Sustainable and Responsible Investing

Gulf International Bank (UK) Limited
December 2017

GIB ASSET MANAGEMENT

<page intentionally left blank>

GIB ASSET MANAGEMENT

Who We Are

GIB (UK) is a London-based international asset management firm. We have been managing institutional assets for over forty years for our clients from our offices in London and New York. We are active in global equities, investment grade and high yield fixed income (including emerging market debt and structured credit) and trade finance.

We strive to align our investment style with the priorities and goals of our clients. By investing with purpose we create the trust necessary to underpin long-term relationships; some of our clients have been doing business with us for over 30 years.

Our objectives:

- To provide a window on the world for our investors
- To challenge conventional thought and status quo
- To institutionalize a responsible investment culture
- To foster economic development through delivery of innovative investment products
- To provide leading analysis and insight to support client investment decisions
- To deliver superior investment performance

GIB (UK) is regulated in the UK by both the Financial Conduct Authority and the Prudential Regulation Authority and is registered as an Investment Advisor in the United States with the Securities and Exchange Commission.

Visit us on www.gibam.com/insights to access our latest publications.

GIB ASSET MANAGEMENT

Contributing Authors

Gregga J Baxter	General Manager
Alan Lehman, CFA	Senior Analyst
New York	+1 212 922 2341 330 Madison Avenue New York, NY 10017

This research benefits from the considerable input of GIB (UK) investment teams in London.

London	+44 207 259 3321 One Knightsbridge London, SW1X 7XS

For more information, contact our sales and marketing team at +44 207 259 3149 or by email:

John Angell	John.Angell@gibam.com
Andrew Houghton	Andrew.Houghton@gibam.com

GIB ASSET MANAGEMENT

Contents

GiB ASSET MANAGEMENT

> “Action without vision is only passing time,
> vision without action is merely day dreaming,
> but vision with action can change the world.”

Nelson Mandela, political leader (1918–2013)

Philosophical Changes

Background

Modern portfolio theory takes for granted the fundamental health of underlying financial assets. This is no longer a sound investment philosophy. "The way that past economic growth has been achieved cannot be maintained: it has been responsible for an expanding list of environmental and social burdens. With many of the catalysts of past growth (e.g. use of fossil fuels and rapid urbanization) no longer sustainable in their current form, future growth is likely to be much slower and more erratic over the next 30 years than over the past 30."[1] At our current rate, the world's demand for renewable natural resources would require 1.6 earths to meet demand (with population held at current levels).[2] It is also expected that the population will grow to reach 8.5 billion people by 2030[3], and will require 50% more energy, 40% more water, and 35% more food.[4]

"Investment activity can no longer support economic activity that is unsustainable."

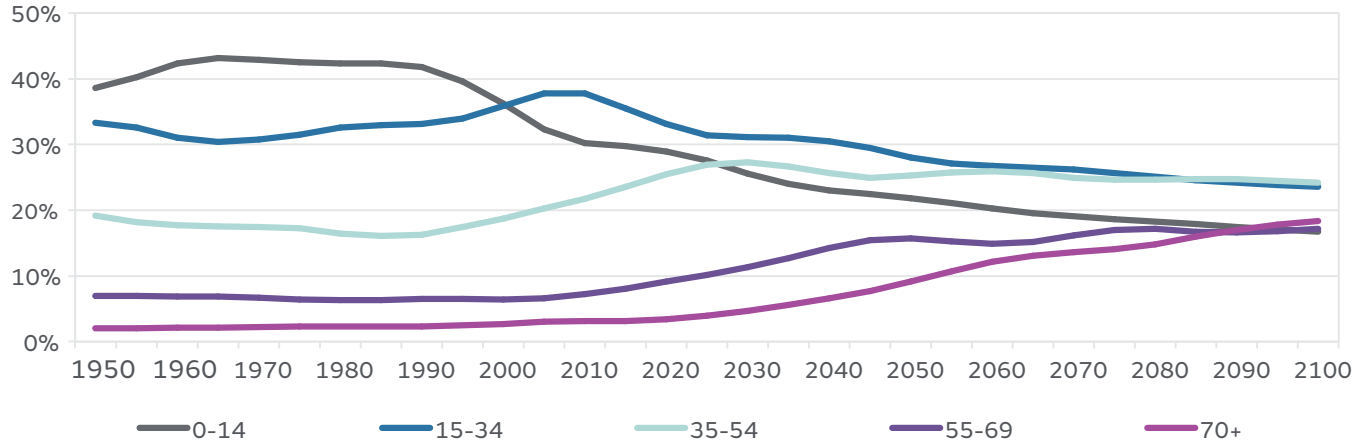
A Change in Attitude

We can already see the tidal wave of change we can expect in the years to come. The large pool of global youth (defined as 34 years old and younger) will alter the global landscape we know today. As these individuals age, their propensity to allocate money will be dramatically different and with much different purpose. US Millennials (born between ~1980-2000) have surpassed the Baby Boomer generation (born between ~1940-1960).[5] In the Middle East the percentage of youth will dramatically decline (as they age) and age dispersion should "normalize."[6]

"Investment allocations will be dramatically different and with much different purpose."

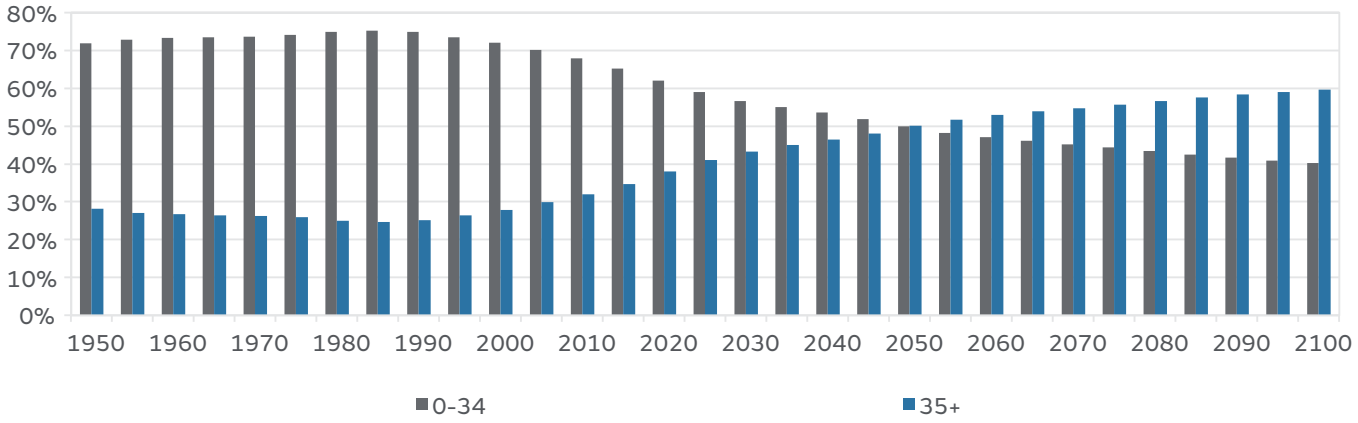
1 The SDG Investment Case – Principles for Responsible Investment 2017
2 http://www.footprintnetwork.org/our-work/ecological-footprint/
3 http://www.un.org/sustainabledevelopment/blog/2015/07/un-projects-world-population-to-reach-8-5-billion-by-2030-driven-by-growth-in-developing-countries/
4 What's driving the future? (PwC, 2014)
5 Definitions of exact date ranges vary
6 https://esa.un.org/unpd/wpp/Download/Probabilistic/Population/

Population by Age Group for the Middle Eastern Region[7]



Source: United Nations DESA/Population Division

Population by Age Group for the Middle Eastern Region[7]



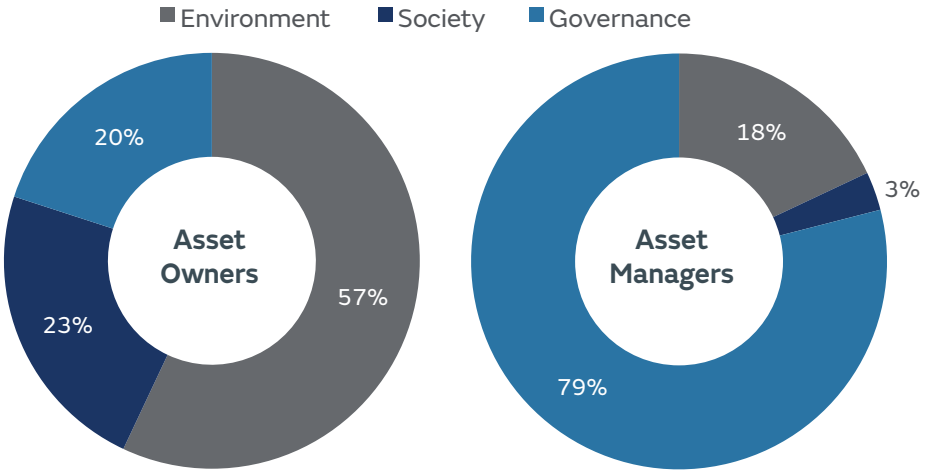
Source: United Nations DESA/Population Division

These demographic changes will have lasting effects on the world. The youth demographic is broadly deemed to possess a different set of beliefs and goals than prior generations.[8] With more young adults attaining wealth there has been a shift in focus on what is deemed important. **We anticipate the world to continue to evolve and offer solutions which cater to the youth generation's demands.** Examples include the popularity of the **"sharing economy"** whether it is Uber, Airbnb, or WeWork, or the surge in **health and wellness** cited by growth in organic food, exercise, or **spiritual wellbeing** with the emergence of a focus upon mindfulness, both inside and outside

7 Defined as Bahrain, Cyprus, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Palestine, Qatar, Saudi Arabia, Syria, Turkey, UAE, Yemen
8 http://kwww.goldmansachs.com/our-thinking/pages/millennials/

the workplace.[9] It is evident that the value system once deemed paramount is no longer valid and companies will need to change their behaviour in order to survive. A survey by US Trust showed that 58% of all participants believe market rate returns are possible through Sustainable and Responsible Investing (SRI) with Millennials 1.5 times more likely to agree (87%). 39% of the total surveyed consider investment decisions as a way to express personal values while Millennials are 2.2 times more likely to agree (86%). Millennials are 10% more likely to agree that companies that have a positive impact have better financial performance than other generations.[10] **The sheer size and attitude of this demographic will alter world markets as we know it.**

Which One of Environment, Society, or Governance Is Most Important



Source: Sustainable Investing and Bond Returns;
A Research Study Into the Impact of ESG on Credit Portfolio Performance - Barclays 2016

