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ASSET MANAGEMENT

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## When Two Worlds Merge Sustainability and the Equity Investment Decision

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October 2020

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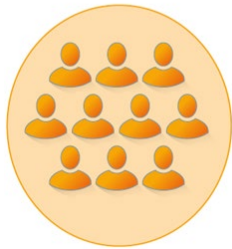
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# A Sustainability Solution

## Lazard and ESG

### LAM APPROACH



Sustainability is a core component of financial analysis for all investment professionals.

## Global Thematic Approach



Themes aligned with societal goals.



All stocks must meet a sustainability threshold.

## Impactful Ownership

**4,000+**

Company meetings by LAM investment professionals globally in 2019.

**42%**

Meetings in which ESG and sustainability issues were discussed.

**37%**

Shareholder meetings where we voted against management in one or more proposals.

## Key Metrics and Exclusions



Carbon footprint lower than the benchmark.



Exclusions?

As of 30 June 2020

Based upon a representative account of the Lazard Global Thematic Equity Strategy versus the MSCI AC World Index.

In the above analysis, Lazard calculates the Carbon Footprint by first identifying the proportion of each company's total market capitalisation for each position in the portfolio and benchmark index. This proportion is then used to determine the share (or contribution) of each company's reported carbon emissions, as defined by Scope 1 (S1) and Scope 2 (S2) under the Greenhouse Gas Protocol Initiative (GHG Protocol). This company-level contribution is then aggregated to produce a total Carbon Emission, or Tonnes of CO<sub>2</sub> ("tCO<sub>2</sub>"), for both the portfolio and benchmark index assuming an investment portfolio of US\$1 billion. Trucost is used as the data source for S1/S2. For companies in the portfolio and index for which Trucost does not provide carbon emissions data, a suitable sector/industry average is adopted as a proxy value for the purpose of this calculation. Allocations and security selection are subject to change.

Source: Lazard, Trucost, MSCI

# A Sustainability Solution

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## Global Thematic Approach



Themes aligned with societal goals.



All stocks must meet a sustainability threshold.

How does an active equity strategy integrate sustainability considerations AND financial investment decisions?

# A Sustainability Solution

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## Global Thematic Approach



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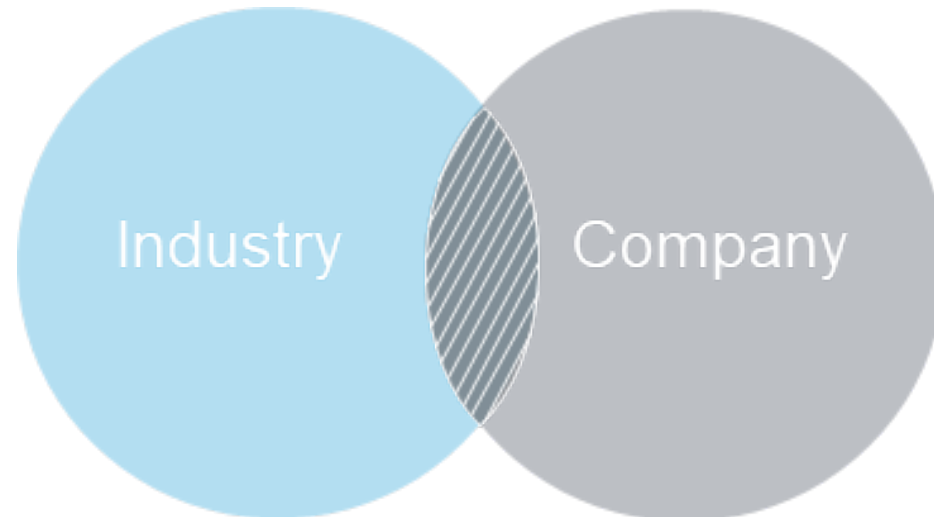
How does an active equity strategy integrate sustainability considerations AND financial investment decisions?

