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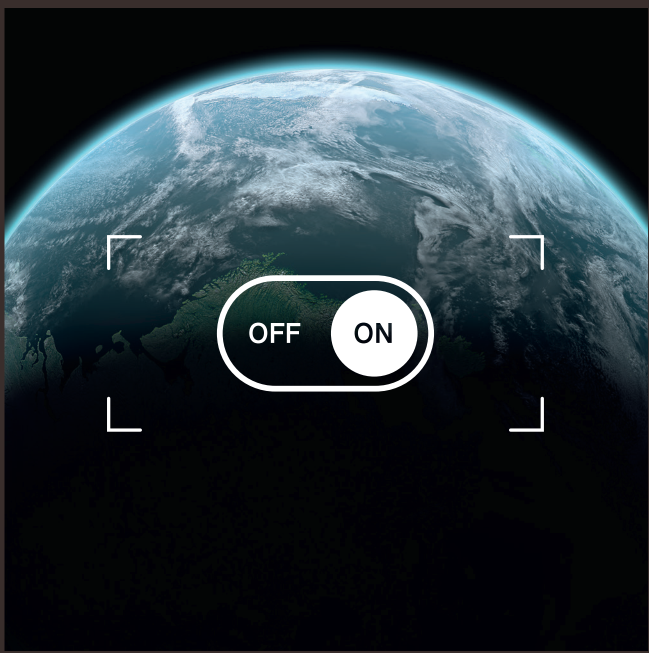
The Sustainability Revolution



summary

the next economic revolution

The next economic revolution is already underway. At Lombard Odier, we believe it will drive returns in the next three to five years and beyond.

The notion of 'sustainability' has most commonly been associated with climate change, but this current revolution goes way beyond that single, albeit very important, issue. It is transforming our economies and the companies that drive them. We believe it will affect every corner of the globe and every asset class in every investment portfolio.

Our current economic, governance and social models are unsustainable, in our view. We are facing some significant long-term structural trends, which are already changing aspects of the ecosystem within which companies exist.

These include, but are by no means limited to:

- Changes in our physical environment caused by climate change;
- Human demographics as our population expands, gets older and becomes more mobile;
- The depletion of natural resources in the face of a growing population;
- Increasing digitalisation and connectivity, which is disrupting traditional governance, social and consumption models;
- Rising inequality, in all its forms, which is already undermining our post-World War II geopolitical stability.

Our operating model has been under pressure for some time, but now we believe it simply has to change.

We have to more fundamentally rethink our approach to many established norms, such as transport, food systems, healthcare, education, data management, infrastructure and on and on. No country, sector, company, or asset class will be untouched.

This is the Sustainability Revolution, and, we believe, it is the largest investment driver in history.


This is the Sustainability Revolution.
Our operating model has to change.

pressure for change

The corporate world has been facing significant pressure to transition to a more sustainable model for years. However, forces are now rapidly converging from several different directions to accelerate the Sustainability Revolution by forcing companies to adapt. These include:

- **Social consciousness** - an increasingly informed and increasingly formidable social consciousness expressed through consumer preferences, voting patterns, social media and the traditional media. The increasing granularity and availability of data continues to educate and shape this growing social consciousness.
- **The political agenda** - given growing social consciousness, the political agenda is turning its focus increasingly towards sustainability in many jurisdictions around the world, which is leading to the rapid implementation of new rules and regulations. These affect companies directly, but also indirectly by forcing investors and consumers to behave differently.
- **Increasing focus from investors** - a recent study by McKinsey & Co found roughly 26% of global assets are now invested according to environmental, social and governance principles[1] as investors increasingly understand the role these factors can play in driving value. In doing so, investors are increasingly directing the flow of capital towards sustainable companies.
- **Rapid development of sustainability enablers** - the digital revolution is providing an unparalleled opportunity to create more sustainable business models and disrupt the unsustainable ones.
- **The growing and ever more apparent cost of climate change** - companies already have to adapt to the consequences of climate change, such as the cost of increasingly frequent and increasingly severe weather events, or shortages of natural resources such as water.

