Douglass
Winthrop

New York Boston Washington, D.C. West Palm Beach

July 12, 2022

Dear DWA Environment Strategy Clients and Friends:

Last December, in its annual look-ahead to the upcoming year, *The Economist* said inflation would decelerate in 2022 and "fade as a macroeconomic concern" and projected that Putin would clamp down on the internet for enabling his democratic opposition.[i] No mention of 40-year inflation highs just ahead, nor inkling that Putin would shortly launch a major European war. It's easy to pick on prognosticators for being wrong, as they often are. The constructive takeaway, we believe, is to be — and stay — invested in high-quality companies whose business models and balance sheets allow them to operate consistently and profitably in the face of such inevitable surprises. Market sentiment may temporarily turn against even such resilient companies when macro pressures come to the fore and drive relatively indiscriminate selling, as they have in the first half of 2022. Such volatility notwithstanding, an individual company's return to shareholders, tends over time toward earnings growth plus dividends. We believe the Environment Strategy portfolio is replete with "coiled springs" that the market will come to appreciate over the course of our typically long holding periods as their respective earnings power is demonstrated, and as their advantages in navigating environmental risks and opportunities are recognized. Of course, there is no guarantee favorable outcomes will transpire; we strive to stay alert to any signs that our thesis on any given company may not be playing out according to our long-term projection and to use diversification and other tools to manage such risks on behalf of clients.

Portfolio Changes

Our reaction to challenging macro conditions is not to trade the rotation-du-jour but to double down on our bottom-up research, taking advantage of any new and unique market conditions to objectively reassess our thesis on each company we hold, including the adaptability of its management team and the resilience of its business model and projected cash flows. This analysis can lead us to tactically re-size a position or sell a company to fund an attractive entry point in a new position. Early in Q1, we made several defensive portfolio adjustments as we monitored the Fed's pivot to a rate hiking cycle and an emerging risk of recession. We boosted our positions in **Thermo Fisher Scientific** and **Danaher,** two healthcare companies with recession-resistant attributes including must-have products and high recurring revenues. We decreased our exposure to **Starbucks** and **Nike**, two consumer discretionary companies facing softening consumer sentiment, persistent cost inflation and headwinds from their exposure to the China slowdown. We reduced our positions in **NextEra**, **Costco** and **Waste Management** in order to harvest and redeploy gains. We sold **Hannon Armstrong** and added new positions in **Goldman Sachs**, **United Rentals**, **John Deere**, and **Trex**.

Hannon Armstrong (HASI)'s core business of financing renewables, energy efficiency and climate resiliency, requires ongoing access to debt and "at-the-market" equity capital, both of which are at risk as rates rise. In our Q3 2021 discussion with management, we also grew concerned about HASI's ability to scale their labor-intensive underwriting model to tap into the next leg of their massive addressable market. We used the proceeds from selling HASI to fund a new position in **Goldman Sachs (GS)**. We believe that GS is well positioned to play a crucial enabling role in financing the global transition to a low-carbon economy, a potential multi-trillion dollar opportunity. GS committed to deploy $600 billion into the "climate transition" by 2030[ii], and is ahead of schedule, whereas HASI has averaged investments of around $2 billion per year. GS also ranks 14th on BankTrack's league table of fossil fuel financiers, favorably lower than other major US banks such as JP Morgan, Citi, Wells Fargo, Bank of America and Morgan Stanley in cumulative financings over the past six years.[iii]

We've long explored how to acquire lower-risk exposure to the rapid adoption of renewables now underway in large emerging markets, and we came to appreciate GS as a vehicle for this. In 2011, the firm provided $200 million in early-stage funding to ReNew Power, the largest investment in India's renewable sector at the time. Subsequently, GS supported ReNew with multiple rounds of equity and debt financings and then shepherded its public listing via merger just last year. Here in the U.S., GS's Renewable Power Group is one of the largest owners of commercial and industrial solar businesses. In its asset management unit, GS has incorporated a low-carbon tilt into many of its active equity funds to help hedge climate risk exposure. CEO David Solomon has diversified GS, building up its recurring revenues and investing in technology and acquisitions to establish a new digital consumer banking unit to accompany the firm's #1 market share in Mergers &

Acquisitions. GS met our traditional DWA investment filters, including an attractive valuation near book value and a solid dividend which has grown 400% since August 2013. The company has built a robust growth engine in sustainable finance that led us to add it to the portfolio as an E-Advantaged company.

