

MyConsultant

NEWSLETTER May 2016



Kirsten Temple
Consultant

Kirsten is the Head of JANA's ESG & SRI team. In this role, she is responsible for maintaining JANA's ESG and SRI research programme, and for assisting clients in the development of their ESG policies and practices. Kirsten is also a member of the Alternative Investment Strategies research team, and supports the Head of Investment Research & Outcomes in overseeing JANA's manager research programme.

In her dual role, Kirsten has consulted to a range of clients including industry superannuation funds and charities, providing asset allocation and investment strategy advice, together with investment manager recommendations.

Prior to joining JANA, Kirsten was based in the UK, most recently as an Investment Associate with London based asset consultancy P-Solve Asset Solutions. Prior to P-Solve, Kirsten was an Investment Analyst at Aon Consulting in London, where she had responsibility for providing manager selection advice to the consulting and multi manager businesses.

Kirsten holds a Masters of Applied Finance through Macquarie University, a Bachelor of Commerce (Economics) and a Bachelor of Arts (Asian Studies) from the University of New England.

Climate change risks: what are your managers doing?

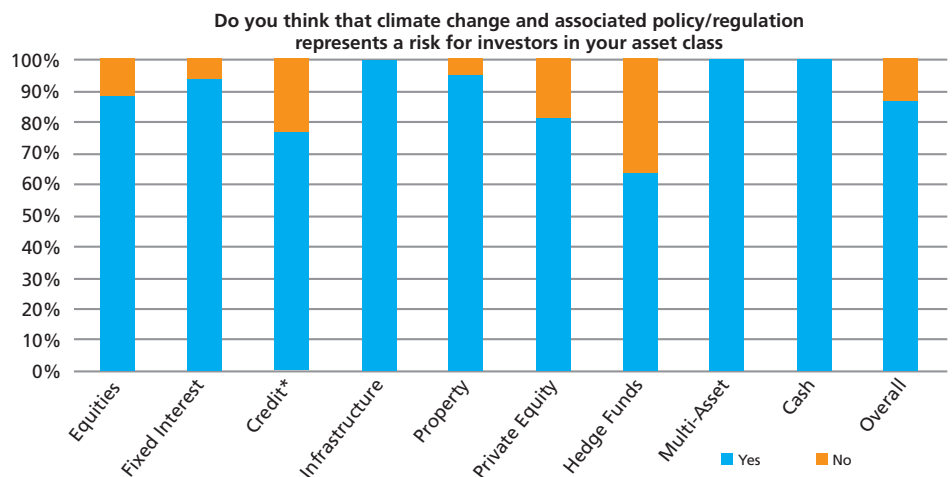
Climate change is arguably the most pervasive of the Environmental, Social, Governance (ESG) risks facing investment portfolios. While the degree to which each investment will be impacted by climate change varies, few assets are expected to be completely untouched by the physical impact of climate change, policy changes and/or by disruption associated with the transition to a lower carbon global economy.

JANA's Research Team has focused on this evolving area, with the question of how best to construct portfolios that minimise this risk being continually debated. JANA is in constant contact with some of the best and brightest investment minds globally. In our discussions with investment managers, it has become apparent that this risk is becoming more front of mind. Given this, and our access to world class investment managers, JANA recently conducted a survey of investment managers regarding their views on the risk posed by climate change to their asset class, and how they are managing these risks in their portfolios.¹

Perception of risk

The majority of managers consider climate change and associated policy/regulation a risk to their asset class (see Chart 1).

Chart 1: Most managers consider climate change a risk in their portfolios



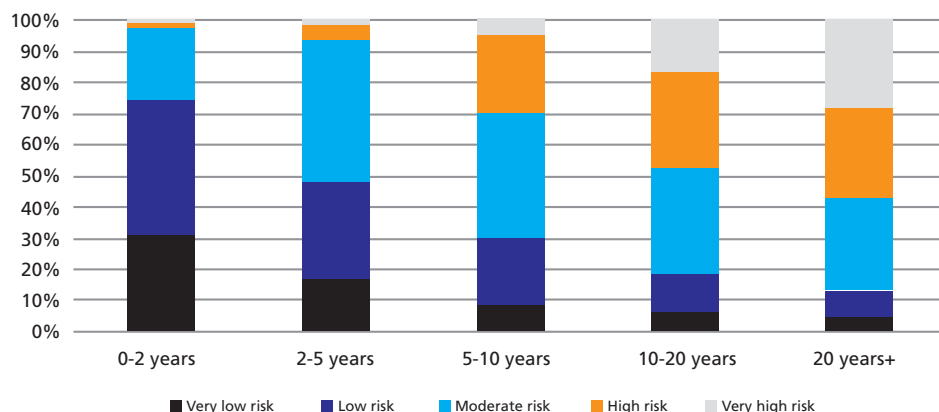
Source: JANA, February 2016.

