telescope
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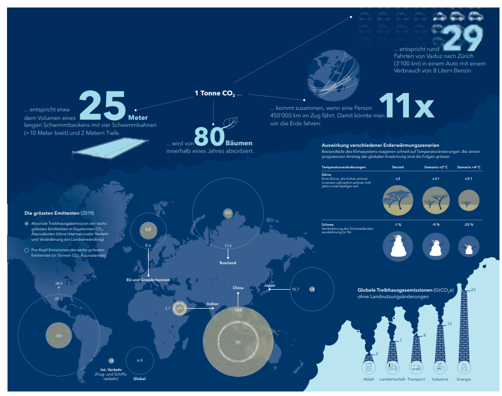
INVESTING WITH A PURPOSE

Investors' convictions about climate change and social issues are increasingly colouring their portfolio decisions

VP BANK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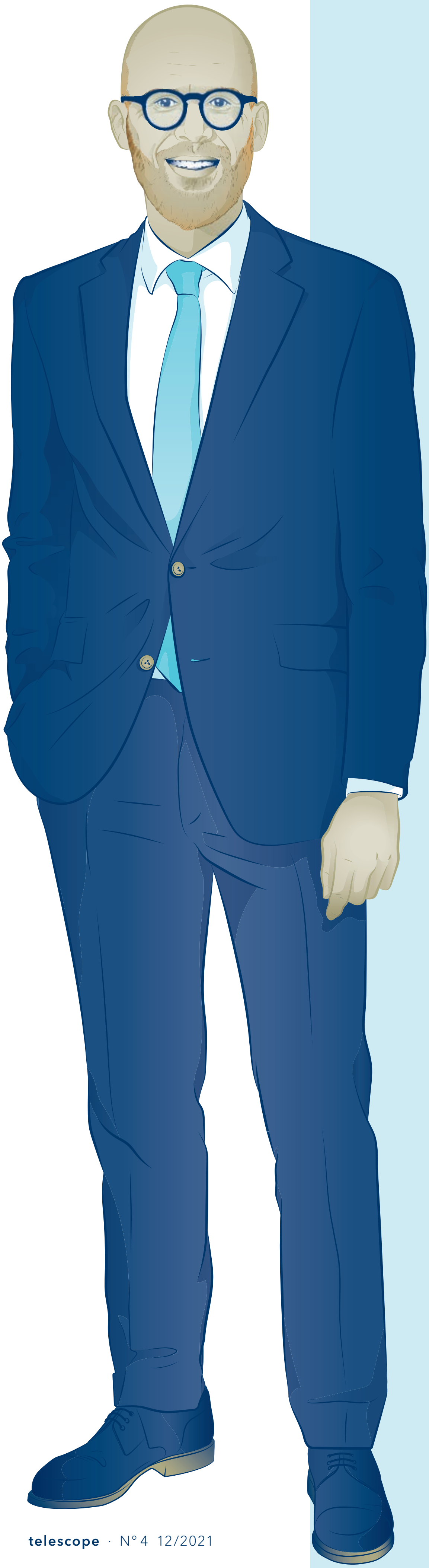


THE RIGHT IMPACT

Dear Reader

There are few proverbs that work well in many languages. But “Money can’t buy happiness” transcends the language barrier. Perhaps it’s because everyone is so familiar with money. And we all know that a good life requires more than money alone.

This insight is increasingly colouring people’s attitude towards investment. What is the point of a high financial return if it’s achieved by flouting one’s personal values and beliefs? Isn’t it possible to put together a rewarding portfolio by investing in companies that help combat climate change or improve working conditions in developing countries?

There are many ways of achieving a purposeful impact (→ page 4). One option is to take an activist approach, like the investors who have targeted oil giant Shell (→ page 18). Or one can make an impact by investing in new technologies. Philanthropy is another effective approach, as former UBS CEO Peter Wuffli has shown with his elea Foundation (→ page 10).

As always in Telescope, we include wider-ranging articles that expand on our core theme. Take a look – you might be surprised.

Dr Felix Brill
Chief Investment Officer
VP Bank

INVESTING WITH A PURPOSE

Sustainability has many aspects. Climate change is one. Promoting social diversity and fighting poverty are also vital concerns. Investors can use their capital to help meet these challenges. But before choosing an investment or revamping a portfolio, we have to ask ourselves where and how we want to contribute. Purpose is a very personal matter.

Felix Brill

"Humanity faces a bleak future on this planet, unless it makes rapid and large-scale reductions in greenhouse gas emissions." That was the warning issued by UN's climate chief Patricia Espinosa at the Cop26 climate summit in Glasgow. Experts are agreed: the window for reducing global warming to 1.5° C above the pre-industrial level is closing. Glasgow was awash with appeals and declarations of intent, but the summit ended with a squabble about what to say about coal power in the final declaration. In any case, words alone will not avert the climate catastrophe. The crucial need is a change in behaviour. And that requires investment and risk capital, with the financial services industry having a vital role to play.

Climate change is not an isolated phenomenon. As well as its direct effects, global warming threatens to undo progress in achieving goal no. 1 of the UN's 2030 Agenda for Sustainable Development: "no poverty". According to the World Bank, over 700 million people worldwide are eking out an existence on less than USD 1.90 a day. What do sustainability and climate goals mean to those living in extreme poverty?

It is human nature to pause occasionally and ask ourselves what our aim in life is. What exactly do we want to achieve? How can we contribute? Or simply, what are we here for? It's all summed up in the word "purpose".

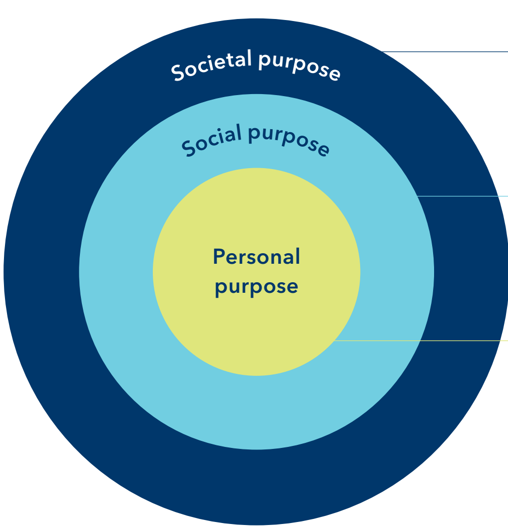
Purpose – what does it mean?

In his book "The Purpose Economy" the American entrepreneur and writer Aaron Hurst identifies three types of purpose: personal purpose, social purpose and societal purpose. He illustrates each type with a true story.

The first is about Warren Brown, a lawyer whose moment of truth came late one Friday night when he was making a cake for a manager in his office. He suddenly realised that his real passion was not the law but baking cakes. What happened then is a classic tale of someone who gave up a good job in order to seek personal fulfilment. In Warren's case the change led to the start of a new business called "CakeLove". A **personal purpose** can give rise to a successful business idea.

The second story is about Kristine Ashe and her "Entre Nous" winery. Kristine didn't come from a wine-making family and she originally didn't have a passion for making good wine. But she created a successful business. The motivation was about her family, which was fractured and living all over the country. Her dream was to use

The three types of purpose defined by Aaron Hurst



For example Kate, who lost her mother when she was twelve and later founded a community for orphaned children.

