Sustainable Development Goals – What are the SDGs?

SATURNA CAPITAL

FROM THE YARDARM
MARKET COMMENTARY & ANALYSIS

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Saturna Capital, manager of the Amana, Saturna Sustainable, Sextant, and Idaho Tax-Exempt Funds, uses years of investment experience to aid investors in navigating today's volatile markets. Founded in 1989 by professionals with extensive experience, Saturna has helped individuals and institutions build wealth, earn income, and preserve capital.

Saturna's deep-rooted belief in value investing shines through in the quality of our investments. We don't follow trends, we analyze opportunities. Years of experience have given Saturna financial strength and stability. Most important to Saturna's success, however, is our clients' success. We believe that our clients' interest always come first.

At Saturna, we believe in making your investment dollars work hard for you. Toward this end, Saturna strives to not only offer the best investment opportunities from mutual funds to IRAs, but to match those sound investments with superior customer service.

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The Global Goals for Sustainable Development (SDGs), officially known as "Transforming Our World: the 2030 Agenda for Sustainable Development," consist of 17 goals and 169 targets that were created to end poverty, promote prosperity and well-being for all, and protect the planet. The SDGs set a course and framework to achieve these objectives. According to the United Nations Conference on Trade and Development, achieving these goals will require investment as high as $7 trillion, with an investment gap in developing countries of about $2.5 trillion.[1] However, achieving these goals could open up $12 trillion of market opportunities in food and agriculture, cities, energy and materials, and health and well-being, while creating 380 million new jobs by 2030.[2] The goals offer a compelling growth strategy for business and the world economy; however, the SDGs also need business to seize opportunities and advance progress.

The SDGs have been gaining broad support. Since their launch, foundations from around the world have contributed more than $50 billion toward achieving the goals.[3] Additionally, companies are incorporating the SDGs as a means of mitigating environmental, social, and governance (ESG) risks as part of their overarching business strategy. For example, 40% of the world's largest companies currently discuss the SDGs in their corporate reporting.[4,5] Identifying good corporate governance – as demonstrated by excellent transparency, risk awareness, and positioning to take advantage of these coming opportunities – could be a major driver of long-term value for investors. Sustainability and performance in a portfolio work together under the framework of the Global Goals.

History and Development of the SDGs

The Sustainable Development Goals were adopted on September 25, 2015. They reflect the culmination of a working process among 193 member states covering a broad range of sustainable development issues.[6] In a large measure, the SDGs reflect a working agenda aimed at addressing the human and environmental challenges of our age. These challenges were concisely captured by Ban Ki-moon, the United Nations Secretary-General from 2007-2016; "We don't have a plan B because there is no planet B."[7]

The SDGs are an extension of prior United Nations programs aimed at alleviating human deprivation, degradation, and conditions associated with poverty. The SDGs' antecedents can be traced as far back as President Franklin D. Roosevelt's "Four Freedoms" speech on January 6, 1941, which later inspired the United Nations Declaration of Human Rights, General Assembly Resolution 217A.[8,9]

Most recently, the updated Global Goals are a modification of the ratified United Nations Millennium Declaration established on September 8, 2000, that created the framework for what was called the Millennium Development Goals (MDGs), outlining an eight point program aimed at alleviating conditions of extreme poverty.[10] The MDGs had notable successes which included the reduction of child mortality by more than half and lifting more than one billion people out of extreme poverty based upon 1990 benchmarks.[11]

Goal Evolution: From MDGs to SDGs

2000	2015
Millenium Development Goals	**Sustainable Development Goals**
Poverty/Hunger	Decent work and economic growth
	Zero hunger
	No poverty
Education	Quality education
Equality/Women	Gender equality
	Reduced inequalities
Child Mortality	Good health and well-being
Maternal Health	
HIV/AIDS/Malaria	
Environment	Climate action
	Clean water and sanitation
	Life on land
	Sustainable cities and communities
	Peace and justice
	Strong institutions
	Life below water
Partnership	Partnerships for the goals
	Industry, innovation, and infrastructure
	Affordable and clean energy
	Responsible consumption and production

Source: PwC Make It Your Business: Engaging with the Sustainable Development Goals, 2015