2015 was formative in the Sustainability Revolution, particularly as it relates to the political agenda. That year governments globally came together in a unanimous, collaborative effort to fundamentally alter the course of our economies in the coming decades to make them more sustainable.

This culminated in 193 countries signing up to the UN's 17 Sustainable Development Goals aimed at ending poverty, fighting inequality and tackling climate change. Only months later, 195 countries agreed to adopt the Paris Accord, which established a wide-reaching set of global goals to address climate change specifically over the coming decades.

In combination, these initiatives provide a roadmap for the future direction of policy and regulation. We are already seeing an acceleration in the implementation of this sustainability-focused legislative agenda. The European Commission's Action Plan on Financing Sustainable Growth, announced in early 2018, is one example of how these formative events are now being translated into policy frameworks. The planned bans of diesel cars in many European cities is another, as is the UK's recently-imposed requirement for all companies with over 300 employees to publish data on gender diversity and pay in their workforce.

As the momentum behind the political agenda continues to build, it is encouraging companies to continue to focus on their business practices and to transition towards more sustainable business models as the primary way to drive results for their shareholders.

[1] From Why to Why Not: Sustainable investing as the new normal, McKinsey & Co: https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/from-why-to-why- not-sustainable-investing-as-the-new-normal.

embedding sustainability into portfolio management

The need for companies to adapt to long-term structural trends is not new. They have been doing it for centuries, and we, at Lombard Odier, have recognised this basic principle for over 200 years.

This is a key part of our DNA as a firm, which runs through everything we do, whether that is managing our clients' assets, or running our own firm. Above all, our independent partnership structure allows us to focus on the long term. In doing so, we recognise the need to protect capital, rethink our approach to investment and embed sustainability in the heart of our investment philosophy.[2]

We believe it is our job to invest in companies that are well positioned to benefit from this Sustainability Revolution as they are likely to generate substantial excess returns. At the same time, we want to avoid investing in businesses which are not able, or willing, to adapt in an orderly fashion because of the risk those business models may become 'stranded'.

We believe that excess returns will be driven by companies with a combination of sustainable financial models, sustainable business practices and sustainable business models.

We translate this into a three-pillar approach, designed to identify which companies are more sustainable over the long-term, and therefore best positioned to benefit from the significant opportunities the Sustainability Revolution presents.