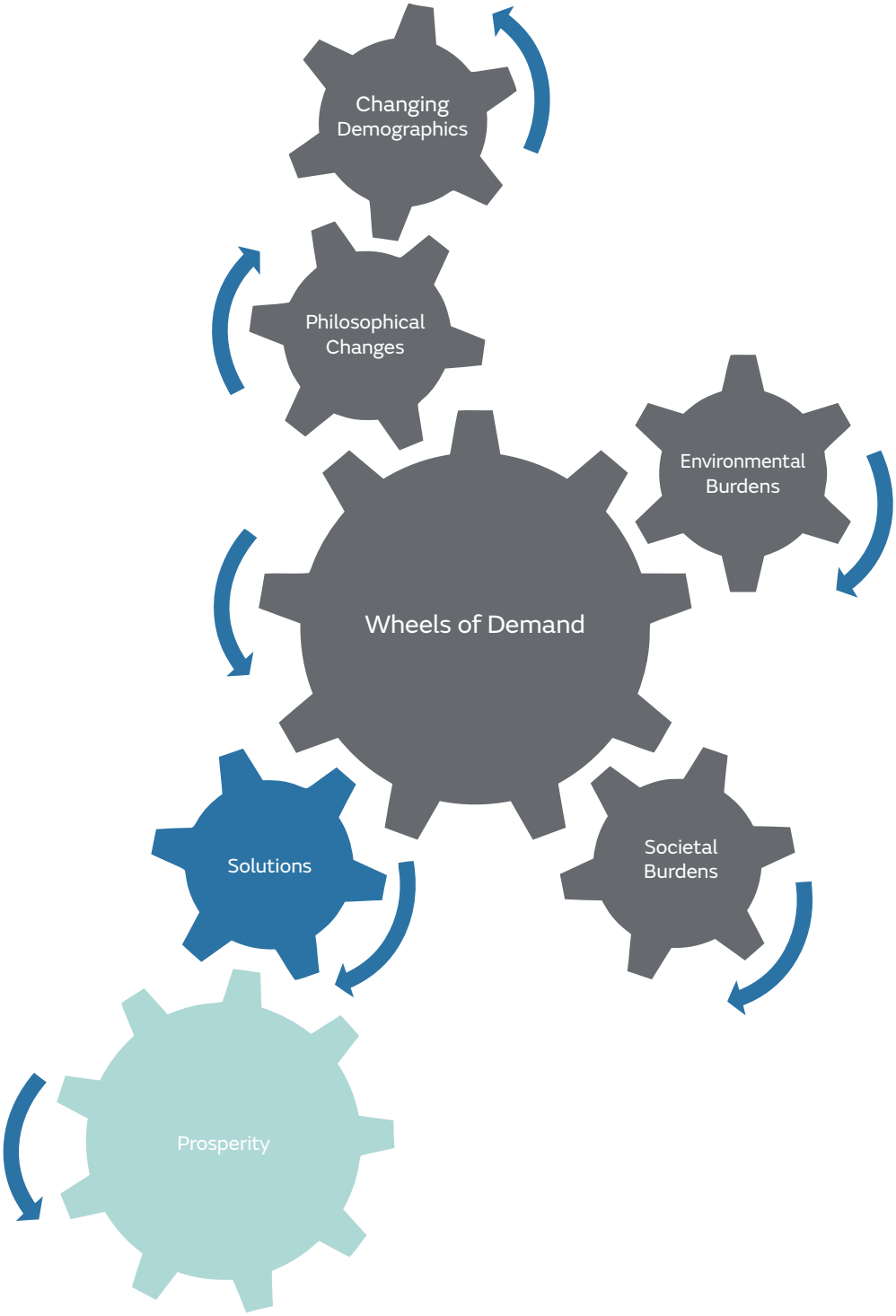
Fostering a Sentimental Shift

These changing demographics are now driving a fundamental change in investment practices. The increasing shift to incorporate Environmental, Social and Governance (ESG) criteria into investment practices supports the case that "sustainable business practices lead to lower cost of capital and equal or even better financial performance."[11] While this has not yet translated into companies with poor ESG ratings starving for capital, we believe over the long term, sustainable, best practice, socially responsible companies will trump their counterparts. We are starting to see business practices designed to penalize unsustainable businesses, e.g. the adoption of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The shift of focus to long term economic prosperity will change business practices. Business education is evolving to reflect these changes: "An M.B.A. education is no longer just about finance, marketing, accounting and economics...Ethical and social issues...are hastily reshaping...curriculums (sic)"[12]. This emerging standard of what is acceptable has led to the emergence of what the PRI deems "real-world impact" (which is directly linked to Sustainable Development Goals (SDGs)) and has started to tie traditional investing guidelines (e.g. financial ratios, cash-flow) with the actions and outcomes of portfolio companies.

"There is a fundamental change in investment practices with a shift to incorporate ESG criteria."

9 http://kwww.goldmansachs.com/our-thinking/pages/millennials/
10 http://www.ustrust.com/ust/pages/insights-on-wealth-and-worth-2016.aspx
11 The SDG Investment Case – Principles for Responsible Investment 2017
12 https://www.nytimes.com/2017/12/25/business/mba-business-school-ethics.html

Interconnected Drivers of Change



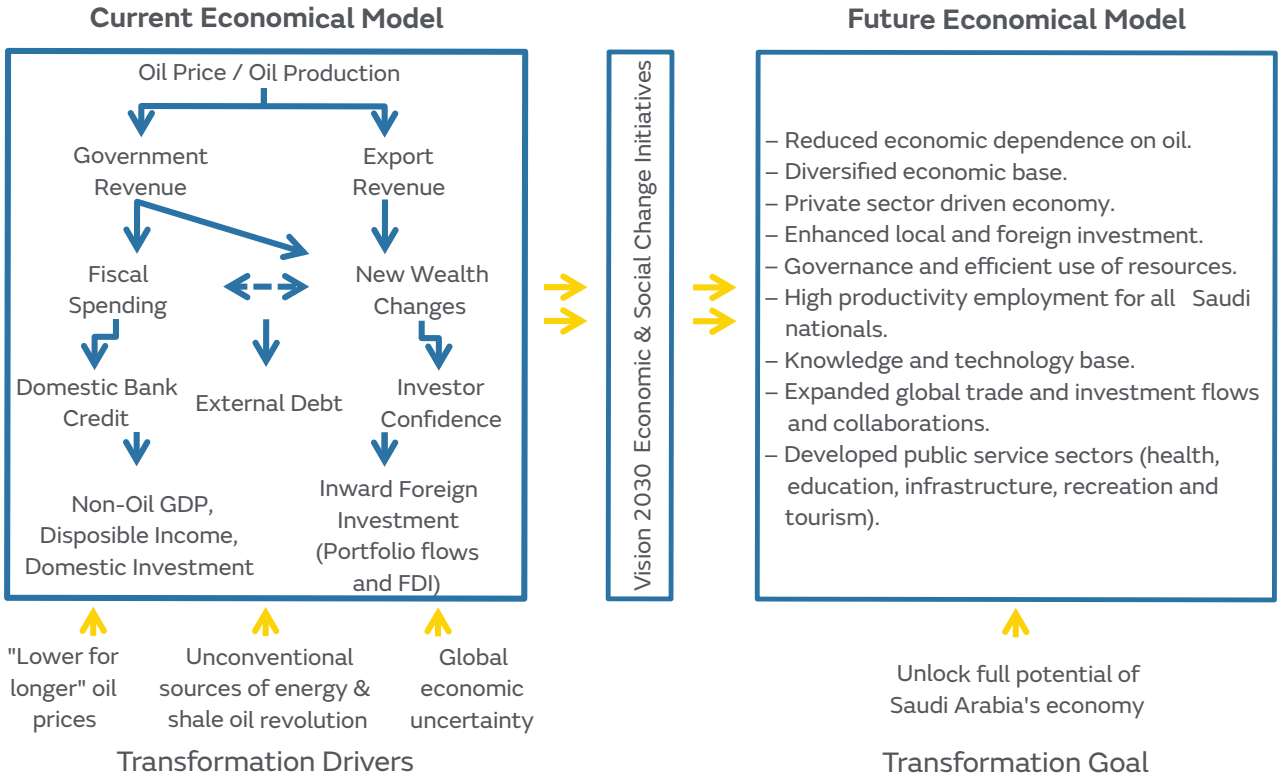
Socially Responsible Investing and the Middle East

Millennials in the Middle East share many of the same values as their peers in the rest of the world. In a survey completed by INSEAD in 2014, 42% of Millennials surveyed in the Middle East said that the private sector had the strongest ability to influence society.[13] This is approximately the same percentage as North America and Western Europe and far ahead of the rest of the world (Asia Pacific, Africa, Central & Eastern Europe, and Latin America). This suggests that the Middle East will become less dependent on the public sector regarding investment priorities. This posture is consistent with the future economic vision for Saudi Arabia.

This creates the **potential for powerful partnerships between institutions and asset managers** to harness the ambition of Millennials (as employees, managers and investors) to shape future investment direction (including SRI) and to realize the social good targets embraced by many regional institutions (e.g. Arab Fund for Economic and Social Development (Arab Fund), Islamic Development Bank (IDB), Saudi Fund for Development (SFD), Arab Authority for Agricultural Development (AAAID), Arab Bank for Economic Development in Africa (BADEA) etc.).

Emergence of Infrastructure

Investor demand for change has resulted in several governmental authorities establishing regulations on companies ESG dealings. In 2015, France launched a "law on energy transition and green growth which carries mandatory ESG and climate change reporting for listed companies, banks, and institutional investors."[14] "Bodies such as Sustainability Investor Forums (SIFs), the International Integrated Reporting Council (IIRC), the Global Reporting Initiative (GRI) and the



Source: GIB Economics / Jadwa Investment

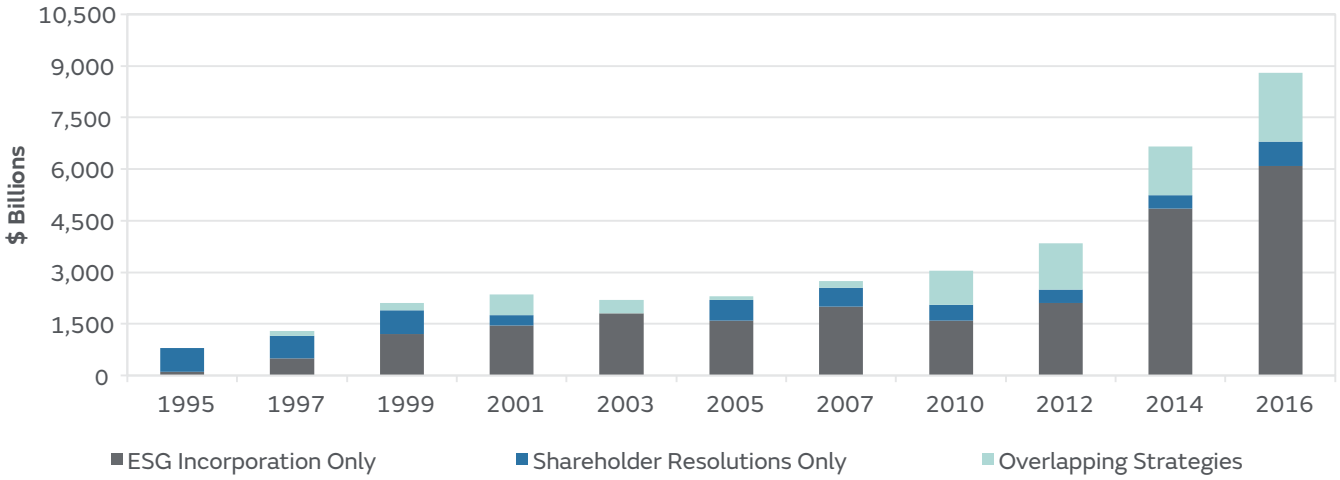
13 INSEAD, Universum, HEAD Foundation Global Millennials Survey
14 https://www.legifrance.gouv.fr/eli/loi/2015/8/17/DEVX1413992L/jo#JORFARTI000031045547

Sustainable Accounting Standard Board (SASB) are all pushing for mandatory reporting standards of nonfinancial material information."[15] Based on data from 2013, 45 countries and regions have sustainability and reporting guidelines (72% are mandatory). This is a sharp divergence from 2006 in which only 19 countries had reporting guidelines (58% being mandatory).[16]

As a result of the aforementioned changes, investment advisors and asset managers are catering to the demands of their investors. Two prominent companies providing guidance in the area of ESG research and ratings are MSCI ESG Research and Sustainalytics. MSCI ESG Research has released groupings of the 17 SDGs into five overarching themes: basic needs, empowerment, climate change, natural capital and governance. They then apply a **classification used by investors to measure and analyze the various SDG pillars.**[17] This will help investors quantify otherwise qualitative metrics which can then be used in conjunction with traditional financial analysis. Sustainalytics offers another platform which "supports hundreds of the world's foremost investors who incorporate ESG and corporate governance insights into their investment processes."[18] They too use a ratings based approach to offer insight into the sustainable dealings of companies.

