Ruffer LLP

Environmental, Social and Governance report

for the year ended
31 December 2017

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About Ruffer

Ruffer is an active fund manager focused on generating positive returns for clients, regardless of how the financial markets perform. We believe our approach to investing is well suited to the needs and goals of many charities, pension funds and private clients. As at 31 March 2018, we manage over £22.0 billion for our clients.

At Ruffer, we have a distinctive approach to investing. Our focus is on delivering stable 'all weather' investment returns and on protecting and growing the value of our clients' assets throughout the market cycle. We define our approach through two investment aims –

— not to lose money in any rolling twelve-month period
— to grow funds at a higher rate than would be achieved by depositing them in cash

We conduct our own research, actively manage investments and operate freely, without the straitjacket of relative return or market benchmarks. The majority of our investments are in traditional asset classes, such as equities, bonds, currencies and in-house funds.

At the heart of our investment approach is an asset allocation which always maintains a balance of growth and protective investments. Protective assets should perform well in a market downturn and defend the portfolio value; growth assets, principally equities, should deliver good returns in favourable market conditions. The blend of offsetting investments reflects the prevailing risks and opportunities that we see in financial markets, rather than any pre-determined allocation. We operate without the constraints of benchmarks that institutional investors have historically been tied to.

Ruffer is a signatory to the United Nations supported Principles for Responsible Investment (UN PRI), the UK Stewardship Code and the Japan Stewardship Code.

Ruffer supports several climate-change initiatives, including the Institutional Investors Group on Climate Change (IIGCC), the Transition Pathway Initiative, Climate Action 100+ and Aiming for A.

Introduction

Welcome to Ruffer's fourth annual environmental, social and governance (ESG) report.

2017 was an exciting year for ESG investing, with significant progress in many areas. New investor initiatives focused on ESG issues made headlines around the world: the European Commission's High-Level Expert Group on Sustainable Finance encouraged the financial industry to integrate ESG considerations, and a number of companies, including ExxonMobil, were pushed hard by shareholders to improve their ESG disclosures.

Ruffer joins climate-change investor initiatives

Ruffer had an active year increasing our ESG efforts. We are now supporting the asset owner-led Transition Pathway Initiative[1], which tracks and evaluates how companies are managing their greenhouse gas emissions and the risks and opportunities arising from the transition to a low-carbon economy. The Initiative is currently aiming to compare companies' recent and future carbon performance with the international targets and national pledges made as part of the Paris Agreement.

Ruffer recently joined the Institutional Investors Group on Climate Change (IIGCC[2]), a forum that brings together 146 investors representing over €21 trillion in assets under management (including nine of the 10 largest European pension funds and asset managers). IIGCC's mission is 'to mobilise capital for the low-carbon future by amplifying the investor voice and collaborating with business, policymakers and investors'. It provides investors with a platform to encourage public policies, investment practices and corporate behaviour that address the long-term risks and opportunities associated with climate change.

Climate Action 100+[3] — a collaborative initiative led by the IIGCC, the UN PRI and HSBC Global Asset Management, among others — was launched on 12 December 2017, with Ruffer as a founding investor signatory. Through this five-year global initiative, investors commit to engaging with businesses to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures. The initial focus list of 100 companies comprises some of the world's largest emitters of greenhouse gases[4]. As of March 2018, 256 investors with more than US$26.3 trillion in assets under management had signed up.[5]

High-Level Expert Group

The European Union is strongly supporting the transition to a low-carbon, more resource-efficient and sustainable economy, and believes the financial sector has a critical role to play in this process.

In late 2016, the European Commission established a High-Level Expert Group (HLEG) to develop a comprehensive European Union roadmap for sustainable finance. The HLEG issued its final report in January 2018, which contained 24 recommendations covering nearly every aspect of the financial system. In policy terms, the fate of these recommendations is now in the hands of the Commission (which will release an action plan in March), the EU member states and the European Parliament.

1 TPI www.lse.ac.uk/GranthamInstitute/tpi

2 www.iigcc.org

3 www.climateaction100.org

4 Based on direct and indirect (scope 1, 2 and 3) emissions data, as reported and modelled by CDP (formerly Carbon Disclosure Project).

5 www.climateaction100.org

The significance of the final report[6] extends far beyond the sum of its individual proposals. Though the HLEG's starting point was to equip the financial system to meet the demands of the Paris Agreement, the group's vision was much broader: to make sustainable finance a core part of the EU's strategy for achieving economic prosperity, social inclusion and environmental regeneration. Looking beyond climate, the report contains fresh thinking on a range of other topics, such as the interrelationships between agriculture, biodiversity and natural capital.

The report also contains proposals to move market and policy frameworks. It proposes an interlocking set of recommendations that consolidate best practice and respond to pressing market needs. The HLEG offers a useful template for other countries seeking to develop a roadmap for sustainable finance. The EU has long played a key role in shaping international norms on sustainable development, not least by championing climate action and providing finance to developing countries, and the HLEG's work continues this tradition.

HLEG has performed a useful service in making 'sustainable finance' the umbrella term for this area — until now we have suffered from a multitude of terms: climate, environmental, ethical, green, impact, mission-led, responsible and social finance. With the emergence of the UN's Sustainable Development Goals (SDGs), 'sustainable finance' seems an appropriate choice.[7]

PRI conference

After joining the UN PRI at the beginning of 2016, we were delighted to be invited to speak at the annual PRI in Person conference, which took place in Berlin in September 2017 and was attended by over 1,000 delegates — the largest such event yet. Our presentation focused on the work we have done in the field of sustainable investing since joining the PRI, and in particular on our efforts to integrate ESG considerations into our investment process.

Integration

We believe that ESG factors are often a signal of management quality and that investing responsibly will lead to better long-term outcomes for our clients. Therefore, we systematically integrate ESG considerations into our investment process, starting at the idea-generation stage and continuing through the stock-review process. In addition, we regularly discuss ESG macro issues and the implications of megatrends such as energy and climate change, automation and technology, and water scarcity.

We believe ESG risks are increasing, in terms of both their impact and their likelihood. This view is shared by others: the World Economic Forum, for example, highlighted in its most recent annual Global Risks Perception Survey that 'environmental risks have grown in prominence in recent years... with all five risks in the environmental category being ranked higher than average for both likelihood and impact over a ten year horizon'[8]. The focus on climate impacts is perhaps unsur-

6 ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

7 ec.europa.eu/info/publications/180131-sustainable-finance-report_en

8 World Economic Forum: The Global Risks Report 2018, pp 6

prising after a year featuring highly destructive hurricanes, extreme temperatures and the first rise in CO2 emissions for four years.

