

TRANSCRIPT: EPISODE 293

7 December 2023 (pre-recorded 20 November 2023)

Below is a transcript of the episode, modified for your reading pleasure. Please check the corresponding audio before quoting in print, as it may contain small errors. Please remember we've been discussing individual companies to bring investing to life for you. It's not a recommendation to buy or sell. The fund may or may not still hold these companies at your time of listening. For more information on the people and ideas in the episode, see the links at the bottom of the post.

[INTRODUCTION]

Staci West (SW): Welcome back to the Investing on the go podcast brought to you by FundCalibre. To mark Human Rights Day on the 10th of December we delve into the unique aspects of addressing human rights within a traditional ESG framework and why Amati Global Investors does things slightly differently from their peers.

I'm Staci West, and today I've been joined by Dr. Paul Jourdan, CEO of Amati Global Investors. Paul, thanks for joining me.

Dr. Paul Jordan (PJ): Hi Staci, a great pleasure to be with you, thank you.

[INTERVIEW]

SW: Today we're going to be talking about something slightly different, which is Amati's ESGH approach. Now, the first part of that should sound familiar to our listeners, ESG or environmental, social and governance factors, but the H is probably new and that stands for Human Rights which is one of these key areas of your analysis, and one that you feel should be included for any responsible kind of investment framework. So, let's start there.

There's any number of socially responsible ethical options in fund management today, regardless of what you want call it, so certainly more than there was in the nineties at least, but do you think that they're missing a trick by not having this 'H' - is that what prompted you?

PJ: Well, I wouldn't call it a trick. I think it's interesting. I think over the last 25 years since I've been managing UK smaller company funds, I had to kind of learn the hard way in many ways about human rights.

The reason why it's worth adding on to ESG is it presents a separate category of investment risk, and it's one that I think is profoundly important to pay attention to. And I think the fact that we've paid so little attention to it as an investment community over the last 25 years has been to our great cost. And there are some major blind spots in the way that we run our lives and our economy which completely ignore some fantastically important human rights abuses that go on in our supply chains.

TRANSCRIPT: EPISODE 293

And the fact that we ignore them actually, is devastating for us in the end. It has terrible consequences, which do come back and bite us.

And a lot of the ideas I've got about this topic I picked up only in 2016 when I came across a man called [Leif] Wenar who was a professor at King's College London when I met him, and he'd just published a book called Blood Oil: Tyrants, Violence and the Rules that Run the World. And it is really a book about the oil curse - or I call the natural resources curse - and he uses this term called blowback, which is an old CIA term actually, when if you really screw up in a country, it comes and bites you because things go sufficiently badly wrong that they then have major implications and they bite you at a time you don't expect it, [when] you've turned a blind eye to it.

And of course if I'd said this back in 2016, most people would have said, yeah, yeah, but look, you know, the world's a peaceful place, how can you be right about this? The fact that we don't need to pay any attention to where we buy our oil and gas from, can't matter that much, can it? And now of course, it's just blindingly obvious that one of the most upsetting features of the last two years has been Russia's invasion of Ukraine, pretty much entirely funded by purchases of oil and gas by western economies. And obviously China buys some too, but it's really western economies that have funded that war primarily and still do. And we've imposed sanctions, but they're very ineffective now India's buying a lot of the oil; we buy it without really knowing it. And we've never tried to control the trade in oil and gas from a human rights point of view. And I think it's been to our huge cost.

But coming back to standing as an investor actually considering, and as an investor, I'd say human rights impacts in a number of areas, but by far the biggest is in the international trade in commodities and oil and gas is the most valuable commodity in the world still. So, that's the most important trade, and it's the trade that funds the most oppression and is the most destructive and violent in its consequences. And we need to pay attention to it.

And I just think it's hugely overdue.

And in some ways we've allowed the climate crisis which, of course, is profound and extremely difficult to deal with, we've allowed it to completely swamp out and cover up the issues of human rights.

