Building stronger portfolios

Investment stewardship

Promoting sustainability through investment-led stewardship

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We believe effective investment stewardship can materially contribute to helping build stronger portfolios over the long term for our clients.

George Gatch
CHIEF EXECUTIVE OFFICER
J.P. MORGAN ASSET MANAGEMENT
Foreword

At J.P. Morgan Asset Management, creating value for our clients is central to everything we do. For more than 150 years, our fiduciary commitment has meant we consider the impact of each decision we make on client portfolios and performance.

We believe that sustainability is a vital part of this commitment. Sustainability factors are those that can have an impact on a company’s ability to operate, today or in the longer term. When we take into account the full range of risks and opportunities – including those related to environmental, social and governance (ESG) practices – in our research, and promote sustainability through our engagement and voting, we strengthen our understanding of how companies will perform in the future, and contribute to stronger outcomes for our clients.

At the heart of our approach lies a close collaboration between our portfolio managers, research analysts and investment stewardship specialists to engage with the companies in which we invest. We call this “investment-led stewardship.”

Regular engagement with our investee companies has been vital to our active heritage. We continue to exercise active ownership through regular and ad hoc meetings, and through our voting responsibilities. At the same time, we recognize that our approach needs to adapt and evolve to remain relevant in an ever-changing landscape.

In this paper, I am pleased to introduce our approach to reinforce and enhance our global investment stewardship model. Leveraging the expertise of more than 1,000 investment professionals working directly with companies, we are building on the foundation of our longstanding corporate engagement practices to focus strategically on a defined set of stewardship priorities that we believe can play a critical role in creating value for our clients.

Investment-led, expert-driven investment stewardship will not only enable us to recognize significant risks, identify new opportunities and better generate attractive risk-adjusted returns, but it should also help us to build stronger and more sustainable portfolios for our clients.

Jennifer Wu
Global Head of Sustainable Investing
J.P. Morgan Asset Management
Our investment stewardship philosophy

As a fiduciary of our clients’ assets, we understand that performance is paramount. We believe that understanding the sustainability of investments is vital to that goal.

We have worked to create an investment stewardship approach that aims to improve long-term, sustainable value. We believe that the companies in which we invest should be focused on responsible allocation of capital and long-term value creation.

For us, investment stewardship is not about adhering to one set of norms or limiting our scope to one collection of standards. Nor is it about arbitrarily extending the time horizon of our portfolios. Rather, we strive to understand how factors impacting sustainability are financially significant to companies over time, understanding that the regions, cultures and organizations in which we invest differ greatly.

Identifying whether a risk or opportunity is substantial enough for us to act upon is a key element in our approach to investment stewardship. Due to the global breadth of our investment universe, we cannot apply the same metrics or standards across the board. Instead, we need to judge securities, assets and situations in context, and decide how significant a particular event or circumstance may be, given that context. This allows us to gauge the financially material elements of a sector, industry or business model from a sustainability perspective, now and into the future. Our focus is on future cash flows or duration of business. We view purposeful leadership at the top of a company, supported by strong corporate governance, as the key to achieving these goals. Where such attributes are discovered lacking, we aim at actively engaging with investee companies to improve governance.

We integrate financially material ESG factors into our active investment frameworks across asset classes. Combining our ESG research capability with the experience and skill of our investment teams and the expertise of our investment stewardship specialists gives us a deep understanding of the risks and opportunities facing different sectors, industries and geographies. By integrating this expertise onto a global common platform, we seek to maintain a consistently high standard of engagement, considering the myriad nuances a responsible investor needs to embrace. Our approach provides for broad flexibility as data, regulations and outlooks change, while focusing on the best prospects for sustainable financial returns.

Please find some of our engagement and voting activity from 2020 on the following page. The sample of engagement reports and voting activity presented here aims to illustrate our approach to investment stewardship.
Our five investment stewardship priorities

We have identified five main investment stewardship priorities that we believe have universal applicability and will stand the test of time. Within each priority area, we have identified related themes that we are seeking to address over a shorter timeframe. These themes will evolve over time, as we engage with investee companies to understand issues and promote best practice. This combination of long-term priorities and evolving, shorter-term themes provides us with a structured and targeted framework to guide our investors and investment stewardship teams globally, as we engage with investee companies around the world.

| Governance | Strategy alignment with the long term | Human capital management | Stakeholder engagement | Climate risk |
Companies that get their governance right tend to get other sustainability issues right.

