HEALTH WEALTH CAREER

THE INVESTMENT LANDSCAPE FOR ENDOWMENTS, FOUNDATIONS AND CHARITABLE ORGANISATIONS

TUESDAY 5TH FEBRUARY 2019

MAKE TOMORROW, TODAY MERCER

YOUR PRESENTERS

RUPERT WATSON

Head of Asset Allocation

- Rupert is responsible for the asset allocation strategy of our discretionary mandates, both in terms of dynamic and strategic asset allocation.
- Rupert manages clients' Growth Portfolios as well as the Mercer Diversified Growth Fund

HILL GASTON

Senior Investment Consultant

- Hill is responsible for advising institutional investors on sustainable investment strategies.
- Hill provides advice to a broad range of clients on integrating Environmental, Social and Corporate Governance (ESG) issues throughout their investment processes.

JAN-HEIN VAN DEN AKKER

Senior Portfolio Manager

- Jan-Hein is responsible for fund manager selection, monitoring and blending of all equity investment products.
- Jan-Hein also assists the Chief Investment Officer with the asset allocation and implementation process and product development

PAUL FLEMING

Head of Investment Solutions UK Charities, Endowments and Foundations

- Paul is responsible for ensuring the full range investment options are made available to Mercers Not-For-Profit clients.
- Paul leads on structuring investment portfolios, creating the most efficient implementation of our strategic advice

AGENDA

01 MARKET OUTLOOK

Outlook for 2019

How not-for-profits should be thinking about positioning their portfolio and asset allocation decisions

02 MERCER'S APROACH TO SUSTAINABLE INVESTING

The reality and implementation of a responsible investment policy in action

03 KEY TAKEAWAYS

What are the next steps you can take for your not-for-profit organisaton

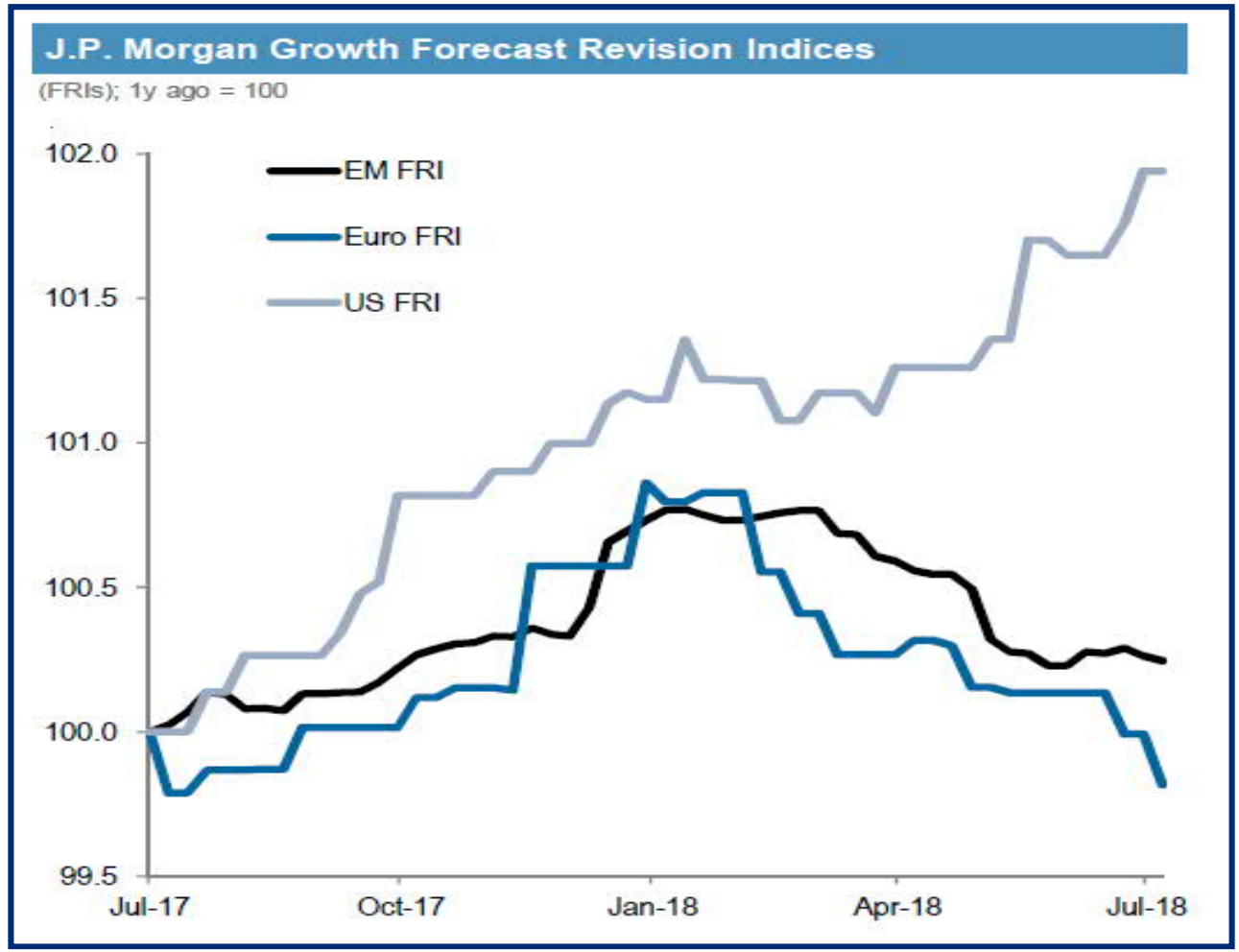
04 Q&A

Ask our expert panel your questions.

MARKET OUTLOOK 2019

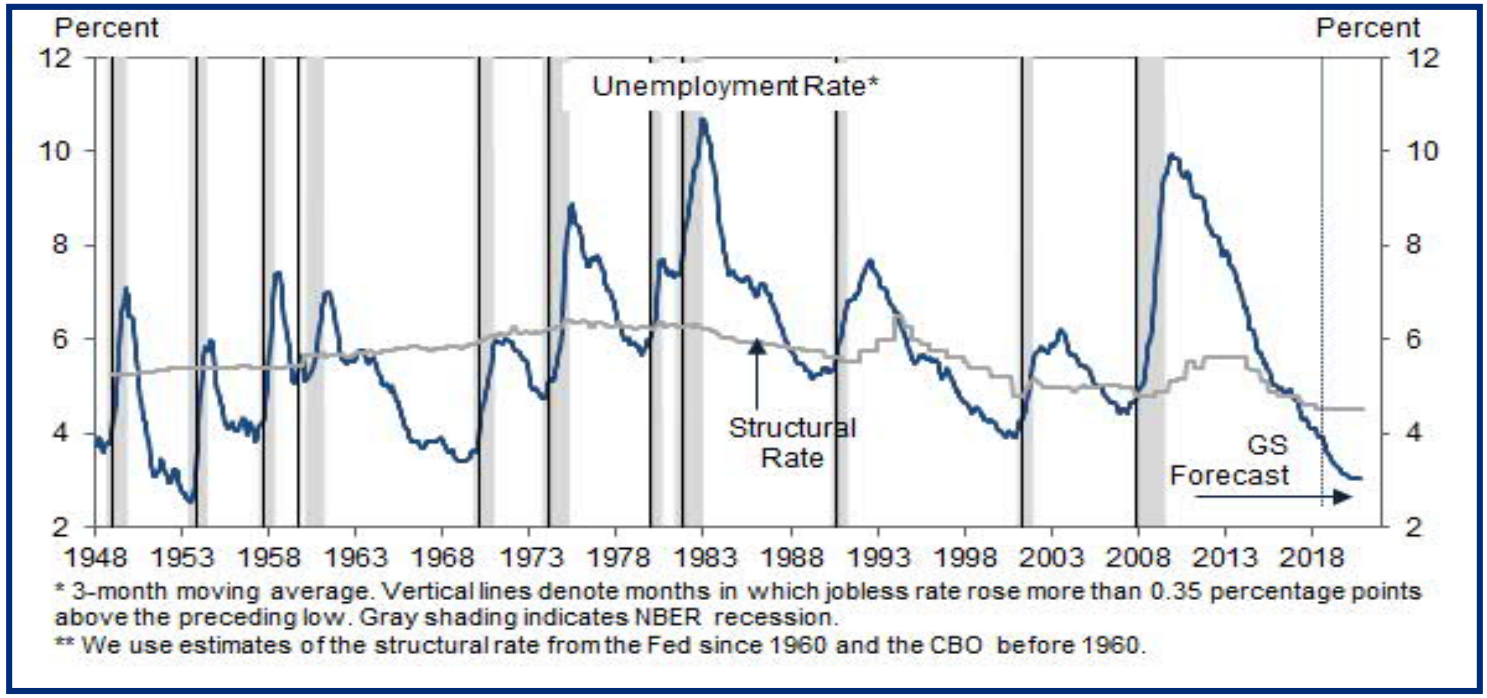
HOW NOT-FOR-PROFITS SHOULD BE THINKING ABOUT POSITIONING THEIR PORTFOLIO AND ASSET ALLOCATION DECISIONS

