Schroders

SUSTAINABLE INVESTMENT REPORT

VOTING AND ENGAGEMENT AT A GLANCE

OUR ACTIVE OWNERSHIP STATISTICS FROM THE QUARTER

ACTIVE OWNERSHIP IN PRACTICE

How we've updated our Engagement Blueprint

The cost of living: an ongoing conversation

Collaborating on climate: IIGCC Engage

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A voyage to greener shipping

What's happening with voluntary carbon markets?

ESG: weathering the market headwinds

Our latest Global Canopy Forest 500 ranking

Sustainability and impact challenges in private assets

FIRST QUARTER 2023

Marketing material.

Andy Howard
Global Head of Sustainable Investment

As we enter 2023, the bar for sustainable investing, as set by clients, regulators and the wider industry continues to rise. Amidst this, we are not standing still. This quarter we explore how we have updated our Engagement Blueprint, first published in early 2022. Our latest version of the Blueprint expands on areas such as the Just Transition, shareholder resolutions and deforestation. We also take a look at our continued active ownership work in crucial areas of the cost of living and climate engagement.

This quarter, our sustainability insights include a snapshot of our latest research on green shipping, as well as a deep-dive into carbon markets. Our QEP team explore some of the performance headwinds of sustainable strategies over the last year. We also discuss how we approach sustainability and impact in private assets. Finally, we are delighted to have been awarded a top position among financial services companies in the latest Global Canopy Forest 500 ranking.

READ MORE: Read our Annual Sustainability Report here

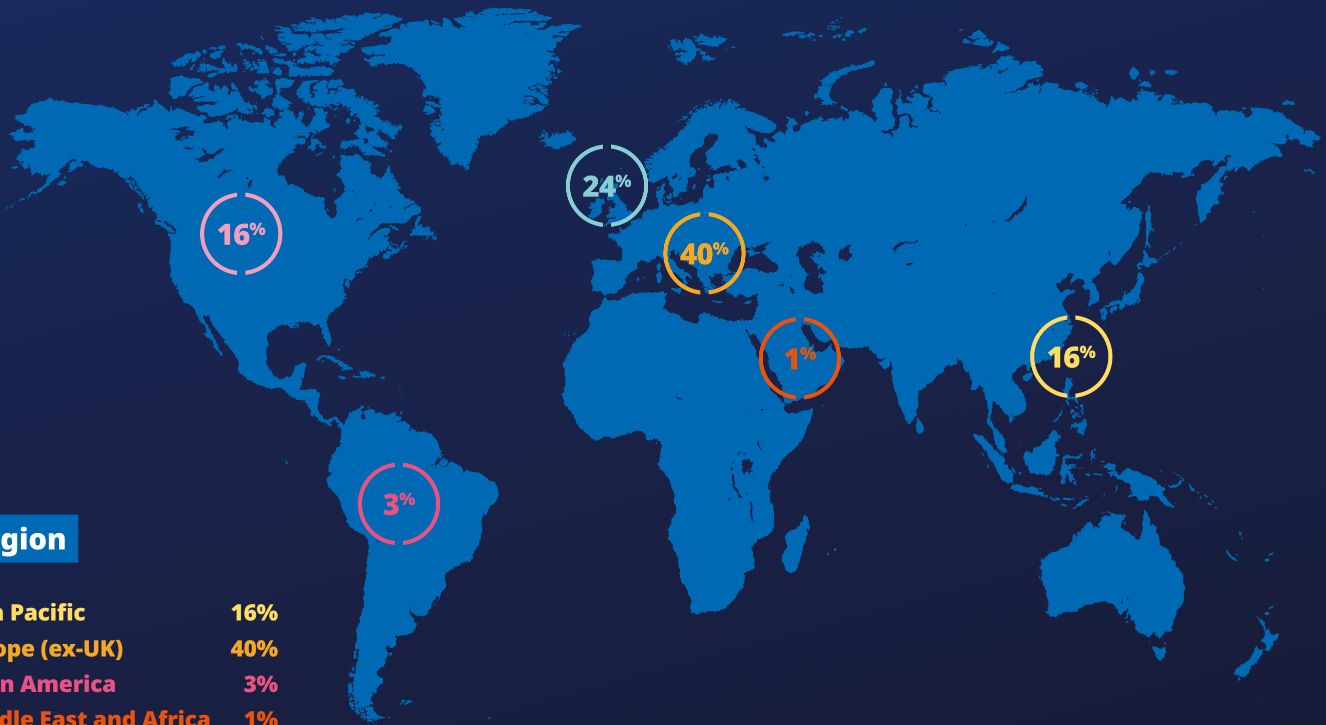
OUR ENGAGEMENTS AND VOTING

ENGAGEMENT IN NUMBERS

Type

Narrow scope ⟷ Broad scope

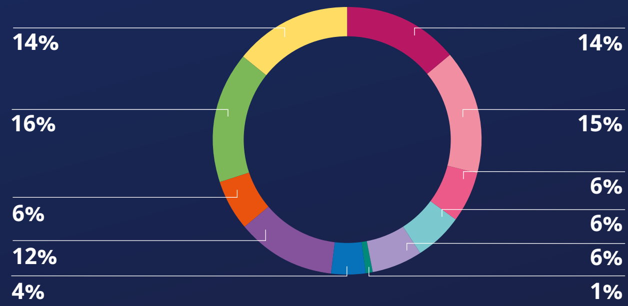
Scope	In-depth sustainability engagement	Investor-led engagement	Collaborative engagements and communicating expectations at scale
Number of engagements	65	132	116



Region

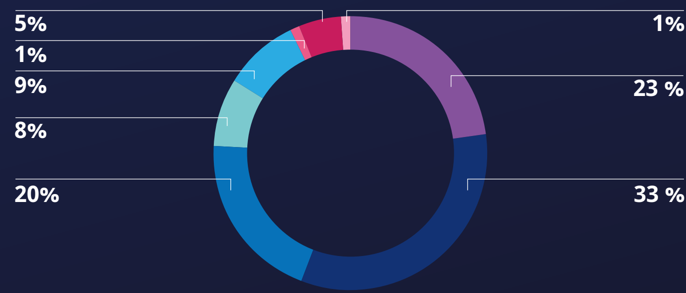
Asia Pacific	16%
Europe (ex-UK)	40%
Latin America	3%
Middle East and Africa	1%
North America	16%
UK	24%

Sector



- Basic Materials
- Consumer Discretionary
- Consumer Staples
- Energy
- Financials
- Government Activity
- Healthcare
- Industrials
- Real Estate
- Technology
- Utilities

Format



- Email
- Collaborative engagement
- Call (one to one)
- Call (group)
- Meeting (one to one)
- Meeting (group)
- Formal letter
- Other

Data Source: Schroders, March 2023. Engagement figures may be subject to revision given ongoing quality assurance processes and delayed logging of engagements. The companies and sectors mentioned herein are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

OUR ENGAGEMENTS AND VOTING

VOTING IN NUMBERS

This quarter we voted on 1012 meetings and approximately 98% of all resolutions. We voted on 71 sustainability-related shareholder resolutions, of which we voted with the board on 55.

