

INTEGRITY

The evolution of ESG



James Harwood
October 2019

Our beliefs

We believe that understanding our beliefs is an important starting point to this conversation

1. ESG factors impact security prices
2. A deep understanding of how ESG factors impact security prices is value-adding to a skilful investment process
3. Embedding ESG considerations into a firm's culture and process improves the likelihood of prolonged and successful investing
4. Active ownership is an effective tool for improving investment outcomes

Integrating ESG across an organisation



Responsible investing is broad

Different ways investors integrate ESG into portfolios



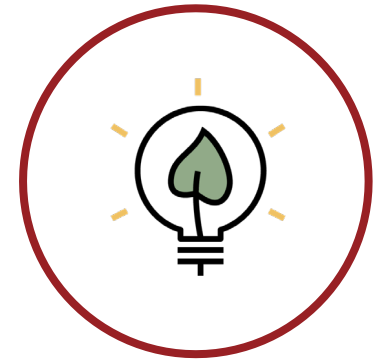
Integrate
ESG factors into
manager selection



Proxy voting
and engagement



Exclusions/
ESG targets

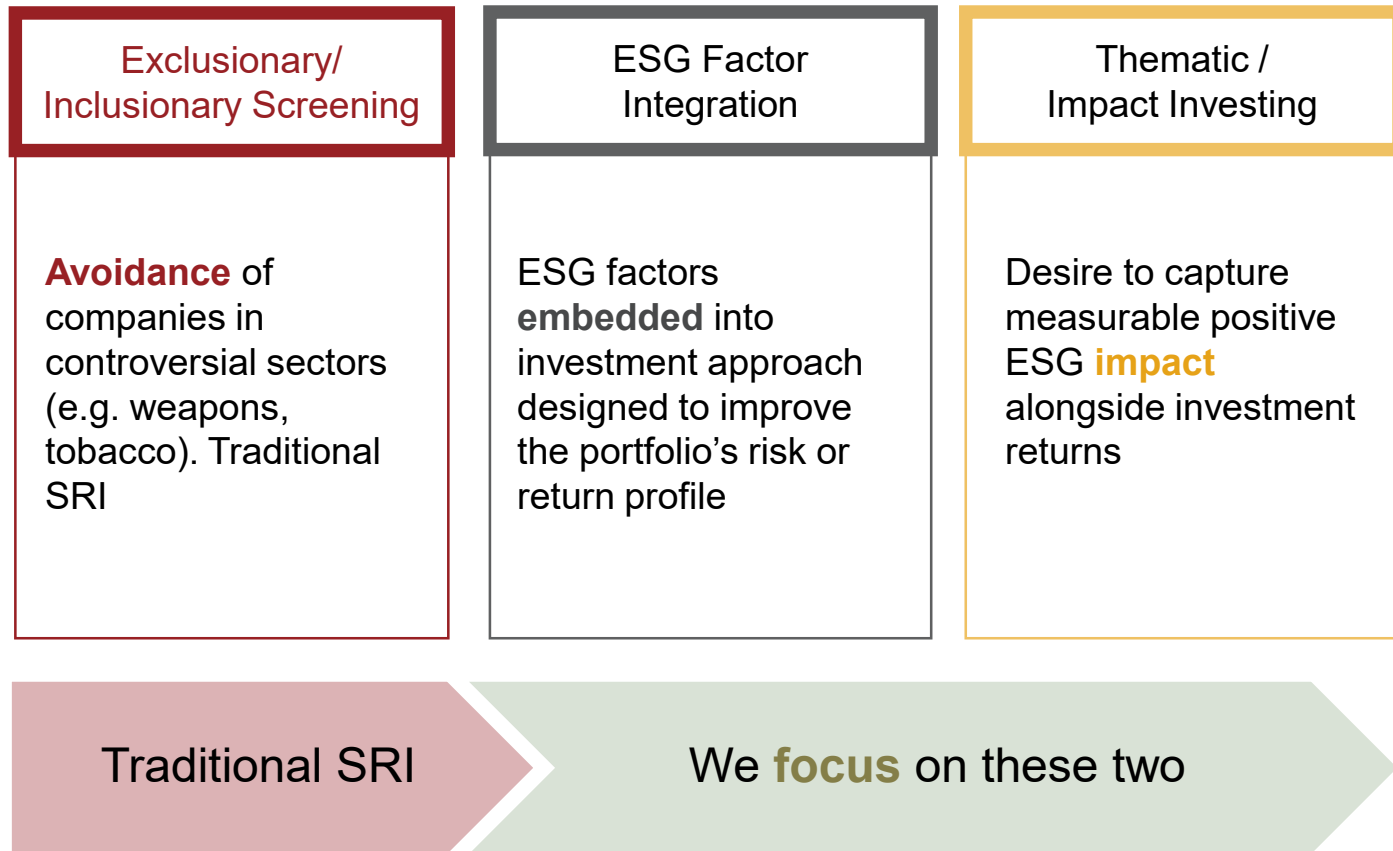


Thematic/
impact
investment

Source: Russell Investments, for illustrative purposes only.

Investment managers are being held to a rising standard

Investor demands and regulatory requirements are shifting, can investment managers keep pace?



Firm-wide holistic ESG integration

Integrating ESG into our practices and processes

Portfolio management

- > Manager ranks
- > Surveys
- > Manager selection



ESG research and metrics

- > Product solutions
- > Research metrics & universes
- > Reporting



Active ownership

- > Proxy voting
- > Engagement
- > Sustainable development goals



Culture and process

- > Integrate ESG across whole firm
- > Sustainable work practices
- > Diversity and inclusion



Active ownership

We are committed to integrating ESG and investing responsibly

Since 2009

UN-PRI signatory

A+ and A

Ratings from UN-PRI *

93,000+

Proxy votes made at 9,873 meetings in 2018

Tier 1

UK Financial Reporting Council

Stewardship codes

Global application of and commitment to the
UK and Japan Stewardship Codes

Portfolio management

ESG research and metrics

Active ownership

Culture and process

Signatory of:



* Across 10 categories, as at December 2019.

Low Carbon Equity Solution



Meeting ESG specific goals and preferences

Spotlight on Russell Investments' ESG specific solutions

Thematic funds

Funds designed to incorporate strategies to commonly desired investment themes, e.g. Low Carbon (can include some or all of below services)

Types of services we offer:

Positive Investments



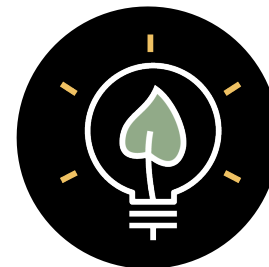
E.g. encourage positive action or support social initiatives, e.g. tilting towards higher ESG scores or impact investing

