Sustainable Investment Report

First quarter 2020

Marketing material

Environmental, Social and Governance
is referred to as ESG throughout

Schroders

Contents

As the unprecedented Covid-19 situation evolves day-by-day, we all feel the effects. As investors we must navigate the immediate challenges, but we must also not lose sight of the long term. Ultimately, what matters most is identifying the investments that with both survive this period and thrive in the long term.

Hannah Simons

Head of Sustainability Strategy

As we prepare the first report of 2020, I'm settling into my new daily routine. My regular commute on a packed train has been replaced with a short walk to my kitchen table. A much welcomed change. I'm also home-schooling my children. I have often thought that one day I would follow in Lucy Kellaway's footsteps and retrain as a teacher. This experience is reminding me that teaching is not as easy as you might think, although I am rather enjoying the output from our daily food tech classes. These distractions are a welcome break from the daily counts of new cases and of course the updated number of deaths.

Markets have reacted violently to the spread of Covid-19, with massive daily swings in asset prices. It's easy to focus on this constant stream of news, but as long-term investors we must look beyond this and consider some of implications further down the line. In our first two articles we consider some of the investment repercussions of Covid-19. Andy Howard, Head of Sustainability Research, looks at the rise of environmental and social challenges and how these increasingly represent financial risks. Peter Harrison, our CEO, emphasises the need to think long term, for both companies as they navigate these challenging times and us as investors supporting them. The stakeholder perspective is critical for companies in terms of focusing on their employees, customers and suppliers rather than short-term profits.

As environmental, social and governance risks (and opportunities) are increasingly being considered alongside traditional financial risks, we must be able to distinguish between those companies that are true leaders and those that simply tell a good story. "Greenwashing" isn't always easy to spot; Simon Webber, Portfolio Manager, Global Equities, shares his thoughts on what to look out for.

In the near term, we recognise that Covid-19 is putting pressure on the profits of the car industry but new European emissions regulations look set to disrupt things in the longer-term. Scott MacLennan, Fund Manager/Research Analyst European Equities and Nicholette MacDonald-Brown, Head of European Blend Equities, discuss how the new regulations present both challenge and opportunity. This highlights the importance of being able to adapt if a company wants to survive and thrive in the long run.

Urbanisation continues at a rapid pace; cities that can attract investment from companies will see continued growth in popularity. The Schroders Global Cities Index, now in its fifth year, rates cities around the world to identify those most economically vibrant. We share the latest rankings which now include an Environmental Impact Score. This has led to a few changes in the relative positioning of the leading cities. For example, Stockholm entered the top 30 for the first time. We also saw all of the Chinese cities tumbling out of the top 10.

As active owners of the companies we invest in we seek to actively monitor behaviour to ensure they are managed in a sustainable way. Our active ownership spans the entire spectrum from the everyday conversations we have about the business environment, to our voting and engagement activities. As the 2020 voting season gets underway, Daniel Veazey, Head of Corporate Governance, provides an overview of some of the key trends and issues we expect to materialise. We've also made some changes to the way we present our engagement activities. We hope the new format will help you better understand the range of discussions we have with companies. We also share an in-depth case study of a recent engagement.

We hope you find this report informative and insightful. Please keep up with our latest research on a range of topics from our dedicated sustainability web page.

Sustainability Insights

How coronavirus is turning the spotlight on sustainable investing

The unrelenting march of the coronavirus reminds us that environmental and social problems are increasingly clear financial risks that investors need to manage appropriately.

Andrew Howard
Head of Sustainable Research

It is difficult to start any article without referring to the threat presented by the coronavirus sweeping across countries. The human impacts are clearly devastating for anyone affected, even if the overall impact is small in the context of major pandemics through history.

The economic and financial impacts are also proving significant. Less than two months after the first reported case, the OECD lowered its forecast for global GDP growth in 2020 by one-fifth in response the virus.

The speed and scale of downturns in stock markets mirror this response. Since the 1970s there have been four periods during which global equities have fallen more than 10% in five days; the 1987 crash, the 2008 global financial crisis, the 2011 Eurozone crisis and the first few months of 2020.

That market response contrasts with the effect of similar crises in the past. Notably, major equity indices rose while Spanish flu raged in 1918-19; the end of the Great War provided a boost but stocks were relatively unaffected even before its end.

The world is a very different place to that of 1918, or even that of a decade ago when the spread of swine flu coincided with a 40% rise in the Dow Jones Industrial Average.

Companies are more dependent than ever on the licenses to operate society provides, supply chains are more complex and connected than ever, social and environmental tensions are more acute than in the past, and regulation is accelerating to address growing imbalances between corporate success and social needs.

Companies don't operate in a vacuum

The changing backdrop underlines the importance of sustainability to the investment industry. If they ever did, financial markets no longer exist in isolation from social or environmental challenges. Companies' fortunes are intrinsically tied to their ability to navigate changes in the societies on which they rely.

We have long argued that companies don't operate in a vacuum. Their success reflects their ability to adapt to challenges and trends in the societies to which they belong. That is more true now than ever; social and environmental challenges, and investment drivers, are increasingly overlapping.

As a result, environmental and social problems are increasingly clear financial risks, moving up corporate agendas to drive long-term strategy and growth plans. As investors, our ability to examine companies and separate winners from losers has improved as corporate sustainability reporting has become mainstream.

Boiling points ahead

A spectrum of social and environmental pressures will reach boiling points in the next decade, for example, looking beyond the current crisis:

– **Climate change will either reshape the physical environment or the global economy**. The International Panel on Climate Change has warned that we have a decade to roughly halve global greenhouse gas emissions. Failure to make a significant move away from fossil fuels will tie the world into escalating physical damage, rising sea levels, less agricultural land and more volatile weather. In the 1960s, emissions were half of what they are today. Returning to that relative level by 2030 - when the world's population will be more than twice as large and its economic output roughly ten times bigger – will require capital reallocation on a huge scale and drive disruption across every industry.

– **Technological advances will reshape the role of workers**. PwC estimates that artificial intelligence could put 30% of jobs at risk by the 2030s, demanding new skills and rendering existing roles redundant. Changes comparable to those which played out over centuries during the industrial revolution will be forced into less than a generation.

– **Social unrest puts political stability and economic systems at risk**. Social unrest has already reached unprecedented levels across the world. Pressures that have been building over the last decade are spilling into breaking points in developed economies as well as emerging. Policymakers can either respond by taking steps to rebalance the economic playing field that has created uneven economic gains, or have changed forced upon them.

Any of these trends alone will have a major impact on economies and industries. Together they represent a cocktail that could reshape stock markets and redefine the investment industry. Understanding those trends and aligning investments to them will be vital. Sustainable investment is becoming a requirement, not a choice.

SustainEx: our innovative investment tool

Growing impacts also demand innovative thinking and more robust investment tools. Off-the-shelf ESG ratings, subjective assessments and lazy rules of thumb have to be replaced by new approaches. This will involve everything from defining and assessing corporate sustainability, to quantifying and comparing companies, to building portfolios and helping investors understand the impacts their portfolios have.

For our part, we have invested heavily in developing tools to help our analysts, fund managers and clients navigate the turbulence ahead. Last year, we detailed the SustainEx framework we have developed to quantify companies' social and environmental externalities, putting a monetary figure to the positive and negative impacts companies have on society. We have rolled that framework out across over 10,000 companies, providing an objective basis on which to assess impacts and risks through an economic lens.

The pendulum is swinging back

That journey will continue. The investment industry became increasingly focused on dissecting financial data for much of the last few decades, emphasising measures of how much money companies make, over how they make money and how sustainable those profits will prove. The pendulum is swinging back; asset managers need to refocus their investments lenses now more than ever.