**1. Incorporate sustainability in a holistic framework to provide context**

# Building a Global Framework

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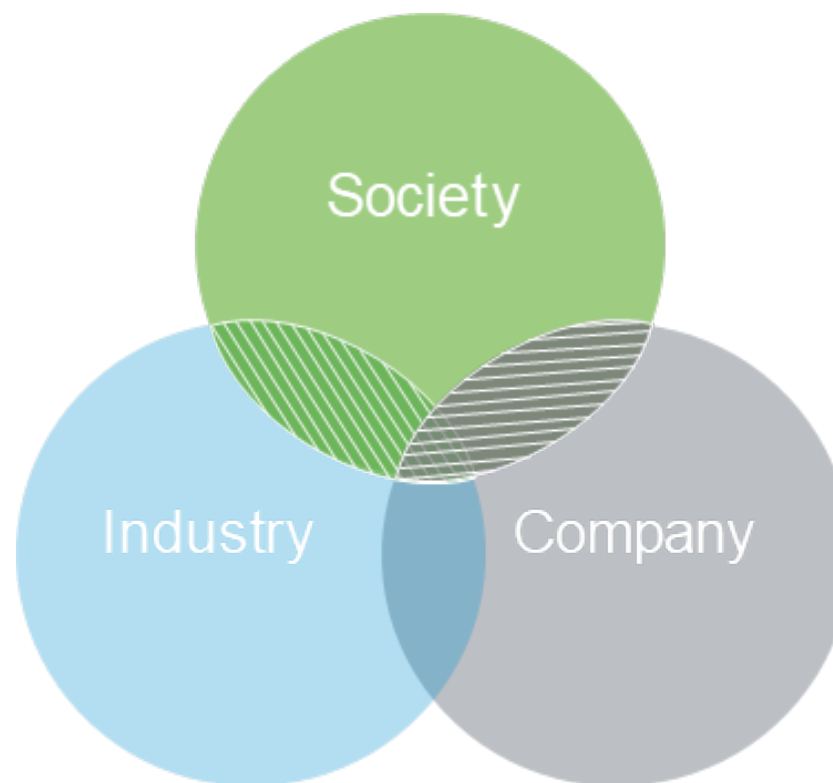
There are increasing demands on companies and capital to solve societal issues...



# Building a Global Framework

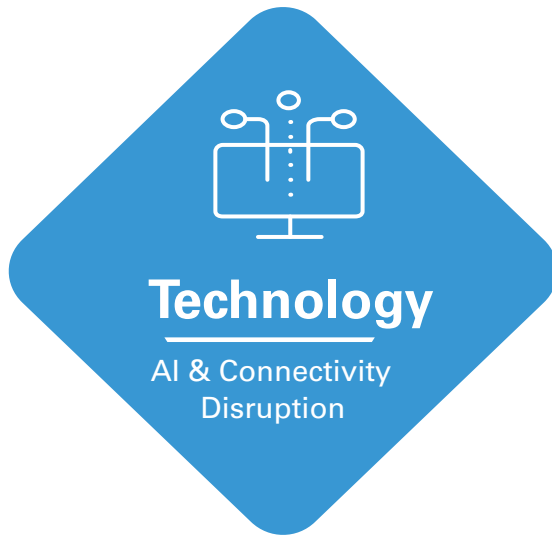
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... creating both risks AND opportunities for investors.



# Building a Global Framework

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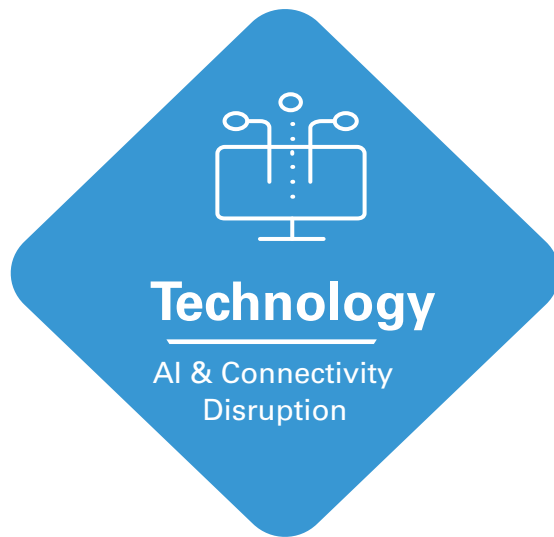


