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ESG Update Q3 2022

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What We've Been Reading:

The US Inflation Reduction Act (IRA) was signed into law on August 16, 2022: The Legislation aims to lower prescription drug costs, improve taxpayer compliance, and invest in domestic manufacturing while promoting clean energy. Whether and when the law will reduce inflation remains a point of contention.

We have been particularly interested in the IRA's climate provisions, which are considered the single largest action ever taken by the US Government to combat climate change. Almost $400 billion in federal funding will be directed to drive down consumer energy costs, increase energy security and reduce greenhouse gas emissions. The funds will be delivered through a mix of tax credits, grants and loans. At a recent energy conference, we heard more than one CEO refer to the IRA as a "game-changer". Our ESG engagements have explored the initial reactions of some of our higher-emitting companies to the IRA's climate provisions. The new and extended tax credits are of particular significance: existing renewables tax credits have been restored and extended, and new technology-agnostic credits have been introduced. Credits are no longer limited to specific technologies and most clean technologies (including wind, solar, biomass, geothermal and carbon capture) now have certainty of a stable tax credit through the next decade. Firms now have the flexibility and incentives to pursue the emissions reductions pathways they consider most compatible with their business models. We look forward to seeing how the IRA might unlock more innovation to prevent the worst effects of climate change.

Aluminum markets in flux: Global aluminum markets were hit by a surge of volatility with reports that the London Metal Exchange (LME) might consider banning new supplies of Russian metals from entering its warehouse network. Rusal, a major Russian producer, accounts for roughly 13% of global aluminum capacity outside China. Elevated aluminum prices could crimp margins for various manufacturers. Increasingly, companies will have to consider not just their own social license to operate but that of their suppliers as an ESG issue with material financial impacts.

Walmart's ESG credentials in the news: We read an excellent article in the Financial Times (unfortunately paywalled) covering Walmart's curious position as both leader in corporate sustainability and target for criticism. In an even-handed treatment of the world's biggest retailer by revenues, one excellent sentence captures the complexity of being Walmart: "Reading [Walmart's annual ESG reports] shows the extraordinary range of issues on which companies are now expected to have a position. Walmart, they reveal, worries about lightbulbs, refrigerants, soil erosion, systemic racism, plastic bags, gun violence, financial literacy, vaccine distribution, disaster preparedness, recidivism rates, cashew yields in Ghana and shark stocks in New Caledonia." Smaller companies must surely focus on a narrower list of priorities – as must most investors.

Europe experienced its hottest summer on record and worst drought in 500 years: The continent experienced wildfires, droughts and deaths. The most severe temperature anomalies were recorded in France where some nuclear plants relying on river water to cool their reactors were forced to scale back production. The river Rhine, a major artery for trade and energy supplies, reached record low levels, at around 50cm (~20 inches), just a quarter of the usual summer reading. Heatwaves on the continent are expected to become a more frequent occurrence. Europe's climate efforts, which to date have mostly focused on mitigation, i.e. emissions reductions, will need to start incorporating more adaptation measures to promote social and economic resilience in a changing climate.

What We've Been Up To:

- **PRI assessment:** We were pleased to receive a solid set of scores in our 2021 PRI Assessment. We believe these scores reflect the tremendous progress in our ESG efforts over the past 4 years.
  - Investment & Stewardship Policy: 4 stars
  - Listed equity: Active fundamental – Incorporation: 4 stars
  - Listed equity: Active fundamental – Voting: 3 stars
- **ESG engagements:** Our work in Q3 is typically dominated by company engagements. This quarter was no different, as we completed 11 ESG engagements. Much of our focus this quarter has been on companies operating in "hard-to-abate" industries such as chemicals, mining and industrial gases. These are sectors where emissions reductions are currently less technologically or economically viable. Our research and discussions have enhanced our thinking around possible pathways to decarbonizing these industries. Companies are taking various strategic approaches to the low-carbon transition, and we are gaining a clearer view of where the challenges and opportunities lie. We look forward to sharing more insights on this topic later in the year.
- **ESG note review:** We continued our review of analyst ESG notes. This process is designed to provide all analysts with bespoke feedback on their ESG analysis, sharpening their understanding of material ESG factors.
- **ESG policy refresh:** We are in the midst of updating our ESG policy and expect to release a revised version by end of 2022. The updated policy will better reflect Epoch's ESG framework and processes.
- **Investment team ESG event:** We have organized a guest speaker to share his views on ESG in the Industrials sector and beyond with our Investment team. This event will take place in Q4 and we will share more details in a future update.
- **Reviewed ISS proxy voting guidelines:** We currently use the ISS Benchmark Policy to guide our proxy voting recommendations. We reviewed the Benchmark Policy in Q3 and compared it with various other specialized ISS policies. We remain confident that the Benchmark Policy represents Epoch's broad views on various proxy voting items, although Portfolio Managers have discretion to deviate from the ISS recommendation should they see fit.