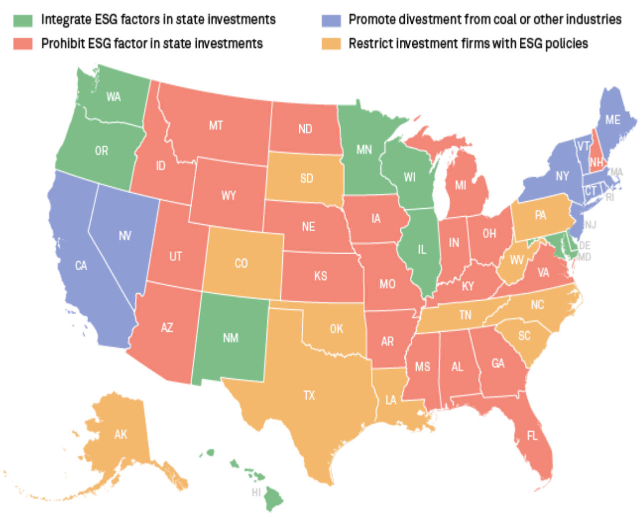
Q1 2023 Responsible Investment Report

Caught in the crossfire – the politicisation of ESG

As momentum builds towards next year's Presidential election in the US, ESG has become a new political 'wedge issue'[1]. There is a growing contingent of people who perceive ESG investing to be driven by a moral agenda which works to the detriment of company profitability and investor returns. This negative sentiment towards ESG is best demonstrated by the anti-ESG laws that govern state investments, which have largely been proposed by Republican Governors. Figure 1 shows the US state regulation that either prohibit or restrict ESG factors from being integrated into the management of state investments.

<u>Figure 1: State Regulation of ESG Investments</u>



Source: Ropes & Gray LLP, S&P Global. Data as at 15 February 2023

What do we actually mean by ESG?

"ESG is both extremely important and nothing special." *– Alex Edmans, Professor at the London Business School*

In his paper "The End of ESG," Alex Edmans argues that ESG does not need a specialised term since, at its core, it is about considering and analysing intangibles that create long-term value. This practice is simply part of investing.

Companies do not operate in a vacuum free from government intervention and public scrutiny. As environmental and social issues have, in recent years, garnered increased attention from both regulators and consumers alike, investment professionals have found it harder to ignore such considerations when assessing the long-term prospects of companies and the predictability of their future cashflows.

There is nothing novel or contentious about incorporating non-financial factors into investment decision-making, especially for long-term investors like Troy. We have always sought to invest in companies with strong, effective boards and capable management teams. Experience has also taught us that the durability and resilience of the companies in which we invest is affected by their ability to withstand changing regulatory environments, adapt to evolving consumer preferences and navigate systemic shocks like global pandemics and climate change.

At Troy, we aim to analyse the ESG factors that are material to each company during our investment and research process. We do not employ a prescriptive checklist, nor do we use

[1] A wedge issue is a political or social issue, often of divisive nature, which splits apart a demographic or population group.

scores which can risk being too reductive. Every company has its unique merits and challenges. The ESG analysis that we undertake is therefore specific to each company and helps us build a richer mosaic of information on which to judge its competitive advantages and long-term performance.

For instance, over the last few years, we have sought to understand how Nestlé manage the biodiversity impact from land-use in its agricultural supply chain. Following thematic research on the topic of biodiversity in May 2021, Troy met with Nestlé's Head of Sustainable Agriculture to better understand the company's Forest Positive strategy. The strategy includes a commitment to deforestation-free commodity sourcing by 2025. Nestlé have also committed to source 20% of key ingredients using regenerative systems by 2025, and 100% by 2030. Nestlé are also increasingly using regenerative agricultural practices[2] to source key ingredients like milk, cocoa, coffee, vegetables and cereals.

