



Morgan Stanley

INVESTMENT MANAGEMENT

2021  
REPORT

# ESG Progress and Outlook

**Global Emerging Markets Team**

GLOBAL EMERGING MARKETS EQUITY | EMERGING MARKETS LEADERS | ASIA EQUITY  
SUSTAINABLE ASIA EQUITY | FRONTIER MARKETS EQUITY | EMERGING MARKETS SMALL CAP  
CHINA A EQUITY | CHINA EQUITY | INDIA EQUITY | LATIN AMERICA EQUITY





1

PROGRESS REPORT

2

TRACKING COMPANY PROGRESS

3

HOLDING BOARDS ACCOUNTABLE

4

2021 ENGAGEMENT PRIORITIES



# 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.

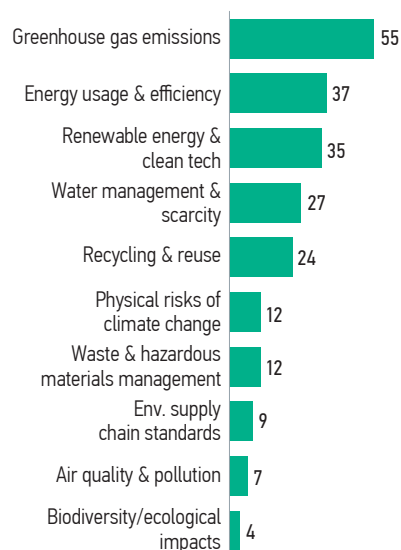
Our ESG and sustainability research in turn informs our engagement strategy. We identify metrics most relevant to each company, considering their home country and geography, sector, recent performance on ESG issues and global peers. Our engagement objective is to press each company for positive change 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

#### ENVIRONMENTAL



#### SOCIAL



#### GOVERNANCE



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
<b>Russian steel producer</b>	<ul style="list-style-type: none"> <li>Improve disclosure on and reduce carbon emissions in line with the Paris Climate Agreement 1.5° scenario</li> </ul>	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.
<b>Asia beverage producer</b>	<ul style="list-style-type: none"> <li>Improve disclosure on material ESG initiatives</li> </ul>	The company subsequently established 2025 targets on circular packaging (100%), purchased renewable electricity (100%), and CO2 emissions reductions (-25%).
<b>Latin American bank</b>	<ul style="list-style-type: none"> <li>Increase independence and diversity of board and committees</li> </ul>	The company subsequently added another female director, split the chairman and CEO roles, and changed the structure of key committees.
<b>Russian mining company</b>	<ul style="list-style-type: none"> <li>Improve environmental and safety standards</li> </ul>	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.
<b>South African pulp and paper manufacturer</b>	<ul style="list-style-type: none"> <li>Establish net targets aligned with the Science-Based Targets Initiative</li> <li>Employee safety</li> </ul>	<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>
<b>Indonesian conglomerate</b>	<ul style="list-style-type: none"> <li>Energy transition risk</li> </ul>	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
<b>Climate change</b>	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 <sup>1</sup> . Worldwide, 1,346 companies have adopted net-zero goals in line with the Science-Based Targets Initiative <sup>2</sup> . 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"> <li>• Decarbonization strategies and progress</li> <li>• Progress toward setting net zero targets in accordance with the Science-Based Targets Initiative</li> <li>• Adaptation and preparedness for physical risks of climate change</li> </ul>
<b>Natural capital</b>	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"> <li>• Waste management</li> <li>• Water management</li> <li>• Biodiversity</li> </ul>
<b>Inequality and human capital</b>	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"> <li>• Pay equity</li> <li>• Living wages</li> <li>• Workforce safety and well-being</li> <li>• Employee and board diversity</li> <li>• Access and affordability</li> </ul>

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.

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

<sup>2</sup> 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

that this portfolio may be subject to certain additional risks. In general, **equities securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, market and liquidity risks. The risks of investing in **emerging market countries** are greater than the risks generally associated with investments in foreign developed countries. Stocks of **small and medium-capitalization companies** entail special risks, such as limited product lines, markets, and financial resources, and greater market volatility than securities of larger, more established companies. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the Portfolio's performance. **Illiquid securities** may be more difficult to sell and value than public traded securities (liquidity risk). **Non-diversified portfolios** often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility.

## 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.

## IMPORTANT DISCLOSURES

The views and opinions are those of the author as of the date of publication and are subject to change at any time due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all portfolio managers at Morgan Stanley Investment Management (MSIM) or the views of the firm as a whole, and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific Morgan Stanley Investment Management product.

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness.