Sustainability Insights

How the investment industry can help during the Covid crisis

A long-term approach is now more vital than ever, says Schroders' CEO. Companies should be supported - but with conditions.

Peter Harrison
Chief Executive Officer

The measures designed to slow the spread of the Covid-19 pandemic will test the finances of individuals and companies to breaking point in the months ahead.

The asset management industry will face its own test. It's a practical test of how we can support otherwise healthy and viable businesses. It's also a philosophical test of whether we are true long-term investors.

As custodians of savers' money, it is the role of investment managers to allocate capital to companies with long-term, sustainable business models.

But even the most forward-thinking of companies are today facing unprecedented short-term shocks. For some, it will threaten their survival.

How do we act?

One thing is clear. There are many, many great businesses that were delivering value to shareholders in the run-up to this crisis. It's imperative for the future wealth of the savers we serve that these businesses are not lost due to the extraordinary events that now surround us.

Fund managers can help with this. As an industry we should be holding honest and open conversations with company management teams on the problems they face. We should be working together to seek inventive solutions.

I would encourage companies to talk to us. I have also asked our portfolio managers to open these critical conversations with companies as we attempt to identify the most pressing challenges. We will talk, individual to individual, to solve them. I have no doubt that some of those solutions will be highly creative; they will only be reached with this sort of human interaction.

In contrast, the shortcomings of mechanised trading will come into sharper focus. The answers will not be conjured up by arms-length algorithmic investment management.

We must work together

Equally, fund managers cannot solve this alone. We must work together with governments, with other shareholders and with banks. We can be supportive when it comes to equity raising for companies, but it only works if the authorities are involved, as well as lenders. Like us, they must also apply imaginative thinking.

Much is at stake. The livelihoods of millions of people will be affected by how we act in the coming months.

I see it as our role to reject short-term opportunists who are seeking to capitalise on price distress. Companies with strong long-term prospects should be supported.

But this support is not offered unconditionally

First, all measures of support should be carefully targeted. As representatives of asset owners, it is incumbent on us to ensure, for example, that well-intentioned help secures the future of employees rather than executives.

The companies receiving support must demonstrate the strength of their social contract with stakeholders. If investors are demonstrating flexibility, company executives should do the same in how they treat employees, suppliers and customers alike. We will be watching closely and actively engaging where necessary.

Secondly, we have a responsibility to help deliver long-term returns for the savers we represent. This is not achieved by handing capital to businesses that have not addressed fundamental weaknesses in their models. That rule must never change.

All stakeholders will inevitably face some pain. Investors have already faced falls in the value of their equity investments. It is inevitable that many companies will also need to suspend dividend payments – perhaps even those that have already been declared.

Despite the intensity of events in the here and now, this is the time for long-termism. Schroders has survived many market crises over its 216-year history by following that philosophy.

Our responsibility today is to ensure industries are supported, that they aren't engulfed by short-term turbulence. Long-termism must win out.

This perspective first appeared in the Financial Times.

An investor guide to spotting "greenwashers"

Greenwashing is the act of misleading consumers about the environmentally friendly qualities of specific products and services. Increasing corporate action to address climate change was a major positive of 2019, but distinguishing real "low carbon leaders" from "greenwashers" takes skill.

Simon Webber
Lead Portfolio Manager

One of the real positives in 2019 was the wave of corporate attention and action on climate change. Reflecting growing concern among customers and employees, many companies have announced ambitious pledges to play leading roles in the transition to a low emission economy.

Making the transition to a low carbon – and within 50 years or so zero carbon – global economy will require huge changes in every corner of the economy and markets. Companies have to plan for comprehensive changes in their own operations, supply chains and customer behaviour.

As scrutiny on companies' climate credentials rises, there is an understandable temptation to pull out headline-grabbing tricks while dodging tough strategic decisions. Given our focus and long experience on investing in genuine "low carbon leaders", we have developed an antenna for this "greenwashing".

Here's a quick guide to some of the key things we look for when assessing company plans:

1. An ambitious long-term goal

An ambitious long-term plan that is consistent with the Paris Climate Agreement goal is critical to guide long-term capital allocation and strategic investments. The plan must have had board level scrutiny and approval, and be regularly focused on by the board.

2. Aspirational, but achievable, interim targets

20-30 year targets can be ineffective (or worse, lead to a reduced sense of urgency) unless backed up by interim targets that can act as stepping stones to the long-term goal. These interim targets must be consistent with the long-term goal, and it is critical that management are incentivised and held accountable to achieving these targets.

3. Focus on achieving real emissions reduction, not relying on offsets

Carbon offsets can be a seductively easy way for individuals or companies to convince themselves that they are doing their bit. They do have a place, provided they are viewed as a temporary mechanism or are seen as a "final step" after stringent efforts to reduce emissions as far as possible.

However, they can sometimes be an excuse to continue with business-as-usual, creating an economy of rising gross emissions with the misplaced hope that offsets will eventually stem the damage. Offset programmes such as tree planting are not of equivalent value to an avoided emission. A tree takes 30 years to mature and actually store the promised carbon. In contrast a CO2 emission today has an effect today - and for each of those next 30 years - until it is fully captured by the tree.

Secondly, there is less than 100% certainty that a planted tree will remain in place in the decades ahead. Natural disasters such as fires or drought over the maturation period could undermine the forest growth and carbon storage. Use of land for forestation can also lead to deforestation elsewhere unless the system is very carefully administered.

When we are evaluating company action plans, we look for real progress and a plan to eliminate the direct emissions of the company, not a reliance on offsets. To be clear, reforestation and carbon removal projects are absolutely essential to the fight against climate change, and offset programs do create an important source of financing for these initiatives. But this is quite different from the challenge of reducing gross greenhouse gas (GHG) emissions. That is where the focus of quality emission reduction plans should be.

Types of greenhouse gas emissions

Scope 1 emissions	All direct emissions from controlled operations of the company
Scope 2 emissions	Indirect emissions from electricity purchased and used by the company
Scope 3 emissions	All other indirect emissions, including from supply chain and use of products sold by the company. These are often the largest source of GHG emissions for a company.

Why not all carbon footprints are created equal

In some industries a low carbon footprint is much more valuable as a competitive advantage than others. In fact, while it might seem counterintuitive at first, it is the emission-intensive industries where a low carbon footprint is often most valuable.

For example, if we look at two financial companies – one of which has switched to using renewable-only electricity and one that has not – the former has a significantly lower carbon footprint than the latter. However direct Scope 1 emissions for both companies remain the same and profitability is not materially affected because electricity use is not a major cost item for either company.

Furthermore, the main climate change impact for an investment company or bank is in the climate exposures of the companies they invest in or lend to. So the point here is that the Scope 1 and 2 emissions on which most investors focus (because they are disclosed and available) can be relatively easy to cut but often give little insight into the risks that certain companies face.

As another example, operators in the European aluminium industry used to get their carbon emission allowances for free, but soon will have to buy more of them on the market at the EU Emission Trading Scheme's price; currently ~€25 per tonne.

If one aluminium company produces 10 tonnes more CO_2 for every tonne of aluminium than a competitor (which frequently happens in global aluminium production) it will pay €250 more per tonne. €250 is more than 10% of the selling price of aluminium, which could easily wipe out the entire profitability of an aluminium producer.

There is also no way to recover this carbon cost. Carbon intensive capacity must either be shut down, or investment must be made in completely new production in order to compete. If the carbon intensive company cannot afford the new investment, the shut down of the old plant will transfer volumes to the carbon-conscious producer with the cash flow and profitability to expand. So in some industries a low emission profile can be a clear competitive advantage.