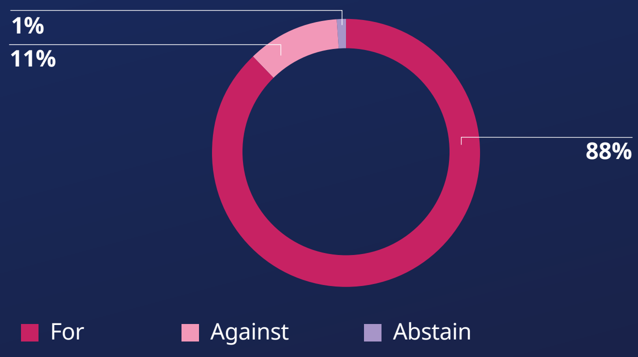
We publish our voting decisions on the voting section of Schroders' website.

We believe we have a responsibility to exercise our voting rights. We evaluate and vote in line with our fiduciary responsibility to clients. We vote on all resolutions unless we are restricted from doing so, for example through share blocking.

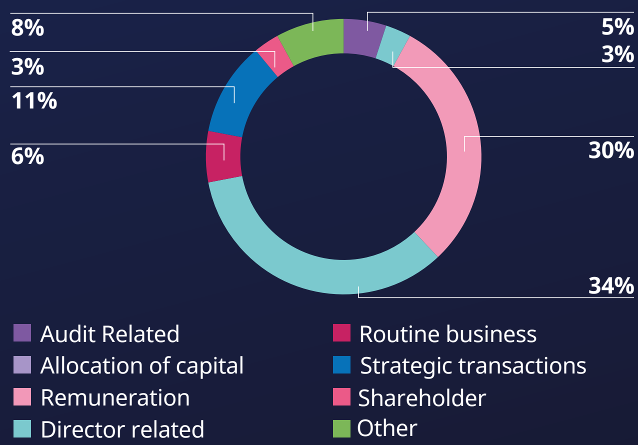
Region

Asia Pacific	62%
Europe (ex-UK)	17%
Latin America	3%
Middle East and Africa	2%
North America	9%
UK	7%

Direction of votes



Category of vote against management



OUR ENGAGEMENTS AND VOTING

ENGAGEMENT PROGRESS

Introducing our new milestone-based approach.

Being able to track the progress and effectiveness of active ownership activities is key. This year we launched ActiveIQ, our new proprietary tool for logging and tracking active ownership activity. ActiveIQ focuses on forward-looking engagement plans and tracking progress based on a milestone approach.

The launch of ActiveIQ included a refreshed outcomes assessment framework, based on clearly defined milestones. The milestones are defined as:

The table shows the milestone progress of objectives in 2022. Please note this is preliminary data ahead of a formal launch of the new reporting framework mid-2023. In our experience, it takes an average of two to three years for companies to effect the change requested. We therefore expect to see more milestone-based progress in the future on these objectives and will aim to reflect on several years' worth progress in future reporting.

ENGAGEMENT OUTCOMES FOR OBJECTIVES SET IN 2022

Milestone	%
M1	67%
M2	24%
M3	7%
M4	2%

M1 Engagement opportunity identified and communication started

M2 Acknowledgement by company of issues raised

M3 Company commits to an improvement plan

M4 Company implements our engagement ask

Data Source: Schroders, March 2023. Engagement figures may be subject to revision given ongoing quality assurance processes and delayed logging of engagements.

ACTIVE OWNERSHIP

Lucy Larner
Engagement Associate

HOW WE'VE UPDATED OUR ENGAGEMENT BLUEPRINT

Here's why and how Schroders has updated its inaugural Engagement Blueprint, which lays out our expectations of companies across six thematic areas.

In 2022, we released our inaugural Engagement Blueprint, setting out our ambitions and approach to active ownership at Schroders. The Blueprint lays out our long-term expectations of companies across six thematic areas. It aims to bring transparency to our investee companies and our clients around our expectations, while also giving our internal investment teams guidance for their engagements on the most material issues.

We are proud that the Engagement Blueprint was awarded ESG Engagement Initiative of the Year at Environmental Finance's Sustainable Investment Awards 2022[1].

Sustainability is a complex and multi-faceted topic. It is also ever-changing, whether that be through new research, expanding data availability, regulation or government action. In this landscape, we cannot stand still and so have committed to update our Blueprint on an annual basis.

We will continue to review our priorities and expectations as our understanding of the issues and market best practice evolves to ensure we are pushing for change in the most effective way.

In order to showcase our shareholder resolution framework in practice, and provide transparency to our clients, we are advanced disclosing our voting decision for a number of shareholder resolutions this year through our voting season blog. Read the blog here.

READ MORE:

Our Engagement Blueprint

Visit our Active Ownership page

Active ownership: our Engagement Blueprint in action

In summary, the main changes to the Blueprint for 2023 are:

1 A GREATER FOCUS ON THE JUST TRANSITION

In an effort to better describe how we address the social implications of the net zero transition, we have added a section on the Just Transition. This sub-theme links to the other relevant themes (human rights, human capital management and diversity and inclusion)

READ MORE: What is the "just transition" and why does it matter for investors?

2 EXPANDING OUR NATURAL CAPITAL AND BIODIVERSITY EXPECTATIONS

Schroders is a member of the Natural Capital Investment Alliance and became signatories to the Finance for Biodiversity Pledge in 2022. Our Biodiversity and Natural Capital Position Statement sets out our approach to the investments we manage and our own operations when it comes to nature and biodiversity.

In this edition of the Blueprint we have expanded our expectations of companies, with a particular focus on deforestation. This reflects our proprietary research, evolving market guidance and our firm-wide commitment to this topic.

READ MORE: in our plan for nature

3 OUR SHAREHOLDER RESOLUTION FRAMEWORK

Shareholder resolutions have seen a growing focus in recent years and we consider them an important tool for expressing our views and expectations to investee companies, especially for areas not covered in standard AGM votes. In this Blueprint we have outlined how we analyse shareholder resolutions in practice around four questions:

- Is the resolution aligned with our Blueprint?
- Is the resolution the best way to address the issue
- Does the resolution add value to what the company is already doing?
- Does the resolution have the potential to cause unintended consequences?

READ MORE: Shareholder resolutions: prepared to disagree

4 IMPACT-FOCUSED ENGAGEMENTS

In September 2022, Schroders became signatories to the Operating Principles for Impact Management (OPIM). Active ownership is an important element to delivering impact, particularly in public markets. In this edition of the Blueprint we have outlined our approach to impact-driven engagements.

The evolution of our Blueprint reflects the evolving landscape and feedback from investors and clients. Looking ahead, we will continue to review and evolve our expectations to ensure we are using our influence to push for progress on the most material risks and opportunities faced across our clients' portfolios.

