A Case For: An Active Fundamental Approach to Climate Transition

Environmental, Social & Governance (ESG)

September 2021

A determined effort by both the public and private sectors to bring about a significant reduction in greenhouse gas emissions in the decade to 2030 also offers the potential for significant capital growth in equities. This new era of climate transition, when paired with discerning and forward-looking equity investment, presents opportunities for generating significant alpha.

The global economy is fast transitioning from being dependent on fossil fuels to being driven by clean energy. Governments and companies are taking concrete steps to avoid the worst climate impacts by achieving net zero emissions[1] by 2050. Approximately 70% of the global economy is now covered by net zero targets.[2]

As the 2021 United Nations Climate Change Conference (COP26) approaches, a series of regulatory and economic drivers are emerging, which have the potential to dramatically reshape equity investing. The COP26 meeting could herald a turning point in global efforts to limit carbon emissions through ambitious climate pledges.

While financial system replumbing is intended to mobilise trillions of dollars to build a global zero-emissions economy, vast investment in new technologies and capital equipment will also be required to realise emissions reductions of 50% or more by 2030 and a net zero transition to 2050.

The Path to Net Zero requires credible corporate transition plans for emissions reductions. Ultimately, mandatory disclosure on climate-related factors and hard carbon pricing will lead to greater accuracy in quantifying the true cost of emissions.

In a climate-focused world, companies will be expected to have a credible transition plan for net-zero emissions. Companies will be assessed on their future transition plans as well as on their progress with regards to their current carbon footprint, and regulatory and physical risks (the short and long-term impact of climate change).

There is already regulatory pressure to incorporate and disclose environmental, social and governance (ESG) characteristics. An example is the UK roadmap for mandatory Task Force on Climate-Related Financial Disclosures (TCFD) disclosure. COP26 is also expected to result in agreements on mandatory climate-related disclosure for corporates. Carbon pricing may eventually be applied to all emission scopes including supply chains (Scope 3 greenhouse gas emissions).

1 Net zero means that carbon emissions are either eliminated or offset.
2 United Nations (2021).

Corporate transition plans are therefore expected to come under sharp stock market scrutiny. Companies may find themselves having to make new investments or to undertake restructuring in order to achieve net-zero emissions in the allotted timeframe. Certain companies will be advantageously positioned to benefit from efforts to tackle climate change.

The implications for investors are clear:
Climate transition planning and competency will become key areas of differentiation for companies — and key drivers for the valuation of *all* equities.

In this shifting climate landscape there will be re-ratings, valuation dislocations and corporate winners and losers, **which creates an environment ripe for active stock-picking.**

FGC and Climate Investment

State Street's Fundamental Growth & Core Equity (FGC) team takes an active, forward-looking, high-conviction approach to equity investing. This approach demands a thorough understanding of our portfolio companies through deep due diligence and engagement.

Philosophically, we look for quality, sustainable growth and reasonable valuation. Much of our assessment is qualitative, relying on the judgment of an experienced team, and a culture of collaboration and constructive debate.