WEAKNESS SEEN OUTSIDE THE US



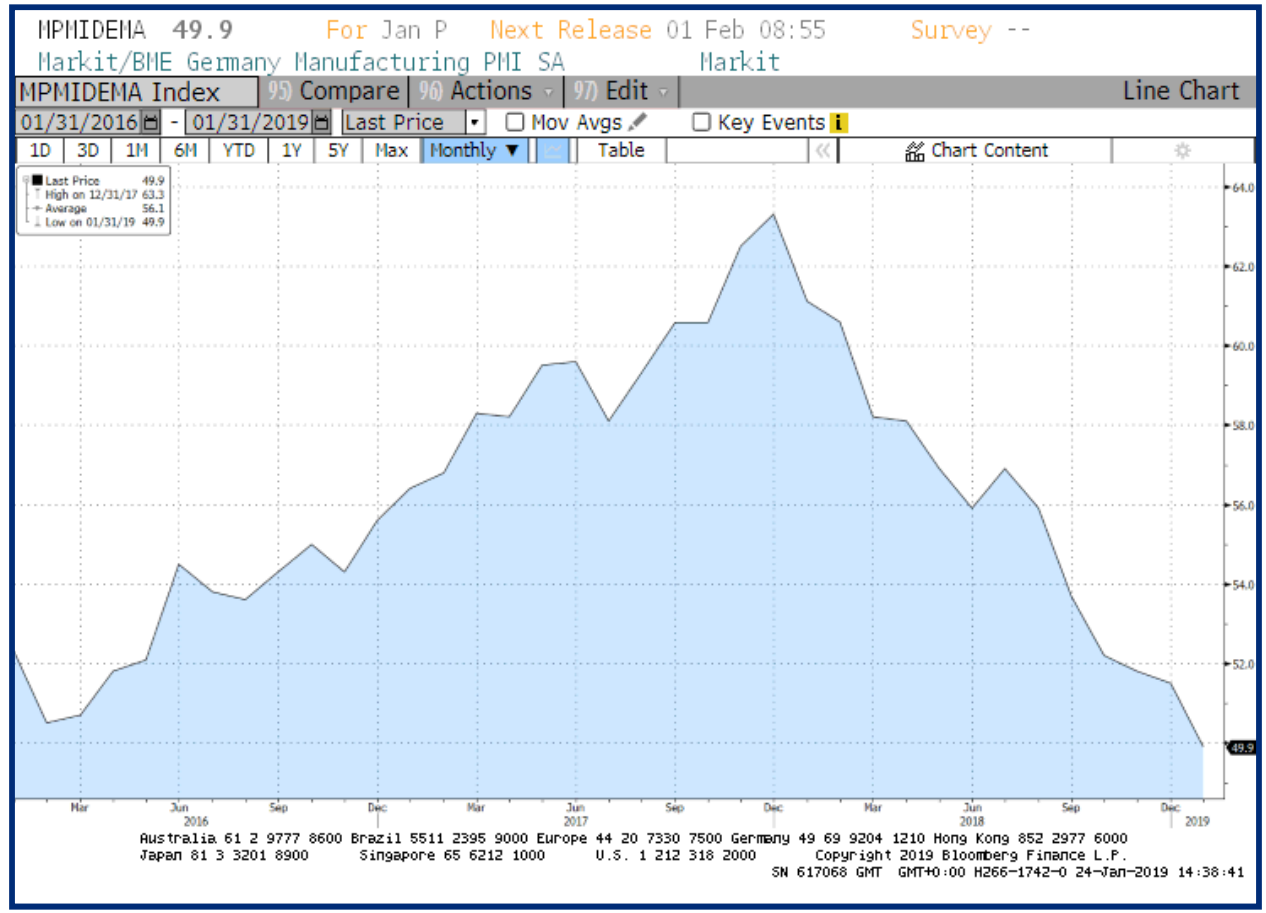
SOURCE: JP MORGAN

US UNEMPLOYMENT LOW AND GOING LOWER



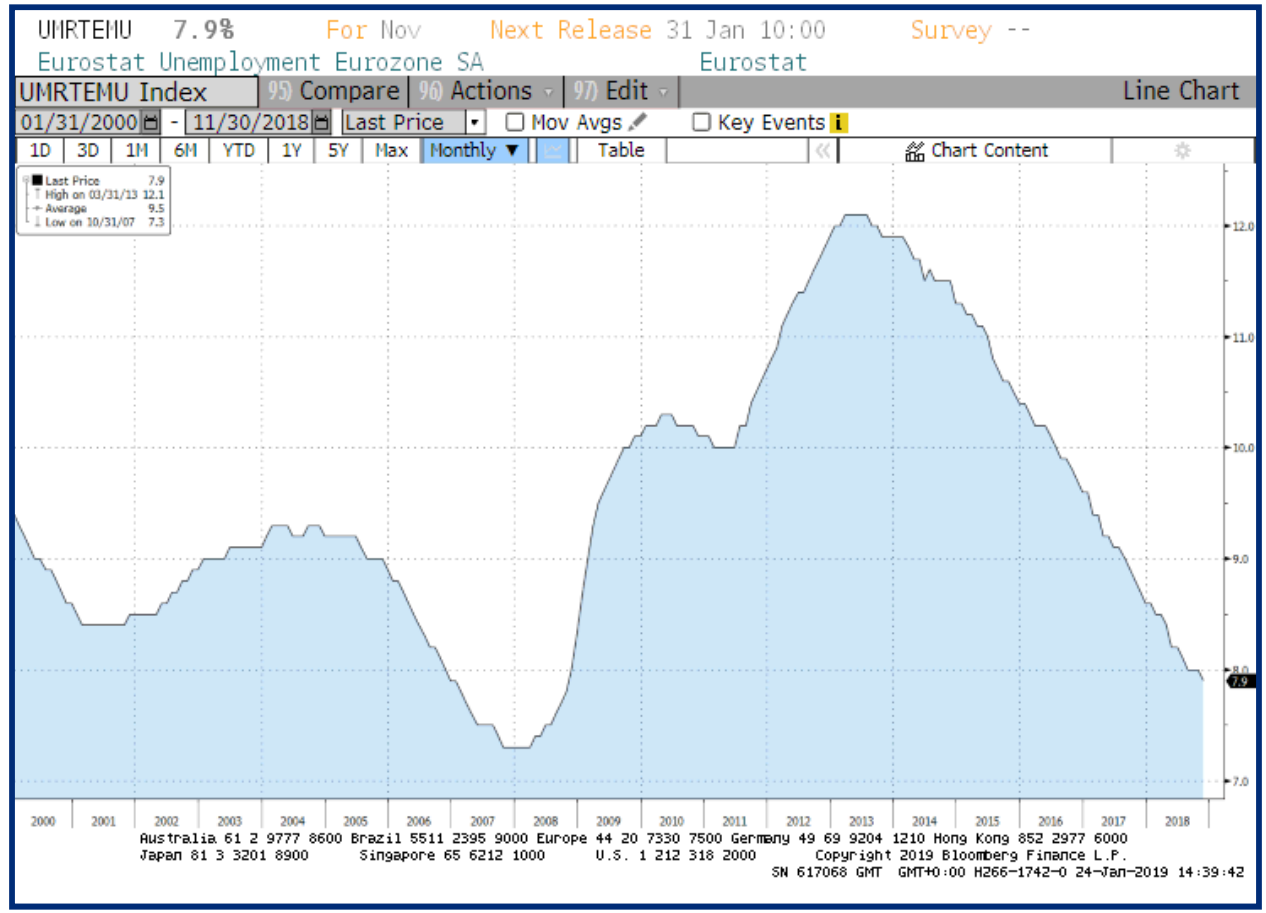
SOURCE: GOLDMAN SACHS

MATERIAL SLOWDOWN IN GERMANY PROBABLY TEMPORARY



SOURCE: BLOOMBERG

EUROZONE UNEMPLOYMENT BACK TO NORMAL

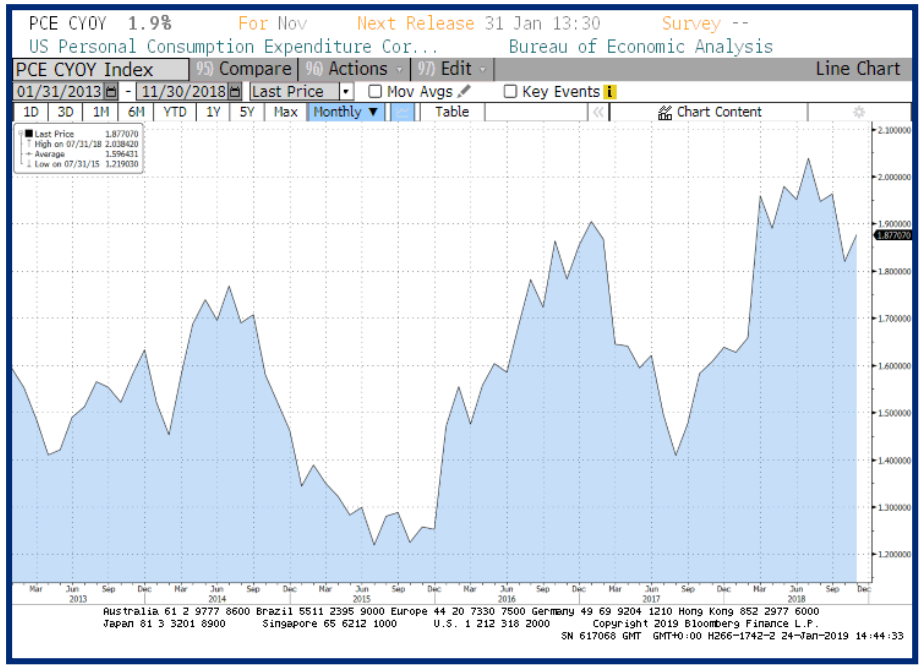


SOURCE: BLOOMBERG

WITH DEVELOPED WORLD UNEMPLOYMENT AT MULTI DECADE LOW, WAGES AT LAST GOING UP

SOURCE: GOLDMAN SACHS

US INFLATION AT TARGET. EUROZONE SLOWLY RISING TOO.



SOURCE: BLOOMBERG, JP MORGAN

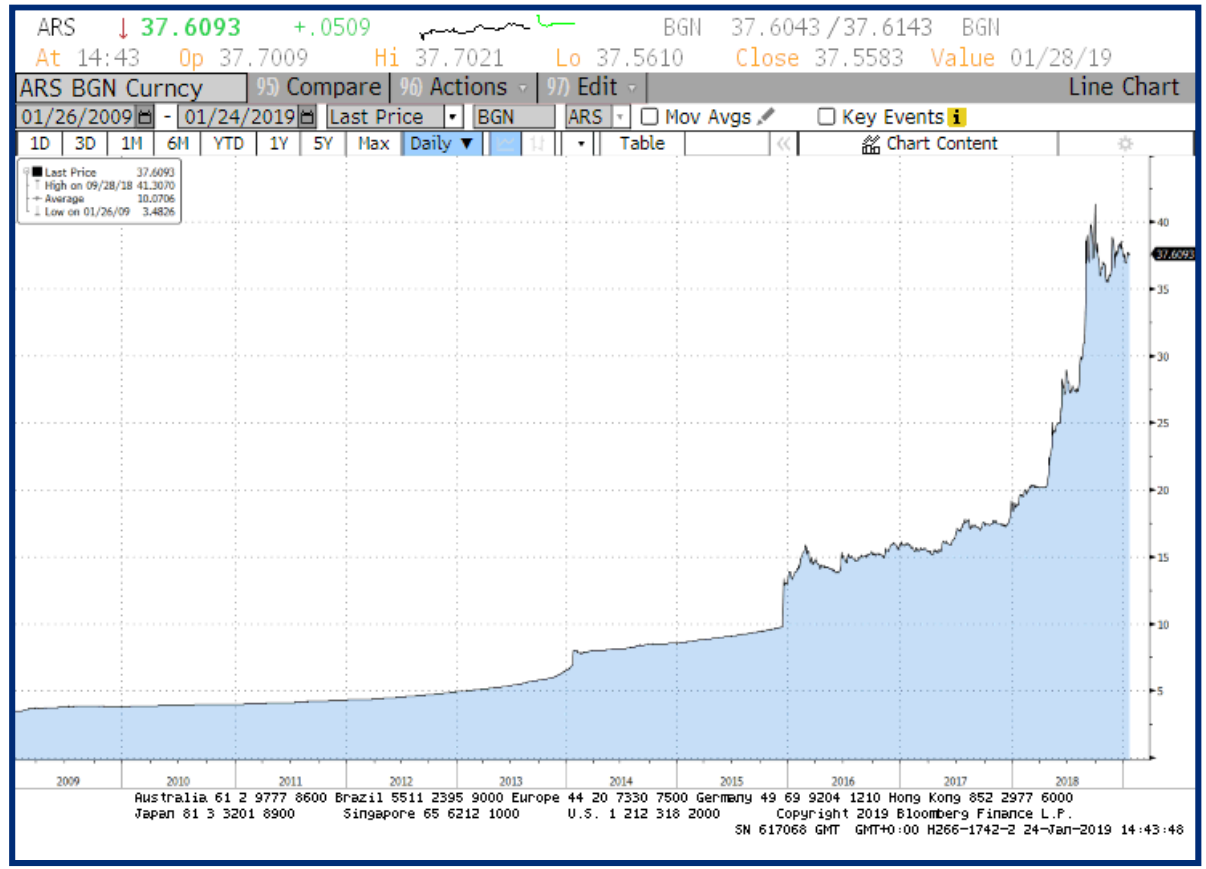
