Brewin
Dolphin

Sustainable Managed Portfolio Service

Quarterly report – Q4 2022
Annual report – 2022

Introduction

Welcome to this expanded edition of our Sustainable Managed Portfolio Service (MPS) investment review. In this report, we cover information and events that influenced performance, not only in the fourth quarter of 2022, but across the entire year.

2022 was a difficult year for investors. The world was buffeted by economic and geopolitical shocks, which created very challenging conditions for investment. At the beginning of the year, concern was rife about the new more transmissible variant of Covid that was spreading around the world. As concern ebbed over the Omicron variant, fears rose over rising levels of inflation.

Central banks in the US and Europe hiked interest rates during the year in an attempt to rein in inflation, which weighed on bonds and equities. During the last few months of the year, there were signs of easing inflation and investors began to anticipate a peak in interest rates. If this comes to pass, it will remove a major headwind for the stock market, which was reflected in equity and bond market rallies over the fourth quarter.

Autumn saw the UK bond market briefly plunged into chaos, as former chancellor Kwasi Kwarteng's pro-growth mini-budget was met with a violent sell off, causing interest rates on loans and mortgages to soar. Following a brief leadership contest, Rishi Sunak was named UK prime minister. This was welcomed by financial markets, as Sunak is perceived to be fiscally conservative and market savvy.

In China, there were protests against the ruling Chinese Communist Party's zero-Covid policy. This policy was relaxed towards the end of the year, and the final days of the quarter saw people beginning to move about once more. This sets the scene for a year in which China's demand for oil is likely to rise.

Concerns remain about the global economic outlook, but several things have improved. One of the most concerning things about 2022 was the inability of wages to keep pace with inflation, but the US did see wages rising faster than prices in the last few months of the year. In Europe, the biggest anxiety has been over energy and replacing Russian supplies, but the last few months saw sharp declines in gas prices resulting from fortuitous weather, high balances in storage, economising by consumers, and record levels of imports of liquified natural gas.

The falls in stocks and bonds during 2022 were driven by improving valuations rather than collapsing profits. Over the long term, returns for investing at these valuation levels have historically been good. While none of these factors alone is enough to begin a new bull market, they do mark important steps along the path to one.

The big picture in Q4

- The last quarter of 2022 was an eventful one, with two Conference of the Parties (COP) events: COP27 in Egypt on climate change, and COP15 in Canada on biodiversity.
- The death of Mahsa Amini, believed to be the victim of severe brutality at the hands of the Iranian morality police, proved to be the catalyst for a series of protests that are considered to be the largest in Iran since at least 2009. Iran Human Rights reported that by December 2022, at least 476 people had been killed by security forces quelling protests across the country, with more awaiting potential death sentences in prison.
- At COP27, almost 200 countries agreed to set up a fund to cover the “loss and damage” that “particularly vulnerable” nations are suffering from climate change. Countries have now agreed that a dedicated fund should be established and that this should be done before COP28 begins in 2023.
- COP15 produced the Kunming-Montreal Global biodiversity framework, which includes four goals and 23 targets to be achieved by 2030. This is a landmark agreement, although notably not legally binding.
- EU countries have finalised the Carbon Border Adjustment Mechanism (CBAM), which will force foreign importers to cover the cost of their emissions. Once formally agreed by leaders at the European Council and adopted into EU law by the European parliament, CBAM will come into force in 2026.
- Vanguard, the second largest asset management group, resigned from the Net Zero Asset Managers initiative and the Glasgow Financial Alliance for Net Zero, citing a need for independence. It had been a member of each group for under two years and there is speculation that this is a reaction to political pressure in the ‘anti-ESG’ backlash.

Market overview Q4 2022

- At the broader market level, the global equities benchmark advanced +4.0% over the fourth quarter amid signs of easing inflation in the US and Europe and the loosening of pandemic restrictions in China.
- European equities gave the strongest performance, rising by +11.3%. The UK equities benchmark gained +8.9% after new chancellor Jeremy Hunt reversed the tax cutting measures in his predecessor's mini-budget. Japanese equities advanced +4.8% and Asian equities rose +3.8%, whereas US and emerging market equities lost -0.6% and -1.8%, respectively.
- After experiencing sharp losses in the third quarter, bonds bounced back with a gain of +2.7%. UK corporates were the biggest contributors to growth, surging by +7.2%. Global corporates (+3.3%) and global inflation-linked bonds (+2.7%) also performed strongly.
- Alternative assets recorded a small loss of -0.4%. Global real estate investment trusts (REITs) and absolute return fell -1.4% and -0.3%, respectively, while gold increased by +0.3%.
- In the US, the Federal Reserve signalled that it would slow the pace of future interest rates rises amid growing evidence that US inflation is on a downward trajectory and the job market may be starting to cool.
- Chinese equities sold off heavily at the beginning of the quarter following the Chinese Communist Party's national conference. Investors were concerned that president Xi Jinping's move to secure loyalists in the politburo would increase uncertainty around the outlook for corporate profits. The expectation is that policy will be more focused on security and state control rather than the economy.
- Markets rebounded after China moved away from its zero-Covid policy. In the short term, activity is being held back by people's fears of catching the virus. Chinese economic growth will likely enjoy a surge later in the year, once natural immunity and vaccination protection become established and case numbers subsequently decline. Despite the change in Covid policy and supportive monetary policy from the People's Bank of China, there a number of headwinds for the region and the outlook remains unclear.
- In Europe, the European Central Bank increased its forecast for gross domestic product (GDP) growth in 2022 by 0.3 percentage points to 3.4%. This followed stronger-than-expected services activity over the summer.
- In the UK, inflation touched a 41-year high before showing signs of decline. This led the Bank of England to raise interest rates two times during the quarter. Although the UK economy is being negatively impacted by high energy costs, gas prices are coming down and several measures of future inflation suggest a slowdown in price increases.
- While not experiencing the same level of inflation as the rest of the world, the Bank of Japan was forced to relax its previously ultra-accommodative monetary policy following pressure from financial markets. This resulted in the Japanese yen appreciating against several currencies.

The value of investments, and any income from them, can fall and you may get back less than you invested.

Sustainable MPS highlights Q4 2022

Asset Allocation

What worked and why?

Our modest underweight to property was a small contributor to returns over the quarter.

What didn't work and why?

The underweight to equities and bonds, particularly in credit, negatively contributed to performance this quarter.

Fund Selection

What worked and why?

Schroders Global Energy Transition was the most significant contributor to performance as markets anticipated stronger future demand for energy. Columbia Threadneedle Responsible Global Equity also supported returns with outperformance through the quarter.

