GLOBAL SUSTAINABLE OUTCOMES

COLUMBIA THREADNEEDLE INVESTMENTS

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News & Views Q1 2021

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Marmite issue: shortages in yeast from breweries, coupled with rising demand, has led to empty shelves.
Source: iStock.

Inflation: a word that has sparked huge debate as well as rotation in the market. But is it temporary or permanent, helpful or harmful? One thing is clear: it has been rising around the world. With successful vaccine rollout programmes in many developed countries, markets are optimistically looking to a full economic reopening. However, the economic recovery is also being fuelled by strong consumer balance sheets – not much spending happens in lockdown – and impressive government fiscal stimulus packages. In the US, for example, President Biden has proposed an Infrastructure Plan that envisages spending $2.25 trillion over eight years on a wide range of infrastructure and social initiatives.1 This plan also supports the US's "green" transition – namely investing in a clean power sector, the electrification of transport, and the decarbonisation of buildings and agriculture.

At the same time global supply chain disruptions – from auto chip shortages to a lack of Marmite on supermarket shelves (supposedly due to shortages in yeast as breweries have closed during lockdowns while demand for the product has gone up) – is leading to a squeeze on input costs. Where manufacturers have pricing power, this is in turn being passed through to the customer. Our strategy's focus on companies and industries with strong competitive dynamics becomes vital in such an environment as these corporates tend to have greater ability to pass through rising costs and sustain financial returns.

Q1 company earnings calls were dominated by both optimistic management outlooks on sales recovery, but also cautionary warnings around rising inflationary cost pressures. This in turn has sustained the rotation into value cyclical sectors such as banks and commodities that began in Q4 2020. Suddenly near-term earnings growth here looks compelling versus traditional growth sectors such as technology.

Although the Threadneedle Global Sustainable Equity strategy was up 2.4%[2] over the quarter, it lagged the MSCI All-Country World Index by 2.1%,[3] with our underweight in developed market banks and commodity sectors such as oil and gas hurting relative performance.

We did, however, have several positive sustainable updates over the quarter. Firstly, Sika,[4] a leading construction materials company, announced an innovative recycling process it has developed for old concrete. According to the European commission, 25%-30% of all waste generated in the EU consists of construction demolition waste materials.[5] Recycling these materials is vital particularly in dense urban areas where most old concrete accumulates. In Sika's process, old concrete is broken down into individual parts which in turn enables the reuse of the components of the old concrete as well as increased recycling of cement aggregates. This innovation, called «reCO_2ver», will make a significant contribution to reducing the ecological footprint of the construction industry.[6]

Paul Schuler, Sika CEO, said in a statement: "In the five largest EU countries alone, roughly 300 million tons of old concrete are generated every year. With complete recycling of these materials, up to 15 million tons of CO_2 emissions can be captured. We are convinced that our new process has the potential to benefit both our customers and the environment."[7]

Another innovative specialty materials holding is Croda,[8] which recently held its 2021 Sustainability Day. At this, management highlighted several exciting initiatives including:

- Increasing its use of bio-based raw materials in its products. In 2020, 67% of raw materials in its beauty and household chemicals were bio-based and it set a new target of 75% by 2030.
- setting a target to save at least 800,000 hectares of land per year. The company is already at net-zero in 2020 in terms of land used and saved and is now aiming to maintain that for every additional hectare of land used to grow its materials – double the amount of land will be saved by using their agriculture technology.

- Implementing an internal cost of carbon of £50 per tonne of CO_2 into all projects to support decarbonisation of all its production.[9]

In March, we attended Exane's "Future of Packaging" conference where we heard positive updates from two of our holdings: UPM, a manufacturer of forest-based products, and SIG Combibloc, a global supplier of aseptic carton packaging. The key takeaway was that consumer pressure is growing on governments and corporates around the world to limit single-use plastic, with regulation around plastic waste gaining momentum. This is leading to strong tailwinds for more sustainable paper-based packaging solutions and away from plastic packaging.

