

Morgan Stanley

INVESTMENT MANAGEMENT

2021
REPORT

ESG Progress and Outlook

Global Emerging Markets Team

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Progress Report

In 2020, we continued to strengthen and expand our environmental, social and governance (ESG) research and engagement. Climate change continues to be a key focus of our ESG research and engagement.

Over the past year, we developed a new country dashboard to track climate metrics, at the country level, across developed, frontier, and emerging markets. The dashboard allows our investment team to compare countries on more than 40 different climate-related metrics, such as water stress or emissions intensity, renewable energy availability, or energy efficiency policies. This allows us to better anticipate the climate-related risks and opportunities facing companies, whether from physical risks like rising sea levels, or transition risks like carbon taxes.

We also expanded our research on decarbonization, focusing on the growing number of nations pledging to achieve net-

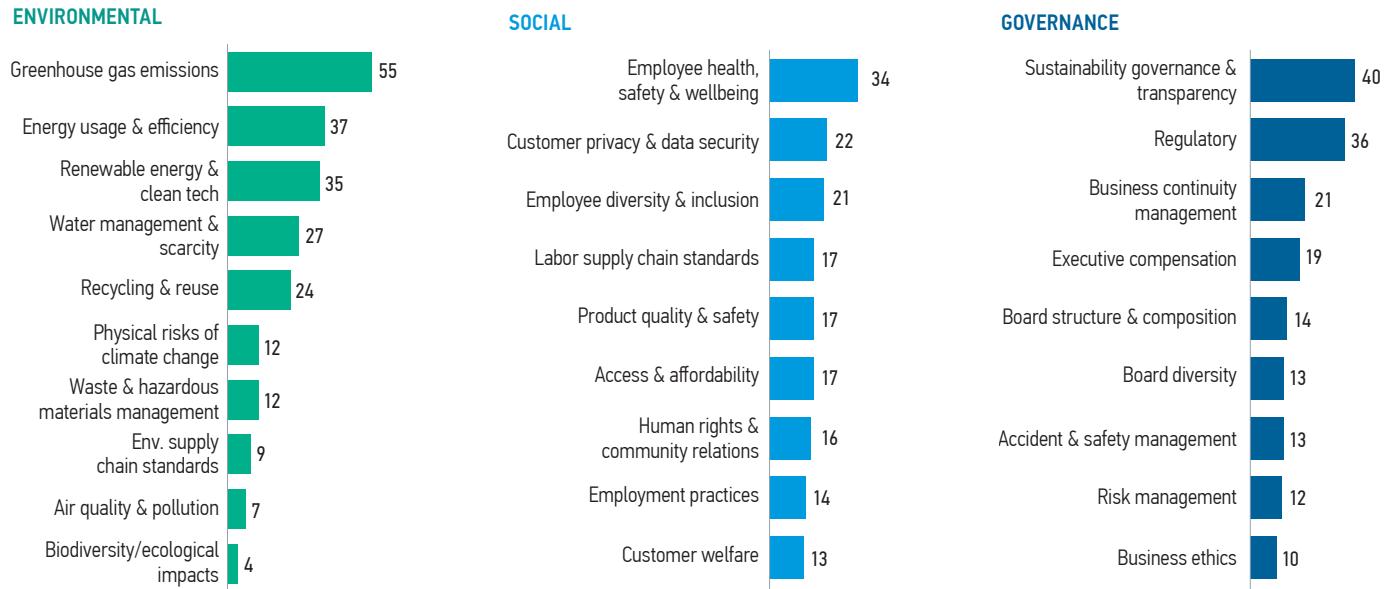
zero emissions, the likely impact on the energy mix, and the resulting implications for countries, industries and companies.

Our ESG and sustainability research in turn informs our engagement strategy. We identify metrics most relevant to each company, considering their home country and geography, sector, recent performance on ESG issues and global peers. Our engagement objective is to press each company for positive change that aligns with long-term shareholder value and track their progress over time. ESG performance data has become an increasingly useful investing tool, informing our forecasts and valuations, and helping us to evaluate how well companies are managing long-term risks.

Engagement Statistics

In 2020, the team engaged with 178 portfolio companies on a range of ESG topics. Of these, 76 were dedicated ESG meetings, a five-fold increase from 2019. Dedicated ESG engagements include an investment team member and ESG specialist. These in-depth ESG meetings focus on how management teams incorporate ESG risks and opportunities into their long-term strategy. The chart below highlights the top ESG topics discussed over the year.

Number of ESG engagements in 2020 by topic



Source: MSIM. Company meetings may cover one or more ESG topics

Tracking Company Progress

Engagements serve the dual purpose of enabling unique insights and encouraging companies to improve performance on ESG issues.

Through our engagement process, we have built a reference database of material ESG issues covering more than 70 industry groups. Our topics of discussion are increasing in granularity as our research develops. For example, in our engagement with an Asian microfinance company, we learned how the company is mitigating risk from climate change by developing loans which encourage farmers to rotate and diversify crops. In our discussion with a logistics operator, we focused on how safety initiatives has led to improved

utilization and returns. By discussing gender diversity with one of the world's largest game developers, we developed a better understanding of how this company was able to develop a wide assortment of games and a large, diverse user base.

