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CAPITAL MANAGEMENT, LLC
Invest in better.

WHY POSITIVE SCREENING IS SMART INVESTING

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The principals of Reynders, McVeigh Capital Management, LLC ("RMCM") have been intimately involved with the evolution of Environmental, Social and Governance (ESG) investing since 1982. We have helped establish and guide its development. We believe the world's economic sustainability is dependent on advancing the social responsibility of businesses and individuals. While most investment managers have not incorporated ESG analysis into their investment strategies, we think thorough ESG research provides direct benefit on many levels: it can improve society, it can avoid investment risk, and it can uncover new opportunities.

RMCM maintains that investing with positive screens in mind is not only a separate category of investing in a "socially responsible" manner – it is simply better investing. We want to invest in companies where we are avoiding environmental and social liabilities, and thus adhering to a higher fiduciary standard. In 2015, the UN in its report, "Fiduciary Duty in the 21st Century," agreed that incorporating ESG factors into investment analysis is, indeed, a higher fiduciary standard. Recent work by Michael Porter of Harvard Business School has illustrated that business is entering a new stage of relationship with society: It is being forced to go beyond simple corporate responsibility (and doing "fewer bad things") to working on actual solutions to social problems. Capitalism can provide answers to our current social and environmental issues, and as Porter says, "If you can meet needs at a profit, you can scale." It is in this sweet spot that we look to find the majority of our investments. How do we do this? Let's start with the history of socially responsible investing before moving to our own analysis.

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THE EVOLUTION OF SRI

Negative screening was the original thrust of socially responsible investing. Religious institutions and other organizations wanted to screen out so-called “sin” stocks – tobacco, weapons, gaming and alcohol. Antiwar activists supported that outlook in their protest of the war in Vietnam. Tied in with negative screening in the 1980s was divestment – usually associated with South Africa and the anti-apartheid movement. This type of investing was often thought of as sacrificing returns in exchange for promoting a social good.

Proxy voting, shareholder resolutions and shareholder advocacy attempted to add a layer of accountability to publicly-traded companies. This continues today with a focus on climate change, employee diversity and other salient issues that are filed by socially responsible firms, religious institutions as well as major pension funds like CALPERS and CALSTRS. This brings minority shareholders' voices to the table and pushes management to address these issues.

In the 2000s, sentiment shifted to move beyond simply screening out certain industries. RMCM has been a leader in the **positive screening** movement since its founding in 2005. (See our white paper “Power of Positive Screening” for a deeper look at the history of SRI.) Positive screening champions forward-thinking companies that are the market leaders for positive social and environmental change in their industry. Such companies limit their risks, open opportunities, and position themselves for success in a market that rewards transparency and social contributions that are tied to the bottom line.

POSITIVE SCREENING CHAMPIONS FORWARD-THINKING COMPANIES THAT ARE THE MARKET LEADERS FOR POSITIVE SOCIAL AND ENVIRONMENTAL CHANGE IN THEIR INDUSTRY.

POSITIVE SCREENING AND BEYOND

ESG (ENVIRONMENTAL, SOCIAL AND GOVERNANCE) SCREENING — a buzzword these days — is simply the entry door. ESG screening tools from companies like Sustainalytics or MSCI, now readily available through Bloomberg, look at what a company reveals in a sustainability report as voluntary corporate disclosures. Its quantitative screens point out a company's greenhouse gas emissions, its water use, the number of women on its board, whether it has supplier codes of conduct and holds suppliers to obeying child labor laws, etc. SASB (The Sustainability Accounting Standards Board) is working to standardize ESG reporting across public companies, much like GAAP reporting has done for financial accounting. We use these screens, and this transparency is paramount to us, but it is simply the tip of the iceberg. *These ESG “scores” are a tool but cannot be used alone to make a judgment about a company.* They can tell you about the DNA of a company, but not what the fully formed entity looks like. Quantitative screens provide poor scores for a lack of standardized reporting (true of many small and midcap companies) and provide no context for the company's goods or services. They certainly make no determination about whether they are thriving in a world where consumers are demanding greater sustainability and better corporate citizenship.