What didn't work and why?

Stewart Asia Pacific Leaders lagged as Chinese stocks rallied strongly on Covid-19 reopening hopes. Brown Advisory US Sustainable also detracted from returns.

Sustainable MPS Portfolio changes Q4 2022

Asset Allocation

In October, the Asset Allocation Committee increased the allocation to UK government bonds, closing the previous underweight position to take advantage of an entry point provided by the fallout from the mini-budget. The allocation to global inflation-linked bonds was also increased, whereas cash and absolute return were reduced.

In November, the weighting to North America was increased, given the region's exposure to growth stocks and the potential for dollar strength. The weighting to Asia was reduced.

In December, there were no changes to the underlying asset allocation.

Fund Selection

There were no new fund additions or removals in the fourth quarter.

We increased the weightings in Brown Advisory US Sustainable Growth, L&G Global Inflation-Linked and L&G All Stock Gilt Index. These were funded through reductions in TB Evenlode Income, Royal London Sustainable Leaders, BlackRock ICS Liquidity and BNY Mellon Sustainable Global Dynamic Bond.

SMPS performance

SMPS PERFORMANCE (%)			
	Q4	2022 YTD	1yr
Income Portfolio	2.0	-11.7	-11.7
Income Higher Equity Portfolio	2.1	-11.7	-11.7
Balanced Portfolio	2.1	-11.5	-11.5
Growth Portfolio	2.1	-11.6	-11.6
Global Equity Portfolio	2.3	-11.7	-11.7

All figures shown above are calculated to 31 December 2022.

Performance Calculation: All income is reinvested. Performance is shown inclusive of underlying fund charges but gross of RBC Brewin Dolphin's investment management charge. Deduction of this charge will have the result of reducing the illustrated performance. Neither simulated nor actual past performance are reliable indicators of future performance.

Funds in focus Q4 2022

Baillie Gifford Positive Change

The Baillie Gifford Positive Change fund aims to both outperform the MSCI ACWI over rolling five-year periods and to deliver positive impact by contributing to a more sustainable and inclusive world. In the pursuit of the performance objective, the team seeks long-term growth companies, which can double in value over five years as a minimum hurdle, with significant growth prospects thereafter.

Baillie Gifford believes exceptional companies produce a disproportionate amount of wealth within and for society; and that the vast majority of long-term wealth creation in markets comes from a very small number of 'explosive' winners. It therefore structures its process to seek out these winners while exploiting the asymmetry of returns within a diversified portfolio. This diversified portfolio approach allows the team to put significantly more importance on upside than downside.

To be included in the Positive Change strategy, a stock must not only have a very strong financial return outlook but must also have a positive impact, defined as system-level changes expected to happen owing to the company's activities and outputs. The team thinks about impact across three dimensions: product impact, intent, and business practices. The product impact assessment looks at how much of companies' revenues are derived from four impact themes: social inclusion and education; environment and resource needs; healthcare and quality of life; and base of the pyramid. This fourth impact theme considers how the world's poorest can be lifted out of the poverty cycle. Intent considers companies' commitment to driving their industries forward, while business practices relates to companies' areas of controversy, the negative consequences of their operations and awareness of those issues.

The team has found the most ideas which meet their criteria within healthcare; approximately one-third of the portfolio. Elsewhere, the fund holds companies active in agricultural technology, electric vehicles, water testing and treatment, accessible education, recycling, offshore wind and banking.

Anna Haugaard
Senior Analyst

Stewart Investors Asia Pacific Leaders Sustainability Fund

Launched in 2003, the Stewart Investors Asia Pacific Leaders Sustainability fund has been successfully investing in Asian equity markets using a very consistent approach for nearly 20 years. It has been a mainstay on the RBC Brewin Dolphin buy list for most of that time. The team's approach has always been to invest in the highest quality businesses it can identify in the region, run by the best management teams demonstrating both skill and integrity, and owning these companies for many years.

Sustainable investing is a natural extension to this long-term, high-quality approach. The team believes that owning companies that deliver benefits to society and the environment will bring fewer risks and provide access to more enduring opportunities over its truly long-term investment horizon. It doesn't put sustainability positioning above, or hold distinct from, company quality, or vice versa. They are one and the same thing. The team analyses the quality of a business across three pillars with sustainability fully integrated into each: the quality of management, the quality of the franchise and the quality of financials.

Another natural outcome of the team's patient investment style is the emphasis it places on engaging constructively with management teams and building relationships around a shared objective of improving the company's quality and sustainability positioning for the long-term benefit of all stakeholders. For instance, it recently commissioned research and subsequently led a collaborative engagement effort on the use of conflict minerals within the semi-conductor supply chain. The team is attempting to raise the bar on best practice within the industry and continues to share its research, discussing these issues with management teams and other industry participants.

The team has been one of the pioneers of sustainable investing in the industry and particularly within Asian and emerging markets. Its genuine approach to the task, combined with the investment skill it has demonstrated over nearly two decades investing in these markets, gives us the confidence to continue allocating to the strategy.

Michael Paul
Head of Funds Research

Update on our SDG alignment scores

Over the last quarter we have seen a significant reduction in some of the portfolios' Sustainable Development Goals (SDG) alignment scores as calculated by MSCI. I wanted to write a short update to provide full transparency and ensure that you, our clients, understand why the scores have reduced.

The two areas that have seen changes are the 'People' score by around 25% in each portfolio, and the Prosperity score by around 20% in each portfolio. This change was first visible on our November factsheets (issued in December). Through November, there were no changes to the investments in our sustainable portfolios and it is the first time we have seen a change in alignment of this magnitude.

After investigating with MSCI, we believe this was due to a number of companies being downgraded on their alignment following the release of the United Nations High Commissioner for Human Rights (OHCHR) publication, "Assessment of human rights concerns in the Xinjiang Uyghur Autonomous Region, People's Republic of China". This looked at the involvement of companies' supply chains with forced labour; several large companies have been found to have suppliers operating in the region. Some of the more recognisable names include Apple, Volkswagen, Nike and Tencent. We have engaged on this issue with fund managers as part of our controversy tracking process on our holdings in Thermo Fisher Scientific Inc. and Marks & Spencer and been satisfied with the companies' actions in both cases.

Companies caught in this have had their alignment scores downgraded across multiple SDGs, including:

SDG 5 – gender equality
SDG 10 – reduced inequalities
SDG 8 – decent work and economic growth
SDG 11 – sustainable cities and communities

The top two form part of our People score, the bottom two are part of our Prosperity score.