**We are witnessing an important convergence of technologies...**

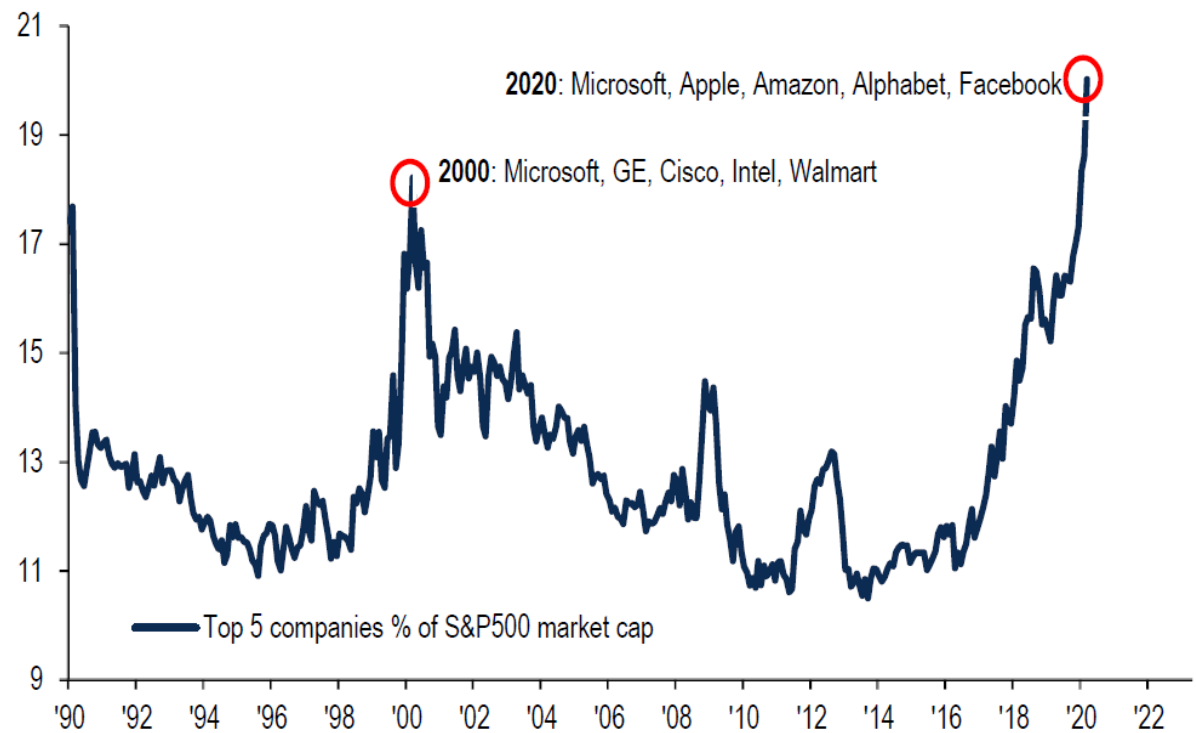
- Computing power
- Storage
- Communications
- Bioscience
- Data science
- Artificial Intelligence

# Building a Global Framework

... but the market already appears to know this.



S&P 500 Five Largest Stocks as % of Market Cap



As of 30 June 2020

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Source: Lazard Global Thematic Equity – Global Framework. BofA Global Investment Strategy, Bloomberg

# Building a Global Framework

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**Global and national political tensions are rising...**

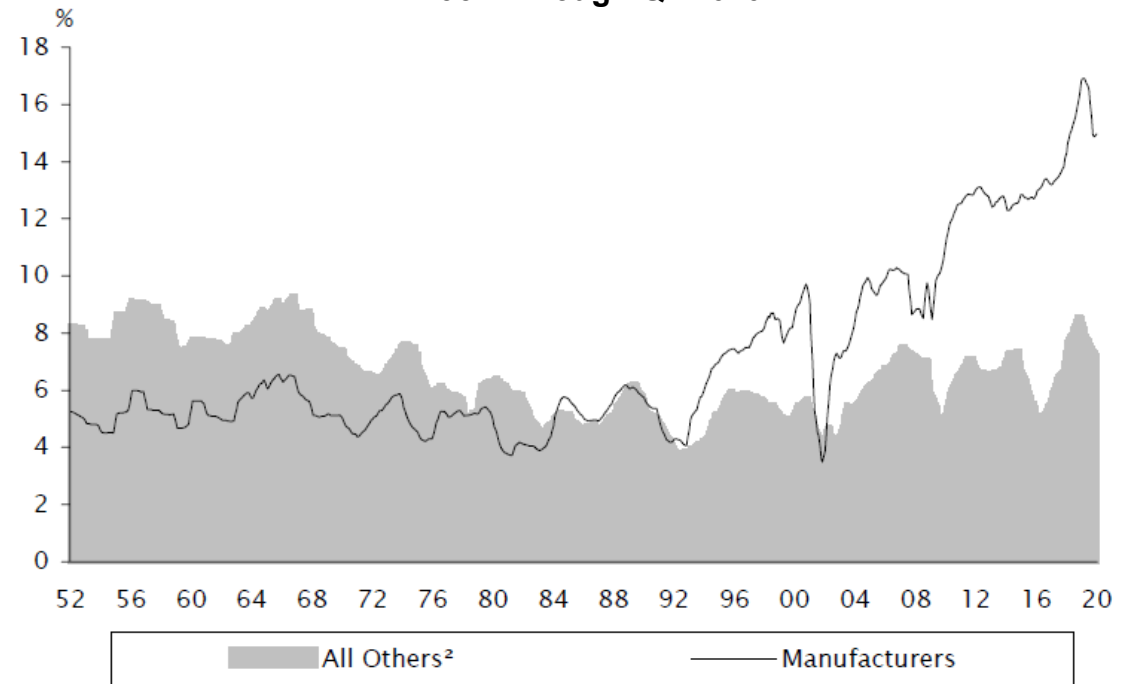


# Building a Global Framework

... threatening the increased profitability of global companies...