For example Kristine, who brought her family together by starting a wine-making business.

For example Warren, who gave up his job as a lawyer to turn his passion for cake-making into a career.

the vineyard to bring them together again. This strong **social purpose** impelled her to make a huge effort to realise her dream. The family did indeed come together and help establish the wine-making business.

Then there is Kate Atwood's story. Kate's experience shows that a successful change of trajectory does not always start with a lengthy search for meaning and purpose. Her awakening happened when she was asked to speak at a camp for kids who had lost a parent. She had lost her own mother when she was twelve years old but had not fully internalised what the loss meant. A conversation with a little girl who told her about losing her own mum and dad opened her eyes. Two years later she left her job and started "Kate's Club", a nonprofit community for children in Atlanta who had lost a parent or sibling. Kate's story shows the impact that a **societal purpose** can have.

What all three types of purpose have in common is the strength of the impact they can achieve: Warren is now happier, Kristine's family has come together in the new business, and all the kids and teens in Kate's Club who have lost a parent have benefited. If passion and purpose show the way, taking risks can pay off.

Purpose makes the difference

This does not apply only to entrepreneurs. In 2020 the consultancy firm McKinsey conducted a survey of around 1,000 employees of various ages and functions. 70% of respondents said their sense of purpose was defined by their work. They did not just identify with their job but defined themselves by it. The survey also clearly showed that employees' satisfaction increases if they can fully identify with their job. Not only that; they show greater commitment to their work and enjoy higher energy levels and better health outside the workplace as well.

So it is no surprise that providers of start-up capital want to get to know not only the young firm's founders but the whole team. Success depends not simply on a good business idea but also on mentality. Enthusiasm can make all the difference, especially in the early stages. A young company with a vibrant sense of purpose is much more attractive to new employees and investors.

US car maker Tesla would not have been able pioneer electromobility single-handedly without the vision of Elon Musk. But vision alone would not have done the trick unless he had also succeeded in attracting a top-notch team and persuading employees and customers to identify with the company and its product.

But woe betide a company that loses its purpose and charisma. The resulting disillusionment can be crushing, as Facebook's recent travails have demonstrated. When whistleblower Frances Haugen appeared before a US Senate subcommittee in October, she started by saying she had joined the company because she thought Facebook had the potential to bring out the best in people. But she continued, "I am here today because I believe that Facebook's products harm children, stoke division, weaken our democracy and much more." The Facebook Files based on inside information leaked by Haugen show that the company has done next to nothing to prevent the spread of disinformation. Internal analyses and suggested improvements have been regularly ignored for fear of jeopardising the business's growth. Facebook's reputation was already severely tarnished, but after the latest revelations it is dead in the water. Facebook's founder Mark Zuckerberg is attempting to salvage the wreck by changing

> // A purpose that transcends investment return. //

Typical sustainability approaches – implementation of personal preferences

the company's name. It is now trading as "Meta". But it remains to be seen whether this will be enough to recapture the business's lost purpose.

Purpose in the portfolio

Facebook is not a small fish. It is one of the ten most highly capitalised companies in the world. At the end of August 2021, shortly before Haugen's bombshell testimony, it had a market capitalisation of over USD 1 trillion. This subsequently dipped to USD 900 billion in October. While Facebook was floundering, Tesla's share price made another leap. In early November Tesla was worth more than Facebook/Meta for the first time ever.

While it would be wrong to attach too much importance to short-term market movements, the example of Tesla and Facebook clearly shows that psychology can be a crucial factor in stock market behaviour. A company that lacks a true sense of direction has a much harder time than one that brims with purpose and vision. This phenomenon, far from being merely a short-term factor, has driven Tesla's meteoric ascent on the stock market in recent years.

If purpose is so decisive for corporate success and employee satisfaction, why shouldn't it do the same for the portfolio? If someone is deeply concerned about climate change or poverty, they can use their portfolio to make an impact. Following Hurst's logic, a portfolio can have a purpose that transcends investment return. It can be structured to carry a personal and societal purpose as well.

Purpose can be realised in various ways. Investors can choose, for example, to put money into businesses that are active in the development of forward-looking technologies to tackle climate change. Or they can seek to influence corporate policy, either by exercising their voting rights in a listed company or by entering into dialogue with management in the case of a private equity investment. And there are also less conventional tactics, as some green activists have shown (→ page 18).

One size doesn't fit all. The right approach will depend on the investor's goals, finances and time horizon. The first step is to define the portfolio's purpose. This is best done by drawing up a "sustainability charter", as suggested by Professor Falko Paetzold (Interview → page 16).

Various approaches

Once the charter has been formulated, the question is how to implement it in the portfolio. The good news is that the market for sustainable investing is growing by leaps and bounds, creating more and more opportunities for aligning portfolios purposefully with investor preferences. Switzerland exemplifies the market's growth momentum. According to the latest market research by Swiss Sustainable Finance, a specialist association founded in 2014, assets managed on a sustainability basis in Switzerland grew tenfold between 2015 and 2020, and the trend shows no sign of slowing.

The bad news: the multiplicity of available approaches can be bewildering. For the sake of clarity, we at VP Bank employ a simple classification (→ diagram on page 7). This classification does not claim to be complete, but it has proved useful in practice. These approaches are also part of VP Bank's sustainability offering.

In negative screening, the focus is on thematic risk. Investments in companies that fall short in terms of sustainability or on the basis of a particular theme such as climate change are excluded. The exclusion criteria are often based on ESG ratings (→ article on the right). Another option is positive screening,

// The market for sustainable investing is growing by leaps and bounds. //

in which investments are concentrated on companies with a good sustainability score. Forward-looking theme- and impact-focused investments are other possibilities. The various approaches can also be used in combination. In the "Investment ideas" section (→ page 21) we offer hints on drawing up a personal sustainability charter. If the purpose is right, investors can achieve an impact that transcends financial return: to the benefit of themselves, the portfolio and the world at large.

www.vpbank.com/
sustainabilityscore

HOW ESG RATINGS ARE MADE

ESG ratings are widely used these days. They aim to provide investors with a convenient guide to companies' sustainability commitment. But what exactly is an ESG rating? And what does it tell us about the entity being rated?

Dominik Pross

ESG-compliance has become a major theme in the investment world. The three letters stand for environmental, social and governance. In everyday parlance, sustainability is usually associated with environmental issues, but ESG highlights the fact that investors are also concerned with social and governance aspects. All three elements have an impact on sustainable financial success.

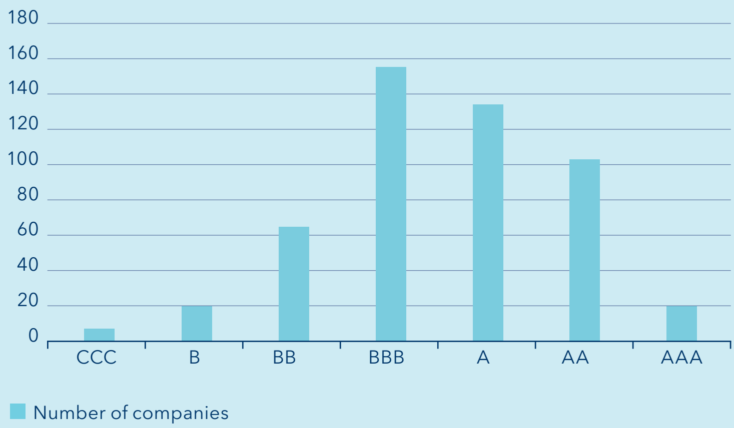
For ESG ratings, the financial services industry relies primarily on assessments by specialist rating providers. The best-known providers of ESG ratings are MSCI (which we use at VP Bank), Sustainalytics and Bloomberg.