Screening



Exclusion of companies which do not fit with investment beliefs

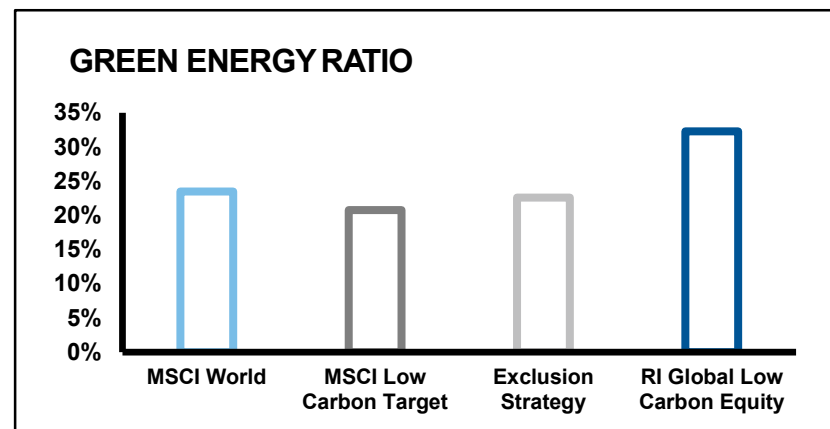
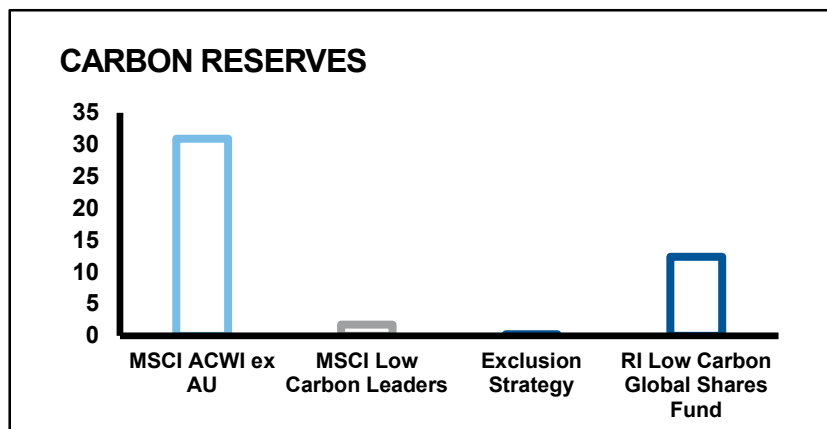
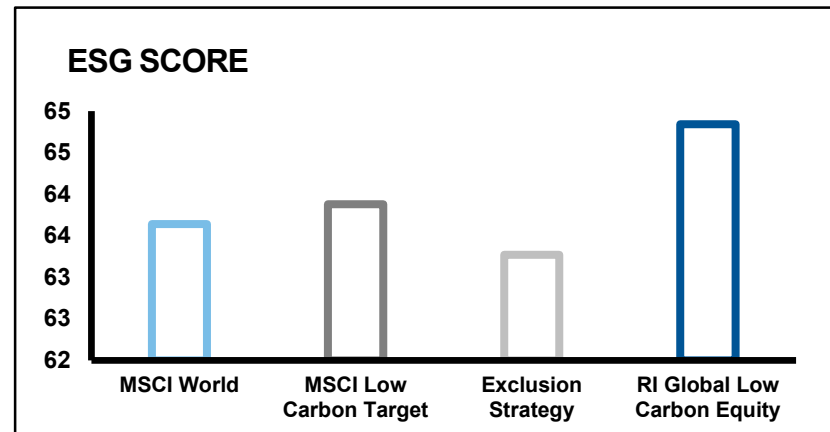
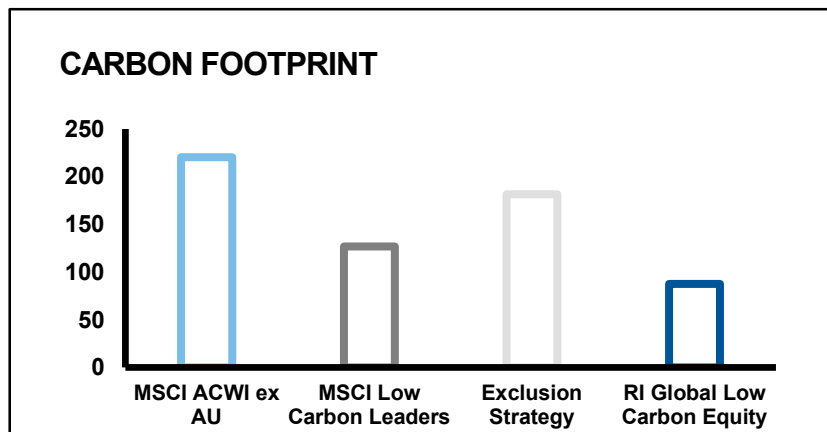
ESG Specific Strategies



Specific portfolio objectives, e.g. reduction of carbon, social capital. Portfolios can be tailored for your needs

Decarbonisation: a differentiated strategy

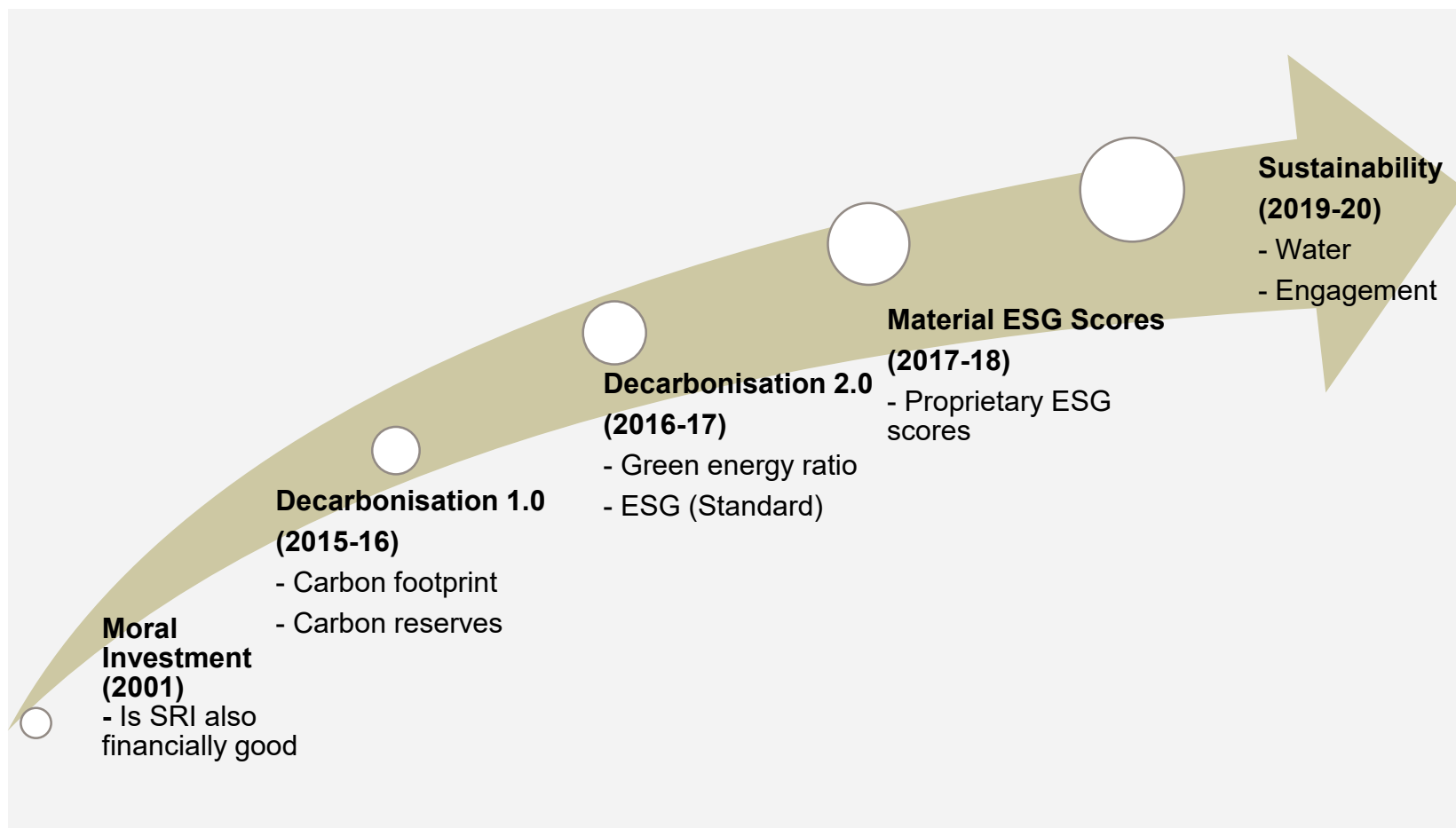
Moving beyond risk and identifying opportunities