The S&P 500: Manufacturers and All Others Net Profit Margins<sup>1</sup>  
1952 Through Q1 2020



As of 31 March 2020

Information and opinions are current as of the date of this document.

Based on trailing four-quarter data smoothed on a trailing three-month basis.

Excludes financials and REITs.

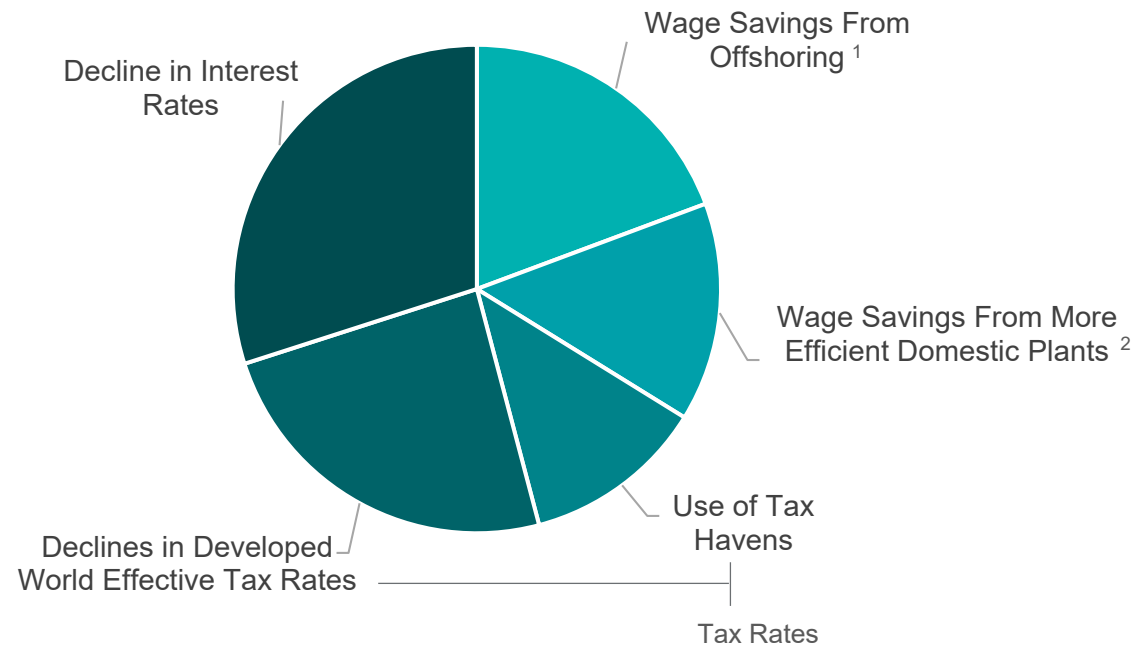
Source: Lazard Global Thematic Equity – Global Framework. Empirical Research Partners Analysis

# Building a Global Framework

... as headwinds to globalization increase.



**S&P 500 Manufacturers Margin Expansion  
Dynamic 2019 versus 2020**



As of 30 June 2020

Information and opinions are current as of the date of this document.

Assumes that U.S. jobs lost were replaced one-for-one by jobs in China at lower rates of compensation.

Assumes the decline in the labor intensity of these plants matches that for the entire U.S. manufacturing system.