Ultimately, we believe this reduction in alignment is a positive, for three key reasons:

This change represents companies being held to a higher standard and shines a light on contentious business practices

ESG data is a relatively nascent field, and the inclusion of more information represents a small step in the path towards maturation

The change in scores triggered an investigation, demonstrating that SDG alignment, while not a direct input into our research process, is providing a useful extra source of insight and monitoring into our portfolios

It is likely that we will see future fluctuations in the various sustainability-related metrics we report on our factsheets, as the EU taxonomy for sustainable activities and UK Green Taxonomy will come into force over the next few years. These will bring significantly more data to ratings providers, likely leading to further re-appraisals of companies in the investable universe. We hope that standards expected of companies continue to be raised and will continue to monitor developments.

Tom Buffham
Portfolio Analyst

ESG reporting for SMPS Income
(as at 31 December 2022)

MSCI ESG Ratings

ESG Quality Score 7.8

Carbon Intensity

Carbon Intensity measures a portfolio's exposure to carbon intensive businesses and is a recommended metric for assessing carbon risk by the Task Force on Climate Related Financial Disclosures (TCFD). It is calculated as a weighted average of each portfolio company's total Scope 1(1) and Scope 2(2) carbon emissions divided by their annual sales, with a lower score representing less (better) Carbon Intensity.

Comparisons of Carbon Intensity figures should be made with caution, as generally companies in the sectors with the highest carbon emissions (such as utilities) also have the highest potential for reducing their carbon emissions. We believe it is important to encourage these reductions in carbon emissions where they have the potential for highest impact.

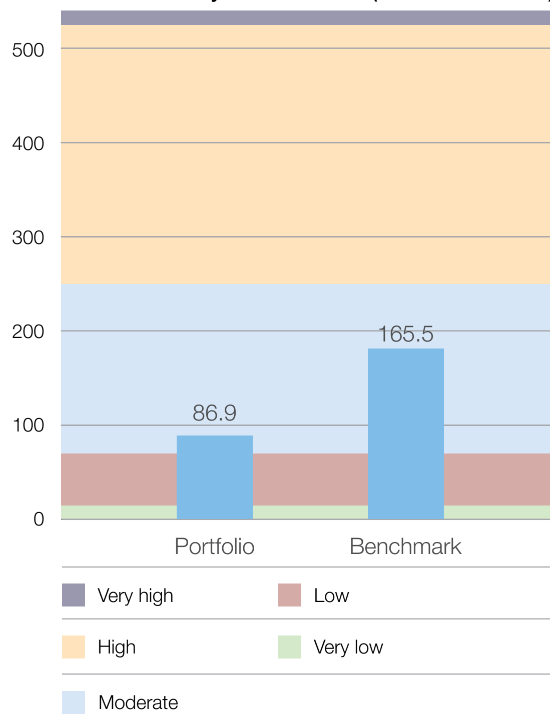
References:

(1) Scope 1: All direct GHG emissions from sources owned or controlled by the company (e.g. emissions from combustion in owned boilers, furnaces).

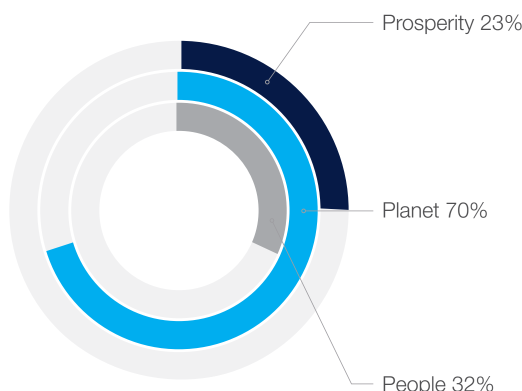
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 45% MSCI ACWI, 55% Bloomberg Barclays Global Aggregate

Carbon Intensity vs Benchmark (TCO2e / $m sales)



SDG Alignment



The UN SDG Alignment provides a framework for considering a broad set of 17 sustainability issues. Although not intended for investment purposes, it provides a useful context for measuring a portfolio's alignment with these goals.

We select 12 of these SDGs and place them into three sustainability themes: People, Planet, and Prosperity, with each sustainability theme consisting of four SDG goals. We use fund alignment data from MSCI to measure the alignment of the portfolio to each of our three sustainability themes. To calculate this, we take a weighted average of each fund's alignment to each of the three sustainability themes.

For instance, if Fund A is a 10% holding in the portfolio, and within the People theme is aligned with both "Zero Hunger" and "Gender Equality" but not the other two SDGs, then the fund will contribute 5% to the overall score of the People theme: 2.5% through Gender Equality and 2.5% through "Zero Hunger".

Prosperity

Planet

People

ESG reporting for SMPS Income Higher Equity
(as at 31 December 2022)

MSCI ESG Ratings

ESG Quality Score 8.0

MSCI ESG RATINGS

CCC	B	BB	BBB	A	AA	AAA

Carbon Intensity

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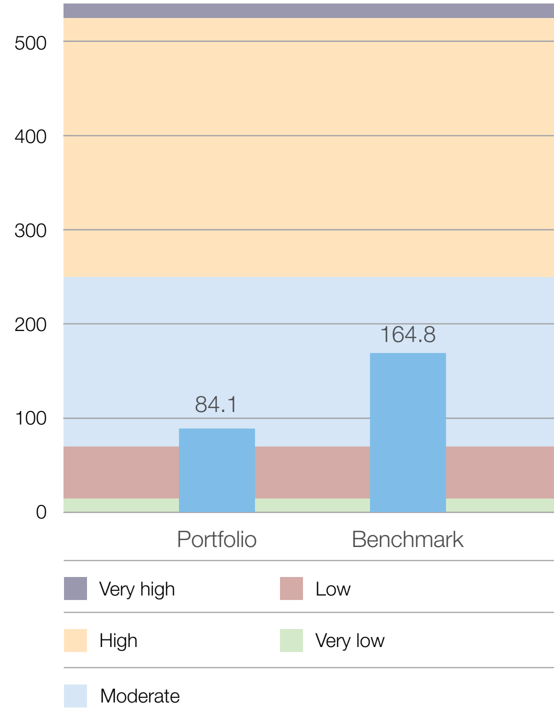
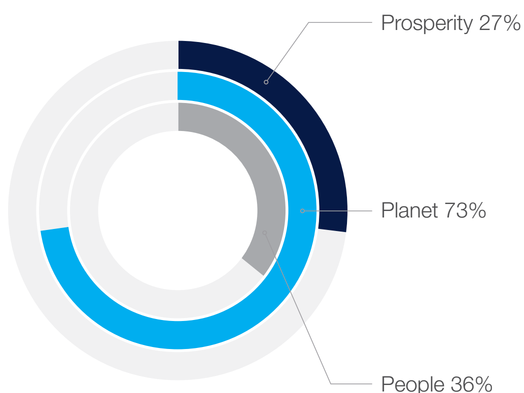
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 55% MSCI ACWI, 45% Bloomberg Barclays Global Aggregate

Carbon Intensity vs Benchmark (TCO2e / $m sales)



SDG Alignment



The UN SDG Alignment provides a framework for considering a broad set of 17 sustainability issues. Although not intended for investment purposes, it provides a useful context for measuring a portfolio's alignment with these goals.