Due to our concern about these risks, Ruffer participates in several climate-change initiatives (described above) and analyses core carbon metrics across our portfolios.

Carbon metrics

The ratification in 2015 of the Paris Agreement — and the commitment to limit the rise in global temperatures to, at most, 2°C above pre-industrial levels — was an important step in the transition to a low-carbon economy. The transition will create significant risks and opportunities for many sectors, so we have taken action to further improve the integration of ESG considerations into our investment process.

To analyse exposure to carbon risks, we tracked the weighted-average carbon intensity[9], carbon footprint[10] and carbon intensity[11] of our portfolios over the last seven years. Based on the recommendations of the Task Force on Climate-related Financial Disclosures, we focused particularly on weighted-average carbon intensity as a measure of our portfolios' exposure to carbon-intensive companies. As this metric allows for decomposition and attribution analysis, it enables us to identify the largest contributors to carbon risk. This informs our thinking on the companies we hold, and their respective weightings.

We are currently discussing how to report the results of this analysis most meaningfully to clients. Please let us know if you would like to provide input.

9 Portfolio's exposure to carbon-intensive companies, expressed in tons CO2e/$m revenue

10 Total carbon emissions for a portfolio normalised by the market value of the portfolio, expressed in tons CO2e/$m invested

11 Volume of carbon emissions per million dollars of revenue (carbon efficiency of a portfolio), expressed in tons CO2e/$m revenue

Voting activities 2017

The 2017 aggregated voting data presented in the following table comprises our voting across Ruffer funds, institutional and private client holdings.

Active stewardship enables investors to provide feedback to companies and encourage boards and management teams to consider and address investor concerns. We review local best practices and corporate governance codes when voting clients' shares, and actively consider companies' explanations for not complying with best practice to ensure we vote in the best interests of our clients. We will vote against a company's proposals if engagement fails to resolve our concerns.

It is Ruffer's policy to vote on Annual General Meeting (AGM) and Extraordinary General Meeting (EGM) resolutions, as well as corporate actions, where Ruffer's clients have a material interest in the company and/or the value of the holding is material to Ruffer's clients. This policy applies unless voting is not in clients' best interests (for example in markets where share blocking applies) or where, after due consideration, not casting a vote is the preferred course of action. Ruffer applies this policy across all shares held, both domestic and international, reflecting the global nature of our investment approach.

Our voting activities have increased in line with the expansion of our ESG engagement. The number of AGMs we voted at has risen significantly over the last two years: from 139 in 2015, to 233 in 2017. Ruffer voted against management 107 times in 2017, compared with 52 times in 2015, an increase both in absolute terms and as a proportion of votes cast.

Voting summary

In gathering information and making our final voting decisions, we place great value on engaging with companies and their advisers. Each analyst is responsible for reviewing the relevant corporate governance issues on a case-by-case basis and exercising their best judgement based upon their in-depth knowledge of the company. We view each proxy-voting decision as an opportunity for analysts to gain additional insight into companies. In forming our voting decisions, we take into account any issues raised by our proxy-voting research provider as part of its assessment of company resolutions and identification of contentious issues. We currently receive proxy-voting reports from the Institutional Shareholder Services (ISS). For ESG research, we subscribe to MSCI ESG Research.

Although we take note of proxy advisers' voting recommendations, we do not delegate or outsource our stewardship activities when deciding how to vote our clients' shares. Equally, we do not automatically support boards. We look to discuss with management any situation where we feel there is a relevant or material issue that could impact our investment in the company. In some situations, this leads us to vote against management. In such circumstances, it is likely that our intention would have been communicated prior to the vote being cast.

Meeting overview		2015		2016		2017
Number of meetings voted	139	%	192	%	233	%
At least one vote against, withhold or abstain	20	14.4	33	17.2	52	22.3
Number of items voted	1,165	%	1,903	%	2,395	%
For	1,119	96.1	1,817	95.5	2,235	93.3
Against	32	2.7	56	2.9	136	5.7
Abstain	14	1.2	30	1.6	24	1.0
Against management	52	4.5	74	3.9	107	4.4
Shareholder proposals	18	1.6	33	1.7	111	4.6

Source: Ruffer LLP

Analysis of votes against management in 2017

The chart overleaf shows votes against management by type of resolution.

We voted against management mainly on issues relating to remuneration policies and reports, pre-emptive rights and capitalisation, and directors' independence.

Directors' independence and remuneration were of increased interest in Japan, where the corporate governance landscape has changed significantly in recent years. More Japanese boards are focusing on balancing their boards, in terms of gender as well as diversity of skills.

Remuneration in Japan has traditionally been low relative to the UK and, to an even greater extent, the US. Increased attention on corporate governance practices has also highlighted a lack of alignment of pay with performance.

Voting for shareholder resolutions against management recommendations

We also voted for a number of shareholder resolutions that company management had recommended voting against.

As we reported last year, we voted for a climate change-related shareholder resolution at ExxonMobil co-filed by the New York State Common Retirement Fund and the Church of England Endowment Fund. Although it failed to win the support of the majority of shareholders in 2016, a similar resolution was co-filed in 2017. This second resolution was successful, with 62.1% shareholder support, despite not receiving the backing of the ExxonMobil board. It again asked for increased disclosure, in particular with respect to scenario analysis[12].

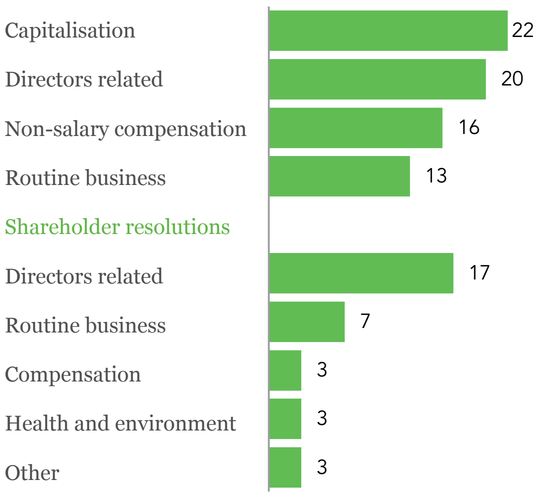
12 Scenario analysis (according to the Task Force on Climate-related Financial Disclosures): 'One of the Task Force's key recommended disclosures focuses on the resilience of an organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario. An organisation's disclosure of how its strategies might change to address potential climate-related risks and opportunities is key to better understanding the potential implications of climate change on the organisation. The Task Force recognises that the use of scenarios in assessing climate-related issues and their potential financial implications is relatively recent and that practices will evolve over time, but believes such analysis is important for improving the disclosure of decision-useful, climate-related financial information.' www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf

In December 2017, ExxonMobil announced that it would publish details of how climate change could affect its business, including analysis of the impact of policies designed to limit the increase in global temperatures to 2°C, the internationally agreed objective. This increased disclosure will enable shareholders to assess the long-term resilience of ExxonMobil's operations if governments deliver on their pledges to tackle climate change.