We are market opportunists looking for the management that has the vision and forethought to invest in the best technologies. These should be on the innovative edge of industries that will be sustainable in a limited resource world.

So where do we direct capital? Where we can hold it for long periods of time. We look for businesses in sustainable areas that are building new markets and making money while doing so. Can this business survive and thrive while managing our existing global resources? Our process begins by eliminating companies whose products or services are detrimental to society. As a result, we screen out companies whose main products are in the tobacco, weapons, gambling and pornography sectors. Many clients also ask us to eliminate other industries or companies they may want to avoid such as alcohol, mining, nuclear power, junk food and fossil fuels.

WE THEN ANALYZE EACH COMPANY'S PERFORMANCE AND POLICIES IN A NUMBER OF KEY AREAS:

ENVIRONMENT

Does the company report on its environmental performance in a transparent and meaningful way? Has it set goals for reducing its emissions and use of resources? How does it measure against its peers on its environmental impact? Has it extended its environmental standards to its suppliers? How has the company responded when it has had environmental problems? Does the company view the changing environment as an opportunity to lower costs and expand sales? Does the company produce something that conserves resources or mitigates environmental issues caused by other industries? Does it contribute as a thought leader to the social, environmental and governance issues of today?

EMPLOYEE RELATIONS

How does the company measure employee satisfaction? What have been the trends here? What is the employee turnover rate? What is the employee diversity policy? Does it guarantee non-discrimination to all regardless of race, sex, religion and identity? Does it measure gender pay parity and offer living wages? What are attractive and innovative benefits? If unions represent some of the workers, what has been the history of these relations? Does the company audit its owned or supplier facilities to insure they are meeting acceptable standards? What percentage of women and underrepresented groups are in the work force, management, and the Board of Directors? How does the company rank on third party measures of workplace satisfaction? How does the company view its employee relations to have improved its financial returns?

COMMUNITY IMPACT

How does the company decide charitable contributions? What percent of pre-tax profits do these contributions equal? Does the company make political contributions and are they transparent about where these go? Is there an established program supporting employees volunteering in the community? If the company is a financial institution, what is their CRA rating? Is the company's advertising respectful? Does the company have a history of upholding international human rights standards? What percentage of management and employees are from local communities?

CUSTOMERS

How do the company's services or products compare based on quality, affordability, convenience, sustainability, and health and wellness? Does the company track and report on customer satisfaction? What is the track record for protecting customer's privacy? How are sales people incentivized? Has the company's advertising been offensive or demeaning? Does it have product liabilities or fines? How has it handled those situations?

CORPORATE GOVERNANCE

How are management and the board compensated? What percent of compensation is made up of salary, stock and options? What has been the average tenure of the CEO? How many different boards do members serve on? What percentage of board members are independent? What percentage of the audit committee is independent? What percentage of board members are women and minorities? Do board members own shares in the company? Are there differing classes of stock that separate voting control from stock ownership? How does the board measure and review the ethics and social impact of the company? Is management's compensation partially tied to meeting social and environmental goals? What is management's vision related to a newer more sustainable world and the company's role in it? Are ethics a priority? Are they setting a standard? Does the company contribute as a thought leader to the social, environmental and governance issues of today?

Although we ask these questions of every company, certain issues are more material to different industries, such as labor within textile supply chains, and water resources for food and beverage companies. Recent work by George Serafeim at Harvard Business School has confirmed that firms making investment in material ESG issues outperformed their peers in margin growth, and that only investment in *material* ESG issues generated this outperformance. Thus, we focus on these material issues and look for change agents within industries. We want to see the power of their impact, not just their breadth. Being a change agent requires fortitude and demonstrates strong ethics and leadership.

Viewing a company through this lens does not mean sacrificing returns. On the contrary, these types of companies tend to outperform over the long term. The market rewards a better corporate citizen, one that is making a fundamental contribution to improving the social and environmental challenges of our time.

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