During the quarter, Troy attended a roundtable with Nestlé's Chairman where we discussed the company's progress on their nature-related initiatives. The Chairman spoke about how Nestlé are carefully balancing the environmental and social tensions at play since smaller farmers are generally slower to progress towards Nestlé's deforestation targets. Nestlé have long supported the livelihoods of smaller, local farmers and are therefore supporting them along the journey to become deforestation-free.

The interplay between social and environmental factors will assume increasing importance for all companies as efforts to restore the environment accelerate over the next decade. We expect companies to demonstrate a strong level of candour and understanding of the tensions between people and planet, and we believe that Nestlé does this well. Solutions will be complicated and require a thorough understanding of the issues, together with a considered and patient approach. This requires companies to look beyond their direction operations.

Whilst an approach that focuses on the nuances and fundamentals of individual companies is more onerous, it allows us to analyse the issues that have the potential to materially impact a company's long-term results. Recognising that ESG is no more or less than a set of intangible long-term value drivers helps to remove this branch of analysis from the political cross-hairs, in our view.

ESG is also about opportunity

ESG factors are often perceived as risks to be managed. However, changing social and environmental trends also offer opportunities for those companies willing to take them.

A company's long-term value is relevant to all stakeholders. Companies that maximise value for their shareholders over longer periods tend to create more employment, empower employees, provide greater customer satisfaction and hold themselves to higher standards of corporate responsibility. The promotion of more sustainable products and services can also generate revenues and profits by meeting growing consumer demand for these attributes.

Ethical investing versus ESG

ESG tends to cause confusion, becoming a catch-all term for different shades of green.

Within the industry, many have argued ESG should be spilt in two. On the one hand, it describes a practice of taking ESG issues into account when trying to assess the potential risk-adjusted returns of an investment. On the other hand, ESG can refer to avoiding harm (i.e., ethical investing) or having a positive impact.

2 Regenerative agriculture is an approach to farming that aims to improve soil health and soil fertility – as well as protecting water resources and biodiversity. Restoring soil health helps capture increased levels of carbon from the atmosphere in soils and plant biomass and promotes healthier soils which increases crop productivity.

Troy's funds span this divide, according to their specific objectives. We believe that it is our fiduciary duty to consider all long-term drivers of an investment's value. This increasingly encompasses material environmental and social factors for the reasons mentioned previously. This analysis forms part of our fundamental research, is not informed by a set of moral guidelines and is employed across all of Troy's investment strategies.

Troy's Ethical funds employ negative screens in addition to the ESG analysis carried out in our research. These negative screens restrict any investment in harmful sectors, as defined by the relevant fund's ethical exclusion criteria. Broadly, these criteria prevent the funds from investing in companies which generate a significant proportion of their revenues from the following: alcohol, armaments, fossil fuels, gambling, high-interest rate lending, pornography and tobacco.

Climate change and the Net Zero Asset Manager's initiative

"Climate change is already affecting every region on Earth, in multiple ways." *– Panmao Zhai, Intergovernmental Panel on Climate Change*

Climate change occupies a unique and important area within the world of ESG. It is a major risk and therefore applies to all companies across all geographies. However, it is also a subject that has created significant debate amongst investors. Vanguard, the world's second largest asset manager, withdrew from the Net Zero Asset Managers (NZAM) initiative earlier this year. This move has led many to call into question the initiative's credibility and what it stands for. Critics of NZAM argue that the initiative encourages investors to exercise their influence, both by allocating capital and engaging with companies, to push for carbon reduction. Some claim this is at odds with their fiduciary duty if it harms corporate profitability.

We approach this debate as long-term, active investors in higher quality businesses. No outcome is certain and in our pursuit to act as a responsible steward of our investors' capital we aim to make educated and informed decisions whilst taking as little unrewarded risk as possible. Climate science is complex and entails predicting potential outcomes far into the future. The one area where the science is generally conclusive is that for every additional degree of global warming there will be more environmental catastrophes and irreversible damage done that will impact entire economies and communities. It is therefore in our interest to reduce this risk as much as we can today to avoid heightened costs tomorrow. For this reason, Troy assesses the climate risks and opportunities of all our investments.