SW: Well, let's talk about oil and gas then a little bit more, because oil and gas kind of, let's say, is a controversial sector for when you're talking about an ethical or sustainable - and we could throw in mining and commodities, nuclear energy, et cetera, into that bucket, but ironically, these things are necessary for our transition to net zero.

So, maybe if you could just explain what systems do you have in place that you are making sure that you are considering ESG and human rights when you're looking at this sector? How do you balance the two?

TRANSCRIPT: EPISODE 293

PJ: First of all, in terms of systems, and we will maybe come back to this, we don't have a magic system that comes up with the answers here. What we have is a framework, an ethical framework, that we operate in, and an understanding of what is the role of ESGH risk analysis in investment.

And I didn't want to put out something hastily that I then realised wasn't going to stand the test of time or to backtrack from or change because some world event has just revealed that it wasn't well enough thought through. And I think if you end up changing your ESGH stance because something terrible's happened, then you just didn't think hard enough about it at the beginning because terrible stuff's happening all the time.

So, for us, the study of ESGH is really about risk analysis for investment.

It's not primarily about making a moral judgment about things and saying, oh, we only want this, so let's do our study to see whether it's of that type and if it's of that type, it's not a kind of 'yes or no' decision box — with the exception of human rights, which for me, is a bit of a 'yes or no' decision box.

And I think actually it is really incumbent on fund managers to explain to their investors very, very carefully where their real 'yes and no' decision boxes are. Because if you're going to exclude something on principle, then you are potentially limiting your fund investors' returns by doing that. So, they need to be very clear about where you're going to do that and where you're not going to do that. And for us that exclusionary principle is really a function of the human rights element of this.

The other elements are, from our perspective, just way more complicated. And it's really about studying the risks and the trade-offs involved in industrial policy, in the move towards net zero, in governance factors; you know, these are all about trade-offs. They're not really so much about big moral positions: you tend to end up in a very difficult place if you try to make them like that. But, as investors, to pay attention to the risks that they throw up is really important.

So, the work we do on ESGH, it does get written down and it's documented. We have a template [that] we borrowed from quite a few sources on thinking through, well, what are the things you really want us think about in relation to a company in order to understand each of these risks? And we produce our own piece of research on it.

It means we spend time looking at what the company publishes. I mean, the volume of information published by companies about ESGH risk factors in sustainability reports has gone up probably by a hundred-fold in the last three years. So the way we categorise ESGH as being about the study of non-financial risk in a company. And that's how we talk about it and think about it. And it's clearly an integral part of the investment process.

So, it's also very important for us that this is something that the fund managers are involved in leading, on getting into the decision-making process and pairing it up with an understanding of

TRANSCRIPT: EPISODE 293

exactly what the company does, who its management are, what are they trying to achieve, and weighing up all of these risk factors in that context. So, we're really not believers in turning this into some kind of systematic 'yes or no', or this company qualifies / this one doesn't qualify for XYZ criteria. I think that's - in most cases - missing the point. It is about the study of non-financial risk as part of your investment decision making.

SW: So, how would that apply to, say, a natural resources company, so oil/gas/mining? Is there a checklist within that sector for companies that is looking at beyond just maybe what you would naturally kind of associate so that you are including the human rights side of things? Or is the human rights aspect of those companies falling within, you know, supply chains, human capital, et cetera? Or is it something else?

PJ: The natural resources sector is a really good place to start with all of this because it throws everything into quite sharp relief. So our starting point would be, in the whole of the natural resources space, is that we are not about to enter a world where we don't need any of these things. And that includes oil and gas. And however successfully we move to net zero, even in the most optimistic scenarios, we're still going to be using oil and gas at quite big scale for another 50 years in all probability, if even you were to reach net zero in 2050, which is looking very optimistic at the moment, we're still going to be using it. And the reason it's called net zero, of course, is because it's to do with offsets.

But I think one of our roles as fund managers has to be to sift the information, to study the propositions put forward, and to end up with realistic judgements and assessments that are not based on fantasies or hope, but assessments that are based on real world outcomes. And so there does have to be a big test applied to anybody intervening in this area is, are you actually just doing more harm than good?

