

**Tammy Cash**

Hello, I'm Tammy Cash, EVP and head of marketing at Horizons ETFs, and welcome to Generation ETFs where we explore everything you need to know about ETF investing. Today we'll be discussing one of the biggest investment stories of 2019, ESG. Environmental, social, and corporate governance issues are becoming increasingly important to Canadian investors. How companies address these issues has implications for your portfolio and the world.

**Tammy Cash**

Today I'm joined by Sucheta Rajagopal, a leading ESG expert and investment advisor and portfolio manager with Mackie Research Capital Corp. Sucheta, thank you for joining us today.

**Sucheta Rajagopal**

Well, it's great. I'm always excited to talk about this topic.

**Tammy Cash**

Excellent. It's a topic that people are caring more and more about. I think 2019 seemed to be a tipping point of ESG media coverage and public interest. Why do you think that it was the year that ESG became mainstream?

**Sucheta Rajagopal**

I think ESG as an investment strategy has been gaining momentum for a number of years. We all love the concept of the overnight success, but I think we've taken a number of steps over the past 13, 14 years that have got us here. I read a great quote by George R.R. Martin, who said that most people were startled to discover that he had written books before Game of Thrones, and that they were published by a major publisher, they were big sellers. He said, "I'm a case of working 40 years to become an overnight success."

**Sucheta Rajagopal**

Even though ESG investing seems to have suddenly burst on the scene, I think we can trace it back maybe to 2006 with the launch of the United Nations Principles for Responsible Investment, the UNPRI. In the world of ESG, we love acronyms and there are lots of them, and you'll be hearing a number of them over the course of our discussion. The Principles for Responsible Investment are a set of six aspirational principles that basically say we will incorporate environmental, social, and corporate governance metrics, ESG metrics, into our investment decisions.

**Sucheta Rajagopal**

From there, we've seen a steady increase primarily in institutional money managed with an ESG lens. For example, the Canada Pension Plan Investment Board, the CPPIB, another acronym, issued its first responsible investing report in 2008. ESG strategies then moved into retail investments, really exploding in the past few years, and I think that's partly because the media is paying a lot more attention. These stories lead to more people knowing about it and then more people investing this way, which leads to more products and more stories, and it's really building now.

**Sucheta Rajagopal**

Climate change too has made a lot of people think about what's in their portfolio. The fossil fuel divestment movement led by Bill McKibben and 350.org and Extinction Rebellion, and of course Greta and the climate marches. I was really excited because I was in Montreal last fall, and I got to march in Montreal, and Greta led that march and it was huge.

**Tammy Cash**

That's exciting.

**Sucheta Rajagopal**

Yeah, one of the largest in the world, and it was so inspiring. I think when you're part of something like that, you start to say, "Well, what can I do?" I think people start to think about, "Well, if climate change is important, what's in my portfolio? Should I be divesting, or should I just be looking at what are my oil and gas holdings? What are my renewable energy holdings?" I think that has been a real impetus, and that adds to other media stories like the wildfires in Australia now. I think because we have social media and the internet, you become much closer to these. You have compelling visuals, and they really make you feel like you have to do something. I'm happy because I think what that's making people do is think about how to get their portfolios more aligned with their values.

**Tammy Cash**

Excellent. Yeah. One thing that I think is garnering more and more media interest and coverage, largely because it's been impacting investors, is those who believe they're invested in ESG funds, only to learn that when they look at the holdings, oh my goodness, there are some "bad actors" held within some of these funds. This to me, I think, brings up the topic of inclusionary factors and exclusionary factors. Can you explain that a bit to our listeners in the range of ESG?

**Sucheta Rajagopal**

Yeah. I think it's a bit challenging, because ESG investing has grown so quickly. It's a little bit messy right now in terms of what it is, what you're getting when you look at something, and these are all issues that are going to need to be addressed and that are being addressed, but I think what we used to have, what was called negative screening, which is basically saying these are things we don't want in the portfolio. These have been many of them, very traditional. They've existed for a long time. They include alcohol, gambling, pornography. Tobacco is a very big one. More recently, fossil fuels has joined that.

## Sucheta Rajagopal

Then we have what we call positive screening, where we are looking for companies that are actively involved in creating a better world. There you'd be looking at things like renewable energy companies. That's one part of very traditional socially responsible investing that is a little bit different than what we see a lot now, which is what's called ESG integration, which means that you're not necessarily excluding or including anything, but you're looking at your entire investment universe and looking at environmental, social, and corporate governance issues as they impact every company within it.