The Business Case for Adoption of SDGs

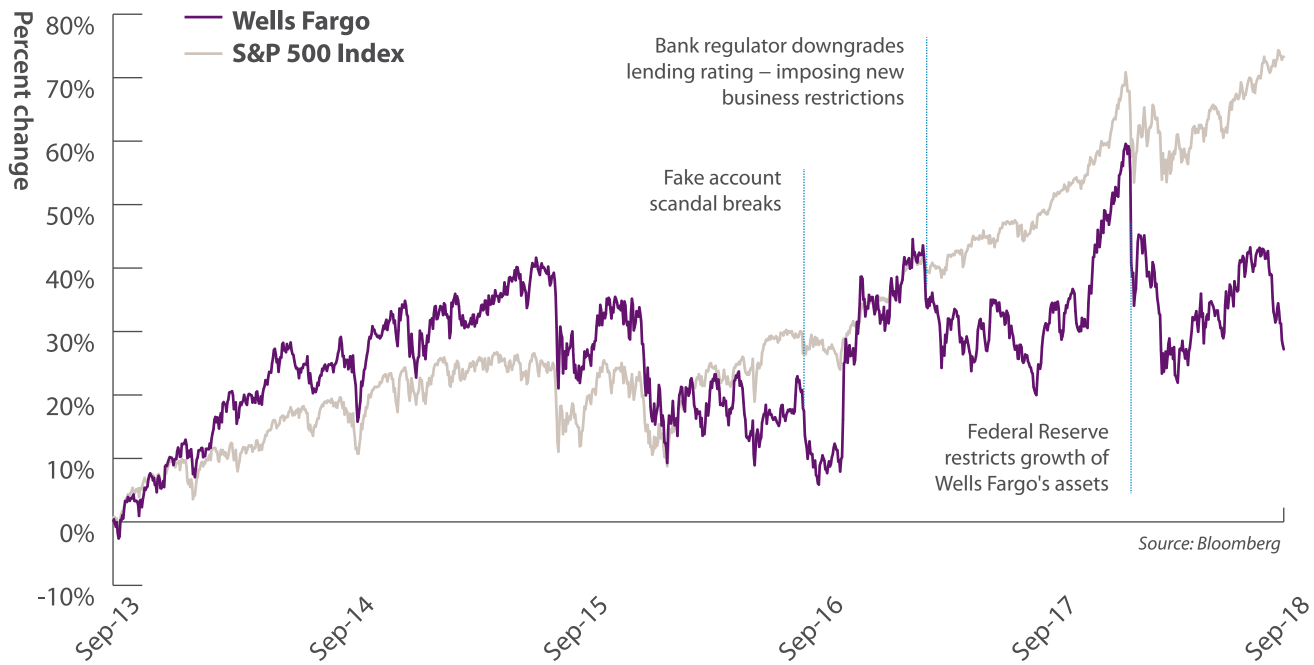
Responsible investing incorporating environmental, social, and governance (ESG) criteria can be an effective way to counter risks that may impact a company's financial results. Corporate issues are subject to differing ESG considerations depending on their industries. For example, utilities and resource extraction companies are more exposed to environmental factors than a firm operating in the service industry. Observing management's willingness and ability to proactively manage these ESG factors may not only reduce financial risk but also create the potential for firms to form a competitive advantage relative to their peers. High-profile corporate missteps call attention to the risks extending outside of traditional financial research. Notable ones include BP's Deepwater Horizon environmental disaster, which has cost the company $65 billion to date.[12] Such financial outlays, in addition to the adverse environmental and community impacts, are not a trivial matter. As a result, it may not be surprising to see that since the ratification of the SDGs, companies with a combined market capitalization of $9.7 trillion have recognized the importance of providing data on their sustainability metrics by referencing SDGs in their annual report.[13]

Investors are using the SDGs as a framework for measuring risk and impact. The 17 goals map well to environmental, social, and governance (ESG) data commonly used in investment analysis. Such an analysis is used to evaluate how securities contribute to the UN's Sustainable Development Agenda and also to evaluate exposure to risks as seen through an ESG lens. The same factors that make it worthwhile for corporations to report and adopt the agenda, also improve performance and investment returns. Strong management quality and proactive business practices tend to enhance business sustainability.

Wells Fargo provides an excellent example of the cost of poor governance. The company, with unreasonable sales goals and a toxic culture, clearly violated SDG 8, which focuses on inclusive and sustainable economic growth and full, productive employment. This was done not only without regard to their employees' well-being, but the company also actively harmed their customers and community. Recent scandals have cost the bank a significantly diminished stock price, a tarnished reputation, and $1 billion of fines related to insurance and mortgage abuses. The chart on the next page details some of the major events relative to the stock price of the bank. Each negative development clearly impacts price, and thus investment return. The Wells Fargo board had received communications as early as 2005 indicating possible cultural problems, but ultimately the decentralized structure of the bank, which gave too much deference to department heads, allowed the problem to fester. Reports show that the board learned about the firing of 5,300 employees with the rest of the world in September of 2016, only highlighting the poor communication in the organization. These issues stress the importance of evaluating board and corporate structure through a framework such as the Sustainable Development Goals.[14]

THE BUSINESS CASE FOR GOOD GOVERNANCE IS CLEAR

Wells Fargo's Stock Price: Effects of Scandal and Restriction



The business case for good governance is clear. However, assessing the strength of governance goes beyond just a financial and structural analysis. Companies and investors are increasingly looking at inclusion and diversity as a source of competitive advantage. A gender-inclusive base of management and board members offers an edge, bringing a wider range of perspectives and experiences to the business. Gender diversity is correlated with both profitability and value creation.

