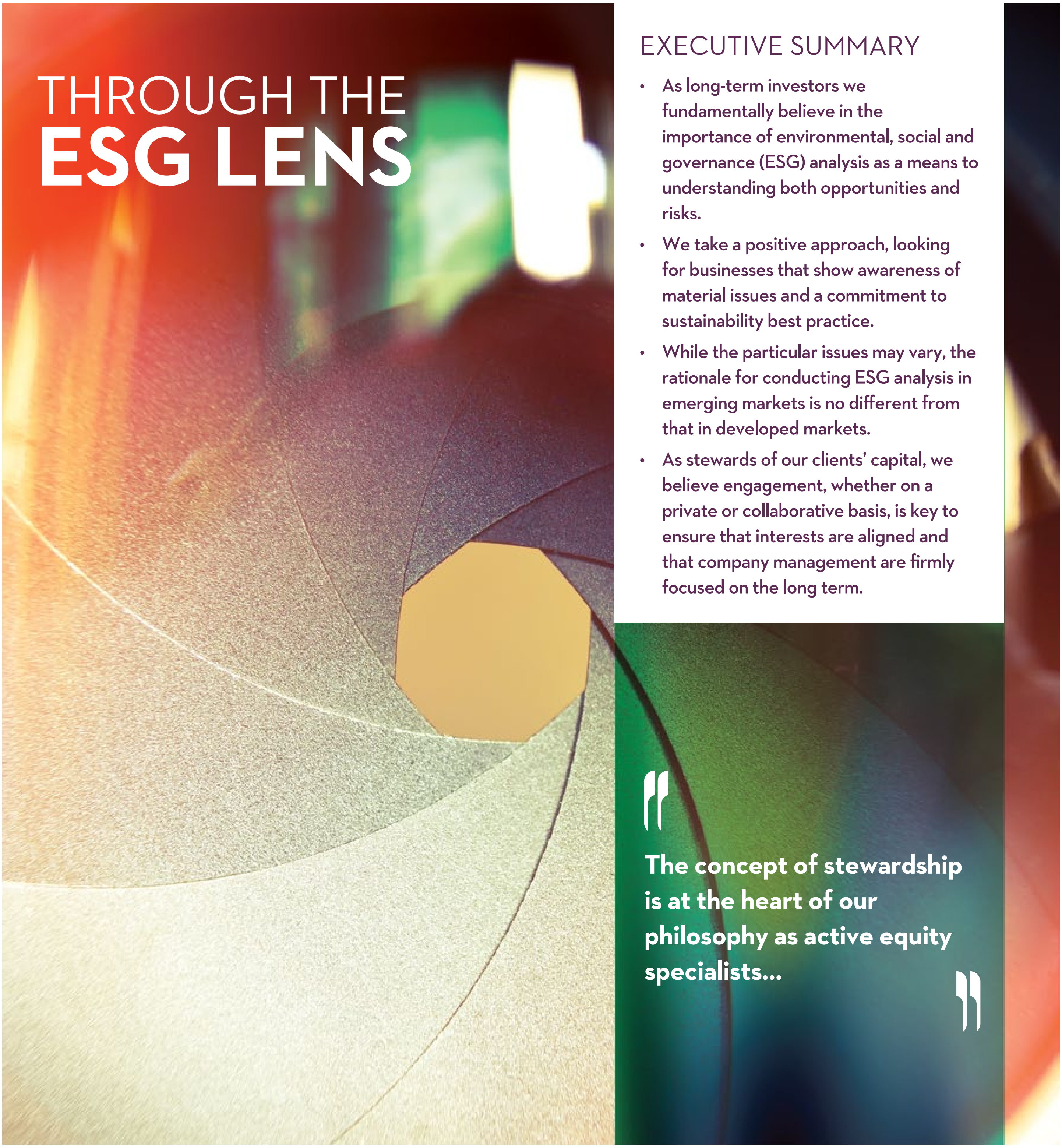
ACTIVE
VIEWPOINT

GLOBAL EMERGING MARKETS

SEPTEMBER 2017 FOR PROFESSIONAL CLIENTS ONLY



THROUGH THE **ESG LENS**

EXECUTIVE SUMMARY

- As long-term investors we fundamentally believe in the importance of environmental, social and governance (ESG) analysis as a means to understanding both opportunities and risks.
- We take a positive approach, looking for businesses that show awareness of material issues and a commitment to sustainability best practice.
- While the particular issues may vary, the rationale for conducting ESG analysis in emerging markets is no different from that in developed markets.
- As stewards of our clients' capital, we believe engagement, whether on a private or collaborative basis, is key to ensure that interests are aligned and that company management are firmly focused on the long term.

