Lazard
Global Sustainable Equity

Sustainability is at the heart of our investment process. By investing in companies that support the shift to a greener, healthier, safer and fairer world, we aim to deliver long term investment growth while contributing towards a more sustainable future.

Key Characteristics

- **Sustainability drives returns:** Sustainability is a material driver of financial productivity; we believe the future level of, or changes in, financial productivity drives long-term investment returns.
- **Unique idea generation:** Focus on the drivers of financial productivity leads to different portfolio holdings.
- **Proprietary, forward-looking sustainability research:** Analysis by sector specialists in the context of our proprietary sector-based approach to ESG-integration, *materiality mapping*[1].

LAZARD
ASSET MANAGEMENT

Sustainability issues encompass some of the greatest challenges the world faces today. The implications of climate change, pollution, and biodiversity loss alongside concerns about social inequality and health are influencing behaviour and changing how we live. We can already witness such changes: consumers, businesses, and governments increasingly consider sustainability when selecting products and services and when developing policies. As global active managers we constantly assess how these changes affect the companies and the world around us.

Over the next decade and beyond, we see this imperative for more sustainable outcomes reshaping the investment landscape. The impact will be dramatic and wide ranging, affecting demand across industries around the globe. While these shifts will be disruptive for many companies, they will be extremely advantageous for others. We see the push for more sustainable outcomes creating significant opportunities for those companies which are providing the products and services that support the shift towards a greener, safer, healthier and fairer world. Long-term structural change creates investment potential, and divergence between winners and losers provides opportunity for active investors.

As companies seek to capitalise on these opportunities, they are under increasing pressure to demonstrate the value that they create for economies, society, and the environment and to ensure they are responsibly managing relationships across their key stakeholders.

Investors should not have to choose between more positive social and environmental outcomes and investment returns. The Lazard Global Sustainable Equity strategy offers a robust investment process that can help deliver both of these objectives.

How We Identify Sustainable Companies

The Lazard Global Sustainable Equity strategy aims to invest in companies where opportunities created by the move to a more sustainable world materially drive consistently high or increasing financial productivity, whilst ensuring the companies are managed responsibly and consider multiple stakeholders.

We see sustainability, financial productivity, and responsible operations as interlinked. This relationship demands an investment approach that has an integrated perspective on sustainability and investment potential (Exhibit 1).

We use this interrelation to identify sustainable companies. To form part of the portfolio, a "sustainable" company must meet the following fundamental conditions:

Exhibit 1
Interlinked: Sustainability, Financial Productivity, and Responsible Operations

For illustrative purposes only
Source: Lazard Asset Management

1. The company provides products or services that are helping to solve the world's sustainability challenges;
2. This must materially drive either high or improving levels of financial productivity;
3. The company must be managed responsibly from a human capital, natural capital, and governance perspective.

Sustainability Drives Financial Productivity

The financial productivity metrics of Return on Equity (ROE), Return on Invested Capital (ROIC), and Cash Flow Return on Investment (CFROI) indicate how effectively a company utilises its capital to generate profits. Our investment philosophy centres on the future level of, or changes in, financial productivity as the key driver of long-term investment returns. This philosophy is reinforced by our empirical research and our successful investment track record and experience.

Snapshot

Strategy	Benchmark	Inception Date	Holdings	Predicted Tracking Error [a]	Excess Return Target [b]
Global Sustainable Equity	MSCI All Country World	1 October 2019	40 – 60	3% – 6%	200 – 300 bps annualised relative performance

a Based on ex-ante analysis. Represents forward-looking forecasts. Source: Axioma

b Target Returns do not represent a promise or guarantee of future returns and are subject to change.

With this perspective on financial productivity, we focus exclusively on two types of investment opportunities. First, we look for where a company has competitive advantages that support high levels of financial productivity for longer than the market expects and where the company has opportunities to reinvest in their business at similar returns to compound profits in the future. We call these companies "Compounders". Second, we look for where a company is working to improve financial productivity either faster than or to a greater degree than the market expects. We call these companies "Improvers".

The Lazard Global Sustainable Equity strategy invests in sustainable companies that are also Compounders or Improvers.

To form part of our portfolio, we want to ensure that sustainability is a critical element of the investment case and that it is a material driver of financial productivity. Our approach identifies the transmission mechanisms by which sustainability drives financial productivity (Exhibit 2).

