

In pursuit
of green



Rathbones
Look forward

The value of investments and the income from them may go down as well as up and you may not get back your original investment.



A change is in the air

In March 2019, I boarded a plane for Florida to visit what was once one of the most important oil and gas conferences in North America.

This time, sustainable investments were the talk of the place.



David Harrison
Fund Manager

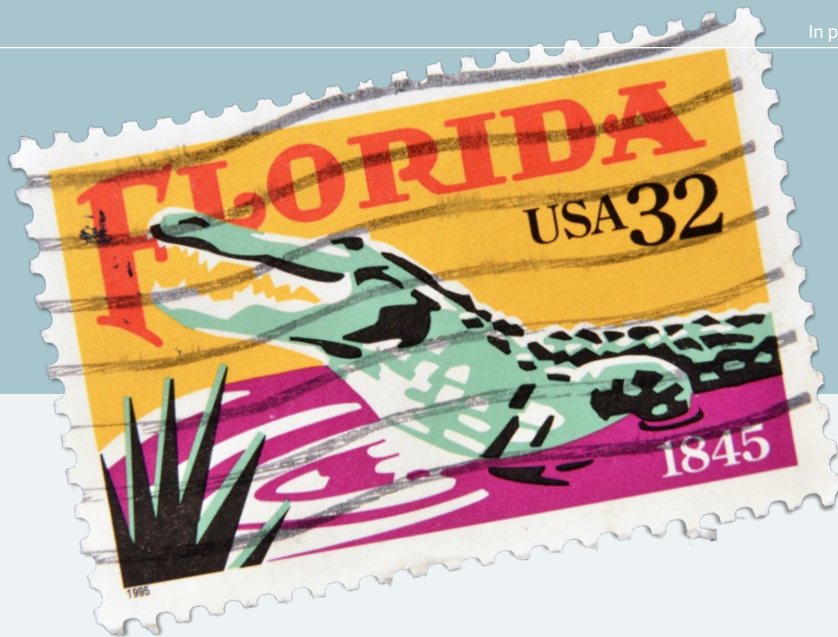
Rathbone Global Sustainability Fund

The institutional investors conference I attended is not billed as an environmental, social, and governance (ESG) affair. This year I found it was filled with great companies trying to do right for the earth and society as well as investors.

It wasn't always this way.



Orlando



For much of its 40 years of life, the conference in the swampy outskirts of Orlando has been a sunny middle ground where moneymen from the East Coast could meet with all manner of companies that always seemed heavy on oil and gas prospectors, whether from the Florida peninsula or the western states.

Over the decades it has developed into a one-stop-shop for investors, giving access to almost 300 companies this year. The conference still hosted many companies that I wouldn't touch because of their unsustainable practices, but the number of conversations about ESG issues was much, much higher than when I last attended two years ago.

These companies are using technology in extraordinary ways to lessen our impact on the environment, improve our lives and make sustainable profits.

I was pleasantly shocked that just a handful of resources companies attended this year. Virtually no-one was talking about the industry.

Instead, software, healthcare and agriculture boasted the largest crowds of analysts. These companies are using technology in extraordinary ways to lessen our impact on the environment, improve our lives and make sustainable profits.

After the conference, I left the balmy south to visit several companies on their frozen home turf up in Chicago and Milwaukee before dropping in on my brother on the West Coast. Again, I was blown away by how much more attuned US companies are to sustainability compared with only a few years ago. Firms are giving farmers the tools to become laser-efficient with resources, small businesses are investing to reduce water use and massive corporations are trying to reduce their mark on the environment and improve society in their own backyards.

American business people can be some of the most cynical in the world when it comes to money. If they are coming round to sustainability and environmental considerations, anyone can.

Report findings

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If you can make it in America, you can make it anywhere



What struck me is that for the first time, US investors were actually asking about ESG. That may sound silly, but the US has been very far behind Europe and the UK in this regard. I've been investing globally for many years now, and while I love the 'can-do' American business culture and respect many of its companies, being a good corporate citizen is sometimes a secondary consideration for US management.