"The concept of stewardship is at the heart of our philosophy as active equity specialists..."

WHY ESG MATTERS

As bottom-up investors with a long-term philosophy we take a holistic view of companies, analysing their performance and prospects from both a quantitative and qualitative perspective. ESG factors are fully embedded in our investment process, as we believe these are critical to a company's ability to generate sustainable long-term returns. Importantly, this assessment is owned by the analysts and portfolio managers who know the companies best, rather than managed by a separate ESG research team. In our experience, this ensures that these matters get a proper weighting in the conviction-building process. We work in close collaboration with Martin Currie's Head of Stewardship & ESG, an experienced practitioner with over 30 years' experience as a global portfolio manager, who assists the team with implementation and best practice.

A FOCUS ON MATERIALITY

Our analysis and engagement efforts are guided by the materiality of the issues in question. There is a growing body of research supporting such a focused approach, underlining a strong correlation between material ESG factors and returns[1]. We recognise that every company is unique and that the particular circumstances it operates under should be factored in when assessing its ESG performance. Over the years, we have developed extensive in-house resources, including industry frameworks which ensure that we focus on the most relevant questions.

Importantly, we appreciate that companies are on a journey when it comes to ESG, so a firm that falls short of our expectations will not automatically be ruled out. Having said that, we expect to see a willingness (and ability) to address the problems identified.

GOVERNANCE AS A STARTING POINT

Governance sits at the heart of our analysis, as we believe this is a fundamental determinant of long-term performance and thus the sustainability of a business. But critically, as emerging market investors, we cannot use a one-size-fits-all approach, given the different traditions and levels of corporate maturity in many parts of the world. We will typically focus on areas such as capital allocation, board composition and the quality of disclosures – as well as how minority shareholders have been treated historically. In our experience, shortcomings here go hand in hand with poor performance on the social and environmental fronts, making it a good proxy for wider problems. The end goal is to develop a truly granular understanding of the degree to which a company will be a good long-term steward of our clients' capital.

[1]For example, Mozaffar Khan, George Serafeim, and Aaron Yoon, 'Corporate Sustainability: First Evidence on Materiality,' Harvard Business School, March 2015.

CASE STUDY: MAGNIT

Magnit is a Russian food retailer that has been growing at a very brisk pace over the past decade. We have held the company in our Global Emerging Markets portfolios since December 2012. Although a laggard when it comes to ESG, we felt that this was due more to poor disclosure than any major deviation from best practice. For context, it is worth noting that Russian companies, in general, score badly in these areas – especially compared with developed market peers. 2016 saw the conclusion of a 16-month long PRI-coordinated collaborative engagement effort with Magnit which we had led. Following the engagement, Magnit appointed a dedicated Investor Relations person, to improve disclosure in this area, and for the first time, published KPIs detailing company performance against indicators relating to employee relations, including turnover and training. This was a fantastic outcome for the engagement and a positive step forward for Magnit.

In addition to this, the company proactively communicated its approach on the consideration of social and governance factors such as supply-chain management and board structure on its website, and committed to doing the same for environmental factors in the future. Significant progress has been made already and Magnit continues to show its commitment to improvement by engaging to raise its understanding of best practice. Although more work is needed to develop these processes, we are encouraged by Magnit's impressive progress and receptiveness to our feedback and will continue to monitor how it addresses disclosure.

"Significant progress has been made already and Magnit continues to show its commitment to improvement by engaging to raise its understanding of best practice."

