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A Constructivist Approach to Sustainability

Our goal when investing is to be value makers. We believe constructive stewardship serves this aim well. Such stewardship is not just about the discharge of a duty. It is also about collaboration and understanding. It gives us an analytical advantage and can act as a source of alpha generation.

In the investment industry, the prevailing wisdom seems to be that the stewardship decision is a binary one: You are either an activist or you are passive. We do not agree. There are many forms of effective stewardship. Academics from Oxford published a note on the four forms of stewardship: conservatism, opportunism, constructivism and activism.

What is constructivism?

At MFS®, we are in the constructivism camp. This does not mean we are afraid of escalating when necessary, but we think that the best outcomes are more likely to be achieved through strong relationships and regular dialogue with the companies that we have chosen to invest in.

CHARACTERISTICS

- Collaborative, open language
- Consensus-focused
- Focus on materiality
- Relationship building
- Investor knows company
- Quality engagement

TOOLS

- Frequent outreach from both sides
- Active ownership (including voting)
- Private engagement
- Investor collaboration

We are confident that our approach of long-term, constructive stewardship is the best way for us to fulfill our duty to clients. We are excited about our ability to create value in a way that is so complementary to our investment process. We will continue to practice

- outcome-focused engagement rooted in a deep knowledge of the company
- highly collaborative, long-term, persistent engagement
- holding companies accountable, not simply jumping immediately to exclusion or divestment or being overly aggressive or short-termist in our tactics

Constructivism in Action

The examples below illustrate how MFS uses constructivism to inform our investment team about thematic issues that impact our holdings, address corporate governance concerns via proxy voting and learn from our mistakes.

Addressing governance concerns with Fuji Soft

Members of our investment team held multiple engagements with Fuji Soft to address significant governance concerns around board oversight and company decision making. Going into the year, Fuji Soft had Japan's lowest margin IT service business and was one of its lowest returning property developers. The company's financial circumstances, coupled with nepotism, a lack of independence and dysfunction in management committees prompted a third-party activist shareholder to submit a proposal opposing the reelection of every executive director including the CEO and supporting the appointment of fully independent directors.

Agreeing on many points of concern around the company's management, we decided to vote in favor of their shareholder proposal to appoint independent directors. By the end of 2022, Fuji Soft was easily the best performing IT service stock in Japan. That suggests we were correct in concluding Fuji Soft's stock performance has been driven by its poor corporate governance and capital allocation which we would not have known had we not engaged with management.

Engaging with Check Point on climate risk and opportunity

In 2021, MFS shared a letter on climate with our 700 largest holdings. This letter was meant to help companies recognize the financial materiality of climate risk and opportunity, hopefully encouraging better carbon disclosure and target setting. Many companies responded positively, but one in particular, Check Point, an American-Israeli software company, launched a carbon neutral commitment in 2022. The company's management team sent us an email suggesting that our letter was influential in their adoption of these targets.

Where we didn't get it right – Activision and Bayer AG

Investing is inherently difficult, and even the most skilled investors do not get it right every time. To illustrate this complexity, we share the following examples of where we didn't get it right and learned valuable lessons. We believe that this type of self-reflection will lead to better investment decision making in the future.

In 2021, we had serious concerns about the culture and work environment at Activision. These concerns led our analyst to move from a buy to a hold rating, and certain portfolio managers sold the stock. The company's next quarterly report justified our concerns as Activision's culture appeared to hurt its ability to deliver new titles on the timeline the market expected. This led the stock to fall substantially. Unfortunately, shortly after that event, Microsoft agreed to acquire Activision. This example highlights that even being "right" about a financially material sustainability topic may not always mean you should sell or pass on a given security. Instead, to produce the best outcomes for our clients, we need to consider all fundamental factors together, attempting to not under- or overemphasize any factor.

Separately, we have been long-term owners of Bayer AG. The company has faced severe controversy regarding the health impacts of its chemical products, which Bayer AG began to manufacture after an acquisition. Our view upon acquisition was that the parent management team would be a more responsible owner of the new subsidiary's assets and products, some of which are highly sought after (e.g., seeds that resist drought). Unfortunately, we did not appreciate the risks associated with litigation related to these products, in spite of deep ongoing research into the topic and the risk. Our expectation has been that the legal risk will be smaller than it has proven to be and that other positive aspects of the business will offset it, which has not been the case so far. Again, this example highlights the complex nature of financial materiality, and the need to accurately account for all relevant fundamental factors.

To learn more about how sustainable investing works at MFS, please visit mfs.com/sustainability.