

# **Willis Towers Watson PODfolio episode 8**

## **The weird and wonderful (part 2 – technology and social impact)**

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SPEAKER 1: Welcome to The PODfolio, Willis Towers Watson's investment podcast series, where we'll give you an update on the latest developments across global markets and talk to expert guests on hot topics that matter to institutional investors and their portfolio.

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LOK MA: Hello, and welcome back to The PODfolio investment podcast. I'm Lok Ma, and this is part two of my conversation with Katie Sims, our global head of multi-asset growth solutions. So in part one of our conversation, we talked about various innovative and new ideas that we've been putting forward for our clients. Those fell within the overarching theme of climate change. So now for part two of our conversation, Katie, where do you want to take us to next?

KATIE SIMS: Well, [INAUDIBLE], for part two, I was thinking that we would explore two other megatrend themes that we're investing in, the first being technology and innovation. And then also, social impact. So shall we start with technology and innovation?

LOK MA: Yes, please.

KATIE SIMS: Great. Well, I'm going to kind of put this into the context of the recent COVID crisis, because I think that that has made everybody acutely aware of the reliance that we place upon technology and society. And when you think about some of the winners and the losers throughout this crisis from a business perspective, it's kind of obvious to assume that data centers, companies like Google and Microsoft, are going to be big winners from the crisis.

And so that is part of the technology and innovation theme. But the way that we express it in our portfolios is slightly different from purely just investing in equity markets, where there are a few dominant players in the market.

So a couple of ideas I'm going to touch on are the first one being cybersecurity. So this is a theme that we picked up on several years ago as being one of the biggest spends that businesses accepted that they would have to make in order to continue doing business. There's an estimation that by the end of 2021, businesses are going to be spending 5 trillion pounds a year on cyber security.

So that's clearly a very long-term theme that we can exploit. But then how do you invest to access that? And that was a job that we gave to our manager research team. And they went to Silicon Valley and went to lots of technology conferences and spoke to people and said, really, who are the key players in this part of the market? And that helped us to identify a private equity firm in California that had been doing this for a really long time.

And through the collaboration with that firm, we actually ended up making a co-investment into a company looking at providing cybersecurity solutions to businesses, and also to industries to protect things like, say, for example, the nuclear generation industry in a particular country-- protect that whole network to identify threats and attacks and keep the infrastructure secure. So that's just a way of thinking about, OK, how does changing society and the changing threats that we face lead to opening up investment opportunities?

LOK MA: So just a couple of quick observations from me if I may, Katie. The first one is around co-investment. You mentioned that again. So it's just striking me that these are very different investments to just holding a portfolio of stocks and shares. And we'll come back to that point around why we want to go that particular route.

And my second observation is your ideas I think about climate change, technology, working from home to do with the pandemic, these overarching themes-- do you guys think that they give you some kind of downside protection in your portfolio? In other words, they're based around long-term concerns of our society, and so investing in line with those kind of trends would give you some kind of protection if those kind of scenarios come to pass.

KATIE SIMS: Absolutely. We are fundamentally long-term investors as are most of our clients. And I think you need to think about the portfolio of tomorrow rather than the portfolio of today. If you look at the stock exchange and all the equities that are listed on there, they're the companies that are doing well and are needed in the situation that we find ourselves in today.

But the environment is changing so rapidly, and the pace of change continues to accelerate. And I think the COVID crisis is just going to be another catalyst in that process, that really, as a long-term investor, you need to be investing in the companies that are needed for the future. And that's what we really talk about when we talk about our philosophy of sustainable investing. We're investing today for a more sustainable tomorrow.

And so just simply accepting the status quo of what the listed stock market looks like now doesn't necessarily stand you in the best stead for that future state. And indeed, there could be some significant losers in terms of business models that are represented in those stock markets that you won't find present in 10 years time or so.

LOK MA: Great. Great. And anything else along that kind of theme of technology and innovation before we move on?

KATIE SIMS: Yeah. So you talked about the resilience of investing in some of these really specific business models. And one example of that resilience through the COVID crisis was an investment we made into a company that is providing business-critical software in the Nordic.

So this is-- if you think about all the software that's needed to run all of the basic functions that a business has to have-- an integrated payroll and regulatory reporting, et cetera, so as long as those companies continue to exist and continue to trade, they still needed to have that software. And so therefore, it's a much more resilient business model because it's providing an essential service effectively. So that's an example of just a completely different type of investment that we made that was really resilient to the crisis.