We believe it is vital to encourage the highest governance standards in the companies in our portfolios. Every company is different, but they all share some exposure to sustainability risks. We aim to ensure that board members and senior management teams are fully focused on their own responsibilities as leaders of people and stewards of investor capital.

A key starting point is appointing the right people to take on board-level responsibilities. A board must assess the skills it needs to oversee the company and make board appointments transparently. Assessing the performance of individual directors, committees and the board in aggregate is key to the ongoing functioning and refreshment of the board.

As an active investor, we demand high standards from company directors, particularly around their interaction with investors, and encourage a strong corporate culture to foster long-term value. We require candid and open communication, access to independent directors as well as executive management and a clear articulation of the board’s thinking on long-term strategy.
We believe long-term thinking leads to sustainable business models.

The role of management and board is to manage the business for long-term outcomes. While a company’s purpose generally doesn’t change, corporate strategies often do, in response to technological, competitive, societal and regulatory change. This can make strategic alignment with the long term challenging. At the same time, over-focusing on the short term clouds long-term thinking. By taking an extended view, company leadership can formulate strategies that should see them ready to react to – if not lead – disruption in their own sector and help them to navigate unexpected shocks. We understand this is not a simple task. A 2020 survey by the National Association of Corporate Directors in the United States found 68% of directors felt they could no longer count on extending their existing strategy over the next five years.

We encourage boards to dedicate more time to long-term value creation, starting with the company’s purpose, culture and strategic roadmap. This requires an internal focus on pushing toward the same future goal – and logging improvements along the way.
Effective management of human capital is critical to an engaged and productive workforce.

Purposeful leadership is critical to defining and developing the right conditions to drive workforce productivity growth. We encourage management to create an environment in which employees at all levels feel valued and can bring their own experiences and perspectives to bear. The attraction, development and retention of personnel with key skills are critical to the successful execution of strategy. The Securities and Exchange Commission has issued recommendations on how companies should report on their specific human capital programs, and we believe human capital reporting has the potential to become a regulatory area of focus.

Diversity of thought, skills and background is as important to most aspects of human capital management as it is to optimal decision-making for boards. We work with investee companies to help them recognize diversity as a key element of recruitment and promotion practices. Employee training and development programs are central to a company’s longevity and are an effective way of raising productivity and adding value.
Generating long-term sustainable returns requires managing the interests of stakeholders.

Companies do not operate in a vacuum; their sustainability depends on other stakeholders beyond their investors and employees. To be sustainable and productive over the long term, a company’s leadership needs to take into account the broader network of relationships in which they operate. This includes suppliers, customers and surrounding communities.

The risks that fall within this area touch all links in the stakeholder chain, from climate change and environmental risks, through data privacy and cyber security issues, to product liability and safety concerns for customers, employees and the surrounding community. According to the National Association of Corporate Directors in the United States, while many of these issues are currently viewed as discretionary rather than mandatory concerns, companies are increasingly likely to see them as “mission critical.”

The willingness to do the right thing is crucial. We believe that a respectful corporate attitude can foster goodwill, which, in turn, is vital to help create and sustain value. Engagement of all stakeholders both within and around a company will be increasingly critical to long-term success.
Climate risk

*Climate change is a global challenge that investors cannot afford to ignore.*

The changing climate needs to be placed high on every corporate agenda as it poses both wide-ranging risks and opportunities that could impact company operations and investment valuations. Physical changes to the environment, technological disruption through resulting innovation, and regulatory risks all pose threats, with the United Nations claiming delays in tackling the issue could cost companies around the world almost USD 1.2 trillion over the next 15 years.

Every company needs to be alert to how the changing climate may impact its business in the future and to its own contribution to climate change, even if such risks may seem distant at this time. Governments, agencies and regulators have begun to put in place policies that will limit greenhouse gas emissions or penalize entities that do not comply with new standards. It is vital for a company’s long-term sustainability to understand the risks posed to its business model by such legislation – compounded by a potential for withdrawal of investor support. As a long-term investor, an understanding of exposure to climate risk is imperative in our assessment of investee companies in our active portfolios.

While solutions to the challenge of climate change will require action by governments and regulators on policy and carbon taxation, we encourage companies to be proactive in assessing their exposures to both physical and transitional climate-related risks and opportunities. Business models may be impacted by future legislation or by shifts in societal opinion. The risk can be existential; some business models may be rendered obsolete as risk assessments evolve.