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For instance, if Fund A is a 10% holding in the portfolio, and within the People theme is aligned with both "Zero Hunger" and "Gender Equality" but not the other two SDGs, then the fund will contribute 5% to the overall score of the People theme: 2.5% through Gender Equality and 2.5% through "Zero Hunger".

Prosperity

Planet

People

ESG reporting for SMPS Balanced
(as at 31 December 2022)

MSCI ESG Ratings

ESG Quality Score 8.1

Carbon Intensity

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References:

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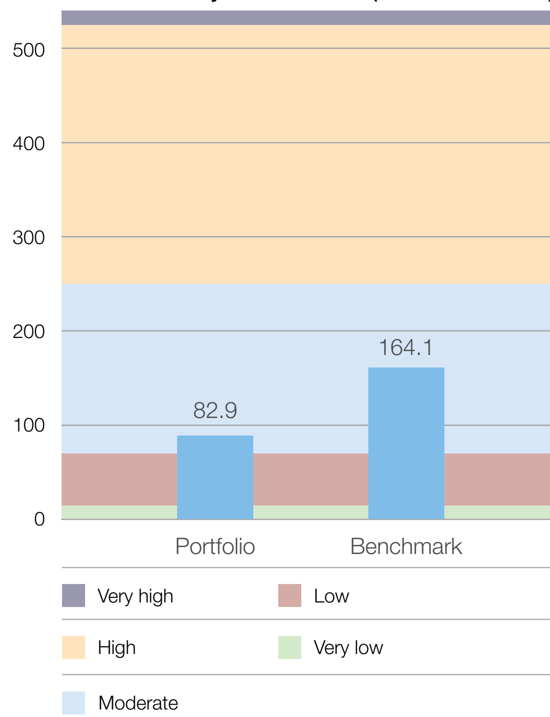
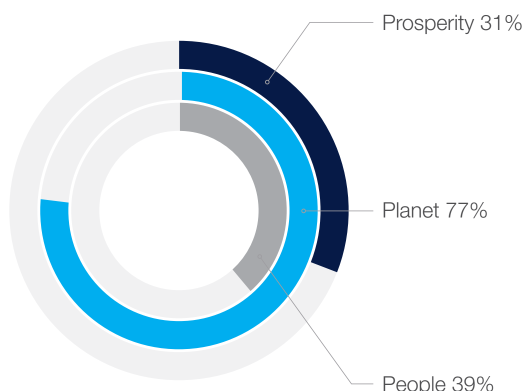
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 70% MSCI ACWI, 30% Bloomberg Barclays Global Aggregate

Carbon Intensity vs Benchmark (TCO2e / $m sales)



SDG Alignment



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Prosperity

Planet

People

ESG reporting for SMPS Growth
(as at 31 December 2022)

MSCI ESG Ratings

ESG Quality Score 8.3

MSCI ESG RATINGS

CCC | B | BB | BBB | A | AA | AAA

Carbon Intensity

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Comparisons of Carbon Intensity figures should be made with caution, as generally companies in the sectors with the highest carbon emissions (such as utilities) also have the highest potential for reducing their carbon emissions. We believe it is important to encourage these reductions in carbon emissions where they have the potential for highest impact.

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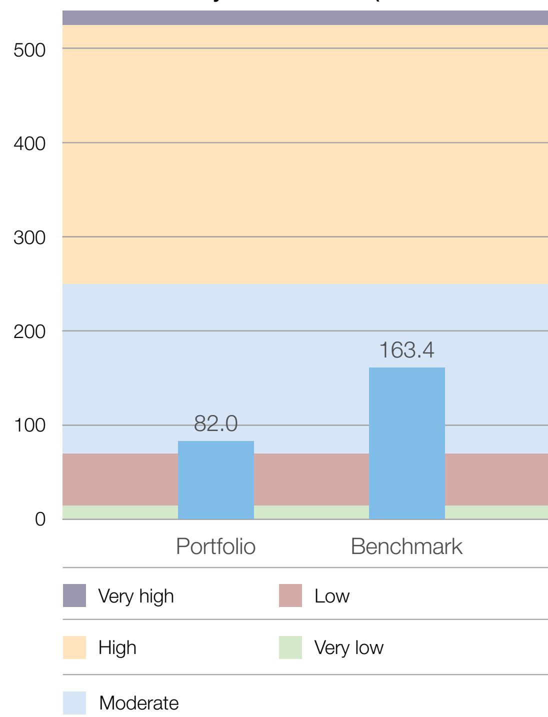
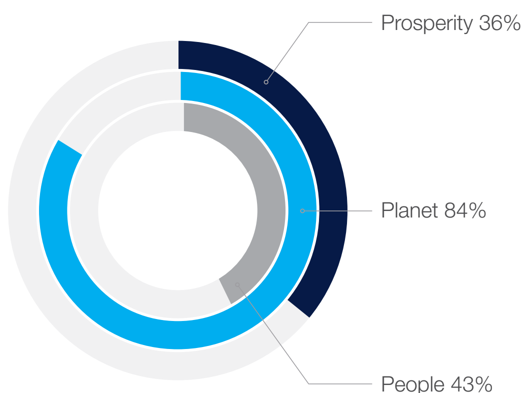
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 85% MSCI ACWI, 15% Bloomberg Barclays Global Aggregate

Carbon Intensity vs Benchmark (TCO2e / $m sales)



SDG Alignment



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Prosperity

Planet

People

ESG reporting for SMPS Global Equity
(as at 31 December 2022)