Europe, by contrast, has a lot of faults, but when it comes to matters of sustainability it's streets ahead. This is probably a structural thing: we all know the European Union (EU) loves making rules. But decades of dealing with heavily unionised workforces and having worker representatives on boards has also contributed. Whatever the reason, European company boards and managers have been better at thinking about how their businesses affect all of their stakeholders, rather than simply focusing on the shareholders.

Make no mistake, this kind of thinking can sometimes go awry. But so can myopic attention on short-term shareholder returns regardless of cost. By squeezing suppliers too

much you could force them to erode the quality of the parts on which your gadget depends. By not thinking about how your actions affect your community, you may find attempts to expand operations are blocked by local voters. By not caring about the environment, you may not have a crop to sell in 10 years time. There goes your business.

There is a general feeling that investing in sustainable companies must come at some cost, that ESG must equal lower returns for investors. I think this is fundamentally wrong.

This is what drew me to ESG investing: it just makes sense. There is a general feeling that investing in sustainable companies must come at some cost, that ESG must equal lower returns for investors. I think this is fundamentally wrong. A company that is well managed, aware of its operations from all angles and engaged with its community is better able to avoid catastrophic risks from public relations disasters, poor supply chains and dodgy boardroom antics. By thinking about businesses →



in a holistic way, I believe these directors, executives and investors are able to judge risk in a more holistic way too.

Conditions are now ripe for sustainable practices to become a real necessity in the US – those that pay lip service could get burned.

For much of my career, however, the US was not on board with this sort of thinking. In America, the dollar was always king and other factors were sometimes secondary. But I think that has already started to change. Conditions are now ripe for sustainable practices to become a real necessity in the US – those that pay lip service could get burned. Bad customer experiences and poor practices can spread across the globe as fast as the sun's rays, destroying a brand and hurting sales. Boycotts and protests could become very dangerous indeed.

The changes in the US will come, I believe, from two directions. Firstly, I think many Americans are starting to realise just how unsustainable their consumption is. If the top 10% of people emitting carbon – many of whom are American – cut their emissions to just the EU average, it would curb global CO₂ by 35%, according to *The Uninhabitable Earth*, a must-read by David Wallace-Wells. And Americans, per head, have cut their emissions considerably since the beginning of this millennium. I think these people will start to vote with their wallets, avoiding unsustainable businesses where possible and even boycotting businesses that fall woefully behind on the environment.

That leads on to the second direction of improvement: companies are seeing this risk to their reputations and market share and making changes themselves. These phenomena should be mutually reinforcing to the point where, I hope, all of society begins to see the imperative of more sustainable lifestyles and commerce.

This makes me really excited because I truly think nothing is more dynamic in this world than an American that sees an opportunity. US capitalism is truly an awe-inspiring vehicle for change. It isn't always pretty or good or just, but it never fails to be powerful. We owe American capitalism much. It brought us mass-produced cars, personal computers, developed the internet and smartphones, and conjured countless miracles of modern medicine, including a cure for measles in the 1960s. Faced with a problem or opportunity, the American market really comes into its own.

Europe's sustainability regime has always been driven from the top down, which I feel is passive. When you move to do something yourself, the impetus tends to be much greater. The US appears to be changing from the ground up. Individual companies are starting to see the risks if they continue as they have for so long and – perhaps even more alluringly for some – they see the potential for making many more dollars too.

Take recycling

At the conference in Florida, a waste management chief executive spoke about getting a call out of the blue from the head of Starbucks.



If you had mentioned ESG at a cocktail party in Florida a few years ago, you would have been laughed at. Now, flitting between knots of chatting people, you can hear these issues being discussed all around you. It's ironic that

this wave has hit during the presidency of a man who has zero interest in the environment beyond a golf course; thinks climate change is a myth and whose governance ethics are sketchy at best. But that's kind of the point I'm trying to make: in America, it's not the policies that matter as much as the people and businesses who see the need to change – or who see the value in doing so for their business. For many companies, structural shifts to better technologies, materials and practices could offer a decade or more of revenue growth above that of GDP expansion.

