

ESG INTEGRATION AS AN ALPHA SOURCE

Experience of Auriel Capital – Equity Market Neutral

The World Economic Forum Global Risks 2015 Risk report (Tenth Edition) identifies **10 risks likely cause an impact on a global scale in the next decade:**

- Interstate conflict
- Extreme weather events
- Failure of national governance
- State collapse or crisis
- Unemployment or underemployment
- Natural catastrophes
- Failure of climate-change adaptation
- Water crises
- Data fraud or theft
- Cyber attacks

All Have An E,S And/Or G Connection.

THREE 'CAMPS' OF RESPONSIBLE INVESTING

> Values-Based, Ethical-Investment

- Negative Screening
- "SIN" Sector-exclusions
- Personal preferences "subjective"
- Ethical indexes, funds
- Unclear evidence of outperformance
- Originally religious, later retail Investors

> Socially Responsible Investment, "SRI"

- Focus on ESG-disclosures
- "Best-in-Class"
- "Glossy CSR-reports" Risk of "Greenwash"
- Sustainability indexes, "FTSE 4Good"
- Some links to LT outperformance
- European investors, mainly retail

> "Materiality"-Based ESG-Analysis

- Sector-specific ESG-analysis, risk management, "HOW"
- "ESG-integration"
- Analytical risk focused, "objective"
- Standardisation: GRI, SASB, IR
- Clear links to LT outperformance
- European and US investors, institutional and retail

External analysis regarding ESG & Performance

➤ Deutsche Bank, June 2012¹

- Analysed 100 academic studies, 56 research papers, 4 meta-studies
- 100% of studies show strong ESG-companies have lower cost of capital
- 89% of studies show strong ESG-companies have stock outperformance

➤ University of Oxford, September 2014²

- Analysed 190 academic studies
- 88% of studies found strong ESG practices result in better operating performance
- 80% of studies show strong ESG-companies have stock outperformance

¹ Deutsche Bank Climate Change Advisors, June 2012: Sustainable Investing: Establishing Long-Term Value and Performance

² University of Oxford, September 2014, From the Stockholder to Stakeholder, How Sustainability Can Drive Financial Outperformance

HOW OFTEN DO RESEARCH PROVIDERS AGREE?

	Top 10%	Top 20%	Top 30%	Top 40%	Top 50%
V1/V2	33%	43%	47%	53%	61%
V1/V3	0%	27%	31%	43%	53%
V2/V3	0%	33%	47%	58%	67%
All3	0%	10%	22%	30%	40%

	Bottom 10%	Bottom 20%	Bottom 30%	Bottom 40%	Bottom 50%
V1/V2	17%	40%	49%	54%	63%
V1/V3	0%	23%	39%	45%	53%
V2/V3	0%	50%	55%	69%	70%
All3	0%	20%	33%	40%	45%

CORRELATION ANALYSIS

	E	E	E	E	E	E	S	S	S	S	G	G	G
E		0.28	0.22	0.25	0.37	-0.14	0.33	0.13	0.62	0.10	0.73	0.12	0.21
E	0.28		0.36	0.39	0.34	-0.07	0.25	0.31	0.17	0.26	0.30	-0.21	0.24
E	0.22	0.36		0.72	0.52	0.03	0.12	0.05	0.23	0.22	0.17	0.13	0.40
E	0.25	0.39	0.72		0.63	0.16	0.07	0.02	0.11	0.21	0.10	-0.05	0.57
E	0.37	0.34	0.52	0.63		0.13	0.18	0.05	0.24	0.27	0.26	0.01	0.47
E	-0.14	-0.07	0.03	0.16	0.13		-0.01	-0.11	-0.07	0.05	-0.11	-0.11	0.13
S	0.33	0.25	0.12	0.07	0.18	-0.01		0.05	0.42	-0.07	0.43	0.04	0.21
S	0.13	0.31	0.05	0.02	0.05	-0.11	0.05		0.10	0.09	0.10	-0.03	0.05
S	0.62	0.17	0.23	0.11	0.24	-0.07	0.42	0.10		0.11	0.52	0.27	0.13
S	0.10	0.26	0.22	0.21	0.27	0.05	-0.07	0.09	0.11		0.13	0.10	0.17
G	0.73	0.30	0.17	0.10	0.26	-0.11	0.43	0.10	0.52	0.13		0.15	0.23
G	0.12	-0.21	0.13	-0.05	0.01	-0.11	0.04	-0.03	0.27	0.10	0.15		0.00
G	0.21	0.24	0.40	0.57	0.47	0.13	0.21	0.05	0.13	0.17	0.23	0.00	

