Mark Dyki, CFA I Clement Chiang, CFA

QV Investors Inc.

Making the World a Better Place

Historical perceptions of successful equity investing are often associated solely with buying companies that make the most money. Little regard was given for how that money was made. As each decade passes, it grows exponentially more difficult for management teams to disassociate themselves from unethical actions by hiding behind traditional mindsets such as "business is business." Making money at any cost is much less acceptable today because investors are becoming increasingly aware of and concerned with environmental, humanitarian and reputational costs required to generate certain profits. Investing in accordance with Environmental, Social and Governance (ESG) criteria take these costs into consideration.

The environmental aspect of ESG quite obviously refers to the degree in which a company does its part to ensure the sustainability of the planet. Social criteria pertains to respecting key stakeholders that the company is involved with including, among others, employees, community members, customers and business associates. Governance broadly addresses the leadership structure of a company, and includes areas such as executive compensation, shareholder rights and the policies that ensure effective and ethical business practices. The number of ESG investment funds is growing at a rapid pace. According to a recent Bloomberg article, twice as many ESG funds were created in 2016 compared to 2013 and the trend is expected to continue this year.

People are often concerned that investing in ESG friendly companies will hinder returns. Most ESG investment funds have a fairly short history, but some of the longest running funds have performance that mirrors that of traditional funds. In 2015 Morgan Stanley published a comprehensive study illustrating that ESG funds achieved comparable returns to traditional funds while experiencing slightly less volatility on average.

The Globe and Mail recently posted its annual ranking of 242 companies on the TSX Composite based on corporate governance factors. QV equity holdings are found dispersed throughout the entire spectrum of rankings, but our average score is 4.5% better than the total average. At the margin, this illustrates a link between the quality companies we actively seek and strong governance. Efficiencies and increased profitability can be a welcomed by-product of ESG practices. Environmental focus pushes companies to invest in cleaner technology, which often reduces costs over time by requiring less input to achieve the desired result. Emphasizing the social aspect keeps employees more engaged and satisfied in their work, thus reducing turnover and increasing efficiency.

We are aware of the risks posed by firms that do not adhere to ESG best practices. Recognizing that these initial non-financial risks can quickly transform into real losses for our clients, we include them in our risk management process. We will not invest in businesses where significant ESG risks impede our ability to realize attractive risk-adjusted returns. At the very least, a company's disregard for ESG guidelines is cause for further research, but does not necessarily terminate our interest in the investment opportunity. Upon further review, the discovery of additional factors inciting a lack of confidence in the management team would likely halt our potential investment.

Possibly the greatest benefit of ESG focused investing is the ability to affect change. It is up to investment firms to decide whether or not to invest in companies with poor ESG practices. Firms that withhold investment due to ESG considerations can be vocal about which companies they will not invest in and why. Public awareness brings matters to the forefront and influences change. If enough firms withhold investment, the company may be impacted financially, which may force it to improve its practices in order to remain competitive. As investors, we are also able to positively influence our businesses by expressing our concerns to management during conference calls and meetings with executives. We do not believe that making money and making the world a better place are mutually exclusive endeavours.