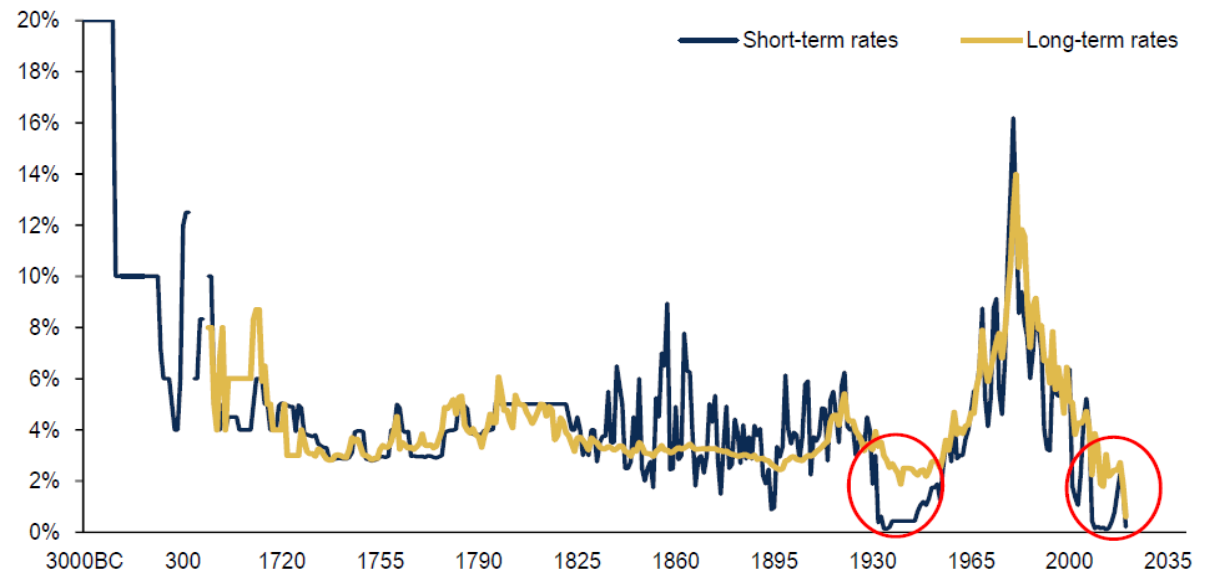
Source: Lazard Global Thematic Equity – Global Framework. U.S. Bureau of Labor Statistics, U.S. Census Bureau, Corporate Reports, Empirical Research Partners Analysis

# Building a Global Framework

We are in a disinflationary world...



Interest Rates Since 3000BC



As of 30 June 2020

Information and opinions are current as of the date of this document.

Source: Lazard Global Thematic Equity – Global Framework. Bank of England, Global Financial Data, Homer and Sylla "A History of Interest Rates" (2005)

# Building a Global Framework

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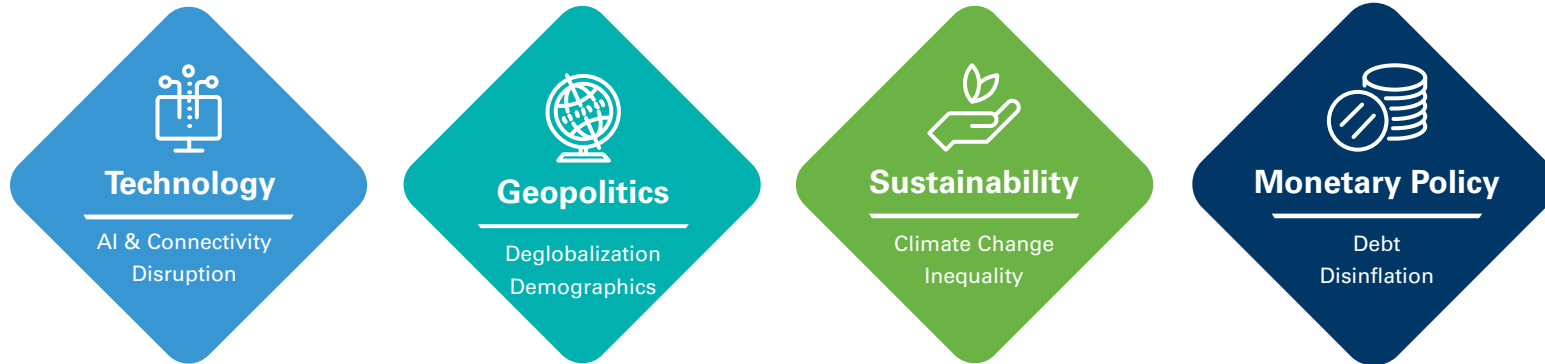
... but there are growing signs that this may not continue.



# Building a Global Framework

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Key drivers for our framework:



Three further considerations in building the Global Framework:

1. Disruption is non-linear
2. Technology, geopolitics, sustainability and monetary policy all interact with each other
3. Government policy is reactionary – we cannot hold it as a constant

# Building a Global Framework



## An investment framework for the next decade

Lazard's investment process is presented here in sequential steps for illustrative purposes only. In practice, the process may not be sequential and will, as needed, weigh certain criteria over others.

# A Sustainability Solution

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## Global Thematic Approach



Themes aligned with societal goals.