Assessments are based primarily on companies' business and sustainability reports plus other publicly available information and reports in the media.

Each rating provider has its own methodology. Typical data points include the company's CO_2 emissions and executive remuneration. In the case of governments or quasi government organisations, the metrics applied will obviously be different from those used for corporate issuers.

Sometimes a best-in-class approach is used to produce comparative results in a given subset. This ensures, for example, that the ratings for an industry like oil production are not all uniformly (and therefore uninformatively) bad.

Distribution of ESG ratings of companies in the S&P 500



As rating providers are reliant on companies' disclosed information, data quality can vary from firm to firm within a given sector or region. Depending on where the company is domiciled or listed and the regulatory regime to which it is subject, the necessary information may not be available or at least not in sufficient detail.

Moreover, as relevant data are usually only published in the company's regular business or sustainability reports, rating updates necessarily occur with a time lag. Added to that is the fact that the data generally relate to the past or present – projections are extremely rare. This means that ESG ratings often provide only a snapshot.

A glance at the US equity index S&P 500 gives an example of the distribution of ESG ratings. According to MSCI, 257 companies in the S&P 500, i.e. just over half, have an ESG rating of A or higher. Only 20 achieve the top AAA score. At the other end of the spectrum, 27 firms get the lowest or second-lowest rating (CCC or B). These so-called laggards are outdone by their competitors in managing their ESG risks. Perhaps the best-known example is auto maker Ford, which is outshone by Tesla's A rating.

IMPACT THROUGH ENTREPRENEURSHIP

The elea Foundation created by Peter Wuffli, former CEO of the UBS Group, fights poverty by supporting young business ventures in impoverished regions. The "elea way" combines philanthropy with impact.

Clifford Padevit

"It is a disgrace that a quarter of the world's population still lives in poverty," says Peter Wuffli, who set up the elea Foundation for Ethics in Globalization together with his wife in 2006. Wuffli, who was CEO of the major Swiss bank UBS from 2001 to 2007, is a fighter on the poor's behalf.

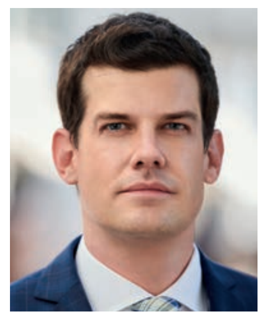
The poverty issue was already close to his heart when he was a student at the University of St Gallen in Switzerland, where he specialised in development economics. He believes that the privilege of having grown up in Switzerland and being able to climb to the top of his profession makes him a beneficiary of globalisation. Globalisation, he says, is the megatrend of our generation. It creates many winners but also leaves losers in its wake. "The money I have earned is partly a globalisation windfall rather than an income due entirely to my own merit. Now I want to share this windfall with those who have not been lucky enough to receive it."

Profit compatible with impact

The elea Foundation espouses an entrepreneurial approach to the "no poverty" goal enshrined in the UN's 2030 Agenda for Sustainable Development. "elea uses entrepreneurial means to combat poverty wherever the average income is below three dollars a day," says Wuffli. The foundation currently supports over 20 ventures in Asia, Africa and South America.

The foundation invests in young companies. "Effective entrepreneurship requires professionalism, full-time commitment and accurate measurement of success." The use of the term "venture" for the foundation's operations points to a venture capital approach. This explains the

Peter Wuffli
Founder of the elea Foundation for Ethics in Globalization



Florin Lanz
Executive Director at elea

time line. On average the foundation's involvement lasts about seven years. "In our ventures we are looking for impact but also for a path to financial sustainability. We do not regard profit and impact as contradictory. Without profit, a sustainable impact is not achievable."

The foundation's investment process is similar to that of a private equity fund. A great deal of effort goes into looking for suitable businesses. "Every year we look at 600 to 1,000 enterprises, of which 15 to 20 are short-listed for a more thorough examination," says Florin Lanz, Executive Director at elea. Finally the list is whittled down to perhaps six ventures in which elea decides to invest. To date, the foundation has invested CHF 19 million in ventures.

The team bases its investment decisions on three criteria. The central criterion is the enterprise's business model and whether it is scalable and capable of having the desired impact, i.e. will it reduce poverty? Second, can elea contribute to the venture's impact and offer appropriate expertise? Third, the elea team must be satisfied with the entrepreneur's qualities and motivation. A face-to-face meeting with

> // The central criterion is the desired impact – reducing poverty. //

Wuffli and the foundation's CEO helps decide if the personal chemistry is right. "We don't beat about the bush," says Wuffli. "For example, we will want to know about the entrepreneur's family circumstances to help us understand his or her impact motivation."

Focus on the pioneer gap

The foundation invests in enterprises whose sales results already show that their business idea works. What is needed, besides an injection of capital, is expert help with organisation, strategy and governance. In his latest book, "The elea Way", Wuffli explains the "pioneer gap" that characterises this stage of a business's development, when risks tend to increase more steeply than sales and cash flow needs to be supplemented. elea helps bridge this gap. "We aim to be the first institutional investor and the last philanthropic investor."

"For every franc of invested capital there needs to be a franc's worth of non-financial support," says Wuffli. At elea, a team of over twenty people with a business background supports the foundation's ventures. "As active investors we usually have a place on the board of directors and therefore contribute time and professional input as well as finance," says Lanz, whose career includes management consultancy and a leadership role in the US expansion of a Swiss software provider.

Exiting from successful ventures can be challenging, as Wuffli frankly admits. Take the example of Coffee Circle. Established in 2010, this company buys high-quality coffee beans directly from farmers in remote areas at fair prices, roasts the beans in its own roastery and sells them online to customers in Germany, Austria and Switzerland. At the same time, it invests in projects designed to improve the farmers' living conditions. The foundation became involved in 2013, when the firm's annual sales were less than a million francs. Sales have since climbed to well over a million a month, and the profit threshold has been exceeded. "Actually they don't need us anymore," says Wuffli. But even professional investors can find it difficult to let go of a successful enterprise, especially one that has such a big impact.

Private persons and organisations that make a financial contribution to elea's activities become members of elea's Philanthropic Investors' Circle. In Switzerland their contributions qualify as tax-deductible donations. Recipient enterprises are selected in consultation with the donor, and 90% of the contribution is invested in venture capital and support, with only 10% going into general expenses. Reporting includes an impact statement in which "impact points" per 1,000 invested francs are calculated using a measurement methodology developed by elea and externally assessed. Points are awarded on the basis of multiple criteria, including "lives touched" directly or indirectly by the investment and various qualitative factors relating to the business model, organisation and elea contribution. In this way an "elea return on investment" can be calculated and one venture compared with another.

Wuffli is convinced that the elea Foundation will continue to thrive even without himself and his wife. "We have an excellent management and a highly talented team. I have no worries at all about elea's sustainability."