"Investment advisors and asset managers are catering to the demands of their investors by providing research, ratings and investment vehicles."

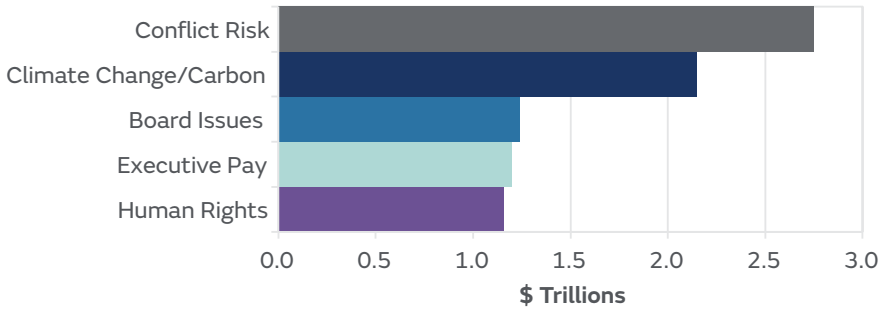
Growth in Sustainable, Responsible and Impact Investing in the United States



Source: 2016 Trends Report: Highlight for Philanthropic Foundations – US SIF Foundation 2016

15 Sustainable Investing and Bond Returns; A Research Study Into the Impact of ESG on Credit Portfolio Performance - Barclays 2016
16 KPMG, Centre for Corporate Governance in Africa, GRI and UNEP. 2013. Carrots and Sticks: Sustainability Reporting Policies Worldwide — Today's Best Practice, Tomorrow's Trend, p. 16.
17 https://www.msci.com/research/esg-research
18 http://www.sustainalytics.com/about-us

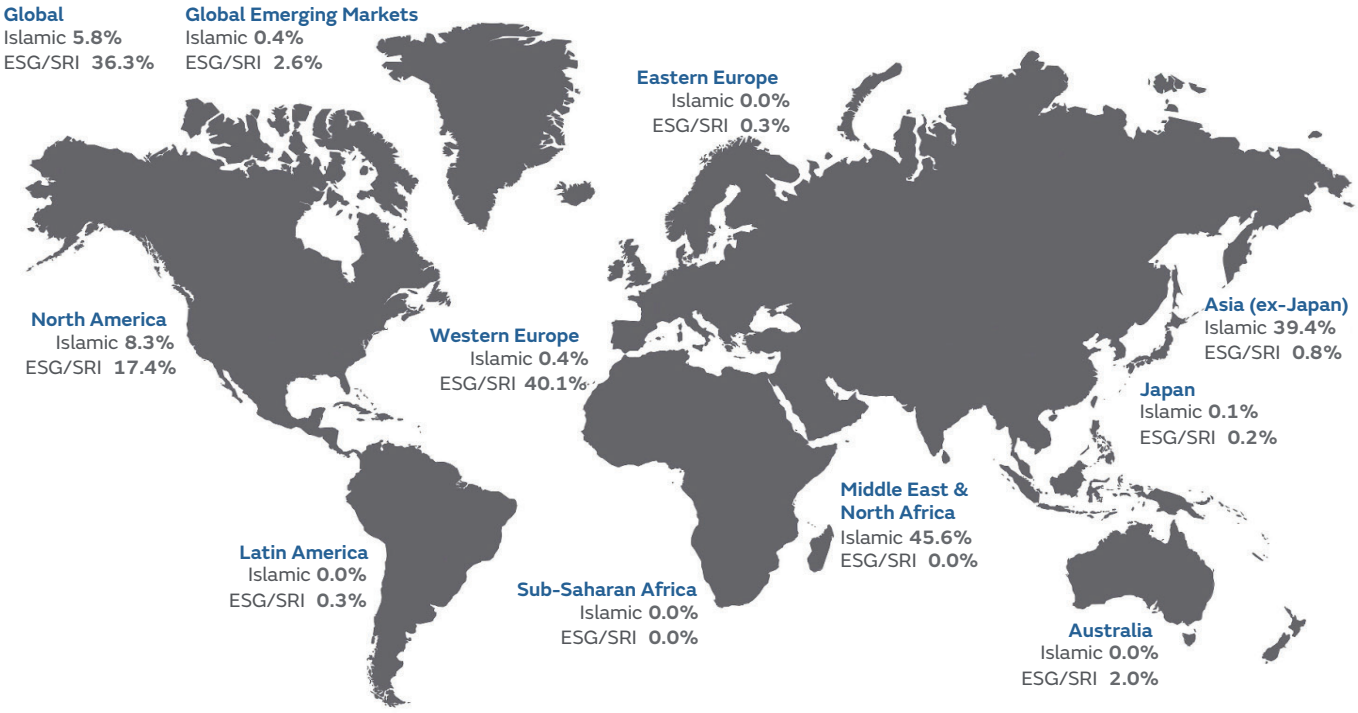
Leading ESG Criteria for Institutional Investors



Source: Sustainable and Impact Investing Institutional Investors – US SIF 2016

In light of the sentimental shift, index publishers now have a **multitude of indices which track SRI and ESG** company performance. Notably Dow Jones and S&P and MSCI (in partnership with Barclays) have released several families of sustainable and responsible indices.[19] This is important as it has allowed investors to monitor and compare their SRI/ESG investment guidelines relative to a comparable index (as opposed to a traditional index such as the S&P 500).

Growth in Responsible Financial Assets by Type



Source: Thomson Reuters Lipper data. Note: Only mutual fund assets are included in this analysis

19 http://www.sustainability-indices.com/index-family-overview

The Future

A comprehensive survey conducted by Share Action highlighted several notable trends within the SRI/ESG space. **There is a high conviction that the overarching SDGs closely align with fiduciary duties, bring reputational benefits, and have the possibility to increase investment return.** Respondents plan to engage with investee companies about issues covered by the SDGs (95%), will allocate capital to investments which support the SDGs (84%), and will support regulatory reforms that promote the SDGs (89%). In addition, there appears to be considerable propensity to grow the industry. Of the 17 goals outlined, investors who are currently not taking action on any of the SDGs, an average of 71% intend to takes steps necessary to promote the success of the SDGs. Response predisposition ranged from the high of 87% for taking action on Affordable and Clean Energy (Goal 7) to the low of 61% for helping achieve Partnerships to Achieve the Goal (Goal 17). These survey results are certainly encouraging and demonstrate an attitude shift from years past.[20]

There are of course **headwinds** which could impede the development of the SRI/ESG industry. These concerns largely surround **data availability and consistency.** Respondents feared the lack of reportable data used in making real-world impact assessments will be a challenging hurdle to overcome (66%). In addition, they demonstrated concern over the consistency of data and the malleability of research (57%). Other notable concerns were the governing framework on reporting standards (57%) and lack of company transparency (55%).[20] Although these concerns seem difficult to digest, steps are taking place to alleviate some of the stress surrounding this new approach to investing. Over time it is expected there will be a consolidation in regulatory and reporting standards as well as a cohesive delivery vehicle for the transformation of qualitative analysis.

"Investment community is starting to address the headwinds of data availability and consistency."

1 What is Socially Responsible Investing

Overview

Socially responsible investing (SRI) is nothing new and has origins dating back to the 18th century and continued to develop from its most simple form into what we know now. SRI can be defined as socially conscious investing using exclusionary criteria, for example by avoiding controversial industries such as tobacco, alcohol or gambling.[21]

This concept has underpinning beliefs that the finance industry will cut off societal burdensome sectors by reducing (or even eliminating) financial support under the notion that these sectors are not sustainable (fossil fuels) or support sinful acts of society (alcohol/gambling). Until recently, **SRI was limited to personal investment mandates, now this concept is being applied more broadly within the investment community.**

20 An Introductory Study of Institutional Investors' Role in Supporting the Sustainable Development Goals – ShareAction 2016
21 Sustainable Investing and Bond Returns; A Research Study Into the Impact of ESG on Credit Portfolio Performance - Barclays 2016

United Nations Sustainable Development Goals

In 2006 the United Nations (UN) implemented Six Principles for Responsible Investing to help investors incorporate ESG issues into their decision making processes.[22] Since then, nearly 1,500 signatories collectively controlling over **$60 trillion of assets under management have signed on as a commitment to sustainable, responsible investing.**[23] The UN doubled down on the importance of sustainable investing and in 2015 launched 17 SDGs in conjunction with each member state. These goals are designed to "end poverty, protect the planet, and ensure prosperity for all."[24] In essence the 17 goals can be grouped into four broad themes: Peace, Planet, Prosperity and Partnerships. Underlying each goal is a set of indicators, in total there are 232 key performance metrics which provide quantitative guidelines for which will help measure success.[25] "The SDGs provide the first generally agreed framework that defines the 'broader objectives of society,' SDG 17 clearly shows the global community's need to get investors on board. But to do so, investors will want to know how contributing to the SDGs will help them fulfil liabilities and beneficiaries'/clients' expectations about risk-adjusted returns."[26]

The Global Goals for Sustainable Development

Environmental, Social, and Governance Investing Divergence

While SRI is a type of ESG Investment, the reverse cannot be said about SRI. SRI is seen more as a philosophy rather than a technique to achieve responsible investing behaviour. ESG investment, on the other hand, focuses on economic tangibles. The three pillars of ESG are **Environmental**; issues connected to global warming, energy usage, pollution and the like, **Social**; factors such as how a company treats its workers, health and safety considerations, and community outreach, and **Governance**; a focus on issues including business ethics, board structure and independence, executive compensation policies and accounting.[23] **ESG investing is primarily focused on the financial outputs of the underlying economics** of each of the three pillars and will use various tools to assess the investments credibility to determine the risk adjusted return of such investments.[27]

22 https://www.unglobalcompact.org/take-action/action/responsible-investment
23 Sustainable Investing and Bond Returns; A Research Study Into the Impact of ESG on Credit Portfolio Performance - Barclays 2016
24 http://www.un.org/sustainabledevelopment/sustainable-development-goals/
25 https://unstats.un.org/sdgs/indicators/indicators-list/
26 The SDG Investment Case – Principles for Responsible Investment 2017
27 Probus-Sigma. "ESG as an investment tool,"http://www.probus-sigma.com/wpcontent/uploads/downloads/2012/09/ESG-As-an-InvestmentTool.pdf