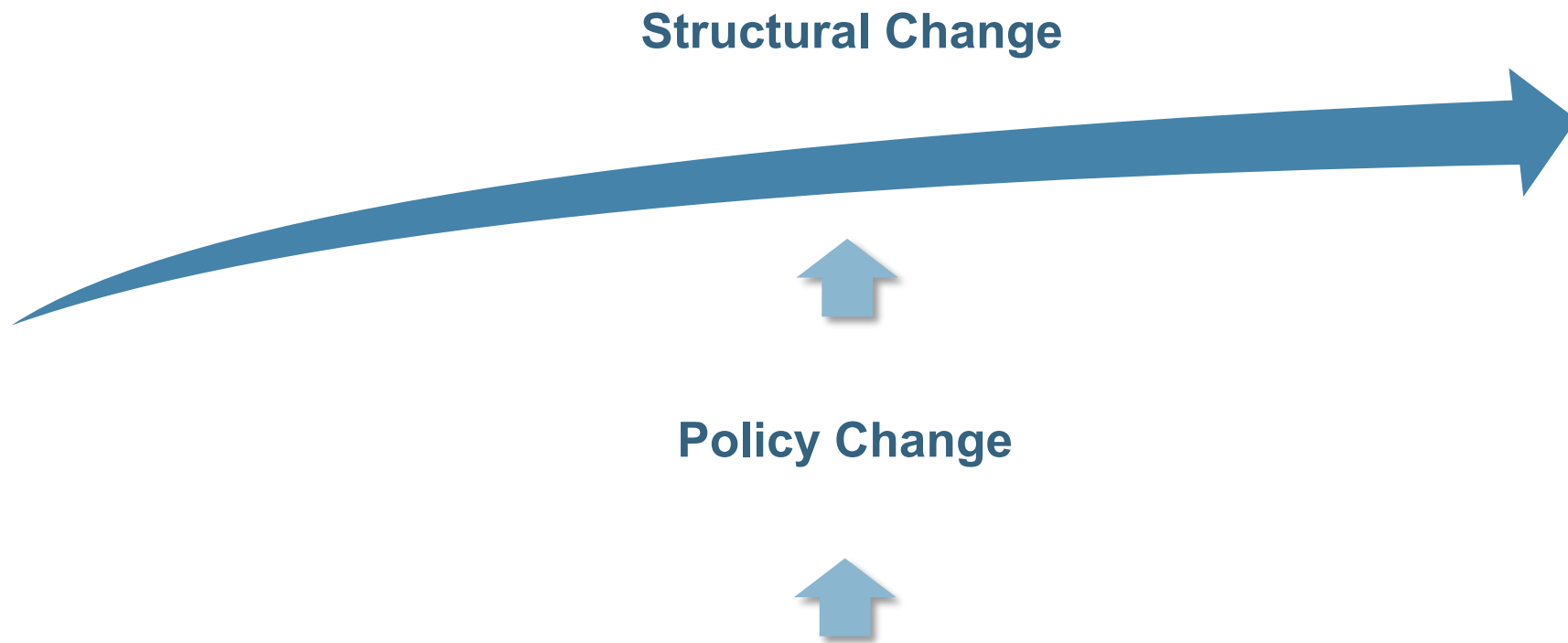
All stocks must meet a sustainability threshold.

How does an active equity strategy integrate sustainability considerations AND financial investment decisions?



1. Incorporate sustainability in a holistic framework to provide context
2. **Identify themes where solutions to societal problems represent a future profit pool**

# Integrating Policy Change

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# GT and Sustainability: SDG Alignment

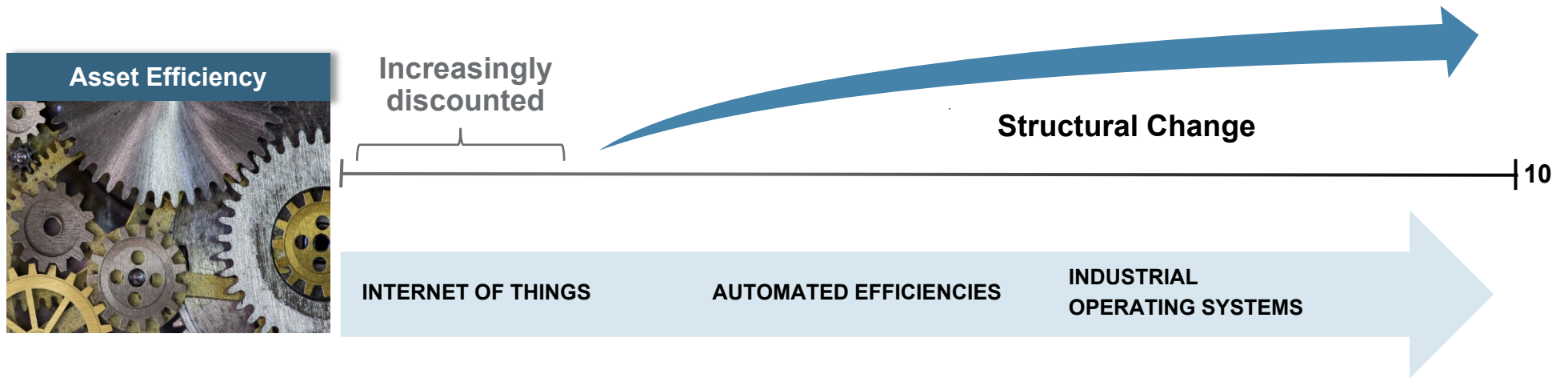
Theme	SDG Solution Pathway	SDG Alignment
<b>Asset Efficiency</b>	Precision agriculture, energy efficiency	   
<b>Bits of Chips</b>	Precision agriculture, energy efficiency	   
<b>Data, Networks &amp; Profits</b>	Cybersecurity, Financial inclusion	 
<b>Software as a Standard</b>	Productivity enhancements, cybersecurity	    
<b>Empowered Consumer</b>	Sustainable capitalism, Consumer engagement	  
<b>Digital Runway</b>	Financial inclusion, Financial literacy	  
<b>First World Health</b>	Affordable health care, Medical technology	
<b>Distribution Footprints</b>	Smaller production footprint, Nutritional security	    
<b>Enduring Brands</b>	Responsible consumption	   
<b>Energy Transitions</b>	Renewable energy, Energy efficiency, Decarbonized fossil fuel	 
<b>Extreme Risks</b>	N/A	