PROFILE

From banker to philanthropist

When Peter Wuffli, together with his wife and the lawyer Harold Grüninger, founded the elea Foundation for Ethics in Globalization at the end of 2006, he was CEO of UBS. He left the bank soon afterwards and has since devoted himself to elea and the development of the "elea way". He also holds a number of directorships. He is Honorary Chairman of the Foundation Board of IMD, a globally leading business school in Lausanne, Member of the Board of Directors of Sygnum, a bank specialising in digital investments, and Vice Chairman of the Zurich Opera House. He was previously Chairman of Partners Group, an investment firm dedicated to private markets, and a Partner in the consultancy firm McKinsey. Wuffli holds a doctorate from the University of St Gallen, is 64 years old and father of three grown-up children.

BONDS WITH IMPACT

Investors' increasing focus on sustainability is giving rise to new forms of financing. After green bonds, we are now seeing the emergence of a market for social bonds.

Clifford Padevit

Sustainability themes are attracting enormous interest. Climate change is a major focus of attention, but social issues are also important. That is why sustainability investments are mostly evaluated on the basis of environmental, social and governance criteria – ESG for short.

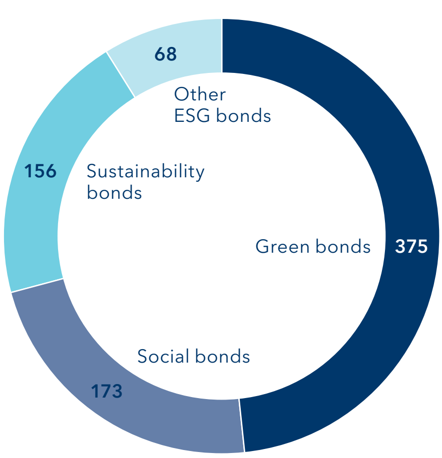
Social impact

For investors looking for fixed income assets that do not merely tick ESG boxes but can also produce a sustained impact, there is already a large market in green bonds. These are the oldest and dominant component of the young ESG market. According to the Climate Bonds Initiative, the ESG bond market grew to a worldwide cumulative volume of USD 1,700 billion in 2020. Two-thirds of this total consisted of green bonds. The rest was in the form of social bonds and sustainability bonds (a hybrid of green and social).

Labelling bonds as green or social requires a standard definition. The International Capital Market Association (ICMA) has taken the lead here. Its "social bond principles" were first issued in 2017 and last updated in 2021. ICMA defines social bonds as bonds whose proceeds are used exclusively to finance social projects and which meet four key criteria: 1) The proceeds should be used for eligible projects, notably providing basic infrastructure (e.g. clean drinking water), access to essential services, affordable housing or job creation in small and medium enterprises (the list is not exhaustive). 2) The issuer should operate a transparent project selection process. 3) The proceeds should be managed in a separate account. 4) The issuer should provide investors with up-to-date information on the use to which the proceeds are put. Transparency is regarded as vital.

The trouble with these principles is that it is the issuers and their banks who decide whether or not they are applied. ICMA recommends that external reviewers should be invited to check the issue's alignment with the four criteria. That would also help in measuring and evaluating the bond's social impact. But this is no easy matter. Social impact is difficult to quantify and depends on a multiplicity of factors.

ESG bond issues 2021
(in billion US dollars, until end of September)

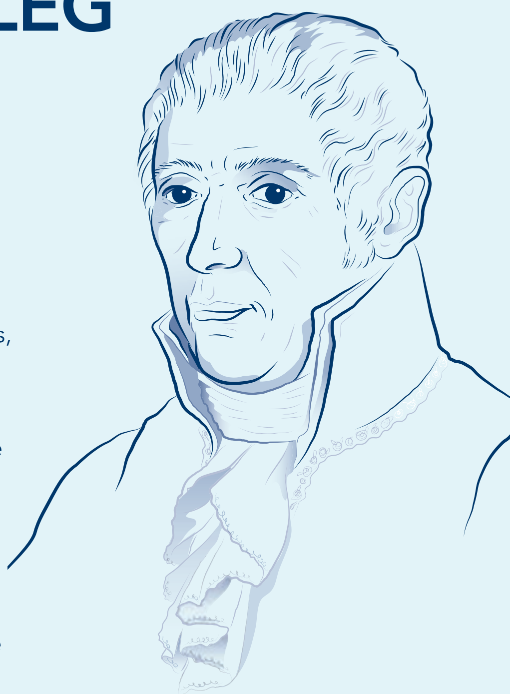


Mostly government issuers

This young market is currently dominated by government and quasi-government issuers, notably in Europe. The European Union's SURE programme has continued to set the pace. Under this scheme the EU will provide financial assistance of up to EUR 100 billion through the issue of social bonds to cushion and combat member states' long-term unemployment problems resulting from the Covid pandemic. According to the Environmental Finance Bond Database, USD 173 billion worth of social bonds have been issued worldwide so far this year (as at end-September).

The broad spectrum of themes covered by social bonds makes these instruments attractive for impact-focused investors. The market's meteoric growth therefore looks set to continue.

IT STARTED WITH A TWITCHING FROG'S LEG



Over 200 years ago the Italian physicist and chemist Alessandro Volta produced the world's first electric battery. This pioneering achievement paved the way for many other discoveries and inventions, including today's electric car.

The story of the first electric battery starts with a misunderstanding. In 1791 the Italian polymath Luigi Galvani published an essay entitled "Commentary on the effects of electricity on muscular motion". His findings sparked a fierce scientific debate. The central character in this debate was a frog's leg.

Galvani had found that by touching a dissected frog's leg with two pieces of metal he caused the leg to twitch. He attributed the movement to "animal electricity" residing in the frog's body. Alessandro Volta, who since 1778 had been professor of experimental physics at the University of Pavia, repeated the experiment but disagreed about the interpretation. He believed that Galvani's frog was twitching in response to an unintentionally created external electric current. The frog's muscles, he said, were detecting the current, not causing it.

Nine years later Volta was able to prove that the detected electricity was generated by a metallic interaction. He experimented with various metals and finally produced a battery by stacking alternate copper and zinc plates separated by thin pieces of leather soaked in brine. The apparatus became known as a "voltaic pile". On 20 March 1800 Volta described his invention in a letter to the Royal Society in London. The voltaic pile made it possible, for the first time ever, to produce a constant electric current.

The invention had huge reverberations, quickly spawning further discoveries. Experiments with voltaic piles led directly to the discovery of electrolysis, a process in which a chemical reaction is driven by an electric current. Only six weeks after Volta's announcement, two English scientists, William Nicholson and Anthony Carlisle, used a voltaic pile to separate water into hydrogen and oxygen. Very soon, electrolysis was used to isolate potassium, sodium, barium, strontium, calcium and magnesium for the first time. Volta's invention also played an important part in the evolution of telecommunications, being used to provide the electric current for the electrical telegraph.

Born in 1745, Volta was not destined to be a physicist at all. His parents wanted him to study law. But his passion for physics won the day and he immersed himself in the study of electricity. In 1775 he popularised an improved version of the electrophorus, a device for generating and transporting static electricity.