And I think in debates around this topic, that that is often underestimated how much harm can be done by drifting into fantasy of some kind. So, these are all commodities that we need and we're going to carry on needing. So, that's not the question; we're not saying to ourselves, 'should we just be excluding all of these sectors?' — that would be utterly irrational from our perspective/

So, the questions then become the human rights question, which is where are these being taken from? And is that being done with adequate consent of the populations where they're coming from?

And in order to understand that question of why that's so important from our perspective is you need some understanding of the way the resources curse works; that when a country becomes sufficiently dominated by an individual or a family or a powerful group who basically can capture all of the revenue from the natural resources stream, that you're selling the natural resources overseas, you're doing a deal with a foreign company, you get incredibly rich on the back of it - that money provides the means of destroying all opposition locally. And that's step one, and steps two and three are much worse as we can see in what's going on in Russia.

TRANSCRIPT: EPISODE 293

But step one is you develop a kind of impregnable fortress of oppression, and from there it just can only get worse. And once that scenario is embedded, then any trade in natural resources from that country is actually quite a profound breach of the human rights of the citizens of that country.

And in the paper I've written, I explained some legal basis for that based on the International Covenant of Human Rights. And you know, I think there's a very good case to make for that. But let's say that even [if] that wasn't true, and I think it is true, but let's say it wasn't, you know, I think it's not difficult to understand the ethics of that. I am certainly very profoundly uncomfortable about making a profit on the back of that. And in any case, then there's the phenomenon of blowback. So, it is profoundly against our strategic interest to do that. So, that's where the human rights piece comes in. And that in a way, it is the main kind of 'yes or no' box.

If you fall below a certain standard of - and I should say that also in this process, we set the bar deliberately very low, we're not looking for perfection, we're not looking for brilliant democracies all over the world. We're looking for something which isn't horrific. And so you set the bar low because investment naturally drives very positive consequences. And in developing economies, outside investment is absolutely crucial. You don't want to deny that in cases where it might actually do a lot of good, but you should certainly deny it in cases where it can't possibly do any good and the harm it does will massively outweigh any positive consequences. So, that's that box.

And then looking beyond that with oil and gas and mining companies, then the ESG questions kick in and there's a whole load of very important questions to ask. So, actually paying attention, it's almost like the poster child in some ways for ESG in natural resources, because the difference is so obvious between good and bad. And those are the kinds of things we look at. And looking to invest in companies with really good practices and having active dialogue with companies so that we're involved in the establishment of that practice. And either learn from it or pass on knowledge from other companies who may have had some good ideas in the past that are relevant.

SW: As you said, natural resources is a great example of environmental factors that you're looking at because it's very obvious. But on the social side of things is where I would typically put human rights, maybe governance as well. But given human rights has its own place in your kind of framework, what other social aspects are you looking at when you're looking at all funds, not just natural resources?

PJ: So, the very first part of building the conceptual framework here is to ask ourselves, well, in terms of what are this company's inputs and what are their outputs? So, what are all the things going into this company and what are all the things coming out? And normally it's only a few. And so that then gives you quite a good clue over what one should be looking at in terms of each of the factors, but certainly E&S [environmental and social factors].

And in terms of social factors, one that's common to every company is employment practices, is a big part of your social impact - what are they like? And that features in every sustainability report

TRANSCRIPT: EPISODE 293

these days, it's possible to get quite a lot of information about the company's employment practices. People, analysts will quite often use data like that can be obtained from companies like Glassdoor. You're looking at whatever bits of information you can find; press reports, if there's been any controversies [with] an employee in a workforce.

And then in terms of the inputs and outputs, you'd be tracing them to ask a few more questions about them. Supply chains of course [are] really important. It's still surprisingly difficult to really analyse supply chains with any great confidence. There are some well-known supply chain issues.