EM AND CHINA HAVE SLOWED SHARPLY AFTER STRONG 2017 AND START TO 2018

CHINESE GROWTH HAS SLOWED

SOURCE: GOLDMAN SACHS

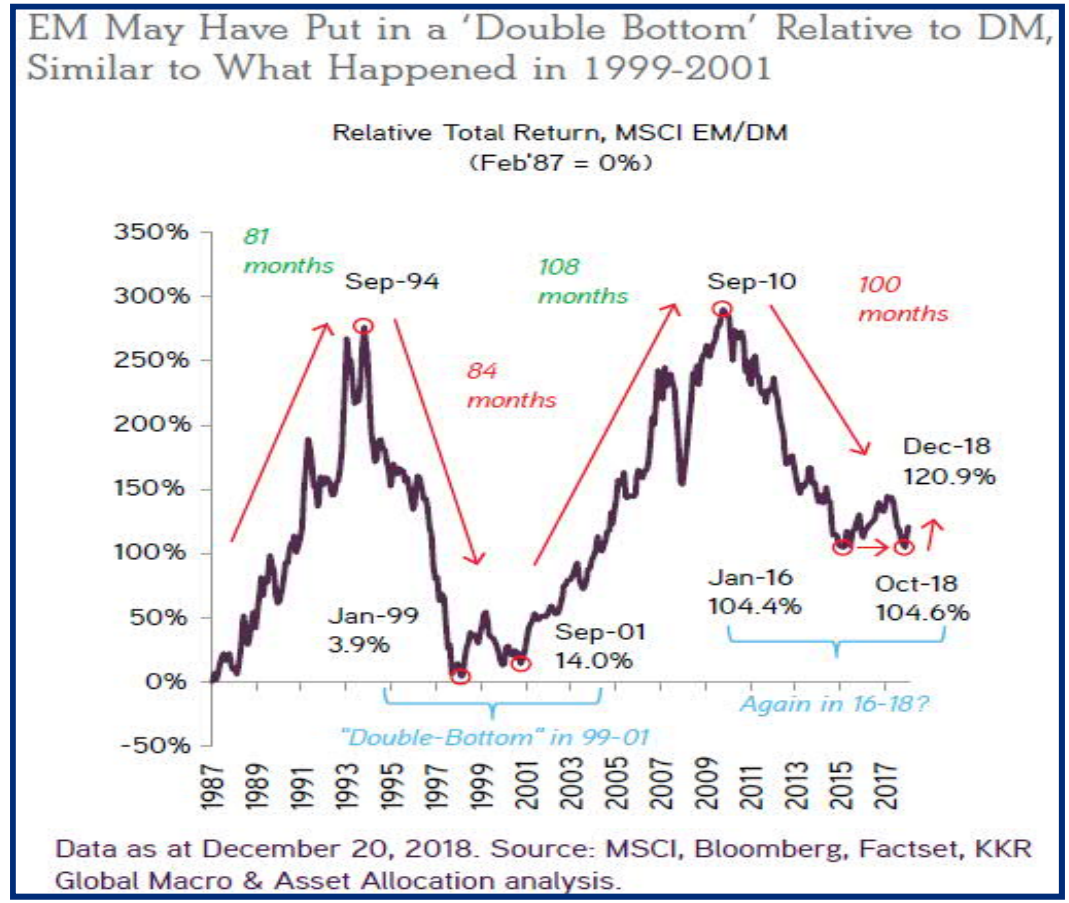
WHILE FX CRISIS HIT ARGENTINA & TURKEY. NOW STABILISING

ARGENTINIAN PESO IN FREE FALL



SOURCE: BLOOMBERG

EM EQUITIES CHEAP & COULD OUTPERFORM MATERIALLY



SOURCE: KKR

EM DEBT ALSO ATTRACTIVE

SOURCE: BLOOMBERG

BOND MARKET EXPECTING FED TO CUT NEXT YEAR. FED EXPECTS TO MOVE BEYOND 3%

SOURCE: BLOOMBERG

GLOBAL DAA DASHBOARD
MAIN ASSET CLASSES 2019 Q1

* In lieu of cash, investors might consider liquid alpha-oriented strategies with low sensitivity to equity, credit and duration.

