

TOP-DOWN ESG CONSIDERATIONS IN SOUTH AFRICA

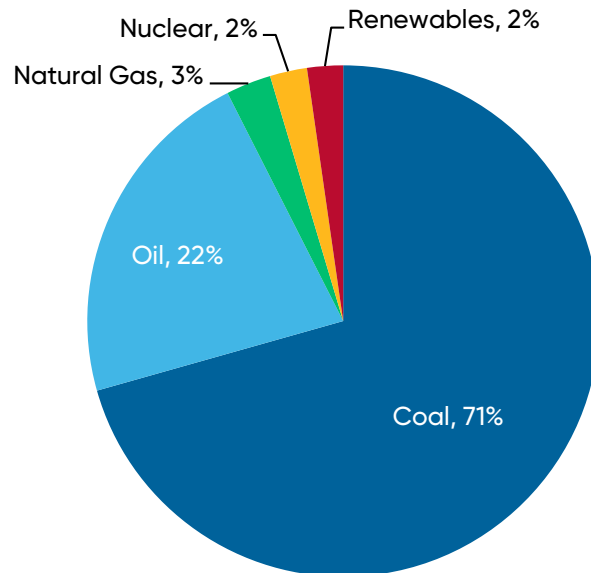
In this paper, we will highlight reasons behind our current underweight to South Africa in our Emerging Markets Equity portfolio to illustrate how ESG issues, viewed from a top-down perspective – such as private sector influence and public sector corruption – can influence our investment decisions.

Country level ESG insights—such as political governance risk in South Africa—influence our active exposures. Currently, we expect South Africa to underperform as the supply and demand of global commodities remain balanced and insufficient infrastructure along with political difficulties constrains investment and domestic growth.

TOP-DOWN ENVIRONMENTAL CONSIDERATIONS

In South Africa, coal accounts for approximately 71% of energy consumption while fossil fuels account for approximately 95% of energy consumption (Exhibit 1). South African state-owned utility Eskom (which produces 95% of the nation's power) currently struggles to efficiently produce and distribute the country's power. Despite poor infrastructure, the government's fiscal deficit, and the utility being on the verge of bankruptcy, South Africa has continued to construct two coal-fired power plants, creating further reliance on coal within the country's economy. With this in mind, South African coal output is expected to increase by roughly 20% in the next few years despite recent efforts to target cleaner sources of power.

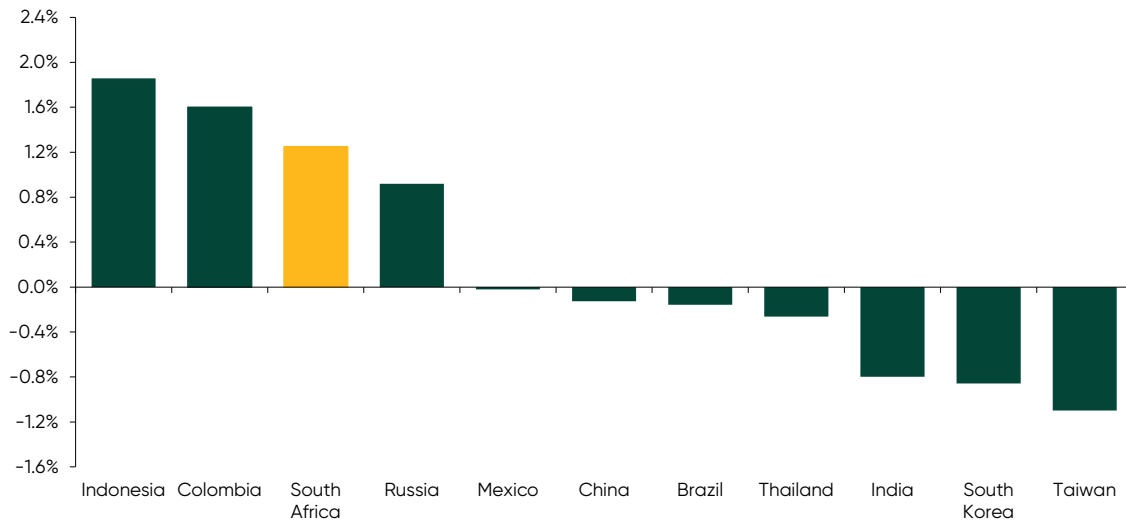
Exhibit 1: South African Energy Consumption by Source



Source: BP Statistical Review of World Energy. As of December 2019.

South Africa has the world's 10th largest recoverable coal reserves (75% of Africa's total coal reserves) and is a net coal exporter (Exhibit 2). As energy production shifts away from coal to natural gas and renewables, this is likely to be a drag on the economy.

