Sustainability in Emerging Markets Equity

Is there a difference in approaching ESG issues in developing markets?

Topic of the month October 2012 (II)

Sustainability trends, and how managers incorporate sustainability into business strategy and practices, can have a significant effect on a company's operations and therefore its value in both the near and long term. Sustainability issues are global, and it is widely accepted that they have a differential influence across sectors, but are there differences in how we approach sustainability issues in emerging markets versus developed markets?
I outline three key issues that sustainable investors should consider in emerging markets:

- *Impact and frequency of environmental, social, or corporate governance (ESG) related incidents*
- *Availability of information*
- *Framework in which ESG issues are evaluated*

Impact & Frequency:

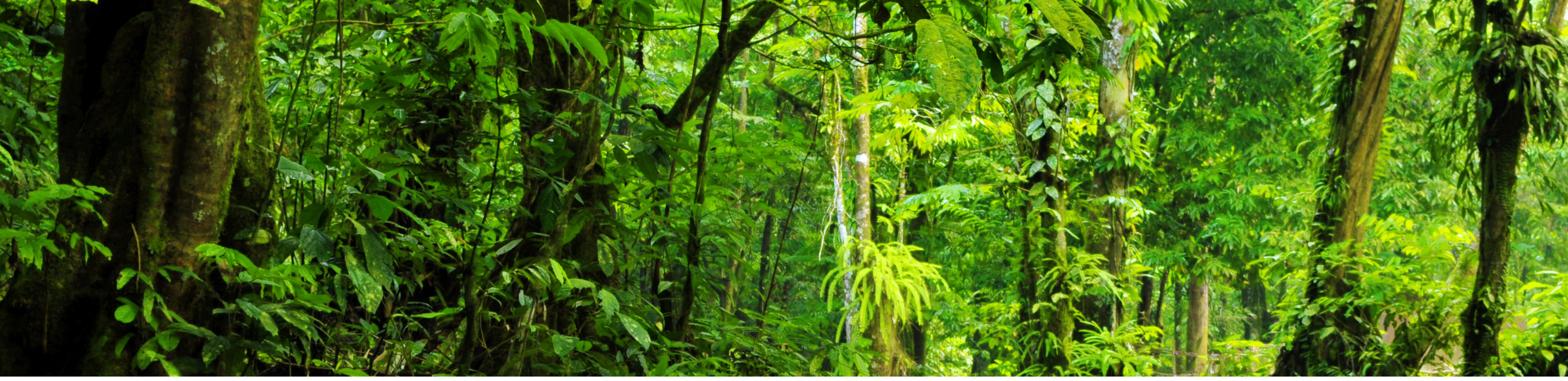
The nature of developing economies provides a rich backdrop for ESG issues, with greater emphasis on environmentally sensitive sectors e.g. resource extraction and power generation; social issues e.g. pay and conditions in labour-intensive export industries or community impact; and governance issues, with governments or family-owners as majority shareholders. Global issues such as water availability and climate change often have a disproportionately greater impact on developing countries, and government policies add further complexity.

It might appear that ESG incidents are more frequent in emerging markets than in developed. However, the sector composition of emerging markets influences this perception, with high impact sectors such as resource extraction forming a larger part of the equity opportunity set. There have been newsworthy ESG breaches by companies in both emerging and developed markets, so we caution against broad generalisations and believe investors need to focus on how ESG issues affect individual companies, and on recognising the circumstances in which they are likely to arise.

> *'The perception that ESG incidents are more frequent in emerging markets compared to other countries is influenced by the sector composition'*

Information Availability:

Just as IFRS is being adopted in emerging markets, disclosure and reporting on ESG issues is also improving. Still, transparency varies significantly between companies and countries so investors must decide how to access information, e.g. through third party sources or by direct engagement with management, and whether the quantity and quality of ESG information available supports confidence in making an investment.



Evaluation Framework:

Should we evaluate emerging markets companies in the context of "Western standards", or against local cultural norms? How should this analysis be integrated into the investment decision? Some investors opt for a ‚best in class' approach, selecting companies from each sector or country that perform best on a set of ESG metrics, regardless of how sustainably each company is managed in absolute terms or the fundamental valuation of the company. Others may use ESG research as just one input into a better understanding of a company.

The purpose of ESG analysis needs to be clear – is it to better understand how the operating environment and management practices affects a company's prospects, or also to apply a minimum standard of sustainability to a portfolio?

Conclusion:

At Vontobel our investment due diligence includes a formalised scoring system to assess ESG factors, requiring the same standards of ESG management from companies in both emerging and developed markets. This promotes a robust and repeatable process, and our clients, mainly based in developed markets, can better relate to the standards and have confidence that their assets are invested in businesses that take ESG risks and opportunities into account.

Whether ESG factors can drive investment returns is often debated and academic studies are inconclusive. In our view, investment opportunity is driven by whether a company's fundamental outlook is reflected in the share price, and it is unlikely that the output of a single piece of analysis in isolation would be a determinant of investment performance.

We believe that an analysis of ESG factors, in combination with fundamental research, delivers insight that enhances investment decisions. Investors have greater conviction in their valuation and risk-reward assessment and are better able to identify security mispricing. Sustainability, therefore, should be an integral part of a disciplined investment process for any region and, At Vontobel, we consider it strategic for both asset owners and investment managers.

'ESG factors can enhance investment decisions - it's all about a holistic approach in line with a disciplined investment process'

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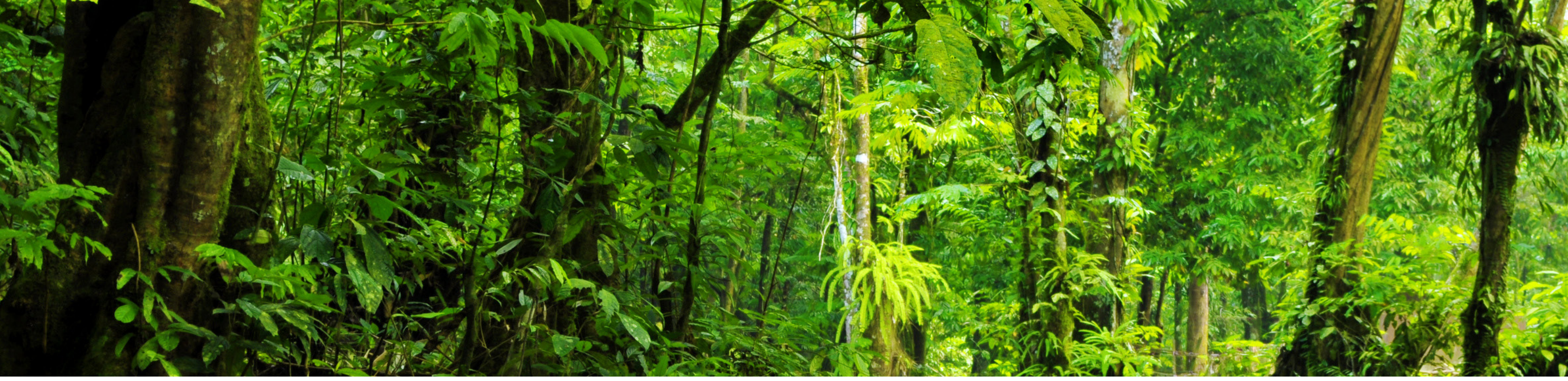
Additional information can be found on the website www.vontobel.com or on the Vontobel Fundnet fundnet.vontobel.com. All sustainable Vontobel Funds are also listed on www.yoursri.com and Sustainable Fundratings ( ) are available for those products.



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