Our centralized engagement database allows us to track each company's progress on material ESG issues. Following are some examples of how our 2020 ESG engagements influenced company actions or our investment decisions.

EXAMPLE	ENGAGEMENT FOCUS	OUTCOME
Russian steel producer	<ul style="list-style-type: none"> Improve disclosure on and reduce carbon emissions in line with the Paris Climate Agreement 1.5° scenario 	The company subsequently published 2023 greenhouse gas emissions and emissions intensity reduction targets. The company is pursuing R&D projects to integrate hydrogen into steel production to further reduce emissions over the medium and long term.
Asia beverage producer	<ul style="list-style-type: none"> Improve disclosure on material ESG initiatives 	The company subsequently established 2025 targets on circular packaging (100%), purchased renewable electricity (100%), and CO2 emissions reductions (-25%).
Latin American bank	<ul style="list-style-type: none"> Increase independence and diversity of board and committees 	The company subsequently added another female director, split the chairman and CEO roles, and changed the structure of key committees.
Russian mining company	<ul style="list-style-type: none"> Improve environmental and safety standards 	We determined that environmental and safety standards remained inadequate. We exited the position after determining the company faced additional climate change and safety-related risks.
South African pulp and paper manufacturer	<ul style="list-style-type: none"> Establish net targets aligned with the Science-Based Targets Initiative Employee safety 	<p>The company subsequently confirmed the establishment of its science-based targets.</p> <p>Continuing to engage and monitoring progress on employee safety initiatives.</p>
Indonesian conglomerate	<ul style="list-style-type: none"> Energy transition risk 	We exited this position based on expected continued headwinds for the company's coal-related businesses and the lack of sufficient growth in non-coal related businesses to offset these headwinds.

Holding Boards Accountable

In our active proxy voting process in 2020, we voted against management on 14% of all resolutions reviewed. Following are a few examples of our votes against the boards.

Indonesian financial services company

Management sought approval of remuneration for top executives, including substantial bonuses for independent commissioners, without offering any rationale for the extra compensation.

Chinese financial services company

Management bundled multiple amendments to its article of association into a single proposal, and shortened the notice period before the vote; we were concerned these measures could effectively disenfranchise shareholders.

Brazilian oil company

Management bundled multiple amendments into a single resolution that would amend the company bylaws. Some of those amendments had the potential to undermine the company's governance standards and its process for nominating directors.

Korean chemicals company

Management sought the election of a non-independent, non-executive director to the board, which was already dominated by company insiders.

2021 Engagement Priorities

We will continue to engage current and prospective portfolio companies on material ESG issues, as identified by our company and country research. Climate change, natural capital, and inequality represent systemic risks and will continue to be a focus of our engagement strategy.

RELEVANCE		ENGAGEMENT FOCUS
Climate change	Though progress remains far from sufficient, 2020 saw many countries and companies issue net-zero emissions pledges. Countries that have made this pledge now account for more than 50% of global GDP ¹ . Worldwide, 1,346 companies have adopted net-zero goals in line with the Science-Based Targets Initiative ² . In 2021, climate change will remain an important topic, highlighted by the 26th Conference of the Parties (COP 26) taking place in November.	<ul style="list-style-type: none"> Decarbonization strategies and progress Progress toward setting net zero targets in accordance with the Science-Based Targets Initiative Adaptation and preparedness for physical risks of climate change
Natural capital	Natural capital includes resources from air to water and living organisms. Depletion of these resources poses a significant challenge for economic growth, wealth and equality in emerging countries. One subset of natural capital, biodiversity, is gaining attention, especially with the 15th Conference on the Parties to the Convention on Biological Diversity approaching in May.	<ul style="list-style-type: none"> Waste management Water management Biodiversity
Inequality and human capital	The COVID-19 pandemic has disproportionately impacted emerging markets and lower income populations. This has exacerbated preexisting inequality issues and presents additional risks to growth and stability.	<ul style="list-style-type: none"> Pay equity Living wages Workforce safety and well-being Employee and board diversity Access and affordability

In our view, the potential impact of ESG issues is greatest in emerging markets, where risks like climate change and social inequality are particularly acute. As active investors we can and will play a critical role in promoting change through better corporate behavior.

We believe that companies that proactively address ESG risks and opportunities will prove more resilient than their peers. To stay ahead of these developments, our research on key investment risks and opportunities and our engagement efforts will continue to expand and accelerate.

¹ Source: United Nations – <https://www.un.org/press/en/2020/sgsm20411.doc.htm>

² Source: Science-Based Targets Initiative – <https://sciencebasedtargets.org/companies-taking-action>

RISK CONSIDERATIONS

ESG strategies that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance. There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to **market risk**, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in a portfolio. Please be aware

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DEFINITIONS

"ESG" investment: Environmental Social and Governance based investment is an investment approach which takes explicit account of the environmental, social and corporate governance aspects of all proposed investments.

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