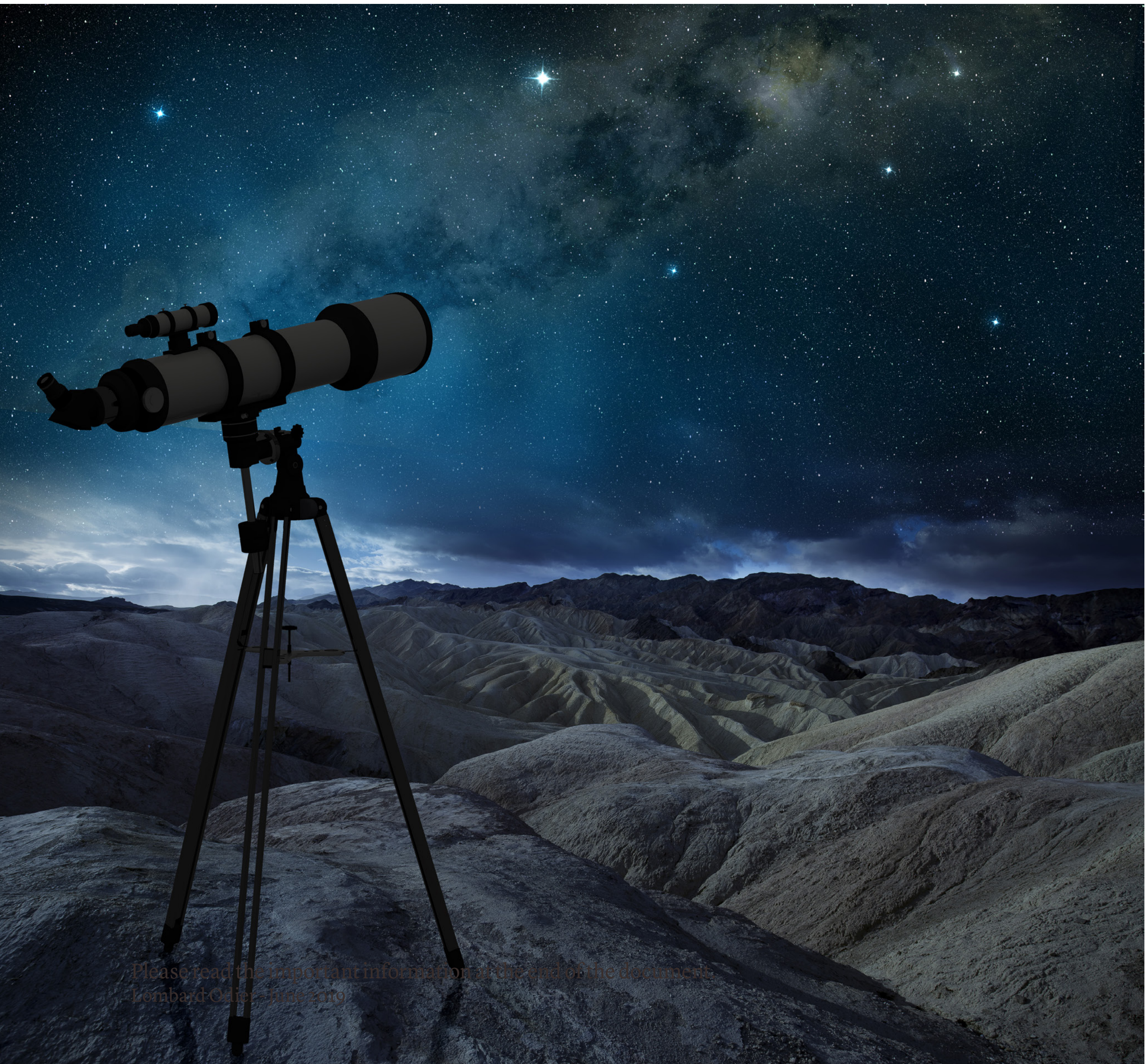
[2] Capital protection/Capital preservation represents a portfolio construction goal and cannot be guaranteed.

our three-pillar approach

1. Sustainability of a company's financial model

The starting point for any investment is the financial viability of the company, whatever the asset class. For equities, for example, we look to identify companies with the ability to generate excess economic returns. To do this, we believe they must be capital efficient, cash generative and be able to balance their books independently from capital markets.

In credit, we assess the overall solvency of a company. We do this by looking at a company's financial data to assess the fundamental credit quality, the ability to pay back debt and refinance. In contrast to traditional market-cap benchmarks, our starting point is the quality of debt, rather than the quantity.



2. Sustainability of a company's business practices

We believe that, for a company to deliver long-term value, it needs to be focused on its broad ecosystem of business stakeholders: regulators, shareholders, employees, clients, suppliers, the environment, and its local community. In other words, to be as focused on its business practices as on its financial performance. In fact, we believe that business practices drive financial performance in the same way that revenues or costs would.

This includes, for example, having programmes in place to address gender diversity, adhering to best practice on board composition, having robust policies in place to ensure employees' health and safety, and minimise any negative impact on the environment.

We have several tools to assess the sustainability of a company's business practices:

- **Long-term metrics – ESG scoring**
  We use 115 distinct, identifiable and credible data points to analyse whether companies are aligned with best practice in terms of Environmental, Social and Governance matters, whether they are making progress in adapting to the transition, and how their business practices are positioned for the likely direction of future regulation.

  We have developed a proprietary 'CAR' methodology, which helps us differentiate between companies that are talkers, doers or achievers when it comes to sustainability. We believe this methodology, which breaks ESG data down into Consciousness, Action and Results, is better than relying on external aggregated ratings as it helps identify companies making genuine progress towards more sustainable business practices.

  We collect, verify and enhance large amounts of raw data in relation to business practices, which we use to enhance our proprietary ESG methodology. We collect the most granular level of non-financial data possible from a range of traditional and alternative sources. Our portfolio managers then integrate this data in their investment process. They are also able to enhance the quality of our ratings through their dialogue with companies, as we build a better understanding of a company's business practices.