MSCI ESG Ratings

ESG Quality Score 8.7

Carbon Intensity

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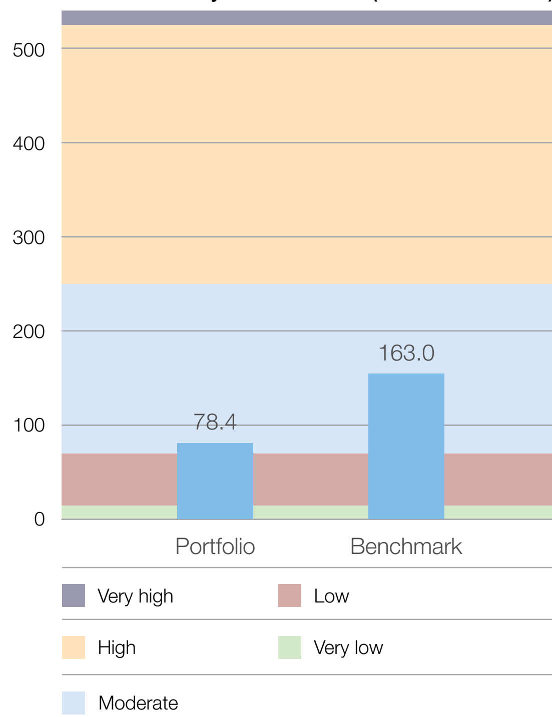
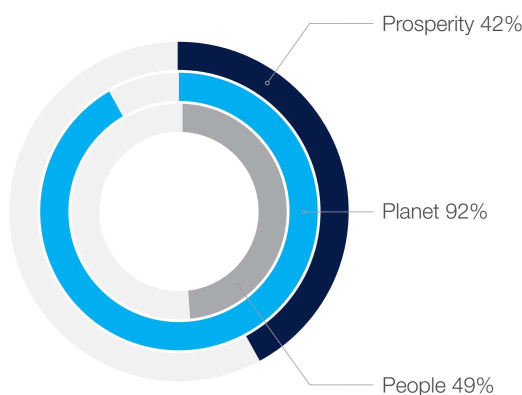
Benchmark for comparison: 100% MSCI ACWI

Carbon Intensity vs Benchmark (TCO2e / $m sales)



SDG Alignment



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Prosperity

Planet

People

Sustainable Managed Portfolio Service

Annual report – 2022

Sustainability at RBC Brewin Dolphin

Sustainability is relevant to everything we do, from being a responsible business and corporate citizen to the way we invest. At RBC Brewin Dolphin, we think of sustainability in terms of three pillars:

Responsible investment	Stewardship	Responsible business
Ensuring that we offer clients the right responsible investment choices for them	Ensuring responsible ownership of the assets we hold for clients	Ensuring we are a company that seeks to have a positive impact on society

In September 2022, Brewin Dolphin was acquired by RBC. We remain committed to being a responsible business – from the way we interact with our clients and employees to how we support our local communities and the environment. The RBC Climate Blueprint is the enterprise strategy to accelerate clean economic growth and support RBC clients in a socially inclusive transition to net-zero. For more details https://www.rbc.com/community-sustainability/_assets-custom/pdf/RBC-Climate-Blueprint.pdf please click here.

In 2022, as signatories to the UN Principles for Responsible Investment (PRI), we received our first PRI assessment. We were pleased with the results, which reflect our robust approach to responsible investment. As responsible investors, we believe that stewardship is one of the most important levers we can pull to drive change. In autumn 2022, we welcomed the successful outcome of our application to remain signatories to the UK Stewardship Code. The Financial Reporting Council's annual review process proved once again to be thorough, with reports that one third of applicants were unsuccessful in this round[1]. We were particularly pleased to receive positive feedback on our improved disclosures. As active and responsible investors, our engagements over the past year have spanned many companies, regions and issues. A couple are noteworthy:

Ethnic diversity at investment trusts

The Parker Review has set a target for FTSE 250 companies to have at least one person from a minority ethnic group on their boards by December 2024. However, we believe that good governance would see boards embrace the ambition and the benefits of improved diversity set out in the review well in advance. In 2022 we engaged with a number of investment trusts on this issue and will prioritise this during 2023.

Continuing our engagement on microplastics

Back in January 2022, we joined over 120 other businesses, the WWF and 1,000 civil society organisations in encouraging the UN Environment Assembly to agree to a legally binding UN treaty on plastic pollution. We were pleased that in March 2022, the 175 countries at the UN Environment Assembly pledged to develop a legally binding treaty by 2024. This momentous occasion should undoubtedly lead to a reduction in life-threatening plastic pollution worldwide. We are proud to have been a supporter of this cause, and hope that the business call we joined went some way to influence the decision taken by the UN. This success adds to our other work in the area of microplastics, in which we co-sponsored a new standard

[1] https://www.responsible-investor.com/uks-frc-adds-new-signatories-to-stewardship-code-switches-focus-to-outcomes/

for firms to use to cut plastic pollution across their supply chain.

We are excited about what lies ahead in 2023. We are supportive of the Financial Conduct Authority's consultation on Sustainable Disclosure Requirements (SDR) and think that greater disclosures will lead to greater transparency for end investors. We are updating our approach to voting and monitoring votes of our fund managers. And we will continue to act as a responsible business – RBC has ambitious targets to reduce operational emissions that we are working towards, and we will continue to support the communities we are part of through our corporate responsibility work.

As a responsible company and provider of Sustainable MPS, RBC Brewin Dolphin remains committed to the highest standards of engagement and corporate responsibility to enhance the value of investments, and to make positive contributions to the world around us.

Tom Blathwayt
Head of Sustainability

Stewardship

We see stewardship as a key part of our Sustainable MPS service. We select funds that are not only industry leaders in integrating ESG factors into investment decisions, but also leaders in stewardship. We believe that firms that act as responsible owners, or good stewards, can help maximise positive outcomes by encouraging better behaviour from investee companies.

We do not stop at the fund selection process, but actively track and monitor what our funds are doing in terms of stewardship. One aspect of this approach is through controversy tracking. Our Research team continually tracks news flow for controversies in the companies to which we are indirectly exposed. We assess specific issues and, if significant enough, we reach out to our fund managers that hold the company in question to understand how they are monitoring and engaging on these issues, and the effect on their investment approach.

Our controversy tracking philosophy

Real-time analysis of ESG leadership

- ESG leadership is often assessed by a collection of factors, such as policies, reporting or committees. However, we believe that you only truly know how a company treats stakeholders when controversies emerge.
- We evaluate a fund's ESG integration predominantly by analysing its past investment actions. Monitoring their response to corporate controversies can build evidence or provide challenge to our conclusions.

Monitor funds' stewardship processes

- Our controversy tracking process allows us to monitor their activities as they are happening, as well as the initial due diligence we undertake with each fund.
- We will escalate matters within a fund house where we feel their engagement is not of a sufficient standard.

Throughout the year, our process highlighted 16 controversies that we felt warranted further engagement. In total, we made contact 133 times with fund managers to confirm their awareness of the issue, rationale for continuing to hold the company in question, engagement efforts and next steps. Through this process, not only do we encourage better outcomes for the underlying companies, but we also effectively monitor funds' ESG and stewardship processes.