Source: Schroders, March 2023. [1] Schroders was awarded ESG engagement initiative of the year at the Environmental Finance Awards in 2022.

Katie Frame
Active Ownership Manager

Pippa O'Riley
Corporate Governance Analyst

ACTIVE OWNERSHIP

THE COST OF LIVING: AN ONGOING CONVERSATION

Background:

At the end of last year, we engaged with a number of leading organisations to better understand the challenges facing businesses around the cost of living crisis. Our podcasts series shed a light on how experts from organisations such as The Living Wage Foundation, Business Fights Poverty and Shift are thinking about tackling living wages.

We undertook a number of engagements with our pan-European supermarket holdings to understand their efforts in addressing cost of living. We also engaged a number of US retail and services companies, to understand approaches and set expectations around sick pay and paid leave. Read more about the engagements here.

Engagement with general retailers in the UK:

In the first quarter of 2023 we have continued these dialogues. We identified the wider retail sector in the UK as one that faces similar challenges as the pan-European supermarkets, as they have a large low-paid workforce. The backdrop of the crisis also means that these retailers are facing increasing scrutiny of their workplace practises. As they are thin margin businesses, with no room for error, we recognise that getting the balance right is critical for both shareholders and society.

Over the quarter, we have spoken to five companies around how they are supporting their employees amid the cost of living crisis, and are continuing to expand our engagement to more holdings. We focused the discussions on worker pay, wider benefits, employee engagement and voice and executive pay. We have learnt a number of insights from the conversations, and have also outlined a number of asks where we think the approach can be improved.

Key insights from the conversations include:

- Companies are very aware of the impact of the cost of living crisis and need to carefully consider the treatment of the wider workforce when determining CEO pay
- Very few retailers offer any form of paid breaks, or may only offer paid breaks to a subset of the workforce (e.g. in distribution)
- Most retailers cite that increasing base pay is often the most frequent feedback they hear through employee engagement mechanisms, one retailer incentivised employee training and development by allowing workers to 'earn as they learn', increasing base pay once workers completed training modules
- Leading retailers are moving towards considering the value or outcomes from increasing focus on supporting workers, such as through increased engagement or reduced turnover

Some examples of objectives we have set with companies as part of our continued engagement on this topic:

- Undertake and more clearly communicate how the company assesses the costs vs. benefits of increasing wages
- Disclose employee turnover and retention metrics
- Bring company pension contributions further in line with peers, and towards market leading offerings

We have also written to all of our investee holdings, ahead of the 2023 AGM season, outlining our voting policy updates and engagement priorities for the year. Within this we highlighted our desire that any salary increases for executives should be at a lower rate than those of the wider workforce, as well as an expectation that the total compensation package should also reflect the hardship many employees and other stakeholders are experiencing. We also encouraged companies to explain how they are considering both salary and additional benefits for the wider workforce, particularly for the lower paid employees.

As part of our ongoing dialogue with directors, we held a series of remuneration lunches with groups of Remuneration Committee Chairs, of which the Cost of Living crisis was a key topic discussed.

Source: Schroders, March 2023.

ACTIVE OWNERSHIP

SCHRODERS HOSTS IIGCC ENGAGE AND JOINED THE NEW NET ZERO ENGAGEMENT INITIATIVE

Our commitment to climate is firm-wide and we see collaborative initiatives as a key part of using our influence to push for progress in this space. In March 2023, we were delighted to host IIGCC Engage. This event brought together IIGCC members and experts to discuss topics including the importance of focusing on implementation; credible transition plans as a core engagement ask; the need for sector-wide engagement to drive the net zero transition, particularly with policymakers; and sharing best practice across the industry.

Andrew Howard, Global Head of Sustainable Investment, opened the afternoon plenary session by welcoming IIGCC's members and highlighting the critical role IIGCC plays in bringing investors together to advance industry best practice. Carol Storey, Climate Engagement Lead, joined a panel to discuss the IIGCC Net Zero Engagement Initiative (NZIF) which was launched at the event.

The Net Zero Engagement Initiative which aims to scale and accelerate climate-related corporate engagement. The objective is to help investors align more of their portfolio with the goals of the Paris Agreement as set out by investor net zero commitments, such as the Net Zero Asset Managers initiative and the Paris Aligned Asset Owners initiative, by scaling the number of companies engaged beyond the Climate Action 100+ focus list.

As part of the initiative, 107 companies have received individual letters from investors seeking confirmation that they have developed, or intend to develop, a net zero transition plan. In line with the NZIF corporate criteria, the key transition plan recommendations set out in the letter are:

- a comprehensive net zero commitment
- aligned GHG targets
- emissions performance tracked
- a credible decarbonisation strategy

"We have undertaken a significant programme of climate engagement as part of our net zero commitment to clients and we are excited to support the shared objectives of the Net Zero Engagement Initiative. Encouraging companies to develop credible transition plans is the key focus of this initiative; we believe how a company responds to the challenges of climate change could ultimately in the future be key to its bottom line."

Carol Storey
Climate Engagement Lead

Source: Schroders, March 2023.

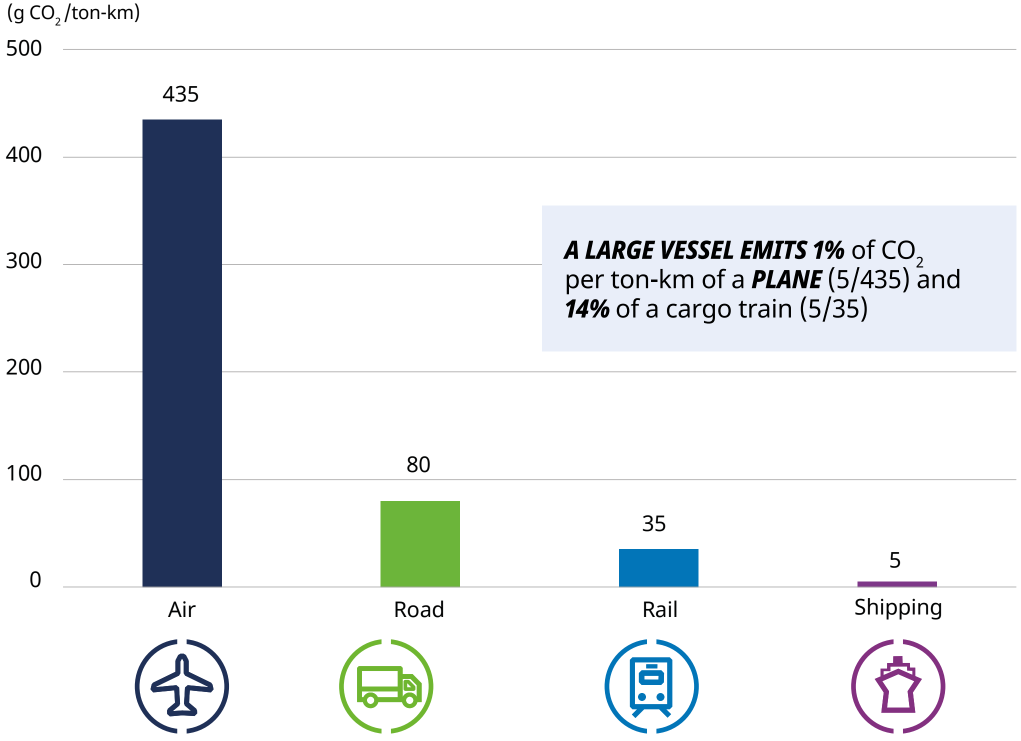
SUSTAINABILITY INSIGHTS

A VOYAGE TO GREENER SHIPPING: RISKS AND OPPORTUNITIES

Shipping is the most carbon efficient means of transportation[1]. However, global shipping still accounts for 1 billion tons of CO_2 per year, which is ~3% of annual global greenhouse gas (GHG) emissions.