## Tammy Cash

Got it. Important distinctions for those who are investing and may not truly pick up on what the nuance is there.

## Sucheta Rajagopal

Mm-hmm.

## Tammy Cash

One thing that's coming up more and more as it relates to awareness is the impact of shareholder engagement and shareholder activism. It's becoming certainly I think an important way for fund managers to be able to push companies to raise the bar, whether that's as it relates to governance or other factors. Can you share some examples in your experience of successful engagement that you think our listeners might be interested in?

## Sucheta Rajagopal

Mm-hmm. I think that's a great follow on from what we were just talking about, because when a lot of people think about responsible investing or socially responsible investing, they immediately think about exclusions and inclusions. I think the idea of shareholder engagement, which is people who own shares in a company, and oftentimes that's your mutual fund, it's not necessarily you as an individual. It's the mutual fund or the exchange traded fund that you own are working in coalitions to have constructive dialogues with companies on ESG issues.

## Sucheta Rajagopal

A one example of that is the Plastic Solutions Investor Alliance. That's an international coalition of investors that engage as publicly traded consumer goods companies on plastic waste. One of their big wins, just towards the end of last year, was with Colgate-Palmolive. Toothpaste tubes are not recyclable, and that's primarily because they are a mix of layers of plastic, often with a thin layer of aluminum. Anything that is mixed materials, like Tetra Pak boxes that have plastic and cardboard and also metal, are a real challenge to recycle, both because you have to take them apart, and also because the people who buy your recycling, they want clean paper, they want clean metal, they don't want these mixtures.

## Sucheta Rajagopal

Colgate-Palmolive has been working on creating a recyclable toothpaste tube, a toothpaste tube that's recognized as recyclable by plastic recyclers, and they started converting to these recyclable tubes last year. They started with Tom's of Maine, which is their most, I guess, green brand.

## Tammy Cash

Most of our listeners would be familiar with that, I'm sure.

## Sucheta Rajagopal

Now it's going to move into all their regular toothpaste. There are about 1.5 billion toothpaste tubes used globally that go into landfill, and landfill has a lot of its own issues as well with methane, but plastics in the ocean is just huge. The fact that plastics tend to degrade and turn into these tiny pieces. This is a big win. Colgate has a 42% share of the global toothpaste market. Once you get a big company doing this, it raises the bar, as you said, for corporate behavior in this sector, and it means that everybody else now who makes toothpaste has to say, "Oh my gosh, got to catch up, got to have a recyclable toothpaste tube."

## Sucheta Rajagopal

A lot of times with engagement, you go after that one company and you get it to do that, and then the whole sector will move up. One of the things is that people look at their portfolio and they say, "What is that company doing in there?" Sometimes the reason that company is there is because it's the subject of some sort of shareholder dialogue. If you dig a little deeper, if you see a company you don't like, you'll often find, "Oh, here's why it's there." It's because they're trying to push it to do better on this specific front.

## Tammy Cash

Very interesting. One of the things that, and I think this is a nice lead in to this subject. We've talked a bit about doing something that's great for the planet and Colgate's a great example of making some changes there. One of the misconceptions that I think that exists with responsible investing is yeah, it's nice. It might make you feel great about doing something positive, but it might not necessarily be great for your portfolio and your investment returns. Can you address whether that is fact or myth for our listeners?

## Sucheta Rajagopal

I call this the zombie myth. It's the myth that won't die. We have so much research now that says you don't sacrifice anything. We have academic studies, we have private sector studies, we have meta studies, which are studies of studies, and they all say that you don't give up performance.

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In the real world, in Canada, we have the Jantzi Social Index, which is an ESG screened replica of the TSX 60. It has been running real-time since January, 2000, so we have 20 years of history now in up markets and in down markets. Throughout that time, you have not sacrificed anything to be using the socially screened replica as opposed to the traditional.

## **Sucheta Rajagopal**

On the global front, we also have a good track record. MSCI runs a lot of global indices and they run something called the ACWI to add to your acronyms. That is the All Country World Index. Running alongside the ACWI is the ESG Leaders ACWI, and the ESG Leaders ACWI, as of December 31st, 2019, has outperformed the ACWI on one, three, five, and 10 year basis. I think that's-

## **Tammy Cash**

This is all proof positive that that is in fact a myth.

## **Sucheta Rajagopal**

It's huge, matching, or out-performance.

## **Tammy Cash**

We've experienced the same with our ETHI ETF here at Horizons and it's been a tremendous success story in that way.

