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INVESTING IN THE FAANGS

The EdenTree range of responsible and sustainable screened 'Amity' Funds hold over 250 different company stocks and debt instruments across their portfolios. As well as having a strong and compelling investment case, each holding must be researched and approved by the SRI team.

INVESTING IN TECHNOLOGY

Technology presents exciting investment opportunities given the exponential rise of digital power. We seek opportunities where companies have strong IP (intellectual property), a leading market share, strong cash generation, a track record in innovation and which exhibit attractive valuations. This leads us to capture multiple sector trends and to invest in a broader portfolio of technology companies such as **Microsoft** (Amity Global Equity for Charities), **Cisco Systems** (Amity Global Equity for Charities, Amity International), **Trimble** (Amity International) and **NXP Semiconductors** (Amity International) being examples.

INVESTING IN THE FAANGS

We are often asked by clients whether we can invest in some of the 'hottest' technology stocks in the market – often referred to collectively as the FAANGs – **Facebook**, **Apple**, **Amazon**, **Netflix** and **Google** (**Alphabet**). Here we look at these stocks in turn and present our House view on each.

The five technology giants that make up what have become known collectively as the FAANG stocks have often been thought of as a single group of dominant enterprises identified with disruption to conventional business models. However, each have very different audience reach, profiles, prospects and weaknesses, with Apple and Amazon becoming the first $1trillion dollar companies in the US in terms of market-cap, and Facebook incurring market weakness on the back of proliferating challenges to its social media model. Where they are similar is having risen together, with the majority of revenues still derived from a core product or service: Google and Facebook with 70% and over 95% of earnings respectively from advertising; the iPhone contributing 62% to Apple, and online sales over half of Amazon's earnings. Given our responsible investment approach, many of these companies present acute ethical dilemmas and challenges, which we highlight below.

At present only Alphabet, the parent of Google, has been approved for investment in the Amity Funds, with Facebook and Apple excluded owing to multiple ethical concerns. Amazon and Netflix have not formally been screened owing to unattractive valuations, however a view is provided here for completion purposes. Other social media stocks such as Twitter would present similar responsible investment challenges and have not been screened.

FACEBOOK INC.

Founded in 2004, brands include Facebook, Instagram, Oculus, Messenger and WhatsApp. Facebook has over 2.2bn active users across its social media platforms. Facebook is the world's largest online social media and networking service available in 100 languages. Advertising accounts for 98% of Facebook revenues.

Positives: Facebook provides a simple to use, free networking service that connects families and friends across distances and has in many ways 'democratised' communication.

Negatives: Facebook's business model has become strained and is being placed under increasing scrutiny. Its model is predicated on user data being mined to enable targeted advertising, leading to claims of data misuse, privacy intrusion and poor control of data. Environmental, Social and Governance disclosure is viewed as weak, although the company has made progress in mitigating climate impacts. We also considered its impact on user addiction and mental health, which are poorly addressed by Facebook. The governance structure is viewed as particularly weak, with ordinary shareholders discriminated against via a dual share structure that gives the majority of voting power to executives.

Conclusion: Facebook is not suitable for inclusion in the Amity Funds given its multiple challenges over data security and data privacy, poor corporate governance and weak business ethics.

APPLE INC.

Founded in 1976, Apple is a manufacturer of mobile devices and personal computers, and originated the iconic Apple-Mac, iPhone, iPad and iPod technologies. Other businesses include Apple Pay and iTunes. Apple has 1.3bn active devices in use including 700-800m active iPhone users; the iPhone accounts for 63% of revenues, with peak sales of 231m units in 2015.

Positives: Apple's unique selling point has been its relentless design innovation connecting the world through 'must have' devices such as the iPhone. Although Apple did not invent the smartphone, it has built a loyal following based on functionality and design. The company has improved environmental performance considerably, developing strong protocols around conflict minerals, traceability and end-of-life recycling. Governance conforms to US norms with a single share class structure and a strong independent Board.

Negatives: Apple's management of social and supply chain risk has lagged its peers; contracted out manufacturing of iPhones to China has led to serious allegations of poor working conditions including excessive working hours, child labour, abuse of student interns, health risks and unpaid wages. Apple has made some progress in reporting on supply chain standards, but we view this as presenting continuing risk in terms of human rights. Apple's model of obsolescence based on desire for the 'latest product' presents acute sustainability issues in a world of finite resources. Whilst the iPhone replacement cycle has lengthened, consumers still replace their device every 3½ years (in the US mobile phone plans build in replacement over the life cycle of the contract).

Conclusion: Apple is not suitable for inclusion in the Amity Funds given its multiple challenges over social and supply chain standards. The company's business model of built in obsolescence makes Apple a poor sustainability play.

AMAZON.COM INC.

Founded in 1994, Amazon is the world's largest online retailer and is the 'arch disrupter' of traditional retailing and distributing. There have been few areas Amazon has not extended its reach into, and the company has 310m active account users. It currently vies with Apple as the world's most valuable company. Brands include Alexa, Amazon Studios, IMB and Whole Foods Market. It also offers cloud computing services.

Positives: Amazon's successful all-encompassing model of retailing has provided a one-stop shop for millions of consumers and has been echoed by other online retailers such as Ali-Baba. It represents the apex of digital disruption with few areas left unexploited. Governance conforms reasonably to US norms and Amazon does not have a dual-class voting system despite the Chief Executive being the beneficial owner of 16% of the issued equity. The Board also has a good level of independence.