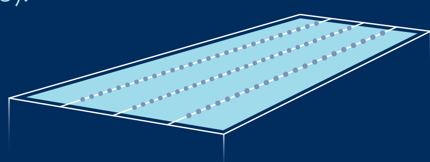
Volta's name has been immortalised in the volts that we use as a measure of electrical potential. The terminology was agreed 54 years after his death at the first International Electrical Congress in Paris in 1881 in recognition of his path-breaking achievements. Today, with electric motors becoming an essential ingredient of the green transition, we should be deeply grateful to Alessandro Volta. He lives on in the volts stored in electric batteries. **CP**

GREENHOUSE GASES – A SUFFOCATING PICTURE

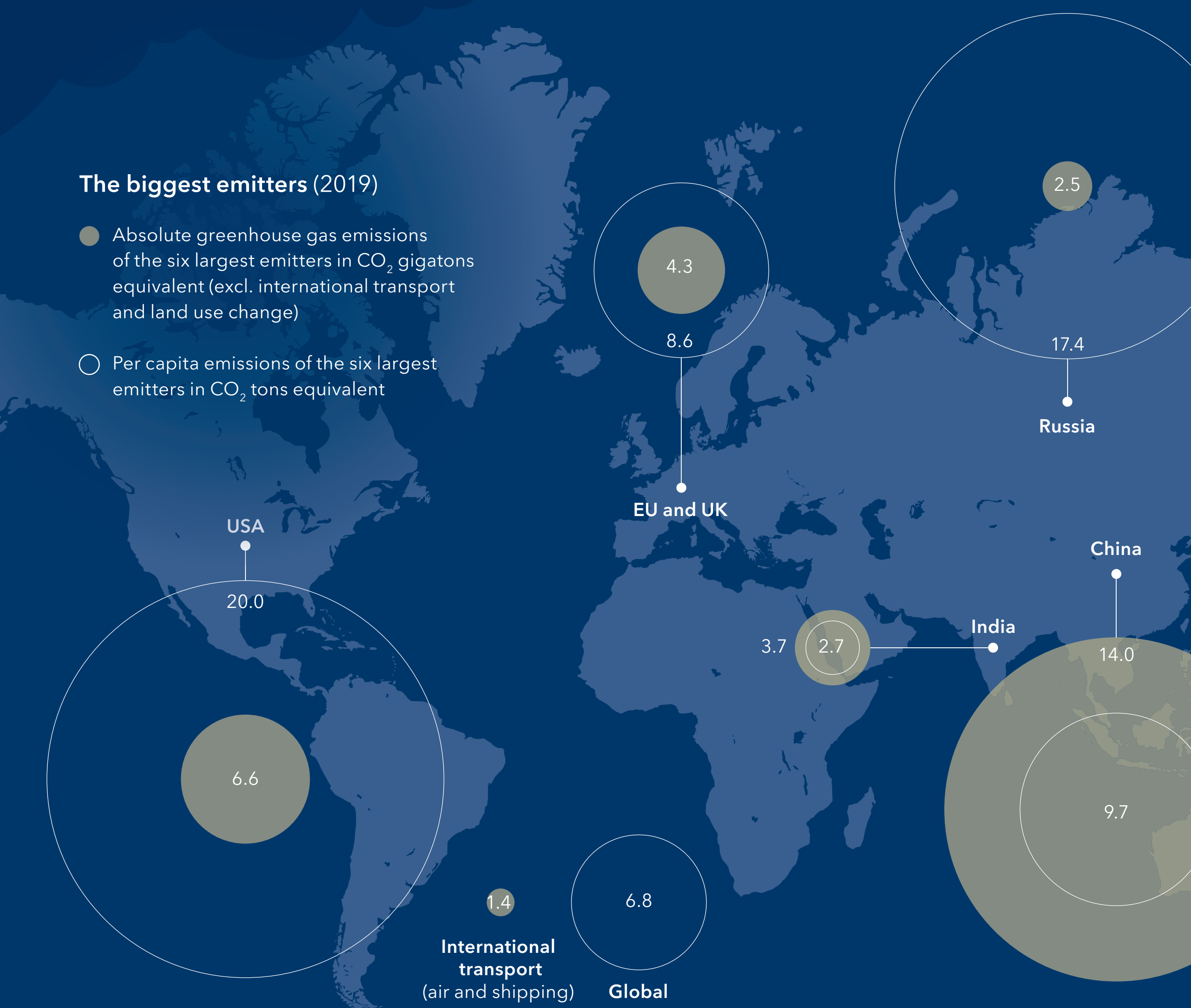
Climate change is the dominant issue in the sustainability spectrum.

1 ton CO_2 …

… equals roughly **25 metre** the volume of a swimming pool with 4 lanes (= 10 metres wide and 2 metres deep).



… is absorbed by **80 trees** in a year.



29

... represents roughly 29 journeys from Vaduz to Zurich (3,100 km) by car with a petrol consumption of 8 litres per 100 km.

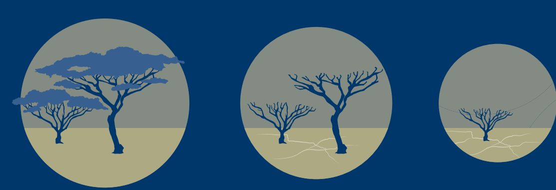
11x

... is the emission caused by a person travelling 450,000 km by train – equivalent to circumnavigating the earth 11x

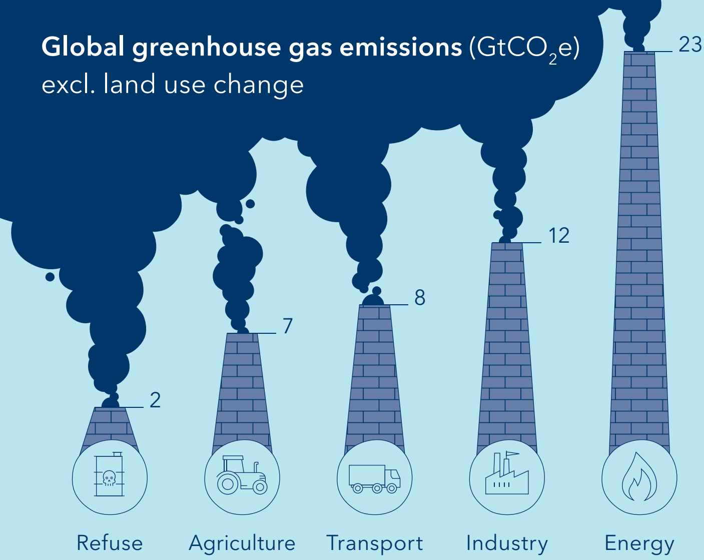
Effects of different global warming scenarios

Many parts of the climate system react rapidly to changes in temperature. The greater the degree of global warming, the greater the consequences.

Temperature change	Present	Scenario +2° C	Scenario +4° C
Drought A drought that previously occurred once in ten years occurs x times more frequently.	x 2	x 3.1	x 5.1
Snow Change in area of snow cover (%)	-1%	-9%	-25%



Global greenhouse gas emissions ($GtCO_2e$)
excl. land use change



"IMPACT IS A BUZZWORD FOR THE OLDER GENERATION TOO"

In wealthy families the question of impact investment has tended to be delegated to the younger generation, says Professor Falko Paetzold. It is important to approach this issue holistically for the entire family assets.

