INCORPORATING SOCIAL RESPONSIBILITY WITH LONG-TERM INVESTMENT GOALS

Including socially responsible products in their investment portfolio is of growing importance to Canadian investors. Between 2000 and 2010, Canadian assets in socially responsible investing (SRI) mandates grew by an average of 27% per year to an impressive $530 billion. Most of these assets are currently represented by institutional investors, including leading pension plans such as the Ontario Teachers Pension Plan and Canada Pension Plan. As is often the case, retail investors are likely to follow this institutional trend, and advisors with a good understanding of how SRI mandates operate will no doubt be ideally placed when it comes to gathering these assets. With that in mind, the following article looks at the approach of RBC Global Asset Management (RBC GAM) to SRI by examining how we incorporate social responsibility into long-term investment goals, and by specifically examining several energy companies included in our SRI universe.

RBC GAM Approach to SRI

Many characteristics of our SRI mandates exist across all RBC GAM investment mandates: the importance of diversification, attractive financials, and the focus on long-term performance. What sets our SRI mandates apart is that they also recognize that corporate behaviour with respect to Environmental, Social and Corporate Governance (ESG) practices is important when making investment decisions.

To a certain degree, some ESG factors are incorporated into our analysis of the companies in which we invest – especially those factors that impact the overall risk profile of a company. Our SRI offerings – represented by the PH&N Community Values Funds and RBC Jantzi Funds – incorporate ESG factors into our company analysis to a much greater degree, specifically by excluding certain companies that are considered poor performers based on their ESG performance.

We have partnered with Sustainalytics, a leader in the research and analysis of corporate ESG practices on a global scale, to provide research and screening services. Sustainalytics developed and maintains the Jantzi Social Index, a Canadian SRI Index that mirrors the S&P/TSX 60. ESG factors are incorporated into the GAM investment process in two ways: through exclusionary criteria and qualitative criteria. Exclusionary criteria remove companies in the investment universe that derive a significant portion of their revenue from the production or sale of undesirable products and services such as alcohol, tobacco, gambling, weapons and pornography. Qualitative criteria assess, both on a positive and negative basis, the performance of companies in the areas of community relations, corporate governance, employee relations, environmental practices, human rights, product safety and business practices.

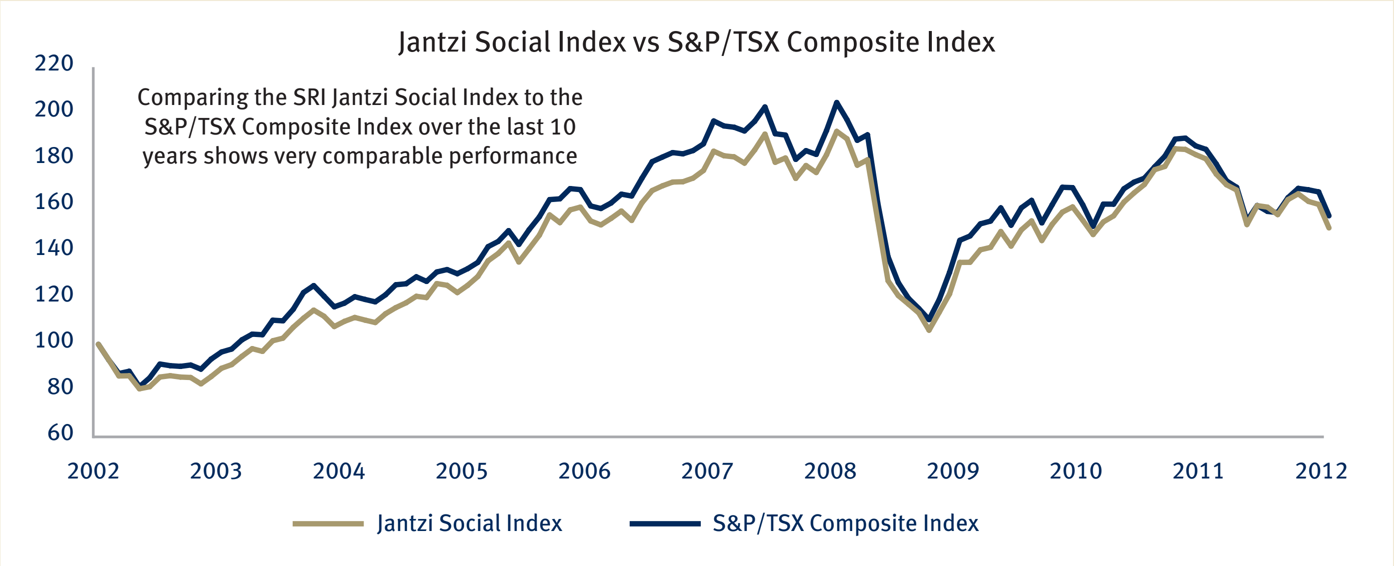
In addition to these two sets of criteria, Best-of-sector™ methodology is also incorporated when determining eligibility for the portfolios. Best-of-sector™ was developed by Sustainalytics as a way to maintain diversification within portfolios by evaluating each company's record in relation to that of its industry counterparts. Rather than eliminate whole sectors of the market such as energy and materials, the worst-performing companies within each sector are eliminated, meaning that companies that meet best practices within an industry are eligible for inclusion in the portfolio.

