October 12, 2022

Dear DWA Sustainable Equity Strategy Clients and Friends,

You have likely noticed that we're addressing you differently in this letter. We have indeed changed the name of the Environment Strategy to the Sustainable Equity Strategy. Sustainable is the right word to convey what we're doing: investing in high-quality business models that we believe will endure profitably for the long-term. We chose it as a more encompassing word. It speaks to the economic dimension of our work, identifying companies with defensible moats that are positioned to *sustain* in the face of foreseeable competitive challenges in their respective markets. It speaks equally to the environmental content of our work, namely our commitment and expertise to assess intensifying environmental risks and opportunities that will shape how and whether a company can prosper through this decade and beyond.

Sustainability is inherently a concept about success over time rather than a static attribute. As such, it encapsulates our core mission to protect and compound our clients' capital in a rapidly changing world. The most famous definition of sustainability comes from the United Nations' Brundtland Commission which defined sustainable development in 1987 as "meeting the needs of the present without compromising the ability of future generations to meet their own needs."[1] This mirrors our objective on behalf of clients, including families navigating intergenerational wealth transfers or endowments who must meet both current and long-term obligations to fund their missions.

Rest assured that this renaming does not reflect any dilution of our focus or competitive edge with respect to environmental factors, which remain at the heart of sustainability and the analytics we perform through our DWA E-Map and E-Assess methodologies. The market continues, we believe, to misunderstand and misprice many such environmental factors, which gives us an opportunity to continue to outperform, as we have cumulatively over 5.75 years since inception. (Past performance is no guarantee of future results.)

That said, we recognize that this year has been a turbulent market and especially for those who have been with us not since inception but rather invested in our Strategy more recently, this is not a comforting time to review the *current* market prices being paid for shares of our companies. Fortunately we intend to own most of them for the long-term, during which we expect their returns to tend toward strong intrinsic earnings growth plus dividends, even though market sentiment and other influences on daily prices will inevitably vary along the way. That earnings power – and its sustainability -- is what we stay squarely focused on, and we maintain high conviction in the quality of our portfolio. We encourage you to read Douglass Winthrop's "flagship" letter every quarter, but especially this quarter, because it puts the current volatility in helpful context.

Our investment theses on the 30 companies in the Sustainable Equity Strategy – and we re-test them frequently -- are not only intact, but well reinforced by events so far in 2022 (although those re-tests led us to exit four positions in 2022 and to purchase six new positions – see discussion below). The geopolitical and economic risks of dependence on fossil fuels have been starkly underlined by Putin's war and recent collaboration with OPEC+ to withhold 2 million barrels per day of production. The war is prompting the U.S. and EU to simultaneously rush toward fossil fuels over the short-term – to replace lost Russian supply and meet immediate needs – and away from them over the mid and long-term by boosting investments in renewables, efficiency and electrification. The latter are among the core secular growth trends that our portfolio is designed and well positioned to benefit from. And speaking of OPEC, it's notable that even Saudi Arabia is now issuing ultra- long 100-year green bonds to fund $10 billion in green deals to drive their own economic transformation toward Net Zero by 2060.[2]

The Most Significant U.S. Climate Policy Ever

The war did not derail climate policy action. Quite the reverse. Our elected leaders in D.C. passed breakthrough climate change provisions in the *Inflation Reduction Act* in August. The $369 billion in climate provisions constitute the most comprehensive climate policy action in U.S. history, with projected emissions reductions to reach 32-42% below 2005 levels in 2030. [3] This would put the country within reach of its national commitment in the Paris Agreement process to cut emissions 50% to 52% by 2030 through complementary policies and investments. The law provides the kind of long-term duration in its tax credits and other policy mechanisms that investors require to deploy capital at scale. We avoid underwriting our base case investment theses for any company on the basis of policy catalysts that are uncertain or, once enacted, could still be reversed; however, there are reasons to think this law will endure. Its passage was responsive to well-documented bipartisan popular support for climate action[4] across the U.S., which has solidified in the face of climatic extremes in recent years, something that Dan Abbasi on our team covered in his presentation at a private White House briefing this past March during earlier deliberations on the legislation.[5]

The law offers 10 years of renewable tax credits that are expected to double wind generation and multiply solar production by 5x by mid-decade and lead to higher growth rates thereafter, while extending eligibility to standalone battery storage; these provisions will benefit our portfolio companies NextEra, SolarEdge, Generac as well as the Renewable Power Group at Goldman Sachs and leading corporate buyers of renewables like Amazon, Salesforce and Alphabet. The law includes enhanced tax credits to drive energy efficient building renovation, benefitting Autodesk, Siemens, and Schneider Electric, and to accelerate uptake of efficient appliances like heat pumps, benefitting Trane. It extends and simplifies access to tax credits for electric vehicles, benefitting Aptiv, a Tier 1 supplier to nearly all major auto manufacturers electrifying their fleets. It incentivizes reshoring of supply chains for EV and battery manufacturing, benefitting Siemens and Schneider Electric whose industrial automation and digitalization solutions help diverse industries build resource-efficient and labor-saving factories.

In addition to turning the domestic battleship on climate, the new law will give the U.S. leverage to drive other large emitting economies forward to more aggressive action at the next round of global climate talks this November in Cairo,[6] creating yet bigger global markets for many of our companies. The primary contribution that a framework law like this makes is to send robust long-term demand signals to promote private sector investment, and to supply incentives to buyers to purchase the resulting solutions. Most of the capital required for decarbonizing our economy will need to come from the private sector. To get to net zero by 2050, an estimated $125 trillion of spending will be needed (70% of that from private sector)[7]. That amounts to $4-5 trillion annually over the next 28 years compared to only $37 billion/year in public funding per year over the next 10 years from the U.S. law – a gap that speaks to the compelling need and opportunity for capital deployed by our Strategy.