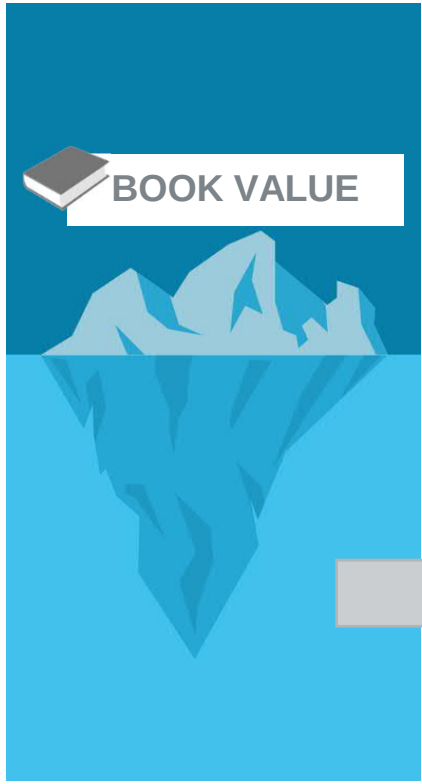
MERCER'S APROACH TO SUSTAINABLE INVESTING

THE REALITY AND IMPLEMENTATION OF A RESPONSIBLE INVESTMENT POLICY IN ACTION

ESG: RISK, RETURN AND REPUTATION

A BROADER PERSPECTIVE – AN ABILITY TO SUSTAIN

What is missing from current finance / investment processes?
How might the future be different to the past?



MACRO RISKS INCLUDING CLIMATE CHANGE

Top 5 Global Risks - Likelihood

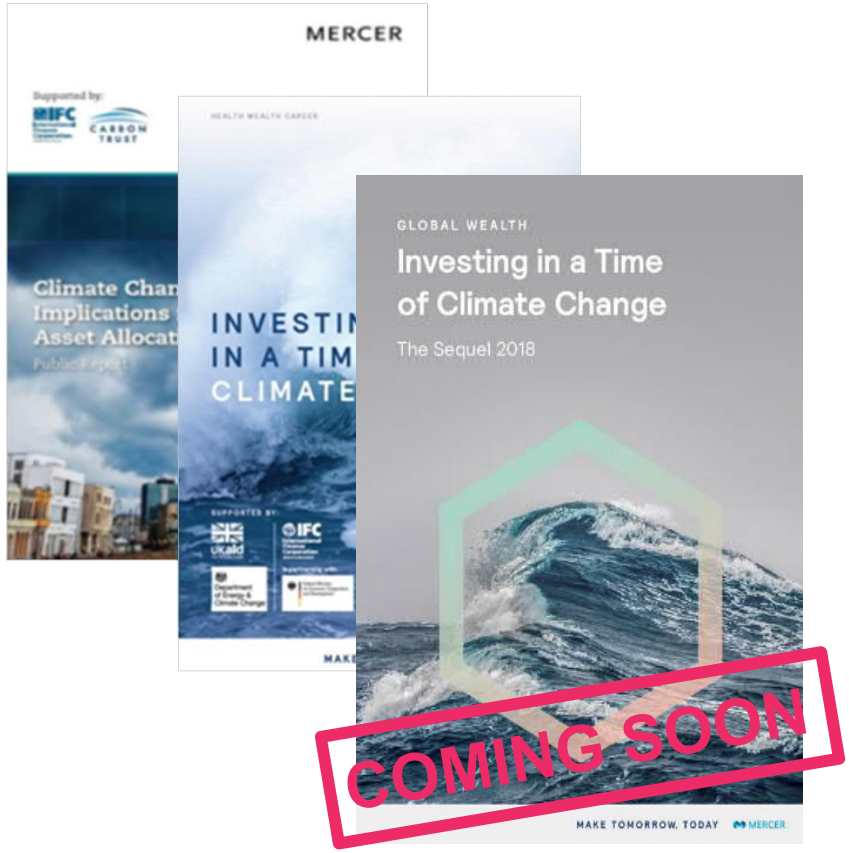
1	Extreme weather events
2	Failure of climate change mitigation and adaption
3	Natural disasters
4	Data fraud or theft
5	Cyber attacks

Top 5 Global Risks - Impact

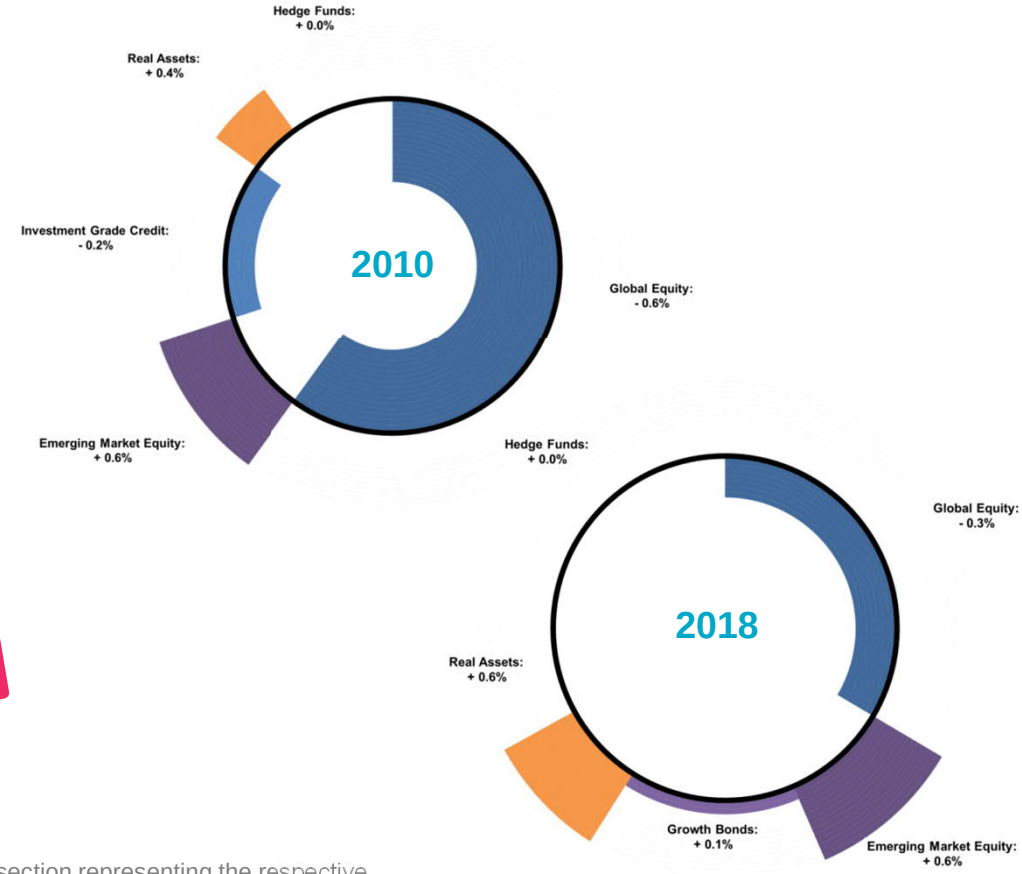
1	Weapons of mass destruction
2	Failure of climate change mitigation and adaption
3	Extreme weather events
4	Water crisis
5	Natural disasters