Scope 3 emissions are currently not measured or reported well, yet can be very important. A car company that has invested over the last 10 years to develop a strong range of electrified vehicles (EVs) may have a similar manufacturing carbon footprint to its competitors, but the products it is now selling result in considerably smaller Scope 3 emissions from the use of the cars by customers.

Indeed, profitability in the companies that haven't invested is probably higher today but they have completely inadequate product portfolio preparation for a surge in regulation and consumer demand towards EVs. Only the company that has invested has a strategy that is consistent with the energy transition ahead.

Lasting, meaningful change

The examples above are simplifications to make a point, and of course many companies have versions of each going on internally. As investors, we need to assess how the companies we hold are investing to manage their emissions exposure.

Firstly, we analyse the quality of the company's long- and medium-term targets. Then we look for evidence of sustained research and development spending on low emission technologies and products. We look for board level commitment to maintain leadership on climate change, and capital allocation decisions that back up the stated policies and goals.

All of these factors come together to help us understand where a company will stand in three, five and 10 years' time. We ask if they can develop true competitive advantage from these investments, and not just what today's carbon footprint snapshot shows us.

Sustainability Insights

Will CO2 rules choke car industry profits?

Europe's car industry needs to tackle the huge challenge posed by new emissions regulations. But for those who do, it's a major opportunity.

Scott MacLennan,
Fund manager

Nicholette MacDonald-Brown,
Head of European Blend Equities

The commitment to limit global warming to 2 degrees is the greatest challenge of our time. If we're going to meet it then we need to cut harmful emissions from industry, and we need to cut them fast.

Transportation is responsible for roughly 30% of carbon emissions, and roughly a third of that is due to passenger cars. Strikingly, this is equivalent to emissions from coal-fired power stations, which are being phased out in many countries as a result.

Public concern about climate change is on the rise. It is no longer something that can be ignored by companies, regulators, or investors. The chequered recent history of the car industry means that it is a prime target. Putting the industry on a more sustainable footing is crucial, both for the future of the planet and for the companies themselves.

What are the new emissions targets?

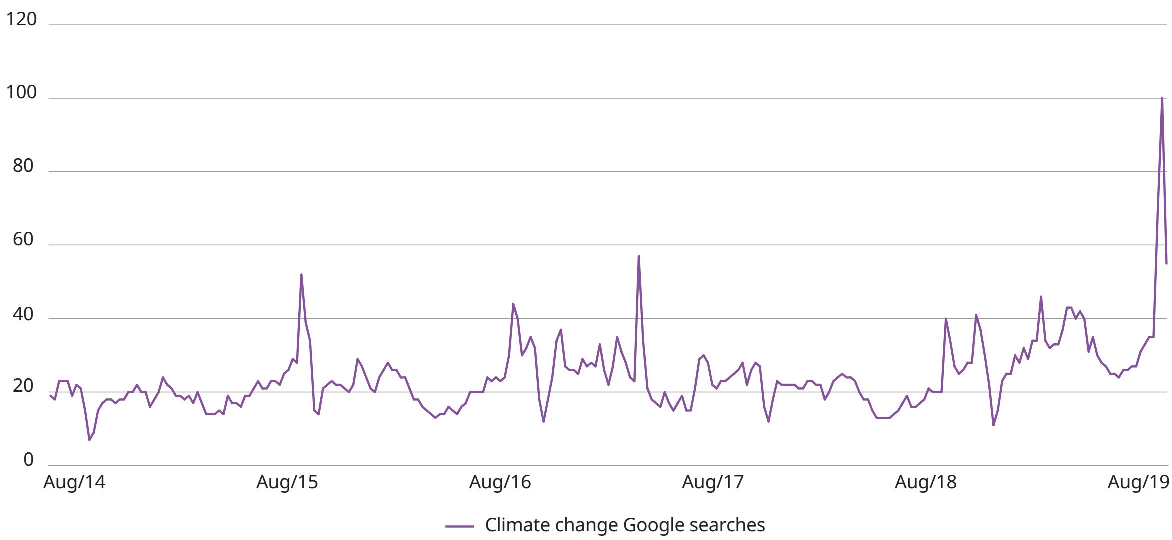
The regulators of car companies clearly agree and want carbon dioxide (CO2) emissions to fall. Our challenge as investors is to try and understand whether this is an opportunity or threat to companies' growth and profitability.

The new rules set car companies an emissions target of 95g of CO2 per kilometre. This is for 95% of their fleet as of 2020, and 100% of the fleet as of 2021. For comparison, this is 20% below the 120g per kilometre sector average from 2018 (find out more here).

Those who do not comply will face fines of €95 per gram over the target, multiplied by the number of cars sold in the EU.

The regulation is designed to encourage ongoing innovation in cleaner powertrains. The standards tighten over time and are currently expected to reach 60g by 2030. This means car companies have to halve 2018 emission levels by 2030.

Public interest in climate change is on the rise



Source: Google trends, as at 1 October 2019. CS2092

How are car makers reacting?

The recent Frankfurt Motor Show showed that companies fully recognise the need to comply with the new regulations. But almost every European car maker has a different plan to tackle the task ahead.

Volkswagen (VW) has been the most proactive. It is putting its focus on pure electric vehicles (EVs) and aims to sell 500,000 EVs in 2020 to achieve CO2 compliance. This is the most commercially significant response of the European car makers to the new regulations.

It's heartening to see VW embrace the challenge, given its role in the 2015 "dieselgate" scandal. That resulted in index provider MSCI downgrading VW's sustainability rating to CCC – the lowest there is. But VW's focus on EVs shows that lessons have been learned and changes are being made.

We feel it is important to identify those companies improving their sustainability, not just the ones who are already "best in class". Only by supporting change can we hope to achieve global climate targets.

VW sells 10 million cars annually; its sheer scale means it has the capacity and deep pockets to make a significant investment in EV production. Other companies are making use of VW's platform and expertise; for example, Ford is planning to use VW's technology to build an EV for the European market.

Meanwhile, **BMW** is largely relying on plug-in hybrid electric vehicles (PHEVs). These are a better fit with its existing business, both in terms of what its customers want and in terms of technology investment that BMW has already made.

Companies are keen to protect pricing, with firms such as Mercedes-owner **Daimler** balancing the demands of profitability with the potential for fines or the need to buy carbon credits. Others in the industry may consider mergers; it could make sense to merge to gain access to another firm's EV capabilities rather than invest in a whole new platform.

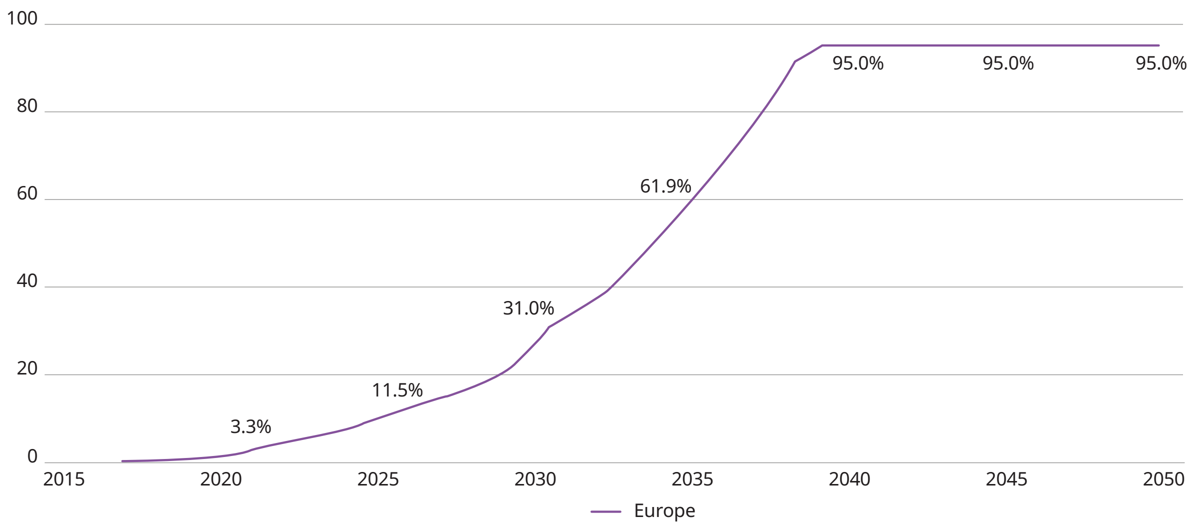
What next?