Other shareholder resolutions that Ruffer voted for that were against the recommendations of boards were particularly focused on director-related matters, such as asking for the removal of specific board members, an independent chair, or the possibility of electing a shareholder nominee to the board.

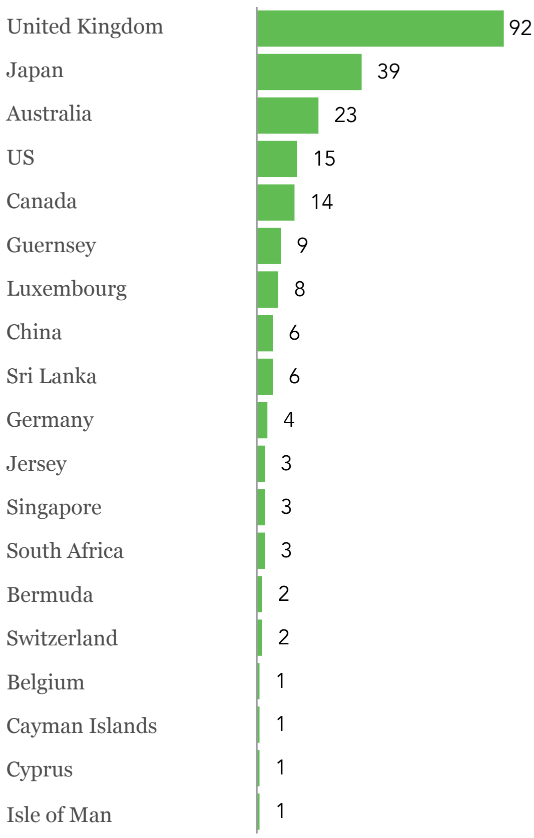
In Japan, Ruffer supported shareholder resolutions focused predominately on increased disclosure of executive compensation.

Votes against management



Source: Ruffer LLP

Geographic distribution of meetings



Source: Ruffer LLP

Engagement activities 2017

We attended over 1,600 company meetings in 2017. Below, we highlight ESG engagements on a range of topics, in aggregate and as detailed case studies. We describe when and where the engagement took place, where possible, we have also shown the outcome and whether the issues are still under review.

ESG engagement by issue

	Board and director	Remuneration	Accounting, audit, bribery, corruption	Environmental, sustainability	Social
AngloGold Ashanti		●			
ExxonMobil				●	
FujiFilm	●		●		
Man Group		●			
Mitsubishi Electric	●				
Mitsubishi Estate	●	●			
Mitsubishi Heavy Industry	●				●
Mitsubishi UFJ FG				●	
Mizuho FG		●		●	
Phillips 66				●	
Sony	●	●	●		
Sumitomo Mitsui FG				●	
Wm Morrison		●			

Source: Ruffer LLP

Engagement themes 2017

Indigenous rights – Dakota Access Pipeline

The Dakota Access Pipeline (DAPL) is a 1,134-mile-long pipeline which transports 450,000 barrels of oil per day from the Bakken fields in North Dakota to a shipping terminal in Illinois.

Its construction, completed in March 2017, has pitted Native Americans against oil companies and the US Army Corps of Engineers. The Standing Rock Sioux, other Native American tribes and activists have protested against the construction, arguing that the pipeline could endanger nearby water supplies and cultural heritage sites. They have argued that local tribes were not adequately consulted, nor given the opportunity to express or withhold free prior informed consent (FPIC).

In March 2017, a United Nations Special Rapporteur issued an 'end of mission' report[13] following on-the-ground investigations. The report found clear failures in the planning, permitting and building process, during which the local tribes' human right to meaningful consultation and FPIC were violated. Numerous companies are directly or indirectly implicated in the alleged violations.

According to a research note on 'The Dakota Access Pipeline Controversy' published by MSCI ESG Research[14], the pipeline supports the development of oil shale resources and specifically the Bakken shale fields. The total project cost of US$3.8 billion was financed, in part, by a US$2.5 billion project finance loan (between Energy Transfer Partners (ETP), Sunoco, Phillips 66 and several banks), with US$1.1 billion available immediately and the remainder available after receiving the necessary permits and approvals. ETP fell behind on contractual obligations to ensure the pipeline would be carrying oil by the end of 2016. According to court papers, delays cost the company US$450 million; additional delays could potentially cost US$83.3 million per month.

We engaged with: Phillips 66, Mitsubishi UFJ FG, Sumitomo Mitsui FG, and Mizuho FG, and provide more details in the following section.

Transition Pathway Initiative (TPI) – climate change engagement with the oil and gas sector

TPI is an asset owner-led initiative, supported by investors with over US$6.9 trillion of assets under management in collaboration with the UN PRI, the London School of Economics and FTSE Russell. It provides a free online tool that evaluates companies on their carbon management ('management quality'), and makes a forward-looking assessment of companies' CO2 emissions and their alignment with international targets ('carbon performance').

On the back of this initiative, we have sent targeted questions to BP, ExxonMobil, Phillips 66 and Tenaris. These included

1. Do you intend to set greenhouse gas emission reduction targets?
2. Do you intend to set quantitative relative or absolute targets for reducing your operational (scope 1 and 2) greenhouse gas emissions?
3. Do you intend to publish information on your scope 3 greenhouse gas emissions?
4. Who is responsible for overseeing climate-change strategies?
5. Can you provide information on the business costs associated with climate change, such as capital investments and costs of carbon permits?

We have had initial contact with the companies and have encouraged them to provide responses to the above questions in the public domain. We will follow up on the questions raised in due course.

13 www.ohchr.org

14 MSCI ESG Research Report, The Dakota Access Pipeline Controversy, April 2017 ©2018 MSCI ESG Research LLC. Reproduced by permission†

Engagement case studies

Q1 2017

AngloGold Ashanti

Main activity
Gold mining

Issue
Governance

Context
Remuneration

Details
We met the company to discuss proposed changes to its remuneration policy and the implications with regards to aligning director performance and shareholder value. We discussed how the key performance indicators in its long-term performance plan relate to overall health and safety targets, the role of the Social Ethics Director on the Remuneration Committee, and who the remuneration advisors are. The company also stated that it is planning to further align with the SDGs and integrate them into its reporting.