SRI versus ESG

Source: GIB UK

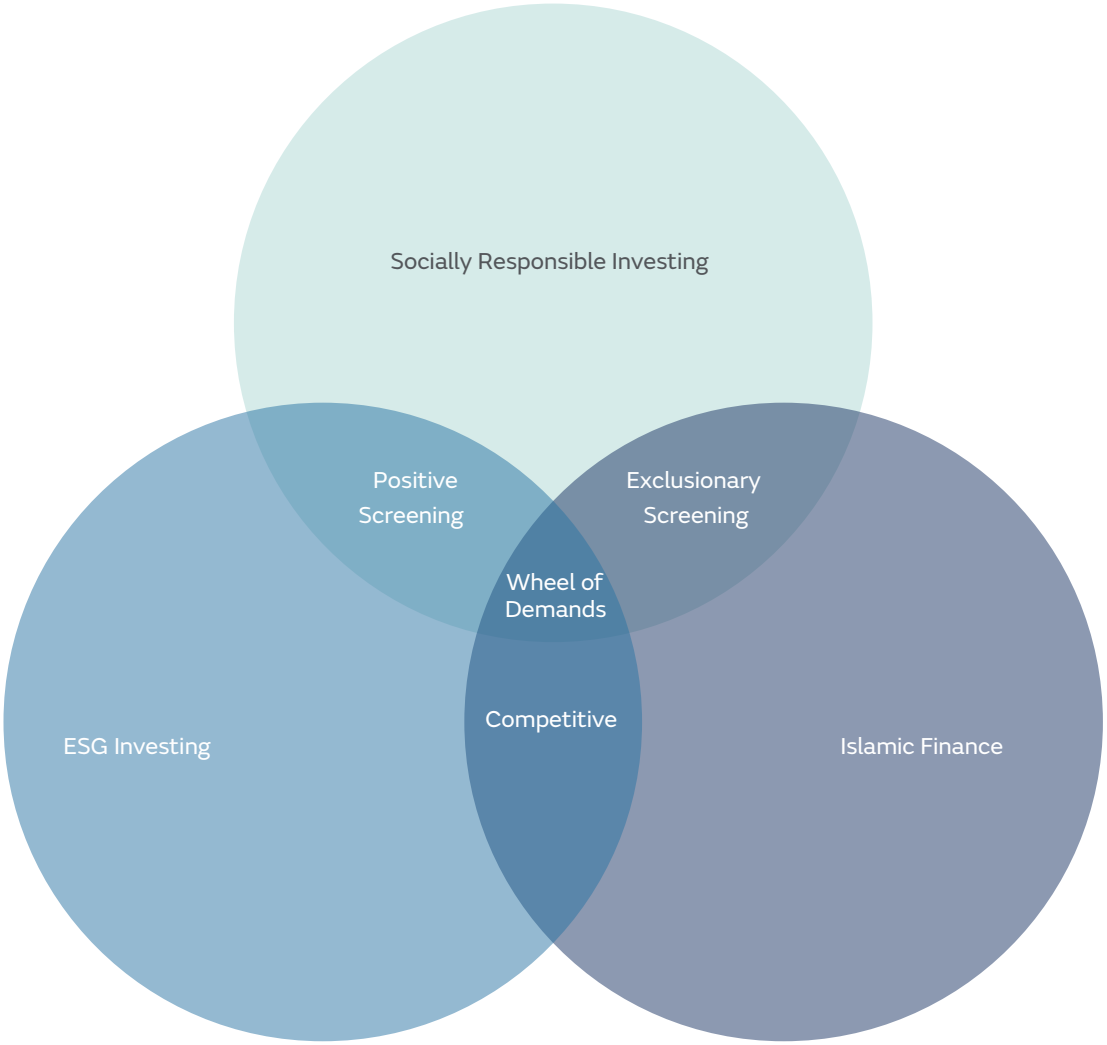
Religious Ties

Since its inception, SRI has always had significant ties to faith and has recently gained traction to marry the principles of SRI to those of various faiths including Sharia. Until recently, the majority of society has viewed "socially responsible" behaviour as an extraneous counterpart to traditional financial practices (such as financial statement analysis) and has not incorporated the potentially detrimental impacts socially irresponsible behaviour may cause financial investments. "The concept of vicegerency (khilafah), where all human beings are God's 'stewards' on earth and are responsible for the balanced attainment of spiritual and material needs[28], 'started gaining currency in the Muslim world post-colonial independence and remains a pillar of modern Islamic Economics, which is trying to build out a framework of equitable distribution of resources based on the concept of vicegerency and other Islamic principles'"[29,30]. Islamic finance has always viewed "responsibility" as a core component of investment practices and is ideally suited to complement the goals of SRI. This concept is further supported by the Islamic jurisprudence of judicial reasoning (ijtihad) which "rationaliz[es] the exploitation of resources in ways which do not compromise the welfare of the generations to come."[30] Furthermore, maslahah (protecting religion, life, intellect, lineage, and property) in conjunction with the Islamic perspective of accountability further strengthen the direct relationship and co-benefits available through sound Islamic Finance practices and SRI.[31]

"Islamic finance has always viewed 'responsibility' as a core component of investment practices and is ideally suited to complement the goals of SRI."

28 The interpretation of vicegerency comes from several Quranic verses, chief of which is Surah Al Baqarah 2:30
29 Originating from the second Caliph 'Umar Ibn Al Khattab that, in the words of contemporary Muslim thinker and Emeritus Professor of Mechanical Engineering Salim Al-Hassani
30 The Emerging Convergence Of SRI, ESG and Islamic Finance – Thomson Reuters – RFI Responsible Finance Report 2015
31 AAOIFI op cit., p. 88

Convergence of Socially Responsible Investing, ESG Investing, and Islamic Finance



Source: The Emerging Convergence Of SRI, ESG and Islamic Finance – Thomson Reuters – RFI Responsible Finance Report 2015

Comparing Responsible Investment and Islamic Finance

	SIMILARITIES	
	Responsible Investment	**Islamic Finance**
Social Good	Strong emphasis on aligning finance with social good.	
Contributions	Seek to increase the contribution of the finance sector to the real economy.	
Sustainability	Pursue a more resilient financial system void of unsustainable system risk.	

	DIFFERENCES	
	Responsible Investment	**Islamic Finance**
General Investment Approach	Holistic approach that aims to include any ESG information that could be material to investment performance.	Values-based approach that mainly focuses on exclusionary screens on specific social and economic grounds.
Active Ownership	Strong emphasis on being active owners and to engage with companies on ESG issues (including proxy voting).	No widespread practice of engagement or active ownership.
Avoiding Investments in Highly Leveraged Companies	Not widely considered.	Sophisticated approach to analyzing financial structures of corporate entities to understand cash flows and avoid investments in companies with excessive leverage.
Impact	Not widely considered, but there is a growing focus on environmental and social impacts of investments (including contributions to the SDGs).	Sharia scholars assess the compliance of financial products from a structural and legal perspective - the focus is not on actual impact or real economy outcomes.

Source: At the Intersection of Islamic Finance and Responsible Investment – Principles for Responsible Investment 2017

Annex

Investment Opportunities

Overview

As a result of recent investor sentiment shift, there are now a multitude of investment products available to prospective investors looking to align their investment goals with the SDGs. There are three widely accepted approaches used to achieve successful SRI/ESG investing. **Exclusionary investing** is most closely aligned with SRI as this approach aims at eliminating unsustainable and sin sectors and does not even consider these sectors as part of a viable investment universe. As a result, this approach can have detrimental effects associated with meeting and/or exceeding benchmark returns (since a portion of the outstanding investment universe is not considered). The second approach is integration, which is becoming the standard for sustainable investing. **Integration** looks at all possible investments and analyzes how well investments tie to the underlying principles of the SDGs. From here, investors are able to weight asset holdings to align their investment goals to business practices they deem most important. Lastly, **impact investing** is seen as a specific approach using investment products to achieve their investment goals (e.g. social impact bonds).[32]

Investment Vehicle Opportunities

Many of the traditional avenues currently available to investors have been developed in recent years to facilitate sustainable and responsible investing. **Listed equities** are seen as the most straightforward avenue to achieve these goals. There has been a surge in products and tools available to investors to aid in achieving these objectives. Notably, MSCI ESG Research and Sustainalytics are leaders in providing in depth analysis of company sustainability and responsibleness. Research providers such as Morningstar and Bloomberg have partnered with these firms to facilitate transparent and simplified data used to aid in investor analysis. Both firms use a ratings profile (similar to credit ratings) to gauge how companies compare versus their peers. Due to the incredible amount of analysis required to estimate a company's sustainability and responsibility, these ratings are paramount in efficiently developing investment ideas. This research "focus[es] on companies that contribute to sustainability goals by fostering good corporate practices and systematically minimizing their environmental and social footprint."[32] In addition to the work applied to equities, the same can be said of **corporate bonds**. There are also new special purpose bonds which target SRI/ESG investing. Examples include Social Impact Bonds (SIB), where the financial return is directly tied to achieving predefined social outcomes. One of the first SIBs was related to the reduction in recidivism of criminals, which had huge success in Europe. These programs, initially supported by government agencies, have developed and investors now partner with private companies to achieve similar societal prosperity.[33]

32 In Challenge Lies Opportunity – Investing for Sustainable Development – UBS 2015
33 http://www.undp.org/content/sdfinance/en/home/solutions/social-development-impact-bonds.html

These financial products are called Development Impact Bonds (DIB), and while they are similar to SIBs, the key difference is that instead of focusing on societal benefits, DIBs concentrate on economic development (mainly in developing countries) whose governments (or local companies) may be unable to provide the necessary financing.[34] Furthermore, there has been an emergence in sustainable **private market investments** which offers investors a direct line to funding projects they deem most important. This includes the concept of microfinance. In many respects, microfinance has been considered the epitome of social and responsible investing, as investors provide small loans (typically less than a few hundred dollars) to individuals who do not have access to traditional finance and are able to develop and grow their company.[35]

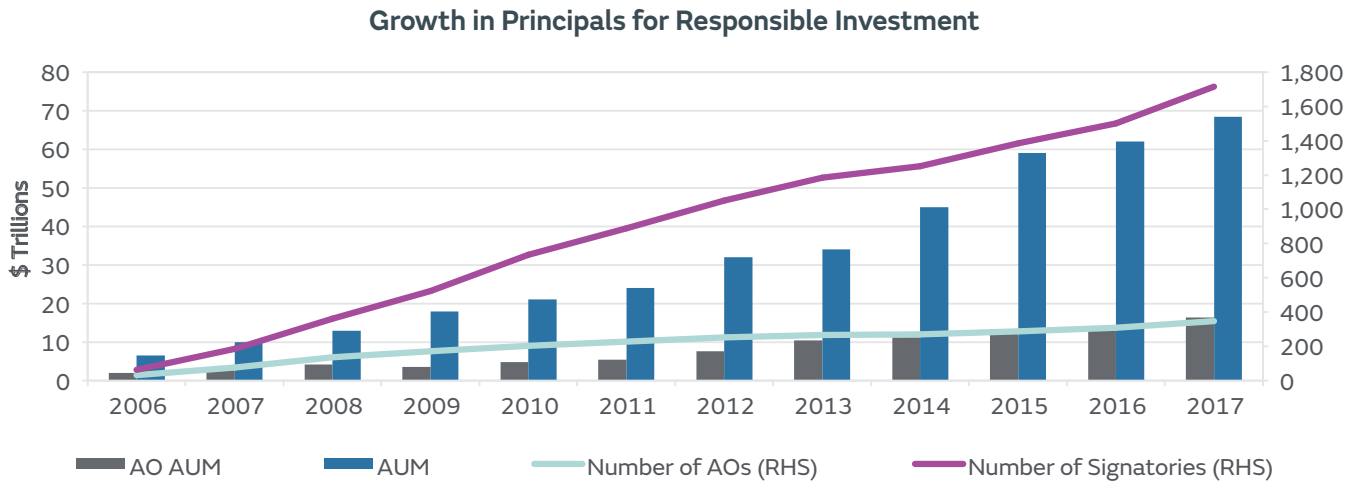
Morningstar Sustainability Rating

Distribution	Score	Descriptive Rank	Rating Icon
Highest 10%	5	High	
Next 22.5%	4	Above Average	
Next 35%	3	Average	
Next 22.5%	2	Below Average	
Lowest 10%	1	Low	