Car companies and investors have to debate several questions, with sometimes contradictory answers. On the demand side, will customer tastes move away from high emission SUVs in favour of EVs? And if so, when? What type of vehicle should car makers produce – pure EVs, hybrids, or traditional internal combustion engine cars?

And the big question for both the car companies and investors is: what is an acceptable profit margin? Currently, EVs are loss-making but the economics are starting to change. Many firms have already made big investments in EV technology. They can start to draw the benefit of that as demand grows, supply chains are created, and economies of scale come into play. On average EVs are expected to reach breakeven in terms of profits in 2022/23.

Electric car sales expected to rise dramatically in Europe

Europe battery electric vehicle estimated sales penetration (%)



Source: Morgan Stanley Research, 2019. CS2092

The new regulations speed up the changing economics for the car companies. For example, VW's Golf actually becomes unprofitable once the CO_2 impact is included whereas the ID (a battery electric vehicle) would see its profitability soar when adjusted for carbon.

It's clear that this is a period of rapid change for the industry. It's impossible to be precise about timings but over our lifetimes the type of cars sold is likely to change dramatically.

What is the impact for investors?

The car industry is becoming a case study for reducing CO_2 emissions. The transition from a dirty industry to a clean industry in a short space of time is without doubt the greatest challenge facing the car makers. The prospect of fines and having to invest in EVs potentially poses a short-term threat to profits. However, this transition is also an opportunity and those car makers who can adapt their businesses for the long term should thrive.

Take-up of EVs is one of the metrics tracked by the Schroders Climate Progress Dashboard, which monitors whether we're on track to limit global warming to two degrees. Progress is better than in many other areas but it's clear that there is still more to do and we hope these new CO_2 regulations will make a difference.

The regulations come as a welcome reminder that companies have to consider the needs of all their stakeholders. Shareholders are one part of this alongside employees, suppliers, regulators, government, and the environment. These new emissions targets, and the threat of fines, reflect the increasing willingness of regulators to make companies pay for the side-effects, or "externalities", that their operations have on others.

As investors, we believe we should be attempting to capture the value of these externalities, positive or negative, in a company's valuation. A negative impact potentially poses risks to profits, reputation and ultimately share price, while a positive externality is a beneficial impact which falls outside typical financial analysis. Our proprietary ESG investment tool, SustainEx, helps us to identify and measure those risks and reflect them in our investment decisions. This means we are as prepared as possible for the uncertain future ahead.

How sustainable are our cities?

Tom Walker
Co-Head of Global Real Estate Securities

Every year, the Schroders Global Cities team produces an index that ranks over 900 cities by their economic strength. Traditionally a city's ranking would be decided by a combination of an Economic Impact Score (EcIS) and a University Impact Score (UIS). In 2019, the team introduced an additional measure: an Environmental Impact Score (EIS) to quantify which cities have the lowest environmental risks based on three aspects. Firstly, the score considers the 'physical' risk to a building from earthquakes, landslides etc. Secondly, it looks at the 'well being' risk to humans from polluted air or water. Thirdly, it examines the 'policy' response of that national or city government.

Changing the methodology to include an EIS has affected the ranking of a few cities. Most notably it has seen Stockholm move up 17 places to enter the top 30 (the first Scandinavian city to do so) while Chinese cities like Beijing and Shanghai now rank lower than they did previously.

LA and London retain the top two places

Los Angeles (LA) retained its position at the top of the index for the fourth year in a row. But its overall score slipped because of a mediocre EIS. London holds on to its number two position, despite Brexit concerns. The UK's financial centre continues to attract multi-national companies, is home to outstanding universities and received a good EIS.

Stockholm: A trailblazer in developing sustainable urban policies

From an environmental perspective Stockholm has one of the strongest scores within our database. This is as a result of both strong policies and good fortune. Stockholm is fortunate in that there is a low probability of 'physical' and 'well being' risks. In addition, it is clear from the various national goals set by the Swedish government that there will be a strong score for 'policy'.

Sweden's capital has long been committed to reducing its environmental impact, with carbon dioxide emissions cut by 25% per citizen since 1990. In November last year, the city was presented with the Smart City 2019 award at the Smart City Expo World Congress for its GrowSmarter project, which is a public/private partnership that aims to promote green solutions in areas such as energy, infrastructure and mobility. Stockholm has also outlined a series of ambitious climate goals. These include the aim to be the first climate positive city in the world by 2040, despite being one of Europe's fastest-growing capital cities.

Apartment blocks in the city have been refurbished to reduce their impact on the environment. The city also promotes the use of electric cars and bicycle-sharing schemes to cut pollution. An innovative new waste management system, which uses high-pressure underground tubes to transport the waste to a single collection centres, means there are fewer garbage trucks on the streets.

Stockholm is also attempting to use energy waste, such as the heat produced by the city's many data centres, to heat homes and businesses. The initiative, which also uses energy waste from supermarkets and crematoriums, was used by the city's district heating network to heat 30,000 apartments in 2019.

Chinese cities down but not out

Chinese cities fared less well on EIS, causing them to fall in the rankings. Although Beijing and Shanghai score poorly on air and water quality, they still hold positions in the top 20 (19 and 20 respectively), given their high ratings in the other impact scores.

Schroders remains extremely optimistic for Chinese cities; we expect their EIS scores to improve over the coming years as they convert to low emission fuels, but this is not yet reflected in the data. While China's greenhouse gas emissions are approximately 27% of the world's total, they are lower on a per capita basis than the US. We believe the transition to renewable energy from coal and the increasing utilisation of electric vehicles are two examples where emissions from Chinese cities will decrease at a fast pace.

Cities are big emitters

Cities are responsible for more than 70% of global CO2 emissions so they clearly have a significant role to play in the transition to a low carbon world. But they are also innovation hubs and the source of some of the world's greatest ideas. We think cities will undoubtedly provide the ideas and policies to reduce climate change. How they respond to the demands of rapid global urbanisation, as well as environmental and social concerns, represents both a challenge and opportunity for policymakers, residents and investors.

Top 30 global cities ranked by economic strength

Rank	City	Country	Rank change
1	**Los Angeles**	**US**	– 0
2	**London**	**UK**	– 0
3	**Hong Kong**	**Hong Kong**	– 0
4	Boston	US	↑ 1
5	Seattle	US	↑ 10
6	San Francisco	US	↑ 3
7	Sydney	Australia	↑ 4
8	Chicago	US	↓ 2
9	New York	US	↓ 5
10	San Jose	US	↑ 3
11	Houston	US	↓ 1
12	Melbourne	Australia	↑ 2
13	Singapore	Singapore	↓ 1
14	Paris	France	↑ 3
15	Atlanta	US	↑ 1
16	Toronto	Canada	↑ 3
17	Washington	US	↑ 1
18	Austin	US	↑ 7
19	Beijing	China	↓ 11
20	Shanghai	China	↓ 13
21	Brisbane	Australia	↑ 9
22	Dallas	US	↓ 2
23	Perth	Australia	↑ 13
24	San Diego	US	↓ 3
25	Baltimore	US	↓ 3
26	Minneapolis	US	↑ 5
27	Manchester	UK	↑ 13
28	Philadelphia	US	↓ 2
29	Stockholm	Sweden	↑ 17
30	Miami	US	↓ 6

Source: Schroders
Any references to countries are for illustrative purposes only and not a recommendation to buy and/or sell.