Interview: Clifford Padevit

Professor Paetzold, in your experience what is wealthy investors' main purpose when they are looking for impact – green or social?
It varies a lot from investor to investor. There are certainly themes that people are especially interested in. Working together with The ImPact (a network of wealthy families committed to aligning their assets with their values), we carry out an annual survey to ascertain the fields in which ultra-high-net-worth individuals (UHNWIs, people with investable assets of over CHF 50 million) want to invest. The results show strong interest in the environment, food and agriculture, energy, resource efficiency and water. The gap between supply and demand is largest in the fields of food/agriculture and water.

The Centre for Sustainable Finance and Private Wealth – CSP – at the University of Zurich has published a guide to achieving impact in financial investments. Investors, says the guide, should take impactful stakes in private and public markets and engage with listed companies through the exercise of their voting rights. Is this recommendation generally applicable?
First we have to define what a company's impact is and how the investor can have an impact on the company. An investor can only claim to have an impact if their investment causes change. This happens either through the provision of growth capital that would otherwise be unavailable or by exerting influence as a voting shareholder. Various efforts are being made to democratise stakeholder influence by giving smaller investors a voice. For example, responsAbility offers microfinance funds that make impactful direct investments. For the most part, however, this is still a field for UHNW families.

So impact is being pioneered by the wealthy?
That is nothing new. Wealthy families are decisive drivers of innovation, because they are often the only group able to do so on a substantial scale. Pension funds are often unable to engage in this field, and for governments it can be very difficult.

Do priorities in these families vary from generation to generation, with the heirs being more interested in impact?
The situation has changed greatly over the last year or two. When we launched our "Next Gen" programme for the next generation at Harvard in 2015, family dynamics were still a crucial factor. The decision-makers within a family tend to be the older generation. The young regard sustainability as the path to the future, whereas many older family members saw it as a passing fad. But that has changed. Impact is now becoming a buzzword for the older generation too. The question then becomes: How to put it into practice? And that is often left to the next generation.

If the family is no longer a barrier to impact investment, what are the roadblocks?
We still regard intermediaries as a barrier, though here one needs to differentiate. Some private bankers do help to implement impact strategies, but the problem is frequently that client advisers have not been adequately trained in this area. There can also be technical obstacles, for example a lack of systems for

quickly showing how a sustainability-oriented portfolio would look like. And some banks do not yet have enough impact products on their platform. The exercise of voting rights, for example, is something that only few banks can help with.

What is the best way for investors to implement their impact priorities?
The most important step is to sit down and draw up an impact policy statement , often referred to as a "sustainability charter": What do I want? What sort of risk/return profile am I looking for? What is my time horizon? What issues are important to me (and why)? And are there themes with which the family is already engaged? We recently had a course participant who owns a large beverage company. She was able to make the connection between climate change mitigation and cooling systems used by her company. This insight enhances the impact that her family can achieve through its investment activity. An independent adviser can help people understand such synergies and become more impact-aware.

Does impact also relate to the family business or only to financial investments?
Most families start out by treating impact as a separate theme and choosing investments in fields that happen to interest them or which they are familiar with. But there has to be an "aha!" moment when they realise that impact is not a separate issue but one that has crucial implications for the family firm. The approach has to be holistic. Families need to look at their entire portfolio of assets and scrutinise their business, family office, trusts and personal assets through the impact lens. How, where and when can everything be brought into alignment?

Is the next generation more prepared to compromise on profit?
That is a big question mark. The younger members of wealthy families often do not regard the family assets as really their own, because the wealth was amassed by their forbears. But it is their job to manage and protect it. This causes confusion and can be emotionally burdensome. But such a way of thinking is artificial. The fact is that the money is theirs.

Does that mean they are less focused on growth?
Many young people ask why they need to turn 300 million into 400 million. It makes no difference to the family, they say, but the world is going to the dogs here and now. This attitude is a feature of the generation gap.

And what does the next generation do about it?
They consider how they should implement their values and carry their family or family office with them. That includes knowing how much investment income they need. They often decide to compartmentalise their assets, devoting one part to sustainability combined with capital preservation and putting the rest into high-risk impact investments. We often hear it said that impact is very risky, for example in the case of direct investments in South America or East Africa. But our alumni regularly report that such exposures turned out to be their best investments. The risk is perceived as higher than it actually is. Impact and sustainability ultimately relate to the key themes of today's society. An impact approach often helps to identify winning themes and avoid losers.

PROFILE

Professor **Falko Paetzold** (38) is Initiator and Managing Director of the Centre for Sustainable Finance and Private Wealth (CSP) at the University of Zurich and Assistant Professor in Social Finance at EBS University in Oestrich-Winkel, Germany. CPS is a spin-off of Harvard University's "Next Gen" Impact Investing Programme of which Professor Paetzold was a co-initiator. Previously he was a post-doctoral researcher at the MIT Sloan School of Management, sustainability analyst at Bank Vontobel and Partner of Contrast Capital, a consultancy firm for sustainable investing.

Note: The opinions expressed in this interview may differ from those of VP Bank.

GREEN ACTIVISTS

Raiders, asset strippers, locusts. Activist investors get called many names, but all the jibes point in the same direction: a lust for maximum profit. Now, however, there is a new type of activist investor: the climate warrior. Oil giant Shell has a story to tell.

Bernd Hartmann

Activist investors don't get a good press. Traditionally they have been a byword for greed and unscrupulousness – like Gordon Gekko in Oliver Stone's 1987 film Wall Street.

But green activist investors are a new breed. Instead of being driven by pure self-interest, these individuals or organisations are motivated by ecological or social priorities that they want to see reflected in the companies they invest in. They seek to change corporate behaviour by exercising their financial muscle. They differ from old-style activist investors not only in their aims but also in their methods. The Anglo-Dutch oil giant Shell is experiencing this new type of activism on several fronts.

Quietly effective

First there are the quiet activists. These are investors who make their protest felt by refusing to maintain investments in companies with whose strategy or business methods they cannot identify. They ask themselves where their priorities lie and take action to bring their investments into alignment with their values. This quiet approach – mostly based on exclusion criteria such as arms sales or non-green energy – is not without consequences for the company concerned.

For one thing, it has a signalling effect. The Dutch pension fund ABP, which manages pensions for government and education employees and is one of the five biggest pension funds in the world, decided at the end of October 2021 to disinvest in companies that produce fossil fuels. With this decision,

