Our approach to integrating environmental, social and governance (ESG) issues in investing
OUR MISSION

Improving people’s lives through successful investing.

Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so they may lose value.
“We look for companies with a long-standing focus on corporate governance. We hold them to high standards of governance and expect them to operate in the best interests of investors, employees and society.”

Robert W. Lovelace
Portfolio Manager and Vice Chairman,
The Capital Group Companies, Inc.
ESG AT THE CORE

Proprietary research is the foundation of our investment decisions and is crucial for assessing ESG risks and opportunities.

Since Capital’s inception in 1931, the goal of achieving superior long-term results for our clients has shaped our distinctive investment process.

An intrinsic focus on sustainability since 1931.

Environmental, social and governance (ESG) factors are intrinsic to this process. A company’s carbon emissions, its relationships with employees and the wider community, the independence of its board of directors and many other ESG factors can have a considerable impact on long-term financial performance and investment returns.

Fundamental research is critical for a full understanding of the risks and opportunities that ESG factors present, especially considering that many companies lack an articulated ESG strategy and public disclosure continues to be inconsistent. We do not separate ESG from the analysis that we conduct for each and every investment.

We look beyond official disclosure and vendor data for a deeper view of a company’s ESG management and how it has improved or deteriorated over time. We believe this holistic view of our investments is essential to our investors’ long-term success.

We conducted more than 12,000 face-to-face private meetings in the past 12 months with companies, as well as their suppliers, customers and regulators, to fully assess their business – including the ESG aspects.
Understanding the changing tides in government policy, environmental concerns and social expectations can be a key driver for investment outcomes.

“Sustainability is a natural ally to our long-term investment horizon and fundamental research.”

Natasha Braginsky Mounier
ESG Investment Director
ESG is integrated into each of the four stages of our investment process, which we have termed MADE.

MEET
... the decision-makers and stakeholders who may impact investment outcomes.

We meet with many decision-makers who could impact the outcome of our investments — not just the CEO. We visit suppliers, regulators, customers and government officials to develop a holistic, long-term perspective — including ESG factors. We conduct over 12,000 such face-to-face private meetings a year.

ANALYZE
... large amounts of information and data in-house.

Our investment decisions are driven by in-house assessments of long-term risks and opportunities, with ESG factors an important consideration. Our investment analysts have an average tenure of eight years at Capital Group, and portfolio managers have an average tenure of 22 years (as of 12/31/2018). This underpins our long-term investment horizon and deep knowledge of the firms in which we invest.
We regularly and systematically meet with management as well as board members. We seek to achieve progress on key ESG issues through engagement, not exclusion. We maintain a robust dialogue with key decision-makers for our investment holdings – management, government officials and others. We exercised our proxy vote in more than 2,500 annual and special general meetings in 2018.

Our portfolio managers are incentivized to take a long-term view of the investments they make: compensation paid to our investment professionals is heavily influenced by results over one-, three-, five- and eight-year periods, with increasing weight placed on each succeeding measurement period. This means only the highest-conviction ideas make it into our portfolios.

... systematically through proxy votes and direct communication with stakeholders.

... the critical long-term success drivers in every investment case.
There is no industry consensus regarding ESG rating methodologies, and the chart on the right demonstrates a dispersion of views on the same issuers. At Capital Group, we do not rely on external ESG benchmarks for our investment decisions. Instead, we base our investment decisions — including ESG factors — on our fundamental research, due diligence and engagement. We believe this is a critical distinction, and it is particularly important given the nature and complexity of ESG issues.

While it has become commonplace for asset managers to use external ESG scoring, we find this approach lacks clarity and consistency.
Inconsistent ESG methodologies create inconsistent results

MSCI vs. RobecoSAM ESG ratings for MSCI ACWI index

$R^2 = 0.2435$

Calculated by MSCI and RobecoSAM across various environmental and social dimensions. As of July 2018.
UTILITIES

ESG as a reflection of management quality and strategic vision:

Iberdrola

Vantil Charles
Corporate Credit Analyst
London

“In the utilities sector, I believe that companies that think very clearly about smaller capabilities, more distributed innovation and lower carbon footprints are the companies to invest in.”