Stewardship Insights

Proxy voting: 2020 pre-season trends

With the mornings getting lighter and the weather getting colder, it can only mean one thing: the busiest period of the year for investors is upon us. Proxy voting season.

Daniel Veazey

Head of Corporate Governance Analysts

We've spent the past year engaging with companies globally on subjects ranging from diversity and board experience to remuneration and how it aligns with shareholder experience. These discussions weren't always company specific so we have detailed below the trends we noticed in our discussions with multiple companies.

Audit quality

Auditors' ability to challenge management's judgment and decisions has increasingly been under the spotlight. Recent high profile failures have shown that auditors may not be providing an appropriate level of scrutiny. As investors we need to be able to rely on auditors to hold companies accountable. While the independence of these auditors is paramount, we now expect audit committees to explain the quality of audits and disclose details of how they've challenged management.

Pensions

While executive remuneration is always an area we look to as an indicator of shareholder alignment, pensions have been at the forefront of our engagements. Egregious payments which are a multiple of salary and taken in cash are seen as an added element of fixed remuneration and we have lobbied for these payments to fall in line with the wider workforce. Several CEOs, especially from UK banks, have voluntarily taken cuts but we have been advising remuneration heads that executive pension payments need to be more closely aligned within three years. This push is not just to reduce executive pay, but to also address company culture and alignment of board and workforce.

Shareholder Rights Directive (SRD) II

In Europe there has been an introduction of SRD II. Although transposed in to member states' laws in June last year, this will be the first opportunity for many European companies to report in line with the

updated Directive. It will also be the first opportunity for investors to have a say on pay at many of their European holdings.

One of the main aims of SRD II is to increase corporate governance standards by encouraging long-term shareholder engagement. Arguably the biggest step forwards for investors is the requirement for companies to put their remuneration report and policy to shareholder vote. The increased burden this causes varies by region. The UK and France, for example, are likely to see very little change as having these items on the agenda is already market practice. On the other hand, in 2019 only four DAX companies put forward an executive remuneration proposal. The tricky part for German companies is that there is no market practice precedent that they can look to for guidance when publishing their compensation details. The likely consequence of this is that we will see a range of reporting standards across Europe this year.

As investors it is our job to ensure that disclosure levels are adequate for us to be making informed voting decisions. Companies that lack detailed disclosures need to be penalised just as much as companies where disclosed governance practices are below standards. One of the most common areas of poor disclosure is where performance metrics are linked to variable pay. At a minimum we expect European companies to disclose the specific performance targets used to determine annual bonus pay-outs one year retrospectively as part of their remuneration report. The specific performance criteria and their weighting within the award should be disclosed in advance, as part of the remuneration policy.

US pay

With CEO pay increases across all market segments and almost all industries in the US reaching record highs in 2019, we expect companies to be increasingly challenged to demonstrate clearer alignment between their pay programmes, strategic goals and long-term value creation. Ballooning pay, particularly in the context of underperformance or high CEO pay ratios and other pay gaps, raises reputational risks or concerns about the strength of the compensation committee's independence.

Diversity

The diversity characteristics of board composition will continue to face attention across many dimensions, with research showing that companies with more diversity of thought and approach within their management perform better in the long term. The share of women on US boards reached a record high in 2019, with 45% of new Russell 3000 board seats filled by women (compared to only 12% in 2008). As the bar rises we are tightening our own expectations around the minimum proportion of female representation (20%); a 'fail' will now generally result in a vote against the chair of the company's nomination committee. We are also looking to broaden our focus to racial diversity and diversity across senior executives.

Stewardship Insights

Engagement in practice: Oilfield services

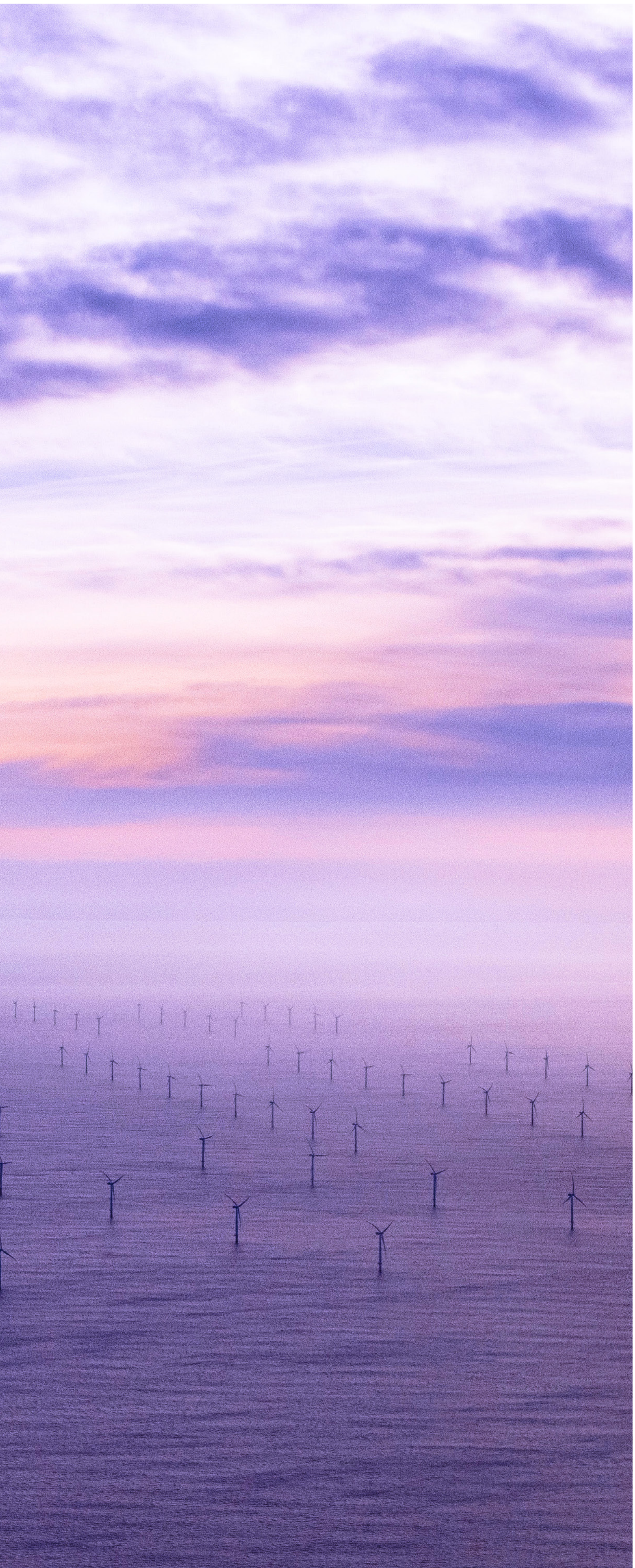
Schroders has long assessed and engaged with energy companies on their carbon impact. However, we believe that the attention cannot solely focus on those that extract and produce fossil fuels; there are other members of the fossil fuel value chain that cannot be ignored. We have turned our attention to the oilfield services (OFS) sector and its path to carbon neutrality.