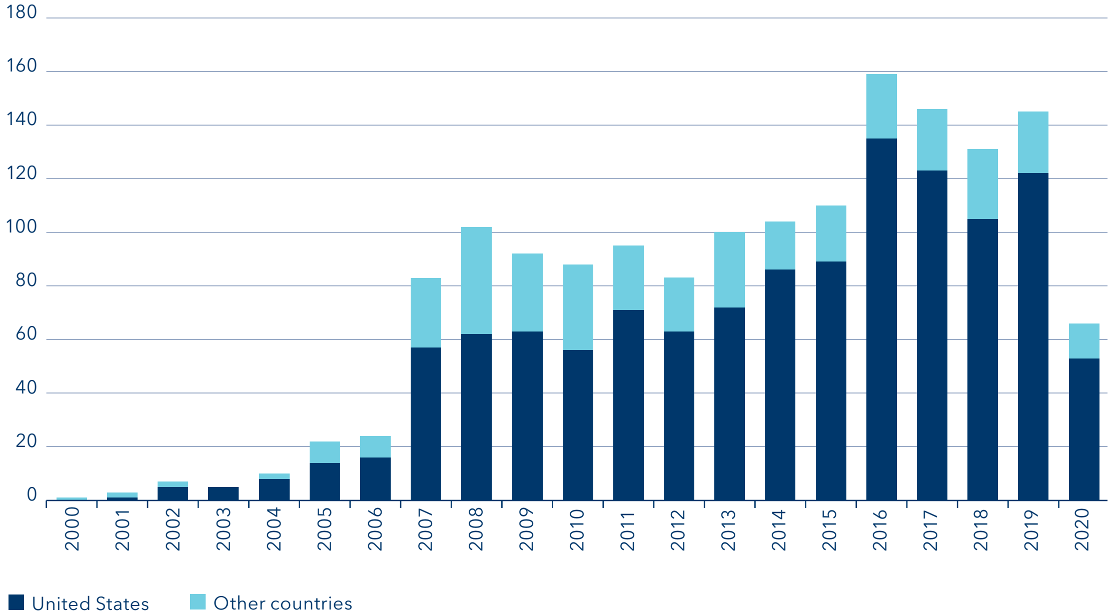
> // The world's fifth largest pension fund no longer invests in fossil fuels. //

Europe's second largest pension fund has bid farewell to Shell, which is the third largest company on the Amsterdam stock exchange with a market capitalisation of around EUR 150 billion.

If many investors act in the same way, the share price of the targeted company will suffer, also making it less attractive to non-sustainability-focused investors and thus putting pressure on the firm's management. Action in the bond market works in a similar fashion. Reduced demand for a borrower's bonds pushes up the company's borrowing costs, with a disadvantageous effect on the profit and loss account. This is usually a gradual and insidious process that doesn't hit the headlines.

Loud activists cause more of a stir. They exert their influence either inside a company or from the outside. On the inside, shareholders who disagree with the course that the company is

Global lawsuits related to climate change mitigation, 2000 until May 2020



following put pressure on the management by exercising their voting rights.

Shareholder rebellions

Pushing through an activist agenda requires a coordinated effort. To get a majority, other investors have to be persuaded to come on board. Success can then be achieved in the face of opposition by the company's management. Engine No. 1's intervention in Exxon is a case in point. This small activist hedge fund held only 0.02% of the US oil giant's shares but was able to rally enough other shareholders to its cause to win three seats on Exxon's twelve-person board, thus forcing the company to take the climate crisis more seriously. Shell could face a similar campaign. The hedge fund Third Point, led by activist Daniel Loeb, has recently demanded that Shell split its operations on the basis of their climate impact.

Some powerful investors adopt a less spectacular approach. Instead of stirring up rebellion at the AGM, they seek to influence the company's management through dialogue. BlackRock, the world's largest fund manager, tends to favour this approach. In May of this year it announced it was having talks with Shell's management about climate objectives and the evolution of the company's CO_2 footprint until 2050.

There are also activists who seek to exert influence from outside. Here, too, Shell has been a target. Climate campaigners have sued the company on the grounds that its net zero emissions strategy for 2050 is not ambitious enough. In May 2021 the court found in the campaigners' favour, insisting that Shell must bear responsibility for its CO_2 emissions. For the first time ever, thanks to this landmark ruling, a company is being forced judicially to meet its climate commitments. The verdict could set an important precedent and trigger a wave of legal actions, though this will depend on the outcome of Shell's appeal.

Focus on values

The number of lawsuits relating to climate change mitigation has risen sharply in recent years (see chart above). In the latest example Greenpeace and Environmental Action Germany are taking legal action against carmakers Volkswagen, Daimler and BMW and oil and gas producer Wintershall Dea on the grounds that their present and planned measures allegedly fall short of the Paris climate goals.

Not all sectors are equally exposed to activists' attacks. So far the focus has been mainly on big oil and gas, which is under pressure to speed up the transition to greener energy. But other companies with a CO_2-intensive business model, like cement and steel producers, could soon find themselves in the firing line. Further potential targets include banks (which as lenders can exert a major influence on other companies) and automobile makers. Alongside green activism, there are also activists who campaign for ethical principles like equal opportunity, social responsibility or improved corporate governance. These issues involve companies across all sectors.

Managements that face sustainability demands from shareholders and other activists should be prepared to enter into a dialogue and make genuine changes. The issues have to be taken seriously. Half-hearted promises and plans can be counterproductive.

The dilemma that management is facing can be very tricky. Management and activists have a completely different time horizon. While activists take a long-term view in their battle to tackle the climate crisis, managers are judged primarily by short-term success. An investment in the green transition might pay off in the long run, but in the short term it can erode the bottom line. Many managers would prefer to pay out more to shareholders.

Green activists should be careful in formulating their demands. That applies to activist investors like Third Point, for example. Its plan to separate Shell's oil and refinery business from renewable energies and liquefied natural gas (LNG) would block the company's strategy of achieving a gradual restructuring in which the old business in fossil fuels finances the switch to renewables.

// Half-hearted promises and plans are counterproductive. //

One wonders who would be prepared to invest in the old part of Shell after a breakup. The upshot could be a delisting via sale to a private investor interested only in cash flow. A similar danger arises if energy companies bale out of their traditional business without creating capacity to provide alternative energy sources. Countries like Saudi Arabia, Russia and Iraq, which are outside the activists' sphere of influence, could simply take their place. How would that help the climate? In such cases, green activists must accept their share of responsibility.

HOW TO INVEST SUSTAINABLY AND WITH IMPACT

Bernd Hartmann

01

Draw up a charter

Investors should ask themselves what their priorities are and where they want to have an impact. They can then draw up a charter (→ page 16) that incorporates these decisions. The UN's sustainable development goals (SDGs) can help guide the investor's choices.

02

Formulate exclusion criteria

Investors should avoid investing in companies whose business activities are incompatible with their personal aims and values. If the transition to CO_2-free energies is important to them, they will not invest in utility companies that rely on coal. On the basis of such criteria, securities and other vehicles that have a critical exposure can be identified and the portfolio adjusted accordingly. VP Bank's Sustainability Score is a useful guide here; investments with a critical exposure are excluded and borderline or questionable business activities and practices get a lower score.

03

Align investments with your values

Investors should ensure that they invest in companies whose activities are compatible with their personal values. We use the SDG and Impact Score (a component of the VP Bank Sustainability Score) to achieve transparency. Our Investment Idea series "Investing in the Green and Social Transition" informs you about relevant investment opportunities.

04

Exert influence

Shareholders can exert influence on the companies they invest in by exercising their voting rights. The trend towards virtual or hybrid AGMs makes this easier. Shareholders who do not wish to participate personally may appoint a proxy. There are consultants who can help with making an appropriate decision. In the case of an investment fund, investors should check whether the fund managers exercise their voting rights and report on their voting behaviour. Some funds also seek an active dialogue with the company.

05

Choose impact investments

A growing number of investment vehicles offer the possibility of making an impact not only at the company level but also in the real economy and society at large. This includes green, social and sustainability bonds (→ page 12) issued by governments or companies to finance green or social projects. Microfinance funds provide capital to organisations that grant small loans to individuals and small businesses in developing and emerging economies. Otherwise these borrowers would have no regular access to the banking system. Private equity investments in this field can also have a strong impact.