Source: Russell Investments, MSCI, Trucost, Sustainalytics as per Dec 31, 2017.

Ongoing enhancement

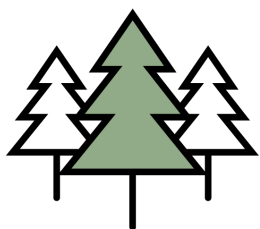
Continuous development embedded in our approach to ESG



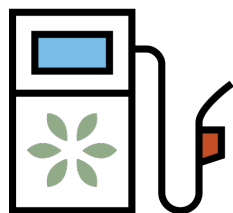
Low Carbon ESG

Moving beyond divestments and identifying opportunities

DECARBONISATION



↓
50% LOWER
CARBON
FOOTPRINT
RELATIVE TO THE
BENCHMARK

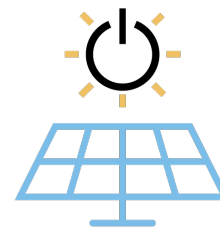


↓
50% LOWER FOSSIL
FUEL RESERVES
RELATIVE
TO THE
BENCHMARK



TARGETED
EXCLUSIONS OF
COAL REVENUES
GENERATING
COMPANIES

BEYOND CARBON REDUCTION



↑
INCREASED
EXPOSURE TO
COMPANIES
PARTICIPATING
IN THE ENERGY
TRANSITION



↑
INCREASED
EXPOSURE TO
COMPANIES
WITH A HIGH
ESG SCORE

A LOW COST ESG GLOBAL EQUITY SOLUTION, WHICH REDUCES CARBON
FOOTPRINT WHILE DELIVERING INDEX LIKE RETURNS

Source: Russell Investments, for illustrative purposes only.

Case study: Utility companies

Wider lens leads to better informed decisions

Capital
Markets &
Quant
Research

TRADITIONAL ANALYSIS

NEXT GENERATION

CARBON FOOTPRINT

ØRSTED

NATIONAL GRID

VS



CARBON RESERVES

ØRSTED

NATIONAL GRID

VS

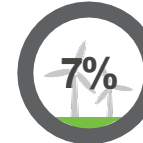


GREEN ENERGY RATIO

ØRSTED

NATIONAL GRID

VS

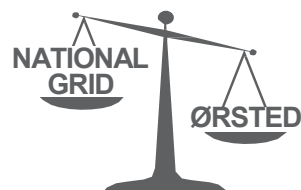


ESG

ØRSTED

NATIONAL GRID

VS



Portfolio Construction

How we construct the combined portfolio

STARTING WITH AN INVESTMENT PORTFOLIO

- ✓ Apply exclusions
- ✓ Reduce carbon footprint by 50%
- ✓ Reduce fossil fuel reserves by 50%
- ✓ Maintain or improve ESG score
- ✓ Improve green energy ratio
- ✓ Apply sector, industry, country, company constraints

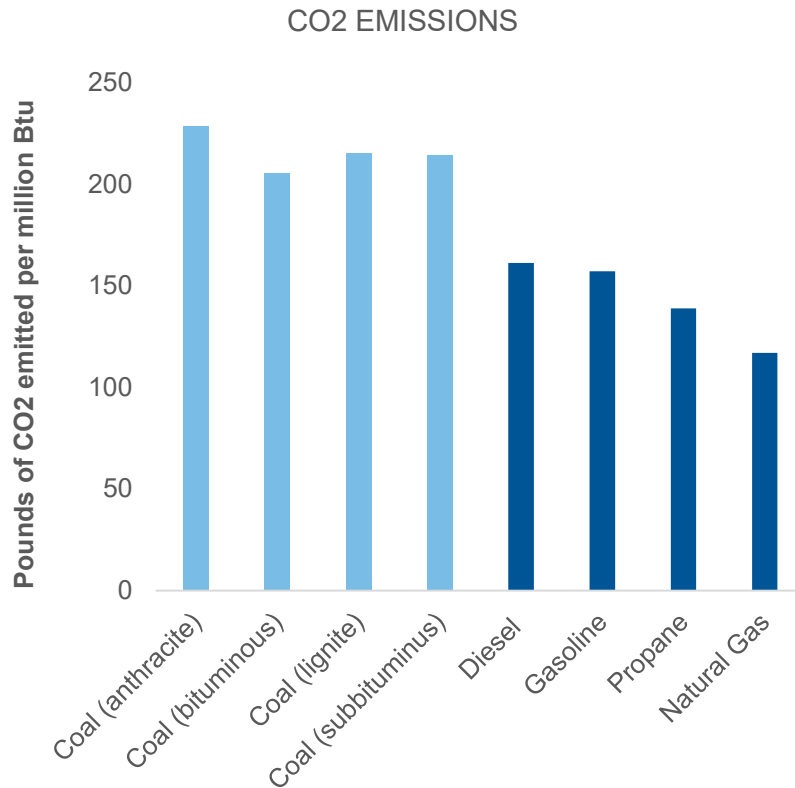
MINIMISE ACTIVE SHARE

The fund minimises active share to effectively deliver low tracking error.