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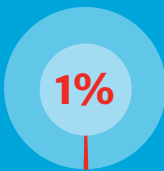
For principled executives thinking of the world they will pass on to their grandchildren, that's a bonus; for anyone else, that's a very powerful incentive.



The coffee chain has a massive waste problem and needs help:

somewhere in the region of **6 billion** disposable cups are thrown out each year...

with each one taking about **20 years** to decompose. That's a lot of Starbucks-branded rubbish.



The waste management company smelled a huge growth area (staggeringly, Starbucks accounts for just 1% of disposable coffee cups globally), and is now preparing to ramp up its recycling operations.



Not just a pivot: technology solving real world problems



By 2030
global water
demand will
outstrip supply
by **40%**



Everybody wants to invest in technology companies and every company wants to be one. This is as true in 30° C Florida as it is on the frozen shores of Lake Michigan, in Milwaukee.

This attitude can become a bit of a trap, for both companies and investors. You hear funny tales of fruit juice companies printing QR codes on their packaging and selling WiFi-enabled blenders for hundreds of dollars a pop. By squeezing a fruit packaging business into a tech company's clothes, Juicero won \$120 million of venture capital funding. In today's world, a rising tech star is more alluring than a food producer. It turned out that Juicero's fruit smoothie sachets worked better if you simply used your hands – especially if your WiFi happened to be on the blink. This is just one of countless cautionary and typically hilarious tales of investors trying to make money on the digital boom. But there's nothing funny about paying tech sector prices for a company if it's your cash that's getting burned!

When I'm looking at technology investments, I think it's helpful to hunt for ways that software and modern gadgets can solve the real world problems of industry and agriculture. Often, some of the most exciting developments are in what many consider humdrum sectors.

Water-heating isn't exactly a sexy subject, but it combines two of the most important fronts of the resource efficiency fight: water and energy. AO Smith, a Milwaukee-based boilermaker, is the largest manufacturer of water-heaters for homes and businesses in North America.

It has led the way in electric, gas, and solar appliances, with innovations that slash power bills for people and businesses alike. Heating water is energy intensive, so quality boilers can significantly reduce the day-to-day emissions of households and small companies. This company is also ahead on doing right by its communities: the AO Smith Foundation has helped fund a range of charitable, scientific and educational works near company plants since the 1950s. The Foundation continues to be funded from the company's profits today.

AO Smith, which I own in the fund, has an Asian water treatment business as well. It helps to improve water quality and reduce the strain on our most precious resource. This water treatment division is expanding rapidly and should continue to do so for years to come. As the population grows – and developing nations become richer – the demand on the earth's fresh water is expected to grow significantly. By 2030, global water demand is forecast to be 40% higher than sustainable demand, unless we change our practices dramatically. This is according to the United Nations Environment Programme.

Thankfully, there is plenty of scope to streamline how we use water. In the US, almost a fifth of fresh water supply is lost through leaking pipes and theft. In Brazil, such wastage accounts for nearly half. That's why I see such promise in smart-metering companies – one that I've had my eye on is a Milwaukee-based company that operates all over the world.



70-80%
of global
water use
is for food
production



Smart-meters are digital tools that help households and businesses keep track of their water usage. That saves them money and all of us precious water. The metering company has also partnered with telco giant AT&T to offer all-encompassing digital flow-measurement systems that towns and cities can use to better manage their infrastructure. Being able to spot the warning signs of leaks and problems from a centralised, remote system means less time on manned inspections and quicker fixes to leaks and breaches. Local governments have more cash in their coffers to improve their pipes, keeping water from being wasted, and deliver better community services elsewhere.

By far the greatest use of water is for growing and raising the food we eat. Watering the fruit, nuts, grains, grass and animals that are destined for our stomachs accounts for somewhere in the region of 70-80% of all the water we use worldwide. Technology can have a massive impact here as well.

One Silicon Valley company that I bought soon after returning from my trip is leading location services, tracking and land survey firm Trimble. Think of the highly calibrated machines that engineers use to take exact measurements of ground levels and ensure real-life buildings match the plans. The yellow-legged ones you see in the street with robotic laser optics whirring around after high-viz-jacket-wearing surveyors. Or, for those eagle-eyed commuters, the laser machines suspended above Underground platforms to ensure nothing is sinking faster than it should.

