

An aerial photograph of Central Park in New York City, showing lush green trees and a winding path. In the background, the dense Manhattan skyline is visible under a cloudy sky. The image is used as a background for the top half of the report cover.

Federated Hermes Sustainable Global Equity

Quarterly Report
Q2 2022

**Federated
Hermes** 
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Introduction

Welcome to our Sustainable Global Equities quarterly update.

In this issue we consider the role of the building and construction sector in the fight against climate change.

Despite its outsize contribution to greenhouse gas emissions, and the relative cost effectiveness of the solutions proposed to mitigate them, it's fair to say the sector doesn't always receive the attention it deserves.

Yet this could be about to change. A rising global population, technological innovation and increased adoption of building codes in the wake of the Paris Agreement could all herald a transformation in the way the sector addresses its carbon footprint. As ever, the challenge for sustainable investors is to identify not just the companies best placed to drive that change – but also to profitably engage with companies who could do more.

As ever, we include a run-down of the strategy's environmental and engagement data and we round off this issue with two case studies illustrating how we invest in practice.

Our vision for sustainable long-term investing in global equities

Federated Hermes Sustainable Global Equity is a high conviction, fundamental strategy targeting sustainable companies: profitable businesses whose products, operations and activities help create a more sustainable future. Our ability to identify these investment opportunities – and engage companies to sustain and strengthen their positive actions – is reinforced by best-in-class ESG and stewardship integration. Through this approach, we seek long-term transformative change and financial outperformance.

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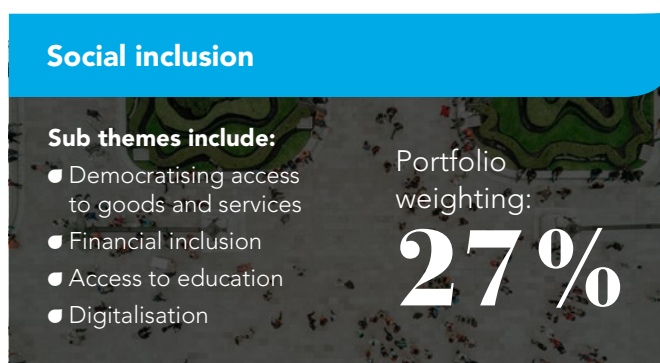
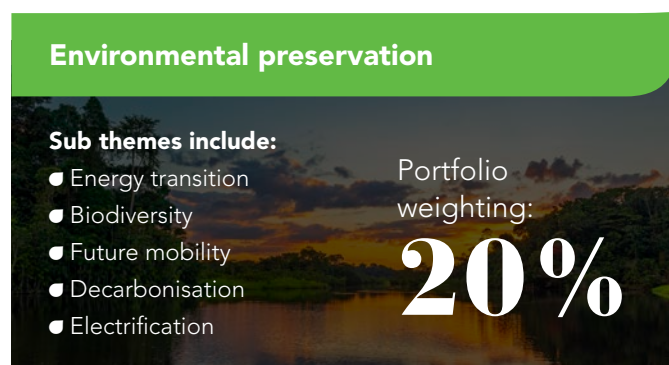
SECTION 1

Sustainable Global Equity: This quarter's highlights

Exposure to sustainability themes

All portfolio holdings fit into one or more of our four investible themes, each of which consists of a number of sub-verticals.




As at 31 March 2022, exposure to these themes was as follows:



Source: Federated Hermes, as at 31 March 2022. The sub themes listed above are not an exhaustive list. The portfolio weightings are subject to change.

Environmental footprint

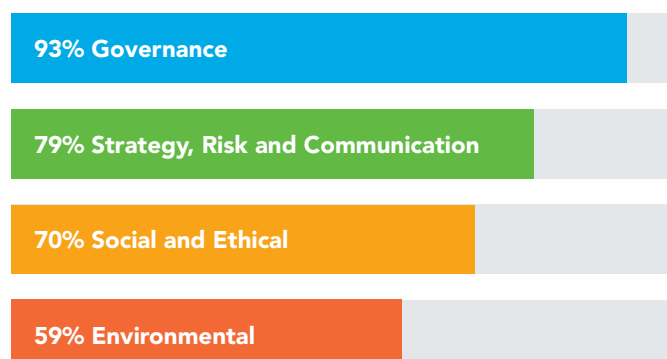
The strategy aims to have a smaller environmental footprint than the benchmark, the MSCI All Country World Index. As at 31 March 2022, the portfolio's CO₂, water and waste footprint measured as follows:

	Portfolio (tonnes per \$m invested)	Benchmark (tonnes per \$m invested)
 CO₂ footprint (scope 1, 2 & 3)	79.5	157.7
 Waste footprint	3.1	11.3
	Portfolio (m³ per \$m invested)	Benchmark (m³ per \$m invested)
 Water footprint	6.4k	22.4k

Source: TruCost, Federated Hermes as at 31 March 2022.

