbon Intensity (Scope 1 + 2, t/M$ Sales)



Source: MSCI, CarbonMetrics, Schroders. Based on a representative account within the QEP Global ESG strategy as of December 31, 2018. For illustrative purposes only. Scope 1: GHG emissions from sources directly controlled by the company; Scope 2: GHG emissions produced from the generation of energy produced by a third party and consumed by the company; Scope 3: All other indirect emissions, e.g. employee travel, waste disposal, etc.

All data and statistics as of December 31, 2018.

A strategic approach to equity investing

There are three distinct components to the QEP team's investment philosophy:

1. All stock selection is focused on two key fundamental drivers of long-run equity returns: stock valuations and business quality (as defined by measures of profitability, stability and financial strength). We believe the strategic diversification between Value and Quality offers investors the potential for outperformance across a broad range of environments.
2. We then use quantitative models to 'scale up' our process, which allows us to access the best opportunities across a broad global universe. These models enable us to maximize the opportunity set and re-balance portfolios in a disciplined way as opportunities evolve.
3. Finally, experienced investors are responsible for implementing every trade decision, providing an important sense check that the process is working as it should and that portfolios' risk profiles remain appropriate. They also feed back insights on portfolio behavior or potential upcoming risks and return opportunities to the team to help guide future research.

ESG integration

The team incorporates environmental, social and governance factors into the investment process in a number of ways:

1. **Social Exclusions.** We implement both industry-specific and sales-based exclusions of 'sin' stocks, defined as tobacco, alcohol, armaments and gambling.
2. **Integration.** ESG considerations are incorporated into our fundamental analysis of companies. We look beyond the headline ESG scores to better understand companies' risks and drivers.
3. **Ongoing research.** We analyze key ESG themes to look for opportunities to integrate these insights into our process. Current research topics include labor management practices in mobile phone supply chains and water stress, as well as carbon intensity (see below).
4. **Engagement.** Working in partnership with Schroders' ESG team, we have an active program of company engagement. We use our analysis to highlight potential candidates and topics, and monitor the long-term progress of the engagements.

A good example of how our research and integration process works is our recent work on climate change, specifically investigating the types of data available on companies' carbon emissions and how best to incorporate this information into the investment process.

In our stock selection process we prioritize businesses with better carbon efficiency as measured using Scope 1 and 2 data (see footnote in Figure 2). We also carefully manage the environmental risks associated with companies with large carbon footprints. This is evidenced by our avoidance of exposure to thermal coal and by our utilities exposure being focused on renewable energy. We also encourage better disclosure of Scope 3 data wherever possible.

Investment process

Our investment process can be summarized in three stages:

Stage 1: Fundamental Drivers

- Universe of over 7,000 ESG rated companies, excluding ‘sin’ industries
- Rank stocks by Value and Quality
- 400+ ESG data points integrated into stock selection and portfolio construction

Stage 2: Stock Selection

- Industry-specific decision trees “trade off” Value and Quality
- Invest in stocks offering an attractive combination of Value, Quality and ESG
- Stock weight (max 1.0%) determined by conviction, risk and liquidity

Stage 3: Portfolio Construction and Engagement

- Ongoing research into key ESG themes
- Identify candidates and topics for company engagement
- Disciplined re-balancing (buy/sell) to take advantage of market volatility

We construct an exceptionally well-diversified portfolio, typically holding over 300 stocks, without compromising on seeking active returns: our portfolio looks very different to the index. We weight stocks according to conviction, not size – just because a company is large does not necessarily mean it should form a bigger part of the portfolio.

About the team

The QEP Investment Team was established in 1996 and began managing assets in 2000. The team, led by Justin Abercrombie, consists of 32 members based in London, Sydney and New York. It manages around $30 billion in a comprehensive range of global and emerging market equity strategies. Its clients are located all over the world and include pension funds, insurance companies and sovereign wealth funds.

Source: Schroders, data as of March 31, 2019 and assets as of September 30, 2018

Key features of QEP Global ESG

Relative return target*	+3% p.a.
Tracking error**	3-4% p.a.
Number of holdings	Typically 300+
Stock weight	Maximum 1% in a stock line and maximum total of 2% at the company level (at time of purchase)
Active share	Typically 65%+
Country / region weights	Unconstrained
Sector weights	Unconstrained

Source: Schroders. Guidelines only and subject to change.

* Outperformance objective is gross of fees p.a. over a complete market cycle versus the MSCI AC World index (NDR) .

** Tracking error is not targeted, this figure is an expected ex post value over the long term.

Benefits of our approach to ESG investing

Based on existing proven strategy

Being based on the long-running QEP Global Blend strategy, we think investors can have confidence in our tried and tested approach.

ESG considerations fully integrated into the process

Complementing the existing QEP approach, the strategy incorporates ESG into the investment process through: exclusions, integration, ongoing research and engagement.

Solid grounding in fundamentals

While ESG factors are clearly important in the stocks we own, we do not compromise on fundamentals and focus on the two complementary drivers of Value and Quality.

Maximized opportunity set

Our universe consists of over 5,500 ESG-rated companies, which enables us to find the best investments wherever they lie, many of which may be below the radar of other managers.

Use of quantitative models

One of the advantages of the team's quantitative models is that we are able to analyze and process large volumes of information, including over 400 ESG data points.

Portfolio construction expertise

Our team is skilled in creating an efficient trade-off between potential risks and rewards, and risk management is integrated throughout our investment process.

Active engagement

We continually review our positions in companies with potential ESG concerns, encouraging positive change where we can, but divesting where the outcome of engagement is disappointing.

Risk disclosures

All investments, domestic and foreign, involve risks including the risk of possible loss of principal. The market value of the portfolio may decline as a result of a number of factors, including adverse economic and market conditions, prospects of stocks in the portfolio, changing interest rates, and real or perceived adverse competitive industry conditions. Investing overseas involves special risks including among others, risks related to political or economic instability, foreign currency (such as exchange, valuation and fluctuation) risk, market entry or exit restrictions, illiquidity and taxation. These risks exist to a greater extent in emerging markets than in developed markets. The success of the investment strategy depends largely upon the effectiveness of the investment team's quantitative model. A quantitative model, such as the risk and other models used by the investment team requires adherence to a systematic, disciplined process. The team's ability to monitor and, if necessary, adjust its quantitative model could be adversely affected by various factors including incorrect or outdated market and other data inputs. Factors that affect a security's value can change over time, and these changes may not be reflected in the quantitative model. In addition, factors used in quantitative analysis and the weight placed on those factors may not be predictive of a security's value. Investments that focus on a single country, sector, and/or factor are more susceptible to the risks within these respective markets, and may exhibit price fluctuations which differ from those of strategies which are less specialized.