VER. 1.0 ESG INTEGRATION

Factor Name	Sectors with scores	Airlines	Automobiles & Parts	Banks NE	Basic Resources	Chemicals	Chemicals Fertilizers	Chemicals Healthcare	Comm. Vehicles & Trucks	Construct. & Material	Financial Services	Food & Beverage	Food Retailers	Forestry & Paper	Healthcare	Industrial Goods	Industrial Services	Insurance	Media	Oil & Gas	Pers & House-hd Goods	Pers & House-hd Luxury	Pharma & Biotech	Real Estate	Retail	Technology	Telecommunica-tions	Transportation Services	Travel & Leisure	Utilities
[REDACTED]	23	21%	21%		14%	15%	15%	15%	21%	18%			16%	14%	17%	15%	40%			32%	12%	12%		14%	16%	23%	39%	48%	12%	18%
euProdInnov	16	15%	15%			6%	6%	6%	15%	5%										9%	10%	10%	10%	10%		10%	11%		10%	8%
[REDACTED]	29	19%	19%	26%	25%	21%	21%	21%	19%	18%	26%	29%	22%	25%	24%	20%	14%	20%	24%	15%	17%	17%	27%	13%	22%	16%	13%	11%	17%	20%
[REDACTED]	18					6%	6%	6%		16%			11%			16%	14%	32%	13%	8%	18%	18%		31%	11%	13%		12%	18%	5%
[REDACTED]	17			12%	2%	1%	1%	1%			12%	3%		2%	3%					5%	2%	4%	4%				6%	2%	4%	2%
[REDACTED]	29	45%	45%	62%	59%	50%	50%	50%	45%	43%	62%	68%	51%	59%	56%	49%	32%	48%	57%	35%	40%	40%	63%	31%	51%	38%	32%	26%	40%	47%
[REDACTED]	29	65%	65%	56%	58%	60%	60%	60%	65%	65%	56%	61%	65%	58%	60%	65%	65%	55%	65%	63%	65%	65%	60%	65%	65%	55%	65%	65%	65%	63%
euShrhldrLoyalty	29	35%	35%	30%	31%	32%	32%	32%	35%	35%	30%	33%	35%	31%	32%	35%	35%	29%	35%	34%	35%	35%	32%	35%	35%	29%	35%	35%	35%	34%
[REDACTED]	6			8%	4%						8%	7%		4%				6%												
[REDACTED]	13			7%	7%	7%	7%	7%			7%			7%	7%			10%		4%			7%			16%				4%
[REDACTED]	7												23%		17%	25%							22%	66%	23%		24%			
[REDACTED]	10	15%	15%						15%			9%					6%		21%		42%	42%				43%			42%	
[REDACTED]	8				25%	16%	16%	16%		26%				25%			10%												21%	
[REDACTED]	11			54%							54%	39%	29%		38%	32%	25%	65%	36%				28%		29%					
[REDACTED]	10				33%								5%	33%		16%	13%		9%	14%			9%		5%			27%		
euIntellCap	18			13%		12%	12%	12%		26%	13%	17%	6%		6%	13%		6%	5%	17%			5%		6%		8%	21%		19%
[REDACTED]	12	51%	51%						51%	28%			6%			7%	23%		17%	52%				34%	6%					40%
[REDACTED]	18			29%		72%	72%	72%		20%	29%	26%	17%		25%			29%	8%		39%	39%	24%		17%		35%	32%	39%	
[REDACTED]	12				41%								6%	41%	12%	7%	23%			17%			11%		6%	57%	33%			40%
euSupplyChain	13	34%	34%	4%					34%		4%	8%	8%		4%				4%		18%	18%			8%					18%

VER. 2.0 ESG INTEGRATION

Environmental	<ul style="list-style-type: none"> • Carbon Efficiency • Energy Efficiency • Materials Efficiency 	<ul style="list-style-type: none"> • Water Use Efficiency • Air, Water, Ground Pollutants • Environmental Impact Risk
Human Capital	<ul style="list-style-type: none"> • Board Level Sustainability Structures • Recruitment Capabilities • Board Diversity & Skillset 	<ul style="list-style-type: none"> • Retention & Workplace Performance Strategies • Knowledge & Organisational Learning • Labour Rights
Organisational Capital	<ul style="list-style-type: none"> • Stakeholder Relations with Regulators • Supply Chain Management • Local Community Relationships • Local Market Knowledge /In-Country Management 	<ul style="list-style-type: none"> • Links to Core Business • Customer Relations / Satisfaction • Human Rights Performance
Adaptability	<ul style="list-style-type: none"> • Horizon Scanning / Trend Anticipation • Structures for Rapid Decision-making • Response to Demographic / Consumer Change 	<ul style="list-style-type: none"> • Response to Regulatory Change • Systems to Analyse all Forms of Risk • Non-Financial Performance Reporting
Innovation	<ul style="list-style-type: none"> • Commitment to R&D / Innovation • Market Penetration of New Products • Structures to Promote Innovation 	<ul style="list-style-type: none"> • Crowdsourcing Practices • Base of Pyramid Focus • Environmental Products Innovation

