COMMENTARY

November 30, 2018

Dear clients and colleagues,

Over the past 11 months, we have seen many natural disasters and extreme weather events across the globe, including hurricanes Florence and Michael in the United States, record heat in Europe and Japan, and the Australian drought, among others. Due to climate change, extreme weather occurs more frequently and brings more severe damages. Scientists and environment experts are calling for unprecedented actions to assist in slowing global warming.

On Tuesday, UN Environment published its “Emission Gap Report 2018”. It acts as a report card on countries’ individual contributions to the Paris Climate Agreement. According to the report, the world is well behind the agreement’s most important goal: “to keep global temperature rise this century to well below 2°C above pre-industrial levels”. The report claims that countries need to triple their efforts to cut emissions by 2030. While 2°C may not seem significant given how temperatures fluctuate in our daily lives, a one-degree global temperature change has a meaningful impact on the overall climate. In the past, a one to two-degree temperature drop could plunge the Earth into a “Little Ice Age”. A five-degree temperature drop was enough to bury a large part of North America under ice 20,000 years ago (*World of Change, NASA*).

Transitioning to a low-carbon, sustainable growth path provides environmental benefits and makes economic sense. Low-carbon growth could deliver a direct economic gain of US$26 trillion through 2030 compared to business-as-usual (*New Climate Economy Report 2018, The Global Commission on the Economy and Climate*).

While governments are leading the actions, cooperation from companies plays a vital role in achieving emissions targets. Each year, an increasing number of companies turn their attention to environmental initiatives and set emission reduction targets. In 2017, CDP, formerly the Carbon Disclosure Project, collected questionnaires from over 4,800 companies, of which 47% noted an emissions reduction or renewable energy target. Year-to-date, over 6,000 companies have responded to the questionnaire, a 25% increase in participation.

At Global Alpha, we make responsible investment decisions by selecting companies not only with high-quality growth, but also with ESG practices that are above industry average. We have been a signatory to the UN Principles for Responsible Investment (PRI) since 2012. As measured by carbon footprint, our portfolios have a significantly lower adverse environmental impact compared to their respective benchmarks. For example, the current carbon footprint of our Global Small Cap portfolio is 67% lower than the MSCI World Small Cap Index, and our EAFE Small Cap portfolio carbon footprint is 76% lower than the MSCI EAFE Small Cap Index. We would also like to highlight the commendable environmental practices of three of our portfolio companies.

Horiba is a Japan-based manufacturer of measurement equipment, specializing in the analytics and measurement of small particles in the fields of environment, health, safety and energy. Horiba manufactures and sells 80% of the global auto emission measurement systems, and played a key role in unveiling the Volkswagen emission scandal in 2015. Its strong position in the measurement field should benefit from tighter global regulation.

Fuji Seal International is another example of a portfolio company with above average ESG practices. Also based in Japan, Fuji Seal is a flexible packaging producer. The company has a leading and stable market share for shrink sleeve labels both in Japan (60%) and globally (35% in US, 30% in Europe). As a packaging company, Fuji Seal strives to minimize its impact on the environment. To save resources and generate less waste, it reduces the film thickness of its main product, the shrink sleeve label, invented by Fuji Seal in 1960. In addition, Fuji Seal uses eco-friendly, recycled materials such as vegetable film and water-based ink and its self-adhesive label makes packaging easier to recycle as no glue remains after peeling the label from the container.

In 2017, China accounted for 27% of global greenhouse gas emissions, so any movement in its emissions greatly affects global emission levels. The Hong Kong companies in our portfolio are also actively working to reduce emissions.

For example, Kerry Logistics is a leading third-party logistics services provider in Asia that was selected as a Member of the Hang Seng Corporate Sustainability Index Series, which include Hong Kong and Mainland China-listed companies that perform well with respect to corporate sustainability. Kerry Logistics provides cross-border road transport solutions, connecting Greater China and ASEAN as an alternative to traditional air and ocean freight services. Trucks are considered to be a more environmentally friendly method of shipping, because they produce emissions equal to one third of an airplane to accomplish the same task. In Hong Kong, Kerry Logistics owns a fleet of 280 commercial vehicles, over 85% of which are Euro IV or similar models that are more efficient. The company deployed three hybrid trucks for logistics projects to support the testing of green and innovative technologies in 2017. Its logistics facilities attained the LEED (Leadership in Energy and Environmental Design) (Gold) recognition for the eco-designs.

We have many other examples of portfolio companies across multiple geographies that are actively taking actions to fight the climate change. Science and data have shown that environmental effort does not mean slower growth, rather the opposite. We will continue to identify and invest in high-quality growth names with favorable ESG practices.

Have a great weekend.

The Global Alpha team