## **Sucheta Rajagopal**

Yeah, and I think when people put their money in and they watch their investments, they realize immediately that, "You know what? I'm not giving up any performance."

## **Tammy Cash**

Yeah, doing good can feel good too.

## **Sucheta Rajagopal**

Yes.

## **Tammy Cash**

With so many ESG ETFs and investment funds, what do you think differentiates some of the funds as more responsible than others? Because, of course, investors coming into this space increasingly have more and more products to choose from. Some, you could say, may fall under the banner of green-washing. A trend, a popular investment asset class that may not actually deliver. Do any stand out to you?

## **Sucheta Rajagopal**

Yeah, I think this is definitely challenging. I recently received a phone call from someone who was interested in responsible investing, and they had gone to the Responsible Investment Association website. That's a great resource for investors, and it's the main organization for responsible investing in Canada. On the RIA website, there's something called the RI Marketplace, which is a listing of all the RI investment products available to Canadian investors.

## **Sucheta Rajagopal**

This person told me that they had looked at the RI Marketplace and there were a lot of choices, and they were just overwhelmed with what was there and they couldn't figure out how to distinguish between them. We definitely need to be sorting out the product and making it easier for investors to figure out what their choices are. I know the RIA is looking at both a classification of products and possibly some sort of certification, and some other entities are doing that as well.

## **Tammy Cash**

Well, that's exciting.

## **Sucheta Rajagopal**

Yeah.

## **Tammy Cash**

Maybe we can expand on that a bit. I think that certification of some kind, many feel has been needed in this space to really verify those who are legitimate responsible investing solutions, and certainly the RIA has made great strides in making sure that investors can explore there. We're on that website as well, and so we're quite familiar with the work that they do.

## **Tammy Cash**

Knowing that there has been a lot of, hype is not the right word, but certainly a lot of increased interest in the last couple of years, what do you think the future holds for ESG as an asset class? Is there potential risk over time of ESG burnout? That responsible investing becomes less attractive to investors, or do you disagree with that rationale?

## **Sucheta Rajagopal**

I don't think of SRI or RI as an asset class. Yes, there are specific themed funds, environmental funds, and recently I think a vegan ETF has launched as well, but most of the broader products use ESG as an extra layer of due diligence in the investment process. We use it to look at risks

and opportunities across sectors, across asset classes, so in equity and debt, in infrastructure and across geographies.

## Sucheta Rajagopal

I read a really interesting piece of research recently from Bank of America Merrill Lynch, and it was talking about intangibles. It was saying that in 1999 35% of the value of most large companies came from intangibles, but today over 70% comes from intangibles. Intangibles are things like brand, reputation, attracting and retaining key talent. These are all things that are captured by ESG, and things that often are not captured in financial statements. I think that that is a real argument to be made about the future of ESG, because you're going to need it more and more alongside your income statement and your balance sheet if you really want to look at, what is this company about?

## Tammy Cash

Excellent. To wrap things up, I'm wondering if you can share with our listeners. As an investment advisor doing some research into your track record, I came across the term 'triple bottom line investing'. Can you share with us what that means from your perspective for your clients?

## Sucheta Rajagopal

Triple bottom line is a term that was coined by John Elkington, and it really is about people, planet, profits, and the fact that all of these things can come together. I think what we're seeing now is more and more people following this. Larry Fink, who's the CEO of BlackRock, and BlackRock is the largest asset manager in the world, and he's really on board with this. In his 2018 letter to CEOs, he writes one every year, and the 2019 one has garnered a lot of interest, because he's talking about climate change in it. In the 2018 letter he said, "Society's demanding that companies serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."

## Sucheta Rajagopal

That really is the triple bottom line. That's what's socially responsible investing has always been about. I've been involved in SRI for 20 years now, and I think it's great that the traditional investment world has finally caught up to us.

## Tammy Cash

That's fantastic. I have to say it's a small world. I tweeted part of that statement just last week, so really it's certainly catching on. Definitely, I think that perspective is one that is quite intuitive to the millennial generation, really wanting to take action around investing and investing with values.

## Sucheta Rajagopal

Mm-hmm.

## Tammy Cash

I want to thank you. It's been such an absolute pleasure to chat with you today. I really enjoyed your observations about ESG investing, and I think it's really important for our listeners to know how to assess who's walking the walk, and not just talking the talk or green-washing. It's great to meet an investment advisor who's focused not just on profits, but on people and the planet too. It's very refreshing. Thank you.

## Sucheta Rajagopal

Thank you.



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