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Pendal Ethical Share Fund

Explaining our approach
to mining investments

PENDAL

Why does Pandal's updated Ethical Share Fund still include mining companies?

We recently re-designed Pandal's Ethical Share Fund to better help investors benefit from opportunities driven by Australia's transition to a more sustainable economy.

This involved several material changes to the fund, including an expanded set of exclusionary screens and a new framework to support the identification of companies leading or enabling the drive to a future-ready economy.

As part of this approach we avoid industries or companies with business models and products or services that undermine a sustainable economy or cause significant harm to society and the environment.

We established a range of sector or activity-based exclusionary screens that effectively knock out harmful companies from the investable universe. These screens cover sectors such as fossil fuel extraction, weapons, gambling and logging.¹

Some values-based investors might be surprised to find companies that mine non-fossil fuel-related minerals such as iron ore and gold are not formally excluded from the fund. Don't such companies also cause harm, these investors may ask?

The answer isn't black and white.

To better appreciate Pandal's approach to mining in regard to this fund, it's important to understand the fund's sustainability-related priorities. In other words, what are we trying to achieve via the fund's holdings and exclusions.





To participate in and support the transition to a more sustainable, future-oriented Australian economy, through our investment decision-making, we think about how we can:

- ✓ Grow and realise the potential of Australia's social capital (that is, our individuals and communities)
- ✓ Foster innovation and enterprise, especially for industries of the future
- ✓ Reduce the environmental impact of economic activity
- ✓ Strengthen the resilience of our institutions, infrastructure and economy more broadly

In essence, how can we move from the economy of yesterday, to the economy of tomorrow?

When considering the sectors to permanently exclude in this fund, we contemplated whether diversified and gold mining should be investable. Here, we outline some of the key reasons why we elected not to have a wholesale exclusion of mining. This is not a static process and we will continue to revisit this approach over time as new practices and technologies emerge.

Contribution to the future economy

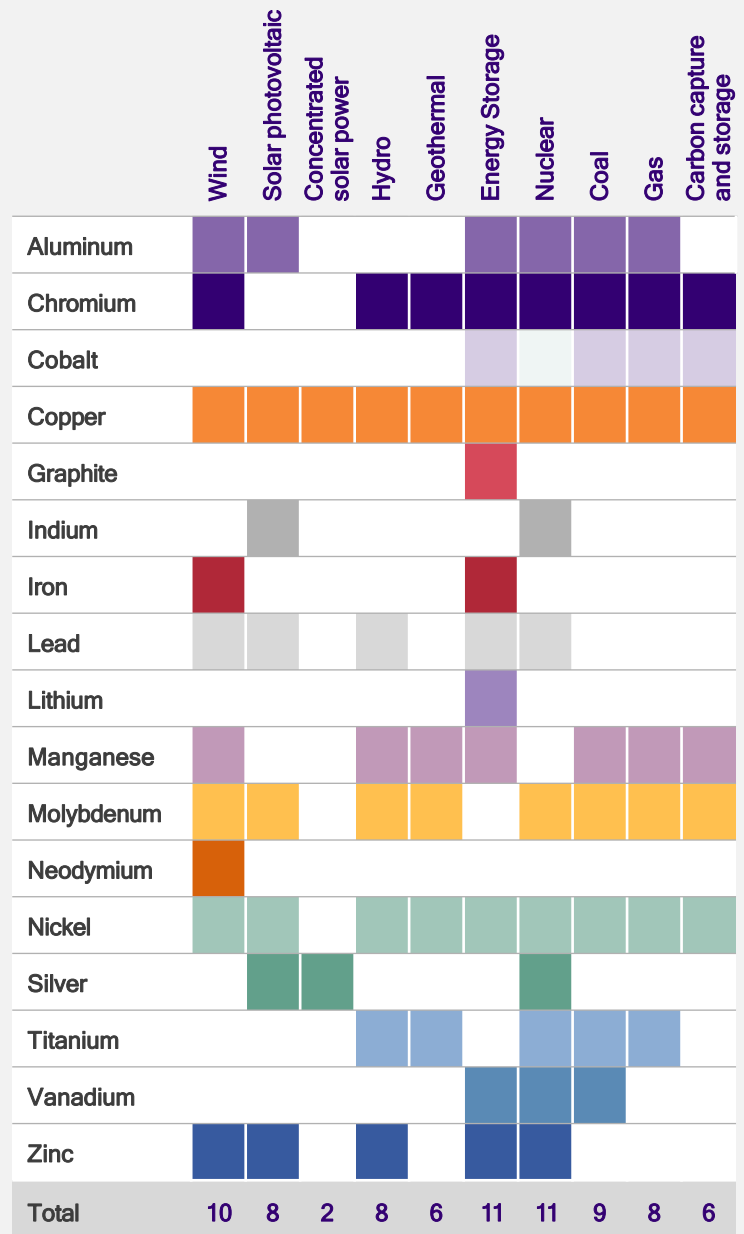
Some metals and minerals already are and will continue to play a role in a range of technologies and activities that is needed to support a more sustainable economy. Additionally, the mining industry itself contributes to the Australian economy as an important employer.