Iberdrola had the vision 15 years ago; it brought the cost curve down, developed scalability and gained a competitive advantage. More specifically, in the wind energy business, by using the expertise of the oil-and-gas sector to replace anchored giant turbines with floating devices, the company demonstrated its first-mover advantage.

Examples shown for illustrative purposes only. This information has been provided solely for informational purposes and is not an offer, or solicitation of an offer, or a recommendation to buy or sell any security or instrument listed herein.
“Regulations have created a less competitive credit card market and likely made credit cards more expensive for individuals. Visa and MasterCard have brought about positive change. The significant steps these companies have taken to secure user data compelled the U.S. credit card industry to follow suit and helped prevent potential financial and reputational damage from customer-related incidents.”

Corporate investments in cybersecurity are critical, and we support those companies that continually search for the best ways to protect consumers.
“When potentially higher margins and a positive environmental impact go hand in hand, they can result in the long-term success of environmentally friendly initiatives.”

While visiting the storage area of Elementia’s cement factory in Mexico, our building materials analyst, Christina Kozak, noticed the cutting-edge recycling technology involved in this project, based on burning tires as fuel substitution. Guaranteeing product quality and positioned lower on the cost curve, this new line sets an example in the Americas while meeting Elementia’s own sustainability and social responsibility standards.
INDUSTRIALS

Potential for investment upside from energy efficiency:

Miura

“Awith the slogan, ‘Get blue sky back to China, and make money for justice,’ the leading Japan-based manufacturer of compact energy-efficient industrial-use boilers has benefited from the (finally) tightening environmental regulation in the country.”

A group of analysts led by Akira Horiguchi recently visited Miura’s factory in Suzhou, where the head of Miura’s China division showed them the new “Beijing standard” boiler. This boiler produces the ultra-low nitrogen oxide (NOX) emissions required to comply with stricter antipollution standards initiated by Beijing in 2017.
Estimating changes in crop yield with climate risk scenarios: Kenya

“Kenya stands out in the region with a dedicated climate change agency that monitors food security and with numerous investments directed toward improvements in irrigation.”

Severe weather events like drought can cause food price inflation that often translates into inflationary shocks. We closely monitor regional rainfall data, which could impact water supply risks and result in lost crops, to anticipate changes in inflation rates.
A strategic look at recyclable plastic: BASF

“By 2022, a new, fully recyclable plastic is expected to replace traditional PET bottles. This could be transformative for BASF’s customers, including downstream packaging and textile companies.”

Initiatives to develop new sustainable chemicals are evidence of a company that thinks strategically about the long term and the changing needs of future generations.
FORENSIC ACCOUNTING

Identifying potential fraud risks:

“\textit{We take the time to analyze financial filings and disclosures, and compare data with what management says. When we find unclear language, significant change or, especially, differing information, then it raises red flags for us, and we dig deeper.}”

Elizabeth Mooney
Accounting Analyst
San Francisco

Even though public companies file audited financial statements, sometimes auditors can be misled or, in extreme cases, can commit misconduct. Enforcement actions against listed companies and audit firms for financial reporting related fraud are evidence that financial statements cannot always be relied on.
Our investment professionals conducted more than 12,000 meetings with companies annually, including extensive visits at operational facilities and within the supply chain.

172 equity analysts

43 fixed income analysts

100+ portfolio managers

22 years average tenure of portfolio managers at Capital Group

As of December 31, 2018.
Our commitment to active stewardship

Active stewardship of our investments reflects our focus on fundamentals and a long-term horizon. We regularly appraise the sustainability of the companies and countries we invest in through our proprietary in-house research and engagement with a range of stakeholders. We rely on our home-grown research rather than external ESG scoring, which lacks clarity and consistency owing to providers’ differing methodologies.