Mitsubishi Estate

Main activity
Real estate. Japan's second-largest real-estate developer and investor.

Issue
Governance

Context
Update on governance code implementation and committee structure.

Details
We engaged with Mitsubishi Estate over its response to corporate governance reforms in Japan. We reviewed changes to the organisation following its transition to a board structure with a nominating committee, which we feel is a very positive development. We discussed the duties and value of each of the board members and plans for an internal audit of the board's effectiveness. One of the contentious issues we have discussed with the company over the last three years is the renewal of its shareholder rights plan/takeover defence measures, which we do not endorse and have repeatedly voted against. The company argues that the renewal and partial revision of the plan in 2016 further restricted trigger events. Partly by emphasising its efforts to enhance corporate value, Mitsubishi Estate has persuaded several institutional investors to approve the takeover defence plan, despite the opposing recommendations of voting advisory companies ISS and GL, resulting in the highest rate of shareholder approval (67.21%) since the measures were introduced.[15]

15 Mitsubishi Estate Co. Corporate Governance Roadshow, January 2018

Mitsubishi UFJ FG, Sumitomo Mitsui FG, Mizuho FG

Main activity
Financials

Issue
Indigenous rights

Context
Dakota pipeline

Details
Ruffer's Japan equity analysts, in conjunction with our ESG team, engaged with these companies over their involvement in the funding syndicate for the Dakota Access Pipeline. Given the widespread media coverage, and the environmental and social implications of the project, we view it as our responsibility as shareholders to engage. We asked for clarification on a range of issues, including the current stance of management, details of each bank's exposure, the resolution process (given that some original lenders have assigned their exposure to others) and the banks' approach to meeting all of the local parties. Our engagement is ongoing and we are currently satisfied with the responses we have received.

Phillips 66

Main activity
Energy, petrol refining

Issue
Indigenous rights

Context
Dakota pipeline

Details
We are currently engaging with Phillips 66 over allegations relating to potential failures in the planning, permitting and building of the Dakota Access Pipeline, during which local tribes' human right to meaningful consultation and FPIC were allegedly violated.

Sony

Main activity
Consumer electronics

Issue
Corporate governance

Context
Corporate governance structures, remuneration, board effectiveness, stewardship

Details
Corporate Social Responsibility Director Shiro Kambe described Sony's corporate governance structures. The company chose to adopt the 'western' three committee board structure a few years ago and is happy with the implementation. It also believes that its shareholder structure – with 50% foreign investors – was helping this transition. Outside directors chair all meetings and Kambe-san stated that the oversight model is working well for Sony. We discussed why there is an Executive Director (CFO) on the Remuneration Committee, which is unusual in the western governance model. The company responded that the CFO shares information about the business' financial situation and budget issues/restraints with the committee, but does not attend the meeting when any specific remuneration proposals are being discussed. He explained that in companies that follow the western governance model there is no decision-maker on the Remuneration Committee, which he thinks is ineffective. At Sony, the CFO decides whether the proposals for CEO and CFO are feasible from a budgetary perspective and signs them off. In terms of the remuneration structure, the company explained the following: the pay-ratio for the CEO is 30% fixed and 70% variable pay including stock options, senior executives receive 40% fixed and 60% variable pay. Further down the organisation, staff will receive more fixed pay and less variable pay. In our view, this represents a better-than-average alignment with shareholder value. Board effectiveness was also discussed with the company, which explained how it restructured the organisation and the planning of board meetings. The number of items discussed was decreased significantly to allow effective discussions and decision making.

Q2 2017

Fujifilm

Main activity
Photography and imaging

Issue
Corporate governance

Context
Accounting scandal and remuneration

Details
We contacted Fujifilm to understand details of the accounting scandal at its Xerox division in Australia and New Zealand. We discussed the changes implemented since the investigation was completed in June 2017. The investigation found losses to shareholder equity of ¥28.1bn as a cumulative total over six years from March 2011 to March 2016[16]. Measures taken to improve management and corporate governance include increasing the presence of Fujifilm Holdings on the board of Fuji Xerox and steps to improve internal controls. More importantly, Fujifilm Holdings has decided to change its own governance structure and has proposed reducing the main board of Fujifilm Holdings from 12 to nine directors, three of whom will be appointed from outside the company.

Mitsubishi Electric

Main activity
Electronics and electrical equipment

Issue
Corporate governance

Context
Board structure

Details
We engaged with the investor relations team of Mitsubishi Electric regarding the re-election of Katsunori Nagayasu as an outside director. We voted against his appointment in 2016 and did so again in 2017. In our opinion, which was shared by the proxy voting agency ISS and a significant number of shareholders in 2016, Nagayasu-san cannot be deemed independent given his ongoing senior advisory role at Mitsubishi UFJ FG.

16 www.fujifilmholdings.com/en/pdf/investors/finance/materials/ff_irdata_report_002e.pdf

Mitsubishi Heavy Industry

Main activity
Industrials

Issue
Corporate governance

Context
Board structure, independence of non-executive directors

Details
We engaged with the investor relations team at Mitsubishi Heavy Industries regarding the election of Nobuo Kuroyanagi as an outside director. We voted against his appointment in 2017. In our opinion, which was shared by the proxy voting agency ISS, Kuroyanagi-san cannot be deemed independent given his ongoing senior advisory role at Bank of Tokyo-Mitsubishi UFJ.

Mizuho FG

Main activity
Financials

Issue
Corporate governance

Context
Remuneration, board practices

Details
We engaged with Mizuho FG to understand the board's recommendation to vote against several shareholder proposals. These included resolutions on income allocation, voting on strategic shareholdings held by subsidiaries, transparency of individual director remuneration and the mandatory separation of the roles of CEO and Chairman. We decided to vote against the board on the issue of director remuneration, voting in favour of more disclosure and transparency despite acknowledging the cultural preference for privacy on such matters in Japan. We also decided to vote against the board on the issue of voting on strategic shareholdings held by subsidiaries as we would like more transparency, in particular around the process used to determine how to vote on these shareholdings. On the issue of the mandatory separation of the roles of CEO and Chairman, we decided to abstain, as we felt we needed to discuss this internally in greater detail and agree on a policy to ensure that we vote consistently.