Samuel Thomas
Sustainable Investment Analyst

FIGURE 1: EMISSIONS BY MODEL OF TRANSPORT



Source: Shell, IMO GHG study 2009.

Unsurprisingly, the largest source of carbon emissions comes from fuel combustion for propulsion. Fossil fuels (HFO, MGO, VLSFO and LNG[1]) currently provide 99% of sector's final energy demand and all have issues from contributing to CO_2 emissions, black carbon and methane leakage. International shipping provides 80–90% of global trade and accounts for 70% of global shipping emissions - if it were a country, it would be the 6th largest emitting country[2].

To reach a 1.5°C scenario the sector drastically needs to decarbonise. However, as yet, in a business-as-usual scenario, the Organisation for Economic Co-operation and Development (OECD) forecast maritime trade volumes to triple by 2050, bringing with it up to 250% increase in CO_2-equivalent emissions.

We have explored three key areas to understand the risks and opportunities that the shipping industry presents.

1) The wave of environmental regulation

- The shipping industry is facing of a wave of upcoming environmental regulations over the next 24 months and beyond. In our research, we look at the upcoming regulations and what they could mean for the industry
- Vessels that do nothing to reduce emissions could face a triple hit of financial penalties, higher carbon taxes and reduced consumer demand

2) Pathways to decarbonisation

- Our research revisits the decarbonisation strategy of the sector, examining the most likely short, medium and long-term pathways the industry can and will implement, including the pros and cons of each

Source: Schroders, March 2023. [1] On a CO2 per ton-km basis HFO = heavy fuel oil, MGO = marine gas oil, VLSFO = very low sulphur fuel oil, LNG = liquid natural gas. [2] Source: IRENA.

SUSTAINABILITY INSIGHTS

There are a number of routes to decarbonisation for the industry. We have grouped these into short, medium and long-term solutions.

SHORT-TERM SOLUTIONS

Energy efficiency improvements:

- Vessel operations
- Vessel design

MEDIUM-TERM SOLUTIONS

- Advanced biofuels
- Green hydrogen (in direct combustion or fuel cell)

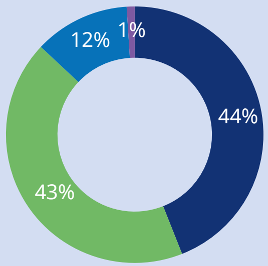
LONG-TERM SOLUTIONS

- E-methanol
- Green ammonia

3) Green shipping – a US$1.9tn market opportunity

- To meet the International Maritime Organisation (IMO) 2050 emission targets, the scale of investment is estimated to be up to $1.9tn[3]
- We have analysed over 100 decarbonisation projects being implemented across the industry and its value chain, focussing on engine technology, renewable fuel production, as well as bunkering and infrastructure projects

FIGURE 2: DECARBONISATION INVESTMENT BREAKDOWN BY SUB-THEME

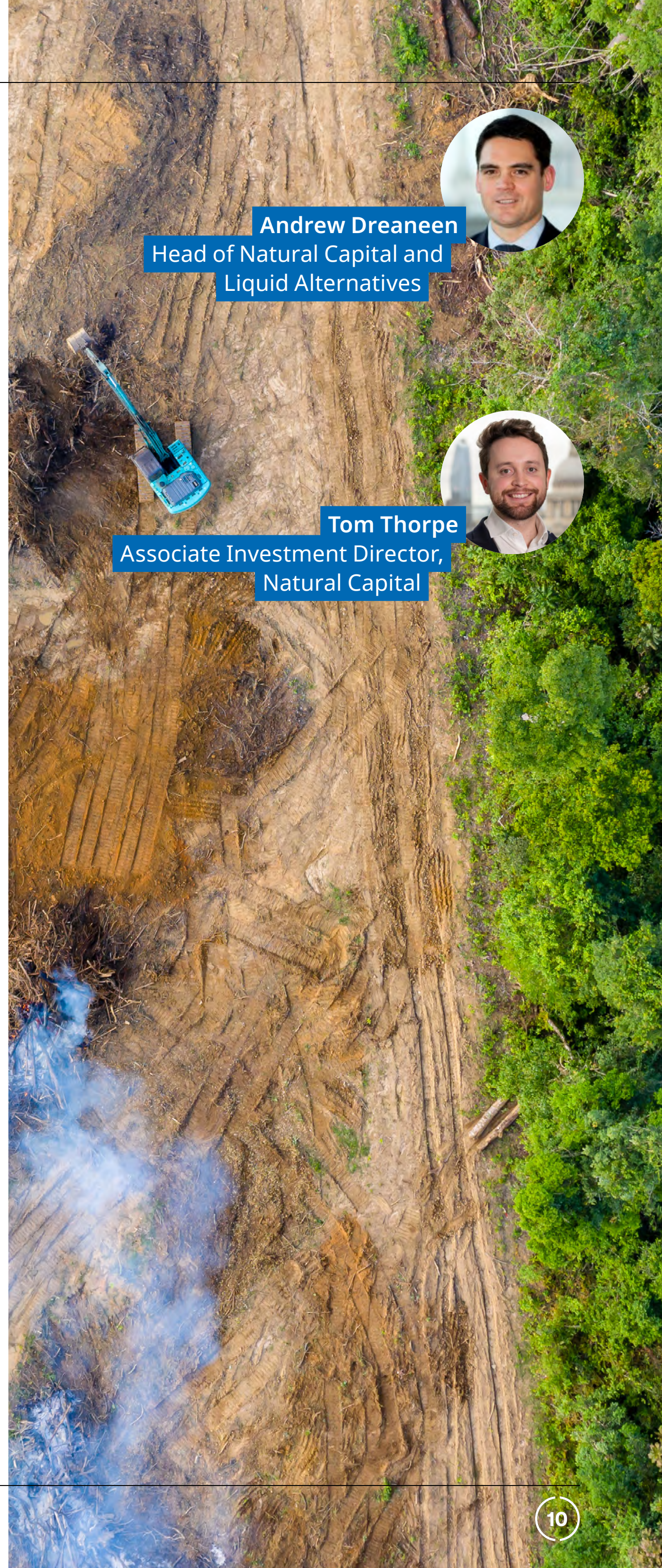


- **$836bn** Hydrogen production
- **$817bn** Ammonia synthesis, storage and distribution
- **$228bn** Engines and storage
- **$19bn** Energy efficiency technologies

Source: Schroders, March 2023. [3] Global Maritime Forum.