ALEXANDER OSPELT

With his entrepreneurial talent, marketing instincts and deep knowledge of the butcher's trade, Alexander Ospelt has set his seal on the family firm.

Clifford Padevit

// An entrepreneur has to be purposeful, imaginative and persuasive. //

Alexander Ospelt

"As a child I used to go to the shop with my father at weekends when he reloaded the smoker," says Alexander Ospelt. "I know the business inside out." Ospelt believes this puts him at a big advantage. He was 32 years old when he took over the management of the Liechtenstein-based Ospelt Group from his father.

His father was not a control freak; he gave his sons ample freedom. But about one thing there was no question: the choice of a career. "We were never asked what we wanted to be," says the 60-year-old. When his brother and he were old enough, the father simply said it was time to start their apprenticeship. It was a foregone conclusion that they were going to learn to be a butcher. The butcher's diploma still hangs on the wall of Ospelt's office. And now one of his sons is preparing himself to take over the chairmanship of the group in a few years' time.

The Ospelt Group is a huge business, but outside Liechtenstein it is almost unknown as a brand. That is because it mostly makes private label products: charcuterie and meat, poultry, fish and seafood, fresh meals, pasta, pizzas, sandwiches and pet food. The group has five production locations, and it is one of Liechtenstein's biggest employers. Malbuner ham and sausage specialities are among the most popular charcuterie products in Liechtenstein and Switzerland.

The story began in 1958, when Ospelt's father, known affectionately in Liechtenstein as "Uncle Herbert", acquired a butcher's shop in Vaduz. 1967 saw the opening of a production facility in the small Liechtenstein town of Bendern, followed by further facilities in Switzerland and Germany.

How does one become an entrepreneur? "I learnt a lot from people who are older than me – from my father, from customers." And with growing success, the entrepreneurial itch became stronger and stronger. "As an entrepreneur you have to be purposeful, imaginative and persuasive."

Opportunity also plays a part – like the pizza factory in Germany, which Ospelt bought in 1999 in a bankruptcy sale, making the group an international operator. In the huge European market he has competed successfully with big name food groups in the baked goods market, so that the Ospelt Group is now one of the three biggest private label producers in this sector. Ospelt regards this as one of his biggest successes. And it was he who chose the "Mal besser. Malbuner" slogan. There were many suggestions, but he knew straight away that this was the right one. "When something clicks like this, you have to go for it."

Ospelt values ideas and innovation. His recipe is to go out, talk to customers and get a feel for the market. That is how he hit on the idea of the "pocket sandwich", a salami roasted sandwich in a packet. It is designed as a "snack on the go" to be displayed at the payment counter of petrol stations and kiosks, where savoury products are mostly lacking.

When Ospelt talks about the pocket sandwich, he shows his salesman's flair. He is a man who knows his market and can persuade people to buy. Another example is the Landjäger semi-dried sausage. In the past these were always sold in pairs, but Ospelt sells them singly. And he also markets a single Mini-Landjäger in a packet. "Butchers used to think they had to sell a big sausage for a low price. We've turned that on its head," says marketing professional Ospelt.

My best investment

"I've always fared best when I've invested in my own business."

Why?
"I've grown up with the firm, I know the business, I know the customers and I have a good nose for new products. There have been missteps, like the Austria venture, but mostly things have gone well."

My worst investment

"A packaging machine that didn't do what it promised. I had to replace it after less than five years."

Did anything good come of it?
"The machine was sold to me as a world beater for making stand-up pouches. I let myself be talked into it, partly because of the price. I should have listened to my gut feeling. That's the lesson."

UPDATE ON EARLIER THEMES

Felix Brill

Issue No. 1 (06/2020)

In our first issue we argued that the dollar's strong performance at that time would not continue. We said we expected the currency to depreciate over the long run and cited various reasons why. The greenback was clearly overvalued in terms of purchasing power parity. America's higher inflation rate and its trade and budget deficits also pointed to a weaker currency. In the second half of 2020 the dollar did indeed come under serious pressure. It rallied slightly in early 2021 and has recently gained further ground. In our view, however, this is only an interlude. We expect the greenback to retreat again in the medium to long term.

Issue No. 2 (12/2020)

In 2020 the EU committed itself to reducing greenhouse gas emissions to net zero by 2050. That was and is a huge undertaking. Governments can set the wheels in motion, but net zero cannot be achieved without the efforts of businesses and individuals. At the end of 2020 the omens looked good for an economic recovery after the devastation unleashed by the coronavirus pandemic. For us the message was clear: a "green recovery" was in prospect. In 2021 the world economy has been able to flex its muscles again. Despite re-imposed lock-downs at the start of the year, economic activity in many countries has returned to its pre-crisis level.

INFO

VP Bank research

Soon you will find VP Bank's research reports – economic commentaries, investment ideas and equity analyses – in a special section of our e-banking website. It will pay you to take a look.

BETTING ON "TRANSITORY"

Bernd Hartmann

Like the pandemic-induced economic downturn, the post-lockdown recovery is presenting special challenges. The upturn has been so swift that supply has often failed to keep up with demand. Supply chain disruptions and materials shortages have been exacerbated by repeated reimpositions of Covid restrictions in Asia.

With order books at record levels, companies should be able to look ahead with confidence, though supply problems are pushing up producer prices. Basically, the economic outlook for 2022 is very positive. However, the speed of the recovery will depend on when shipping delays are resolved and supply chains restored to normal. Only then will firms be able to dig into their order backlogs.

Falling inflation

Forecasting the inflation trend is somewhat easier. After this year's acceleration, next year's year-on-year price rises will be less dramatic. Even so, inflation rates are unlikely to fall to pre-pandemic levels. We expect them to approximate to the central banks' relaxed targets.

Financial markets have coped with these uncertainties extremely well so far. Investors are reacting calmly and refusing to be rattled. Supply bottlenecks, materials shortages and rising inflation are regarded as transitory phenomena, not serious enough to undermine sentiment. This judgment is probably correct. But the market's optimistic expectations make it vulnerable to disappointments.

> // We recommend a growth-oriented positioning. //

Investors' assumptions are in line with central bank thinking. The official scenario likewise assumes that current economic stresses and strains will be transitory. Central banks are therefore planning only relatively small adjustments in monetary policy. Given the expansionary bias of fiscal policy and the strong economic outlook, the planned adjustments do not add up to a change of course. The central banks' frank information policy is also helpful. The markets can therefore take the expected measures in their stride.

Equities well supported

Nevertheless, the tapering of ultra-expansionary monetary policies and rising bond yields could put pressure on today's high equity valuations, especially in the United States. Doubts as to whether the central banks might be forced into a sharper change of course may well trigger occasional higher volatility. Even so, equity markets are still well supported, given the unattractiveness of fixed income assets at a time when inflation-adjusted yields are in negative territory.

We recommend a growth-oriented positioning. This should not be achieved by an aggressive equity allocation but rather by significantly underweighting bonds. The economic outlook is better than it has been in a long time, but the financial markets have already anticipated a lot. Any doubts about the positive scenario would create good buying opportunities.

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Page 9: MSCI, VP Bank
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Pages 14–15 Infographic:
- Calculations 1 ton CO_2: Swiss Climate, MyClimate
- Emitters: UN Environment Programme (UNEP) Emissions Gap Report 2020
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