United Rentals (URI) can be considered the "Uber" of heavy duty equipment. As CEO John Flannery noted, URI is a pioneer of the "sharing economy," a business model where asset utilization is maximized and environmental footprint correspondingly lowered. The largest equipment rental company in the world, with over 1300 locations in North America and a growing presence internationally, URI's diverse end markets across industry and construction reduce its full-cycle volatility. Its $16 billion fleet of equipment generated nearly $10 billion in revenues just last year and 45% profit margins before interest costs, depreciation and amortization. URI's equipment is utilized at an estimated 4x higher rate than their customers achieve with their owned equipment. In our analysis, this produces a meaningful, if somewhat hidden, reduction in "embodied carbon" (i.e., the energy and materials consumed to manufacture equipment even before it's used) since fewer pieces of equipment are required to do the same number of jobs. URI benefits from the secular shift from ownership to renting, one we regard as resilient to potential scenarios ahead. If we tip into recession, more customers will rent instead of spending scarce capital on new equipment. If equipment pricing and financing costs increase due to inflation, renting is likewise more attractive. URI is positioned to benefit from the 2021 $1 trillion infrastructure law that should drive construction activity in earnest in 2023. URI also possesses an underappreciated growth opportunity as an enabler of climate adaptation, offering flexibly dispatchable equipment for storm response and reconstruction in the aftermath of increasingly prevalent and destructive climate events.

We added **Deere (DE)** to the Environment Strategy to boost our exposure to precision agriculture, along with longtime holding **Trimble (TRMB)**. With the population burgeoning to 9.8 billion by 2050, the world must double food production while reducing the use of emissions-intensive fertilizers as well as water, pesticides and herbicides. In an environment where labor and fuel are more expensive, DE's products reduce costs and improve yields, capitalizing on the $150 billion precision agriculture market opportunity. DE's fortress-like balance sheet and seasoned management team have been battle-tested through multiple recessions and are well suited to implement the next wave of technological initiatives. With over 140 connected software tools, Deere assists in meeting nearly all farming needs. Higher penetration of software and subscription services is enhancing its mix of non-cyclical "recurring" sales, increasing the stability of DE's earnings.

Performance

			Reference Indexes		
	DWA Environment (gross)	DWA Environment (net)	MSCI SRI TR Index	S&P 500 Total Return Index	MSCI World TR USD Index
Annualized Returns					
1Yr	-21.06%	-21.72%	-13.64%	-10.62%	-14.34%
3Yr	11.28%	10.37%	8.70%	10.60%	7.00%
5Yr	13.65%	12.72%	9.48%	11.31%	7.67%
Inception	15.40%	14.45%	10.63%	12.04%	8.94%
Cumulative Returns					
1Yr	-21.06%	-21.72%	-13.64%	-10.62%	-14.34%
3Yr	37.79%	34.45%	28.44%	35.29%	22.49%
5Yr	89.64%	82.01%	57.31%	70.86%	44.69%
Inception	119.73%	109.97%	74.25%	86.82%	60.11%

Please note: Past performance is no guarantee of future results.

We believe the 2022 pullback in equity markets has created an especially attractive entry point for new investors into the DWA Environment Strategy. Accordingly, and as usual, we welcome any referrals you might wish to make to individuals, endowments or other institutions who you think might benefit from an allocation to the DWA Environment Strategy. Please reach out to Mary Kush (mary@douglasswinthrop.com) or Dan Abbasi (dan@douglasswinthrop.com) if you would like to set up a call with the team. Mary leads our institutional engagement and Dan serves on the Environment Strategy Portfolio Management Committee.

Best regards,

The Douglass Winthrop Team

[i] https://www.economist.com/the-world-ahead/2021/11/08/what-will-happen-to-inflation-in-2022

[ii] https://www.goldmansachs.com/our-commitments/sustainability/sustainable-finance/documents/reports/2020-sustainability-report.pdf

[iii] https://www.banktrack.org/download/banking_on_climate_chaos_2022/2022_banking_on_climate_chaos.pdf