Source: World Economic Forum, Global Risks Report 2019

CLIMATE SCENARIO MODELLING



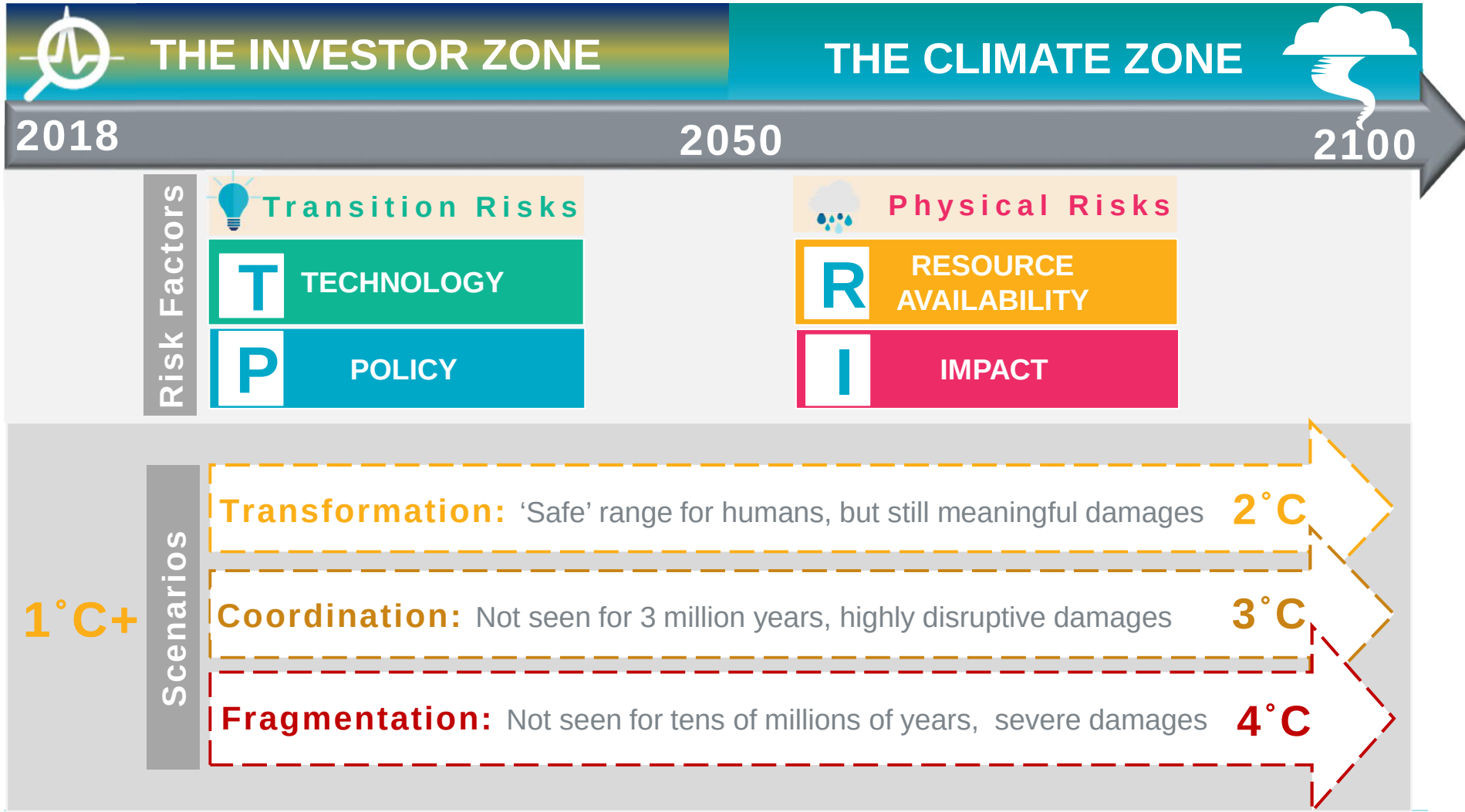
Annual Additional Return Impact – over 10 Years (2˚C Scenario)



The black circle represents the total portfolio, with the width of each asset class section representing the respective percentage weighting. Asset class sections expected to experience a reduction in returns will move towards the circle centre and those expected to experience additional returns will move outwards from the circle.

CLIMATE RISK FACTORS AND SCENARIOS

Significant increases in GHG emissions are raising average temperatures and changing the Earth's climate



THREE REASONS FOR INVESTORS
WHY?

MERCER BELIEF STATEMENTS - SUSTAINABILITY

- ESG factors can have a material impact on long-term risk and return outcomes.
- Climate change poses a systemic risk given the low-carbon transition and physical impacts of different climate outcomes.
- Stewardship (voting and engagement) gives investors an opportunity to enhance the value of companies and markets.
- Taking a broader and longer-term perspective on risk, improves risk management and identifies new investment opportunities.

We believe a sustainable investment approach - *where investors consider ESG factors in risk, return and reputation decisions* - is likely to deliver more sustainable outcomes.

THE REGULATOR IS TELLING US SOMETHING

THROUGH 'COULD' AND 'SHOULD' TO 'MUST'

INVESTMENT DECISION MAKERS WITH DISCRETIONARY POWERS HAVE A FIDUCIARY DUTY TO THEIR BENEFICIARIES, WITH INTERPRETATION OF THESE DUTIES EVOLVING OVER TIME

1992

Rio Earth Summit
UN Conference on Environment & Development

2000

UK Disclosure Regulation

- First pensions disclosure regulation

2000

UN Global Compact launched

- Ten sustainability principles

2005

Freshfields Report

- Legal opinion on ESG having financial impacts and ESG analysis was consistent with fiduciary duty, arguably required.

2006

UN Principles for Responsible Investment (PRI) launched

Six principles founded in environmental, social and corporate governance (ESG) factors having potential risk and return impacts

2008

Global financial crisis and subsequent tax payer funded banking bailout

2010

UK Stewardship Code

- Asset owner / manager systemic role as 'stewards
- Engaging with companies on good corporate governance;

2012

Kay Review

- Raised short-termism issues and fiduciary duty confusions as problems.

2014

UK Law Commission

"No impediment to trustees taking account of ESG factors where they are, or may be, financially material".

2015

Paris Agreement

2016 - 2018

EU IORP II 2016

- Consider ESG incl. climate change and stranded asset in IPSs.

Global FSB Task Force on Climate-related Financial Disclosures (TCFD) 2017

UK DWP Regulates ESG into Trust based scheme SIPs 2018

UK FCA consultation "evaluating ESG", "climate change", due Q1 2019

EU Action Plan for Sustainable Finance 2018 Changes in MIFID, IDD, IORP II, Non-Financial Reporting expected)

- Investor Duty
- Green Taxonomy
- Benchmarks
- Role of Institution (EIOPA, ESMA, EBA)

A SUSTAINABILITY FRAMEWORK

THE EVOLUTION AT MERCER

2004-2006

- RI consulting practices developed and new team formed
- Mercer advises UN on PRI development

2007-2010

- Launches ESG ratings platform for investment strategies
- Publishes many ESG materiality and education papers

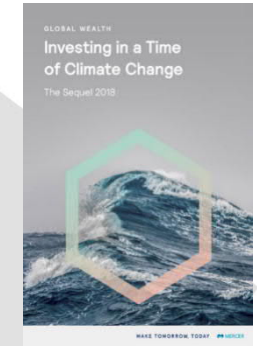
PRI Principles for Responsible Investment

2011-2013

- Climate Change and Strategic Asset Allocation report
- MMC launches Climate Change Task Force managed by Mercer
- Sustainable Opportunities private markets solution launched

2014-2015

- Investment beliefs formalised
- Sustainable Growth Framework
- Investing in a Time of Climate Change report
- ESG ratings for passive equity managers
- ESG ratings reach over 5,500 strategies
- Sustainable Investment Policies established for delegated solutions



2016-2019

- Sustainable Global Equity Fund launched and second Sustainable Opportunities closes
- Mercer represented on FSB Task Force on Climate-related Financial Disclosure
- Investment beliefs updated - strengthened
- Investing in a Time of Climate Change Sequel due for release

GOVERNANCE – BELIEFS TO PORTFOLIO

BELIEFS

We believe a sustainable investment approach is more likely to create and preserve long-term investment capital

POLICY & PROCESSES

Sustainable Investment Policy since 2015, updated November 2017:

1. ESG integration, aiming for highly rated strategies vs peers.
2. Climate change integration, that follows the recommendations of the FSB Task Force.
3. Stewardship monitoring, on voting and engagement activity and UK Stewardship Code.
4. Taking a broader and longer-term perspective on risk, including sustainability trends.
5. Screening or exclusions approach.

The process and responsibilities for policy execution is clearly documented.

PORTFOLIO

There are four key strategies for portfolio implementation

- INTEGRATION
- STEWARDSHIP
- INVESTMENT
- SCREENING

FROM THEORY TO PRACTICE

SUSTAINABILITY FRAMEWORK
FOUR STRATEGIES FOR IMPLEMENTATION

Stewardship

Annual Stewardship Monitoring report

Review:

- Polices using the UK Stewardship Code principles
- Engagement priorities
- Voting and engagement activity

Integration

ESG Ratings included in quarterly performance report

- ESG Ratings review vs asset class peer group
- Carbon foot-printing of equity portfolios
- Climate scenario modelling

Investment

Sustainable Global Equity Fund included in the model growth portfolio 2016

- Semi-annual reporting on the Sustainable Global Equity Fund

Sustainable opportunities Fund available within PIP V (Private Markets)

Screening

- Exclusion framework for equities* and fixed income
- Screening reviews for the Sustainable Global Equity Fund