Exhibit 2: Coal Is A Headwind For South African Economy – Net Coal Exports (% of GDP)



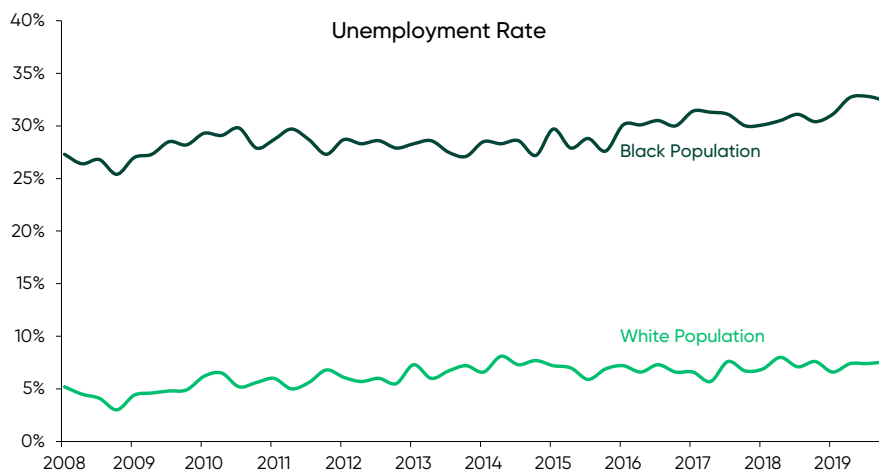
Source: World Bank and World's Top Exports as of December 2019.

TOP-DOWN SOCIAL CONSIDERATIONS

Unemployment Rates and Income Inequality

Differences in unemployment amongst the black population (80% of the population) and white population (10% of the population) remains quite wide, as the country has struggled with the lingering impact of generations of Apartheid policies. (Exhibit 3). Furthermore, despite modest progress since 2011, white South Africans earn 5 times more than black South Africans. The South African government has proposed a number of reforms over the years to address income inequality in the country. If successful, these reforms could narrow the income gap, spurring economic growth and promoting external investment in South Africa. Reforms could be detrimental, however, if they are seen as weakening private property rights in the country.

Exhibit 3: Black Unemployment vs. White Unemployment Remains High

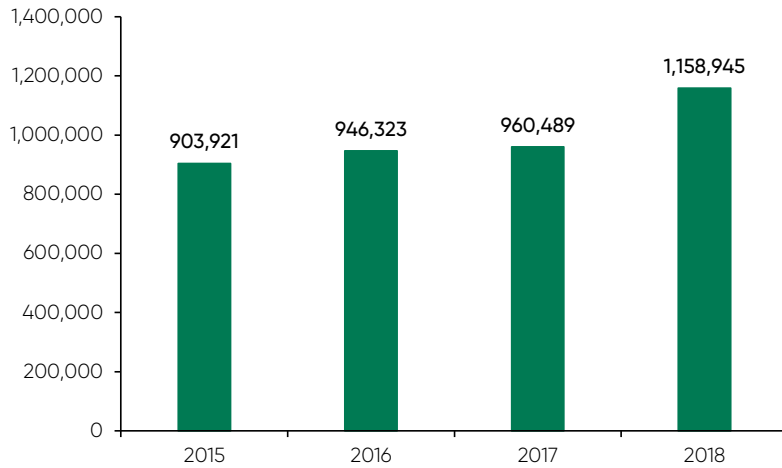


Source: Statistics South Africa as of December 2019, which is the latest data available.

Labour Lost to Strikes

The South African Department of Labour estimates that over 1.15 million working days were lost in 2018 because of strikes – a 20% year-over-year increase and continuing an alarming trend (Exhibit 4). Also in 2018, thousands of workers from South African materials company Sasol Limited went on strike over a share scheme exclusively offered to Black staff. As labor force participation continues to drop and controversies such as Sasol's continue to rise, we see this as a headwind within the South African economy.

Exhibit 4: Working Days Lost due to Strike Activity – by Calendar Year



Source: South African Department of Labour. Data through 2018 which is the most recent available.