ESG IN EMERGING MARKETS

Emerging markets have made great strides when it comes to ESG over the years, and there is now a constellation of companies which can go head to head with their developed-market peers. Indeed, recent research[2] has underscored that emerging markets have caught up with developed ones when it comes to environmental and social performance, even if they – in aggregate – are lagging somewhat in terms of governance metrics. Granted, investors need to be cognizant of different ownership dynamics – government ownership is more prevalent, and while this may not be a problem, understanding the motivations and stakeholder alignment in such cases is important. Equally, family ownership is more common than in developed markets, but as studies have shown, investing alongside family owners can be a very beneficial long-term strategy[3].

LEADING THE WAY

We observe a wide range of approaches to ESG both at a company level and between countries, and in a number of areas emerging markets lead by example. For instance, in South Africa the adoption of the 'King Report on Corporate Governance' has led to some of the best integrated reporting anywhere in the world, communicating a clear holistic approach to strategy, planning and how companies' resources are used to create value.

Our work also shows another area where emerging markets differ from US norms is on board tenure and age profile, with generally better age diversity and shorter-tenured directors.

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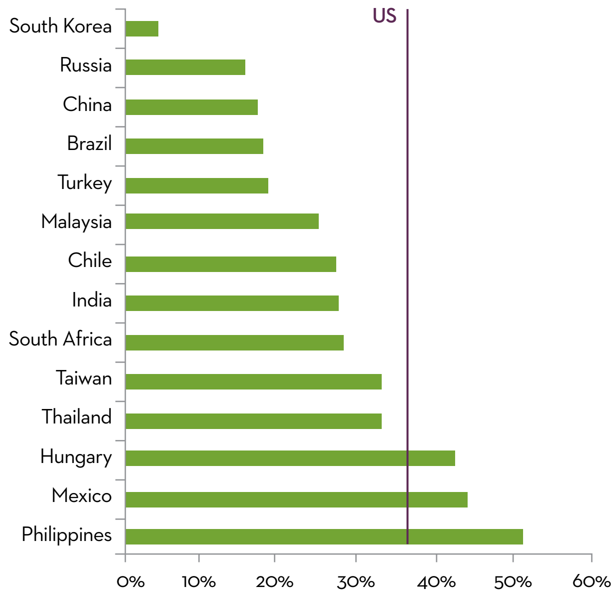
Average % of board directors with a tenure greater than 10 years



Source: Martin Currie and MSCI ESG Research. As at August 2017.

[2]Wai-Shin Chan et al., 'Global ESG Sector Playbook: Profiting from Emerging Markets,' HSBC, August 2017.
[3]Hubert Jeaneau et al., 'Why do Family-Controlled Public Companies Outperform? The Value of Disciplined Governance,' UBS Global Research, April 2015.

When it comes to environmental issues, government policy will often play a role. And here it is important to highlight that many emerging market countries have reaffirmed their commitment to the Paris Agreement on climate change, following the US's decision to leave.

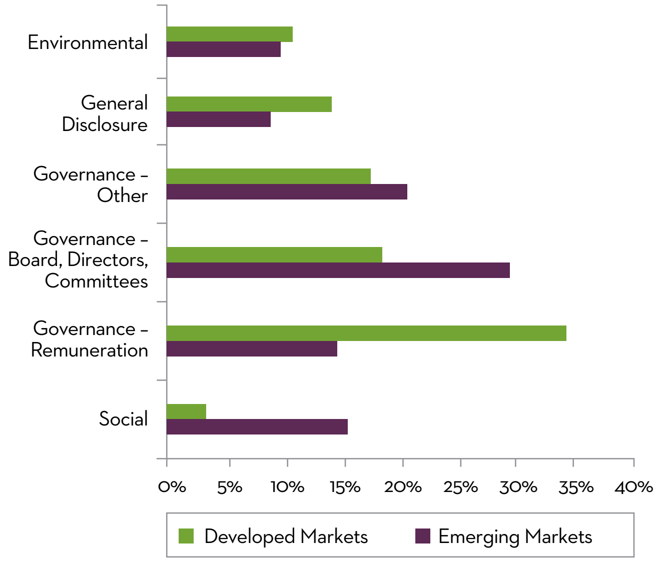
With regard to executive compensation – which regularly makes the headlines in developed markets – this issue is somewhat less controversial, due to the relatively modest pay packages offered to the typical emerging market executive. While incentive schemes still require scrutiny, our focus tends to be on ownership structures and board composition. This is reflected in our internal engagement data (see chart), with pay a far more prominent topic in developed markets.