Long time ago, we did a bit of study and we were shareholders for a while in a company called Boohoo, which then had a massive controversy you know fairly early on. We were uncomfortable about it even when we bought it. But then, we started sending the company questions about their supply chains and getting answers that were just kind of not really good enough. And it was enough to cause us to sell the shares in the company because we just felt we couldn't really vouch for the supply chains. And everybody knows in fashion and retail, supply chains are a really big issue and they tend to be very opaque. And there's a lot of bad practice that goes on. So, you need ways of building up your confidence in it. So, manufacturing supply chains are a big deal.

There's the issue of properly measuring climate change factors, and there there's been a lot of emphasis in the last couple of years amongst investors about reporting on climate change numbers. And I do treat all of this with quite a big pinch of salt at the moment. Partly because often you just end up comparing apples with oranges; in fact, almost the whole time you do.

So, the numbers don't really allow you to make very good comparisons other than with themselves. So over time, if a company chooses to measure itself one way, you can look at it a year later and say, well, how did you do? And then there's the whole issue about scope one, two and three; and lots of emissions one might properly care about are in scope three, but they don't really get counted very much at the moment. And they're very difficult. Scope three covers just a massive range of very diverse factors, some of which are hugely important, some of which less so. So that's all problematic, but we look at it, try to analyse it as best we can but I'd be very wary of trumpeting any of that too hard.

SW: Well, you've mentioned a few things there about when you're speaking to companies, which was going to be my next question of: what is top of your agenda when you are engaging with companies? Or does it potentially vary with who you're talking about? And I guess my other question, given your background with smaller companies, is when you're engaging with smaller companies, is it different? Are there different challenges than when you are engaging with some of the more established names?

PJ: Yeah, I think the conversation is completely different depending on the size of company and what it's doing. And there's no point talking to a very small company really about their carbon

TRANSCRIPT: EPISODE 293

emissions because actually, particularly if it's like a professional services business or something where the carbon emissions are fractional anyway, it's just not really the point.

Which is why what I'd then be saying, you then want to talk about what's really going to make the most difference and when you have a strategic discussion with a business, you want to be focused on things in order of importance. And that needs to be true of ESGH factors as well. And it's also why I think fund managers need to be involved in that process, because if you know a business well commercially, then you are in a position to say, well, actually these are the things that are the most important ones to focus on. And some other factors that might be really important for the box ticking exercise of getting the right score in some platform for ESG that shouldn't be driving the agenda in any way. It should be driven by priority of where you can have the biggest effect. And small companies have more limited resources. You really don't want to bring about things that cause them to spend lots of money on things which are irrelevant.

And you know, on the other hand, I get wary if I see companies doing ESG window dressing and presenting stuff to make them look good when I know perfectly well that hasn't really made any difference to anything. So keeping the discussion real.

And I think one of the problems with the ESG having gained so much momentum so quickly is that it encouraged a bit too much window dressing and too much focusing away from real priorities and away from the idea of businesses have to be commercial entities and they need to think about value for money and spending their resources on things that are actually going to matter, and not just getting caught up in fashion or pleasing people for the sake of it, and expensively, for things that don't really change very much.

SW: Well, we've kind of walked through various different parts of ESG, which as I said, hopefully our listeners are well versed in already, but the real differentiator as we've alluded to throughout, is the addition of human rights. So, maybe before we get into exactly what that means, you could just give us a brief overview of when you are talking about human rights, what exactly are you referencing?

I think for most people, human rights tends to just kind of almost equate to modern day slavery, and they tend to view them as one and the same, but there is a lot of different elements when we're talking about human rights, especially when it comes to what you are talking about with companies. So, maybe before we dig a little bit deeper into it, you could just give us an overview of when you are talking about human rights in this ESGH framework, what does that mean to you?

PJ: So, yeah, I think of the four factors - and the reason why we separate human rights into a separate category really is - ESG, they're all factors where you can be bad or you can be very good. And so if you do ESG really well as a company, you actually achieve something which can boost the company's rating quite rightly because you're making a stronger business because you've dealt with those factors really well. I think with human rights, that's not really the case.

