Sustainable investing in 2022

Key messages:

1. Demand for sustainable investment options continues to grow among both investors and advisors
2. Sustainable investing is not homogenous; there are multiple approaches for investors seeking to align their investments with their values
3. Greenchip and Betterworld both approach sustainable investing differently, leaving room for these complementary styles to work together in most client portfolios

Event summary

The webcast featured a conversation with John Cook and Andrew Simpson, respectively lead managers of Mackenzie's Greenchip and Betterworld Sustainable Investing boutiques. We discussed the outlook and positioning of both the Greenchip and Betterworld investment mandates, two very different sustainable investing approaches albeit with complementary characteristics.

John Cook and Greg Payne co-lead the Mackenzie Greenchip Team and manage the following funds:

- **Mackenzie Greenchip Global Environmental All Cap Fund**
- **Mackenzie Greenchip Global Environmental Balanced Fund** (launched in April 2021)

Andrew Simpson leads the Mackenzie Betterworld Team and manages the following funds:

- **Mackenzie Betterworld Canadian Equity Fund**
- **Mackenzie Betterworld Global Equity Fund** (both launched in September 2021)

Our goal was to demonstrate how combining these two complementary strategies, the thematic approach of Greenchip and the core approach by Betterworld, can allow investors to participate in a sustainable future, without sacrificing returns.

Demand for sustainable investments

We discussed the remarkable growth in sustainable investment solutions over the last several years, with sustainable investment AUM in Canada reaching over $42 billion by the end of 2021.

This increase in popularity is a result of the combination of both investor and advisor appetites. Investors are looking to align their investments with their environmental and social views, with the most recent RIA (Responsible Investment Association) Investor Opinion Survey (2021) indicating that 77% of investors wanted to discuss investing sustainably with their financial service provider, but only 27% had been asked. Moreover, sustainable investing products surpassed US$3.9 trillion globally by the end of Q3 2021, more than doubling from year-end 2020.

Boutique summary

Our primary goal was to explore these two distinctly different approaches to sustainability in greater detail and show how they can be used individually or in combination.

Mackenzie Greenchip

- Thematic approach
- All-cap (cap agnostic)
- Value focused
- Centred on the environmental impact of industrialization and the Great Energy transition
- ESG (environmental, social, governance factors) screening is used as a risk mitigator and final step before inclusion in the portfolio, not as the primary identifier

Mackenzie Betterworld

- Core approach
- Large-cap (predominantly)
- Growth focus
- The strategy is comprised of "best-in-class" ESG leaders across most sectors of the economy with a list of very specific exclusions
- The team leads with ESG as the first step in their investment process and prior to deeper fundamental analysis

<u>Mackenzie Greenchip investment universe</u>

John Cook mentioned that almost everything related to environmental investing is related to energy. It's important for investors to understand the breadth and complexity of our energy industry – with a proprietary universe of over 800 companies and over $13 trillion in market cap in the space that Greenchip covers. The team breaks down the 800+ company universe into six main environmental sectors:

1. Clean energy
2. Energy efficiency
3. Clean technology
4. Sustainable agriculture
5. Water
6. Transportation

Mackenzie Greenchip investment process

- Within the 800+ companies in the initial universe, the team is looking for high-quality companies at the right price
- Extensive due diligence is conducted on the top 150 names
- ESG is utilized to make final decisions for selection into the portfolio
- The main portfolio will generally be comprised of 30-50 stocks while being sector and market cap agnostic

Growth of solar and comparisons to wind

- Solar has a better growth trajectory in the team's view, the sun is more predictable in certain parts of the world than wind. It is also easier to put panels on rooftops, whereas wind tends to be much more industrially focused and installed with larger scales in mind.
- Chinese solar stocks have historically been undervalued in comparison to their North American competitors. Daqo and Jinko recently listed in China, and this has resulted in upswings in their North American listings as well. The team views dual listings favourably.
- The fundamentals driving wind right now are far more expensive than solar. Installations tend to be longer-term and much more labour and material-intensive. For example, it is much more expensive to install offshore wind turbines than a solar farm.