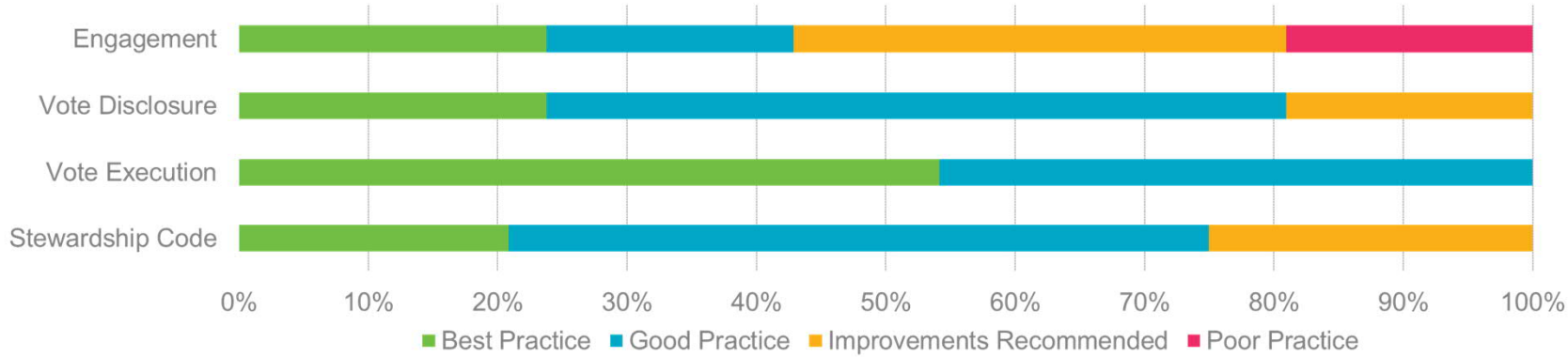
And coming soon…

- Climate-related financial disclosure
- Sustainable index development

* Equities includes both active and passive equities however market cap weighted indices are excluded at this time.

STEWARDSHIP
MONITORING LEADS TO RESULTS

STEWARDSHIP MONITORING 2018 – AGGREGATE RESULTS



MANAGER ENGAGEMENT TOPIC PRIORITIES

- **Governance:** Executive compensation; Board independence; Corruption.
- **Environmental:** Climate change – disclosure and strategy; Pollution.
- **Social:** Supply chain (modern slavery); Human rights, Community relations.

Emerging themes from leading managers also include:

- Diversity & inclusion; Sustainable Development Goals; Cybersecurity; Antibiotic resistance; Opiods; Sugar; Carbon emissions & cryptocurrencies.

UK STEWARDSHIP CODE REVIEW

* The UK Stewardship Code review is a firm level assessment, while the Voting and Engagement review is a strategy level assessment.

INTEGRATION
MERCER'S ESG RESEARCH PROCESS

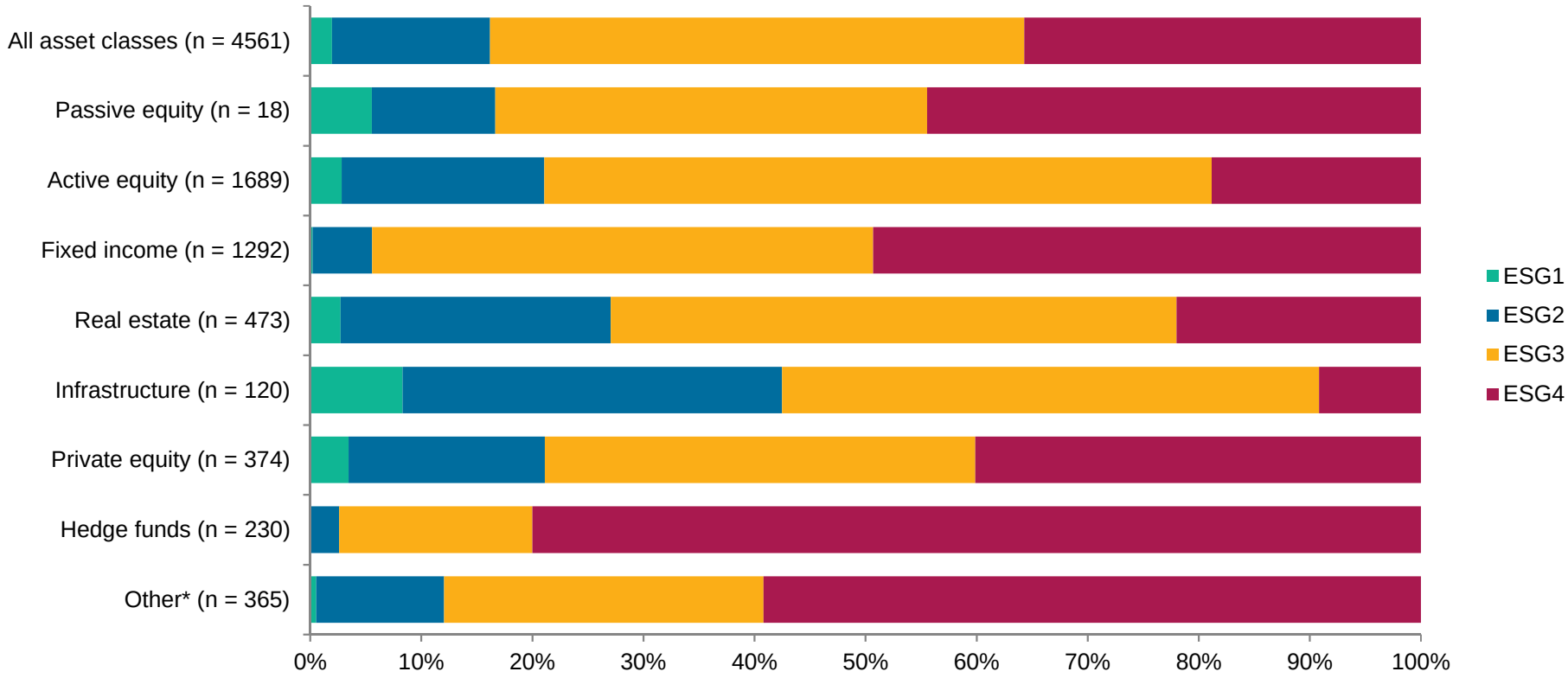
- Mercer's ESG ratings have been undertaken by Mercer's global manager research team since 2010, as part of the standard research process by strategy
- Rating represents our assessment of how ESG factors are included within a strategy's process for: Idea Generation, Portfolio Construction, Implementation, & Business Management
- ESG 1 = highest possible rating and ESG 4 = lowest possible rating

ESG1	ESG2	ESG3	ESG4
Leader in the integration of ESG factors and active ownership into core processes	Less advanced than ESG1 but with **moderate integration of ESG factors** and active ownership	**Limited progress** with ESG integration and active ownership, albeit with **signs of potential improvement**	**Little or no integration of ESG factors** and active ownership into core processes and no strong indication of future change

- Used in different ways:
  - As a screen for highly rated strategies e.g. only ESG2 and above
  - As a differentiator in monitoring questions and selection processes

INTEGRATION
MERCER ESG RATINGS BY ASSET CLASS

Distribution of 4,500+ Mercer ESG ratings*



Over **4,500** strategies rated currently – ratings began in **2008**

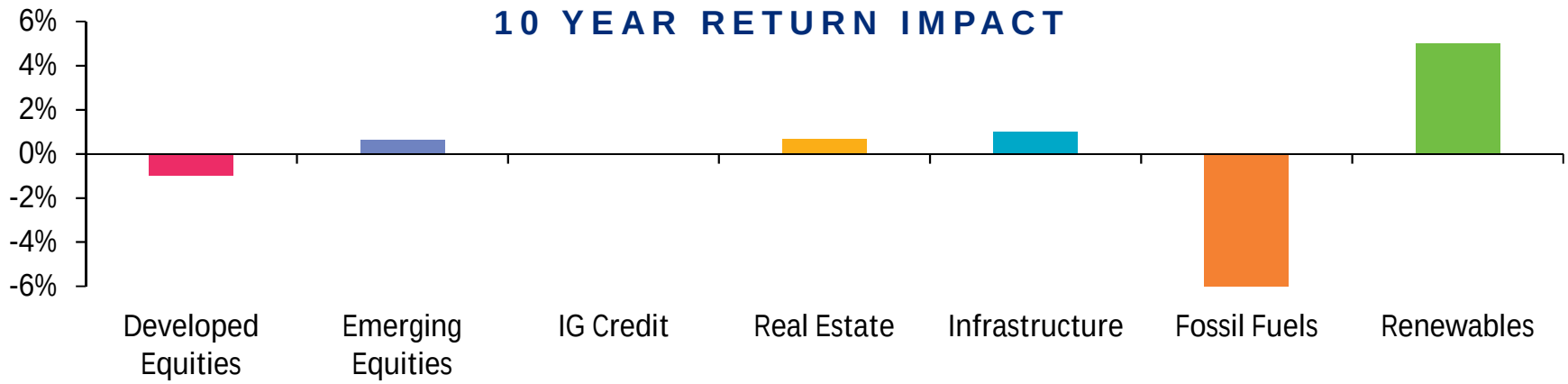
Less than **17%** achieve an **ESG1** or **ESG2**