Exhibit 2
Sustainability Must Contribute to Fundamental Factors

Sustainability may contribute to Financial Productivity in some of the following ways:

1. Increased total addressable market
2. Ability to gain market share
3. Opportunity for pricing power and margin enhancement
4. Reinforcement of existing competitive advantages
5. Creation of attractive reinvestment opportunities

For illustrative purposes only
Source: Lazard Asset Management

Our fundamental investment research, therefore, aims to understand sustainability challenges, how companies address them, and the impact on financial productivity. In our view, this sustainability perspective should contribute to investment performance. Long-term sustainability tailwinds can give us more confidence in maintaining consistently high levels of financial productivity and reinvestment in meeting sustainability challenges can support compounding profits over time.

We believe our idea generation is differentiated. Financial productivity directs our attention towards sustainable companies that are generating an economic profit. We look to avoid companies that offer obvious sustainable products and services with strong sales growth, but where intense and emerging competition imply an unattractive level of financial productivity over time.

During investment due diligence and discussions with company management, we can discover instances where sustainable outcomes are having a material impact on a company and its financial productivity, even though the company may not operate in an industry obviously associated with sustainability.

Applying this investment philosophy suggests that the portfolio is likely to have very different holdings and exposures compared to thematic sustainability strategies that aim for broad exposure to each sustainability or impact sub-theme. We would also expect the portfolio financial productivity to be materially different from other sustainability strategies.

Operating Responsibly

An equally important element of being sustainable is that a company must do what it can to minimise the negative externalities from their operations, by responsibly managing their business, stakeholders, and supply chains. We expect companies to meet minimum thresholds for responsible management practices across each of the key areas within human capital (employees, community, supply chain, and customers), natural capital (resource intensity and resource management), and governance. We engage with companies that have room for improvement, and our typically long holding period for investments provides us the time for impactful ownership and effective engagement. Considering these conditions, we would not expect to see investment in a number of sectors, such as fossil fuels and tobacco, which we see as in conflict with building a more sustainable world.

Integrating Sustainability and ESG into the Investment Process

As a firm we have developed proprietary tools to fully integrate sustainability assessments across our investment processes by mapping the most material risks and opportunities that companies and industries face. As active managers, we seek to understand change. Evaluating how sustainability will affect industries and companies requires an integrated fundamental analysis of opportunities, risks, and management practices. The firm's sector specialists are long-standing experts in their respective industries, with granular and in-depth knowledge. We feel they are best placed to contextualise these broad issues relative to investment opportunity. They use the firm's internally developed materiality maps to identify the most material environmental, social, and governance issues and to help frame how they affect the products and operations of a business. These forward-looking insights serve as a foundation for the firm's sustainable investing strategies.

Sustainable Investing Matters More than Ever

As behaviour changes across generations to support a greener, healthier, safer, and fairer world, sustainable investment will play an important role in allocating capital to those companies that are contributing solutions. By investing in companies that advance sustainability and identifying where sustainability drives returns, we believe we can help build a more sustainable world for future generations while delivering long-term investment growth on behalf of our clients.

Portfolio Management Team

Louis Florentin-Lee
Managing Director
Portfolio Manager/Analyst

Barnaby Wilson, CFA
Managing Director
Portfolio Manager/Analyst

Jenny Hardy
Senior Vice President
Research Analyst

Notes

1 Lazard's proprietary materiality mapping process is based on the foundation of SASB Materiality Map™.

Important Information

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Equity securities will fluctuate in price; the value of your investment will thus fluctuate, and this may result in a loss. Securities in certain non-domestic countries may be less liquid, more volatile, and less subject to governmental supervision than in one's home market. The values of these securities may be affected by changes in currency rates, application of a country's specific tax laws, changes in government administration, and economic and monetary policy. Small- and mid-capitalization stocks may be subject to higher degrees of risk, their earnings may be less predictable, their prices more volatile, and their liquidity less than that of large-capitalization or more established companies' securities. Emerging markets securities carry special risks, such as less developed or less efficient trading markets, a lack of company information, and differing auditing and legal standards. The securities markets of emerging markets countries can be extremely volatile; performance can also be influenced by political, social, and economic factors affecting companies in emerging markets countries.