TRANSCRIPT: EPISODE 293

So human rights can only be a negative, really. And the way we score our [ESG] factors is 1 - 10, but human rights is 0 - 5 because 5, which for us, that means it's not going to have any market impact, it's market neutral; that's as good as you can get, so, you can do no harm in human rights.

But you are right, the topic of conversation with human rights tends to focus on modern day slavery. But for us, there are two factors: modern day slavery is a big issue, very difficult to analyse, difficult to see, because nobody's going to tell you about it voluntarily, you have to dig really hard if you actually want to know about it. Often company management teams will be almost deliberately naive about it because they don't want to know either, if there is a problem. But the other one is to do with the natural resources curse, which is different to that. You could say it's overlapping, but it is different. And that's much more about the level of freedom in a country.

So actually, if we were dealing with a company operating in an emerging market, I would probably as a matter of routine, go and have a look at the reports on the website at Freedom House, which is a very useful free resource. Everyone can go and do this incredibly easily because that will very quickly tell you about the information you need to bear in mind when you're looking at operations in that country.

So, in terms of our own template, under the human rights section, we'll list the areas of operation of a company that have the three lowest scores on Freedom House, because those are the territories we'll focus on. And then we'll go and we'll consider, well what are the risks involved in this? What are the risks of - let's say it's not a natural resources company so the natural resources curse is not really the question - but what are the risks of abuses of other kinds happening? Whether it's the risk of losing your assets or the risk of very poor employment practices, slave labor being the most extreme of those but there's a whole load of shades of grey in the pathway to slave labour. And are these risks that we can properly factor in to an investment case?

So, that is just sort of paying attention to territories where you have very low levels of freedom to then ask more questions. And, it's not to say that that's where all the bad practices happen, but you're definitely at higher risk of slavery or indentured labour in economies with low levels of freedom. Of course it can happen in some other countries too.

SW: And so what are some of the biggest challenges that you found in integrating ESGH approach across your funds? Has there been one that sticks out or has it been something that's almost been so ingrained in your approach that it was just about having that set framework kind of formalised, if you will and not, you know, overhauls didn't need to be made?

PJ: Yeah, I think it was a challenge to think it all through. And yeah, I would say that I always had ideas about how I wanted to operate as a fund manager and certainly as I developed this the natural resources approach, which I call 'clean trade' because that's the name coined by Leif Wenar who wrote the book which in relation to natural resources, a long time before I gradually started writing it down.

TRANSCRIPT: EPISODE 293

What's been good is that I've found that all of the fund managers at Amati have very quickly bought into the ideas that we use and the way we do things. I've not had to twist anybody's arm over it. It's made sense to people and I think we're trying to operate with a framework that just makes sense to most of our managers. That's really what we're after.

So, it shouldn't be really something going against the grain the whole time. It's not designed to be non-commercial, but it is designed to be effective. I'd say we've gone from that phase of thinking it all through, starting to document, going through the process almost phase one is really dealing with this hugely increased volume of information that's now being published by companies, but then not getting totally caught up in that, because obviously that's written from the perspective of aren't we brilliant as a company?

That's the case for the defence, but where do you find the case for the prosecution?

That's always a bit more difficult and they have to go digging into all kinds of sources, all kinds of sources online. And we've actually been helping with the development of a company who specialise in tapping all kinds of small little, lesser-known media source sources, information across the world, local papers, local journals all kinds of publications. It is called Auquan, and I happened to have a conversation with the founder about a few years ago [and] thought, well actually, she's really on something interesting here. We should try and help develop this into something fund managers can really use.

And so we use that as a way of just trawling very large numbers of data points, looking for the case for the prosecution is what we're after; the things which the companies won't publish but might appear somewhere online, in a little-known source in another language. How are we going to find that? So, we have a tool which is still a work in progress to a degree, but it's come a long way to help us with that. And, so that's where we've got to sort of looking. It's sort of systematising that side of things. But that is challenging.