In addition, UPM highlighted its concern that the EU taxonomy did not view existing forestry management as a taxonomy-aligned activity. However, the European Commission subsequently has presented its new act on taxonomy regulation where they now classified existing forestry management as a taxonomy-eligible activity.

Although markets remain volatile, we believe our sustainable themes are robust with government policy and consumer trends around the world continuing to shift towards a greener and more inclusive future.

Engagement highlight: Nextera[10]

Nextera has been a longstanding holding in the strategy as the leading developer of renewable energy in North America. FPL (Florida Power & Light), part of Nextera, has set a "30-by-30" plan to install more than 30 million solar panels by 2030 and make Florida a world leader in solar energy. The end result will be the largest installation of solar panels by a regulated utility in the world and a 67% fleet-wide reduction in CO_2 emissions by 2030 compared to the national average. The company has also developed the largest combined solar-plus-storage facility in the country. This cutting-edge project incorporates a 10MW battery storage project into the operations of a 74.5MW solar power plant.[11]

Given all of this work we were surprised to see that the company had a fairly average score according to the Transition Pathway Initiative, which is a global, asset owner-led initiative which assesses companies' preparedness for the transition to a low-carbon economy.

We scheduled a call to discuss this with the company in more detail and discovered that it was due to disclosure gaps rather than poor practice. We were reassured to hear that it was already working to close these gaps and we are confident its strategy is well aligned to the energy transition.

As active managers we see the importance of regularly engaging with the companies we own, to ensure that their values remain align with our own. Through regular communication and close relationships, we are able to ensure we maximise sustainable outcomes for this strategy.

1 Bloomberg, March 2021.
2 Gross of fees. Past performance is not a guide to future returns.
3 Bloomberg, as at April 2021.
4 Mention of specific stocks should not be taken as a recommendation to buy.
5 https://www.interregeurope.eu/policylearning/news/1770/construction-and-demolition-waste/
6 https://www.sika.com/en/media/media-releases/2021/sika-achieves-breakthrough-in-concrete-recycling.html
7 https://www.sika.com/en/media/media-releases/2021/sika-achieves-breakthrough-in-concrete-recycling.html
8 Mention of stocks is not a recommendation to buy or sell.
9 https://www.croda.com/en-gb/sustainability/targets
10 Mention of stocks is not a recommendation to buy or sell.
11 https://newsroom.nexteraenergy.com/2019-01-16-FPL-announces-groundbreaking-30-by-30-plan-to-install-more-than-30-million-solar-panels-by-2030-make-Florida-a-world-leader-in-solar-energy

Sustainable Theme Focus: Sustainability in fashion

I love shopping for clothes – I admit it, *writes Pauline Grange*. But increasingly, my shopping is tinged with guilt. I am now much more aware of the terrible environmental impact that comes with fashion, with the textiles industry one of the most pollutive in the world.

Around 100 billion apparel items are sold per year, which is a circa 50% increase versus 2006.[1] This is in large part due to the rise of "fast fashion" – ie cheap, high-fashion items. In fact, the industry now emits more CO_2 than the aviation and shipping industries combined, and uses 79 billion m3 of fresh water a year while causing around 20% of industrial water pollution. But unfortunately, very little of what the industry produces is recycled and reused, with the majority of items ending up in landfill or incinerated within a year of production.[2] Indeed, according to the Ellen Macarthur foundation, the global fashion industry produces about 53 million tonnes of fibre a year, of which more than 70% ends up in landfills or on bonfires. Less than 1% is reused to make new clothes.[3]

This raised awareness has changed my consumption patterns – I now buy fewer but higher-quality items. In addition, I have changed my negative view of buying second-hand clothing and now happily scour for bargains either through online platforms or local charity shops. And it looks like I'm not alone: 70% of women have or are now open to shopping second-hand up from 45% in 2016.[4] As a result, rental and resale fashion platforms are seeing strong growth. In the Threadneedle Global Sustainable Global Equity strategy we own one such resale platform, Mercari, which has seen accelerated growth over the past year in its two key markets of Japan and US, with both users and engagement on its platform increasing.

