Research & Engagement Brief

First Quarter 2017

Spring is the season when investors vote on items that management and shareholders place in U.S. company proxy statements for annual shareholder meetings. Ballot items run the gamut from management sponsored votes to elect directors and approve compensation plans to shareholder resolutions addressing climate change and human rights. The Department of Labor, which regulates private pension plans, and the Securities and Exchange Commission (SEC) have long recognized proxy voting as a fiduciary duty.

In other words, proxy votes matter.

PROXY VOTING AND SHAREHOLDER RIGHTS

Many of the world's largest financial institutions proclaim that environmental, social, and governance (ESG) issues such as climate change affect long-term shareholder value. Why then do too many of these same institutions often fail to support shareholder resolutions seeking best practice ESG policies? Walden is challenging investment managers to address this contradiction.

Walden and our clients filed shareholder resolutions seeking a review and report on proxy voting policies and practices related to climate change at **BlackRock** (the world's largest asset manager), **JPMorgan**, and **T. Rowe Price**, as well as two **Vanguard** U.S. equity index funds (the first time Walden has filed a proposal at a private mutual fund company). Walden withdrew the BlackRock proposal upon its publication of a new website statement on priorities for company engagement—including climate risk disclosure, board composition and diversity, among other strategic issues—and its commitment to "exercise our right to vote against management recommendations" when they do not observe progress. We also withdrew at JPMorgan after the company updated its approach to assessing climate change risk, including for proxy voting purposes. Vanguard revised its proxy voting guidelines, which could open the door to supporting some shareholder resolutions on environmental and social topics. Walden will examine the 2017 proxy voting records of these investment firms. If they were to support ESG proposals, the impact on company policies and practices could be transformative.

A trend toward virtual-only annual general meetings (AGMs) is threatening the tradition of in-person AGMs. In 2016, 154 companies avoided physical meetings, a seven-fold increase from five years ago, according to Broadridge Financial Solutions. In March, *The New York Time*s quoted Walden's Tim Smith, "These are not management's meetings, they are the meetings of the owners of the company… [Online-only events give company officials] tremendous power over controlling, censoring, and really limiting the engagement of share owners with the board and management." While we understand that there are good reasons to have a virtual capability, we do not believe this should come at the expense of a once-a-year opportunity for shareholders to communicate directly with management and directors. Many investors agree. The Council of Institutional Investors calls for virtual meetings to be a supplement to, rather than substitute for, physical meetings. New York City pension funds announced plans to vote against directors on corporate governance committees if they abandon traditional AGMs.

We are concerned as well by concerted efforts of the U.S. Chamber of Commerce and the Business Roundtable (BRT) to curtail the rights of shareholders to file proxy resolutions. Walden is a leader in an investor coalition that is pushing back. For example, along with the California pension CalSTRS, we have written numerous corporate leaders on sustainability who are members of BRT to urge their support for a constructive shareholder resolution process. Walden commits to doing our part to preserve a process that, over decades, has had a significant, positive impact on corporate policies and practices.

CLIMATE CHANGE

Walden's primary focus of engagement on climate change is to encourage companies to adopt science-based greenhouse gas (GHG) reduction goals (defined currently as global emissions reduction of 55% by 2050 and net zero emissions before 2100). Along with the Interfaith Center on Corporate Responsibility, Walden is leading a collaborative initiative involving 60 investors and more than 100 companies on science-based targets (SBT), of which two dozen are represented in our clients' portfolios. **PepsiCo** established a SBT that includes its entire value chain, among the first companies to do so. **Tiffany**, which made a public commitment in 2015 to carbon neutrality by 2050, is now developing a SBT that will incorporate emissions within its entire value chain. **Hubbell** completed baseline research on energy efficiency and hopes to have a goal in place by mid-year. At **Johnson & Johnson**'s request, Walden provided detailed input on best practices with respect to corporate climate change policies. Lastly, our resolution asking **Emerson Electric** to establish GHG goals received shareholder support of 34% at its annual meeting in February.