ESG ratings for passive equity introduced in **2014**

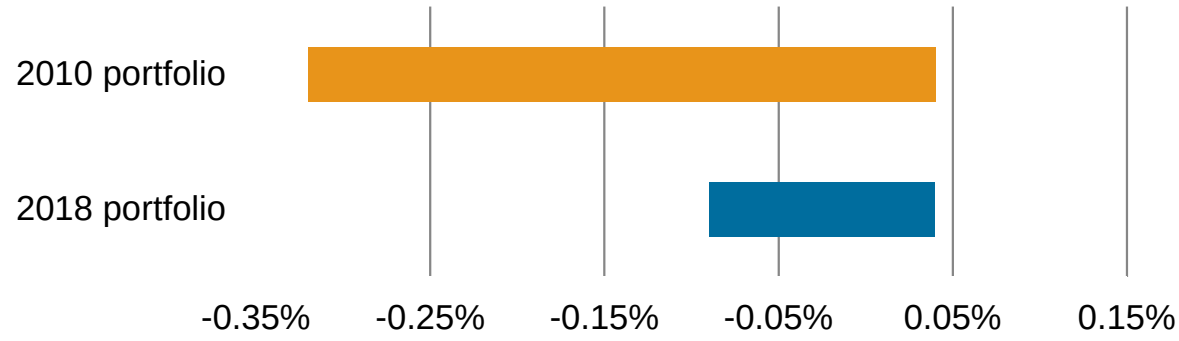
* Other includes multi-asset, private debt, natural resources
**Analysis as at June 2018

INTEGRATION
CLIMATE CHANGE

10 YEAR RETURN IMPACT



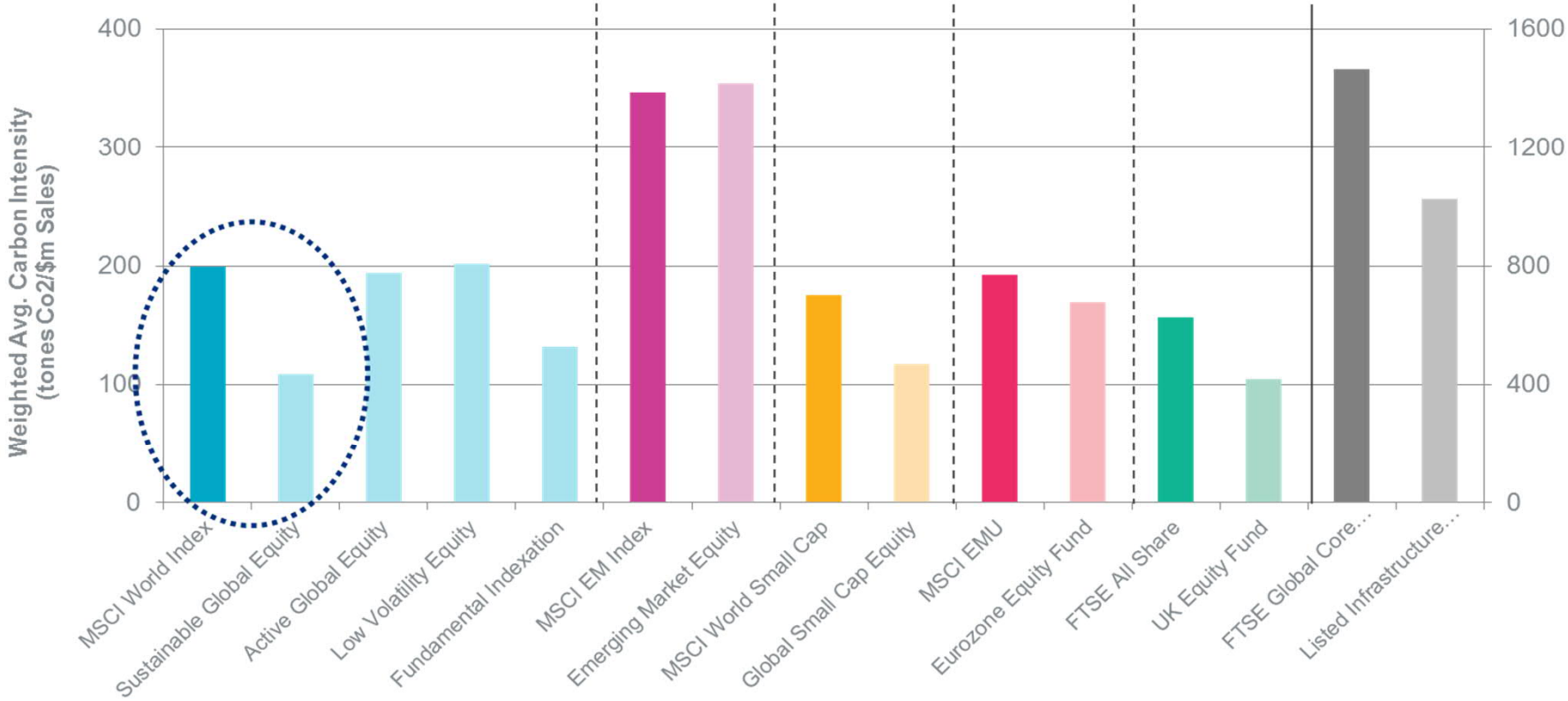
PORTFOLIO CLIMATE CHANGE RETURN IMPACT



INTEGRATION
CARBON FOOTPRINT ANALYSIS

Reviewed 9 equity funds. **7 funds (78%)** have a lower carbon intensity than their benchmarks.

Portfolio's Weighted Average Carbon Intensity (WACI),
calculated as the sum of (scope 1 & 2) tCO2 emissions / US$ revenue



*Note: Listed Infrastructure on secondary axis on RHS – same units (i.e. tones Co2/$m Sales).

INVESTMENT
NEW SOLUTIONS – NEW OPPORTUNITIES

RENEWABLE AND ALTERNATIVE ENERGY

Solar, wind, wave, biofuels, and geothermal technology

ENERGY EFFICIENCY

Storage plus power network, industry, building, and transport efficiency

WATER INFRASTRUCTURE AND TECHNOLOGIES

Irrigation, storage, treatment, drainage and flood protection

POLLUTION CONTROL

Pollution control solutions and environmental testing

WASTE MANAGEMENT AND TECHNOLOGIES

Recycling processing, hazardous and general waste management

HEALTH AND SOCIAL SERVICES

Positive impacts for social development and poverty or aging population

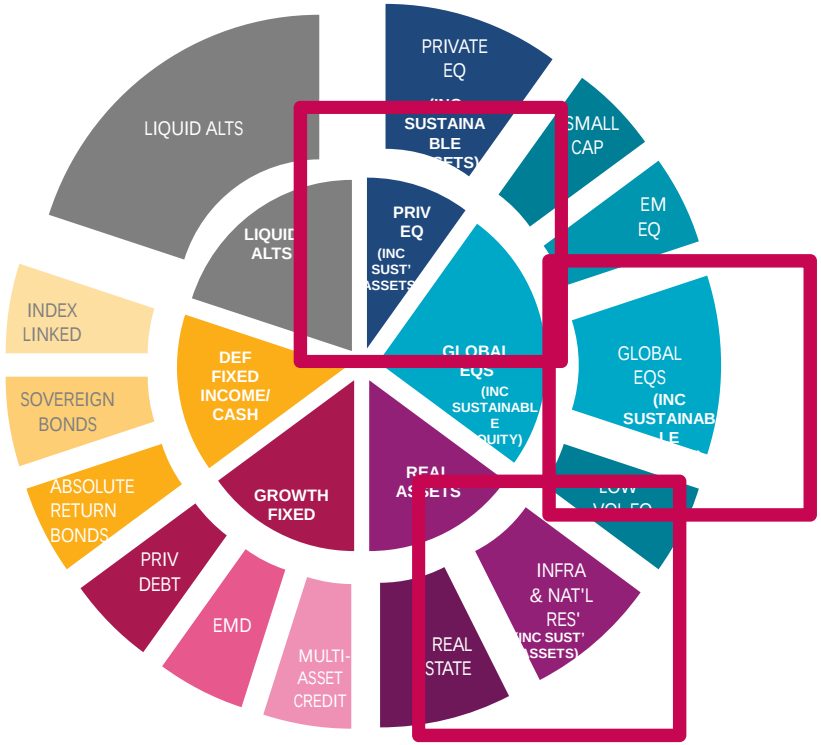
SUSTAINABLE CONSUMER GOODS

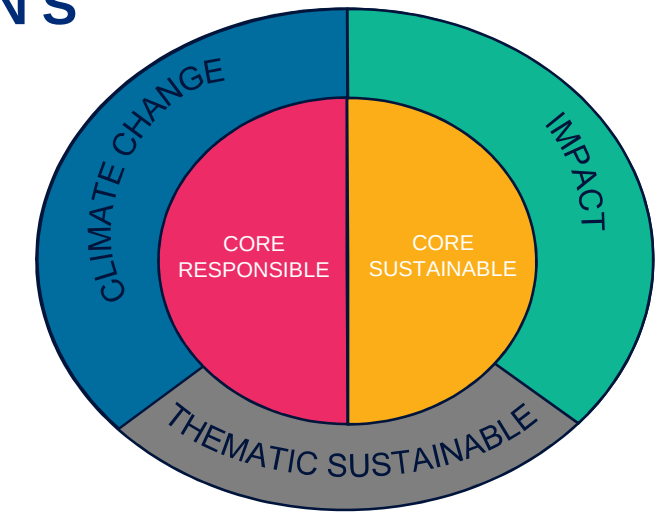
Meeting shifting consumer demands in sourcing and technology