Access to energy is fundamental to fulfilling basic social needs and supporting sustainable economic and human development. The decade ahead is going to see growing global energy demand resulting from industrialisation and electrification, at a time where large-scale transition to lower-carbon energy solutions will be needed to limit global warming to below 2°C.

These trends will be instrumental in shaping the supply and demand for critical metals and minerals in coming years. Whether it is aluminium needed for solar PV panels, iron for wind turbines, or graphite, nickel and lithium for energy storage, decarbonisation will not be possible without continued extraction of these materials as illustrated in Diagram 1.

Diagram 1

Mapping minerals with relevant low-carbon technologies



Source: World Bank Group, 'Minerals for Climate Action - The Mineral Intensity of the Clean Energy Transition', 2020

Some metals and minerals will play a role in the future economy simply because of a lack of potential for substitution, rather than their contribution to sustainability.

Iron ore, which is essential to making steel, is a good example. While it is hoped innovative technology can be developed to produce steel in a less carbon-intensive manner, iron ore will remain a key input.

Geopolitical competition is becoming increasingly entwined with access to critical minerals reflecting their increasing strategic importance as enablers of clean technologies along with high supply risk.

These critical minerals are highly geographically concentrated and vulnerable to disruption, as we saw during the recent global pandemic. Given global dependence on these raw-materials, the possibility of resource scarcity represents a growing concern to nations and industries and has prompted the US, Japan and the European Union to compile critical materials lists.

These lists include the raw materials they plan to support locally as part of their strategies to reduce reliance on imported supply alongside increased recycling initiatives.

Geologically, Australia has an abundant supply of minerals. Our nation is well-placed to benefit from growing global demand for critical minerals such as lithium, tungsten, titanium, vanadium and bauxite.

It is in our best interest to ensure we have ongoing and adequate access to these essential inputs to support our own transition to a more resilient economy, able to better navigate future shocks like COVID-19 and the large uptake in clean-tech applications, like electric vehicles, batteries and renewable energy.

Finally, the mining industry also contributes to the economy as an important employer and active supporter of diversity and inclusion programs, both gender and indigenous orientated, and in remote areas of Australia where often there are less employment opportunities.

Regional footprints of mining operations also support economic activities more broadly in the area and overall social wellbeing. We believe that, where mining activities are not causing significant harms, it can contribute to an outcome we wish to see as part of a future economy: provision of decent work.





Demand

With demand for these minerals and metals increasing, we do not want our clients to miss out on investment opportunities. A recent World Bank report has projected that demand for clean energy technologies could drive the production of “strategic” minerals such as graphite, lithium and cobalt to increase by nearly 500% by 2050.

For a country like Australia which is resource-rich and has strong mining capabilities, it would be remiss for the country to not leverage this to capitalise on such opportunities, while contributing to the clean energy transition. Where Australian mining companies are positioned to responsibly meet this demand, we believe we should be able to allocate capital towards them.

² The World Bank & International Bank for Reconstruction and Development, 'Minerals for Climate Action: The Mineral Intensity of the Clean Energy Transition', 2020



Safety nets within our investment process

As mentioned above, the Fund has a framework for identifying companies that do or don't contribute to a more sustainable, future-oriented Australian economy. We identify those that directly enable a more sustainable economy or are innovating so as to accelerate the transition. We also identify those companies that detract from a more sustainable economy. These companies are involved in business activities which are formally excluded under our sector-based screens.