Q3 2017

Man Group

Main activity
Financials

Issue
Corporate governance

Context
Remuneration

Details
We met Man Group CEO Luke Ellis and CFO Mark Jones at the Ruffer offices to follow up on our previous discussion about board effectiveness, as well as changes to the remuneration policy, which will require shareholder approval in 2018.

Man Group

Main activity
Financials

Issue
Corporate governance

Context
Remuneration

Details
Ruffer had a follow-up call with Man Group to discuss its progress on drafting a new remuneration policy for approval at the 2018 AGM. We will continue our engagement with the company.

Wm Morrison Supermarkets

Main activity
Food and drug retailers

Issue
ESG

Context
SDGS, board structures, general corporate governance issues

Details
We met the new Remuneration Committee Chairman and the Head of Human Resources at our offices, who saw an urgent need to consult shareholders after relatively low support for the company's remuneration report at its 2017 AGM. We raised concerns again with regards to the clarity of communication over the long-term-incentive-plan (LTIP) cash-flow target. The report was unclear what measure of cash flow was to be used as an LTIP target. We recommended simplifying and improving the clarity of targets in future reports. Ruffer highlighted that it appeared Wm Morrison had misjudged the move from a pay-out of 240%-300% under the LTIP. The company responded to shareholders with improved transparency around the rationale for the LTIP in February 2018.

Q4 2017

Mitsubishi Heavy Industry

Main activity
Industrials

Issue
ESG

Context
SDGS, board structures, general corporate governance

Details
We met Mitsubishi Heavy Industry's CFO at the Ruffer offices. The company asked for feedback on its latest corporate governance structure, board evaluation as well as remuneration for directors. The CFO also highlighted his role at the Japanese Business Federation 'Keidanren', where he is leading corporate Japan's efforts on implementing and committing to the SDGs.

Natural Capital and the role investors play

We are at a critical point. With mercury poisoning the waterways of the Amazon rainforest, plastic littering our oceans and air pollution in many cities around the world at levels much higher than recommended, we are pushing our planet to the limit of what it can cope with.

After three years of stable carbon emissions, a preliminary report from the Global Carbon Project[17] suggests emissions from fossil fuels and industry grew 2% in 2017; at this rate, within the next four years we will have produced so much carbon that it will no longer be possible to limit global warming to within 1.5°C above pre-industrial levels.[18] In 2017, 'Earth overshoot day' — the day by which we used more from our planet than it can renew in a year — was 2 August.[19] The pressures on the planet will only grow more severe as countries develop and the global population grows to an estimated 9.7 billion by 2050.[20]

Natural capital is a concept that can be defined in many ways, and its definition is constantly evolving. It is most often defined as the world's stock of natural assets, such as air, water, soil and all living things. Human life is possible because of these natural assets — which include not only the food we eat, the water we drink and the air we breathe, but also other vital processes such as climate regulation, flood defences and carbon storage. These assets, and the ecosystem services we derive from them, are difficult to protect and even harder to value. And, as is often the case with shared assets, they have been exploited and used wastefully for many years. This is not only a 'tragedy of the commons': in the words of Mark Carney, Governor of the Bank of England, it is a 'tragedy of the horizon', as a lot of the damage is cumulative and persistent. Crucially, individual issues cannot be considered in isolation: their combined effects can be catastrophic as ecosystem productivity and resilience declines.

Natural capital depletion has been discussed by conservation campaigners and impact investors for many years. Through payment for ecosystem services schemes, such as REDD+[21], efforts have been made to protect natural assets. However, the success of these schemes has often been questioned, partly because of the difficulty of valuing the underlying assets. But significant progress has been made in recent years in this regard. In 2014, a study published in the journal Global Environmental Change estimated the total value of the world's ecosystem services at US$124.8 trillion per year, almost twice the value of global GDP.[22] There have also been efforts to estimate 'environmental externality' costs, with Trucost (on behalf of The Economics of Ecosystems and Biodiversity) suggesting that the world's primary production and processing sectors alone are responsible for costs of US$7.3 trillion per year.[23] With these new perspectives comes the opportunity to hold companies accountable for the damage they are doing and require them to provide financial compensation for their exploitation of natural assets. Since the full cost of environmental damage is often significantly higher than the narrow costs of preventing or limiting pollution, taking into account environmental externalities is likely to lead to a more efficient allocation of capital globally.

17 Global Carbon Project (13 Nov 2017), Global Carbon Budget 2017

18 Carbon Brief (2017, 5 April). Just four years left of the 1.5C carbon budget www.carbonbrief.org/analysis-four-years-left-one-point-five-carbon-budget

19 Global Footprint network database

20 World Bank databank

21 United Nations Collaborative Programme on Reducing Emissions from Deforestation and Forest Degradation in Developing Countries www.un-redd.org

22 Costanza, R et al (2014). Changes in the global value of ecosystem services. Global Environmental Change, Volume 26, pp 152-158

23 Trucost (2013). Natural Capital at Risk: The Top 100 Externalities of Business

Clearly, these pressures could ultimately increase operating costs and reduce the profitability of whole industries, so there is now a strong case for all investors to consider natural capital issues — not only with respect to individual companies, but also to their portfolios overall. The latter can be assessed through scenario analysis using recommendations provided by the Task Force on Climate-Related Financial Disclosures and CDP (formerly the Carbon Disclosure Project), which focus on issues such as how a portfolio would be affected by lower water availability or a higher carbon price.

The world's natural capital is made up of diverse assets. There are many ways these assets can be impaired, and the number of companies, industries and sectors causing the damage is vast. It is clear that all investment decisions are ultimately dependent on natural assets and the services derived from them. Investors must appreciate that changes to these natural assets, accompanied by changing environmental regulations, are going to create risks and opportunities in the years ahead.

To preserve and protect the world's natural capital, we need to develop valuation techniques and methodologies that allow businesses to quantify the impacts they have and the extent to which they are dependent on natural assets. The Natural Capital Protocol[24] is an important step in achieving this. However, there are still many questions relating to the rationale for and consistency of the metrics being used. Only when these metrics can be linked to traditional valuation metrics will it be possible for investors to fully evaluate a company's impact on natural capital.

For investors, natural capital is no longer just an environmental concern; it is a financial issue that cannot be ignored. The pressures are mounting fast and it is important to consider these issues now. The changes will affect entire sectors, but there are also opportunities for efficient companies to benefit and for new industries to develop. It is in investors' best interest to review their portfolios and seek to protect themselves from the negative impact on returns that these pressures will bring, and also to take advantage of the opportunities that will arise.