SUSTAINABILITY REPORTING

Walden's two resolutions seeking comprehensive ESG disclosure were withdrawn after reaching agreements with both companies. Late last year **Nordson** committed to develop annual sustainability reporting. Since then, Nordson hired consultant Brown Flynn, who interviewed Walden as part of a stakeholder outreach process to identify material ESG factors to include in its first ESG report. **Oceaneering** committed to expand qualitative disclosure on its website by the end of 2017, increase quantitative disclosures over time, and update reporting on at least an annual basis. Walden also provided substantial feedback on **BB&T**'s inaugural ESG report.

EQUAL OPPORTUNITY

Constructive discussions with **Omnicom** led to enhanced disclosure of workforce diversity metrics and progress, resulting in the withdrawal of Walden's shareholder resolution addressing equal employment opportunity (EEO) disclosure. Unfortunately, our engagement with North Carolina women's fashion retailer **Cato** encouraging best practice EEO policies—policies that include explicit protections for LGBT employees—was hampered by the company's successful request to the SEC for permission to omit our shareholder proposal from the proxy statement. We continue to explore opportunities to make the case to Cato of the many advantages of inclusive EEO policies. We hope that media attention in NC to our proposal encourages management to rethink its approach. Conversely, Walden successfully withdrew a similar resolution at **Netgear**.

Walden Portfolio Carbon Footprints

What impact do your investments have on climate change? Will climate change have an impact on your investments?

As an investment manager and global citizen, we need to ponder these questions. Walden believes climate change is the world's foremost environmental challenge—it may also be the biggest investment theme of our generation.

One way to think about the risks of climate change to an investment portfolio is by measuring the carbon footprint of the portfolio. In previous years, Walden has published portfolio carbon footprints for representative large cap core equity portfolios, including a fossil fuel free (FFF) portfolio.[i] This year, we added a representative small cap portfolio.

We are pleased to report that on this measure all three portfolios are relatively well positioned. The Walden portfolios are more than twice as carbon efficient than their respective benchmarks (see table). Stock selection is the biggest driver of relative performance. The largest contributors to the Walden carbon footprint are materials and industrial companies.

This tool has limitations. Footprint methodologies of Walden and independent providers do not currently include value chain emissions. For most companies, value chain emissions dwarf emissions from direct operations. The footprint also gives no indication of industry dynamics, which may help predict winners and losers, in a scenario in which there is a price on carbon. The underlying data do not reflect commitments companies may have made to reduce their carbon footprints going forward, or whether a company's products are positive or negative from a climate perspective. And data availability and quality continues to be a concern. To wit: Less than five percent of small cap companies disclose their emissions, necessitating estimates based on industry market share.

Total Footprint (tCO_2e/$million invested)	**Small Cap**	**Large Cap**	**FFF Large Cap**
Walden Portfolio	49	39	42
Benchmark	174	113	113
Carbon Intensity (*relative to benchmark*)	**-72%**	**-66%**	**-63%**
Attribution: Sector allocation*	-2	-22	-40
Attribution: Stock selection*	-128	-67	-78
#1 contributing stock	AIRM	COP	APD
#2 contributing stock	CCC	PX	PX
#3 contributing stock	SLGN	UNP	UNP

Source: Boston Trust, MSCI
Note: Less than 5% of the small cap benchmark, by market value, discloses their emissions. Approximately 70% of the large cap core and FFF benchmark, by market value, disclose their emissions. Walden references MSCI estimates for some additional firms.
*Allocation and selection do not sum to the difference between the absolute portfolio and benchmark footprints due to interaction. Interaction measures the combined impact of a manager's allocation and stock selection within a sector.

Nonetheless, using the carbon footprint as an indicator, Walden portfolios appear to be better positioned to weather the impact of global climate change. We caution against reading too much into the results of the carbon footprint, and continue to refine our thinking on how to create robust portfolios that can withstand, and potentially prosper, in the face of climate risk.

[i] In contrast to previous years when outside data providers did the calculation, Walden produced these carbon footprints utilizing data provided by MSCI. Walden's February 2016 publication, "The Value of Footprints," provides previous portfolio footprints as well as a more comprehensive analysis of the measurement tool.