Electric vehicle (EV) demand and metals inflation

- The most efficient way to move people is with trains and buses, not private cars. EVs represented about 8% of car sales last year, however, the team does not believe that number will hit 16% this year.
- Global battery prices need to be about $100/kWh or less for mass adoption to occur. At around that point, EVs have a great shot at overtaking the internal combustion engine.
- Battery prices for the automakers right now are still quite expensive. The team participates in this area with a heavier focus on the actual materials and components within the car.

Mackenzie Betterworld investment universe

The team starts from the broad S&P/TSX composite for the Canadian fund and the MSCI World for the global fund, creating an initial universe of around 1,800 companies. From here, they apply exclusions and then whittle down eligible companies until they feel they've identified ESG leaders across various sectors.

Mackenzie Betterworld investment process

Andrew Simpson stated that the team has a proprietary process that focuses on what they call the four As:

- **Avoid**: Companies operating under controversies or in industries generating revenues from unsustainable businesses. Fossil fuels, tobacco, alcohol, weapons, pornography, nuclear energy, and private prisons are all excluded. **Facebook** was given as the example of a company that has not done enough to prevent hate speech and misinformation on its platforms and is thus excluded from the portfolios.
- **Assess:** Focusing on ESG leaders within the team's investment universe and the ability to generate positive impact from a company's products and services. **Savaria** was given as an example here; it manufactures accessibility and mobility products. The 60+ population in the world is expected to double by 2050 and this company could benefit from this trend with the products and services they provide.
- **Analyze:** Screening out negatives, adding positives, and then using traditional fundamental analysis to determine what each company's potential upside will be over the coming three years.
- **Advocate:** From an approximately 400-company universe, the team selects 40-45 companies for Canada and 60-65 for the global fund. However, ESG analysis shouldn't stop once the investment is made. The team wants businesses to align their revenues with the UN Sustainable Development Goals. The team are not activists, but rather advocates. The team believes that engagement is very important for investment managers and will become more so in the coming years. The team does not outsource any engagement work. Doing it in-house helps the team manage ESG risks more effectively. **Vodafone** was an example given here as a company from South Africa that provides banking services via mobile phones. This makes financial products and services accessible to individuals who otherwise may not have access.

Meaningful differences in sector allocations

- The speakers highlighted how these strategies are very different from each other and can be effectively used together in investment portfolios. None of the funds have any exposure to the energy sector.
- In discussing some of these differences, John Cook highlighted that wind falls under industrials and solar currently falls under technology. The Greenchip products will generally have an overweight to industrials, materials, and utilities but have no exposure to health care, financials, and consumer technologies.
- Andrew Simpson stated that the Betterworld team wants best-in-class exposure across various sectors while still being fossil fuel-free. Investing in companies that contribute to good health and wellbeing is a great way to do this. **Costco** was the example here. Some of the things that the company is doing are training and advancement for women, detailed supply chain reviews, less packaging for their products, and more focus on recycling.

The key point here, Greenchip and Betterworld both approach sustainable investing differently, leaving room for these complementary styles to work together in most client portfolios.

Carbon footprint and WACI

- Weighted average carbon intensity (WACI) is essentially the amount of revenue generated by a company's direct and indirect emissions.
- John Cook mentioned that electric arc furnaces (EAF) can produce steel with a WACI score of just 20% that of traditional blast furnace steel. Higher exposure to industrials, materials and utilities – which will have higher carbon emissions in the near term – are the reason why the Greenchip funds have higher WACI scores than their benchmarks. However, the world needs to get dirty in the near term to get clean in the future.
- Andrew Simpson stated that the WACI measurement is a tool for the team to help them make decisions and look for opportunities to decarbonize. It's an area where they also conduct a great deal of engagement – the example here was financial services and the financing of carbon-intensive projects.

The key point here, the Betterworld strategies are "core" and WACI is one of the metrics that investors absolutely should measure these strategies by. The measure is less relevant for a "thematic" strategy, with its overweight to the carbon-intense sectors that John Cook discussed.