24 www.naturalcapitalcoalition.org/protocol

Company case studies

As an active investment manager, our in-house equity analysts play a crucial role in identifying companies that are suitable for our portfolios. In this section, we highlight some companies that we feel have some outstanding ESG credentials, are crucial in the energy transition or are furthering the Sustainable Development Goals (SDGs).

We discuss Japanese consumer products company Kao and its approach to improving the use of palm oil in its supply chain, and UK supermarket Marks & Spencer, which has a longstanding tradition of combining quality products with internal ethics. We also introduce Group Nutresa, the Colombian food producer that is incorporating the SDGs into its reporting framework, and car component manufacturer Aptiv.

These case studies aim to highlight positive ESG developments at companies in our portfolios. It does not constitute investment research, investment advice or a personal recommendation, and should not be used as the basis for any investment decision.

Kao (Japan)

Company overview

Kao Corporation is in the consumer products and chemicals businesses. The company operates in four segments: beauty care, human health care, fabric and home care (collectively, these segments comprise its consumer products businesses), and chemicals. It owns brands including Kanebo, Sofina, Molton Brown, Merries, Clearclean and Magiclean.

ESG

Kao is a member of the Roundtable on Sustainable Palm Oil (RSPO) and procures RSPO-certified palm oil. The company has also been working to establish the traceability of palm oil outside of the RSPO framework. Kao aims to use only sustainable palm oil with a traceable origin by 2020. The company reported in its 2015 Annual Communications of Progress (ACOP) report to RSPO that 23% of its products are RSPO-certified.[25]

In some regions, palm oil cultivation has caused – and continues to cause – deforestation. Land that was once predominantly covered by primary forest (ie forest untouched by man) has been cleared and converted into palm oil plantations. This has contributed to a loss of biodiversity and population declines in a number of protected species. Some palm oil plantations have been developed without consulting local communities, some have even forcibly displaced people from their lands. Violations of workers' rights to fair payment and safe working conditions and other malpractices have also occurred.

Kao discloses measurable carbon-emission reduction targets for its product portfolios, which are exposed to moderate risks that rising energy prices and carbon constraints could increase input, production or distribution costs. It has comprehensive programmes to mitigate these risks, and an aggressive target for reducing carbon emissions throughout its products' lifecycles. The company has also taken responsibility for tackling the issue of microbeads in cosmetics, which it has now phased out completely.

Analyst – Tristan Matthews

Tristan joined Ruffer in 2009 after graduating with an Economics degree from the University of Cambridge. After working with a portfolio manager for three years in Ruffer's fund management department, he became an equity analyst in the firm's Hong Kong office. Since early 2013 he has been based in London as an equity analyst focusing on Japan. He is a CFA charterholder.

25 Roundtable on Sustainable Palm Oil, Kao Annual Communications of Progress Report 2016 rspo.org/file/acop2016/submissions/kao%20corporation-ACOP2016.pdf

Marks & Spencer (UK)

Company overview

Marks and Spencer (M&S) is a 133-year-old FTSE 100 retailer, which predominantly operates in the UK but with material franchises and owned operations overseas. The company derives just over half of its revenues from food, skewed heavily towards fresh and chilled produce, with the rest from clothing and home products. M&S remains the largest clothing retailer in the UK by market share. In recent years the company has come under pressure from changing consumer behaviour, such as the shift towards online shopping. M&S remains steadfast in its commitment to operating sustainably, as increasingly demanded by its customers and staff.

ESG

M&S has always had a more ethical bias than some of its retailing peers, but it started laying out a measurable commitment to improving its social and environmental performance in 2007. The company refers to this initiative as Plan A (so called because 'there is no Plan B'), which encompasses many distinct areas within an overarching sustainable framework.

Some of the areas in which the company promotes sustainable operations directly impact the lives of its customers. M&S is aiming to achieve 50% of its food sales from healthier products by 2023, incentivising customers to choose them through the Sparks card loyalty programme. It has also implemented a clothes recycling campaign, called Shwopping. In addition, the company has launched a community-support initiative in areas surrounding some of its stores that are considered most in need, in an attempt to make a 'positive and measurable difference' to these neighbourhoods.

M&S focuses on sourcing products in an ethical and sustainable way. Its Human Rights initiative has been scored as the best for an apparel and food products business[26], and the company is collaborating with Oxfam to combat modern-day slavery and in-work poverty. Management is also aiming for all of the three billion food, clothing, home and beauty products M&S sells every year to have at least one 'Plan A attribute' by 2020, such as using MSC-certified fish in ready meals or FSC-certified timber in furniture.[27] Today, about 80% of M&S products[28] fulfil this criterion.

Management currently gives every factory supplying M&S food a bronze, silver or gold sustainability rating to drive measurable improvements in social and environmental performance. For example, to be rated silver, factories need to have reduced their energy use by 20%, and to regularly survey staff to understand how to improve job satisfaction. The company also measures the waste its food suppliers send to landfill (70% of sites[29] now send zero) and is trying to reduce usage of water and energy per tonne of production (over half have reduced this in the last year). The firm aims to have 50% of food[30] it sells coming from gold-ranked factories by 2025, with 95% of the remainder from silver-ranked factories. Transparency with customers is important too, and M&S publishes digital maps showing all factories producing its food and clothing.

26 corporate.marksandspencer.com/documents/plan-a/plan-a-2025-commitments.pdf, pp 4

27 MSC: Marine Stewardship Council, FSC: Forest Stewardship Council

28 corporate.marksandspencer.com/documents/plan-a/plan-a-2025-commitments.pdf, pp 4

29 corporate.marksandspencer.com/documents/plan-a/plan-a-2025-commitments.pdf, pp 5

30 corporate.marksandspencer.com/documents/plan-a/plan-a-2025-commitments.pdf, pp 5

M&S also has a keen focus on the sustainable sourcing of raw materials, with a particular emphasis on areas where it purchases in sufficient scale to make a difference. These include sugar, cocoa, fruit, vegetables, cotton, wool and leather.

Internal wastage is another key area and since 2007 the company has reduced its operational carbon footprint by about 70%.[31] Since 2012 M&S has sent no internal waste to landfill, and by 2025 the company aims to be a zero-waste business across its entire operation, including its supply chains and packaging.

These efforts have not gone unnoticed by customers and third-party observers, and M&S is rated the top-performing global retailer in sustainable sourcing, food safety and carbon emission reductions by MSCI ESG Research in its most recent report.[32]

Analyst – James Verdier

James graduated from the London School of Economics, then qualified as a Chartered Accountant. He joined Commerzbank as a telecoms analyst in 1999 and subsequently worked on the Special Situations trading desk. In 2005 he joined Lehman Brothers, where he worked on the Long Term Value proprietary fund. He joined Ruffer in 2008.