Engagement themes

As a percentage of the strategy's AUM, the team's engagement efforts for the last 12 months breakdown as follows:



Source: Federated Hermes 31 March 2022

The strategy aims to have a smaller environmental footprint than the benchmark, the MSCI All Country World Index.



Portfolio positioning

As at 31 March 2022, the portfolio's top 10 active positions were as follows:

Holding	Portfolio active weight (%)*
Mastercard	3.4
Microsoft	3.2
Novo-Nordisk	3.0
Deere & Co	2.9
Thermo Fisher	2.9
Adobe	2.8
ASML	2.8
Lonza Group	2.8
Costco	2.8
Wex	2.7

Source: Federated Hermes

*The portfolio active weight is calculated as the strategy weight minus the benchmark weight.

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SECTION 2 - THEMATIC FOCUS

The best kept secret in climate change mitigation?

Look away from the headlines and there's a less-talked-about sector that can make a big contribution to CO₂ reductions, says Martin Todd, manager of the Federated Hermes Sustainable Global Equity strategy.

Fast reading:

- While the transportation and industrials sectors get the most attention when it comes to cutting carbon emissions, buildings and the built environment offer the greatest and most cost-effective reduction opportunities.
- Progress has been encouraging, with building codes and technological innovation helping to lead the way towards a lower carbon footprint – but more needs to be done.

When we think of solutions to climate change we tend to think of the headline acts: electric vehicles, the energy storage revolution, smart cities, the rise of renewables. These are the glamour topics that seem to enjoy the biggest audience when it comes to decarbonisation.

But away from the main stage, there's another act that has a big part to play. It's not often that we think of buildings and the built environment as being the 'rock stars' of climate change mitigation – but that's exactly what they are.

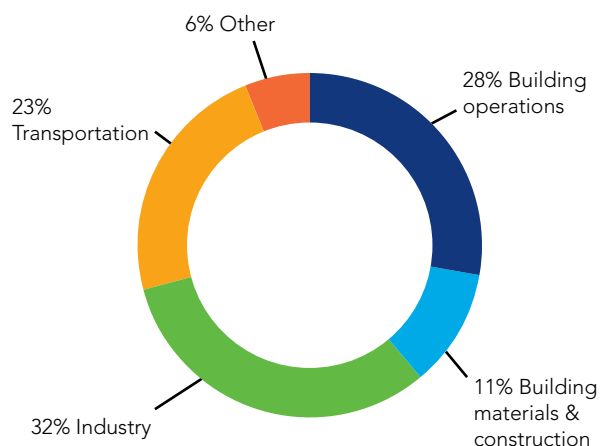
To understand why, consider the following from the International Energy Agency (IEA). Buildings, according to the IEA, represent nearly 40% of global energy-related carbon-dioxide emissions. That's considerably more than the entire transport sector (which accounts for some 23% of emissions) and more even than industry (accounting for 32%).

But there's more. Not only do buildings account for a significant portion of CO₂ emissions, they also offer some of the most cost-effective opportunities to mitigate them.

The European Commission has identified roughly 75% of the EU building stock as being energy inefficient. So, in Europe alone, that equates to a lot of wasted energy – all of which could be addressed by renovating existing building stock and building better when it comes to new construction.

Indeed, the Intergovernmental Panel on Climate Change (IPCC) suggests that of all the emissions reductions possible through 2030, buildings are by far the largest source of low-cost opportunities. Taken together they could be equal to all the opportunities in agriculture, industry, energy supply and forestry combined.

This is doubly important given the longevity of building stock. With an average useful lifespan of between 40 to 100 years, what happens to buildings today can still be relevant and meaningful for decades to come.

Global CO₂ emissions by sector

Source: Global Alliance for Buildings and Construction, 2018 Global Status Report, IEA

Building better: Fast facts

- By 2060, the world is projected to add 2.4 trillion square feet of buildings—more than double the current global building stock. Given population trends, this will largely occur in India, Africa and parts of Asia.
- This pace of development equates to adding another New York City to the planet every 34 days for the next 40 years.