SUSTAINABILITY INSIGHTS

WHAT'S HAPPENING WITH VOLUNTARY CARBON MARKETS?



Andrew Dreaneen
Head of Natural Capital and Liquid Alternatives

Tom Thorpe
Associate Investment Director, Natural Capital

The emerging world of carbon credits is a polarising one. Proponents argue that voluntary carbon markets offer a market-based solution through which investors can both offset their carbon emissions whilst channelling funds into projects that restore and conserve degraded or damaged ecosystems.

Critics meanwhile argue that carbon credits do not encourage the positive changes necessary to truly shift the dial on climate change, instead effectively representing a license to pollute.

Regardless of which side of the argument you stand on, 2023 has already witnessed a dramatic shift in the voluntary carbon market.

THE FIRST QUARTER OF 2023?

Sceptics have often questioned the scientific integrity of voluntary carbon credits. In January, The Guardian published an article claiming that '90% of rainforest carbon offsets by the biggest certifier are worthless'.

The offsets this article is referring to are those issued under the methodology of 'reducing emissions from deforestation and forest degradation', abbreviated to REDD+. These are credits issued for example if a project developer can justifiably claim that without their efforts, deforestation would have led to increased CO_2 emissions. The projects issuing these credits have been verified and vetted by the largest carbon credit registry in the world – Verra.

In their article, The Guardian claim that of a sample of 94.9 million carbon credits issued under the REDD+ methodology, there were only 5.5 million real emissions reductions. This is mainly because:

- Only a handful of projects supposedly showed evidence of deforestation reductions.
- The threats to the forests by which the issuance of credits is measured was overstated by an average of 400%.

Verra of course refute this, arguing that their methodology for measuring rates of deforestation is more robust than that used in the research that forms the basis of these claims.

At the heart of this debate is the issue of carbon credit quality, which is typically determined through the analysis of a number of factors including:

- Additionality – Would the project activities have occurred anyway? If the answer is yes, then credits should not be issued.
- Permanence – The extent to which any emissions reductions are at risk of reversal.
- Leakage – The shifting of emissions from one source to another (e.g. deforestation moving from a protected project site to the surrounding area).
- Co-benefits – Does the project contribute to additional sustainable development goals?

Regardless, it is still incredibly difficult for willing participants to truly measure the quality of a carbon credit and the project developer issuing the credit.

WHAT DOES THIS MEAN FOR VOLUNTARY CARBON MARKETS?

The voluntary carbon market on its own is not enough to solve climate change. However, it represents a tool with great potential if combined with a fully fledged net-zero transition plan.

For this market to scale, questions around integrity and transparency must still be addressed. Eventually, we may see the emergence of regulations being applied to voluntary carbon markets.

At Schroders, we continue to closely monitor these developments and the voluntary carbon market more broadly. Over time, we believe that high quality carbon credit prices are likely to appreciate, but are unlikely to reach the stratospheric levels predicted by certain market commentators.

Voluntary carbon markets show promise as a market-based tool for channelling capital into protecting and restoring nature. However for this potential to be truly unlocked, improvements must be made to deliver confidence in the credibility and effectiveness of carbon credit projects.

Source: Schroders, March 2023.

SUSTAINABILITY INSIGHTS

SCHRODERS TOPS FINANCIAL INSTITUTIONS IN THE LATEST GLOBAL CANOPY FOREST 500 REPORT

We're proud to have topped the list of financial institutions in this year's Global Canopy Forest 500 report, a ranking of companies and financial institutions deemed "powerbrokers of zero deforestation"

In what Global Canopy, an environmental not-for-profit, considered a "watershed year for action on deforestation", our score jumped to 50% to lead the financial institutions in the 2023 report. The report also highlighted the pressing need for more action across financial institutions and other companies. While we are pleased that our efforts have been recognised, we realise that more will be needed as pressure on companies grows.

We have considered deforestation risk for many years, including committing to end commodity-driven deforestation at COP26 in 2021. Over the last year, we have focused in ensuring that we publish more information on our approach to nature and biodiversity. Key initiatives include a formal deforestation plan, published in our Group Position Statement on Nature and Biodiversity, and our Plan for Nature, both launched in October 2022.

We also launched an award-winning Engagement Blueprint at the start of 2022, which provides clear guidance on how to engage with companies over six core themes, including natural capital and biodiversity. And we have expanded on our expectations of companies this year, with a particular focus on deforestation.

Forest 500 identifies the 350 companies and 150 financial institutions with the greatest exposure to tropical deforestation risk. The annual report, running since 2014, assesses the actions taken by organisations on deforestation and associated human rights risks. Data is collected to examine organisations' approaches to managing exposure to four commodities – timber, soy, palm oil, beef and leather – including policies, implementation and transparent reporting.

The assessment aims to hold the 500 organisations to account, provide a comprehensive public dataset on their performance and drive forward progress towards commodity supply chains that are free from harmful deforestation.

READ MORE:
Global Canopy Forest 500 report

Andrew Howard
Global Head of Sustainable Investment

"With more than half of global GDP at moderate or severe risk due to nature loss[4], nature risk has become a more prominent factor to investment risk and returns. We firmly believe that managing nature risk is part of our responsibility to clients and key to us continuing to deliver robust, long-term returns.

"While our leading ranking among financial institutions in the latest Global Canopy Forest 500 report is recognition of the significant action we are taking, we also acknowledge more needs to be done and look forward to continuing our action in this area."

Source: Schroders, March 2023.
[4] https://www.weforum.org/agenda/2023/01/davos23-nature-loss-is-an-economic-crisis-innovation-is-needed-now/

SUSTAINABILITY INSIGHTS

SUSTAINABILITY AND IMPACT CHALLENGES IN PRIVATE ASSETS AND HOW WE ADDRESS THEM

Maria Theresa Zappia
Schroders Capital Head of Sustainability and Impact and BlueOrchard Deputy CEO

Anne Dardelet
Sustainability and Impact Manager, Schroders Capital

As sustainability and impact are becoming performance drivers in private assets, the industry faces challenges and opportunities. At Schroders Capital, these challenges and opportunities shape our ambition, and the way we invest in the private assets ecosystem.

1. SUSTAINABLE AND IMPACT DATA

Due to uneven sustainability disclosures standards, the quality of data – in terms of availability, relevance, integrity, usability, and completeness – remains a concern for all private markets participants.

For this reason, data is at the heart of our stakeholder engagement strategies. Our objective is to build a private markets sustainability and impact database that would allow all parties, especially our investors and clients, to benchmark private assets managers' performance on sustainability and impact, and link it to financial performance.