Grupo Nutresa (Colombia)

Company overview

Grupo Nutresa is Colombia's leading processed food producer. They sell biscuits, chocolates, cold cuts and coffee, amongst other products, and have a rapidly growing restaurant business. About 60% of the company's business is in Colombia, with the remaining 40% spread across the Americas, with larger businesses in Central America and Chile. The company has 45,000 employees.[33]

ESG

Sustainable development is at the core of Grupo Nutresa's values. The company has performance indicators spanning key ESG metrics, including nutrition, responsible marketing, food safety, responsible sourcing, human rights and the quality of life of employees, and the environmental impact of its operations.

In its 2016 integrated report, the company showed evidence of how it fulfils the requirements of the United Nations Global Compact (UNGC) and its contribution to the SDGs.

In its report, the company has mapped the SDGs to its six strategic priorities, which include 'reducing the environmental impact of its operations and products', 'building a better society' and 'promoting a healthy lifestyle'.[34] The company actively participated in the implementation of the SDGs in their first year, through its connection with the private sector Advisory Group of the UN SDG Fund

31 corporate.marksandspencer.com/documents/plan-a/plan-a-2025-commitments.pdf, pp 2

32 MSCI ESG Research Report, April 2018, Marks and Spencer Group, pp 1 ©2018 MSCI ESG Research LLC Reproduced by permission†

33 www.gruponutresa.com/en/presencia-internacional

34 Grupo Nutresa, 2016 Integrated Report www.gruponutresa.com/wp-content/uploads/2017/03/integrated-report-2016_gruponutresa.pdf, pp 8

and with the Corporate Leadership Group created by The Global Reporting Initiative (GRI).

To improve sustainability in its supply chain, the company launched a project with the World Wildlife Fund (WWF) to generate knowledge about and conduct analysis of palm oil production. The purpose of the project is to identify and reduce the environmental and social risks of using palm oil. Additionally, a sustainability-focused audit programme was implemented to supplement existing supplier audit programmes. Some 30 audits were carried out by Icontec (Colombian Institute of Technical Standards and Certification).[35]

With respect to the environment, Grupo Nutresa has reduced its water consumption by 26% from 2010 levels and is aiming for a 30% reduction by 2020. The company has also cut its energy consumption by 17% and greenhouse gas emissions by 21%, is using 99% clean energy and has dramatically improved its waste recovery.[36]

The company is moving aggressively to improve the nutritional content of its products – amongst other things by reducing salt, sugar and fat – and is pioneering front-panel nutritional labelling. Local sourcing of ingredients has also becoming increasingly important to Grupo Nutresa: in 2016, 84% of ingredients were locally sourced, up from a percentage figure in the high-70s in 2010).[37]

In 2017, the company received a Silver Class award from RobecoSAM (behind only Nestlé in the food products category). Grupo Nutresa is a member of the Dow Jones Sustainability Index.

Analyst – Alex Barnett

Alex joined Ruffer in 2013 after 12 years on the sell side. He began his investment career in Canada in 2000, focusing on the healthcare sector, before moving in 2005 to Jefferies International in Paris, where he researched pan-European small/mid caps, and then industrials. He is a CFA charterholder.

Aptiv (UK)

Company overview

Aptiv, one of the largest global automotive component suppliers, is positioned to benefit from the industry trends towards increased safety, greater connectivity and green technology. Formerly Delphi Automotive, the company was listed in 2011; in 2017, it spun off its powertrain business (Delphi Technology) as a separately listed entity. Aptiv operates 109 manufacturing facilities and 14 technical centres globally, and spends around US$1 billion per annum on research and development.[38]

ESG

The transport sector is the fastest-growing contributor to climate change, accounting for 23% of global energy-related greenhouse gas emissions.[39] Electric transport offers a means of cutting millions of tons of greenhouse gas emissions per year, as well as reducing transport-related air and noise pollution. The automotive industry faces multiple growing challenges, including product innovation, automation of production processes, urbanisation and regulatory action.

35 Ibidem, pp 88

36 Ibidem, pp 4

37 Ibidem, pp 30

38 MSCI ESG Research Report, April 2018, Aptiv pp 39 ©2018 MSCI ESG Research LLC Reproduced by permission†

39 www.ipcc.ch/pdf/assessment-report/ar5/wg3/ipcc_wg3_ar5_chapter8.pdf pp 611

Global authorities have set challenging regulations requiring reductions in emissions and improved fuel economy. These standards will necessitate meaningful innovation as original equipment manufacturers (OEMs) and suppliers are forced to improve engine management, electrical power consumption, vehicle weight and the integration of alternative technologies (eg electric/hybrid propulsion). As a result, suppliers are working to find ways to significantly improve fuel economy, emissions and the performance of petrol and diesel internal combustion engines to enable engine downsizing without loss of performance.

We feel that Aptiv is well positioned to supply the automotive industry with parts that will enable OEMs to be ready for the transition to a low-carbon economy. The company has already adjusted its business model and produces a number of components for hybrid and electric vehicles.

As one of the technology leaders and innovators in the sector, it is developing key enabling technologies in the areas of charging and power distribution, which are essential for its customers' electric vehicle platforms.

In an effort to capitalise on the opportunity, Aptiv's US$1 billion R&D budget[40] (approximately 8% of sales) is one of the highest in the sector.

MSCI ESG Research ranks Aptiv in the top quartile of companies positioned to benefit from the growing demand for clean technology products.[41]

Analyst – George Williams

George joined Ruffer in 2015 as an equity analyst. He graduated from the University of Bristol with a Master's degree in Mechanical Engineering. He is a qualified Chartered Accountant and previously worked at Ernst & Young in both the Audit and Corporate Finance divisions.