34 In Challenge Lies Opportunity – Investing for Sustainable Development – UBS 2015
35 There's Nothing "Micro" About Poverty – The World Bank Group and Microfinance

Returns Analysis Overview

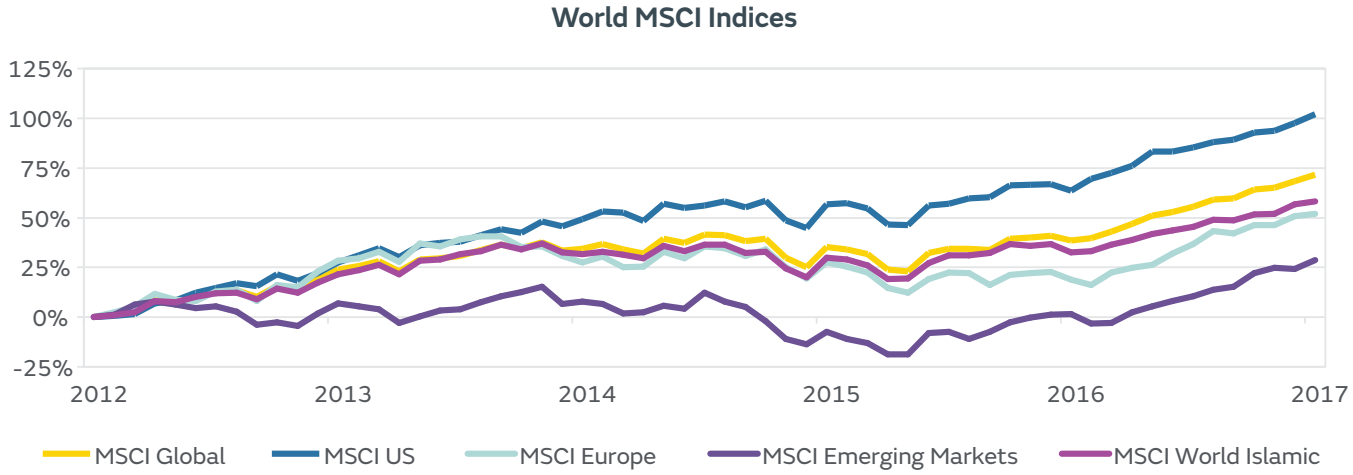
One key misconception about social and responsible investing is the notion that investment performance will lag traditional techniques. Reviewing the results of more than 2,000 studies, there is evidence that this notion is wrong. Since the mid 1990's there is positive correlation that social and responsible investing is of the utmost importance in fulfilling fiduciary duties all while enacting social benefits in society.[36] This is evident in the recent surge of growth in the SRI/ESG sector.



Source: UN PRI

Equity Markets

Global markets have been robust over the past five years.



Source: Bloomberg

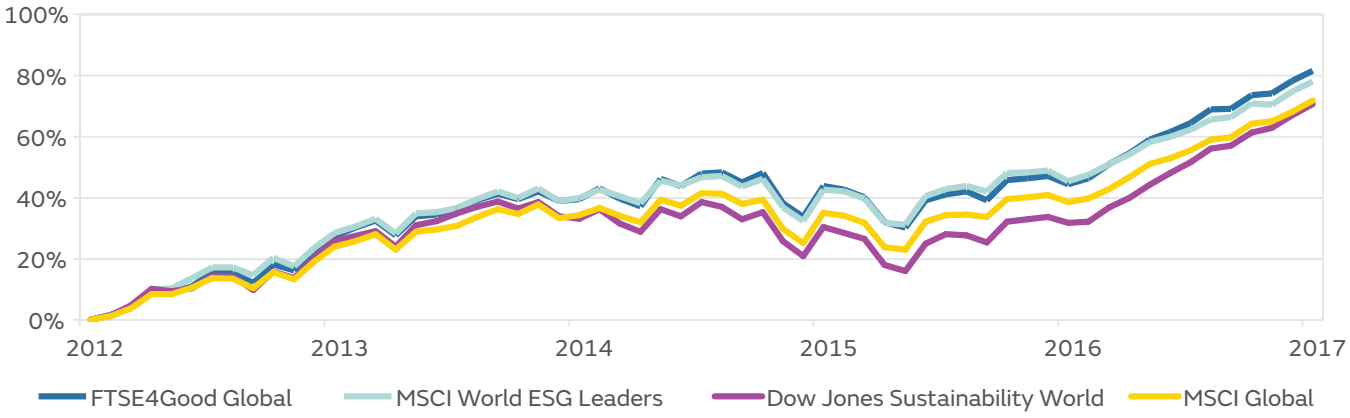
36 ESG and Financial Performance: Aggregated Evidence from More than 2,000 Empirical Studies – Gunnar Friede, Timo Busch, and Alexander Bassen 2015

Ticker	Index	Const.[1]	Total Return[1]			Std Dev (pa)[1]			Sharpe Ratio[1]		
			1y	3y	5y	1y	3y	5y	1y	3y	5y
MXWD	MSCI Global	2,490	23.9	27.9	71.9		10.6	9.9		0.7	1.1
MXUS	MSCI USA Index	632	23.5	35.4	102.1		10.1	9.5		1.0	1.5
MXEU	MSCI Europe	445	27.7	19.2	51.9		6.1	8.8		0.5	0.7
MXEF	MSCI Emerging Markets	838	26.9	19.3	28.8		5.7	4.8		0.4	0.4
MIWO	MSCI World Islamic	539	19.4	20.3	58.4		10.3	9.9		0.6	0.9

Source: Bloomberg: 1 Respective factsheet

When we compare global ESG performance we note that ESG indices have kept pace with their traditional peers. The top performer has been the FTSE4Good with the Dow Jones Sustainability World Index lagging slightly. Overall, ESG investment performance has delivered similar robust returns for investors over the past 5 years.

"It is a misconception that social and responsible investing lags the performance of traditional investing."



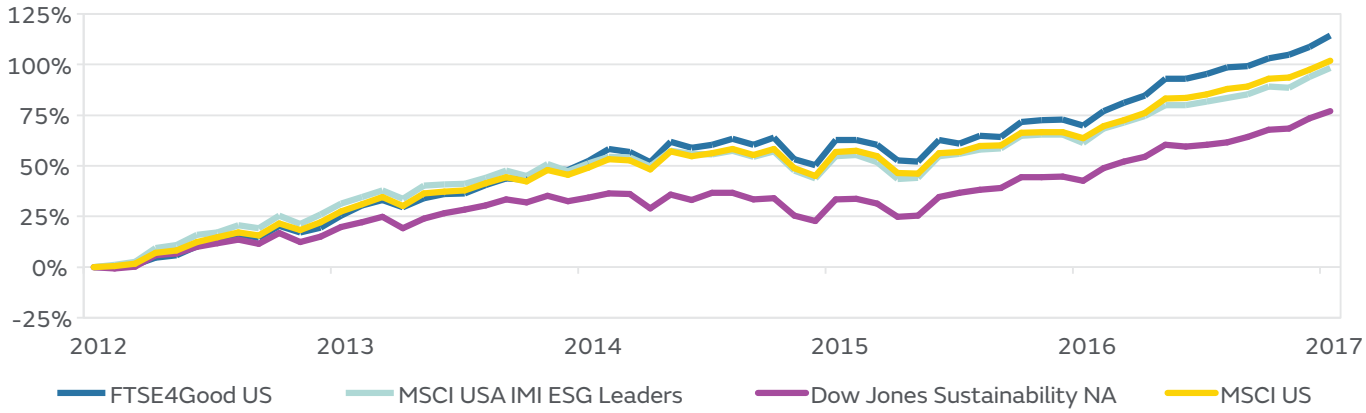
Source: Bloomberg

Ticker	Index	Const.[1]	Total Return			Std Dev (pa)			Sharpe Ratio		
			1y	3y	5y	1y	3y	5y	1y	3y	5y
4GGL	FTSE4Good Global	878	25.7	30.1	81.6	6.6	11.7	11.0	3.8	0.8	1.2
GSIN	MSCI World ESG Leaders	819	22.4	27.2	78.1	6.2	11.2	10.5	3.5	0.8	1.2
W1SGI	Dow Jones Sustainability World	318	29.7	28.2	70.9	7.5	13.2	12.2	3.9	0.7	1.0
MXWD	**MSCI Global**	**2,490**	**23.9**	**27.9**	**71.9**		**10.6[1]**	**9.9[1]**		**0.7[1]**	**1.1[1]**

Source: Bloomberg: 1 Respective factsheet

Moving onto US based ESG investing, again the FTSE4Good was the top performer (better than the MSCI US Index) and the Dow Jones Sustainability Index remained a lagger.

US ESG Indices vs the US MSCI Index



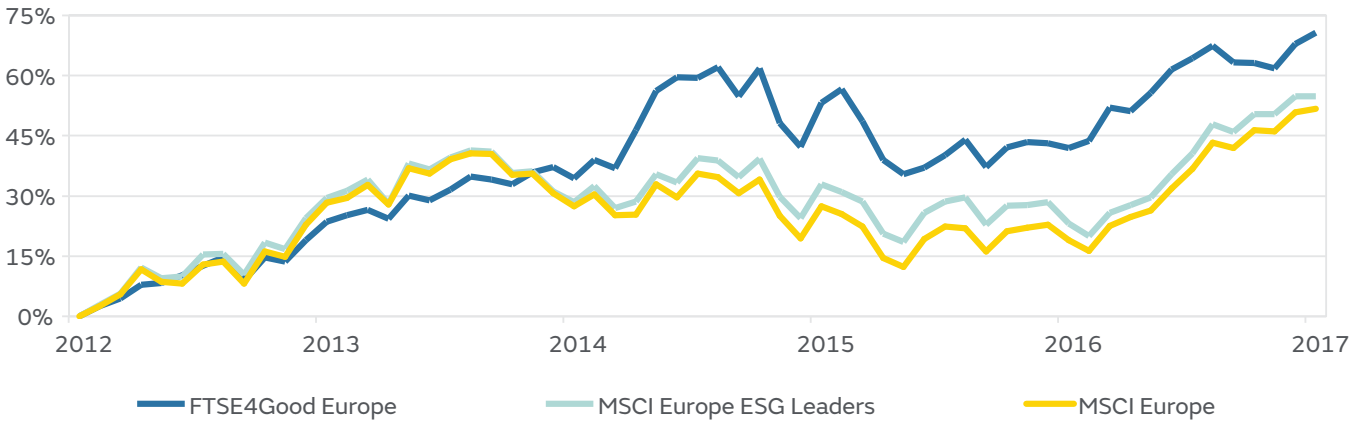
Source: Bloomberg

Ticker	Index	Const.[1]	Total Return			Std Dev (pa)			Sharpe Ratio		
			1y	3y	5y	1y	3y	5y	1y	3y	5y
4GUS	FTSE4Good US	429	26.2	40.6	114.4	7.7	12.7	12.2	3.3	1.0	1.4
USSI	MSCI USA IMI ESG Leaders	350	22.9	31.1	98.4	7.6	12.7	12.3	3.0	0.8	1.3
A1SGI	Dow Jones Sustainability NA	149	24.0	31.7	77.0	7.2			3.3		
MXUS	**MSCI USA Index**	**632**	**23.5**	**35.4**	**102.1**		**10.1[1]**	**9.5[1]**		**1.0[1]**	**1.5[1]**

Source: Bloomberg: 1 Respective factsheet

In the European region, again the FTSE4Good Index outperformed. In addition, the MSCI Europe ESG Leaders Index also outperformed the MSCI Europe Index (a display of strong financial markets).