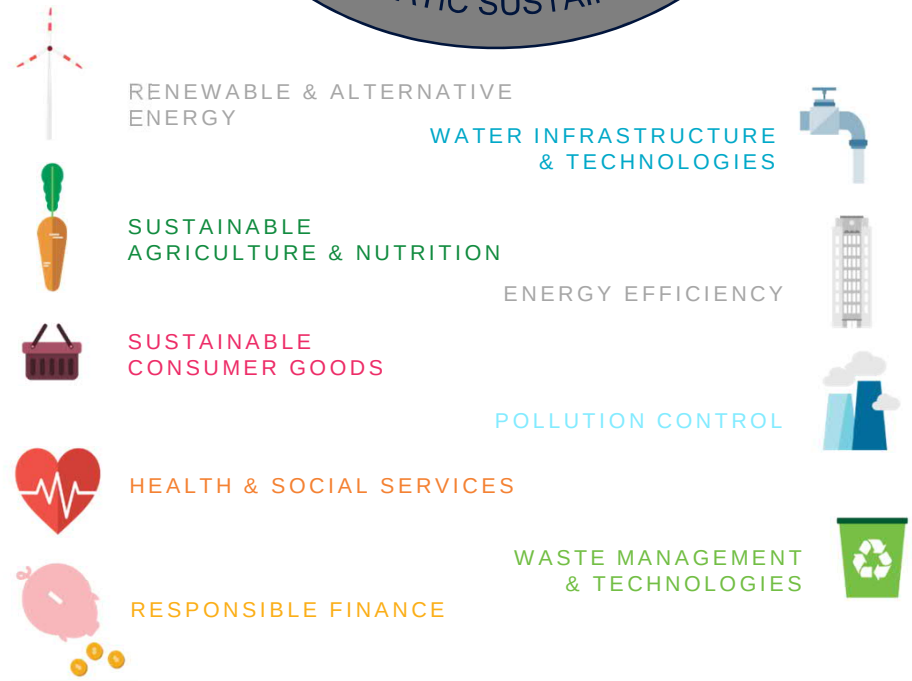
RESPONSIBLE FINANCE

Supporting role for real economy

INVESTMENT
SUSTAINABILITY ALLOCATIONS





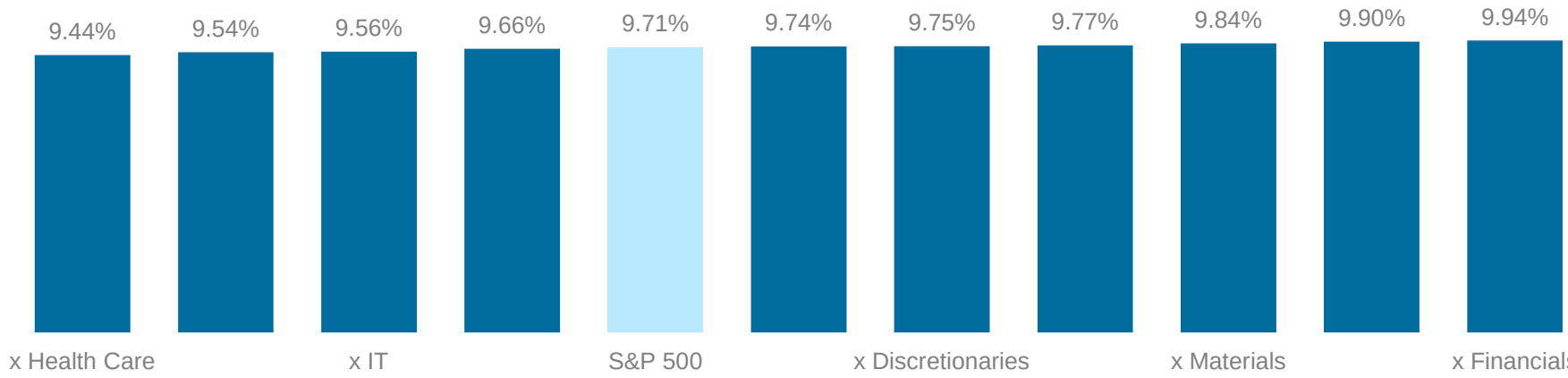


Sustainability themed exposures are recommended within listed global equity, private equity, and real assets (infrastructure and natural resources)

EXCLUSIONS
MANAGING RISK, RETURN AND REPUTATION

	Risk/Return	Reputation
Past	What would have been the financial impact?	What has been the reputation impact so far of owning the product/activity?
Present	What are the costs to implement an exclusion?	What are the fiduciary ramifications of excluding?
Future	Is the product/activity likely to outperform or underperform long term?	Are reputational concerns likely to increase or not? Is engagement likely to be effective?

ANNUALIZED RETURNS ON THE S&P 500
1989 - 2017



Source: GMO, S&P

SUSTAINABILITY FRAMEWORK
FOUR STRATEGIES FOR IMPLEMENTATION

Integration

Include ESG factors in investment analysis/decisions to assess materiality

AIM:
Financial objectives + risk management improvement

Stewardship

Actively engage with companies failing to address ESG risks through voting and engagement

AIM:
Financial objectives + financial system improvement

Investment

Allocate to sustain. themes/impact investments, e.g. renewable energy, water, social housing

AIM:
Financial objectives + positive social + environmental impact

Exclusions

Screen out sectors or companies deemed irresponsible or misaligned with values

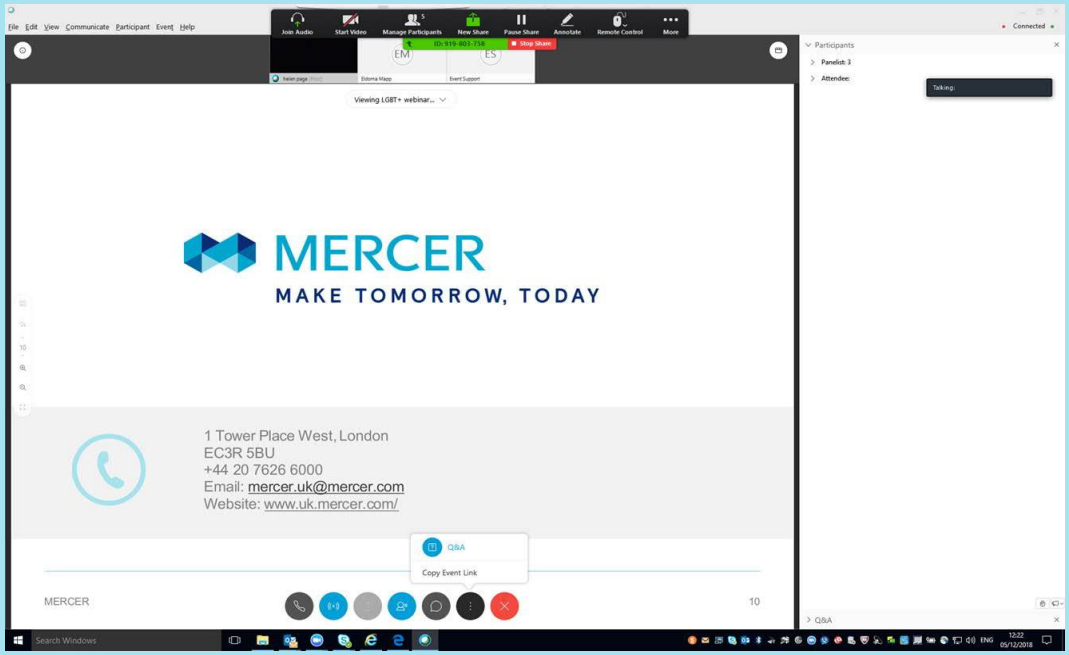
AIM:
Align with values/ reputation/risk management or longer term financial expectations

KEY TAKEAWAYS

QUESTIONS?

Please type your questions in the Q&A section of the toolbar and we will do our best to answer as many questions as we have time for.

To submit a question go to the floating panel at the bottom of your screen, click the circle which contains the three dots and select Q&A. Please make sure you send questions to "all panelists."



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