Our framework acknowledges that some companies make a neutral contribution towards our sustainability-related priorities. These are 'do-no-harm' companies - on balance they don't cause significant harms yet they don't directly advance our priorities.

Even when thinking about a company's negative, neutral or positive contribution to a more sustainable future economy, our framework still has embedded within it means to avoid companies which do not meet our minimum ESG risk management standards, or are subject to an incident-based controversy which warrants their exclusion from the Fund. In other words, no individual company's inclusion in the Fund should be taken as given.

For us, we are confident that should any mining company fail to adequately manage its ESG risks, or cause significant harms to society or the environment, that it would be captured within our framework and thus not make it into the portfolio. We have a robust process in place supported by a large and experienced team of analysts, covering our Australian investment universe, to assess a company's management of ESG matters. Additionally, we actively monitor for incidents which may constitute a breach of social licence to operate.

For example, should a company breach environmental management standards, leading to negative impacts to the surrounding habitat and biodiversity loss, it would be excluded until we were satisfied any issue was remedied and standards improve. The same would go for a company which was complicit in any human rights abuses or whose management of relationships with traditional owners fell short of community expectations.

The role for engagement

A cornerstone for this fund is our active approach to engagement with companies we hold or wish to hold in the future. Through engagement and proxy voting activities we encourage companies to lead change that will define the successful companies of the future – and at a minimum to avoid obstructing such change.

We believe we can further this objective by providing information to empower corporates to make informed decisions on ESG and sustainability initiatives, expressing an opinion through proxy voting and using our strong market position to influence boards and leadership in private conversations.

The potential to influence mining companies for the better, should we have a shareholding, contributed to our inclusion of the sector in our investable universe. As a longer-term investor in many of these companies, we believe clients are best served by taking a constructive and forward-looking approach and supporting companies to improve their ESG and sustainability credentials.





Portfolio risk management

The fund has an objective to deliver on investment performance while supporting sustainability. Our investment edge lies in our company-level insight and our risk management. We build portfolios that are primarily driven by this insight – that is by stock-specific risk, rather than style, sector or thematic exposures. This approach of delivering a high-conviction, all-weather, nimble portfolio enhances our ability to deliver alpha. We believe this stock-driven construction will deliver a more consistent performance profile through the cycle than style-based strategies.

This approach is grounded in the deep experience of the investment team, particularly that of Portfolio Manager Crispin Murray. The strategy was launched in 2001. Its success is demonstrated by the subsequent track record of long-term outperformance.

We note the particular role holding gold-related mining stocks in the portfolio can have in supporting financial objectives. The ASX has a number of gold companies in the index. Investing in these companies not only provides diversification due to gold's low correlation to other stocks. It can also be a defensive play given its history in maintaining value in the face geopolitical or macroeconomic uncertainty.

In an era of Covid-19, technological disruption and system-wide risks such as climate change and geopolitical tensions, we believe more challenging times are ahead for financial markets.

The systematic nature of these risks limits the ability of these risks to be “diversified away”. Hedging strategies will be important. The role gold plays as a store of value in the economy during times of widespread uncertainty and market volatility makes its inclusion in the fund desirable.

We acknowledge that gold processing has negative impacts on the environment. Our proprietary ESG integration framework supports the assessment of this risk. But in addition to its role as a financial hedge, gold does make a small contribution to some sustainable products and services. For example, small amounts of gold are essential to the operation of nearly all sophisticated electronic devices, from personal devices through to electronic medical equipment, due to its conduction properties. For this reason, we consider gold mining to make a neutral contribution to our priorities of a more sustainable Australian economy.

That said, as outlined above, we have robust processes in place. Should a gold company not meet our minimum ESG standards or incident-based exclusion criteria, it would not make it into the fund.

The outcome is a fund that is built for performance while also acting as a force for positive change in Australia's future.

The fund is aligned with developing trends, from digitisation to decarbonisation, while benefiting from Pandal's proven capability.

More info

For more information on the Pental Ethical Share Fund, please visit the product's webpage [here](#), or contact Nicki Ashton or Jeremy Dean.



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