

WHY WE AVOID GOVERNMENT-LINKED COMPANIES

INTRODUCTION

The invasion of Ukraine has thrown a spotlight on the Russian investments of ESG and sustainable funds, which has surprisingly included certain companies with very close links to Putin's government.

Although recent events have brought these issues to the fore, we have often been asked as to how we can invest in countries where the ruling or political regimes are frequently undemocratic and autocratic. In no way do we condone or endorse these governments which unfortunately exist in every region of the world. However as a responsible investor with a clear social mission, **we do want to support sustainable economic development for people across Emerging and Frontier markets**. So, how do we do this, you may ask?

WHY ESG STANDARDS MATTER

Firstly, we **set unwavering ESG standards for all our holdings**. As well as strict environmental and social criteria, **we set industry leading governance red flags**. This often means **we don't invest in companies many ESG peers do** (examples include Samsung, Alibaba and Naspers). Whilst governance transgressions are usually not as visible or publicised (unlike a pollution or health and safety incidents) they do indicate the values of the management teams that we are trusting with our clients' assets. Our process thus gives us confidence that even during times of economic or political uncertainty, our holdings will "do the right thing" not the easy thing.

AVOIDING STATE-OWNED COMPANIES AND POLITICALLY SENSITIVE SECTORS

However, if companies have some degree of "state ownership" (i.e. a significant proportion of their capital is owned by the government or a government controlled entity) then there is a clear and significant risk that during difficult times, these companies will be coerced into acting in the government's interests rather than those of minority shareholders. As some of our ESG peers who have invested in the Russian gas company, Gazprom (or Sberbank) are belatedly discovering, **no amount of potential upside return can mask the clear and present danger of the company being commandeered as a pawn in the state's wider ambitions**. These risks don't just occur in undemocratic political systems; state owned banks and energy companies in India for example have been frequently pressed into "national service" depending on the economic or political fortunes of the government. We don't invest in fossil fuels for environmental reasons, but **sectors such as energy and utilities are highly politically sensitive** and even if independent, they are often forced to act through political or social pressure. As a result, if the economic and political environment in a country is so dire that it is impossible for any company to operate with due regard to the interests of minority shareholders and all stakeholders, then we will have a zero weighting in that country. For this reason, we divested entirely from our position in Myanmar post-coup.

During a period where many investors are questioning the values of **ESG funds** and the prevalence of greenwashing, it is important for us to re-emphasise some of the often "boring but important" parts of our process. Like umbrellas, **their true value only comes to light when that sunny morning turns into an afternoon thunderstorm**.

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