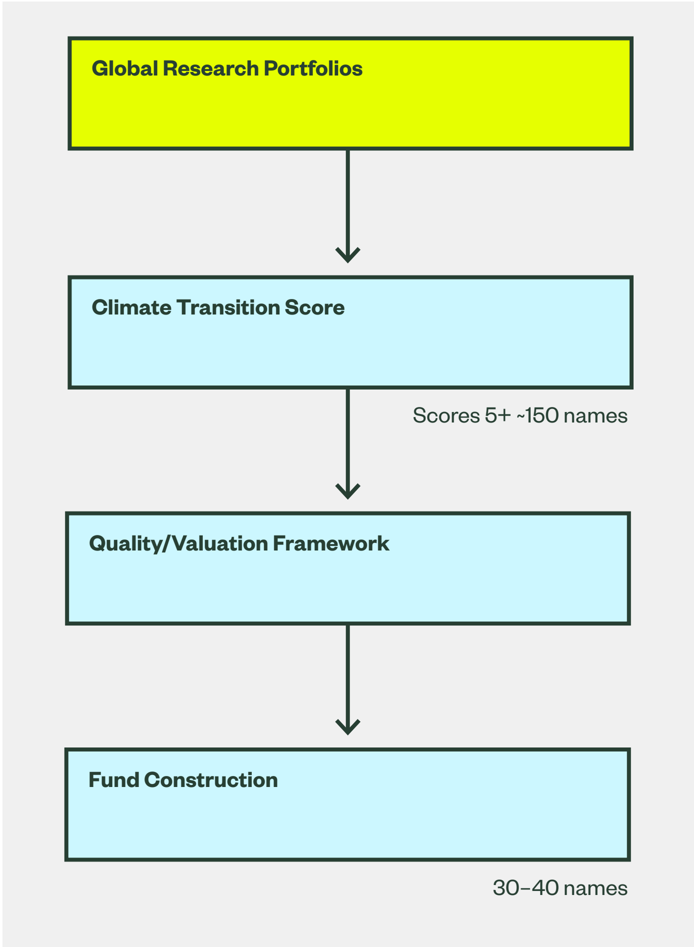
Relatively few companies meet our strict criteria for investment. For this reason, we seek to concentrate our portfolios in our highest-conviction names.

ESG considerations are integral to the FGC team's alpha thesis and have been fully integrated in the team's investment process since 2002. In recent years, we have continued to evolve our ESG research effort to align with the unfolding climate landscape.

Key Criteria for Climate Transition Strategies

- All FGC climate-related strategies will aim to generate long-term capital growth through investment in equity securities which contribute directly towards climate change mitigation and/or are leaders in their respective industries regarding climate change preparedness with credible transition plans.
- Determination for inclusion will be based on a proprietary, in-house assessment of climate readiness and opportunities.
- Portfolio holdings must also meet our requirements related to overall quality, sustainability of growth and reasonable valuation.

Figure 1 **FGC Team's Investment Approach to Climate Transition**



Inclusion: Companies that are determined to be leaders with regards to risk positioning, opportunities & preparedness for climate change.

ESG score included in Quality framework.

Source: State Street Global Advisors

The Three Pillars of Our Philosophy

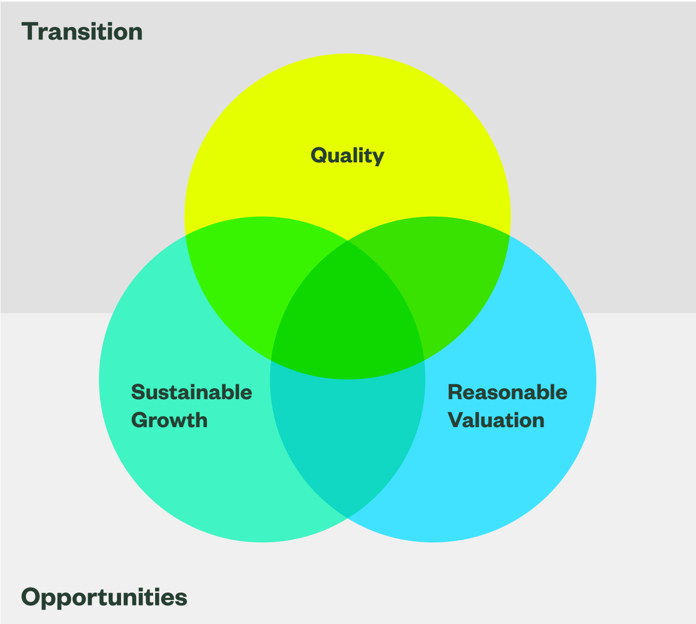
Grounded by the FGC Team's Quality 'Growth at a Reasonable Price' (GARP) philosophy, our analysts assess each company on:

Quality Driven by the Confidence Quotient (CQ), our proprietary method of "scoring" companies on qualitative attributes. Our analysis of quality focusses on attributes that lead to sustainable growth.

Sustainable Growth We believe that the power of long-term, compounding growth is underappreciated by the market. Our extended investment horizon is a crucial part of how we seek to generate alpha.

Reasonable Valuation We don't chase growth at any price. We insist on a valuation that is justified by the firm's growth potential.