European ESG Indices vs the European MSCI Index



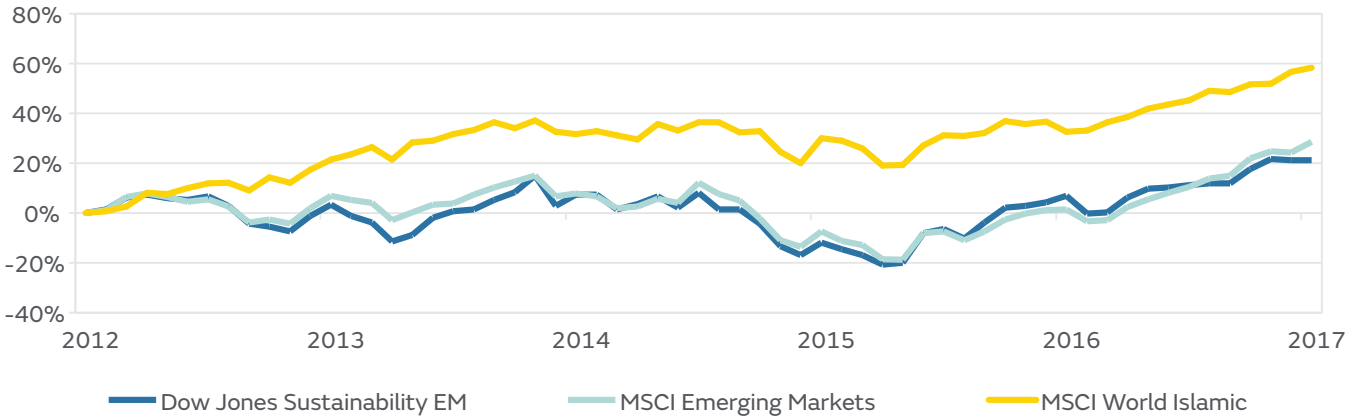
Source: Bloomberg

Ticker	Index	Const.[1]	Total Return			Std Dev (pa)			Sharpe Ratio		
			1y	3y	5y	1y	3y	5y	1y	3y	5y
4GEU	FTSE4Good Europe	378	20.3	27.1	70.9	9.0	17.6	15.7	2.4	0.6	0.8
EUSI	MSCI Europe ESG Leaders	211	25.8	20.6	55.0	9.7	16.5	15.3	2.6	0.5	0.7
MXEU	**MSCI Europe**	**445**	**27.7**	**19.2**	**51.9**		**6.1[1]**	**8.8[1]**		**0.5[1]**	**0.7[1]**

Source: Bloomberg: 1 Respective factsheet

Taking a look at Emerging Markets, performance was similar across ESG style investing and the traditional index. Although the MSCI World Islamic Index is not an ESG style, it performed in line with the Global ESG universe – a testament to the similarities between Islamic finance and ESG investing.

Emerging Market ESG Indices vs the Emerging Market MSCI Index

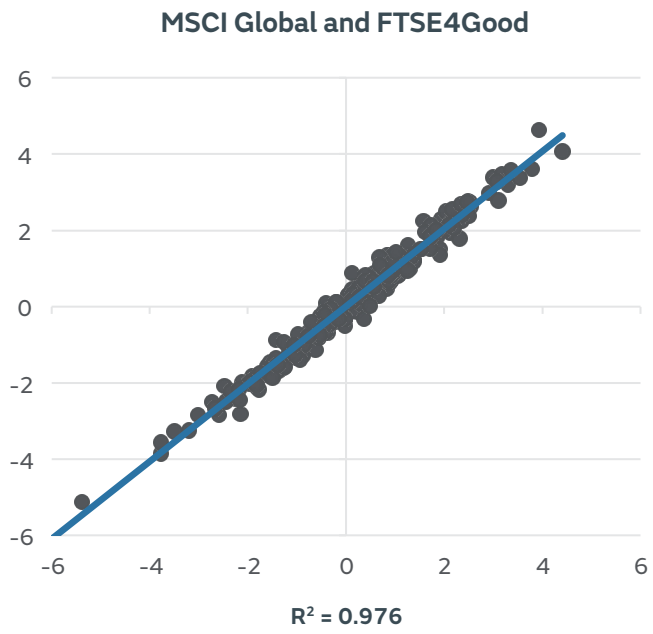


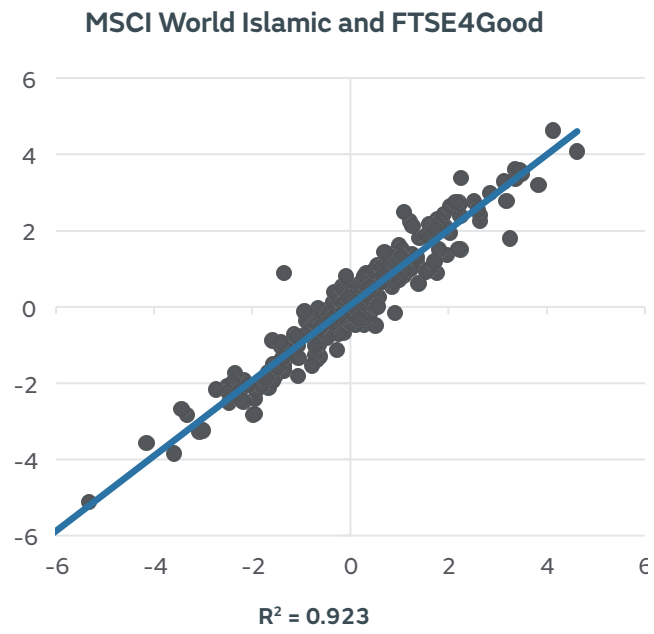
Source: Bloomberg

Ticker	Index	Const.[1]	Total Return			Std Dev (pa)			Sharpe Ratio		
			1y	3y	5y	1y	3y	5y	1y	3y	5y
DJSEMUP	Dow Jones Sustainability EM	91	13.3	12.9	21.3	11.4	16.9		1.2	0.3	
MXEF	MSCI Emerging Markets	838	26.9	19.3	28.8		5.7[1]	4.8[1]		0.4[1]	0.4[1]
MIWO	**MSCI World Islamic**	**539**	**19.4**	**20.3**	**58.4**		**10.3[1]**	**9.9[1]**		**0.6[1]**	**0.9[1]**

Source: Bloomberg: 1 Respective factsheet

Given the strong correlation between ESG and traditional investing we examined the MSCI Global Index and compared it to the FTSE4Good Index. We found strong correlation between the two indices with an R^2 of 0.976. Given the breadth of both indices it is acknowledged that these results reflect strong global equity performance in general; **there is no current data to compare relative index performance in more benign or bearish market conditions.** To further emphasize how well Islamic Finance is tied to ESG style investing we ran a regression between the MSCI World Islamic Index and compared that to the FTSE4Good Index. The results were not as strong as the previous example, however, we still found an R^2 of 0.923 indicating Islamic Finance and ESG philosophies are closely aligned.





Source: Bloomberg

Statistically, there are few (if any) diversions from traditional investing. Measuring standard deviations and risk adjusted returns, Nuveen found there are little to no differences when taking a responsible, socially conscious stance. Of the indices observed, **standard deviations were immaterially different than the benchmark index with each respective Sharpe ratio marginally different.**[37]

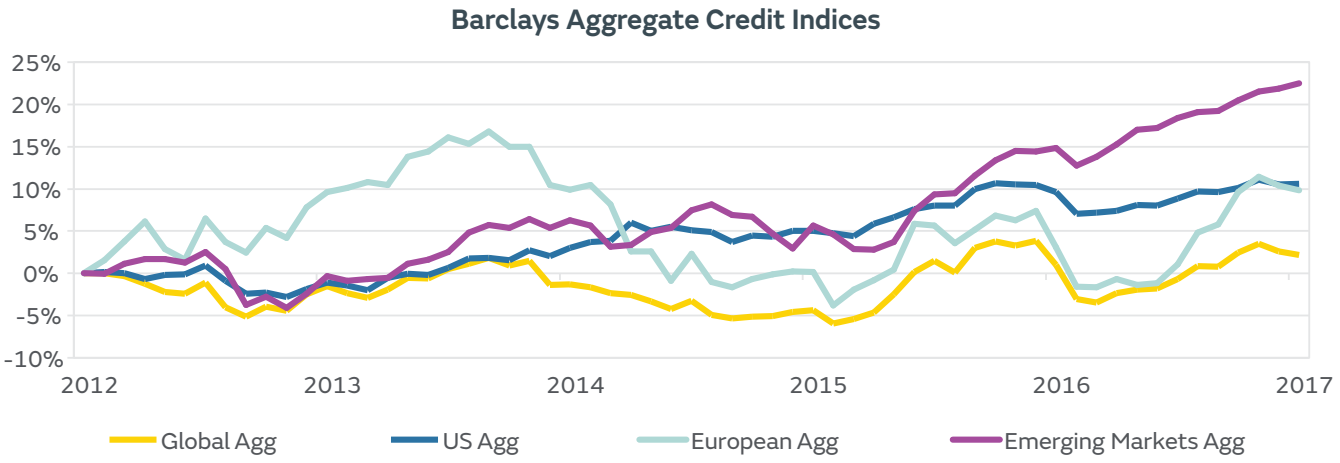
One important consideration to note relates to tracking error and diversification benefits. Because socially responsible investing often times limits the breadth of an acceptable investment universe (through exclusionary, best in class, or other philosophies of screening) it could be possible that performance would suffer. However, with a broadly diversified portfolio these concerns can be eliminated. Nuveen found cross holdings between indices analyzed and the benchmark ranging from 23% to 78%. It was found that by incorporating ESG criteria did not result in higher levels of risk (as seen by standard deviations and Sharpe ratios) and any difference was attributable to random variation as opposed to systematic divergence.[37]

Although there has not been significant outperformance in equity indices, there certainly is not underperformance as believed by many new to this space. It is important to note that there was no meaningful difference in returns when comparing socially responsible investing to that of the broad markets.[37] A research article reported that of 60+ separate academic studies, more than 80% found no statistically significant difference between socially, responsible investing techniques than that of traditional investing.[38]

37 Responsible Investing: Delivering Competitive Performance – Nuveen/TIAA Investments 2017
38 Stock Selection: Research and Results – Empirical Research Partners 2014

Fixed Income Markets

Turning to fixed income, markets too were very strong with Emerging Markets leading the way and Global Aggregate lagging.