Source: The American Institute of Architects



Brick by (low carbon) brick

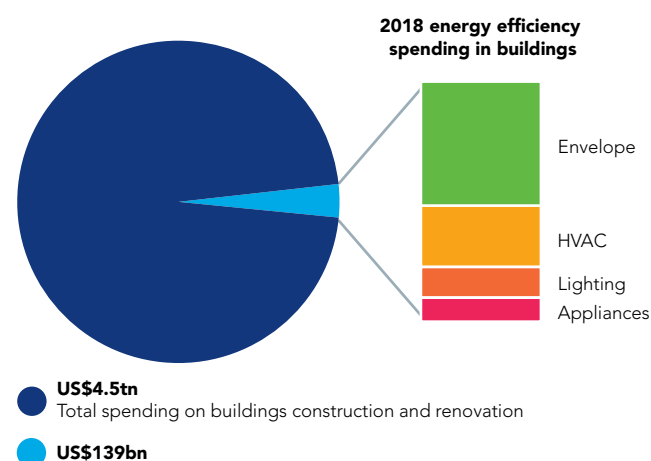
So, where are we today on our road to a world where buildings account for a lower carbon footprint?

In many ways, progress has been encouraging. The European Commission estimates that since the first measures were introduced under national building codes, the energy consumption in new buildings has halved, relative to typical buildings from the 1980s.

Meanwhile, more countries each year are putting building energy codes in place, green building certification is rising, and investment in energy efficiency increased to more than \$180bn in 2020 from \$129bn in 2015, when the Paris Agreement was adopted, according to data from the UN's Environment Programme.¹

In Europe, the EU Green Deal sets out an ambition to increase investment in renovated, energy efficient buildings. In the UK, likewise, the government is currently forming a new policy that all homes and businesses will have to meet rigorous energy efficiency standards to lower energy consumption and bills, helping to protect the environment.

Global energy efficiency investments and total spending on buildings, 2018





Even so, clearly, much more needs to be done. UN data suggests two thirds of countries worldwide still have no mandatory building energy codes. And, while there has been a boost in energy-efficiency investment, this has come predominantly from only a few European countries.

In Europe, the EU Green Deal sets out an ambition to increase investment in renovated, energy efficient buildings.

More worrying is the evidence that the headwinds are growing. The UN estimates that without meaningful change, emissions from buildings could double by 2050, rather than drop. This is due to a combination of factors: a slowdown in energy efficiency gains (from 3% annual improvement to 1.3%), coupled with a growing global population and the associated need for floor space around the world.

In the US, the average family uses more than

300 gallons of water each day at home. 

70% of this use occurs indoors. 

Turning the tide in water preservation

To understand how this building back better might work in practice, let's consider the question of water wastage.

In the US, the average family uses more than 300 gallons of water each day at home. Roughly 70% of this use occurs indoors. Of this, 24% is attributed to toilet use, 20% shower use and 19% taps².

Water scarcity is a growing issue in many regions, including in the US where a number of communities are beginning to face supply challenges – a US Government Accountability Office report from 2014³ noted that 40 out of 50 state water managers expected water shortages in some portion of their states over the next decade. To state the obvious, the less water we are able to use in the home, the less strain put on reservoirs and the more water available in lakes, rivers and streams.

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The challenge, then, is to identify the right companies that are not only committed to providing solutions to the question of water wastage but which are also well-placed to provide a healthy return for our investors.

Investible solutions

The Sustainable Global Equity team believes efficient production and resource allocation are among the most effective methods to achieve a reduction in emissions and that, by doing more with less, companies in the construction sector can begin to establish a circular economy.

Technology also offers opportunity for reducing emissions of building operations:

- Smart metering technology can now not only let you know how much energy you are using, but also speak to the grid, allowing users a greater understanding of supply.
- More efficient cooling and heating systems such as heat exchange pumps can save energy inputs.
- Light bulb technology has shown significant improvement in reducing electricity needs.

¹ United Nations: '2021 Global Status Report for Buildings and Construction', 19 October 2021.

² Water Research Foundation, Residential End Uses of Water, 2016.

³ Freshwater: Supply Concerns Continue, and Uncertainties Complicate Planning (gao.gov)



CASE STUDY

Trane Technologies

A global designer and manufacturer of HVAC (heating, ventilation and air conditioning) units

Investible theme and sub-theme: Environment, Green building



With growing rates of urbanisation and a forecast rise in global temperatures, the way we heat and cool our homes and workplaces will play an essential role in addressing climate change.

Regulators have recognised this and have begun to increase pressure on companies in the real estate sector to reduce carbon emissions and to improve energy efficiency standards, particularly with reference to heating, ventilation and air-conditioning (HVAC) technology. In Europe, for instance, the EU will bring in more stringent requirements on the use of refrigerants in heating and air conditioning units by 2023/4.