And then finally, in the technology and innovation area, I just really want to talk about our partnership with OSI-- Oxford Sciences Innovation. So this is taking a very tried and tested business model that's been used in the US, where institutions like Caltech, MIT, other big universities, where they're coming up with lots of new intellectual capital and ideas, they've sort of successfully had a model to help those researchers and academics take it from the conception phase through to actually an implementable and executed business model.

And so OSI have taken that concept from the US and applied it to Oxford University where, as you know, there is a great deal of innovation that goes on in the sciences department there. And we've committed capital to our side to help basically fund these startup ideas from the researchers. And that's looking at things that are going to make a real practical impact on day-to-day lives of people in the future.

So it's looking at clean energy generation, looking at improving-- using AI to improve diagnostics for doctors. But most importantly is the work that they've been doing in the response to COVID. So you probably will have seen various news articles about the vaccines that are being produced across the world.

So in our OSI portfolio, actually two of the portfolio companies are working on vaccines. So the stats are that there is around 72 vaccines currently being studied around the world. Of these, six show the greatest promise, and two of them are being developed by OSI-- companies in the OSI portfolio.

LOK MA: And Katie, just to clarify, the two that we invested in, they are part of those six initiatives that showing potential.

KATIE SIMS: Absolutely. That's right. And one of them has been widely publicized in the press, where there's a partnership with AstraZeneca to actually start manufacturing the vaccine, because they are very confident that it will be successful.

And it's important to note that the company is making the vaccine available to vulnerable parts of the population on a not-for-profit basis. So whilst it's obviously going to be a good thing for that company in terms of getting them recognized and getting them off the ground, we're not looking to profit directly from the crisis.

LOK MA: Well, so obviously, fingers crossed that one of these two vaccine initiatives turns out to kind of meet its promise, not only-- not at all, really, from the point of view of the impact on the portfolios, but obviously, for the wider benefit that's going to bring.

So shall we move on to your other thing, Katie, which I think is around kind of social impact type investments. Do you want to give us some examples of those.

KATIE SIMS: Absolutely. Yes. This is an area that I really wanted to talk about, because I think when people think about Environmental, Social, and Governance investing-- ESG-- they often overlook the S. And I think it's because people don't necessarily understand how to invest to have a positive social impact or what type of opportunities are out there.

So I just wanted to talk through a couple of those examples, the first one being an investment that we've made into emergency accommodation for homeless people in the UK. And there are some really quite distressing statistics out there around homeless levels.

So 1 in 73 people in Birmingham are homeless at the moment. And that's not just rough sleepers. That's kind of the more visible part of the problem. But there is also victims of domestic violence, people that have been evicted from their homes at short notice and sort of need immediate relocation.

And the local authorities have a requirement to find them emergency housing. And typically, they'll just put them up in B&Bs or hotels, which if you're a family, it's not necessarily the most supportive environment for people to be living in. And it's pretty expensive as well for the local authorities to be paying.

So we've made an investment into kind of purpose-built or purpose-adapted accommodation with 25-year leases with registered housing authorities, that they provide somewhere safe and secure and fit for purpose and about half of the cost for those local authorities to put people up in.

LOK MA: So I'm going to ask a slightly pointed question if I can, Katie, listening to this. Because I think that's-- I get the case for making a social impact. Is there potentially maybe a concern that you're seen to be kind of making money out of vulnerable people in a way?

KATIE SIMS: I can understand why people may have that concern. But the reality of the situation is that if we weren't-- this is an area that is chronically underfunded, unfortunately. And if we weren't providing that lower cost funding and working with reputable managers to deliver higher quality accommodation, then people would be finding themselves in a worse position, being in B&Bs or being in hotels. And it would be costing the government and local authorities more.

So what we do when we work with managers in this space is to make sure that we are working with really reputable firms that do take it very seriously to be providing a good quality service for the local authorities. And we're not trying to eke as much return out of this as possible. We're talking about mid-single digit returns here. And we will, when we engage with managers, say if you need to spend a bit more money and reduce returns marginally to deliver a better quality solution, then that is aligned with our purpose and what we're trying to do.

LOK MA: And I think that would be aligned with the interests of the investors that we work with as well, in terms of kind of making sure that you're doing some good and being aware of kind of potential reputational damage if you didn't do the stuff properly. So I'm very pleased to hear that.

