June 25, 2020

Marketing Material

Sustainable success stories

Increasingly, Sustainable Development Goals help drive our global outlook for sector allocation.

- Over the last two years, we have integrated Sustainable Development Goals (SDGs) into our investment-decision-making process.
- This enables us to identify true SDG leaders, allowing us to capture investment opportunities while reducing risks.
- The sectors with the greatest SDG exposure are healthcare, technology and real estate.

Petra Pflaum
CIO for Responsible Investments

Sometimes, setting goals is the easy bit. The hard task is actually implementing them. Over the last two years, we have been examining how to integrate Sustainable Development Goals (SDGs) into our investment-decision-making approach for listed markets. This work has taken place against the backdrop of broader efforts to set aspirations and targets for economic development, social inclusion and environmental sustainability around the world.

Building on its previous Millennium Development Goals, the United Nations (UN) has set 17 SDGs, including Affordable and Clean Energy (SDG7), Climate Action (SDG13) and Good Health and Well-being (SDG3), the areas where the most prominent SDG investment opportunities are typically concentrated. Achieving the 17 Sustainable Development Goals require governments, businesses, investors and civil society to join together in taking action. Unlike the predecessor framework of the UN's Millennium Development Goals, the current SDG agenda explicitly calls on the private sector to deliver solutions. Many companies around the world have already started to incorporate sustainability into their business activities. For example, more than 12,000 companies are signatories to the UN Global Compact, officially launched in July 2000. This initiative encourages companies to follow ten principles in the areas of human rights, labor standards, environment and anti-corruption.

The SDGs take this commitment further, calling on companies to incorporate the SDGs into their business models, innovations and investments. In its 2017 "Better Business, Better World Report," the 35 chief executives and civil-society members of the Business and Sustainable Development Commission identified 60 major market opportunities across the food and agriculture, urban-development, energy and materials, and health and well-being sectors.[1] Examples of business opportunities are reducing food waste, new farm technologies, affordable housing, energy-efficient buildings and public transport or developing circular business models in big sectors.

Which is all well and good, but how can such thinking be integrated into a coherent investment approach? Having done so for quite a while, we can tell you that it is by no means straightforward. Our work included research originally published in April 2018 outlining our proprietary methodology as to how best to invest through an SDG lens.[2] During the current year, we have enhanced that methodology to deliver more granularity. This includes assessing not just issuers'

1 Business and sustainable Development Commission (January 2017). Better Business, Better World
2 https://www.dws.com/insights/global-research-institute/Integrating-UN-sustainable-development-goals-into-investment-portfolios/

positive contributions to the SDGs but also the ability to evaluate their negative contributions to the SDGs. With it, we believe that we can now deliver a more complete picture of an individual issuer's overall net contribution to the SDGs.

Our investment universe for this analysis is the MSCI AC World Index. Within this index, we assess where companies' product and services are contributing the most to specific SDGs. We find that company activities are typically clustered around five SDGs, namely Climate Action (including alternative energy and energy efficiency, SDG 13), Quality Education (SDG 4), Good Health and Well-being (SDG3) as well as Responsible Production & Consumption (including pollution prevention, SDG 12). However, within the sectors, the exposure to the different SDGs varies substantially.

From this analysis, we aim to identify true SDG leaders. This starts with identifying companies with revenues positively linked to SDGs. Furthermore, the firms thus identified face additional scrutiny through a risk-control layer. The layer is designed to identify true leaders, by removing issuers with any severe issues either in ESG quality, as measured by our DWS SynRating, or any norm violations or controversial sector involvement. True leaders, in other words, are companies with the highest net contribution (i.e. positive SDG contribution net of risk factors, including revenues from SDG-dubious activities).

Our analysis shows that most of the industries focus their efforts on contributing to SDG 13 (Climate Action). However, this reveals significant variations both within and across sectors. Notably, we can differentiate between positive to negligible contribution observed in the communication services, real-estate, materials and healthcare sectors on the one hand and negative contributions of the energy and consumer-staples sectors. By contrast, we have found that the only sectors contributing meaningfully to SDG 11 (Sustainable Cities & Communities) and SDG 3 (Good Health & Well-being) are the real-estate and healthcare sectors, respectively.

When examining the results from our in-depth analysis, we find that the sub-sectors that have the highest contribution to the SDGs are within healthcare, technology and real estate. By contrast, the sectors with the lowest share of "True SDG leaders" and "SDG leaders" are energy and communication services.

In spite of norm violations in product safety which penalizes the SDG rating across the healthcare sector, both the sub-sectors of pharmaceuticals, biotechnology & life sciences and health care equipment & services have high proportions of "true SDG leaders" and "SDG leaders" (81% and 82% of the market cap in their sub-sectors respectively).

In the IT sector, all three sub-sectors have a high proportion of SDG leaders. We find that IT products are typically deployed for energy-efficiency purposes and are associated with SDG13 (Climate Action); the same also applies to certain devices in the semiconductor sub-sector.