Regulators have recognised this and have begun to increase pressure on companies in the real estate sector to reduce carbon emissions and to improve energy efficiency standards, particularly with reference to heating, ventilation and air-conditioning (HVAC) technology.

As a high-quality, fast-growing pure-player in the HVAC segment, this company is providing solutions to the megatrend of decarbonisation. A focus on ESG/sustainability is integral to its business strategy, its product portfolio and its culture; and this, in our view, should support value creation over the long-term.

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The company's product portfolio includes equipment, controllers and software all designed to address the need of building owners and managers to monitor, optimise and reduce their energy consumption.

The company estimates its products can influence some 45% of the total energy consumption in a building, and about 32% in a single-family home, significantly lowering energy bills and reducing greenhouse gas emissions.

Separately, the company's transport refrigeration business addresses the need to move perishable food safely, thereby reducing food waste and, indirectly, greenhouse gas emissions.

The company estimates its products can influence some

45% of the total energy consumption in a building, and about
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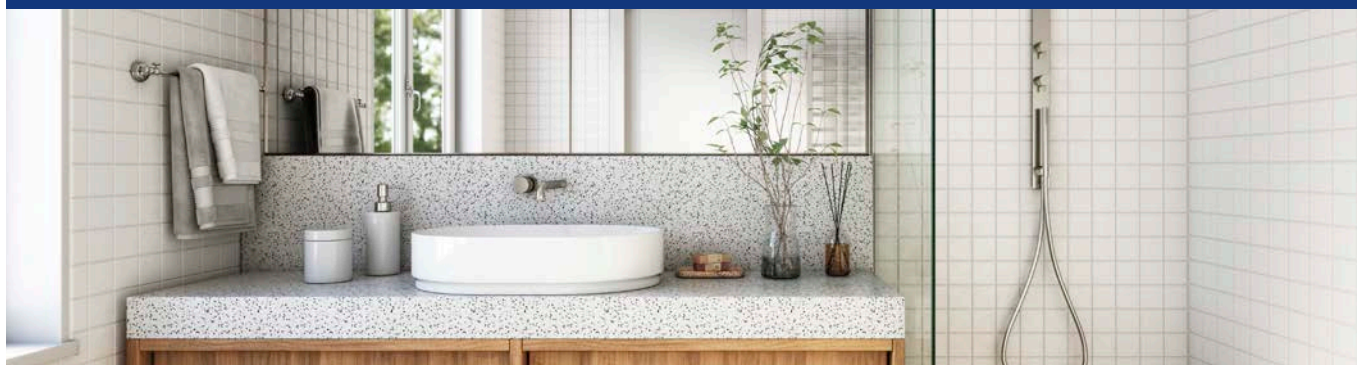
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CASE STUDY

Fortune Brands

A predominantly US-based manufacturer and distributor of kitchens, bathrooms, entryways, and outdoor living spaces.

Investible theme and sub-theme: Environment, Water Preservation



With increasing populations and requirements for clean water, efficiency in water usage is an ecological imperative. According to the Water Research Foundation,⁴ the average American family uses more than 300 gallons of water each day – with an obvious impact on reservoirs, lakes, rivers and streams.

Our engagement case for this company focuses on their potential to address the issue of sustainable water usage. The company has a leading market share in several home products with strong competitive positioning. It has cyclical exposure to the improving US housing market, which has structural under supply of housing, and so enjoys a potential structural tailwind. In our view it is a well-managed and governed business with an extended track record of execution, along with a strong balance sheet and free cashflow generation.

40%+

Percentage of global energy output consumed by buildings



15%

Percent of global carbon emissions attributable to HVAC



10%

Percentage of global greenhouse gas emissions attributable to food loss and wastage



Source: The Climate Group: Built environment; IEA: Cooling; WWF: Driven to waste. Accessed 10 March 2022

With encouragement from shareholders, the company's primary bathroom brand has committed to saving one trillion gallons of water by 2030 – equivalent to 40 million swimming pools or 24 billion baths. We calculate that, over the period 2018-2020, through its bathroom faucet and showerhead sales, the company has saved 5.6 billion gallons of water. Its water savings each year increased 28% over that period.

For the future, we are engaging with the company to encourage it to establish a sustainable timber policy with targets for certified wood sourcing and recycled timber.

5.6bn

Gallons of water saved in 2018-20 through this company's sale of water-efficient bathroom showerheads and faucets



8-10

Percentage of global production and trade in forest products carried out in violation of national laws



1m

Number of trees prevented from being cut down through this company's commitment to sustainably sourced wood



Source: Federated Hermes, WWF: Responsible Forestry, company estimates.

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⁴ Water Research Foundation: Residential End Uses of Water, 2016

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