Well, this company has spread far beyond that urban origin and has taken its business into the fields. One of its most exciting divisions uses GPS technology to remotely steer farm machinery, like harvesters. It also designs soil monitoring systems that can pinpoint exactly which areas of a farm need water or fertiliser and those places that don't.

Rather than simply throwing water and nitrogen around liberally all over the place, farmers can be much more sparing, saving them money and helping conserve the world's resources. It's technology like this that really gives me hope about our ability to reduce our impact on the planet.

It's not about companies that 'pivot' to tech – that pretend to be something they're not. I think you need to look for those companies that are taking good technology out into the world to solve real problems.





Silicon Valley feels like the Roman Empire

At the height of its imperial power 1,900 years ago, Rome was a city of contrasts. It was full of money, power, technology and opportunity. Yet poverty and grime surrounded the city's gleaming marble columns and opulent patricians.

Silicon Valley, the 30-mile strip of land running south east from San Francisco to nearby San Jose, is one of the most hyped places on earth. It's where budding tech entrepreneurs want to be, it's the engine room of the West Coast that accounted for 60% of all US private equity dollars invested in 2018. It is arguably Rome for the digital 21st century.



I stopped by San Francisco to catch up with my brother 'on the way home' from meeting companies on the East Coast. He lives with his family in Oakland, so I can't pass up even a half chance to see them. Like many people, when they were looking for a place to buy they came up against pretty spicy prices; demand for property at the centre of the world tends to be red hot. Oakland is across the bay from San Francisco proper. A former naval base and still one of the busiest ports in America, it's now buzzing with the new economy as well.

While the West Coast is at the cutting edge of the digital revolution and most major US cities are at least close to the handle, the rest of the nation is very, very far behind. The potential growth of digitisation in the US is massive. That's in things like small businesses creating websites which don't look like they were built in the late 1990s. Many American businesses' online presence is little more than a digital Yellow Pages advert – virtually worthless as an e-commerce portal. And if the customer-facing parts of the company are that bad, imagine how much modernisation needs to happen with the back-office stuff – about half of all inter-business payments are made with cheques rather than electronic transfers...

From the rise of e-commerce to better web design and investment in up-to-date business systems, companies selling these services have another decade of growth at twice the rate of GDP growth, in my opinion. That's why I own a number of them, because I think we are nowhere near 'peak' internet.



This includes companies like Adobe, in San Jose, which delivers that most basic yet versatile of digital documents: the humble PDF. It's a simple yet crucial tool in an increasingly online age. But that's not Adobe's only business. It owns a whole suite of other programmes that have become indispensable to professionals and hobbyists alike. Take Photoshop: it's effectively a digital darkroom for photographers. Or InDesign, the 21st century's typesetting department for publishers. The digitisation of business has further to run, in my opinion, which is why I own Adobe. Also, I think the company's move toward a subscription-model and away from one-off purchases should smooth cash flow and make its returns on capital much more attractive.



Cognizant, based in New Jersey on the other coast, is another company in my portfolio. This IT giant helps businesses plan their digital strategies and then provides the full range of services to make it happen. It does a lot of work with healthcare providers as well as financial services, essentially specialising in helping intricate businesses digitise – a difficult job that not everyone can do! Another large portion of its business is taking on outsourced IT work for other companies. Cognizant is smaller than many of its competitors, but we think its value stacks up and its business model is sound.

One of the most high-profile Silicon Valley companies out there helping businesses roll out digital upgrades is Salesforce.com. It's impossible to miss this company, given the \$1.1 billion tower that carries its name that can be seen from everywhere in the city. Salesforce has come a long way in its 18 years of existence. Last year's \$13.2 billion of revenue was a staggering 13 times higher than it was 10 years ago. As of December 2018, Salesforce is now the largest employer in San Francisco.