As active investors who favour high-quality companies with strong balance sheets and the ability to re-invest their profits at high rates of return, we believe our portfolio companies are best placed to approach this challenge thoughtfully. Not only do they have adequate resource to adapt to a changing environment, they also typically have management teams who appreciate the commercial benefits of transitioning to a low carbon economy.

Though we recognise the challenges that lie ahead in this transition, we continue to believe that ambition is necessary. We also anticipate that policymakers will eventually take meaningful action to avert future disasters. Troy remains a signatory to the Net Zero Asset Managers initiative and is committed to encouraging our investee companies to align themselves with the transition towards net zero through constructive engagements.

The long path to maturity

We find that the inclusion of ESG considerations in the investment canon is no different to the acceptance of novel political ideas or new technologies. Development tends to go through phases of maturity as the details are exposed to challenges and criticism. Some of these directed at ESG in the last 18 months are well-founded, others are misguided, but all contribute to the establishment of robust standards.

Troy was founded on the principles of independence and common sense, and we are guided by our purpose to protect and grow our clients' irreplaceable capital over the long term. Our investment process aims to incorporate material changes to the profile of investment risks and rewards, including those related to the environment and societal expectations, whilst upholding high standards of corporate governance. This is an ongoing effort and we look forward to keeping our investors updated as it evolves.

Sian-Azilis Evans

Investment Analyst

April 2023

Responsible Investment at Troy

UK Stewardship Code

Signatory of:
STEWARDSHIP CODE | 2021

United Nations' Principles for Responsible Investment

Signatory of:
PRI Principles for Responsible Investment

Net Zero Asset Managers Initiative

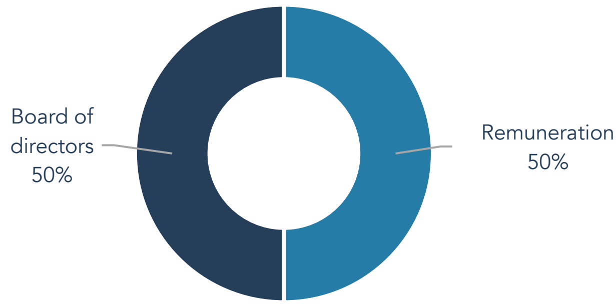
NET ZERO ASSET MANAGERS INITIATIVE

Voting

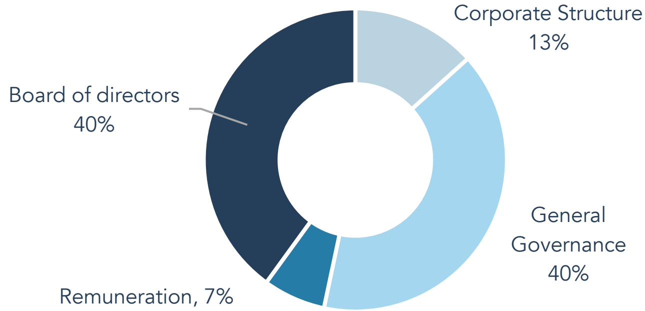
	2022	2023 YTD
Meetings Held	108	15
Meetings voted	100%	100%
Meetings with at least 1 vote Against Management*	29%	40%
Management Resolutions		
Total management resolutions	1,643	273
Votes against management resolutions*	4%	5%
Votes against ISS recommendations	4%	5%
Shareholder resolutions		
Total shareholder resolutions	95	2
Votes in favour of shareholder resolutions	28%	100%
Votes against ISS recommendations	17%	50%

Source: ISS. *This may include abstentions.