SDG Alignment has been mapped according to our qualitative assessment of where a theme thesis substantially overlaps with a solution pathway for a specific SDG. As our themes evolve over time, these alignments will also evolve. We disregarded company-level, idiosyncratic examples of SDG-aligned behavior: for example, a software firm with a particularly green headquarters that may rightly consider itself aligned with a set of SDGs, in the context of its own company operations.

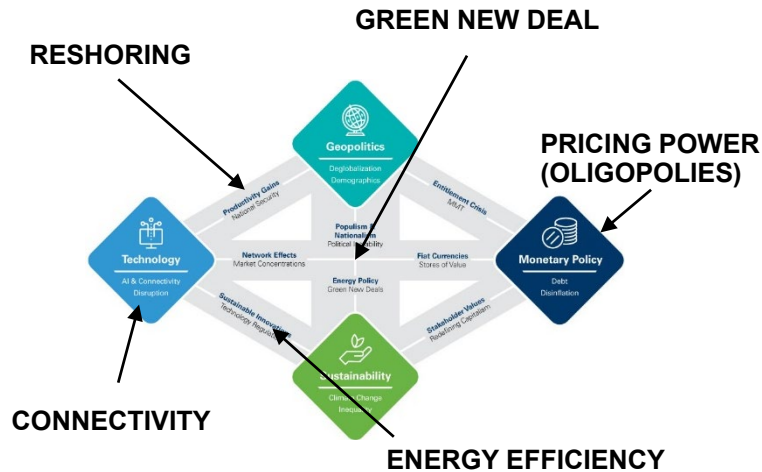
Solutions for one SDG pathway may be indirectly relevant to others, as described in the UN document “Blueprint for Business Leadership on the SDGs – A Principles-Based Approach”. We have excluded these indirect relationships in our mappings as we only wish to highlight themes we consider directly relevant for each SDG.

Source: United Nations

# Theme Example: Asset Efficiency



## Framework



## Summary

### Harvesting efficiency gains from the Internet of Things

- IoT as a concept is well recognized. Business models which evolve around service agreements and recurring revenues, rather than growth in unit sales, represent potential long-term winners.
- The next step is that physical assets will automatically share efficiency best practice with each other.
- The platforms enabling this are very long cycle and represent semi-permanent industrial operating systems.

## SDG Map



Information and opinions are current as of this document.  
For illustrative purposes only  
Source: United Nations

# GT and Sustainability: Stock Examples



**30%**

Productivity increase from Connected Fleet. Precise planting/harvesting cycles adapted to local climate.

**90%**

Less herbicide. Deere's Blue River Technology builds smart farm machines that can target individual weeds.

**1-2**

Years payback. Affordable for farmers.

**7-9%**

Sales growth through 2023.

**15%**

Mid-cycle OP margin target 2022 vs historical 13%.

**15x**

P/E based on June 30, 2020 share price and 2021 Consensus earnings forecast.<sup>1</sup>



**40%**

Of Global CO2 emissions comes from buildings.

**20%**

Guaranteed efficiency savings for customers by installing JCI building management systems.

**28**

Million metric tons of CO2 emissions reduced for customers since 2000.

**4-6%**

Organic sales growth through 2023.

**13%**

EPS CAGR 2020-2023

**14x**

P/E based on June 30, 2020 share price and 2021 Consensus earnings forecast.<sup>1</sup>

As of 30 June 2020

<sup>1</sup> Source: FactSet

Mention of these securities should not be considered a recommendation or solicitation to purchase or sell the securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein. There is no assurance that any securities referenced herein are currently held in the portfolio or that securities sold have not been repurchased. The securities mentioned may not represent the entire portfolio.