I don't own this company because I think it's just too well-loved: there's a lot I admire about Salesforce, but it's very expensive and doesn't fit with the style I'm trying to run. Its founder and chief executive, Marc Benioff, recently issued a mea culpa about the tech industry's hand in San Francisco's inequality 'train wreck'. He was an advocate for boosting a payroll levy on big San Francisco businesses to raise money to fight homelessness in the city. Prop C, as it was called, is expected to deliver an extra \$300 million, or 70% more, a year for housing and welfare. This split Silicon Valley's patricians, with some tech billionaires believing it was the industry's place to help solve the problems at home while others thought it was unfair.

Many people in the tech industry have grandiose dreams and ideas for solving the world's problems, but perhaps some have forgotten that help should really start at home.

Here's an interesting fact: despite the generosity of many high-profile tech moguls, the IT industry as a whole isn't actually that philanthropic. According to a report by the Philanthropy Roundtable, tech-heavy cities like San Francisco, Seattle and Austin noticeably lag other large, more broadly diversified cities when it comes to the proportion of annual income citizens donate to charity. And when Bay Area residents, companies and foundations do give money away, a full 90% of it goes to groups and charities that operate elsewhere. Many people

in the tech industry have grandiose dreams and ideas for solving the world's problems, but perhaps some have forgotten that help should really start at home.

Hanging around the city – even across the bay from the Golden City in Oakland – you can sense the amount of money bubbling around. And when you swing by some of the shops you can feel the cruel economics such concentration of wealth creates (anyone who has visited the mean streets of Switzerland will know what I mean). We had a quick bite to eat at a nice little Lebanese place: flat bread, ground chickpeas and a kebab was upwards of three times what it might cost in London. I was thankful I hadn't suggested steak!



This kind of voracious inflation has had massive social effects on San Francisco and the wider Bay Area. Taking an Uber from Oakland to the train station on the way to the airport, I got talking with the driver. He was intrigued to see a British visitor – there used to be quite a few tourists from the UK and Australia he said. But since the cost of living rose (and our two countries' currency slumps won't have helped), fewer and fewer now seem to drop by. I asked him how business was as an Uber driver in the tech 'mecca'; turned out he was actually a full-time software programmer by day. He had a wife and two kids at home, an hour outside of the city, so this incredibly smart, well-educated →

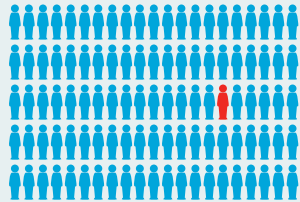
guy was driving a cab at night to earn extra cash to make ends meet. Imagine adding another shift at the wheel to your two-hour daily commute...

Many, many people have been priced out of this place because of astronomical rents and costs of living. Others have been even more unlucky: it's not hard to go bust quickly here.



San Francisco

Second highest concentration of billionaires



But 1 in 100 are homeless



San Francisco has the second-highest concentration of billionaires and the highest rate of homelessness in the US. It's a stark reminder that Silicon Valley is exciting and innovative but in no way some kind of utopia. You drive (everyone uses ride-hailing, like Uber or Lyft) past fancy restaurants, beautiful parks and ageless architecture as often as you pass homeless people, used needles, tents and urine stains on the sidewalk. There is so much money and opportunity here, but a whole lot of sadness too. San Francisco has always had a lot of

people living on the street, but the number has risen noticeably since 2011 and now stands somewhere around 7,000. That's close to one person out of every 100 city residents currently homeless.

And the irony is that this is supposed to be the place that disintermediated the world: the place that created the gadgets and systems that allow us to connect with anyone, anywhere. The cradle of the e-commerce that helps us find the best-priced option with just a few taps of a smartphone, is now packed to bursting with more people than it can handle. I guess remote working was a fad.

All of this reminds me that capitalism isn't that healthy right now. There are plenty of things that need fixing and companies' social impacts are just as important as the products and the profits they make.

That's why I run the fund I do. I love finding great companies that can succeed and make investors money while not costing the earth or our society.

Get in touch

For more information, contact the team on 020 7399 0000, rutm@rathbones.com or visit rathbonefunds.com

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