

April 22, 2022

Dear Environment Strategy Clients and Friends,

Happy Earth Day!

The first quarter of 2022 marks 5.25 years since inception of the Environment Strategy. Our goal when starting this strategy was to expand our fundamental, bottom-up analysis of an investable company to incorporate environmental risks and opportunities we deem to be material to its financial prospects over the coming decades. Rather than substituting subjective values for investment judgement, we are driven by a commitment to enhance portfolio returns through a performance-first approach. When constructing equity portfolios for our clients, our goal is to protect and grow their wealth in a time of accelerating global change. In doing so, we have found it increasingly important to understand how climate change, natural resource and water scarcity, geopolitical competition, regulatory developments and technological advances will affect the prospects of our portfolio companies.

Inaugural “Impact” Report

Our core performance objective aligns well with the opportunity to deploy capital into companies that are achieving a wide variety of positive environmental impacts. Environmental change is accelerating, as documented by the Intergovernmental Panel on Climate Change’s authoritative scientific update this yearⁱ, spotlighting the urgency of allocating capital to solutions at the scale and leverage that can only be afforded by the public equity markets. The U.S. SEC and the EU are proposing new requirements for corporate and investor disclosure concerning climate changeⁱⁱ that we believe will cause these factors to be increasingly priced into the equity markets. Shareholder engagement on environmental issues has intensified as evidenced by events like Engine 1’s proxy victory installing reformist directors at Exxon.ⁱⁱⁱ Accordingly, we are more focused than ever on documenting the “impact” of our portfolio companies. We have just published the first **Douglass Winthrop Impact Report**, which you can find on our website at <https://www.douglasswinthrop.com/environment-strategy.php> (the report password is **dwa2022**). The report shares statistics and observations relevant to understanding the impact associated with our holdings in 2021 and will be an annual report that covers portfolio positions across each calendar year at their average weightings. In the report we discuss how environmental strategies can be good for companies and the world, several criticisms of ESG’s “Saintly Narratives”, and what we mean by impact - namely that every dollar counts, scale is important, and we see ourselves as active owners seeking to support the companies we invest in. We also provide specific data relevant to our holdings and frame the challenges of incomplete and sometimes confounding data and definitions as the ESG market continues to mature.

An Eventful First Quarter

While we commend the report to those who are interested in an extensive impact analysis of each company in our portfolio during 2021, we also wanted to share a few thoughts about the first quarter of 2022. During the quarter the news has been dominated by inflation and an unspeakable tragedy befalling Ukraine. As would be expected, the equity and bond markets have seen increased volatility. Please see below our performance through Q1 of 2022.

Because we are investors and not traders, we have long encouraged clients to join us in maintaining a long-term view. Our annualized and cumulative performance remains well ahead of our three reference benchmarks on a 3-year, 5-year and since-inception basis, and we maintain high conviction in the long-term quality of our portfolio.

DWA Environment Composite

Since Composite Inception - 1/1/2017 to 3/31/2022

Reference Indexes

	DWA Environment (gross)	DWA Environment (net)	MSCI SRI TR Index	S&P 500 Total Return Index	MSCI World TR USD Index
Annualized Returns					
1Yr	10.13%	9.22%	13.16%	15.65%	10.12%
3Yr	21.71%	20.72%	17.90%	18.93%	14.98%
5Yr	20.27%	19.29%	14.66%	15.99%	12.42%
Inception	21.08%	20.09%	15.32%	16.48%	13.13%
Cumulative Returns					
1Yr	10.13%	9.22%	13.16%	15.65%	10.12%
3Yr	80.31%	75.94%	63.87%	68.20%	52.00%
5Yr	151.61%	141.53%	98.19%	109.94%	79.58%
Inception	172.85%	161.27%	111.21%	122.67%	91.03%

(Please keep in mind that past performance is no guarantee of future results.)

The Q1 2022 pullback in equity markets is unsurprising, particularly after outsized gains over the last several years. Our investing playbook, however, does not change in the face of adverse market conditions. Regardless of the market environment, our intrinsic value-oriented investment philosophy and disciplined process remain the same. We invest based on our proprietary forecasts and conviction about company prospects over the next 5-10 years, favoring compounders with strong, recurring cash flow growth. For long-term investors, the pullback has created what we deem as more attractive entry points into companies that meet our demanding criteria and whose prices have been drawn down somewhat indiscriminately. Anxiety at times like this is greatest for those with a trading mindset who are trying to “play” the next 12-18 months by being one step ahead of emerging rotations. Instead, we adhere to our process: staying calm and methodical in execution of our investment disciplines.



The attributes we look for in our companies often confer defensive qualities that have served our strategy well in times of market stress. For example, many of our companies offer essential services that are needed regardless of economic conditions: electricity (**Schneider Electric, Siemens, SolarEdge, NextEra**); food (**Trimble, Costco** and Q1 portfolio addition **Deere**); water (**Danaher, Xylem**); and waste services (**Waste Management**). Others create innovative materials that allow their customers to work around commodities that have been constrained and spiking in price during recent supply chain stresses (e.g., **Aptiv** pioneered Selective Metal Coating that enables its automaker customers to replace a portion of high-cost copper content with aluminum); or around prevailing labor shortages (**Siemens** and **Schneider Electric** are leaders in factory automation). Other portfolio companies have led in enabling digitalization of workforces and physical assets to maintain productivity in the face of a range of business interruption risks that have been growing in prevalence – whether COVID-19 or extreme weather events (**Generac, Salesforce, Microsoft**).

Crisis Can Lead to Opportunity

The tragedy of war in Ukraine will accelerate the transition to a low-carbon economy. In making such a forecast, timeframes are crucial: short term pressures to compensate for the Russian supply gap and populist pressures to cap gasoline and electricity prices may prompt more oil and gas production. It may boost short-term extension of coal fired generation to shore up energy security, and has prompted a scramble by many countries to ensure access to LNG. In the mid and longer term, however, the risks of continued reliance on fossil fuels, produced in many instances by unfriendly nations, have been made abundantly clear. Indeed we see European countries and others reinvigorating their commitments to wean themselves from fossil fuels even more quickly. The Wall Street Journal characterized the situation well: “Russia’s invasion of Ukraine has led countries to tear up their timelines to transition from fossil fuels. In their quest for more secure energy supplies, they are simultaneously rushing toward and away from oil, gas and coal.”^{iv} We believe our thesis for the Environment Strategy remains intact. The solutions our portfolio companies offer will be even more in demand in coming years. Given our long hold periods, we don’t need to be especially prescient or precise about the exact timing.

As usual, we welcome any referrals you might wish to make to individuals, endowments or other institutions who you think might benefit from an allocation to the DWA Environment Strategy. Please reach out to Mary Kush (mary@douglasswinthrop.com) or Dan Abbasi (dan@douglasswinthrop.com) if you would like to set up a call with the team. Mary leads our institutional engagement and Dan serves on the Environment Strategy Portfolio Management Committee.

Warm regards,

The Douglass Winthrop Team

ⁱ <https://www.ipcc.ch/report/sixth-assessment-report-working-group-ii/>

ⁱⁱ <https://www.sec.gov/news/press-release/2022-46> and https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en

ⁱⁱⁱ <https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html>

^{iv} https://www.wsj.com/articles/oil-gas-russia-renewable-energy-solar-wind-power-europe-11649086062?mod=Searchresults_pos4&page=1