Source: John Deere, Johnson Controls, Company reports

# A Sustainability Solution

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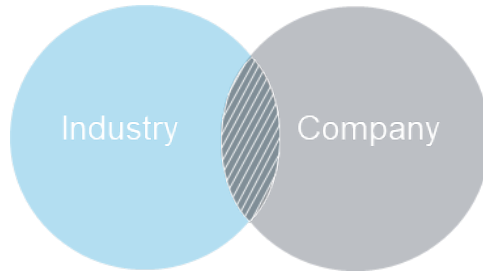
1. Incorporate sustainability in a holistic framework to provide context
2. Identify themes where solutions to societal problems represent a future profit pool
- 3. Ongoing and dynamic assessment of the societal license to operate**

# Sustainability: Sustainability Framework

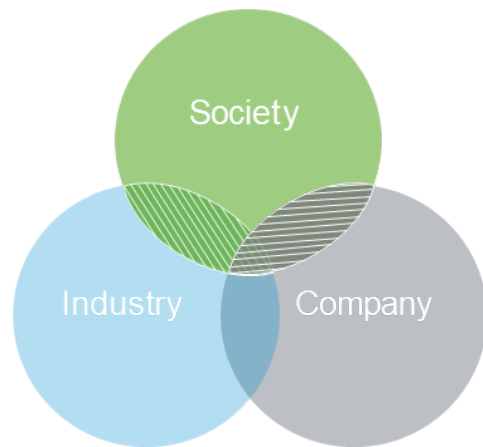


**Relationships with society represent risks to sustainability**

# GT and Sustainability: Sustainability Framework



**Traditional Risk Analysis Focuses on the Relationship between a Company and Its Industry**



**Adding Society Creates Two Further Relationships for Analysis**

## Key Features

### Relationship Analysis

We believe the structure/nature of industry and company relationships with society will be the key mechanism through which sustainability risks impact company fundamentals and stock prices in the future. Our framework assesses the strength of relationships among a company, industry, and society.

### Formal Rating System

The framework offers a consistent, disciplined approach to complex issues. It also provides a formal context for discussions between the portfolio team, Lazard analysts, and Lazard's ESG resources.

### Threshold Test

Sustainability risks represent "fat-tail" events: avoidance of the risk of ruin and capital impairment is key. For this reason we have set a threshold level of risk. If a stock fails to pass the threshold test it is not added to the portfolio.

### Direction of Change

We acknowledge that a good company or industry on a deteriorating trend can be a bad investment and a bad company or industry on an improving trend can be a good investment.

### Dynamic and Integrated

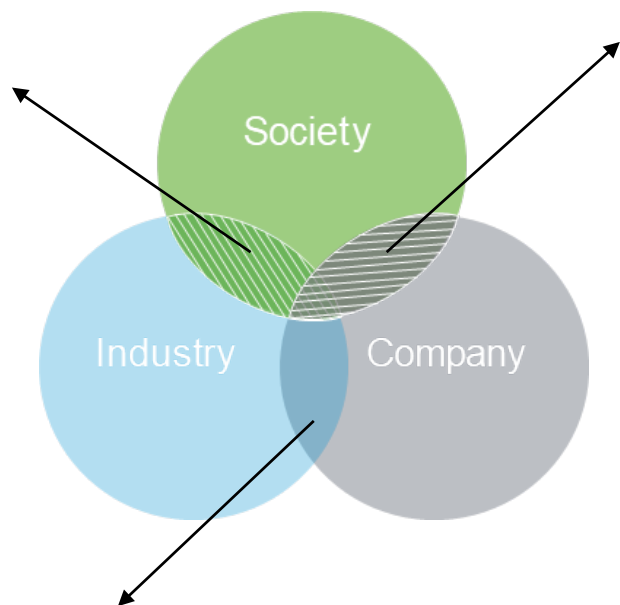
The framework combines data and judgment over time. It is not dependent on any one external data source. Decisions are ultimately based on qualitative investment judgment.

### Fundamental

A process entirely based on what we believe are drivers of long-term company performance.

# GT and Sustainability – Example: Alphabet

## Society/Industry Assessment



## Industry/Company Assessment

## Society/Company Assessment

	Good			Neutral			Weak		
	+	=	-	+	=	-	+	=	-
Society/ Industry	✓					✓			
Society/ Company					✓				
Industry/ Company	✓								

x2 = Fail Existing holdings Placed "Under Review" for maximum 6 months  
 x1 = Fail Proposed holdings Excluded from selection

- Final Assessment: Pass

**All stocks must pass a sustainability threshold based on societal license.**

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