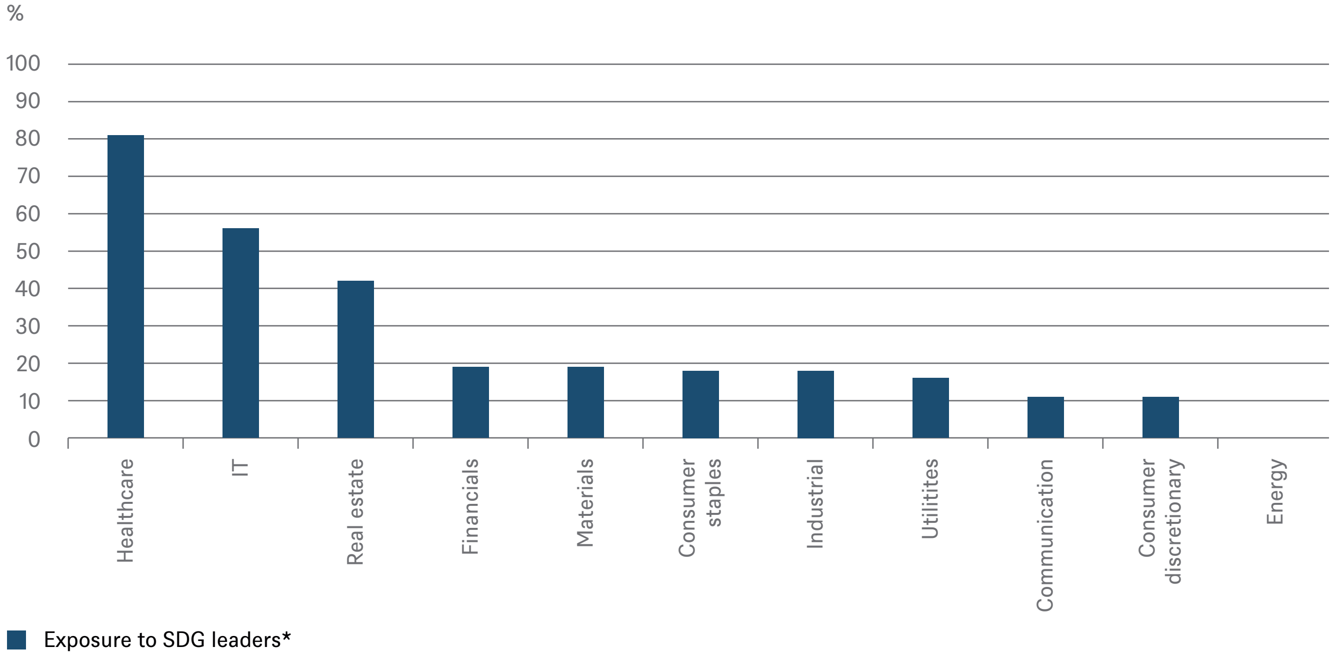
In the food and beverages sub-sector, we often observe a lower exposure to the Sustainable Development Goals than one might have expected. These companies are contributing to the SDGs, but nevertheless have disappointing ratings due to their net negative SDG contribution particularly to SDG 2 (Zero Hunger – Nutrition). Within SDG 2, one of the main targets that need to be achieved is the elimination of all forms of malnutrition by 2030 and to address the nutritional needs of society. That means some companies within the consumer-staples sector get punished when their SDG contribution is calculated. This includes companies producing soft drinks, confectionary, desserts, red-meat-based products and highly processed food products with critical levels of certain non-healthy nutrients (e.g. salt, sugar, fat). As a result, this negative impact typically offsets any positive contribution in the area of SDG 2, for example dairy products with limited processing or additives, unsweetened tea and staple foods such as rice.

Last but not least, most of the companies in the communication-services sector have little to no positive SDG revenue. As a result, and even though many companies may score highly in terms of ESG quality they will be marked down on an SDG basis, achieving an SDG rating of "D" at best. By contrast, SDG leaders are rated "A" or "B."

So, what does it all mean? Well, our analysis shows that the sectors with the greatest SDG exposure are healthcare, technology and real estate. In the sub-sector analysis, standouts include technology hardware and equipment, pharmaceuticals, biotechnology & life sciences, health-care equipment & services as well as the household and personal products companies. Beyond that, it illustrates the usefulness of having a formal framework to assess issuers across consistent criteria sets in deriving our global outlook for our sector-allocation and security-selection processes. By including ESG information in general and SDG information in particular, we aim to reduce our investment risks, capture investment opportunities and facilitate efforts to improve environmental and social challenges faced by society.

A DIFFERENT WAY TO THINK ABOUT TACTICAL AND STRATEGIC SECTOR ALLOCATION

Our proprietary SDG methodology reveals big variations in terms of which sectors have the highest proportion of SDG leaders



* Percentage share of companies with the two highest ratings, "A" or "B," on our proprietary SDG methodology
Source: DWS Investment GmbH, as of 6/17/20

GLOSSARY

The MSCI AC World Index captures large- and mid-cap companies across 23 developed- and 24 emerging-market countries.

CRC 076675 (06/2020)