Holly Turner
Sustainable Investment Analyst

Oilfield services companies generally provide equipment or services for the petroleum exploration and production industry, but largely do not produce petroleum themselves. Activities include onshore/offshore rig and pipeline equipment, construction and/or vessel support. At present, companies in the oilfield services sector typically generate over 90% of their revenue from oil and gas production.[1] If these companies do not adapt their business practices to align with a low carbon world, they will struggle to prosper in the long term. The big question lies in knowing which companies will a) attempt this transition and b) complete it successfully. There is no one "right" way for companies to adapt. For example, it may be through offering energy savings to existing fossil fuel customers, or sharing knowledge and experience to develop new green technologies.

In short, there appears to be a plethora of responses to the low carbon transition within the sector, depending on the type of service or equipment construction individual companies are involved in. At the end of 2019, together with the European equities team, we engaged with players in the

1 Source: MSCI



European OFS sectors to understand:

1 Their view on the low carbon transition;
2 Current and planned efforts to expand in the renewable energies and low carbon space and;
3 How adaptable the business could be towards these new sources of revenue.

Aligned with our proprietary stakeholder framework, we sought to understand how companies were thinking about transition risks and new revenue opportunities across all stakeholder groups, from employees and customers to regulators and environmental dynamics.

Positive responses, but is it enough?

All companies enthusiastically expressed their involvement in low carbon technologies, predominantly in offshore wind and tidal/wave, using vessels and equipment transferrable from legacy oil and gas operations. Some even suggested that offshore wind construction and engineering would be less complex than their existing offshore oil and gas equivalent. While there was a desire from all companies to increase their involvement with technologies such as renewable energy carbon capture and storage, and hydrogen, only a few set targets on capital expenditure, revenue or research and development dedicated to these areas. Companies may be restricted in their ability to forecast and set targets due to immature markets and the low frequency of projects of this nature. Only a couple have published a clear target, with others signalling their commitment in terms of divisional structures and disclosure instead.

Informing our investment decisions

We are expanding this engagement project into the US OFS sector to compare the viewpoints and actions in different geographies. This will enhance our understanding of the broader sector's ability to transition from its legacy oil and gas offering into new technologies aligned to a low carbon world. At a more granular level, we are becoming better equipped to determine which companies in this sector show strong potential to become part of the transition solution or transform their services into renewable energy, thus becoming a potentially suitable addition to our sustainable investment universe.

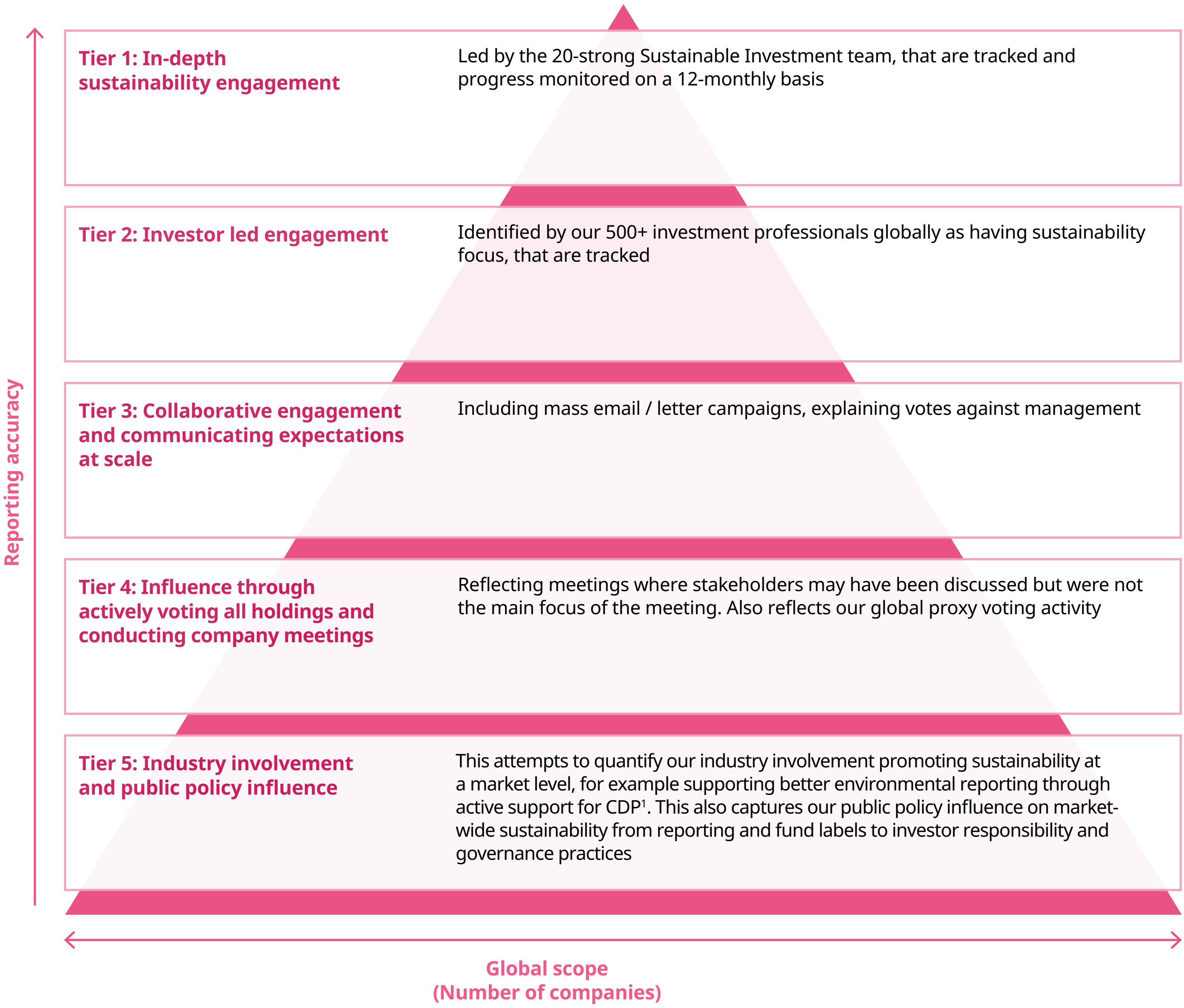
This project is currently ongoing as we continue to actively engage with companies in the OFS sector. The collaborative effort between the Sustainable Investment team and the European Equities team promotes knowledge sharing to view the information we gather through different lenses and deepen our understanding from different perspectives. This information feeds back into the conclusions drawn by our analysts and fund managers and, in turn, into investment decisions.

A new approach to reporting

We are changing the way we report on our engagement activities. As we make progress towards our goal of integrating ESG factors across all our investment desks by the end of 2020, we feel it is important that we reflect our full sphere of influence in our reporting. This includes how we talk about our engagement activities, whether it is led by our dedicated Sustainable Investment Team or independently by an individual investment desk. Going forward, we will capture all of our engagement activities under a tiered structure, illustrated below.