Last year we adjusted this process to monitor more effectively our large passive investment managers. As these funds hold entire indices, tracking individual controversies would have meant engaging with them on a disproportionate basis. Instead, we introduced annual meetings covering stewardship resources and processes, as well as discussing the approach to climate, voting records and specific engagement case studies – stemming from our identified controversies. Through these meetings we were able to identify clear differences in the strength of stewardship processes in place and provided relevant feedback.

Case study: Pepsico Inc.

Over the past years, PepsiCo has been repeatedly criticised by several NGOs for its indirect involvement in abuses related to its supply chain and palm oil sourcing in Indonesia, Cambodia and Papua New Guinea. Allegations against Pepsi allude to its supply chain being involved in cases of land grabbing and violence against local communities, with links still highlighted in NGO reports issued in 2022. We agreed that these supply chain issues could, as a minimum, only harm the reputation of company. We therefore engaged with ten fund managers across our buy list, including those included in our Sustainable MPS portfolios, to assess their understanding of the issue and approach.

We were pleased to find that the majority of our managers had already identified these issues as an area to be monitored closely and had been engaging with the

company to track progress. Most managers who had not engaged with the company were aware of the issue and went on to explain why it was not prioritised. While the quality of explanations varied this gave us additional insights into the managers' processes, and we provided feedback accordingly. A few of our managers also indicated appetite for further monitoring and engagement on this issue, either as part of ongoing engagement plans or prompted by our questions – with two outlining clear next steps for engagement with the company and areas for improvement. Overall, managers were able to back their continued confidence in how the company is managing associated risks.

Case study: Credit Suisse

In January 2022, a significant controversy was highlighted by our research provider for Credit Suisse (CS). The company replaced its chair over breaches of Covid-19 rules amid an ongoing reorganisation to address governance and risk management deficiencies, highlighted by the collapse of Greensill Capital and Archegos Capital Management. Both high profile cases raised serious concerns over reputational, operational and legal risks for CS.

The severity of the controversy led us to engage with 13 fund managers across our buy list, including those included in our Sustainable MPS portfolios. We asked about their assessment of the bank's governance and risk management and the financial implications based on the regulatory and legal risk, as well as about any engagement undertaken and the effect on related investment decisions.

The majority of our fund managers provided detailed responses to our questions, as they were indeed increasingly concerned over risk management and oversight at the company, with some even reducing or eliminating the position. However, there was also broad consensus among managers on their confidence in the capital position of the bank. We were satisfied that those who remained invested had processes in place, including ongoing engagement, to monitor developments and the company's efforts to strengthen their governance and risk management practices.

Case study: Transition Pathway Initiative

This year we concluded our second round of engagement using the Transition Pathway Initiative (TPI) data set to assess our indirect exposure to high-emitting companies that are not adapting their strategies to align with international climate goals. The TPI is a global, asset owner-led initiative which assesses companies' preparedness for the transition to a low carbon economy.

Using this data, we reached out to 45 fund houses, covering 129 funds including some within Sustainable MPS, which hold approximately 100 companies showing as non-aligned. We asked managers to comment on how they have assessed the attempts of these companies to reduce emissions and the financial implications of failing to comply with global pledges. We also wanted to understand any engagements that had been undertaken, voting records and assessment of company progress.

Most fund houses responded in an efficient and timely manner, with the majority of responses showing a thorough knowledge of the underlying company and the associated climate risks. The most impressive responses had clear and rigorous processes to assess and engage on climate risk across multiple teams, and showed genuine incorporation of related factors into investment decisions. They also demonstrated commitment through supporting multiple initiatives.

It also became clear to us that some of the large fund houses without an organisation-wide approach had disparity in approach across teams, resulting in

potentially sub-optimal outcomes; and while some of the smaller firms have started to implement climate-related policies at a company level, we have yet to see how these policies affect investment decisions and outcomes of their engagement. The responses were ranked, and feedback was provided to each fund house.
In the year ahead, we will be looking into carrying out the engagement again, building on the last two years of responses.

Athanasia Karananou
Stewardship

Sustainable MPS annual market overview 2022

- A series of economic and geopolitical shocks made 2022 a difficult year for investors. At the start of the year, concern was rife about a new, more transmissible variant of Covid. As concern ebbed over the Omicron variant, fears rose over increasing levels of inflation.
- While most investors and policymakers went into 2022 expecting a return of inflation, few foresaw just how sharply and persistently prices would rise. The US Federal Reserve expected to raise rates by less than 1% by the end of the year, but ended up hiking by more than 4% in what was, arguably, the most aggressive interest rate hiking cycle on record.
- Inflation was more persistent than expected, and therefore interest rates rose by more than expected. This meant bonds were worth less and the growth of company profits was generally outweighed by falling valuations in the equity market.
- In the UK, investors were buffeted by a series of political crises and a mini-budget that was released without the support of the Office for Budget Responsibility's forecasts. The sharp rise in bond yields caused by the mini-budget triggered a vicious circle of rising yields, requiring some leveraged pension schemes to sell assets which, in turn, pushed yields higher. The Bank of England stepped in to end this cycle, but the ultimate task of restoring confidence to the market was left to the government.
- In China, president Xi Jinping secured a third term in office. Shortly after, protests against the government's zero-Covid policy reached a fever pitch. The policy was relaxed and the government transitioned from telling people to avoid spreading the virus at all costs to pressuring them to work whilst infected if symptoms were not too severe. Fear of infection was still a powerful suppressor of economic and social activity, although in the final days of the year it did appear that people were beginning to move about once more.
- One bright spot during the year was gold, which rose almost +13% driven largely by weakness in the pound. Cash was mildly positive thanks to interest rate hikes from the Bank of England and other central banks.
- Interest rate hikes and the bungled UK mini-budget proved damaging for bonds. UK gilts and UK corporate bonds fell by around -20% over the year. Global bonds fared little better, with losses in the mid to high teens.
- Most equity regions fell by between -5% and -10%, but the UK equity market proved resilient as demand for energy and raw materials increased following the pandemic reopening and the war in Ukraine.
- The global property REITs benchmark fell by around -15% but absolute return (as measured by the HFRX Absolute Return index hedged to GBP) was up by just under one percentage point.

Sustainable MPS highlights 2022

Asset Allocation

What worked and why?

Overall, the allocation positioning was beneficial over the year. The underweight to bonds and the overweight to cash and absolute return were positive contributors to performance.

What didn't work and why?

The overweight to equities in the first half of the year detracted from performance. However, reducing this overweight quickly and using market rallies to reduce exposure meant that throughout the year the allocation effect from equities was positive.

