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European Equities: ESG approach

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Henderson European Focus Trust plc

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European Equities: ESG approach

The Fund Managers of Henderson European Trust plc consider there to be a clear link between good corporate governance - in each of the environmental, social and governance (ESG) factors – and the cost of capital applied by global investors. Their approach is built upon fundamental stock-picking blended with sector themes which allows them to isolate investment decisions from ‘market noise’. However, the resulting approach can be contrarian, and can lead to investing in change. ESG factors can play a role in identifying trends in corporate change and sector development.

Investment approach

ESG considerations begin at the in-depth research stage of the investment process, where a stock or sector are assessed. Importantly, the ESG analysis undertaken focuses more on the rate of change of a company’s ESG credentials than its current ESG scores. Although headline ratings from external providers are a useful starting point, the Fund Managers believe that these metrics are often backward looking. External providers of company ratings face huge difficulties in aligning subjective topics contained within the ESG arena with a single scoring system and this has resulted in a high level of dispersion in ratings depending on the agency. For this reason, the Fund Managers strive to gain a good understanding of the procedures and initiatives a company is putting in place to improve their ESG practices, focusing on the delta rather than the absolute. This research is often far ranging, including topics such as board composition and staff remuneration as well as carbon targets and green financing.

ESG integration

The Fund Managers’ approach to ESG is pragmatic and focuses on the areas that they believe will be the most material. Governance considerations are an integral part of the approach to fundamental analysis as it is these factors that have historically been proved to be material to an investment case. Environmental and social factors can also prove to be material. In some instances, they will be pivotal to the emergence of sector themes, such as electromobility or renewable energy. The Fund Managers utilise a number of sources of quantitative and qualitative company research.

- **Internal Research Platform:** Investment teams share relevant ESG research produced in-house by Janus Henderson’s analysts across a centralised research platform.
- **Governance & Responsible Investment (GRI) Team:** The Fund Managers meet and collaborate closely with the internal GRI team, as a specialist resource on ESG issues, to review portfolio ESG risks, obtain additional perspective on issues for an individual company or industry, and to help stay abreast of changing market developments related to ESG.
- **External ESG research, data, and ratings:** The GRI team subscribes to a broad range of specialist external ESG information providers and this information is utilised by the Fund Managers.

European Equities: ESG approach

Climate change risk

The issue of climate change is a growing risk and opportunity for investment portfolios as it becomes a greater focus for government policy in Europe and around the world. The Fund Managers approach this issue in the same way that they analyse and deal with the 'S' and the 'G' of ESG and are primarily concerned with the vigour and pace with which companies address environmental issues.

Where an investee company has 'sunk' or 'legacy' assets which could impact the company's progress, the Fund Managers are likely to disown or meaningfully underweight the stock or sector. However, they retain an open mind that situations can change and it is not impossible that a slow moving company may choose to move the needle more meaningfully via portfolio change and/or merger and acquisition activity. Such situations could result in a company being considered for portfolio inclusion.

This approach has caused the portfolio to typically avoid exposure to oil exploration and production companies in favour of European utilities, which appear well placed to benefit from the energy transition – that is, the movement away from traditional energy sources, such as fossil fuels, and towards alternative energy sources.

In addition to the more obvious beneficiaries of the energy transition (i.e. renewable energy production), the Fund Managers' research extends to other green technologies such as companies involved in the installation of electrical vehicle charging stations and electricity transmission and distribution services (e.g. supporting integration of renewable energy); the design and production of semiconductor chips at the core of electrical vehicles; fully recyclable polyethylene terephthalate (PET) bottles made from wood to replace plastics; LED lighting used in vertical farming and other commercial buildings and, mining equipment suppliers, whose products are essential to extract and process the extra volumes of copper required in an e-mobility world.

European Equities: ESG approach

Company engagement

Company engagement is an important source of insight into a company and forms a key part of the Fund Managers' assessment of management and ESG standards.

The Fund Managers maintain active and continuous dialogue with most of the companies they invest in and engage with the senior management of the majority of holdings at least once, and often more than twice, a year. Discussion points are wide ranging and include business strategy, compensation, capital allocation, risks, management succession and environmental and social issues where relevant.

The GRI team provides support to the Fund Managers on research and engagement and lead participation in various external ESG initiatives. In advance of company meetings, the GRI team works to screen companies for significant issues and maintains a range of ESG screens. These are applied across all holdings, with the aim of identifying material ESG issues that can be fed into the engagement and/or investment processes. On occasion, the Fund Managers will participate in governance-focused meetings jointly with the GRI team and may join collaborative investor engagements if it is believed that shareholder interests are more adequately served that way. Company engagement around general meetings is used to inform voting decisions.

If the Fund Managers do not feel that shareholder concerns are being addressed when engaging with a company, they will be prepared to consider disinvesting.

Risk oversight

The Fund Managers monitor for ESG risks as part of their investment process and utilise the following resources:

- **ESG risk reporting:** the team receives a monthly ESG risk report highlighting companies rated high risk according to their overall ESG rating, controversies, corporate governance score or climate impact. The reports utilise data from Sustainalytics and ISS.
- **Governance & Responsible Investment Team:** the GRI team highlights portfolio ESG risks and review ESG risk data.

Janus Henderson Investors

201 Bishopsgate, London EC2M 3AE

General enquiries: +44 (0) 20 7818 4411

Email: sales.support@janushenderson.com

Website: janushenderson.com

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