The information herein is a general communication which is not impartial and has been prepared solely for information and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The material contained herein has not been based on a consideration of any individual client circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

This communication is not a product of Morgan Stanley's Research Department and should not be regarded as a research recommendation. The information contained herein has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

## DISTRIBUTION

**This communication is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.**

**Ireland:** MSIM Fund Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland. Registered in Ireland as a private company limited by shares under company number 616661. MSIM Fund Management (Ireland) Limited is regulated by the Central Bank of Ireland. **United Kingdom:** Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA, authorised and regulated by the Financial Conduct Authority. **Dubai:** Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **Germany:** MSIM Fund Management (Ireland) Limited Niederlassung Deutschland, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** MSIM Fund Management (Ireland) Limited, Milan Branch (Sede Secondaria di Milano) is a branch of MSIM Fund Management (Ireland) Limited, a company registered in Ireland, regulated by the Central Bank of Ireland and whose registered office is at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland. MSIM Fund Management (Ireland) Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 11488280964. **The Netherlands:** MSIM Fund Management (Ireland) Limited, Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of MSIM Fund Management (Ireland) Limited. MSIM Fund Management (Ireland) Limited is regulated by the Central Bank of Ireland. **France:** MSIM Fund Management (Ireland) Limited, Paris Branch is a branch of MSIM Fund Management (Ireland) Limited, a company registered in Ireland, regulated by the Central Bank of Ireland and whose registered office is at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland. MSIM Fund Management (Ireland) Limited Paris Branch with seat at 61 rue de Monceau 75008 Paris, France, is registered in France with company number 890 071 863 RCS. **Spain:** MSIM Fund Management (Ireland) Limited, Sucursal en España is a branch of MSIM Fund Management (Ireland) Limited, a company registered in Ireland, regulated by the Central Bank of Ireland and whose registered office is at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland. MSIM Fund Management (Ireland) Limited, Sucursal en España with seat in Calle Serrano 55, 28006, Madrid, Spain, is registered in Spain with tax identification number W0058820B. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branch Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41(0) 44 588 1074.

**U.S.:** A separately managed account may not be appropriate for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required. For important information about the investment manager, please refer to Form ADV Part 2.

**Please consider the investment objectives, risks, charges and expenses of the funds carefully before investing. The prospectuses contain this and other information about the funds. To obtain a prospectus please download one at [morganstanley.com/im](https://morganstanley.com/im) or call 1-800-548-7786. Please read the prospectus carefully before investing.**

Morgan Stanley Distribution, Inc. serves as the distributor for Morgan Stanley Funds.

**NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT**

**Australia:** This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accept responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. **Hong Kong:** This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This publication should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"), (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. In particular, for investment funds that are not authorized or recognized by the MAS, units in such funds are not allowed to be offered to the retail public; any written material issued to persons as aforementioned in connection with an offer is not a prospectus as defined in the SFA and, accordingly, statutory liability under the SFA in relation to the content of prospectuses does not apply, and investors should consider carefully whether the investment is suitable for them. This publication has not been reviewed by the Monetary Authority of Singapore.

**Japan:** For professional investors, this document is circulated or distributed for informational purposes only. For those who are not professional investors, this document is provided in relation to Morgan Stanley Investment Management (Japan) Co., Ltd. ("MSIM")'s business with respect to discretionary investment management agreements ("IMA") and investment advisory agreements ("IAA"). This is not for the purpose of a recommendation or solicitation of transactions or offers any particular financial instruments. Under an IMA,

with respect to management of assets of a client, the client prescribes basic management policies in advance and commissions MSIMJ to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIMJ accepts such commission. The client shall delegate to MSIMJ the authorities necessary for making investment. MSIMJ exercises the delegated authorities based on investment decisions of MSIMJ, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IAA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20% per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above.

#### **IMPORTANT INFORMATION**

**EMEA:** This marketing communication has been issued by MSIM Fund Management (Ireland) Limited. MSIM Fund Management (Ireland) Limited is regulated by the Central Bank of Ireland. MSIM Fund Management (Ireland) Limited is incorporated in Ireland as a private company limited by shares with company registration number 616661 and has its registered address at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland.

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Prior to investing, investors should carefully review the strategy's/product's relevant offering document. There are important differences in how the strategy is carried out in each of the investment vehicles.

**A separately managed account may not be appropriate for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing.**

Past performance is no guarantee of future results. Charts and graphs provided herein are for illustrative purposes only.

MSIM has not authorized financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. MSIM shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary.

The whole or any part of this work may not be directly or indirectly reproduced, copied, modified, used to create a derivative work, performed, displayed, published, posted, licensed, framed, distributed or transmitted or any of its contents disclosed to third parties without MSIM's express written consent. This work may not be linked to unless such hyperlink is for personal and non-commercial use. All information contained herein is proprietary and is protected under copyright law.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.