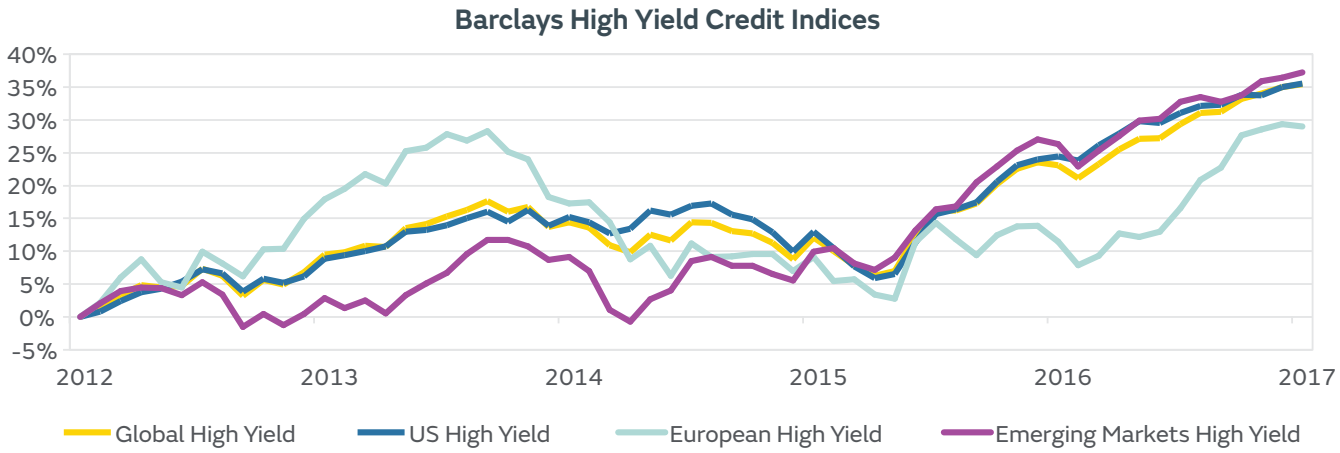


Source: Bloomberg

Ticker	Index	Const.	Total Return 1y	Total Return 3y	Total Return 5y	Std Dev (pa) 1y	Std Dev (pa) 3y	Std Dev (pa) 5y	Sharpe Ratio 1y	Sharpe Ratio 3y	Sharpe Ratio 5y	Mod Dur
LEGATRUU	Global Agg	20,944	1.2	3.6	2.2	5.6			0.1			7.0
LBUSTRUU	US Agg	9,650	0.9	7.4	10.6	3.1	3.3		0.0	0.6		6.0
LBEATRUU	European Agg	4,497	6.6	0.0	9.8	9.4	9.9	8.9	0.7	0.0	0.2	6.7
BSEKTRUU	Emerging Markets Agg	596	6.7	15.2	22.5	2.1	2.7	2.8	2.8	1.7	1.4	4.7

Source: Bloomberg; certain data unavailable

Moving to world high yield markets, the market surged the past year with Emerging Markets leading the way and Europe lagging. There has been considerable volatility within this space, especially Emerging Markets and Europe.



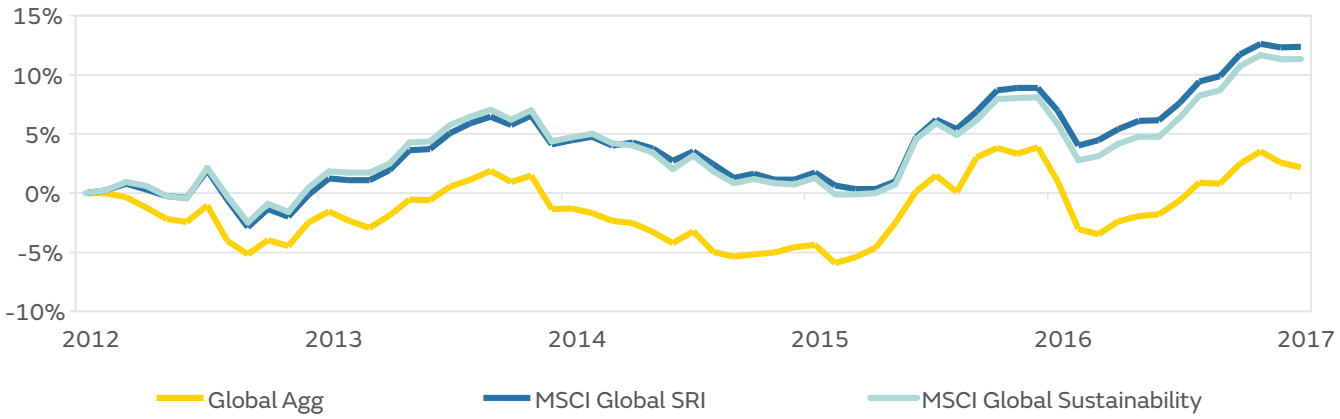
Source: Bloomberg

Ticker	Index	Const.	Total Return 1y	Total Return 3y	Total Return 5y	Std Dev (pa) 1y	Std Dev (pa) 3y	Std Dev (pa) 5y	Sharpe Ratio 1y	Sharpe Ratio 3y	Sharpe Ratio 5y	Mod Dur
LG30TRUU	Global High Yield	3,412	10.0	18.4	35.5	3.0	4.0	3.6	3.1	1.4	1.7	4.2
LF98TRUU	US High Yield	2,032	8.9	17.6	35.5	2.4	4.2	3.7	3.5	1.3	1.7	3.8
LP01TRUU	European High Yield	630	15.7	10.0	29.0	8.2	9.4	8.4	1.9	0.4	0.6	4.4
BEBGTRUU	Emerging Markets High Yield	700	8.7	25.8	37.3	3.9	5.1	4.8	2.0	1.5	1.3	5.3

Source: Bloomberg

Given the relative infancy of the socially and responsible market, there a fewer indices dedicated to the fixed income space but we selected two to compare against various markets. Highlighting the importance of the governance pillar within ESG investing, it was expected that this would lead to outperformance. This was certainly the case as both SRI/ESG indices outpaced the Global Aggregate Index.

Global Credit Indices

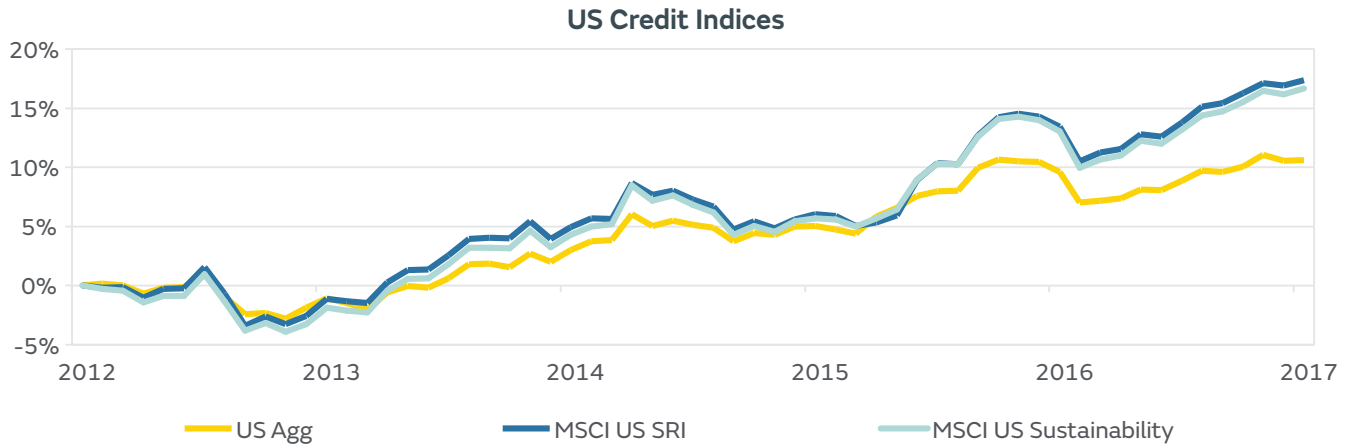


Source: Bloomberg

Ticker	Index	Const.	Total Return 1y	Total Return 3y	Total Return 5y	Std Dev (pa) 1y	Std Dev (pa) 3y	Std Dev (pa) 5y	Sharpe Ratio 1y	Sharpe Ratio 3y	Sharpe Ratio 5y	Mod Dur
RGCMTRUU	MSCI Global SRI	9,122	5.1	7.5	12.4	4.2	4.4	4.3	1.0	0.5	0.5	6.4
SGLCTRUU	MSCI Global Sustainability	6,546	5.2	6.3	11.3	4.6	4.8	4.7	1.0	0.4	0.4	6.5
LEGATRUU	**Global Agg**	**20,944**	**1.2**	**3.6**	**2.2**	**5.6**			**0.1**			**7.0**

Source: Bloomberg; certain data unavailable

Turning to US based fixed income the story is little changed with both SRI/ESG indices also outperforming their traditional counterpart.

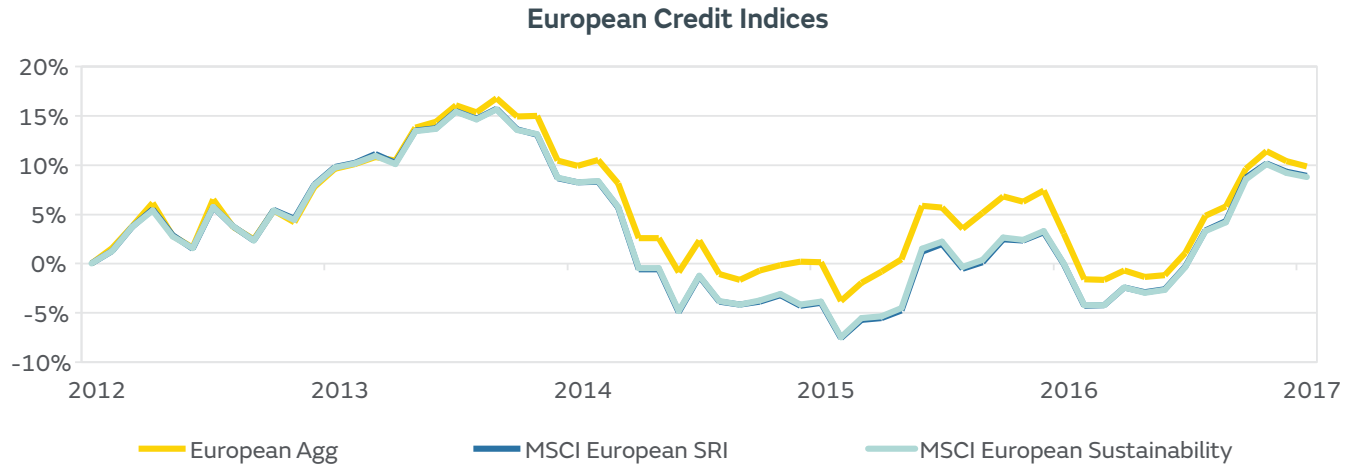


Source: Bloomberg

Ticker	Index	Const.	Total Return 1y	Total Return 3y	Total Return 5y	Std Dev (pa) 1y	Std Dev (pa) 3y	Std Dev (pa) 5y	Sharpe Ratio 1y	Sharpe Ratio 3y	Sharpe Ratio 5y	Mod Dur
RUCMTRUU	MSCI US SRI	4,455	3.5	11.8	17.4	3.6	4.3	4.2	0.8	0.8	0.7	7.2
SUCMTRUU	MSCI US Sustainability	3,119	3.2	11.9	16.7	3.8	4.4	4.3	0.7	0.8	0.7	7.4
LBUSTRUU	**US Agg**	**9,650**	**0.9**	**7.4**	**10.6**	**3.1**	**3.3**		**0.0**	**0.6**		**6.0**

Source: Bloomberg; certain data unavailable

In the European markets, the SRI/ESG indices lagged their counterpart. This, we believe, may be due to recent turmoil in the region offsetting the positive governance aspect of credit investing.