Fund Selection

What worked and why?

Against a backdrop of rising interest rates and the war in Ukraine, funds that were either exposed to the energy sector or were value oriented tended to perform better. Schroders Global Energy Transition Fund was our top performing pick, benefiting from higher energy prices and the Inflation Reduction Act, which boosted renewable investing in the US. Within bonds, our two key contributors were from Robeco Global Credits SDG Fund and the L&G Global Inflation Linked Bond Fund, which has a shorter duration than our strategic benchmark.

What didn't work and why?

Growth-oriented funds tended to struggle over 2022, meaning that fund selection was an overall headwind for returns through the year. The most significant detractors were Brown Advisory US Sustainable Growth and Liontrust Sustainable Leaders. Within our alternatives allocation, BNY Mellon Sustainable Global Dynamic Bond detracted as it is reliant on the bond market to generate returns.

Sustainable MPS Portfolio changes 2022

Asset Allocation

Equity and bond markets fell over the first nine months of the year. Against this backdrop, the Asset Allocation Committee reduced exposure to both equities and bonds, and increased exposure to cash and alternatives. As indications rose that central banks were getting closer to the end of their interest rate hiking cycle, the disastrous mini-budget in the UK provided a good entry point for raising exposure to sovereign bonds in October.

Fund Selection

Following the recommendation of the Asset Allocation Committee, 2022 saw a general increase in cash and alternatives. The BlackRock ICS Sterling Liquidity Fund and Muzinich Global Tactical Credit Fund were both introduced as investments in those respective categories. These allocations came from reducing our equity exposure, with the most significant decreases coming from Royal London Sustainable Leaders and TB Evenlode Income.

ASI Global Government Bond Tracker Fund was added as a replacement to the HSBC Global Government Bond Tracker. This followed a recommendation by our Sustainable Investment Advisory Group to avoid the inclusion of Chinese government bonds in the latter.

We have seen increases in the weights of the L&G All Stocks Gilt Index and L&G Global Inflation Linked Bond funds as our tactical asset allocation took advantage of the sudden sell off in bonds following Liz Truss' controversial mini-budget.

Impactful companies

Many of the companies held within RBC Brewin Dolphin's Sustainable Model Portfolio Service are driving the transition towards a more sustainable economy. Our clients' investment in these companies indirectly supports them in their ongoing expansion. So, we have picked a few highlights to demonstrate some of the amazing things that are happening under the bonnet of the portfolios:

Environmental

TE Connectivity held in NinetyOne Global Environment

TE Connectivity is the world leader in connectivity and sensor solutions across a broad range of applications. Sustainable decarbonisation requires a more efficient global vehicle fleet and, ultimately, a move away from the internal combustion engine towards electric vehicles powered by renewable energy. Electric vehicles have double the connector content of traditional internal combustion engines. TE Connectivity offers the broadest range of technologies in this space. Furthermore, its custom-engineered connectivity solutions are used to drive industrial automation and to make datacentres greener. TE Connectivity works with almost every global original equipment manufacturer, with its engineers working onsite to assist in developing the next generation of vehicles.

Umicore held by Baillie Gifford Positive Change, CT Responsible Global Equity, Schroders Global Energy Transition

Umicore is one of the world's largest manufacturers of automotive catalysts and lithium-ion battery cathodes, which are essential for reducing the negative impacts of poor air quality and climate change. The rising adoption of electric vehicles will support significant growth in demand for cathode materials. Umicore's catalysts reduce air pollution, and its materials improve battery performance in electric vehicles, reducing emissions from transport. Umicore estimates that its electric mobility and recycled products avoided 35 million tonnes CO2e (2016 - 2020).

Process know-how and relationships with automotive manufacturers should enable Umicore to earn a decent return in this growing market. This will more than offset a longer-term decline in the automotive catalysts business, with metal recycling and opportunities in hydrogen fuel cells — both critical enablers of the energy transition — providing additional upside in investment returns and climate impact.

Social

International Bank for Reconstruction and Development held by BNY Mellon Sustainable Global Dynamic Bond

The IBRD offers loans to middle-income developing countries. The IBRD is the first of five member institutions that compose the World Bank Group. Its mission is to "fight poverty and improve living standards for people in the developing world." As well as financial services, the IBRD also provides strategic coordination and information services to its borrowing member countries. The bank only finances sovereign governments directly, or projects backed by sovereign governments.

To help borrowers protect against catastrophes and other special risks, the bank offers a catastrophe deferred drawdown option to provide financing after a natural disaster or declared state of emergency. It also issues catastrophe bonds which transfer catastrophic risks from borrowers to investors. The top ten borrowers are India, Indonesia, Brazil, Mexico, China, Turkey, Argentina, Colombia, The Philippines and Egypt. The number of IBRD borrowers who are today cut off from the market has more than doubled since 2020 as globally rising interest rates have prompted investors to withdraw capital from emerging markets. Notable projects sponsored this year include loans to Kyrgyz Republic to mitigate the immediate emergency caused by the Russian economic decline, and funding for sustaining the government administrative and service delivery capacity in Ukraine.

CSL Limited – Stewart Asia Pacific Leaders

CSL Limited is an Australian multinational specialty biotechnology company that researches, develops, manufactures and markets products to treat and prevent serious human medical conditions. It seeks to develop global leadership in three distinct areas: rare and serious diseases; influenza vaccines; and iron deficiency and nephrology. Cell/gene therapies are now beginning to come to the market after years of development. For diseases with few effective therapeutic options, such as certain blood cell cancers, or where successful therapy has required a lifetime of regular symptomatic treatment, such as rare inherited genetic deficiencies, they offer the promise of a long-term cure.

Governance

VeriSign – Liontrust Sustainable Future Growth

Verisign is an internet infrastructure service provider. It operates two of the internet's 13 'root servers', domain name registries for two of the internet's most important top-level domains, .com and .net, and is also the contracted registry operator for the .name and .gov top-level domains. VeriSign provides a digital certificates infrastructure though a network of Certification Authorities (CA) that encrypts and digitally signs electronic communications. It offers tools and services to combat cyber threats, such as DNS attacks, as well as fraud screening software to support merchants using e-payments.

Wolters Kluwer – Evenlode Global Income and CT Responsible Global Equity

Wolters Kluwer provides its clients in the health, tax and accounting, governance, and risk and compliance sectors with legal and regulatory services. It has used its deep expertise across these areas to create productivity tools, which enable customers to make better decisions. The business lines are split between:

A range of tax and accounting services to help companies with compliance and regulatory requirements, and Consulting services and educational materials that supports access to health, governmental and legal education.