Figure 2 **The Three Pillars of Our Philosophy**



Source: State Street Global Advisors.

Conclusion

We see the world at a tipping point. Governments, countries, corporations and investors are coming into alignment at a pace not seen in the past, in a determined response to reduce greenhouse emissions and achieve net zero objectives.

To discern the winners and losers in this evolving climate-related landscape, the FGC team believes an active, forward-looking approach, based on in-depth fundamental analysis is a necessity. Our team invests for the long-term. Going forward this will include an assessment of known climate risks as well as corporates' readiness for climate transition, which will be specifically characterised within our overall ESG score.

Our concentrated portfolios reflect our highest conviction, best ideas based on our rigorous and time-tested investment philosophy of quality, sustainable growth and reasonable valuation. Lastly, our fully integrated global and regional track records reflect the strength of our global analyst team and the stock-picking expertise of our seasoned portfolio managers.

We look forward to continuing this important conversation with you.

About State Street Global Advisors

State Street Global Advisors serves governments, institutions and financial advisors with a rigorous approach, breadth of capabilities and belief that good stewardship is good investing for the long term. Pioneers in index, ETF, and ESG investing and the world's fourth-largest asset manager*, we are always inventing new ways to invest.

* Pensions & Investments Research Center, as of December 31, 2020.

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Investment Risks

Investment in the Fund carries with it a degree of risk.

Investors should read the "**Risk Information**" section of the Prospectus. The following are the principal risks of investing in the Fund:

Currency Hedging Risk Hedges are sometimes subject to imperfect matching between the hedging transaction and the risk sought to be hedged. There can be no assurance that the Fund's hedging transactions will be effective. As the purpose of currency hedging is to try to reduce or eliminate losses caused by exchange rate fluctuations, it can also reduce or eliminate gains where the currency in which the Fund's assets are denominated appreciates.

Equity and Equity related securities Risk The market prices of equity and equity related securities may go up or down, sometimes rapidly or unpredictably. The value of these securities may decline for reasons that directly relate to the issuer and/or due to general industry or market, such as real or perceived adverse economic conditions, changes in the general outlook for corporate earnings, changes in interest or currency rates, or adverse investor sentiment generally. Equity markets tend to move in cycles, which may cause stock prices to fall over short or extended periods of time.

ESG Risk If the Fund invests in companies taking into account environmental, social and corporate governance (ESG) criteria, then the performance of the Fund may trail the returns of a portfolio of securities that includes companies that are not excluded as a result of such ESG criteria. Investing only in a portfolio of securities that are not excluded as a result of such ESG criteria may affect the Fund's exposure to certain types of investments and may adversely impact the Fund's performance.

Integrating Sustainability Risk Integrating Sustainability Risk into the Fund's investment process does not assure the mitigation of any or all Sustainability Risk. Any deterioration in the financial profile of an underlying investment affected by a Sustainability Risk may have a corresponding negative impact on the Net Asset Value and/or performance of the investing Fund.

Modelling Risk The Investment Manager and/or Sub-Investment Manager uses quantitative models in an effort to enhance returns and manage risk. Any imperfections, errors or limitations in these models or in their programming could limit any benefit to the Fund from the use of the models, or could result in incorrect outputs or in investment outcomes different from or opposite to those expected or desired by the Investment Manager and/or Sub-Investment Manager. Such imperfections, errors or limitations might never be detected, or might be detected only after a Fund has sustained a loss (or reduced performance). Further, there can be no assurance that the models will behave as expected in all market conditions.

Screening Risk There is a risk that the screen provider may make errors, such as incorrect assessment of the screen criteria and/or include incorrect/exclude correct constituents in the screening process or discontinue its screening services. In such circumstances, the Company may change the screen provider although there is no guarantee that a replacement screen provided would result in a similar screening process to that intended or would be available at all.

The returns on a portfolio of securities which exclude companies that do not meet the portfolio's specified ESG criteria may trail the returns on a portfolio of securities which include such companies. A portfolio's ESG criteria may result in the portfolio investing in industry sectors or securities which underperform the market as a whole.

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor.

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