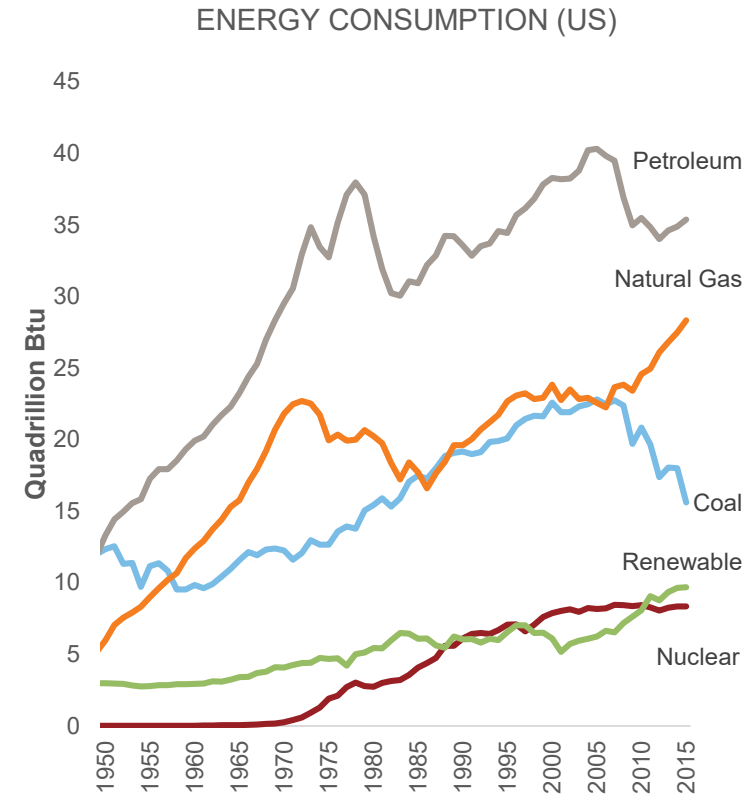
This portfolio construction process negates unintuitive outcomes that can arise with other optimisation techniques.

Why exclude coal?

THE SINGLE LARGEST CO2 EMITTER



LOSING RELEVANCE IN THE ENERGY MIX



Source: U.S. Energy Information Administration Annual Energy Outlook 2016.

Reducing carbon footprint

CARBON FOOTPRINT

(SCOPE 1 + SCOPE 2) METRIC TONS

TOTAL REVENUE (USD)

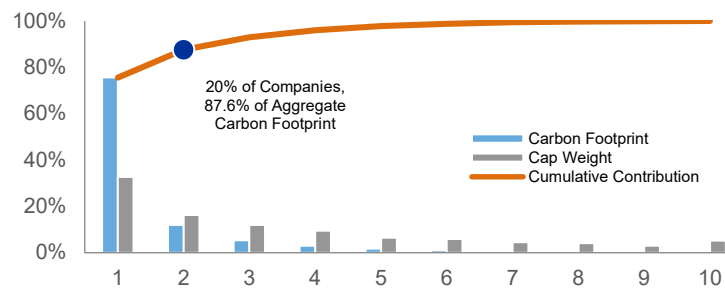
Scope 1 (Direct):

Includes emissions that arise directly from sources that are owned and controlled by a company e.g. fuel combustion and industrial processes.

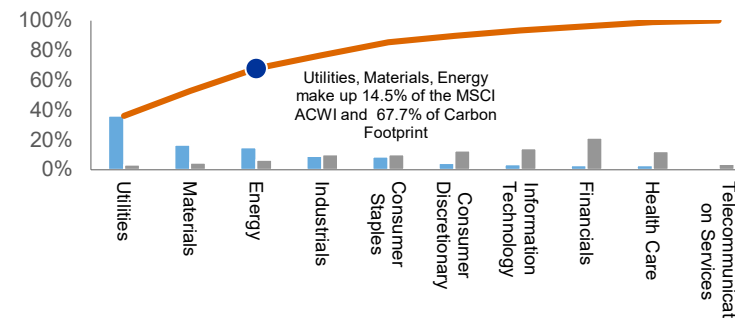
Scope 2 (Upstream):

Includes emissions generated by purchased electricity consumed by a company, e.g. generated by heating and cooling systems.

OPPORTUNITY



CHALLENGE



Source: Russell Investments, Trucost, MSCI as at 30 June 2016

Reducing stranded asset risk

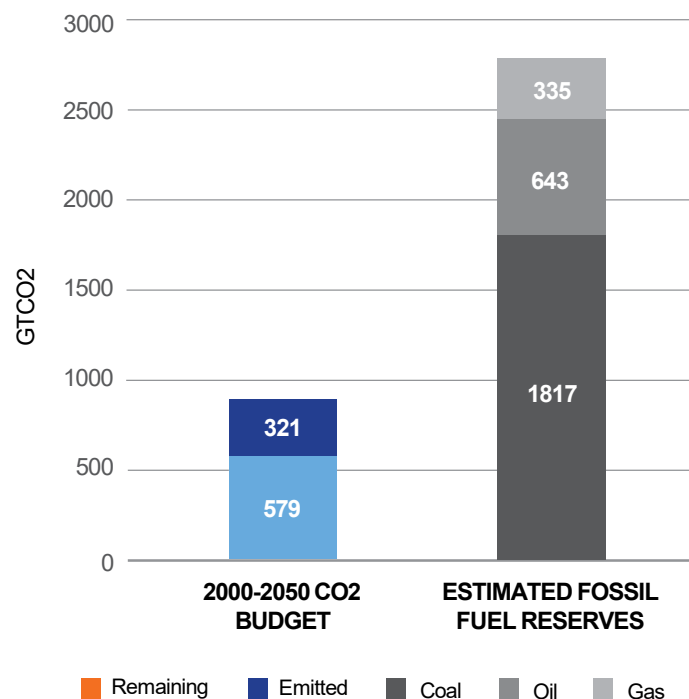
CARBON FOOTPRINT

FOSSIL FUEL RESERVES METRIC TONS

TOTAL ASSETS (USD)

- 2 Degree Climate Change scenario may present challenges to the extraction of fossil fuel reserves in the future
- Current estimates are that 80% of fossil fuel reserves are unburnable. Largest impact is Coal.

2 DEGREE SCENARIO



Source: Carbon Tracker 2011, UBS 2016.

Increasing exposure to energy transition

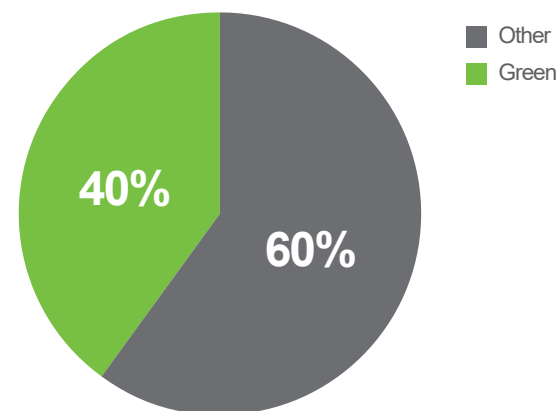
GREEN ENERGY RATIO

GREEN POWER GENERATION (GWH)

TOTAL POWER GENERATION (GWH)

- There is a shift away from traditional (brown) sources of energy to more renewable (green) sources.
- Evidence that this transformation is already underway: renewables accounted for nearly half of all new power generation capacity in 2014*.

GREEN VS BROWN NEW ENERGY CAPACITY



GREEN

- Wind
- Solar
- Biomass
- Geothermal
- Wave & Tidal
- Hydroelectric

GREY

- Nuclear Power
- Landfill Gas
- Other Power

BROWN

- Coal
- Natural Gas
- LPG
- Petroleum
- LNG Power

*World Energy Outlook: <http://www.iea.org/publications/freepublications/publication/WEO2015SpecialReportonEnergyandClimateChange.pdf>
Source: Russell Investments, Trucost as of August 2016.