- **Short-term metrics – controversies**
  A company's exposure to controversies in the short term is a strong signal that it is not focused on best business practices over the long term. We look at companies' exposure to controversies and the severity of those issues as a way to manage portfolio risk.

- **Impact metrics**
  We also analyse companies' carbon emissions and water consumption. This helps us to assess how companies are trying to improve their business practices in a carbon and water constrained economy.

our three-pillar approach

3. Sustainability of a company's business model

In addition to looking at a company's financial sustainability and the strength of its business practices, we also look at the sustainability of its business model. This means assessing a company in light of the long-term transformative trends that will result from the transition of the global economy towards a more sustainable model. How well is the company positioned to take advantage of the opportunities the transition presents? This forward-looking analysis is a critical step in understanding if companies' performance is repeatable and sustainable over the long term. It starts with the identification of the mega trends that will shape our economic and social outcomes over the same timeframe.

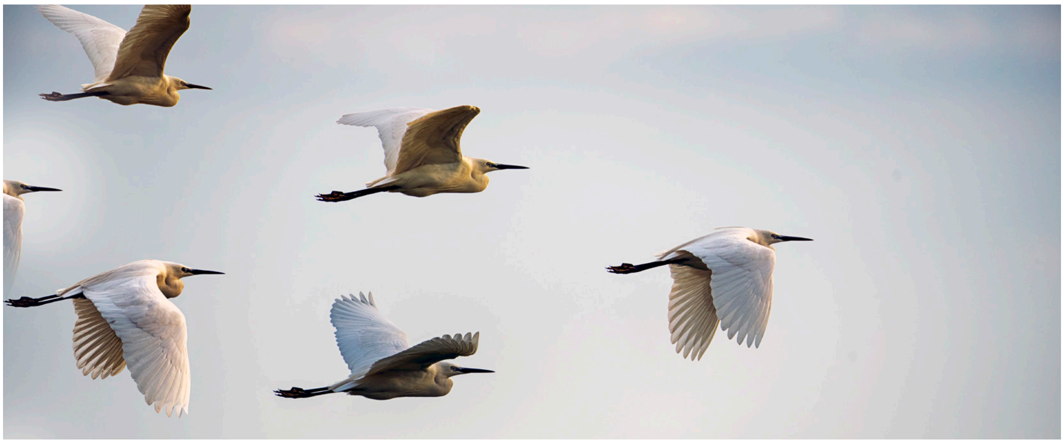
At Lombard Odier, we believe there are five mega trends that are driving the Sustainability Revolution: Demographics, Climate Change, Natural Resources, Digital Revolution and Inequality.

Within each of these mega trends, we can then map out the likely path of future development to better understand which sectors will be impacted, and how. This, in turn, allows us to identify opportunities that can be translated into investment themes. In the case of Climate Change, for example, positive investment themes include renewables, energy storage, transmission, distribution and efficiency, electric cars and smart transportation. Negative themes would include carbon-intensive natural resources, traditional utilities and other carbon-intensive activities. We find the UN's 17 Sustainable Development Goals a useful way of analysing companies' engagement with these themes.

stewardship

On top of our investment analysis, at Lombard Odier Investment Managers[3], we also believe strongly in the importance of active ownership. It offers us a means to make a positive contribution to the Sustainability Revolution, by promoting the sustainability of the companies and economies we invest in through board-level and regulatory engagement.

This is a valuable tool to help companies transition in an orderly fashion, to adapt and increase their resilience. We enter into dialogue with companies, engage with them, and use our votes to influence them towards a more sustainable operating model. We also use this dialogue to enhance our understanding of a company's sustainability, giving us an information advantage that can feed back into the investment analysis.



We believe that sustainability will be the single largest engine of the global economy in the years to come. We believe the transition to a sustainable economic model will affect every corner of the globe and every asset class in every investment portfolio. It is the largest investment opportunity in history.

We believe that sustainability needs to be approached through three main lenses: the financial model, business practices and the business model. Each one of these is a necessary condition to build a sustainability-focussed portfolio that will generate real excess return.

[3] Asset management services are not available in all jurisdictions.

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