40 MSCI ESG Research Report, April 2018, Aptiv pp 39 ©2018 MSCI ESG Research LLC Reproduced by permission†

41 Ibidem pp 3

Glossary

AGM	Annual General Meeting
Aiming for A	A collaborative shareholder engagement initiative on climate change; the 'A' in Aiming for A refers to the best A-E CDP performance band. Within the performance banding methodology, considerable weight is given to operational emission management alongside strategic and governance issues like those covered in the resolutions.
Climate Action 100+	A five-year initiative led by investors to engage with the world's largest corporate greenhouse gas emitters on climate-related matters.
CDP	Formerly the Carbon Disclosure Project, now CDP
Engagement	A long-term process of dialogue with companies which seeks to influence behaviour in relation to environmental, social and governance practices.
ESG	Environmental, social and governance
Exclusion	An approach that excludes certain sectors or companies from a fund based on specific criteria, such as arms manufacture, publication of pornography, tobacco, animal testing.
FPIC	Free, Prior and Informed Consent (FPIC) is the right of indigenous peoples to give or withhold consent to a project that may affect them or their territories.
FSB	The Financial Stability Board (FSB) is an international body that monitors and makes recommendations about the global financial system.
GRI	The Global Reporting Initiative aims to improve and (in some cases) standardise the way businesses and governments communicate on issues such as climate change, human rights, governance and social well-being.
HLEG	Established in 2016, the High-Level Expert Group on Sustainable Finance was set up to 'steer the flow of… capital toward sustainable investments', among other goals.
Integration	The explicit inclusion by investment managers of ESG risks and opportunities into traditional financial analysis.
IIGCC	Institutional Investors Group on Climate Change
KPI	Key Performance Indicator
LTIP	Long Term Incentive Plan
METI	Ministry of Economy, Trade and Industry (Japan)
Natural Capital	Usually defined as the world's stock of natural assets, such as air, water, soil and all living things as well as interdependencies such as climate change and water scarcity.
OEM	Original Equipment Manufacturer

Paris agreement	A 2016 agreement dealing with greenhouse gas emissions mitigation, adaptation and finance, which aims to keep global temperature rises to less than 2°C below pre-industrial levels.
Principles for Responsible Investment (PRI)	There is a growing view among investment professionals that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios. Investors fulfilling their fiduciary (or equivalent) duty therefore need to give them appropriate consideration. The Principles for Responsible Investment provide a framework to do so. The Principles are voluntary and aspirational. They are not prescriptive, but instead provide a menu of possible actions for incorporating ESG issues into mainstream investment decision-making and ownership practices.
REDD+	Stands for countries' efforts to Reduce Emissions from Deforestation and forest Degradation, and foster conservation, sustainable management of forests, and enhancement of forest carbon stocks.
Responsible investment	The integration of ESG considerations into investment management processes and ownership practices in the belief that these factors can have an impact on financial performance. Responsible investment can be practiced across all asset classes.
RSPO	The Roundtable on Sustainable Palm Oil aims to Advance the production, procurement, finance and use of sustainable palm oil products.
Scenario analysis	A process of examining and determining possible events that could take place in the future by considering various feasible results or outcomes. It is a key step to better understanding the potential implications of climate change on an organisation.
Stranded assets	Assets that have suffered or will suffer unanticipated or premature write-downs, devaluations or assets which could become liabilities.
Sustainable Development Goals (SDGs)	A set of seventeen aspirational 'global goals' with 169 targets between them. Spearheaded by the United Nations, through a deliberative process involving its 194 member states as well as global civil society, the goals are contained in paragraph 54 of United Nations Resolution A/RES/70/1 of 25 September 2015.
SRI	A generic term covering responsible investment, sustainable investment, ethical investment and any other investment process that combines investors' financial objectives with their concerns about ESG issues.
TCFD	Task-force on Climate-related Financial Disclosures
UNEP FI	United Nations Environment Programme Finance Initiative
UNGC	UN initiative to promote responsible corporate citizenship regarding human rights, labour standards, the environment and anti-corruption.

UN PRI

UN Principles for Responsible Investment

Ruffer supports and is a signatory to the United Nations-supported Principles for Responsible Investment (UN PRI) as part of our approach to good stewardship. We believe that ESG issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions and asset classes, and through time). Therefore, where relevant, we commit to the following principles –

1. We will incorporate ESG issues into investment analysis and decision making.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

Ruffer LLP

Who we are

Ruffer is a privately-owned investment management firm. As at 31 March 2018, we manage over £22.0 billion for pension funds, charities, companies and private clients, and employ over 250 people, with offices in London, Edinburgh and Hong Kong. We have a single investment strategy that has followed the same tried and tested investment approach since the firm started in 1994.

Our investment objectives

Our goal is to deliver consistent positive returns, regardless of how the financial markets perform. We define this through two investment aims –

- not to lose money in any rolling twelve-month period
- to grow funds at a higher rate than would be achieved by depositing them in cash

Since Ruffer started, this approach has produced returns ahead of equity markets, but with much lower volatility and risk. Over shorter time periods, if equity markets are rising, our returns are likely to be lower than those of equity indices, since we will always hold protective assets as well. Although these are our aims there is always the chance that we may lose money because of the nature of the investments involved and it is possible that individual constituents of the portfolio lose all their value.

How we invest

Ruffer portfolios are predominantly invested in conventional assets, such as equities, bonds, collective investment schemes, commodities and currencies; we also will make use of derivatives. At the heart of our investment approach is an asset allocation which always maintains a balance of growth and protective investments. Protective assets, such as bonds, should perform well in a market downturn and defend the portfolio value; growth assets, principally equities, should deliver good returns in favourable market conditions. This blend of offsetting investments reflects the prevailing risks and opportunities that we see in financial markets, rather than any pre-determined allocation. We operate without the constraints of benchmarks that institutional investors have historically been tied to. The asset allocation is fulfilled through specific stock selections. We invest only in companies that reflect the themes we seek to benefit from in portfolios. We never simply invest in a stock market index.

Our investment team

Ruffer's investment team and strategy are led by Jonathan Ruffer (Chairman) and Henry Maxey (Chief Investment Officer). They are supported by a Research Team of over 30 analysts, focusing on economic and market trends, company analysis and developing investment ideas. These are used by portfolio managers on the Fund Management Team to construct portfolios in line with the investment strategy. The average experience of Ruffer's investment team is over 15 years.

Contact us

Stewardship and ESG

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Further information

The following documents are available at www.ruffer.co.uk

Our response to UK Stewardship Code
Our response to Japan Stewardship Code
ESG policy
2016 and 2015 ESG reports

Franziska Jahn-Madell
Director – Responsible Investment

Joined Ruffer in 2014 after working for 10 years at EIRIS, a research provider for environmental, social and governance performance, in several positions. Her last role as a Principal Research Analyst at EIRIS mainly focused on Corporate Governance issues and criteria development. From 1999-2003 she worked at the Moral Theology department at Frankfurt University for the Business Ethics Chair. In 2003 she graduated from Frankfurt University with an MA in Theology and an MA in Literature.

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