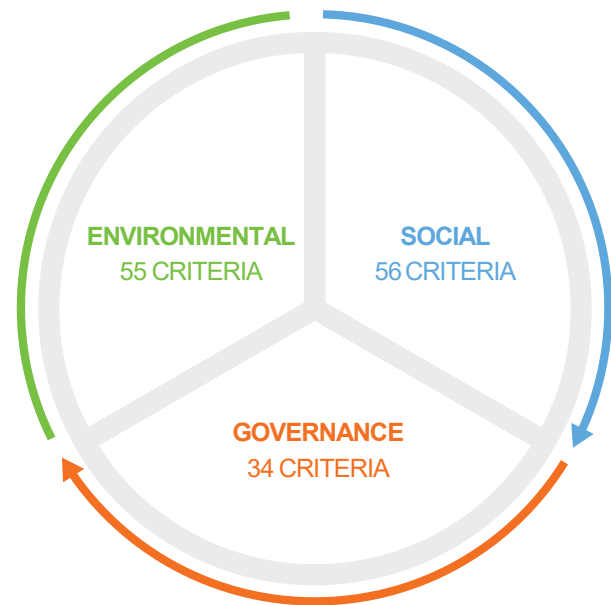
Incorporating the ESG Score

ENVIRONMENTAL, SOCIAL AND GOVERNANCE

145 DIFFERENT CONSIDERATIONS

- Explicitly favour those business whose practices are consistent with sustainability objectives.
- Avoid exposure to those companies that present the highest risks and actively engage for greater impact.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE

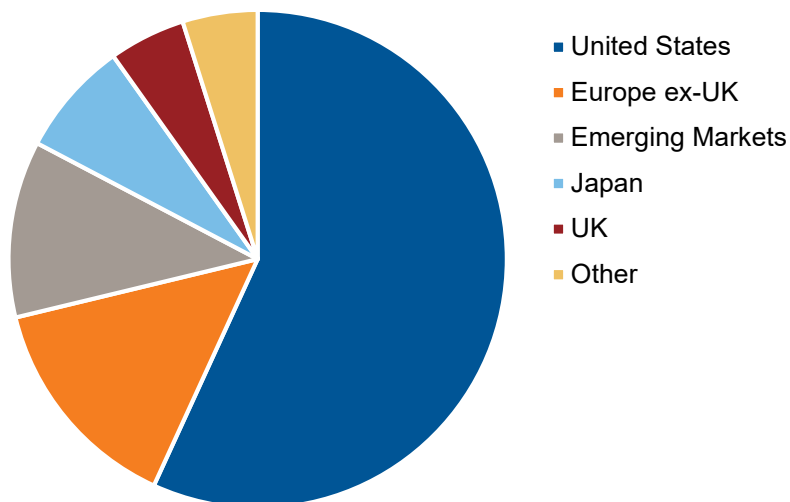


Source: Russell Investments, for illustrative purposes only

RI Low Carbon Global Shares Fund

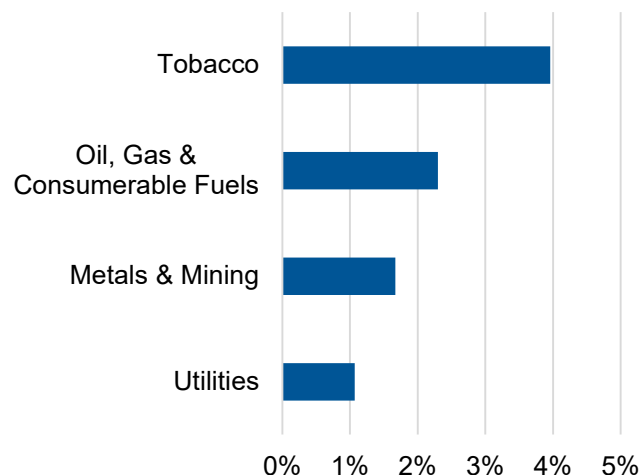
Fund Characteristics

Country/Regional Weights



Globally diversified core equity portfolio

Top Industry Contributors to Active Risk



Underweights to high carbon emitting industries and tobacco drive relative performance

Source: MSCI, FactSet, Bloomberg, Russell Investments as of 30 Sep 2019. Benchmark is MSCI ACWI ex-Aus Index.

RI Low Carbon Global Shares Fund

Fund Characteristics

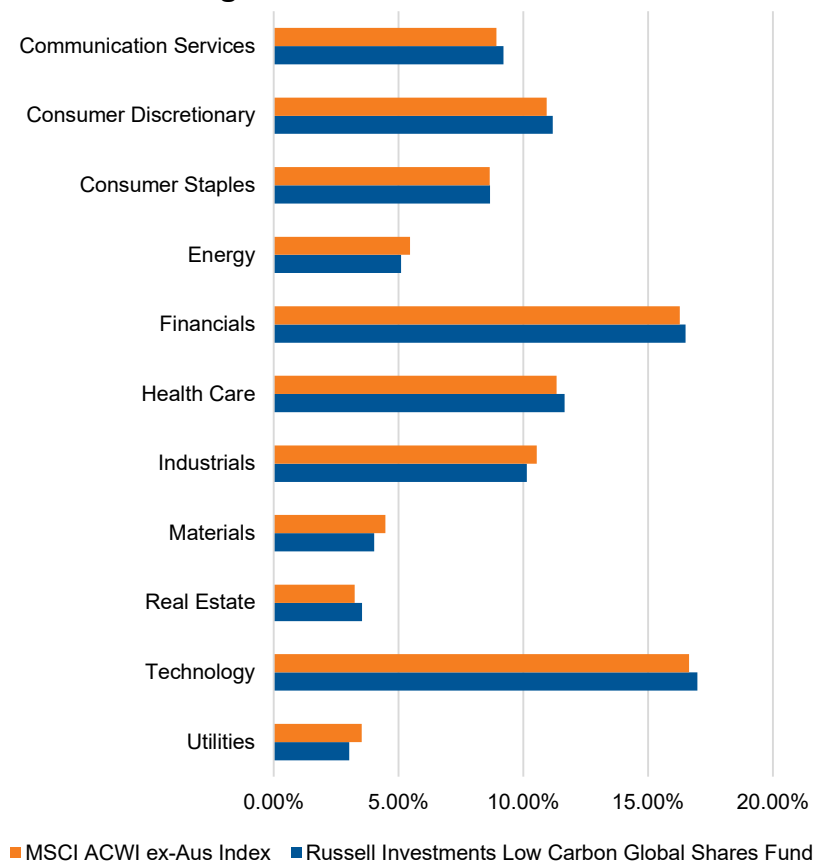
Top 10 Holdings

Holding	GICS Sector	Weight
Apple	Technology	2.24%
Microsoft	Technology	2.17%
Amazon.com	Consumer Discretionary	1.55%
Facebook	Communication Services	0.93%
Alphabet (C)	Communication Services	0.83%
JPMorgan Chase & Co	Financials	0.82%
Alphabet (A)	Communication Services	0.82%
Johnson & Johnson	Health Care	0.76%
Nestle	Consumer Staples	0.73%
Visa	Technology	0.68%

Portfolio Characteristics

Holding	Fund	Benchmark
Number of holdings	1,811	2,784
Weighted average market cap (NZD billion)	\$242.1	\$245.5
Dividend Yield	2.4%	2.4%
Price-to-book	2.3x	2.2x
Price-to-earnings	17.9x	17.5x
Price-to-earnings 12-mth forward	16.3x	16.1x

Sector Weights



Source: MSCI, FactSet, Bloomberg, Russell Investments as of 30 Sep 2019. Benchmark is MSCI ACWI ex-Aus Index. Sector weights excludes cash position.