According to the McKinsey report "Delivering through Diversity," companies in the top quartile for gender diversity on their executive teams were 21% more likely to have above-average profit margin relative to peers than companies in the fourth quartile. When the same set of companies is measured by earnings before income and taxes (EBIT) margin, those in the top quartile were 27% more likely to have industry-leading performance.[15] Additional research by Credit Suisse on 2,400 companies has shown that greater gender diversity also attracts an investment premium. They show that companies with at least one female director generated a compound excess return per year of 3.5% for investors since 2005 compared to companies where the boardroom is entirely male. The study also revealed that companies with female CEOs attract a 19% premium on the price-to-book multiple and show return on equity (ROE) 19% higher on average. It's important to note that unfortunately, the data is somewhat constrained due to the relatively small number of female CEOs in the sample, composing 3.9% of total at the time of the report.[16]

A separate and ongoing study by MSCI revealed that over a five-year period (2011 – 2016) US companies that began the period with at least three women on the board experienced median gains in ROE of 10 percentage points and earnings per share (EPS) of 37%. In contrast, companies that began the period with no female directors experienced median changes of one percentage point in ROE and -8% in EPS over the period.[17] The issue is gaining traction within the investment community, with assets in the US funds focused on gender diversity growing at an 81% compound annual growth rate from 2014-2017 to around $910 million.[18] The growing focus on ESG/impact investing suggests that assets focused on investing in gender diversity will continue to grow. Saturna is committed to this goal from a business perspective in that we have female representation in executive management and on the board. Additionally, the firm incorporates gender diversity as an important part of the investment analysis process. Details are provided in our 2018 Impact Report.

GENDER DIVERSITY ON THE BOARD AND IN THE C-SUITE CORRELATES WITH BETTER FINANCIAL PERFORMANCE

Gender diversity on boards and in executive management integrates easily into the framework of the Sustainable Development Goals. One of the targets within SDG 5 – Gender Equality is to "ensure women's full and effective participation and equal opportunities for leadership at all levels of decision-making in political, economic and public life." To guide the process of achieving the goals, the United Nations provides implementation strategies: in this case, to "adopt and strengthen sound policies and enforceable legislation for the promotion of gender equality and the empowerment of all women and girls at all levels."[19] When investors and corporations use this framework, these targets provide a guide to measure impact and risk.

SDGs: A Valuable Framework, Not a Passing Fad

The SDGs help formalize an important framework for both investors and companies to communicate potential risks and also to offer greater transparency regarding better business practices. The resulting outcome is that the SDGs are quickly gaining traction. For example, approximately 40% of the 250 largest global corporations are reporting on the UN Sustainable Development Goals. Companies are increasingly focused on key areas – which tend to have global impacts – such as Climate Action (SDG 13), reported by 64% of respondents, and Decent Work and Economic Growth (SDG 8), reported by 59% of respondents. Other issues with relatively high profiles include Good Health and Well-Being (SDG 3) at 55%, Responsible Consumption and Production (SDG 12) at 54%, and Gender Equality (SDG 5) at 52%.[20] Corporations are increasingly identifying specific goals that are highly relevant to their business conduct and analyzing impact in achieving those goals.

Companies that are making greater efforts to disclose potential material ESG risks can look to the SDGs as means of identifying key stakeholders. For example, the business consulting firm PwC has categorized how 10 different industries may affect SDG stakeholders through their business activities and supply chain. The "SDGs: Top business impacts by industry" table details the breakdown of material SDGs by industry. Several goals are common themes and thus reflect the most reported information – such as Climate Action (SDG 13) and Decent Work and Economic Growth (SDG 8), both of which are instrumental when evaluating risk and business models.