2. REGULATORY CHANGES

As the volume of regulation rises across jurisdictions, public and private market participants are tasked with managing an increasingly complex regulatory environment including the potential for regulatory divergence on certain key topics. In private assets, additional challenge comes from the fact that sustainability-linked regulations are generally drafted with listed asset strategies in mind.

Therefore we actively track and scope fast-evolving regulations and guidance, aiming to go beyond pure compliance and to create investment portfolios that can proactively integrate sustainability and impact aspects.

3. KNOW-HOW AND RESOURCES

Sustainable and impact investing is a rapidly evolving and resource intensive space with new concepts, frameworks, methodologies and data capabilities emerging all the time. At the same time, while implementing the latter in private assets, we need to account for the specificities of each private investment practice, underlying assets and stakeholders.

To this end, we have assembled a strong team of practitioners, including climate and net zero specialists. We will continue to upgrade our capabilities and contribute to industry initiatives as we believe the fast-growing pace of sustainability requires new forms of synergies and cooperation.

4. PORTFOLIO CONSTRUCTION, ENGAGEMENT

Asset managers must satisfy multiple different considerations simultaneously: sustainability and impact, financial performance, regulatory classifications, alignment with international frameworks such as the SDGs, but also - and even more so in private assets - adequate liquidity, and diversification.

To address these challenges, we are embedding sustainability and impact at each stage of the investment process, proactively managing any trade-offs in terms of portfolio construction and diversification. Our goal is to push the boundaries of active engagement, especially on climate integration and alignment, as we believe this is a unique lever we can use as private markets investors.

5. PERFORMANCE

With high levels of liquidity in key ESG sectors in certain markets, core financial performance might be challenging to achieve. How fund managers define and pursue alpha is critical to the success of sustainable and impact strategies.

As long-term investors, we believe that sustainable and impact investing can, in fact, be a value enhancer ad it is key to articulate how these features can effectively contribute to financial value

6. GREENWASHING

Either intentional or not, greenwashing involves a firm making unsubstantiated or misleading statements about its sustainability and impact delivery and credentials. We take the risk of greenwashing extremely seriously as both forms are immensely destructive.

To protect our reputation and the reputation of our investors our approach is to be as transparency as we can. For impact driven strategies, we also submit ourselves to an external independent verification as we believe this is the most concrete manner to address any concerns, and continue to improve.

To find out more on our sustainability ad impact approach in private assets, we invite you to read Schroders capital sustainability and impact report 2022 which is publicly available on our website.

Source: Schroders, March 2023.

SUSTAINABILITY INSIGHTS

ESG: WEATHERING THE MARKET HEADWINDS

The past two years have been challenging for sustainably-focussed strategies. Our Quantitative Equity Product (QEP) team explain these recent headwinds and how we are navigating them.

The recent headwinds for sustainably-focused strategies were primarily driven by the outperformance of industries which have heightened environmental or social risks. Many of these industries (e.g., coal, tobacco, weapons) are typically excluded from sustainable strategies. Another headwind was the growth bias that sustainable strategies often contain,

This mini-ESG winter has reinforced the need to focus on implementation as well as taking a forward-looking approach. Careful implementation of sustainability considerations should not lead to outsized impacts to a portfolio's fundamental profile or unexpected performance outcomes.

The recent change in market leadership has provided the first real test for sustainable-focussed strategies. It has highlighted the benefits of a diversified approach and the importance of allocating to a blend of styles as part of an overall portfolio in a way that also captures sustainability considerations. More generally, we regard the current headwinds as largely transitory and we maintain our conviction that sustainability risks will increasingly be priced over time. The most compelling stocks will have not only the best fundamentals, but also prove to be the most adept at adapting to fast-developing sustainability challenges head on.

Recent challenges for ESG-oriented stocks

The standard exclusions based on business involvement have not detracted from performance historically over the longer term.

However more recently, elevated oil prices has meant that any blanket aversion to fossil fuels in a portfolio context has been costly.

With volatile markets, defensive industries have also been in favour (e.g., tobacco, alcohol), and weapon producers have generated strong profits as geopolitical risks remain high.

These are all areas that are likely to be underrepresented in or excluded from sustainable strategies. The result is that 'good ESG' lagged 'bad ESG' in 2022 (Figure 3), with the exception of governance. The table also illustrates the top performing industries in 2022 relative to the MSCI AC World index. In short, some of the worst areas from an ESG perspective have recently performed best.