Portfolio Changes

We have been reasonably active this year – purchasing six companies and selling four, while re-sizing other positions in two rounds of portfolio rebalancing. All actions were informed by our continuous assessments of each company's progress and forward earnings trajectory, including its ability to navigate significant macro changes that have come to the fore in 2022, from central bank rate hiking around the world to reverberations from the unresolved war. We wrote about four of our purchases in the Q2 letter and in the year-end letter we will write about a fifth – a leading consumer packaging company paving the way toward a circular economy by substituting infinitely recyclable aluminum for plastics. Our holdings in the consumer discretionary sector and our European industrials have pulled back significantly, as have our two holdings that are dominant in semiconductor manufacturing. The sales we executed in Q3 reduced our exposure to the softening consumer in favor of better long-term opportunities. Our European industrials offer solutions to enable the major wave of energy efficiency ahead as the EU acts on the war's lessons (beyond the easy pickings of turning the Eiffel Tower off early[8]) and are poised to benefit from currency-driven trade effects that will make European goods cheaper on a dollar-denominated basis. Our two semiconductor companies supply manufacturing equipment, process technology and services to produce the advanced chips needed to embed resource-saving digital intelligence into vehicles, buildings and factories; these are profound trends into this decade and beyond that should, in our estimation, prove more material than any near-term softness in PCs and other market segments.

Among the sales, we exited longtime holding Xylem based partly on concerns that the team was unable to articulate to us, on an engagement call, a strategic market and customer segmentation for how they will prioritize solution selling in response to increasing water pricing over the coming decade across their addressable market. We also became concerned that the slowdown in utility orders for Xylem's Sensus FlexNet water metering system may reflect not just short-term spending pullbacks, but a longer-term challenges selling a system based on

dedicated radio spectrum that requires customers to install capital-intensive towers and related infrastructure[9]. Many competing solutions harness cellular infrastructure and cost-effectively piggyback on the large infrastructure build-out being funded by telecom providers, which we think could be a potent advantage over Xylem's offering. The company's stock price performance over the last two years was driven primarily by multiple expansion not earnings growth, creating excess valuation risk in a time of rising rates and skewing the risk-reward from here to the downside. While the Xylem sale leaves our portfolio with no pure-plays in the water segment of the DWA E-Map, Danaher, a position we upsized earlier this year, announced in mid-September that it will spin out its Environmental & Applied Solutions unit in 2023, including its leading water brands.[10] We are continuing to investigate another water-related company on our close watch list, but appreciate Danaher's plans to unlock value through this spinoff of a pure-play into a capital market eager for such offerings.

Performance

DWA Sustainable Equity Composite
Since Composite Inception – 1/1/2017 to 9/30/2022

			Reference Indexes		
	DWA Sustainable Equity (gross)	**DWA Sustainable Equity (net)**	**MSCI SRI TR Index**	**S&P 500 Total Return Index**	**MSCI World TR USD Index**
Annualized Returns					
1Yr	-25.44%	-26.05%	-19.84%	-15.47%	-19.63%
3Yr	9.29%	8.41%	5.83%	8.16%	4.56%
5Yr	11.50%	10.59%	6.95%	9.24%	5.30%
Inception	13.86%	12.93%	8.87%	10.52%	7.33%
Cumulative Returns					
1Yr	-25.44%	-26.05%	-19.84%	-15.47%	-19.63%
3Yr	30.54%	27.40%	18.54%	26.54%	14.30%
5Yr	72.31%	65.39%	39.93%	55.55%	29.47%
Inception	110.90%	101.13%	62.96%	77.70%	50.21%

Thank you for your confidence in us to navigate a turbulent 2022 and beyond. We believe the pullback this year continues to present an attractive entry point for new clients. As usual, we welcome any referrals you might wish to make to individuals, endowments or other institutions who you think might be interested. 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 Sustainable Equity Strategy Portfolio Management Committee with Josh Huffard and Bowdy Train.

Best regards,

The Douglass Winthrop Team

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1 https://sustainabledevelopment.un.org/content/documents/5987our-common-future.pdf

2 https://www.wsj.com/livecoverage/stock-market-news-today-2022-10-05/card/saudi-s-sovereign-wealth-fund-begins-green-bond-sale-eATu6Irm2wc8tYaxUASo?mod=Searchresults_pos3&page=1 and https://gulfbusiness.com/saudi-arabias-public-investment-fund-raises-3bn-via- inaugural-green-bond/ and https://www.bbc.com/news/world-middle-east-58955584

3 https://rhg.com/research/climate-clean-energy-inflation-reduction-act/

4 https://climatepublicopinion.stanford.edu/

5 https://www.whitehouse.gov/ostp/news-updates/2022/02/25/readout-of-white-house-climate-science-roundtable-on-countering-delayism-and-communicating-the-urgency-of-climate-action/

6 https://www.unep.org/gan/events/un-environment-event/un-climate-change-conference-2022-unfccc-cop-27

7 Bruce Usher, *Investing in the Era of Climate Change* (Columbia University, 2022), page 18

8 https://www.wsj.com/articles/paris-lights-energy-conservation-11665177876?mod=Searchresults_pos2&page=1

9 https://www.xylem.com/en-au/solutions/communication-networks/flexnet-communication-network-int/

10 https://investors.danaher.com/2022-09-14-Danaher-Announces-Intention-to-Separate-Environmental-Applied-Solutions-Segment-to-Create-an- Independent,-Publicly-Traded-Company