* Credit includes investment grade credit, structured credit and emerging market debt. Fixed Interest incorporates government bond and diversified fixed interest strategies.

Those that answered "Yes" were then asked to complete a number of questions regarding their perception of risk over varying time frames. Unsurprisingly, many managers were of the view that the risk to their asset class was higher in the longer term than the immediate future, with 73% indicating that they viewed the risk in the next two years to be either very low or low. This fell to 18% and 13% in the 10-20 years and 20+ years time periods, respectively.

¹ JANA surveyed 276 distinct strategies in February 2016 and received an 80% response rate. In some cases, investment managers responded on behalf of a number of strategies and asset classes. A number of managers that answered "No" to our survey were answering on behalf of passive or quantitatively managed strategies.

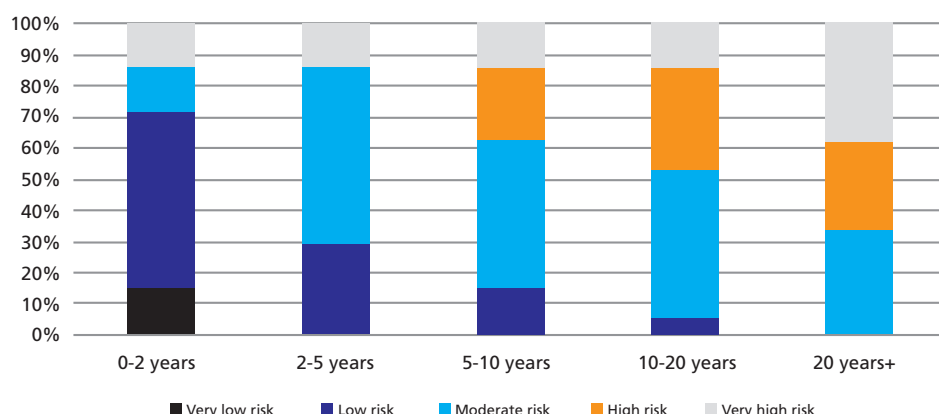
Chart 2: Manager views on the investment risk of climate change over varying time frames



Source: JANA, February 2016.

Perception of the magnitude of risk over time periods varied considerably by asset class, particularly over the medium to longer term time frames. Unsurprisingly, infrastructure managers were more likely to perceive a high risk to their asset class, both in the near term and over longer time periods. Infrastructure assets are arguably more vulnerable to the physical and policy related impacts of climate change, in addition to having less flexibility to reposition portfolios.

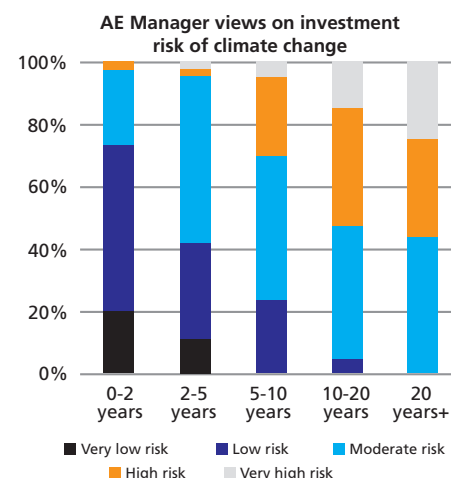
Chart 3: Infrastructure manager views on the investment risk of climate change over varying time frames



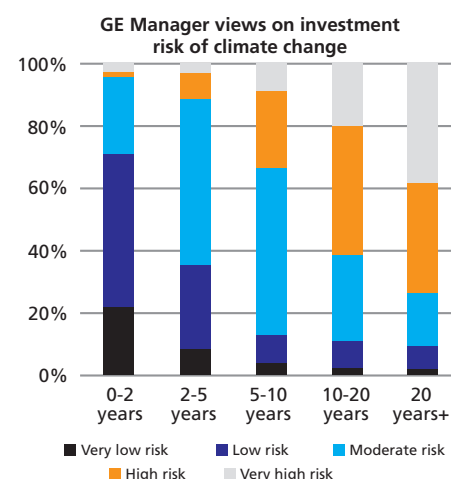
Source: JANA, February 2016.