Regional diversification benefits

- Andrew Simpson mentioned that the Betterworld team tries to position the portfolio for strong earnings growth. The team has a growth bias so it will have a slight bias towards the US at most times. The team could be considered as a more sustainable proxy to the MSCI World.
- John Cook stated that since inception, the Greenchip team has been underweight US while being overweight Europe and Asia – this has been the case for 15 years and is unlikely to change in the near future. European and Asian companies tend to be better run in the thematic environmental space. The team's funds have historically been very different from most other products not only in the traditional space, but also within the ESG or sustainable space. He believes this will continue.

Public Q&A

How are the supply chain issues affecting this space? For example, material costs and supply chain issues in the solar sector?

- *John Cook*: Input costs, such as those for polysilicon, are so much more than they used to be. Additionally, the chip shortage doesn't affect just cars – it will affect various industries and sectors.
- *Andrew Simpson*: In addition to agreeing with John's main points, he says the cost of power purchase agreements (PPAs) has gone up. But this isn't necessarily bad – he mentioned this could be an indicator of how companies are trying to behave more sustainably.

Renewables pulled back quite a bit last year. What's your outlook for 2022?

- *John Cook*: In 2021, solar increased from 141 to 180 gigawatts, wind also increased. There was a big run-up in 2020 and we had a bit of a reset in 2021, especially for the pure-play power producers. Lots of fantastic opportunities in some of the integrated power producers based in Europe.

How much of an impact does the "S" or social factors really have on company valuations?

- *Andrew Simpson*: they have become readily apparent and applying a stakeholder lens has become increasingly important. Six stakeholders (shareholders, employees, customers, suppliers, community, and the environment) should be considered that are not often captured in financial statements. Do companies have paid sick leave? How are they treating employees through the pandemic? Customers will vote with their wallets and buy elsewhere – which will impact share prices.

What keeps you up at night? What are the biggest risks in the market?

- *John Cook*: Worried about geopolitics – it seems we're in a pickle in Eastern Europe as well as with the ongoing US vs. China issues. Inflation is a bigger concern and is much more ingrained in our economy due to underinvestment in critical parts of our infrastructure. This could result in long-term issues.
- *Andrew Simpson*: Inflation is a concern, however, climate action is also a big concern. There's a gap between what needs to be done and what is being done. He gets worried that the pace has slowed more than expected.

What has you excited for 2022?

- *John Cook*: Well-positioned right now. The ability to produce food in a sustainable way, energy in a more sustainable way, will be increasingly important. Feels like price is on the team's side but that 2022 will be a difficult year.
- *Andrew Simpson*: Excited about regulation. What makes a true ESG-focused fund? There are a lot of different views. Helping investors identify the right solutions and provide clarity will be good for everyone associated with the markets and he feels they will be on the right side of that.

Summary

Host Mike Evans closed with a summary on the quality of our management teams and highlighted three things: experience, performance, and the complementary nature of the strategies.

- **Experience:** Both John and Andrew are pioneers in the space and were focused on ESG long before it become the "latest investment trend." The authenticity of the boutiques was emphasized: John Cook co-founded Greenchip in 2007 while Andrew Simpson first started investing with an ESG lens over 20 years ago.

- **Performance:** Both managers have achieved the highest level of accolades possible from an investment lens. The Greenchip team just recently received the 5-star rating for the Mackenzie Greenchip Global Environmental All Cap Fund in November of 2021 when they crossed the three-year mark.
- **Complementary strategies:** With trillions of dollars required annually to make meaningful change a reality, investment opportunities abound. By combining these two boutiques, the Mackenzie Greenchip "value-focused" thematic approach centered on the Great Energy Transition, and Mackenzie Betterworld's core approach to large-cap growth through an ESG lens, can both play an important role in your client portfolios.

The suggested ranges for portfolio construction ideas are highlighted below:

Fund	**Mackenzie Greenchip Global Environmental All Cap Fund**	**Mackenzie Betterworld Canadian Equity Fund**	**Mackenzie Betterworld Global Equity Fund**
Range	5-15%	20-30%	30-50%