So let's move on a little bit from the ideas themselves and start thinking about why you would consider these sorts of investments in the first place. So obviously, they're all very interesting. But it's also clear that you need to do quite a lot of legwork to access these sorts of areas-- so potentially also more complexity and higher fees. So what kind of improvements are you hoping to make to the portfolio by including these assets?

KATIE SIMS: So ultimately, what we're looking to do is improve risk-adjusted outcomes for investors, whilst having a positive impact on the world and society. So taking kind of each of those components of that statement-- improving returns, we absolutely believe we can do by investing into these types of assets. In some instances, they have better expected returns than

more traditional markets. And in other instances, they provide really diversifying characteristics.

So they're much more resilient when other markets tend to be suffering and falling in value. So both of those kind of features of these types of investments means that overall, we would expect, by including them into portfolios, to get a smoother ride throughout the course of market cycles.

And the really nice thing about them is that you can achieve all of those beneficial impacts on a portfolio. And at the same time, you can be investing to improve outcomes for individuals, the planet, and society as a whole.

LOK MA: Yeah. And I like what you say about spreading the risk across your portfolio. So I think that we're saying equities, stocks and shares are particularly bad, they're a good way of generating a return on your capital. It's just these are some of the other ways you could do, which-- just as attractive characteristics. And by combining some of these with more traditional investments, as you say, you just control the kind of variability of the outcomes that much better.

So that's absolutely great. But how do you then go about making sure that the advantages in terms of diversification and risk management, how do you make sure that these advantages outweigh the disadvantages in terms of potentially higher cost and complexity?

KATIE SIMS: Yes. Taking cost first-- that's something that we always consider the expected outcomes net of all costs. So if something is more expensive, it needs to kind of pull more weight in a portfolio to justify it, or it needs to have a really big impact in terms of reducing risk. So cost is kind of integrated into everything that we do.

And then we also look to minimize costs as much as possible. So by working with managers, by doing co-investments, we get much lower fees. And then we also look at costs all the way through the value chain, and look at minimizing things like operational costs and the costs of trading and so on and so forth. So the whole cost structure is scrutinized, and we absolutely make sure that it stacks up in the investment case.

And then complexity-- I think complexity is in the eye of the beholder sometimes. So if we were to ask a group of trustees that meet quarterly to try and govern some of these investments, that obviously just would not be feasible.

But the fact that we have a global research team of over 80 people, we have operational due diligence researchers, we have a huge support function as well, we're able to tackle that complexity. And indeed, we expect to be rewarded for it. If you can move into areas that are slightly more difficult or require specialist resource, or you move just down the size spectrum sometimes, that can add a significant premium onto your expected return.

So in a very simple example of property markets, if you're bidding against where the weight of the capital is going in, in the very large end of the property market versus looking at smaller properties, there's a half to 1% per annum yield differential there. So it's a little bit harder to do. But if you have the resources, then it's absolutely something that you can tackle.

LOK MA: Right. So just to sum up our conversation across kind of the two parts of our episode. I mean, we've talked about a number of themes across climate change, innovation, and also kind of making the social impact. I mean, my summary of these investments is attractive ideas in their own right in terms of the risk and return. But particularly within a wider portfolio alongside some other traditional asset classes that's got that kind of risk-dampening effect as well.

I like the idea of keeping the cost down through kind of co-investments and getting into these ideas potentially ahead of the other people realizing these trends are going on. And also, kind of having that benefit to wider society as well, as well as just being kind of very interesting things to talk about in their own right. So thank you very much for your time, Katie.

KATIE SIMS: You're very welcome, [INAUDIBLE]. It's been my absolute pleasure. And I'm really pleased to have been able to talk about some investment ideas that not only generate great returns, help manage risk, but are also having a really positive impact on the world and society. And it just goes to show that those things are not mutually exclusive, and we're going to continue to keep looking for those ideas to invest in on behalf of our clients.

LOK MA: And before I sign off, just to say very quickly that we've had some numbers in for the podcast, and it seems like people are indeed listening to The PODfolio. I don't know why I sound so surprised. But obviously, it's very nice and we're very grateful. So we're definitely going to work hard to keep future episodes appearing on a regular basis on your podcasting service and on our website.

I think for the future episodes we've got a few ideas to go into specific parts of the portfolios, going into a little bit more detail into different areas. And until then, do please take care of yourselves, and thanks for listening.

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