We expect this to be a dynamic process; our experience shows that achieving long-term change typically takes at least two years of engagement activity. To reflect the evolution of our dialogue, specific company engagements may advance to higher tiers over time. For more information, please see pages 31 – 32 of our [2019 annual sustainable investment report]:

Schroders' new engagement tiers



Source: Schroders, March 2020
1 Carbon Disclosure Project

Engagement in numbers

Engagement by tier

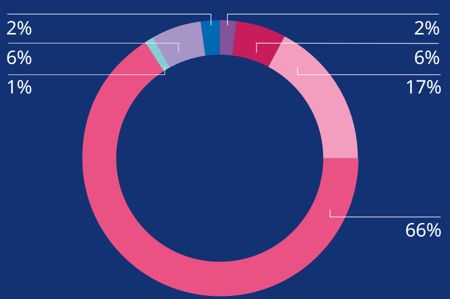
Tier	Scope	Number of engagements
1	In-depth sustainability engagement	52
2	Investor-led engagement	125
3	Collaborative engagement and communicating expectations at scale	38
4	Influence through actively voting all holdings and conducting company meetings	2759
5	Industry involvement and public policy influence	Reported annually

Regional engagement (tiers 1 – 3)

Asia Pacific	30%
Europe (ex-UK)	21%
Latin America	2%
Middle East and Africa	1%
North America	19%
UK	27%

Source: Schroders as at 31 March 2020

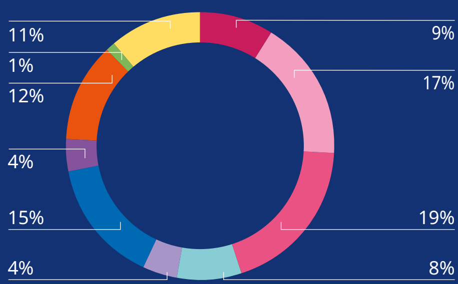
Engagement type (tiers 1 – 3)



- Group call
- One to one call
- Collaborative Engagement
- Email
- Group meeting
- One to one meeting
- Other

Source: Schroders as at 31 March 2020

Engagement by sector (tiers 1 – 3)



- Consumer Discretionary
- Consumer Staples
- Energy
- Financials
- Health Care
- Industrials
- Information Technology
- Materials
- Telecommunication Services
- Utilities

Source: Schroders as at 31 March 2020

Voting in numbers

We believe we have a responsibility to exercise our voting rights. We therefore evaluate voting issues on our investments and vote on them in line with our fiduciary responsibilities to clients. We vote on all resolutions unless we are restricted from doing so (e.g. as a result of shareblocking).

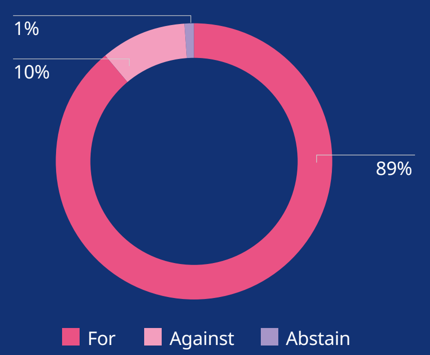
This quarter we voted on **877 meetings and approximately 91% of all resolutions**. We voted on 105 ESG-related shareholder resolutions, voting with management on 42.

The charts below provide a breakdown of our voting activity from this quarter. Our UK voting decisions are all available on our website at http://www.schroders.com/en/about-us/corporate-responsibility/sustainability/influence/.

Company meetings voted

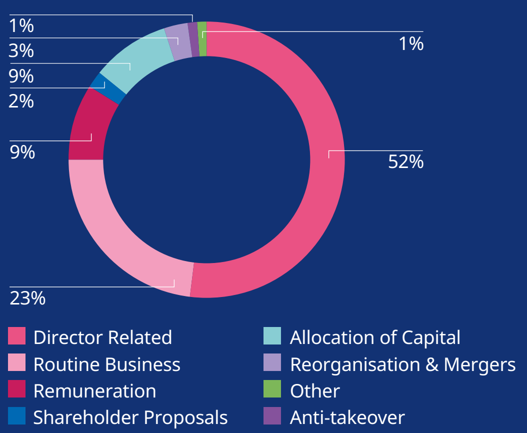
Source: Schroders as at 31 March 2020

Direction of votes this quarter



Source: Schroders as at 31 March 2020

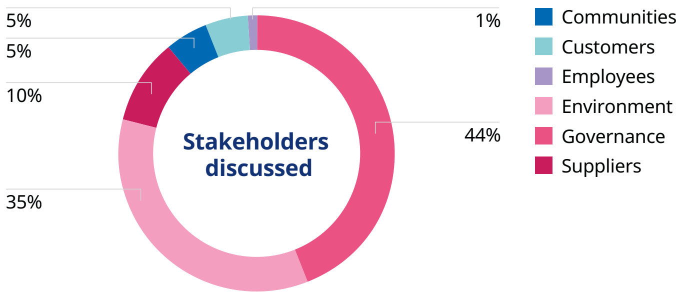
Reasons for votes against this quarter



Source: Schroders as at 31 March 2020

Total company engagement

215 tier 1-3 engagements took place this quarter with the 202 companies listed below. Where possible, we have summarised whether the broad range of topics discussed with each company fall under "environmental", "social" or "governance". The chart opposite illustrates the topics discussed this quarter categorised by stakeholder.



Company	E	S	G
Consumer Discretionary			
888		✔	
Amazon		✔	
Banpu	✔		✔
Berkeley			✔
Burberry			✔
Carnival		✔	
Headlam Group			✔
Inchcape			✔
Marks and Spencer	✔		✔
Mitchells and Butlers		✔	
NACCO Industries	✔		✔
Pearson		✔	✔
Pendragon			✔
Pets at Home	✔	✔	✔
Sports Direct		✔	
VFC			
Vivendi Universal			✔
Whitbread		✔	
Consumer Staples			
Associated British Foods		✔	
Beiersdorf		✔	
BIM Birlesik Magazalar			
Britvic			✔
Carrefour	✔		✔
Coles Group	✔		✔
Conagra	✔		✔
Costco Wholesale	✔		✔
Danone		✔	✔
Essity		✔	
General Mills	✔		✔
Glanbia		✔	
Greggs		✔	
Grupo Nutresa	✔		✔
Henkel		✔	
J Sainsbury	✔		✔
Kerry Group	✔	✔	✔
Koninklijke Ahold Delhaize	✔		✔
Kraft Heinz Foods	✔		✔
Kroger	✔		✔
Lindt and Spruengli		✔	
L'Oreal		✔	
Marine Harvest		✔	
Nestle	✔	✔	✔
Reckitt Benckiser		✔	
Tesco	✔		✔
Tyson Foods	✔		✔
Unilever	✔	✔	✔
Walmart	✔		✔
Wm. Morrison	✔		✔
Woolworths	✔		✔
Energy			
Adaro Energy	✔		✔
Alliance Resource Partners	✔		✔

Source: Schroders, 31 March 2020.
The companies and sectors mentioned herein are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

Company	E	S	G
Arch Coal	✔		✔
Bogdanka	✔		✔
Cairn Energy		✔	
China Coal Energy	✔		✔
China Shenhua Energy	✔		✔
Coal India	✔		✔
Consol Energy	✔		✔
Contura Energy	✔		✔
Delta Dunia Makmur	✔		✔
Energy Fuels Canada	✔		✔
Geo Energy Resources	✔		✔
Guanghui Energy	✔		✔
Hallador Energy	✔		✔
Halliburton	✔		
Harum Energy	✔		✔
Helmerich & Payne	✔		
Idemutsu Kosan	✔		✔
Indika Inti Energi	✔		✔
Indo Tambangraya	✔		✔
Inner Mongolia Yitai Coal	✔		✔
Jastrzebska Spolka Weglowa	✔		✔
Natural Resource Partners	✔		✔
New Hope	✔		✔
NexGen Energy	✔		✔
Peabody Energy	✔		✔
Petrofac	✔	✔	
Premier Oil		✔	
PTT	✔		✔
Sasol	✔		✔
Schlumberger	✔		
Semirara Mining	✔		✔
Shanxi Lu'an Environmental Energy	✔		✔
Shanxi Xishan Coal and Electricity Power	✔		✔
SK Networks	✔		✔
Sunnova			
Tambang Batubara Bukit Asam	✔		✔
Terracom	✔		✔
Vivint Solar			
Whitehaven Coal	✔		✔
Financials			
ADO Properties			✔
Amigo		✔	✔
Aroundtown			✔
Aviva			✔
AXA			✔
Barclays	✔		
BBVA			✔
BNP Paribas			
Brewin Dolphin		✔	
Cassa Depositi			
IG Group			✔
Nationwide			
Paragon			✔
Plus500		✔	
Prudential			✔
Weyerhaeuser	✔		✔
Health Care			
Amgen	✔		
Danaher	✔	✔	✔
Dechra		✔	
Gerresheimer	✔		
Hikma Pharmaceuticals	✔	✔	✔
Novartis			
Roche Holding			
Smith & Nephew			✔
Straumann			✔
Industrials			
Adani Enterprises	✔		✔
Aggreko		✔	