In fact, consumers are increasingly prioritising sustainability, which is starting to influence the way they shop. Nearly 2.5x more consumers plan to shift their spend to sustainable brands.[5] At the same time, regulation around building a more circular economy is rising too, such as the EU Circular Economy Action plan which aims to shift production and consumption from the linear "Take, Make, Dispose" model to more circular use of products and materials.[6]

Adidas has been a core holding since the inception of the Threadneedle Global Sustainable Equity strategy. Its production and promotion of technical sports performance products contributes positively to our social theme of "Good Health and Wellbeing".

But if we own a textile company, we also want its products to not have a detrimental impact on the environment. Fitness wear is generally worn more frequently and retained for longer than high-fashion items. In addition, Adidas is a sustainable leader in the industry. At its Capital Markets day in March, sustainability was once again front and centre of its agenda. It detailed its innovation around making its products more circular and sustainable and highlighted its target to have nine out of 10 of its articles environmentally sustainable by 2025 using a "Three-loop" strategy:[7]

1. **Recyled loop:** sourcing recycled raw materials from outside of its own products, namely 100% recycled polyester or Parley ocean plastic waste (upcycled plastic waste collected on shorelines and coastal areas).
2. **Circular loop:** producing products that can then be recycled and remade into new Adidas products – "made to be remade". It has launched an Ultraboost trainer that can be returned, recycled and subsequently remade into a new pair, with the aim to expand this concept to more franchises and categories overtime.
3. **Regenerative loop:** Where products cannot fit into the above categories, Adidas aims to make these products from natural materials that can biodegrade.

Management has in fact set a target for 100% of its products to use only recycled polyester by 2024 aided by the introduction of their Primeblue and Primegreen fabrics (see below).

All of which sounds positive, but we wanted to see first-hand how sustainability was embedded into the company's marketing and products on the shop floor. So, more than a year since our last visit we revisited the Adidas flagship store on Oxford Street, London.

Adidas has improved the integration of sustainability across its product ranges. Before, "green" ranges were showcased separately and in very limited parts of the store. Today, recycled materials are evident across all their ranges throughout the store.

Adidas uses two sustainable materials in its ranges, which are clearly marked (via a label) on different apparel items and trainers:

- **Primeblue:** this is a high-performance yarn made with at least 50% Parley ocean plastic.
- **Primegreen:** this is a series of high-performance materials that are made from recycled ingredients.

Rummaging through men's, women's and children's apparel and trainers, these products made up a substantial percentage of each range. This is a huge advance from a year ago.

Adidas also aims to implement sustainability innovation at scale to make its most popular products its most sustainable. This was on display upon entering the flagship London store where you are greeted with its new "green" Stan Smith selection, one of Adidas's most iconic trainer franchises which are now made from either Primeblue or Primegreen materials. It also showcased an industry first: a Stan Smith made using Mylo, a mushroom-based material that performs like leather but is biodegradable.

Another in-store service is the "Sneaker services" repair station. This allows customers to repair their trainers, preventing early and unnecessary disposal. Extending the life of a garment by just nine months reduces its environmental impact by an impressive 20-30%.[8]

There was also evidence of progress in targeting our social outcome of "Good health and Wellbeing":

- **Expanding sizing in apparel ranges**
  Previously there was a separate section for plus sizes. This has now been replaced with expanded sizing integrated across all ranges as well as the use of plus-size dummies to model clothes for both women's and men's ranges. This helps promote inclusion in sport and exercise.
- **Greater focus and dedicated innovation around women's training**
  Adidas has increased investment in women's training ranges. This was evident in-store from the impressive technical items in the women's Terrex outdoor range to the exciting new women's Tennis range.

Digital is another key area of investment for the firm, and the integration of digital and sustainability was on display in the store. For example, there were photo booths where you can take and share your picture and environmental pledge with the online Adidas community.