SDGs: Top business impacts by industry

Chemicals	Communication	Energy, Utilities and Mining	Engineering and Construction	Financial Services	Health Care	Manufacturing	Professional Services	Retail nad Consumer	Technology
13 CLIMATE ACTION	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	7 AFFORDABLE AND CLEAN ENERGY	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	8 DECENT WORK AND ECONOMIC GROWTH	3 GOOD HEALTH AND WELL-BEING	8 DECENT WORK AND ECONOMIC GROWTH	8 DECENT WORK AND ECONOMIC GROWTH	8 DECENT WORK AND ECONOMIC GROWTH	8 DECENT WORK AND ECONOMIC GROWTH
12 RESPONSIBLE CONSUMPTION AND PRODUCTION	8 DECENT WORK AND ECONOMIC GROWTH	8 DECENT WORK AND ECONOMIC GROWTH	8 DECENT WORK AND ECONOMIC GROWTH	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	8 DECENT WORK AND ECONOMIC GROWTH	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	4 QUALITY EDUCATION	3 GOOD HEALTH AND WELL-BEING	4 QUALITY EDUCATION
2 ZERO HUNGER	4 QUALITY EDUCATION	13 CLIMATE ACTION	13 CLIMATE ACTION	5 GENDER EQUALITY	5 GENDER EQUALITY	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	5 GENDER EQUALITY	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	13 CLIMATE ACTION
3 GOOD HEALTH AND WELL-BEING	3 GOOD HEALTH AND WELL-BEING	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	11 SUSTAINABLE CITIES AND COMMUNITIES	13 CLIMATE ACTION	4 QUALITY EDUCATION	13 CLIMATE ACTION	3 GOOD HEALTH AND WELL-BEING	2 ZERO HUNGER	3 GOOD HEALTH AND WELL-BEING
6 CLEAN WATER AND SANITATION	13 CLIMATE ACTION	6 CLEAN WATER AND SANITATION	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	4 QUALITY EDUCATION	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	7 AFFORDABLE AND CLEAN ENERGY	13 CLIMATE ACTION	13 CLIMATE ACTION	12 RESPONSIBLE CONSUMPTION AND PRODUCTION

Source: PwC SDG Engagement Survey, 2015

Pursuing sustainable and inclusive business models can unlock significant economic opportunities, including but not limited to stock performance related to a gender diverse board, or the fact that a company's license to operate and ability to win large public-sector contracts is increasingly influenced by its ability to demonstrate the economic value it generates for the local and national economy.[21,22] Given the benefits of this framework from both a risk and value perspective, we expect to see adoption continue to grow.

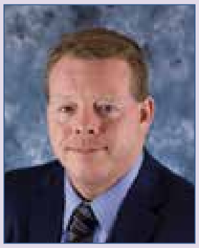
Saturna's investment process incorporates many of the material sustainable development goals.

Our proprietary ESG model scores all of our investment holdings on the major risk and impact factors within the goals. Climate, resource use, company gender diversity, and fair employment standards are all considered before purchase. Ultimately, risk, impact, and best business practices are all aligned such that choosing the best actors under the framework of the Sustainable Development Goals can also lead to good investment and return decisions.

About The Authors

Elizabeth Alm CFA®
Investment Analyst

Elizabeth Alm CFA, Investment Analyst, joined Saturna Capital in April of 2018. Originally from Connecticut, she graduated from New York University with degrees in Economics and Anthropology including field work completed in Luxor, Egypt. Prior to joining Saturna, Elizabeth spent 11 years at Wells Fargo Asset Management as a senior research analyst focusing on high-yield municipal bonds. As part of her previous role, she also worked on the management of several municipal SMA strategies. Elizabeth is a Chartered Financial Analyst® (CFA®) charterholder.



Patrick Drum MBA, CFA®, CFP®
Senior Investment Analyst and Portfolio Manager

Patrick T. Drum, Research Analyst and Portfolio Manager, joined Saturna Capital in October 2014.

He is a former adjunct professor of finance for the Sustainable MBA Program at the Bainbridge Graduate Institute (BGI) currently known as Presidio Graduate School. Mr. Drum holds a BA in economics from Western Washington University and an MBA from Seattle University Albers School of Business. He is a Chartered Financial Analyst Charterholder and a Certified Financial Planner®.

Prior to joining Saturna Capital, Mr. Drum led environmental, social, and governance (ESG) research and was director of fixed income portfolio management since 2007 with a private account group at UBS Institutional Consulting Services specializing in investment management for global conservation and national wildlife park endowments as well as sustainable-social screened client portfolios. He is a former Chair of the United Nation's Principles for Investment (UNPRI) Fixed Income Outreach Subcommittee and a current member of the UNPRI's Bondholder Engagement Working Group (BEWG), an advisory committee working to elevate important ESG considerations and best practices among issuers and investors.

Mr. Drum's past experience also includes business valuation at Moss Adams and portfolio management at Washington Mutual Bank. Mr. Drum is a member of the board of trustees to the Museum of Glass in Tacoma and a member of Rotary.

Footnotes

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Important Disclaimers and Disclosures

As of September 30, 2018, no Saturna Fund held any securities of British Petroleum, Credit Suisse, PwC, or Wells Fargo.

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