ROOM FOR IMPROVEMENT

As mentioned, ownership by founders and governments is more common in emerging markets and this means that there is a greater focus on board dynamics, including director independence and nomination processes.

While South Africa leads the way on integrated reporting, there are clear laggards elsewhere in emerging markets. In Europe, where disclosure standards are very good, it would be reasonable to assume that those companies with poor disclosure also have a lax attitude towards ESG matters. However, it is not sensible to make this assumption in emerging markets. Rather than poor underlying practice, it is often simply a matter of disclosure, with management lacking an understanding of why these factors are of interest to investors and how they can be most effectively reported on.

Engagements in emerging markets vs. developed markets



Source: Martin Currie internal data. Breakdown of company-wide engagement topics for 2016 calendar year.

In our experience, there is a clear appetite for engagement, and learning by emerging market companies – a keenness that is often stronger than that exhibited by their developed-market counterparts. We are able to leverage our extensive experience and understanding of ESG matters to help companies deliver improved outcomes in this area. Active ownership, through our engagement and voting, is a key element of how we discharge our stewardship duties on behalf of our clients.

CASE STUDY: CREDICORP

Credicorp is another good example of a successful, long-term holding where we have a history of constructive engagement with management. It is Peru's leading financial group with 30–40% market share in the key product areas of wholesale and consumer banking. The Peruvian banking system is highly consolidated and deeply underpenetrated – a perfect combination. As a result, Credicorp has a long history of sustainable growth and strong capital returns, which we expect to be maintained over the coming years. We initiated a position in March 2011. Key sustainability risks identified at the time were weak environmental risk management in corporate banking and unclear responsible lending practices in retail lending. These areas are relevant as banks are increasingly held responsible for the socio-environmental impact of their corporate credit decisions – so there are reputational and legal risks here. Also, banks worldwide are under legal and social pressure for alleged mis-selling practices, risks that are especially high in less-developed economies such as Peru.

In this specific case, we engaged with senior management on both areas of concern, identifying risks and describing opportunities. We introduced senior management to best banking practice in other markets where we have strong relationships with leading banks, for example in South Africa. This led to a group sustainability review and a benchmarking exercise versus best industry practice – the outcome of which was its adoption of the Equator Principles (January 2013), a global standard risk framework for managing environmental and social risk in project financing. Secondly, Credicorp published its Stakeholders Relations Policy (October 2014) which commits the bank to promote a client-based culture inside the bank, recognising the risks of mis-selling to an unsophisticated customer base. Credicorp's receptiveness to our feedback, and evident willingness to improve its ESG performance, has been central to our strong conviction in its prospects.

MARTIN CURRIE AND ESG AT A GLANCE

The concept of stewardship is at the heart of our philosophy as active equity specialists, and ESG is a critical component of this, informing our research and engagement efforts. Analysis of these factors has been embedded in our emerging market team's stock research process since the inception of the strategy, and we routinely engage with businesses both privately and collaboratively with a view to effect change. Recent examples of the latter include areas such as water risks in the agricultural supply chain, fracking practices in the oil and gas sector, and cybersecurity, to mention but a few. While most of our engagement takes place in private, we will continue to join up with other investors when we deem this to be more impactful than acting alone.

As signatories to the Principles for Responsible Investment (PRI) we have committed to report on our activities in relation to responsible investing each year. In its latest assessment (for 2016) PRI awarded us the highest possible rating (A+) in each of the three top-level categories: 'strategy and governance', 'incorporation' and 'active ownership'. We have also received the highest ranking (Tier 1) by the Financial Reporting Council for our statement of compliance with the UK Stewardship Code. Importantly, we believe in holding ourselves to the same standards that we expect of others, and live our values through the management of our own business. This includes participating in industry initiatives to raise the profile of ESG issues, as well as sharing ideas about best practice.

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ACTIVE VIEWPOINT is just one part of our range of investment materials. To access further perspectives on our strategies and key investment themes, visit: www.martincurrie.com

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For further information on Martin Currie or our strategies, please visit our website – **www.martincurrie.com**
You can find your local contact at **www.martincurrie.com/contact_us**

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