In 2022, Wolters Kluwer was awarded a 'Stevie Award' at the American Business Awards for its proprietary solution that aids companies with their ESG and environmental reporting. Its software is also being used in Mongolia by doctors in rural areas to provide information in areas that lack internet connectivity.

Tom Buffham
Portfolio Analyst

Asset Allocation Committee investment outlook

These views are implemented across our portfolios but there may be deviations where asset classes or suitable investments are unavailable or excluded.

Cash

We remain overweight cash, which is a relatively attractive asset class at a time when global growth momentum is slowing but bonds are not rallying. Moreover, the Bank of England base rate continues to move higher.

Bonds

We raised our exposure to government bonds again this month, adding weight to the UK. This decision was underpinned by the UK's relatively high interest rate sensitivity and other factors that we thought would weigh on UK economic growth and limit the upside in UK bond yields. We upgraded global inflation-linked bonds instead of global conventional government bonds because inflation expectations have dropped sharply. Looking ahead, there probably isn't much more downside, with one important reason being that oil prices should remain reasonably strong. If inflation expectations end up moving sideways, that leaves other factors, including index composition, that will determine conventional versus index-linked relative performance. On that front, Japan has a high weight in the global conventional index, but a small weight in the global inflation-linked benchmark. Japan is set to be a global growth bright spot in H1 2023. This, combined with the yen weakness of the past two years, should add to the inflationary pressure that is beginning to emerge in Japan. Against this backdrop, the risk is that Japan continues to tweak its yield curve control policy. If it does, that would push bond prices lower around the world, but the odds seem high that Japanese government bonds would be most susceptible to declines in this scenario. We remain underweight corporate bonds as there is scope for further spread widening if economic growth continues to deteriorate as we expect.

Global Equities

Bond yields are approaching a peak in our view, so how much further the equity market declines from here will come down to how severe the earnings recession is. There is still a pathway for the US economy to avoid a recession, which would be supportive of corporate earnings. But the probability of this scenario unfolding does not seem to be particularly high. That said, for now the US economy is holding up relatively well, and a recession may not begin until the end of this year or early 2024. If the US economy evolves as such, global equity markets may end up trading in a broad range throughout the first half of 2023. While there is no way to know how much earnings per share will ultimately decline at this stage, it's reasonable to believe that a severe decline is unlikely. Importantly, while excesses and imbalances are currently present, the backdrop is not dire.

Alternatives

It is too early to position for a sustained decline in real yields and a drop in the dollar. As such, we retain our neutral position on gold. We also remain underweight property; inflationary pressure is weakening, valuations are unattractive, and real bond yields should remain elevated. Finally, we are overweight absolute return; this is a relatively attractive asset class at a time when the risk/reward backdrop for equities and bonds is not great.

UK Equities

Rate hikes are having a more pronounced detrimental impact on growth in the UK than they are in the US, partly because mortgage terms in the UK are much shorter. Higher mortgage rates are pushing UK house prices lower, and that has historically coincided with weaker consumer spending. Relatively weak UK economic growth tends to weigh on UK equity relative performance. Nevertheless, UK equities have outperformed of late (in common currency terms) on the back of both the strong rebound in the pound versus the dollar and the outperformance of the value style-oriented stocks the UK market is heavily weighted in.

US Equities

We retain a modest bias to US equities for several reasons. The first is our outlook for the dollar. If markets slip back into a 'risk-off' environment, which we expect, that should provide the backdrop for a final bout of dollar strength. A strengthening currency generally leads to regional equity outperformance in common currency terms. Second, a cyclical top in sovereign bond yields is probably not far off. Rising bond yields have been good for the relative performance of the global equity value style over the global growth style. If it is correct that bond yields aren't far from a peak, that is good news for the relative performance of growth stocks, which is supportive of the US given that it is heavily overweight the growth style. Third, although an eventual US recession still seems likely, for now the US remains a global economic growth bright spot.

Europe ex-UK Equities

Europe ex UK equities continue to rebound versus the global equity benchmark (in common currency terms). Helping drive this turnaround has been the strength in the euro, which has received a boost thanks to the decline in natural gas prices, increased European Central Bank hawkishness, and the shift to a more risk-on environment. Looking ahead, to believe the pro-cyclical euro will build on this rally will need both global growth momentum and risk assets to be closer to bottoming. We do not believe we are there yet. Without continued upside in European FX, it will be difficult for Europe ex UK to sustain its recent outperformance in common currency terms.

Japan Equities

Given Japan's plunging population and birth rate, Japanese equities are confronting major demographic headwinds. This acts as a strong disincentive for Japanese businesses to invest, which is a structural roadblock to equity market outperformance. More immediately, Japanese equity relative performance (in common currency terms) has been resilient, helped by the drop in the dollar versus the yen. Looking ahead, we do not expect a catalyst to arrive that could spark a sustained period of Japanese equity outperformance. That said, the Japanese economy should benefit from its delayed pandemic reopening in the first half of this year, which is coming at a time when US/European economic growth is slowing. Against this backdrop, the relative performance outlook is balanced, in our view.

Asia ex-Japan Equities

With the region heavily oversold, Asia ex Japan equities were primed for a rally. Announcements from the Chinese authorities, such as its 16-point plan to support the property sector and 20-point plan to optimise Covid restrictions (before dropping them completely), helped to catalyse the gains made since late October. In addition, like all regions outside the US, Asia ex Japan has also received a big relative performance boost from the decline in the dollar. In terms of the outlook, as always there are pros and cons. While the list appears balanced, it is probably right to think that there is a cyclical window of opportunity for the region to outperform. Longer term, it is difficult to have a strong view, especially due to the lack of policy visibility.

Emerging markets ex-Asia Equities

Brazil, Saudi Arabia, South Africa, Mexico and the United Arab Emirates are the countries with the highest market cap weightings in EM ex Asia, making it a very commodity-exposed index. Looking ahead, there are crosscurrents confronting the region. On the one hand, EM ex Asia remains very cheaply valued, and there is scope for the economies in this index to bounce back from the Covid crisis. On the other hand, EM FX should depreciate versus the dollar as global economic growth slows. Against this mixed backdrop, we maintain an exposure slightly below the benchmark.

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The Sustainable MPS model portfolios promote investment into firms with positive environmental, social and good governance characteristics, but they do not have sustainable investing targets. Due to the sustainable focus of this portfolio, there are companies and sectors in which we are unable to invest, meaning the portfolio's performance may be lower than that of an unconstrained investment portfolio with the same benchmark.

The value of investments, and any income from them, can fall and you may get back less than you invested.

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