Performance

Low Carbon Global Shares Fund to 30 September 2019

	YTD	1 YEAR	SINCE INCEPTION (ANNUALISED)
Russell Low Carbon Global Shares Fund	22.50	9.75	13.23
MSCI ACWI ex Aus Index Net	21.25	8.65	12.85
Excess return	1.25	1.10	0.38

Fund size: \$A617m

Inception date: 10 October 2017

Returns are gross of fees and are expressed in Australian dollars

Fund target objectives

	50% REDUCTION	50% REDUCTION	IMPROVEMENT	MAINTAIN AND/OR IMPROVE	50bps
	Carbon footprint reduction	Carbon reserves reduction	Green energy ratio	Material ESG score	Tracking error (12 months)
AS AT Sep-19	62%	70%	121%	104%	0.41%

Research Updates



Materiality matters

Developing proprietary ESG scoring method

- > Traditional ESG scores are built for a variety of use cases.
 - > **Investors'** portfolio analysis and investment decision making,
 - > **Corporations'** own sustainability performance and analysis of supply chain risks/vendors,
 - > **Governments'** benchmarks and assessing partnership risk

Our goal:

*A customised ESG score with an explicit focus on identifying ESG issues that are considered **financially material** to a firm's business*



Materiality matters:

Targeting the ESG issues that impact performance
– the material ESG score



Russell Investments // Materiality matters: Introducing a new ESG metric

FEBRUARY 2018

Material ESG scores

Is there a performance impact?

Differentiating companies on material issues led to better investment outcomes than focusing immaterial issues

Differences in four-factor alphas	
High – Low Quintile Performance RGI Global LC Dec 2012 – June 2017	
Material sustainability issues	1.19%**
Immaterial sustainability issues	0.30%
Traditional ESG score	0.97%*

Source: Russell Investments. Alphas refer to high minus low portfolio returns regressed on four-factor models including Mkt-Rf, SMB, HML, and UMD. ***, **, * refer to significance at the 1%, 5%, and 10% levels respectively.

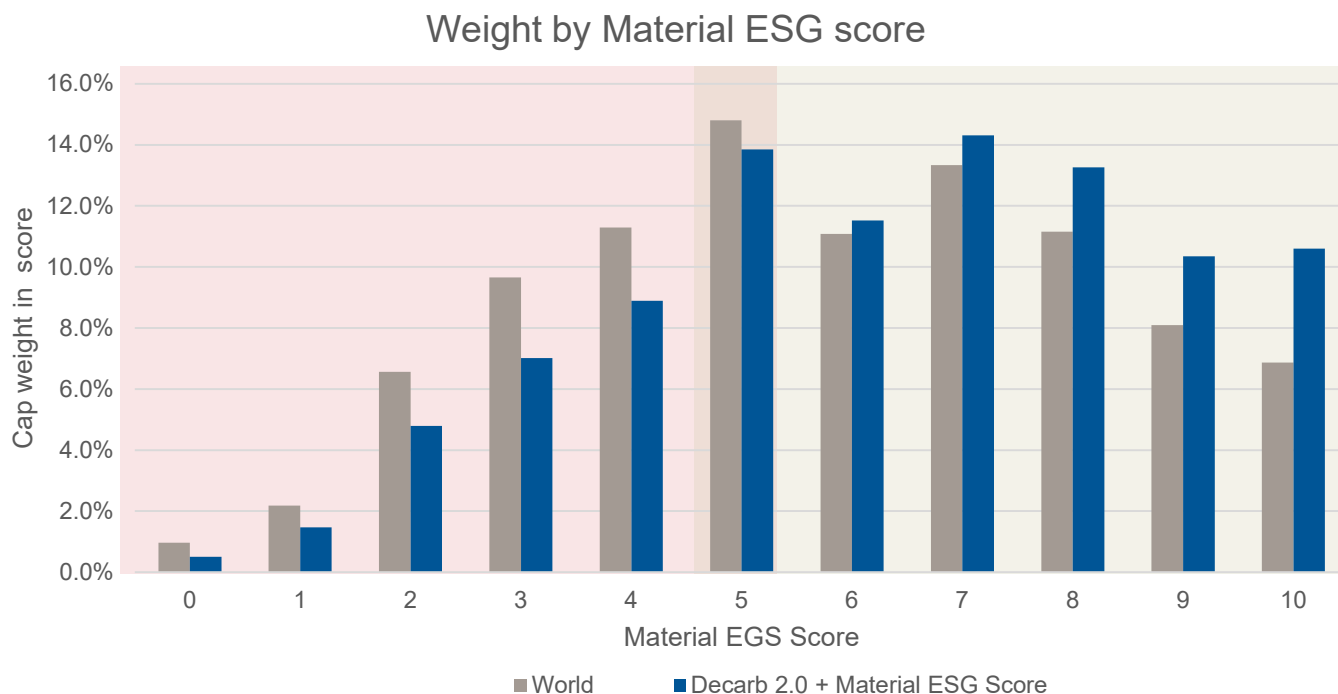
When further isolating performance on material vs immaterial issues, low performance on material issues is especially costly

Double-sorted buckets RGI Global LC Dec 2012 – June 2017	Annualised alpha	Difference in alpha vs bucket #1
1 - High material, low immaterial	-1.18%	
2 - Low material, Low immaterial	-4.60%	1.22%*
3 - Low material, high immaterial	-3.38%	2.20%*
4 - High material, high immaterial	-0.95%	-0.23%

Source: Russell Investments. Alphas refer to portfolio returns regressed on 4-factor models including Mkt-Rf, SMB, HML, and UMD. ***, **, * refer to significance at the 1%, 5%, and 10% levels respectively.

Material ESG scores

How do we use it?