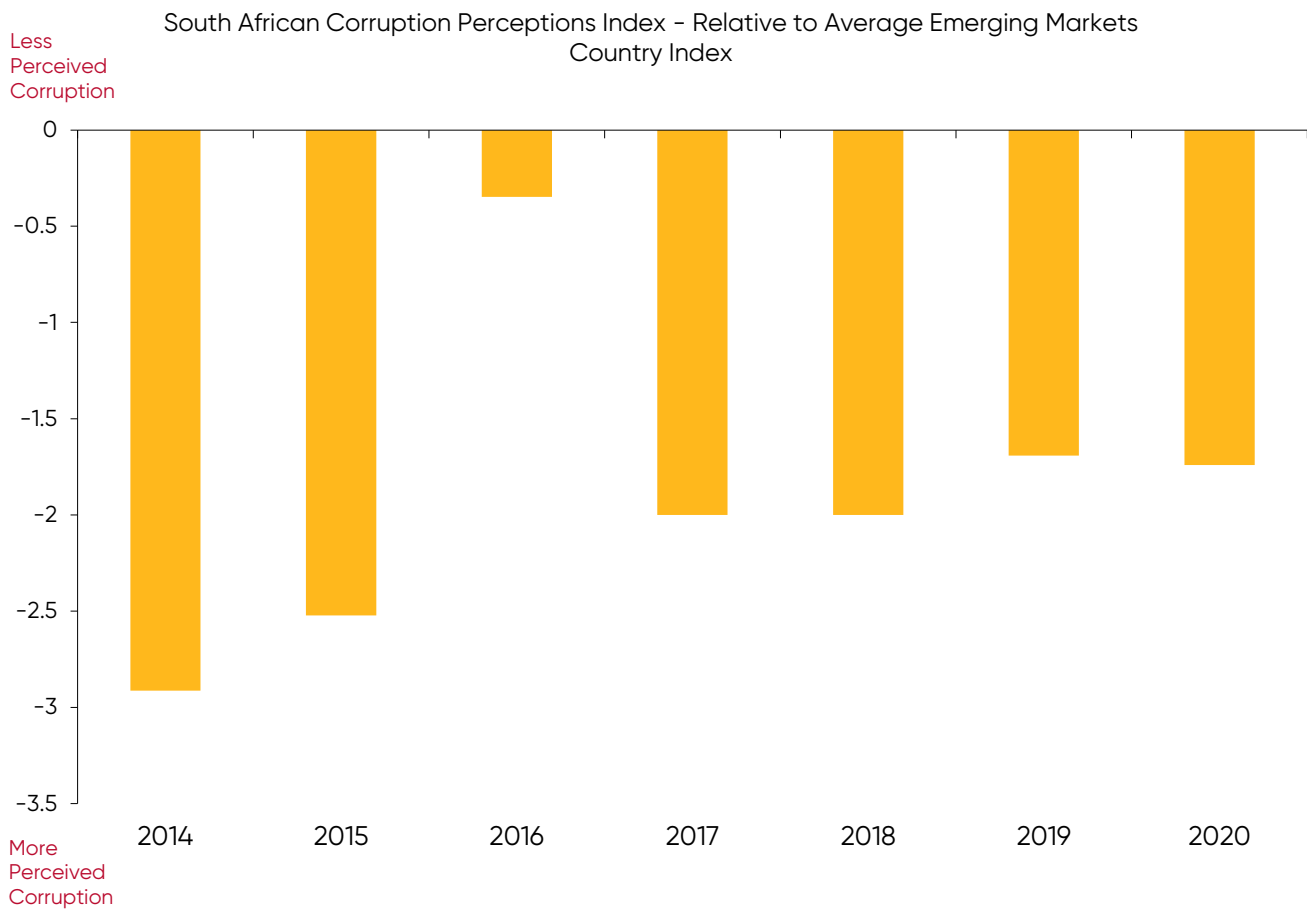
TOP-DOWN GOVERNANCE CONSIDERATIONS

Political Risks

Political risk factors—such as corruption, unsecure property rights and heavy-handed state intervention are driving our limited exposure to South Africa.

The Corruption Perception Index ranks 180 countries and territories by their perceived levels of public sector corruption according to experts from Transparency International. The index uses a scale of 0 to 100, where 0 is highly corrupt and 100 is not corrupt at all. South Africa ranks below the average of all Emerging Market countries in each of the last seven years (Exhibit 5).

Exhibit 5: South African Corruption Not Improving



Source: Transparency International as of December 2020. Countries were only included for a given year if they were part of the index as of year-end of the years indicated.

Proposed Land Reform

The South African government led by President Cyril Ramaphosa has been progressing land reform. The Department of Agriculture recently announced plans to lease state owned underutilized or vacant land to farmers, prioritizing disadvantaged communities, which adds a small amount of agricultural activity and helps relieve issues with access to nutrition without impacting property rights. Another land reform, that would expropriate land without compensation to the current owners, is more controversial. While the goal of this reform is to improve income and wealth disparity, it weakens the strong property ownership rights that separate South Africa from other African nations and increases the risk of discouraging foreign direct investment, hurting relative performance (Exhibit 6). Additionally, such programs have been criticized for benefitting only a small portion of the Black population and widening the wealth gap within that demographic.

Exhibit 6: South African Relative Returns Since Land Reform Proposal



Source: FactSet as of 31/12/2020.

TOP-DOWN ESG THEMES IN EMERGING MARKETS

Top-Down ESG considerations affect thematic positioning of our investment process. ESG considerations are particularly important in Emerging Market countries—where there are less rigorous mechanisms in place to prevent public and private sector corruption.

Corporate Governance on the country level is one of many factors that help us determine the gap between reality, expectations and expected risks in the portfolio. We hold no bias in favour or against any specific country.

Although there is a high concentration of Materials companies in South Africa, given high-level ESG considerations, we positioned our portfolios to gain Materials exposure in other areas with significantly less political risk.

Further top down considerations such as Environmental and Social factors have influenced the thematic position of the portfolio. South Africa's reliance on coal as its primary source of energy and social factors such as labour strikes could detract from South Africa's performance.

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