Our dedicated team of more than 20 stewardship professionals conducted more than 250 ESG engagements in 2018.

Ongoing conversations with company decision-makers is an important part of active stewardship. This is in addition to the more than 12,000 meetings held by investment professionals as part of the fundamental investment research. This deep on-the-ground research and engagement anchors our ability to exercise proxy votes on each of our holdings through in-house decision-making, rather than outsourcing this function. In the past 12 months, we voted at more than 2,500 annual general meetings (AGMs).

We encourage companies to adopt best practices in key areas, such as board diversity, as a means for greater inclusion of different perspectives. Our proxy voting guidelines are regularly assessed by a team of senior investment and governance professionals as a roadmap for proactive engagement before AGMs take place.

We believe engagement, not exclusion, is a more effective path toward positive impact. As an active investor, we exercise our proxy vote, and in fixed income, we focus on the strength of our engagement. Ultimately, as an active investor, we reserve the right to simply walk away.

If an ESG challenge arises, we focus on engagement, rather than exclusion, as a path to create positive impact.
We believe ESG impacts the long-term outcomes of the companies and countries we invest in. Although we have been discreet about these issues in the past, we are becoming more vocal in expressing our views on active stewardship, which is at the heart of our culture. We use our voice as investors to contribute to setting high standards of industry practice.

Capital Group has been a signatory to PRI (Principles for Responsible Investment) since 2010. PRI is the largest voluntary global organization of asset owners and asset managers supporting responsible investment practices.

Capital Group’s Vice Chairman, Robert W. Lovelace, and Natasha Braginsky Mounier are both members of the Sustainability Accounting Standards Board (SASB) and the Investor Advisory Group (IAG), which comprises leading asset owners and asset managers.

Capital Group is also a member of the following industry groups:

- **International Corporate Governance Network (ICGN)**
  The ICGN is a globally recognized membership organization of around 600 leaders in corporate governance. With members in 50 countries, its mission is to raise standards of corporate governance worldwide.

- **Council of Institutional Investors**
  This U.S.-based nonprofit association of pension funds, other employee benefit funds, endowments and foundations has combined assets of more than US$3 trillion. The Council advocates effective corporate governance and strong shareholder rights.

**Asian Corporate Governance Association (ACGA)**
ACGA promotes good corporate governance standards in Asia. Much of the effort of this organization is directed at influencing regulators and stock exchanges to demand higher governance standards from listed companies. Capital Group Portfolio Manager Steve Watson is Vice Chairman of ACGA.

Capital Group is also a signatory to the U.K. and Japan Stewardship Codes. We are active participants in the above organizations, and senior leaders of our company contribute by speaking at key industry events and collaborating on engagement initiatives and working groups such as the ICGN’s Cross Border Voting Working Group and the International Accounting Standards Board and Financial Services Agency to improve accounting transparency.
In-house governance and proxy associates worldwide, and one dedicated global ESG Investment Director in London.

Annual and special general meetings during which we exercised our proxy vote in 2018, all based on internal assessment of proposed items.

Proposals evaluated across our institutional and global mutual funds, and more than 32,000 unique ballots voted.
Statements attributed to an individual represent the opinions of that individual as of the date published and do not necessarily reflect the opinions of Capital Group or its affiliates. This information is intended to highlight issues and should not be considered advice, an endorsement or a recommendation.

The Capital Group companies manage equities through three investment divisions that make investment and proxy voting decisions independently. Fixed-income investment professionals provide fixed-income research and investment management across the Capital organization; however, for securities with equity characteristics, they act solely on behalf of one of the three equity investment groups.

While Capital Group uses reasonable efforts to obtain information from sources which it believes to be reliable, Capital Group makes no representation or warranty as to the accuracy, reliability or completeness of the information.

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