Tilt portfolio to shift weight from low scoring companies to high scoring companies

Source: Russell Investments. Based on hypothetical global equity portfolio with Low Carbon ESG overlay applied

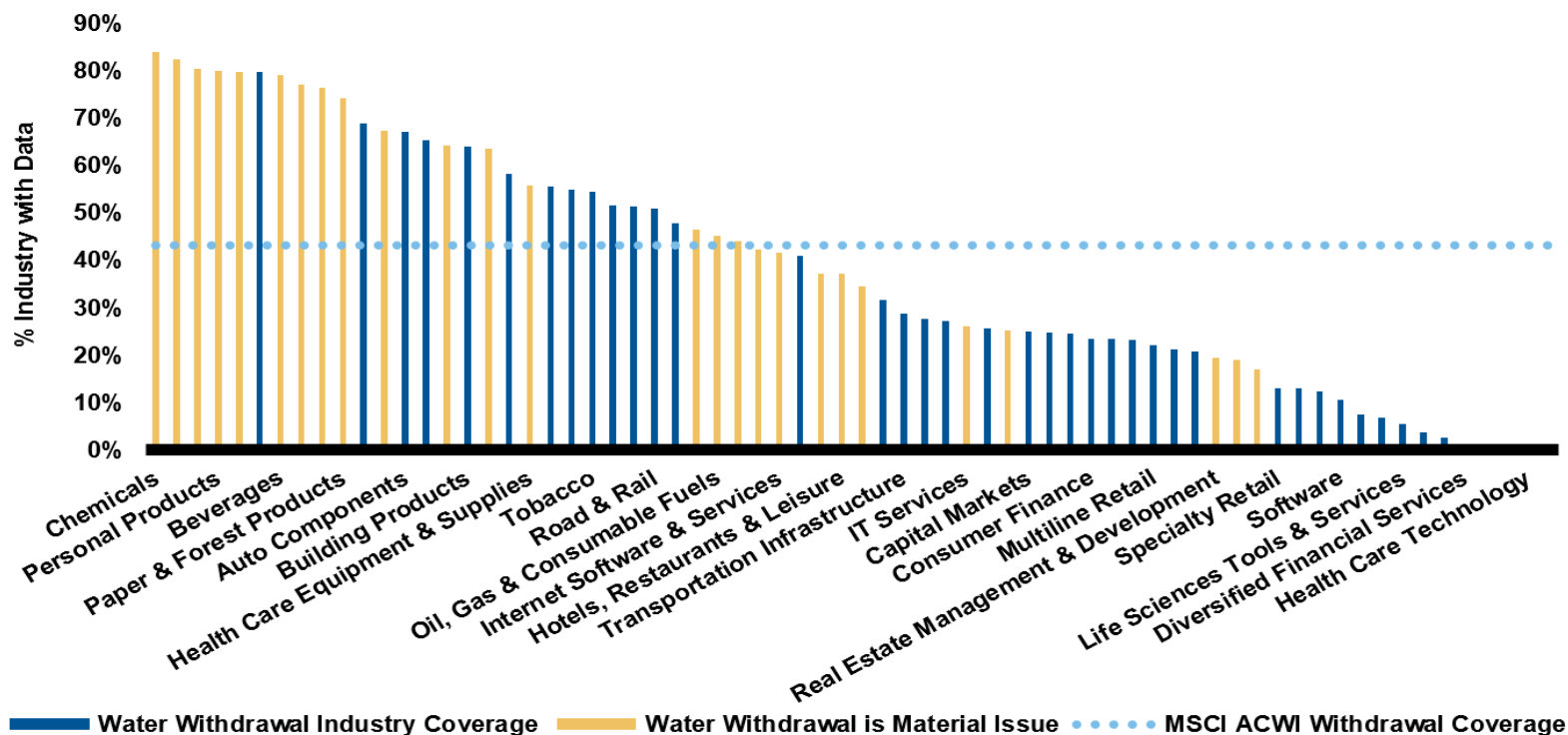
Recent research



Consideration #1: Data reporting is low

Water withdrawal coverage

Water Withdrawal Data Coverage by Industry

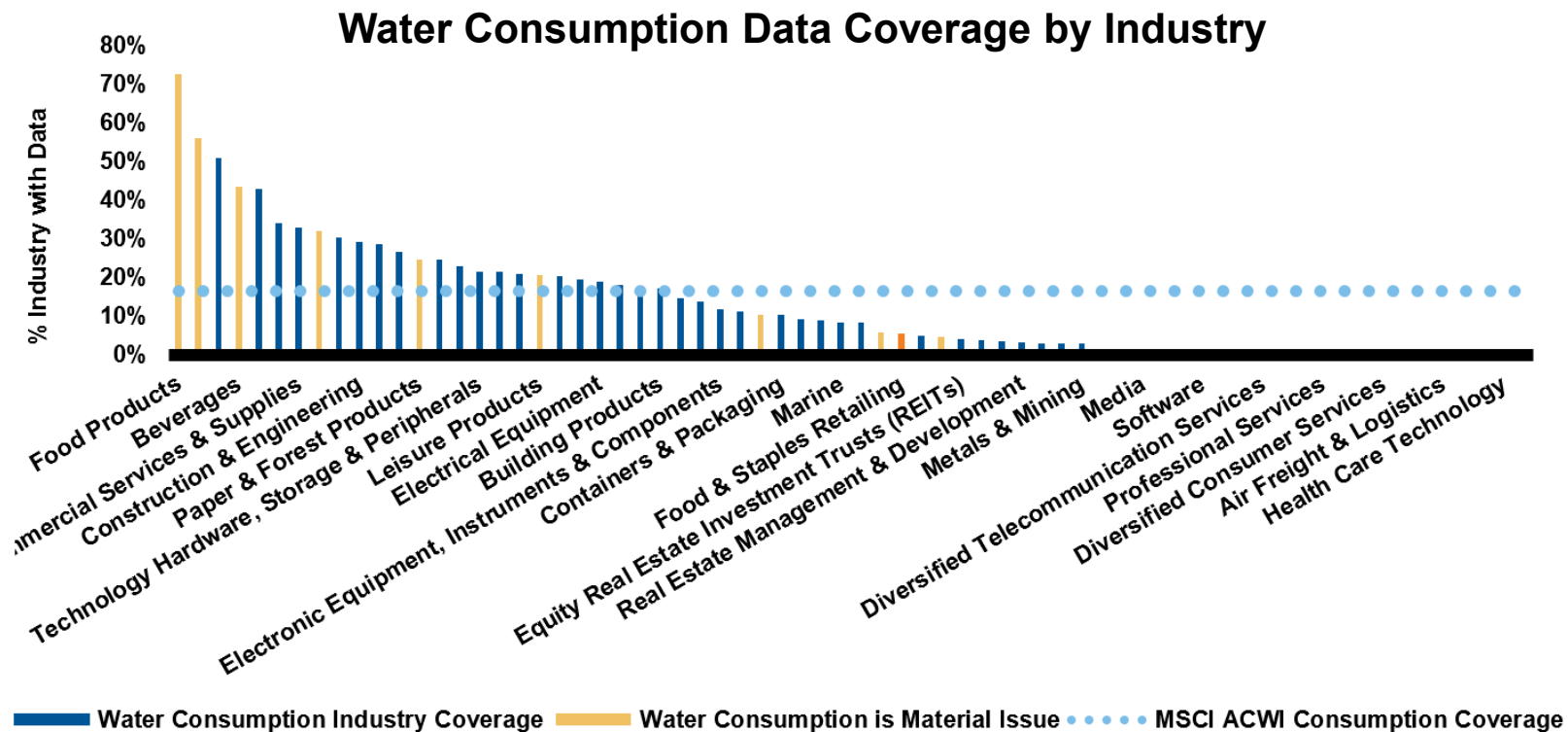


Source: Russell Investments and MSCI, data as at 30 September

Coverage on water withdrawal data is 43% for the MSCI ACWI Index.