Negatives: Amazon's sheer reach may make it the Standard Oil of the 21st century. The company has faced multiple allegations of poor labour relations and inadequate working conditions, aggressive tax avoidance and potential weaknesses in product governance e.g. fake and counterfeit products. The level of disruption Amazon represents to the conventional economy may ultimately have a destabilising or cannibalising effect on jobs and the wider economy. Amazon is viewed as a laggard as far as environmental and social reporting is concerned, although Amazon Web Services (AWS) renewable energy program is considered 'best-in-class'.

Conclusion: Amazon has not been scoped for investment inclusion. The current House view is that Amazon, owing to multiple labour, tax and supply chain controversies would most probably not pass our positive screens, and would therefore not be suitable for inclusion in the Amity Funds.

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NETFLIX INC.

Founded: 1997. Netflix is a retailer and producer of streamed video content with revenues derived from subscriptions. The company has 130m members. Since 2013, Netflix has moved into original content and production, becoming a 'disruptor' to the studio system of film and television production. It operates in 190 countries.

Positives: Netflix is a pure entertainment play, and is therefore more 'benign' in responsible investment terms than others in the F.A.A.N.G group.

Negatives: The scale of growth has not been accompanied by mature reporting around environmental, social and governance issues, and the company is a laggard in qualitative reporting. Its model relies heavily on third party platforms and delivery systems which are not within its control. The company's reporting on responsible advertising is weak, and there is little in the public domain regarding marketing to children. Unlike some of its peers, governance conforms to US norms and does not have a dual-class voting system, although it has not instituted a majority vote standard in uncontested director elections. Given it is a content provider, there may be some exposure to violent material, although it is presumed this would be only modest. Netflix is one of just a handful of companies no longer holding a physical AGM, opting instead for a virtual meeting. Our current view is not to support this option without guarantees around shareholder discrimination.

Conclusion: Netflix has not been scoped for investment inclusion. The current House view is that Netflix would probably be suitable within the Amity Funds, but we would seek to engage prior to investing owing to poor disclosure and weak governance.

ALPHABET INC. (GOOGLE)

Founded in 1998, Alphabet is the holding company of Google which contributes 98% of revenues. Google is a multi-faceted technology provider that includes search, advertising, cloud computing, software and hardware. Google dominates the market in terms of internet search with seven of its services having more than 1 billion distinct users. The company owns Android (the world's largest mobile operating system), Gmail, YouTube, Google Play, Chrome, Google Maps and Waymo.

Positives: Whilst dominating its market, Google has been a facilitator of news, knowledge and information democratising the internet for users. Its broad family of accompanying services such as Android and Google Maps have been positive enablers. The company has been a leader in technology environmental management and has been 'carbon-neutral' since 2007. Google has also been a powerful advocate for the community and charitable sector with a commitment to award $1bn in grants and to make advertising to charities free. The company is well-known for its positive life-work balance ethic with an engaged workforce.

Negatives: Google's size and global reach present similar challenges as Amazon, with concerns around market abuse, tax avoidance, anti-competitive practices, patent infringement and data privacy. Alphabet has three share classes in which 50% of the equity carry no votes. The founders continue to exercise control via a controlling share. The Board has overall poor independence levels. Disclosure on social and human rights issues as with the other F.A.A.N.G stocks is generally weak and could be improved.

Conclusion: Google (Alphabet) presents challenges for the responsible investor, not least around regulation and market dominance. We have engaged with the company and continue to monitor developments, not least suggestions Google may seek to enter China where internet search services are censored. Google (Alphabet) has been deemed suitable for inclusion in the Amity Funds and is held in the Amity International Fund.

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CONCLUSION

The technology sector is fast-moving with dynamic prospects. It is also broad encompassing; processors, hardware, systems, software, media, telecommunications, mobile devices, wearable technology, appliances, electronic payment systems, enterprise logistics and games.

As responsible and sustainable investors we have exposure to the sector particularly in areas of high market penetration, proprietary technology, cyber security, hardware, systems and processors. The group of technology giants, Facebook, Apple, Amazon, Netflix and Google have become dominant and pre-eminent in their specialist areas (interestingly, part of the investment case is their operational and strategic diversity). This very dominance has attracted strong criticism for market abuse, tax avoidance, poor labour conditions and supply chain risk. All of the companies featured, with the exception of Netflix, have been subject to sustained and serious controversy.

Only one company – Alphabet – has been approved for inclusion in the Amity Funds, with Apple and Facebook excluded. Amazon would most probably not meet our minimum standards for inclusion. Netflix would, on balance, probably be viewed as suitable but at present there are no plans to invest owing to unattractive valuations.

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THE EDENTREE RI TEAM

Neville White
Head of SRI Policy and Research

Esmé van Herwijnen
Responsible Investment Analyst

Jon Mowll
Responsible Investment Analyst

We have a specialist in-house Responsible Investment (RI) team who carry out thematic and stock-specific research to identify ethically responsible investment ideas for our range of Amity funds. Headed up by Neville White, Head of RI Policy & Research, and supported by Responsible Investment Analysts Esmé van Herwijnen and Jon Mowll, the team is also responsible for creating an on-going dialogue with companies, allowing us to engage on a wide variety of ethical and socially responsible investment concerns. Our ethical and responsible investment process is overseen by an independent Amity Panel that meets three times a year, and comprises industry and business experts, appointed for their specialist knowledge.

We hope you enjoy this RI Expert Briefing and find it useful and informative. For any further information please contact us on 0800 011 3821 or at ifa@edentreeim.com