Our SRI funds invest in the broad market based on ESG principles and are not meant to provide a vehicle for "green" investing. A "green" fund may only consider companies within a certain sector for its mandate, such as renewable energy companies, while our funds are diversified across all industry sectors.

Does SRI Hurt Investment Returns?

One of the foremost concerns of clients considering SRI mandates, typically, is what impact the SRI approach will have on their portfolio performance. The short answer is that over the long-term, there is no impact on performance. For the 10-year period ending May 31, 2012, the Jantzi Social Index generated an annualized total return of 6.98%, while its non-SRI equivalent, the S&P/TSX Composite Total Return Index, generated a 6.73% return over the same timeframe. The only real difference between the two indices is that the Jantzi Social Index has a slightly smaller investment universe due to the ESG screen. As such, performance should not be materially impacted by incorporating ESG factors into the investment management process over the long-term.

Achieving Your Investment Goals Through SRI...



Source: Bloomberg. Data as of May 29, 2012

Investing in Energy Companies

In Canada, the energy sector provides a great example of how the SRI process works. This sector has an undeniable impact on the environment, and, at 26% of the S&P/TSX Composite, it is also an important component of an appropriately diversified Canadian portfolio.

Instead of excluding this sector altogether due to environmental concerns, the Sustainalytics SRI process looks for firms that understand and respond to ESG challenges better than their counterparts. In practice, these are energy companies that are trying to reduce their greenhouse gas emissions, invest in renewable energy sources and improve their environmental practices. They also work with local communities to minimize impact, respect human rights and provide safe working conditions for employees. They will be socially responsible, have strong corporate governance and provide positive examples to other firms as ESG leaders, which in turn may also help encourage positive corporate change.

From an investment standpoint, thanks in part to their ESG policies, these firms are often positioned for sustainable future growth and may have the financial characteristics our portfolio managers are looking for in a compelling investment opportunity.

Because the Jantzi Social Index excludes a number of Canadian energy companies, it has an energy weighting of 22.6% compared to 26% for the S&P/TSX Composite. The following examples highlight the actions certain energy companies are undertaking in order to earn their status as corporate ESG leaders and eligible SRI investments. (Information provided by Sustainalytics.)

Cenovus Energy Inc. (TSX: CVE)

Based on ESG factors, Cenovus Energy is currently the highest-rated oil company in Canada and ranks eighth worldwide. In 2010, the company's volume of spills decreased by 68% compared to their average for the previous four years. That same year, its oil sands greenhouse gas (GHG) emissions intensity decreased by 26% over the previous six years, resulting in a reduction of approximately 70,000 tonnes of GHG emissions since 2007. Cenovus recorded an absolute increase of GHG emissions in 2010 compared to 2009, but that was due to an increase in oil production, not an increase in emissions intensity. Its carbon emissions are below the industry average. Cenovus also operates 3,900 solar panels to produce power, and currently close to 5% of the company's primary energy use comes from renewable energy sources.

Suncor Energy Inc. (TSX: SU)

Based on ESG considerations, Suncor scores the second highest in its class out of Canada's oil sands corporations and ranks tenth worldwide. It is a part of the Syncrude joint venture, in which both companies now recycle much of their water usage from oil sands production. There are clear targets in place whereby Suncor aims to reduce its water intake by 12% by 2015 compared to 2009 levels, and the company's oil spill volumes have decreased by 74% over the last five years. Suncor also takes part in site reclamation efforts to return disturbed land to its original state, and in 2010 was the first oil sands company that completed a tailings pond reclamation.

Concerned Investors Can Make a Difference

SRI is a rapidly growing opportunity in the Canadian and global investing landscapes. By combining the analysis of Sustainalytics with the investment management approach of RBC GAM, we aim to integrate social responsibility into the goal of long-term wealth generation. Ultimately, this can help investors build a more sustainable world while earning competitive investment returns.

For the past decade, RBC GAM has been offering SRI solutions to our private and institutional clients across multiple asset classes through the RBC Jantzi Funds and PH&N Community Values Funds.

For more information on SRI solutions offered by RBC GAM, please contact your advisor or visit our website www.rbcgam.com/sri.

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Jason is Manager ESG Policy & Research at RBC Global Asset Management. He joined the private client department of Phillips, Hager & North Investment Management in 2000 and became the Corporate Governance Analyst two years later. He assumed his current role in 2008 and is now responsible for proxy voting, and is the in-house expert on environmental, social, and corporate governance issues as they relate to the investment process. Prior to joining the firm, he worked in the corporate finance department of a national brokerage firm and as a mutual fund accountant. Jason became a CFA charterholder in 2001.

RBC Global Asset Management