ALL THE SAME

	Environment	Human Capital	Organisational	Adaptability	Innovation
Environment		0.95	0.91	0.83	0.91
Human Capital	0.95		0.95	0.92	0.87
Organisational	0.91	0.95		0.93	0.84
Adaptability	0.83	0.92	0.93		0.74
Innovation	0.91	0.87	0.84	0.74	

FACTOR EXPOSURES OF ESG INTEGRATED PORTFOLIOS

	MktCap	GSCIBeta	GoldBeta	OilBeta	Cost Of Debt	CapStrR	Beta	Vols	IRBeta	AulmpVol	portDivInd	Leverage	Liquidity	DivYld	GrowthBeta
Vendor 1	3.7	-8.3	-4.4	-10.8	-1.1	-1.8	-7.6	-9.2	-3.6	-15.6	1.1	-0.3	0.6	-1.0	4.0
Vendor 2	3.2	-6.7	-3.6	-8.5	-1.0	-0.3	-5.6	-7.9	-2.8	-13.6	1.7	0.6	-0.9	-1.1	2.8
Vendor 3	3.3	-8.4	-4.5	-11.1	-1.1	-0.9	-7.6	-9.3	-3.6	-15.9	1.3	-0.4	0.0	-1.4	4.0
Vendor 4	3.7	-8.2	-5.0	-10.8	-1.2	-1.0	-6.7	-9.0	-3.2	-14.8	2.3	0.1	0.2	-0.4	3.3
Vendor 5	4.3	-7.1	-4.0	-9.7	-1.4	-1.5	-5.4	-8.2	-2.7	-13.5	1.3	0.6	-0.1	1.3	2.4

EXPOSURES BY SECTOR

	Value	Oil	MktCap	Gold	Growth	Cost Of Debt
Portfolio	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Aerospace & Defence	2.62%	0.68%	0.70%	1.29%	2.65%	3.62%
Automobiles & Parts	6.38%	3.93%	2.28%	-3.14%	6.37%	4.87%
Basic Resources	-2.65%	-1.77%	0.50%	-0.44%	-2.60%	-3.98%
Chemicals	6.94%	12.99%	2.38%	17.56%	6.70%	6.96%
Chemicals Healthcare	1.17%	1.42%	1.01%	-0.77%	1.30%	3.59%
Construct. & Material	11.75%	9.49%	-0.18%	12.48%	11.78%	9.64%
Food & Beverage	5.07%	5.58%	31.51%	8.20%	5.11%	24.99%
Food Retailers	2.90%	1.38%	0.33%	6.05%	2.91%	0.20%
Healthcare	3.03%	0.82%	1.08%	-2.35%	3.08%	-6.09%
Industrial Goods	6.90%	10.19%	5.63%	14.77%	6.95%	10.36%
Industrial Services	10.37%	9.56%	0.61%	7.09%	10.41%	-1.57%
Insurance	13.01%	10.67%	-1.20%	9.24%	12.96%	3.13%
Media	-1.64%	0.01%	0.91%	-5.62%	-1.55%	-8.97%
Oil & Gas	4.34%	9.68%	18.12%	10.58%	4.24%	13.48%
Pers & Household Goods	4.99%	5.79%	8.70%	2.93%	4.96%	1.67%
Pers & Household Luxury	0.95%	0.88%	4.56%	0.20%	1.01%	4.85%
Pharma & Biotech	3.34%	4.09%	15.39%	9.51%	3.31%	10.47%
Real Estate	-0.71%	-1.13%	1.02%	-2.52%	-0.65%	2.85%
Technology	6.31%	3.86%	3.95%	2.21%	6.30%	4.39%
Telecommunications	4.96%	3.11%	0.61%	2.15%	4.88%	9.82%
Travel & Leisure	4.61%	4.87%	0.45%	7.05%	4.56%	2.67%
Utilities	5.36%	3.90%	1.64%	3.55%	5.34%	3.34%

ESG REPLICATION

	T-stat	Beta
Intercept	1.62	0.00
MktCap	15.61	2.98
GoldBeta	-1.8	0.00
OilBeta	-0.83	0.00
CostOfDebt	-5.11	0.00
Beta	-2.06	-0.01
ValueBeta	-6.34	-0.07
R Square	0.74	

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