SW: And do you think that other asset managers will follow suit in taking a closer look at human rights, but also as you said, kind of stepping back from maybe an over-emphasis on climate change when there's so many other things that we can also be looking at and addressing within ESGH?

PJ: Yeah, I think so. And in some ways, we had a bit of a kind of ESG mania in 2021 perhaps, and the world has stepped back quite a long way from that. While in some ways that was very positive and that represented a big change of mindset in the investment community, the problem with it was, it also brought in some pretty unrealistic thinking and some quite muddle-headed thinking as well. And that hasn't done the cause a huge number of favours.

What you need is you need clarity; you need things that are widely agreed that most fund managers can buy into very easily, where there isn't a strong sense of, well this is just hugely in conflict with the commercial business of investing. And it doesn't need to be and it shouldn't be. So, I think

TRANSCRIPT: EPISODE 293

where we are moving to now is actually quite a good place with all of that, where there isn't quite the same sort of fever-pitched, almost sort of evangelical zeal to ESG. It's becoming better considered. I personally don't favour naming funds after ESG or after particular themes like sustainability or whatever it was, because I don't think you should need to label funds. I think it should be just taken as read that if you're a good fund manager, you think about all of these risks and they're part of your process and that should be enough and that should be how we operate.

SW: We've talked through quite a lot today in respect to ESGH. And my final question for you is maybe leaving on a bit of a high note of: do you have an example that you can share where you have been successful in advocating for a positive change? Or where you've really seen this process kind of get a gold star from your point of view in one of the funds?

PJ: Well, that is a good question. I think in terms of corporate engagements we have lots of corporate engagements with companies. In terms of the smaller companies work that we do where we're very, very often behind the scenes, talking to companies about strategy, talking, you know, figuring out what's going well, what's not going well, what are the things that can make a difference? And that's just kind of routine and part of our work.

I think, even if we had some of those conversations from our point of view produce a great outcome and we feel well pat ourselves on the back and we've been good over that, I probably wouldn't say because I just don't really think you can ever take that kind of credit as a fund manager. The people who deserve the credit for the companies are primarily the people that run them and create them and work in them. We are there to sort of assist along that journey

SW: Because of the ESGH framework, have you had to disinvest in something because it's flagged up some concerns. I guess one example that we kind of already talked about was potentially Boohoo - you had concerns over the supply chain that they couldn't address - but something along those lines where the framework actually caused a positive change for a fund?

PJ: Yeah, I mean, I suppose when the war in Ukraine started, we had no investments that had anything to do with Russia because we'd have pretty systematically avoided that kind of exposure over the past good number of years before then. Well on the positive side, I can think of, this is very relevant to our mining fund [WS Amati Strategic Metals] and our mining fund have a big investment in a Brazilian lithium company. And that's an absolutely poster child for really excellent environmental management. And the company's done very well on the back of it and it's one of the first of the sort of new lithium mines to get into production. It's called Sigma Lithium. It's quite a significant company now. And yeah, the environmental policies and practices they adopted in building that mine were exemplary. So, that's on the positive side.

On the negative side, we had one that the mining team had an investment in a company that had assets in Africa, and they then acquired an asset, I think it was in South Sudan. And South Sudan wouldn't have met our criteria from a human rights point of view. So they sold out of that company.

TRANSCRIPT: EPISODE 293

I can't tell you whether that was a good or bad thing from an economic point of view, but my experience is if you go wandering into natural resource assets in countries where the level of freedom is extremely poor, it's very rare that you come out of it well, so I'm pretty happy that we don't do that.

SW: Well, that has been so incredibly interesting. So, thank you very much for your time and walking us through quite a lot of the ESGH that you do at Amati. It's very fascinating and incredibly robust, so thank you so much for your time.

PJ: Thank you very much, that was wonderful, thanks Staci.

SW: To learn more about Amati's approach to ESGH, I highly recommend the two in-depth documents written by Paul, which are attached in the show notes and available on our website at fundcalibre.com. And please don't forget to subscribe to the Investing on to go podcast, available wherever you get your podcasts.