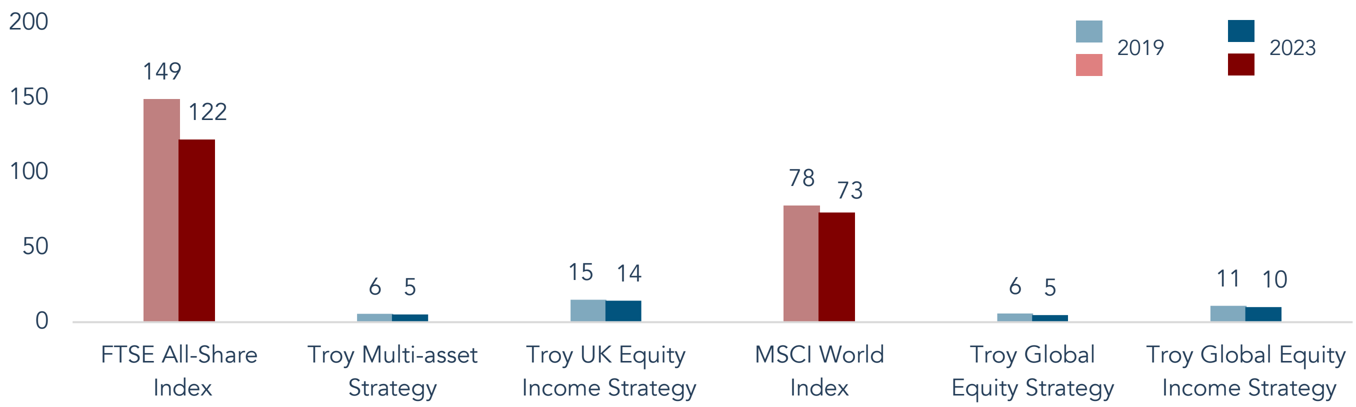
Votes in favour of shareholder resolutions – 2023 YTD



Votes against management recommendations – 2023 YTD (both management and shareholder resolutions)

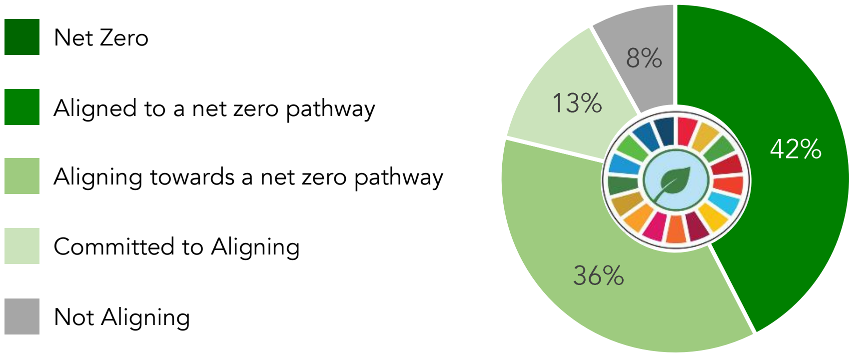


Portfolio Carbon Footprint (Tons CO2e / $M Invested)*



*Carbon footprint calculated using market capitalisation.
Source: MSCI ESG Manager, portfolio holdings as at 31 March 2023 and data as at 4 April 2023. Asset Allocation subject to change. The information provided is based on calculations relating to corporate securities only. Where the fund holds other asset classes, such as cash or government bonds, these are excluded from the portfolio. The information shown relates to a mandate which is representative of, and has been managed in accordance with, the relevant Troy Strategy. Past performance is not a guide to future performance.