Source: Schroders, 31 March 2020.
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Company	E	S	G
AKR	✔		✔
Alfen			
Balfour Beatty			✔
Capita Group			✔
CITIC Pacific	✔		✔
De La Rue			✔
Deere & Co		✔	✔
DMCI	✔		✔
G4S			✔
Ingersoll-Rand		✔	✔
Itochu	✔		✔
IWG		✔	
Marubeni	✔		✔
Melrose Industries			✔
Mistui	✔		✔
Mitsubishi	✔		✔
Munters Group			✔
Polygon			
Posco Daewoo	✔		✔
Recruit Holdings		✔	
Schindler			✔
Schneider Electric			✔
SK Holdings	✔		✔
Speedy Hire			✔
Sumitomo	✔		✔
Toyota Tsusho	✔		✔
United Tractors	✔		✔
Wincanton			✔
Information Technology			
21Vianet	✔		
Dolby Laboratories			✔
Hynix Semiconductor			✔
Playtech			✔
Sophos		✔	
Spirent		✔	

Company	E	S	G
TT Electronics			✔
Materials			
African Rainbow Minerals	✔		✔
Altius Minerals	✔		✔
Anglo American	✔		✔
Anglo Pacific	✔		✔
China Resource Cement	✔		
Engro	✔		✔
Eregli Demir ve Celik Fabrikalari			
Ferguson			✔
Ferrexpo			✔
Grupo Argos	✔		✔
Gujarat Nre Minerals	✔		✔
Hindalco	✔		✔
India Cements	✔		✔
Jindal Steel & Power	✔		✔
Johnson Matthey			✔
Mechel PJSC	✔		✔
Polymetal		✔	
PT Semen Indonesia	✔		✔
RHI Magnesita		✔	
Shougang Fushan Resources	✔		✔
Thyssen Krupp			✔
Timah Persero	✔		✔
Toagosei	✔		
UPM	✔		✔
Vale	✔		✔
Zijin Mining	✔		✔
Real estate			
CPI Property			
Telecommunication Services			
Telstra			
Utilities			
Adani Power	✔		✔
Allete	✔		✔

Source: Schroders, 31 March 2020.
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Company	E	S	G
American Electric Power	✔		✔
Black Hills	✔		✔
Centrica		✔	
China Power International Development	✔		✔
CLP	✔		✔
Drax	✔		
EDP Renovaveis			✔
Electric Power Development	✔		✔
Electricity Generating Company	✔		✔
Elia			
Enea	✔		✔
Engie			
Hong Kong & China Gas	✔		✔
Huadian Power	✔		✔
Naturgy Energy	✔		✔
NTPC	✔		✔
Public Power	✔		✔
Reliance Power	✔		✔
Samchully	✔		✔
Tata Power	✔		✔

Key

E – Environment
S – Social
G – Governance

Source: Schroders, 31 March 2020.
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Engagement progress

This section reviews progress on historical engagements. We record our engagement activity in our proprietary research database to facilitate the monitoring of companies in which we are invested. To ensure this is effective, we define expected timeframes for milestones and goals; track progress against the defined milestones and goals; and revise the goals, if necessary, depending on progress.

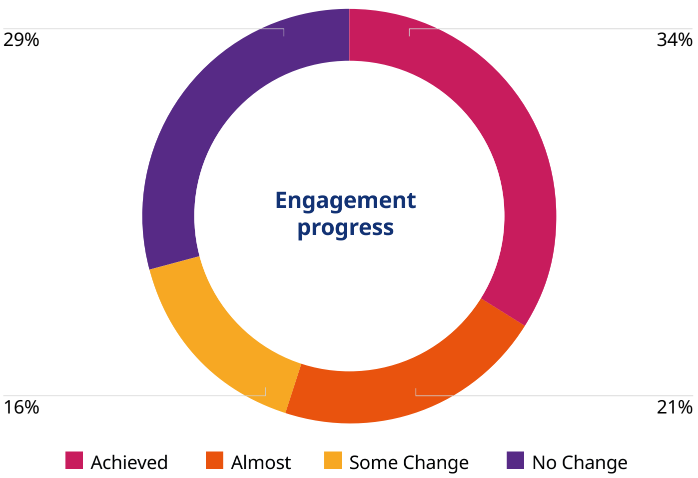
There are five possible results: 'Achieved', 'Almost', 'Some Change', No Change' and 'No Further Change Required' (typically because we have sold out of the position).

We recognise that any changes we have requested will take time to be implemented into a company's business process. We therefore typically review requests for change 12 months after they have been made. We continue to review progress on an ongoing basis thereafter and will escalate where necessary.

In Q1 2019, Schroders undertook 80 requests for change classified as tier 1 engagements. Upon reviewing these engagements in Q1 2020, the pie chart below shows a breakdown of the progress we have made.

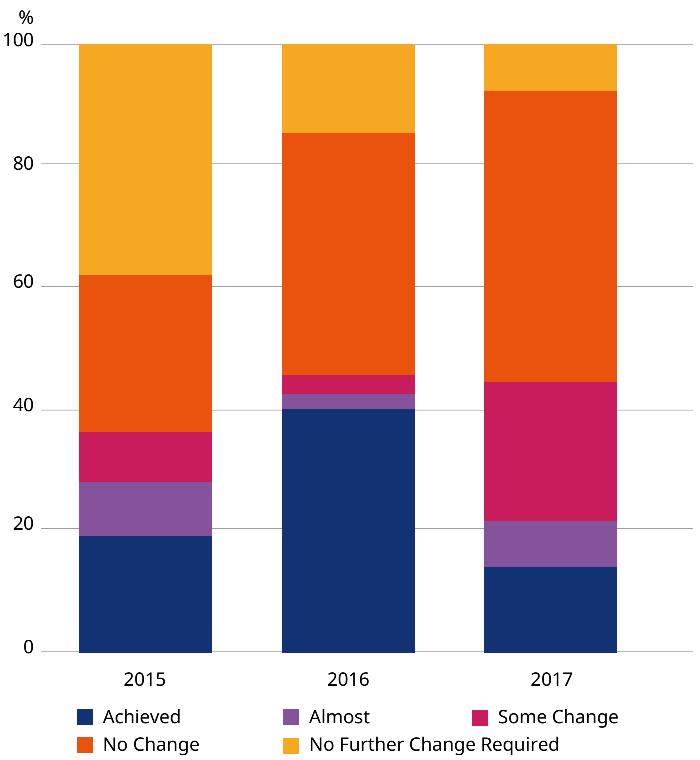
The bar chart below shows the effectiveness of our requests for change over a three-year period. Our experience shows that at least two years of dialogue is typically required before our requests begin to materialise into measurable change within a company. It is for this reason that the two most recent years are omitted from the chart.

Engagement progress from Q1 2019



Source: Schroders as at 31 March 2020

Effectiveness of requests for change - 3 year period



Source: Schroders as at 31 March 2020

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