Within equities, it was interesting to note that those Australian equity managers that viewed climate change as a risk to their asset class were more sanguine regarding the magnitude of this risk than global equity managers. At the outset of this survey, JANA had anticipated that the higher concentration of resource stocks in the Australian market, and the degree to which the Australian economy is reliant on resource related revenues would result in a greater perception of risk.

Chart 4: Global equity managers view the magnitude of climate change risk as greater than Australian equity managers



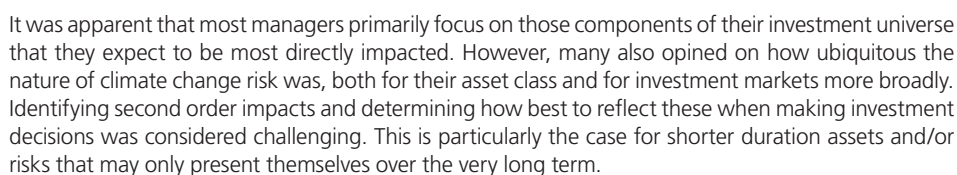
Source: JANA, February 2016.



Source: JANA, February 2016.

Where is the greatest risk?

We asked managers to highlight the areas of the investment universe that they considered to be most at risk from climate change. While there was a reasonable level of commonality in the areas that the majority of managers considered to be most at risk, there were some key points of difference. For example, while gas was frequently highlighted as an 'at risk' segment of the market, some managers saw the gas sector as a beneficiary of climate change, because gas produces less carbon than coal for each unit of power. Equally, diversified fixed interest managers, who invest in both government and investment grade securities differed in their views regarding which components of their investment universe faced the most risk. Whereas some managers pointed to the investment grade credit issuers (and energy and mining issuers in particular), others felt that government issuers faced considerable risk because of the risk climate change poses to economic activity.



Comment

- the strong focus on climate change risk amongst infrastructure managers;
- the growing use of external ESG data and carbon reporting;
- the lower response rate of private equity managers and the lower perception of risk amongst those private equity respondents; and
- the lower perception of risk amongst hedge fund managers.

Most investment manager focus has been on the potential first order risks of climate change, including physical risks (e.g. property and infrastructure assets) and policy and economic transition risks (e.g. coal mining companies). This is arguably a reflection of where the greatest risks to investment portfolios lie and where the range of potential outcomes is somewhat clearer. Ultimately, investment managers must balance consideration of a broad range of investment risks, and less certain, longer term risks may be less influential on investment decisions. We would expect this to be the case for all risks of this nature, irrespective of whether they relate to ESG.

JANA asked managers to explain how they manage climate change related risks in their portfolios. In response, managers advised that they utilise a range of techniques, including requiring a higher return to compensate for risk, portfolio risk management strategies and avoidance of most at risk assets. Property and private equity managers were more likely to emphasise the role of portfolio level risk management. Many managers reported climate change risk to be an integrated component of their analysis, with consideration of potential impacts considered when assessing each investment.

Climate change risk has gone from a third order risk to being front of mind for many in the investment management community, as evidenced by our survey results. Managers are allocating additional resources to assess this risk, both through the development of their internal capabilities and through increased use of third party providers.

While climate change presents a ‘top down’ risk for diversified investors, the nature and magnitude of risk will vary for individual investments. Investment managers play an important role in assessing and managing this risk at the asset level on behalf of their investors. The skill and capabilities of active managers varies, and selecting high calibre managers with strong investment capabilities is essential for managing risk and delivering on expectations.

Information current as at May 2016. This document may not be copied or redistributed without the prior consent of JANA Investment Advisers Pty Ltd. This document is intended for use only by persons who are 'wholesale clients' within the meaning of the Corporations Act. It is intended to provide general information only and has been prepared without taking into account any particular person's objectives, financial situation or needs. Investors should, before acting on this information, consider the appropriateness of this information having regard to their personal objectives, financial situation and needs. We recommend investors obtain financial advice specific to their situation before making any financial investment or insurance decision. While due care has been taken in the preparation of this document, no warranty is given as to the accuracy of the information. Except where under statute liability cannot be excluded, no liability (whether arising in negligence or otherwise) is accepted by JANA Investment Advisers Pty Ltd for any error or omission or for any loss caused to any person acting on the information contained in this document.