Current Alignment of our Holdings with Net Zero by 2050

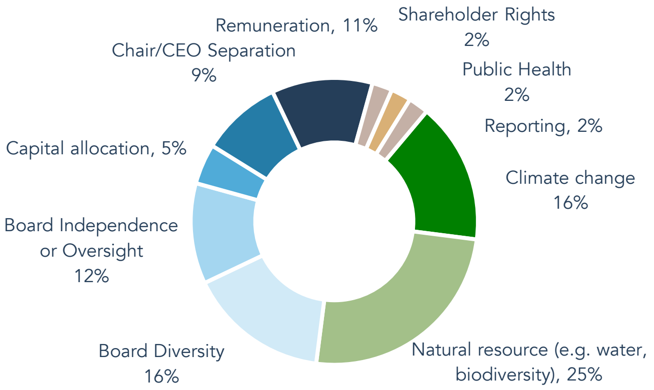


Source: MSCI ESG Manager, 31 March 2023.

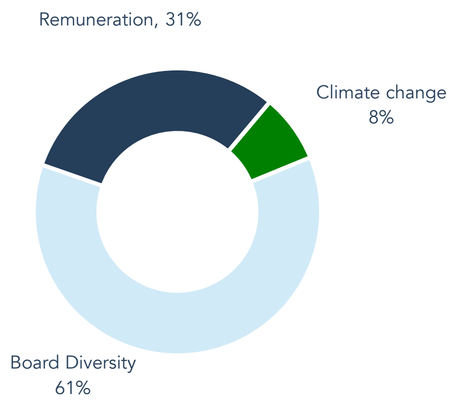
Troy has categorised all equity holdings along an alignment maturity scale in accordance with the Institutional Investors Group on Climate Change's (IIGCC) Net Zero Investment Framework methodology. This reflects our commitment under the Net Zero Asset Managers initiative to ensure our investments are on track to meet global ambitions of net zero emissions by 2050 or sooner. We currently have engagements underway with all holdings deemed 'not aligning', our goal is to move all holdings along the climate maturity scale with the ultimate objective of achieving net zero. For further information please see [Troy's Climate Change Mitigation Policy](#).[3]

Engagement

2022 - 44 engagements with 29 companies



2023 - 13 engagements with 13 companies



Notable Firm Engagements – Q1 2023

Company	E, S or G	Theme	Summary
Texas Instruments	E	Climate Change	In light of Troy's net zero by 2050 commitment we have an engagement underway with companies that have not yet set a net zero target. Texas Instruments (TI) does have carbon reduction targets and has been making progress year on year to reduce their carbon footprint but does not have a long-term goal to be carbon neutral. We have asked TI to set a net zero target and ensure their climate strategy is aligned with an emissions reduction pathway that would meet the goals of the Paris Agreement.
McDonald's	G	Board Diversity	As part of Troy's effort to engage with all investee companies with less than 30% female representation at Board level, Troy has written a letter of engagement to McDonald's expressing our desire to see improved female representation at Board level. We have asked the company to progress on: setting targets for diversity at Board and senior management levels with robust strategies to achieve them; build a diverse candidate pipeline and ensuring that succession planning accounts for diverse talent; report regularly on progress against diversity targets. McDonald's have acknowledged our letter and we will check on their progress in the next 12 months.
InterContinental Hotels Group (IHG)	G	Remuneration	IHG consulted with Troy to shape their 2022/23 remuneration policy. Nearly 70% of IHG's profits are generated in the US. US companies pay their executives substantially more to retain/recruit talent, IHG needs to increase Directors' remuneration. The objective of this engagement is to make sure that IHG's remuneration policy is competitive enough against US peers. This way, IHG can recruit the talent they need to grow the business and generate value for shareholders. We look to ensure that the quantum of compensation is not excessive and that the LTIP is driven by performance measures that align with shareholders' interest.

Source: Troy Asset Management, 31 March 2023.

[3] This policy outlines the consideration of climate risk in our investment decision-making process for mandates which meet the criteria under Article 8 of the European Union's Sustainable Finance Disclosure Regulation

Disclaimer

Further information relating to how ESG integration is applied to the fund can be found in the fund prospectus and investor disclosure document. For further information relating to Troy's approach to company voting and engagement, please see Troy's Responsible Investment and Stewardship Policy available at www.taml.co.uk.

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