Consideration #1: Data reporting is low

Water consumption coverage

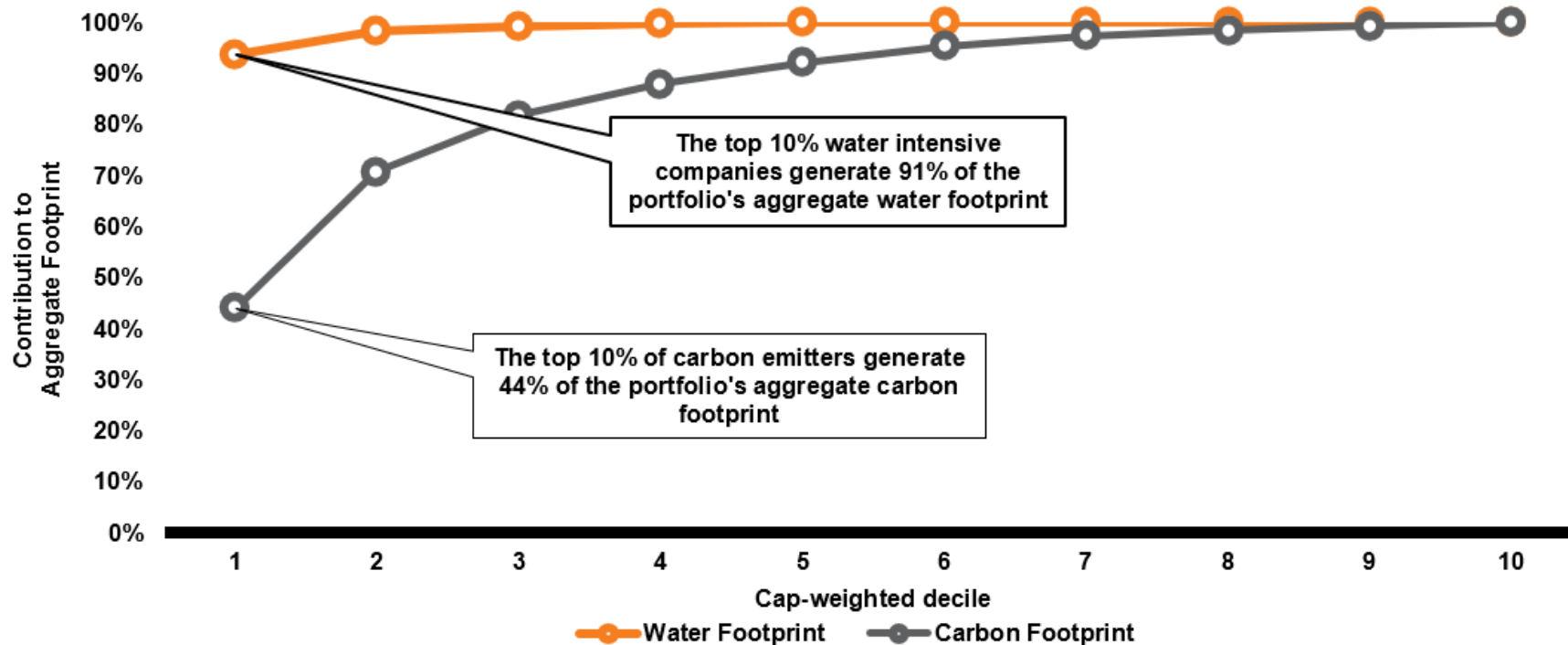


Source: Russell Investments and MSCI, data as at 30 September 2018.

Coverage on water consumption is lower at roughly 16% for the MSCI ACWI Index.

Consideration #2: Water usage is highly concentrated

Contribution to Aggregate Portfolio Footprint – Water Footprint versus Carbon Footprint



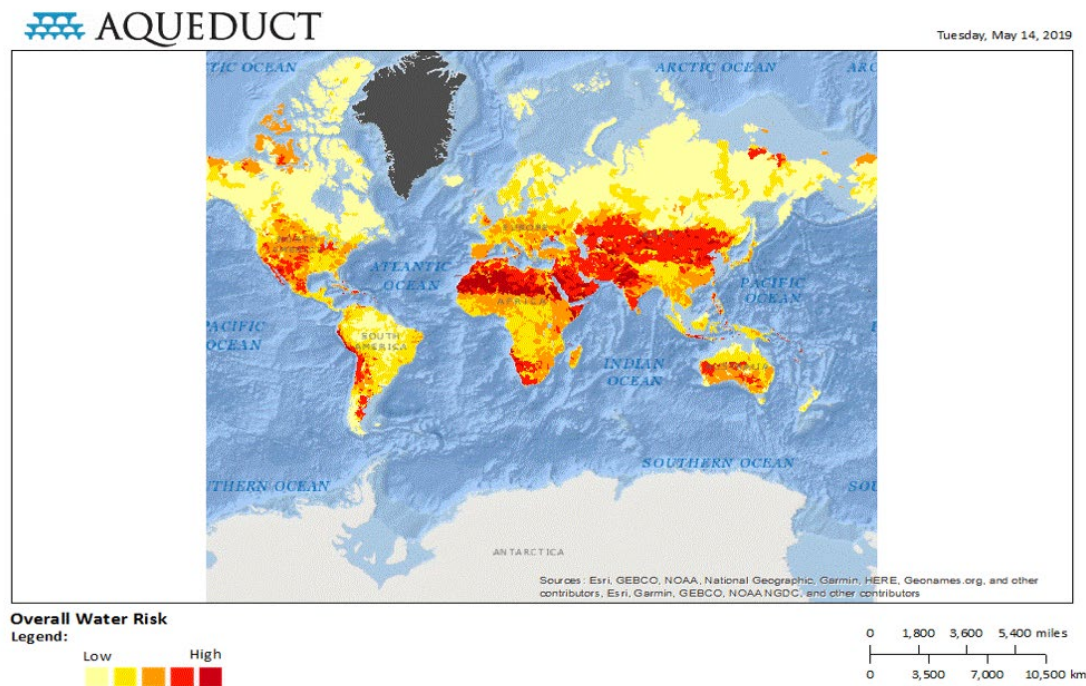
Source: Russell Investments and MSCI, data as at 30 September 2018.

The highest water usage is found in the utilities, materials and energy sectors.

Consideration #3: The market is highly exposed to water-stressed regions

A regional lens is critical

Look for not just how much water was consumed, but also what percent was in high-stress regions.



Source: The Aqueduct Global Maps 2.1 database, 2019. Retrieved 14 May 2019.

71% of companies exposed to high-stress water regions

Consideration #4: Identify forward-looking information and proactive companies

A forward look

- > *TCFD's Final recommendation report encourages organisations to undertake both historical and forward-looking analyses*
- > One piece of forward-looking data that can be considered is a company's water-related targets

Water as a material part of a company's business

- > When material, have companies set water-use targets?

Proactive companies

- > Proactive steps to contribute to Sustainable Development Goal 6: "Ensure availability and sustainable management of water and sanitation for all"

Thank you.

Any questions?

Important information

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