FIGURE 3: "ANTI ESG" MARKET

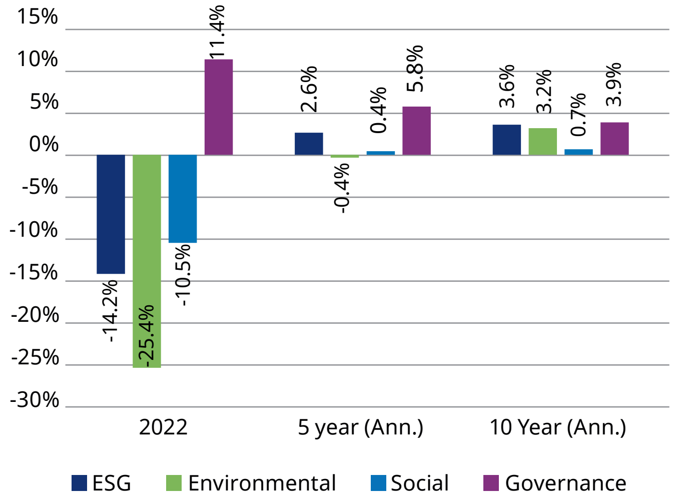


FIGURE 4: TOP 10 INDUSTRIES IN 2022

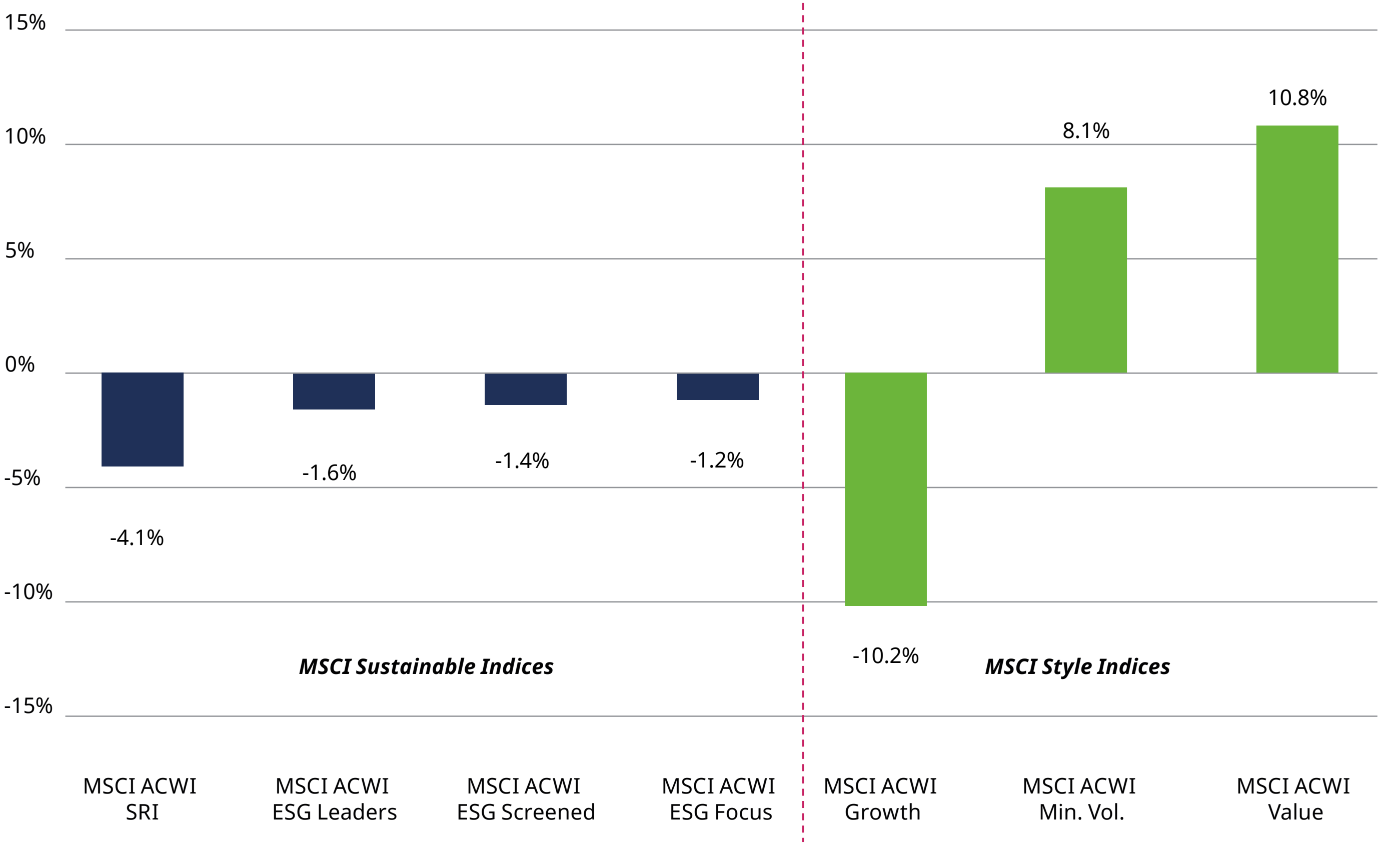
Rank	QEP Industry	Relative Perf.
1	Coal	+81.6%
2	E&P O&G	+67.2%
3	Equipment O&G	+63.9%
4	Integrated O&G	+61.4%
5	Refiner O&G	+39.4%
6	Transportation O&G	+33.8%
7	Tobacco	+31.0%
8	Mining	+30.7%
9	Defence & Aero	+29.6%
10	Education	+25.7%
	MSCI AC World	*-18.4%*

Source: QEP, Schroders. Top chart: QEP ESG Ranks, total return performance of the top-quintile (20%) minus the bottom quintile for the relevant periods as at 31st December 2022. Bottom chart: QEP Industry performance versus MSCI AC World in USD, as at 31st December 2022. The companies and sectors mentioned herein are for illustrative purposes only and are not to be considered a recommendation to buy or sell. E&P = Exploration and production, O&G = Oil and gas.

SUSTAINABILITY INSIGHTS

It is, therefore, not surprising that naïve approaches to sustainable investing, such as passive sustainability indices, have fallen behind the broader market (chart below), with many of the indices also underperforming in 2021.

FIGURE 5: INDICES RELATIVE RETURN VS. MSCI AC WORLD INDEX (2022 CALENDAR YEAR)



Source: Schroders, Eikon in USD, as at 31 December 2022.

FOUR KEY PRINCIPLES TO ASSIST IN MITIGATING THE RISK OF SHORT TERM REVERSIONS:

After a bruising year for equities, the additional headwinds against ESG managers has clearly been unhelpful if not understandable given the market backdrop. As with most trends, it is rare that they progress in straight lines and sustainability should not be regarded as an exception to the rule. However, there are ways to mitigate the risks of short term reversions and we would advocate a number of key principles to assist in this journey:

DON'T FORGET ABOUT VALUATIONS: ①

Incorporating a valuation bias not only provides a more balanced portfolio but also avoids overpaying for high conviction themes that may not necessarily offer the best prospective returns.

MAXIMISE THE GLOBAL OPPORTUNITY SET ②

Investing outside of the mainstream indices provides additional flexibility, offering increased options in less analysed areas of the market and further encourages diversification.

BE DYNAMIC: ③

Sustainability themes are evolving fast and it is critical to remain ahead of the curve in terms of identifying evolving trends that may play out over several years. Inherently, this requires a forward looking approach that places as much weight on selecting "enablers" and "best in class leaders" today alongside side-stepping the laggards.

ACTIVE ENGAGEMENT IS KEY ④

Through constructive and committed engagement with management teams at the companies and assets we invest in, active ownership is a key element of the value we bring to our clients. Social and environmental forces are reshaping societies, economies, industries and financial markets.

OUR ENGAGEMENTS AND VOTING

COMPANIES WE'VE ENGAGED WITH

We undertook 313 engagements this quarter with 250 companies listed. We show here which of our Engagement Blueprint themes were addressed at each company. The chart shows the percentage breakdown of the themes we engaged on in Q1 2023. For further details about active ownership at Schroders, please contact your client director.

Thematic breakdown of engagements

- Climate Change (CC)
- Diversity and Inclusion (DI)
- Governance and Oversight (CG)
- Human Capital Management (HC)
- Human Rights (HR)
- Natural Capital and Biodiversity (NC)

Source: Schroders, March 2023.

Company	CC	NC	HC	DI	HR	CG
Basic Materials						
Acerinox	✓					
Akzo Nobel	✓					
AMG Advanced Metallurgical	✓					
Antofagasta	✓					
Arkema	✓					
BHP Group	✓					
Brenntag	✓					
Buzzi Unicem	✓					
Cemex SAB de CV						✓
Covestro	✓					
Croda International	✓					
DS Smith	✓					
Ecolab		✓				
Ecora Resources	✓					
Elkem	✓					
Ems Chemie Holding	✓					
Ence Energia y Celulosa	✓					
Evonik Industries	✓					
Givaudan	✓					
Granges	✓					
Hansol Chemical		✓				
Hindalco Industries	✓					
Holmen	✓					
Hyundai Steel	✓					
IMCD	✓					
Imerys	✓					
James Hardie Industries	✓					
Johnson Matthey	✓					
Kemira	✓					
Metsa Board	✓					
Mondi	✓					
Norsk Hydro	✓					
Rio Tinto						✓
Satellite Chemical	✓					
Sika					✓	
Stora Enso	✓					
Symrise	✓					
Umicore	✓					
UPM	✓					
Voestalpine	✓					
West China Cement	✓					
Yara International	✓					
Zijin Mining Group					✓	
Zotefoams						✓
Consumer Discretionary						
Amazon	✓	✓	✓		✓	
ASOS						✓
Assa Abloy AB	✓					
Aston Martin Lagonda	✓					
boohoo						✓
Bridgestone	✓	✓	✓			
Burberry						✓
BYD	✓	✓				
Cafe De Coral Holdings					✓	
Currys						✓
Eclat Textile		✓				
Ferrari	✓					
Forbo Holding						✓