Overall, we walked away confident that Adidas might achieve its corporate mission: "Through sport we have the power to change lives. By striving to expand the limits of human possibilities, to include and unite all people in sport and to create a more sustainable world".[9]

[1] https://www.ubs.com/global/en/investment-bank/in-focus/2021/industry-at-risk.html?caasID=CAAS-ActivityStream
[2] https://www.ubs.com/global/en/investment-bank/in-focus/2021/industry-at-risk.html?caasID=CAAS-ActivityStream
[3] https://theconversation.com/fashion-production-is-modern-slavery-5-things-you-can-do-to-help-now-115889
[4] GlobalData Consumer Survey, December 2019-January 2020.
[5] https://www.thredup.com/resale/#methodology-and-sources
[6] https://ec.europa.eu/environment/topics/circular-economy/first-circular-economy-action-plan_en#:~:text=The%20new%20Circular%20Economy%20Action%20Plan%20presents%20measures,...%204%20Ensure%20less%20waste%3B%20More%20items...%20
[7] Unless stated elsewhere, all facts and figures regarding Adidas are from this document: https://news.adidas.com/running/adidas-aims-to-end-plastic-waste-with-innovation---partnerships-as-the-solutions/s/be70ac18-1fc9-45c1-9413-d8abaac2e849
[8] https://traid.org.uk/wp-content/uploads/2018/09/impacts_of_clothing_factsheet_23percent.pdf
[9] https://www.adidas.co.uk/impossibleisnothing

Threadneedle Global Sustainable Equity Composite

GIPS Report: Columbia Threadneedle Investments EMEA APAC

Reporting Currency: USD

Statement of Performance Results

Calendar Year	Gross-of-fees Return (%)	Net-of-fees Return (%)	Index Return (%)	Composite 3-Yr St Dev (%)	Index 3-Yr St Dev (%)	Internal Dispersion (%)	Number of Portfolios	Total Composite Assets (mil.)	Total Firm Assets (bil.)
2020	28.12	27.30	16.82	N.A.	N.A.	N.A.	≤ 5	1.5	149.8
2019	33.17	32.32	27.30	N.A.	N.A.	N.A.	≤ 5	1.2	140.5

Inception Date: 12/31/2018

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3. A concentrated global equity strategy with a focus on high quality companies that seeks to deliver both positive sustainable outcomes, in accordance with the UN Sustainable Development Goals (SDGs), and superior financial returns. The composite was created November 30, 2018.

4. The portfolio returns used in composites are calculated using daily authorised global close valuations with cash flows at start of the day. Composite returns are calculated by using underlying portfolio beginning of period weights and monthly returns. Periodic returns are geometrically linked to produce longer period returns. Gross of fee returns are presented before management and custodian fees but after the deduction of trading expenses. Returns are gross of withholding tax. Net of fee returns are calculated by deducting the representative fee from the monthly gross return. Policies for valuing investments, calculating performance, and preparing GIPS Reports, as well as the list of composite descriptions, list of pooled fund descriptions for limited distribution pooled funds, and the list of broad distribution pooled funds are available upon request.

5. The dispersion of annual returns is measured by the equal weighted standard deviation of portfolio returns represented within the composite for the full year. Dispersion is only shown in instances where there are six or more portfolios throughout the entire reporting period. The Standard Deviation will not be presented unless there is 36 months of monthly return data available.

6. The three year annualised ex-post standard deviation measures the variability of the gross-of-fees composite and benchmark returns over the preceding 36 month period.

7. The following fee schedule represents the current representative fee schedule for institutional clients seeking investment management services in the designated strategy: 0.65% per annum. Gross of fee performance information does not reflect the deduction of management fees. The following statement demonstrates, with a hypothetical example, the compound effect fees have on investment return: If a portfolio's annual rate of return is 10% for 5 years and the annual management fee is 65 basis points, the gross total 5-year return would be 61.1% and the 5-year return net of fees would be 55.9%.

8. The MSCI AC World Index is designed to provide a broad measure of equity-market performance throughout the world and is comprised of stocks from 23 developed countries and 24 emerging markets. Index returns reflect the reinvestment of dividends and other earnings and are not covered by the report of the independent verifiers.

9. Past performance is no guarantee of future results and there is the possibility of loss of value. There can be no assurance that an investment objective will be met or that return expectations will be achieved. Care should be used when comparing these results to those published by other investment advisers, other investment vehicles and unmanaged indices due to possible differences in calculation methods.

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