We expect managements to engage with investors, and to articulate how the company intends to navigate the risks and opportunities posed by climate change and the oversight provided by the board on progress of implementing such plans.
Our team and approach

Locally focused, globally accountable

We are global investors who take a local approach. Our heritage of active investment has taught us that one size rarely fits all and, to create outperformance by picking long-term winners, local knowledge and understanding is key.

Around the world, including in New York, London, Hong Kong and Tokyo, our regionally based investment teams work closely with our sustainable investing and investment stewardship specialists to select, reject or engage with companies to enhance long-term performance. Together, these teams use our proprietary investment-led, expert-driven investment stewardship framework to establish benchmarks that are relevant and reliable, based on their local and sector-based context. Direct engagement and shareholder voting are all carried out at a local level, with guidance from our regional and global investment stewardship teams.
Voting responsibly and engaging for change

Our global network of investment professionals takes a research-driven approach to uncovering opportunities and risks. Analysis of companies and sectors through an ESG lens is a vital component in helping us to assess long-term value.

By examining the ESG profiles of companies within our investment universe, we can establish the risks, and the materiality of those risks, around a specific sector and location. This helps us to identify outliers based on our five priorities and conduct targeted engagements with companies where we believe improvements are warranted. We engage with companies to help us understand the issues they face and support them to adopt best operational and strategic practices.

As our aim is to increase and release sustainable, long-term value, we employ two branches of engagement. Our portfolio managers and investment analysts work with companies on improving elements of their operations and strategy that they deem to have a financially material impact on their profitability over the long term.

Where the issues identified relate to long-term sustainability, our investment stewardship team may conduct additional engagement. When we make an assessment of the future path of a company, we consider existing cultural issues, potential changes in regulation, societal matters and economic shifts. We conduct around 500 dedicated ESG engagements with companies around the world each year, in addition to the regular interaction between our investment teams and company leadership.

A key element to our process is actively voting at shareholder meetings. Effective use of our clients’ proxy votes is critically important, and we manage the voting rights of the shares entrusted to us in the same way as we would manage any other asset. We actively vote at approximately 8,000 company meetings each year, in 80 markets around the world. We maintain detailed voting policies in each region, based on a mixture of international standards of corporate governance and local market best practice. Our investment teams and investment stewardship specialists in the relevant region are responsible for implementing those policies, taking into account individual circumstances as well as our investor insights, based on their deep knowledge and experience of the country, sector and company.

Under our enhanced framework, we apply the lens of our five investment stewardship priorities in our voting decisions, and use votes, where appropriate, as a means to reinforce views expressed through our corporate engagement, in order to vote proxies in the best interest of our clients.

Our investment-led, expert-driven stewardship process has been developed over our extensive history of active management. It is backed by more than 1,000 investment professionals, based around the globe, and overseen by our investment stewardship team, which consistently monitors good practice to ensure we are achieving our aims, and creates feedback loops into our investment process.
Gaining deeper insights through wider data sets

The digitization of the global economy has opened up many new possibilities for collecting and processing data. At J.P. Morgan Asset Management, we have developed in-house technological capabilities to gain insights from a wide pool of unstructured data. Our capabilities include machine learning and natural language processing technology, which make it possible to gather and process multiple data sets into meaningful data at a scale, as well as artificial intelligence.

To highlight an example, our data science team has used natural language programming to pick up key phrases from anonymous reviews of companies by current and former employees on Glassdoor, a human resources website. We have begun to process, evaluate and apply this data to track companies’ progress on human capital management and corporate culture. This tool will allow us to employ a forward-looking approach to formulate views on specific companies and sectors, alongside third-party ESG data.

We are excited to be able to generate new ways of finding relevant information from unconventional, alternative data sources, enabling us to build a rounder view of companies and apply it not only for investment research and portfolio construction purposes but also for effective corporate engagement. We continue to develop these capabilities and look for opportunities to apply them to a broader range of strategies.
A FIDUCIARY
FOR 150 YEARS+
Commitment to considering the impact of each decision we make on client portfolios and performance

1,000+
INVESTMENT PROFESSIONALS
Engaging with companies globally

INVESTMENT-LED, EXPERT-DRIVEN

FOCUSED ON FINANCIAL MATERIALITY

ENGAGING
>500 ESG engagements with companies around the world each year

ACTIVELY VOTING
Across 80 markets around the world
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