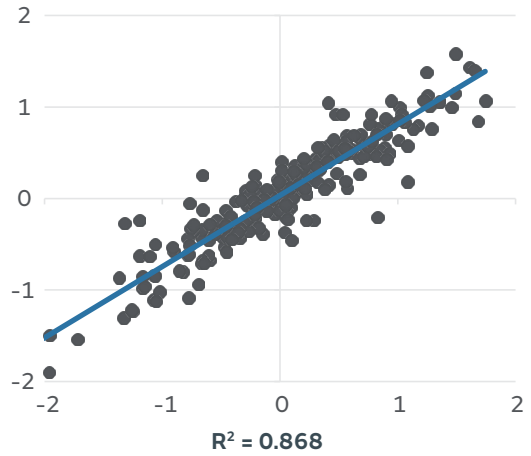
Source: Bloomberg

Ticker	Index	Const.	Total Return			Std Dev (pa)			Sharpe Ratio			Mod
			1y	3y	5y	1y	3y	5y	1y	3y	5y	Dur
RECMTRUU	MSCI European SRI	1,877	8.9	0.6	8.9	8.7	9.6	21.8	1.0	0.0	0.2	5.2
SECMTRUU	MSCI European Sustainability	1,630	8.7	0.5	8.8							5.2
LBEATRUU	**European Agg**	**4,497**	**6.6**	**0.0**	**9.8**	**9.4**	**9.9**	**8.9**	**0.7**	**0.0**	**0.2**	**6.7**

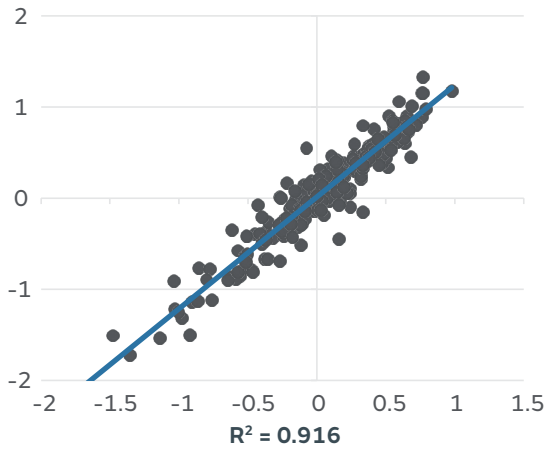
Source: Bloomberg; certain data unavailable

We ran the same style test on various credit indices and found the regressions were not as strongly connected. This is logical since credit markets are heavily influenced by management skill set and risk appetite. When comparing the Barclays Global Aggregate Index to the MSCI Global SRI Index we found an R^2 of 0.868. This reflects our assumption that the SRI index was able to outperform its peer by applying more emphasis on governance. We see a slightly stronger correlation in the US markets with an R^2 of 0.916.

Barclays Global Agg and MSCI Global SRI



Barclays US Agg and MSCI US SRI



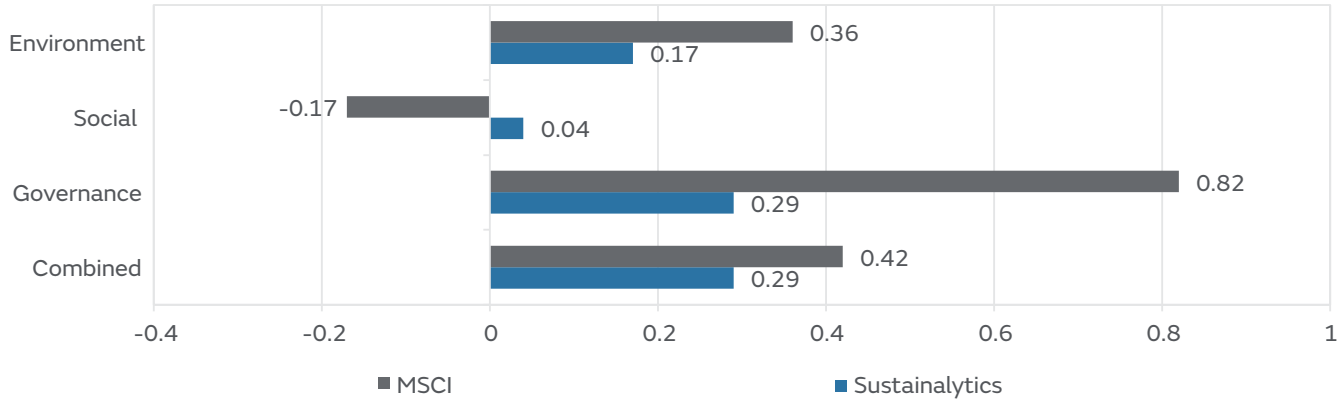
Source: Bloomberg

Barclays conducted a study aimed at determining a cause/correlation between fixed income investments and the companies associated ESG rating and the results were extremely encouraging for investors looking for a sustainable way to add value while aligning their investment goals with the SDGs. The study looked at ratings provided by MSCI and Sustainalytics and determined the "difference in rating between high and low ESG buckets corresponds to a one-notch change in credit rating."[39] Furthermore, the study examined the respective spread for each pillar of ESG and found similar findings. The average difference for high-ESG rated bonds is 38bp lower than bonds with low-ESG ratings (MSCI) and 35bp lower for Sustainalytics.

"SRI bond investing has outperformed its traditional peers."

39 Sustainable Investing and Bond Returns; A Research Study Into the Impact of ESG on Credit Portfolio Performance - Barclays 2016

Return Difference (%/y) Between Portfolios with High and Low Scores



Source: Sustainable Investing and Bond Returns; A Research Study Into the Impact of ESG on Credit Portfolio Performance - Barclays 2016

Governance was seen to be an extremely important pillar when evaluating the success of corporate fixed income investments. This is logical since **high quality management emphasis on responsible governance is assumed to be mutually beneficial for companies as well as investors.** Environment and Social factors, while less paramount, still add value to corporate bond portfolios (even after accounting for negative yearly returns as shown by MSCI). Furthermore, there was no trend of systematic richening of corporate bonds due to investor sentiment shift and bond returns were still derived from traditional analysis techniques (sector, quality and duration). This suggests there is a clear niche in which investors could capitalize on screening potential investments based on ESG ratings.[40]

There is further evidence that aligning sustainable and responsible investing techniques with that of bond analysis is mutually beneficial. Bonds with high MSCI governance scores experienced significantly fewer credit rating downgrades (2010-2016 examination period). Bonds with higher ESG ratings averaged roughly 5% (12m rolling average) fewer ratings downgrades than their lower rated ESG counterparts.[40]

Concerns

As with any new opportunity, there are several notable concerns investors should be made aware of before considering this new frontier.

- With the implementation of SRI/ESG investing, financial firms have dedicated significant resources to better understand the implications of this approach to investing. As a result, these **costs may be transferred to potential investors** and increase the cost of performing sound, prudent financial analysis. One example is the ESG ratings agencies – this research is obviously not free, but will investors be willing to pay for the analysis and how much of a benefit will the end user generate for these increased costs to make economic sense?

40 Sustainable Investing and Bond Returns; A Research Study Into the Impact of ESG on Credit Portfolio Performance - Barclays 2016

- Will ESG investing be a distraction from what is most important? The financial markets have undoubtedly become more complex and as a result there have been several instances of **industry participants putting their aspirations ahead of the investor.** Will regulatory concerns alleviate some of these concerns and how will investors respond to the increased cost of performing business in this sector?
- How will the flow of capital be affected in light of these new regulatory burdens? As companies look to become more marketable in an ESG world, will they pass these costs down to end investors? In addition, **how transparent and cohesive will their reporting be?** This is especially important in developing countries where governance is lacking.

With all these questions, there is certainly concern; however there is sound research and proof of concept that socially responsible investing is the future of pragmatic prudent investing.

Conclusion

While this exercise was driven to better understand this rapidly growing sector we undoubtedly did not fully examine this complex and rigorous industry but rather, attempted to capture main themes. We used indices as a vehicle to understand (broadly) how well this sector compares to its traditional counterparts. However, there are hundreds upon hundreds of indices, ETFs, investment funds, and asset specific vehicles which have been created in recent years. The job of the asset manager is to determine which vehicle best suits their investor's needs. There is an enormous amount of research available to investors and will likely continue to grow as money flows into the space.

"We believe this sector will continue to attract demand. Investors now have the real ability to make the world a better place for generations to come."

We believe this sector will continue to attract demand as world demographics and individual philosophies change. There is becoming an ever increasing need to protect the planet and its constituents and having adequate capital to drive this change; investors now have the real ability to make the world a better place for generations to come.

GIB ASSET MANAGEMENT

GIB (UK) Disclaimer

This discussion document has been prepared by Gulf International Bank (UK) Limited [GIB (UK)] for the exclusive use of GIB (UK) clients.

Past performance figures contained in this document should not, under any circumstances, be considered as being a guide or indication to future performance. Investing involves risk and the investments discussed may be subject to sudden and large falls in value. The prices and value of the investments and the income arising from such investments may fluctuate and you may not get back what you invested. Changes in the rates of foreign exchange against the base currency of the investor may also have an adverse effect on the value, price or income of the investments.

Although forward-looking statements contained in this document are based upon what GIB (UK) believes are reasonable assumptions, there can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements.

The investments discussed may not be suitable for all recipients of this document and if you have any doubts, you should seek advice from your investment adviser, stockbroker, lawyer, bank manager or other professional adviser.

This discussion document is not an offer to purchase any product or service rendered by GIB (UK). Such services may only be offered subject to a discretionary investment management agreement a standard draft copy of which includes a full risk disclosure and is available from GIB (UK).

This discussion document may not be distributed in all jurisdictions and is confidential and may therefore not be reproduced or disclosed (in whole or in part) to any other person without GIB (UK)'s prior permission.

GIB (UK) is authorized by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. GIB (UK) is registered as an Investment Advisor with the Securities and Exchange Commission in the United States.

This document has been prepared by GIB (UK). The views expressed in this publication are those of the author(s) alone and are subject to change without notice. GIB (UK) has no obligation to update this publication. This information is intended for informational purposes only. The information contained in this publication has been obtained from sources that GIB (UK) believes to be reliable, but GIB (UK) makes no representations that the information contained herein is accurate, reliable, complete, or appropriate for use by all investors in all locations. Further, GIB (UK) does not guarantee the accuracy or completeness of information which is obtained from, or is based upon, trade and statistical services or other third party sources. Because of the possibility of human and mechanical errors as well as other factors, GIB (UK) is not responsible for any errors or omissions in the information contained herein. GIB (UK) is not responsible for, and makes no warranties whatsoever as to, the content of any third-party web site accessed via a hyperlink contained herein and such information is not incorporated by reference

Notes

Notes

<page intentionally left blank>

Invest with us

What we invest in matters.

Long-term relationships to shape your investment imprint are at the heart of what we do.

Get in touch to see how we can help you invest for your unique imprint.

W: gibam.com
T: +44 (0) 20 7259 3149
E: solutions@gibam.com

Signatory of:

PRI Principles for Responsible Investment

Gulf International Bank (UK) Limited is a signatory of the United Nations Principles of Responsible Investment (UN PRI). The UN PRI is a voluntary initiative that encourages investors to embed environmental, social and governance (ESG) factors into their investment decision-making.

GIB ASSET MANAGEMENT