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Company	CC	NC	HC	DI	HR	CG
Ford Otomotiv Sanayi	✓					
Geberit	✓					
Grafton Group						✓
Greggs			✓			
InterContinental Hotels Group	✓					
LVMH Moet Hennessy Louis Vuitton	✓					
Next			✓			
Nordstrom	✓	✓				
Pendragon						✓
Pets at Home		✓	✓			✓
Porsche Automobil						✓
Rockwool	✓				✓	
Stellantis						✓
Tesla			✓	✓		✓
Tokai Rika						✓
TV Asahi				✓		✓
Vitesco Technologies	✓					
Volkswagen					✓	
Walt Disney			✓			
Yamaha Motor	✓		✓			
ZEAL Network						✓
Consumer Staples						
Associated British Foods	✓					
Berkshire Hathaway						✓
BRF		✓				
Cargill	✓	✓				
Chocoladefabriken Lindt & Spruengli	✓					
Danone						✓
Essity AB (publ)	✓					
Etablissementen Franz Colruyt						✓
First Resources	✓					
Illinois Tool Works	✓					
Kerry	✓					
Koninklijke Ahold Delhaize	✓					
Koninklijke DSM	✓					
Mowi	✓					
P/F Bakkafrost	✓					
Siam Cement	✓					
Tate & Lyle	✓					
Tesco	✓					
Tiger Brands						✓
Energy						
Aker BP	✓					
Diamondback Energy	✓					
Enagas	✓					
Energy Transfer		✓			✓	
Galp Energia SGPS	✓					
Hunting			✓			✓
Jastrzebska Spolka Weglowa	✓					
JinkoSolar Holding					✓	
Neste	✓					
Petroleo Brasileiro Petrobras						✓
Polski Koncern Naftowy Orlen	✓					
Rubis	✓					
Siemens Energy	✓					
Snam	✓					
Tenaris	✓					
TotalEnergies	✓					
Tullow Oil						✓
Financials						
Axis Bank	✓					
B3 Brasil Bolsa Balcao	✓					
Banco Bilbao Vizcaya Argentaria				✓		
Banco de Chile				✓		✓
Barclays	✓					
Chailease						✓
Haci Omer Sabanci	✓					
Heritage Financial				✓		✓
Intermediate Capital						✓
Jpmorgan Chase & Co	✓					
Prudential						✓
Qatar National Bank	✓		✓			✓
Swiss Re	✓			✓		✓
Toronto-Dominion Bank	✓					
United Overseas Bank	✓					
Government Activity						
Toronto-Dominion Bank		✓				
United Overseas Bank	✓					
Health Care						
Apollo Hospitals Enterprise					✓	
Bristol-Myers Squibb	✓				✓	
CVS Health			✓			

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Source: Schroders, March 2023.

Company	CC	NC	HC	DI	HR	CG
Dechra Pharmaceuticals						✓
EBOS			✓			
Novartis					✓	
Roche Holding	✓					
Sanofi					✓	
Smith & Nephew						✓
UnitedHealth			✓			
Industrials						
Aalberts						✓
Abb	✓					
AerCap Holdings	✓					
BAE Systems	✓					
Balfour Beatty	✓					✓
Capita			✓			
Chemring						✓
Clean Harbors	✓	✓				
CNH Industrial			✓			✓
Deutsche Lufthansa	✓					
Deutsche Post	✓					
DFDS	✓					
Easyjet	✓					
Finnair	✓					
First	✓					
Hapag Lloyd	✓					
International Consolidated Airlines	✓					
International Distributions Services			✓			
Johnson Controls International	✓					

Company	CC	NC	HC	DI	HR	CG
JTOWER						✓
Knorr Bremse	✓					
Mitie					✓	
Ryanair	✓					
Sandvik	✓					
Schneider Electric	✓					
SMC	✓					
TE Connectivity	✓					
Toyota Industries						✓
Turk Hava Yollari	✓					
Volution	✓					
WEG	✓					
Western Union				✓		
Wizz Air Holdings	✓					
Real Estate						
Avalonbay Communities		✓				
Crown Castle	✓					
Digital Realty Trust	✓					✓
Hammerson						✓
Ingenia Communities Group	✓					
Invitation Homes			✓			
Keppel DC REIT	✓					
Prologis			✓			
Sumitomo Realty & Development						✓
Sun Hung Kai Properties	✓					✓
Swire Properties	✓					
Vicinity Centres						✓
Welltower OP	✓					

Company	CC	NC	HC	DI	HR	CG
Technology						
ASM International	✓					
ASML						✓
Barco				✓		
Blancco Technology						✓
Comcast	✓					
Grab Holdings		✓			✓	
International Business Machines				✓		✓
Luxshare Precision Industry					✓	
Meituan	✓		✓		✓	
MercadoLibre					✓	
Meta Platforms					✓	
Microsoft			✓	✓	✓	
Nikon		✓		✓		
Orange	✓	✓				
Quadient						✓
Roblox			✓			✓
SAP						✓
Siemens	✓					✓
Software						✓
Spirent Communications						✓
Tele2						✓
Telstra Corporation		✓				
Ubisoft Entertainment			✓			
Verizon Communications		✓	✓	✓		✓
Vodafone						✓
Western Digital		✓	✓			✓
Zhen Ding Technology					✓	

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Company	CC	NC	HC	DI	HR	CG
Utilities						
A2A	✓					
Anglian Water						✓
Centrica						✓
China Everbright Environment	✓					
Drax Group	✓					✓
E ON SE						✓
EDP Energias de Portugal	✓					
EDP Renovaveis	✓					
Electricite de France					✓	✓
Elia	✓					
EnBW Energie Baden Wuerttemberg	✓					
Endesa	✓					
Enea	✓					
EVN	✓					
Iberdrola						✓
Mytilineos	✓					
National Grid						✓
Nextera Energy Operating Partners	✓					
Northumbrian Water						✓
Orron Energy	✓					
Orsted	✓					
Pennon Group						✓
Red Electrica Corporacion	✓					
RWE	✓					✓
Severn Trent	✓	✓				✓
Southern Water Services						✓
SSE						✓
Telecom plus						✓
Terna Rete Elettrica Nazionale	✓					
Thames Water Utilities						✓
United Utilities	✓			✓		✓
Vattenfall	✓					
Veolia Environnement	✓					
Verbund	✓					
Wessex Water Services						✓
Yorkshire Water Finance						✓

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