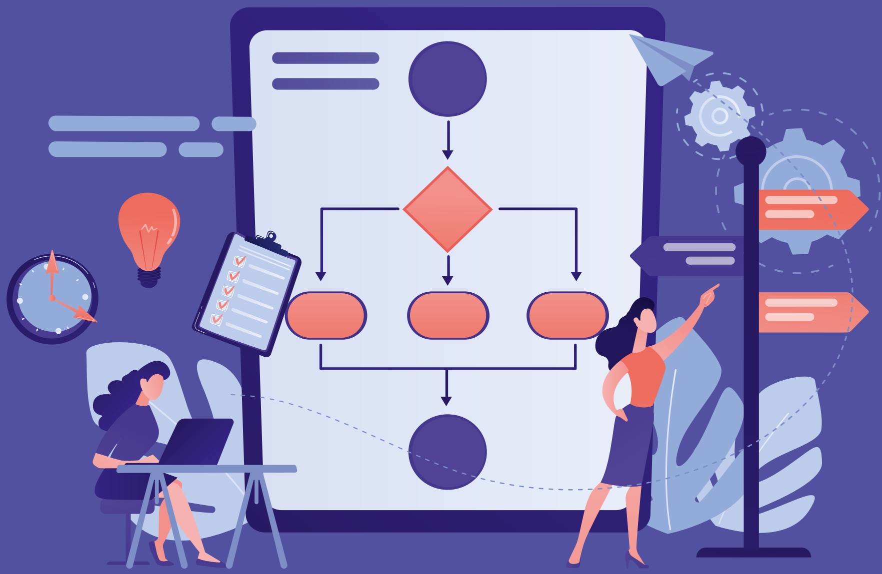
INDUSTRIES WE DON'T TOUCH

Approach to Exclusions at the Deep Research Fund

DEEP RESEARCH FUND



Introduction

In this document, we introduce the types of exclusions we implement in our research process.

Most of them are based on our sustainability criteria and create hard limits on what we consider an acceptable portfolio company. Others are based on past encounters with particular issues, circle of competence or industry-specific considerations. This document explains our thinking and details the rules behind the exclusions as well as their result. In the conclusion, we use the example of our screening process to illustrate how exclusions reduce our research universe of close to 100’000 companies by more than half.

Country-based exclusions

At our sustainability workshops, we discussed that it is important to us that our investments are not involved in corruption scandals or pay taxes to dictators who then use that source of income to oppress their people.

Additionally, if a company is listed in a country with a high rate of corruption, it is possible that its accounting may not be as reliable as we expect. In "finance speak," one could say that companies listed or operating in countries with high levels of corruption are more likely to experience fat tail events. And we prefer reliability. To maintain a systematic and replicable approach to country exclusions, we rate countries using the Corruption Perception Index published every two years by Transparency International.

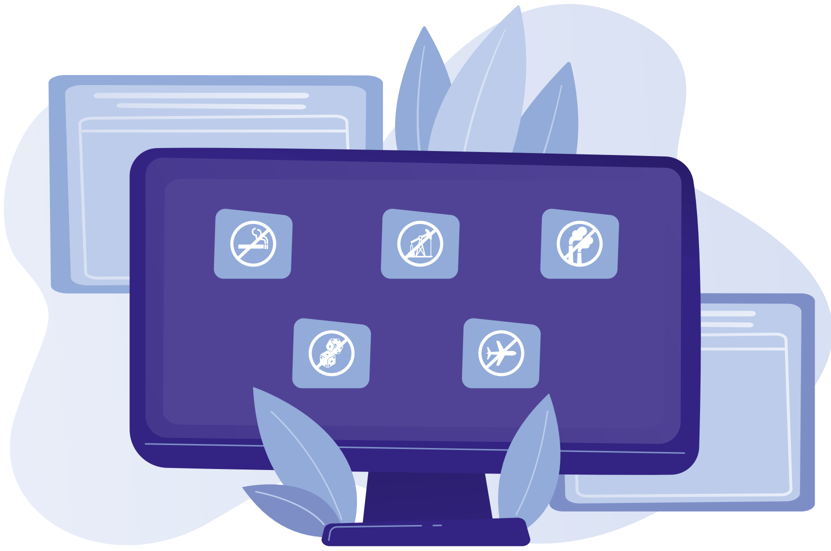
This data helps us ensure that our investment universe reflects our values.

Rules for excluding certain countries

- Eliminate from the list of permitted stock listing venues those stocks trading in countries that scored less than 50 on the most recent Corruption Perception Index.
- Eliminate stocks of companies whose largest revenue contributing country scored less than 30 on the most recent Corruption Perception Index.

Results

- The current count of excluded countries with a score below 50 is 121 (out of 180 countries).



Industry-based exclusions

We want to avoid investing in companies that are active in industries whose negative impact on the environment or society is inextricably part of the business.

We acknowledge that some of these industries may be important components of the current economic system or crucial sources for local employment. However, we want to encourage transition into a greener and stronger world. With this goal, we have detailed the below rules for excluding such industries.

Rules for excluding industries with poor ESG performance

- Exploration, production, processing, transport, and storage of oil (0 % tolerance)
- Exploration, mining and processing of coal and fossil fuels (0 % tolerance)
- Thermal coal energy generation (0 % tolerance; or if a clear transition plan is present then max. 20 % revenue tolerance)
- Production of chemical fertilizers (0 % tolerance)
- Tobacco producers (0 % tolerance)
- Tobacco retailers, suppliers, and distributers (max revenue 20 %)
- Casinos and gambling (0 % tolerance)
- Airlines, air freight, and aviation logistics (0 % tolerance)
- Aerospace and defence (0 % tolerance)

Results

- The current count of industries* excluded due to inherently poor ESG is 14.

*Based on the GICS industry classification standard.

Weapons

We identified weapons as one of our key sustainability issues very early on. Our concerns centered on the destruction of the lives and health of immediately affected people as well as of future generations and the inevitable material destruction.

No arms manufacturer has ever been selected for inclusion in our portfolio, even before we introduced our exclusion standards. At our sustainability workshops, we also discussed that we were concerned about accidentally profiting from weapons manufacturing and supplying militaries. As a result of our workshops, we came up with the following rules:

Rules for excluding companies that manufacture, distribute or sell:
- Nuclear weapons (0 % tolerance)
- Biological weapons (0 % tolerance)
- Chemical weapons (0 % tolerance)
- Landmines (0 % tolerance)
- Cluster munitions (0 % tolerance)
- Depleted uranium (0 % tolerance)
- White phosphorus (0 % tolerance)
- Conventional weapons and firearms producers for the military (0 % tolerance)
- Conventional civilian firearms (0 % tolerance)
- Civilian suppliers to the defense sector (tolerance of 25 % of revenue from contracts with military or private security)
- Companies listed under the GICS code for "Aerospace & Defense"

Results
- The current count of companies excluded due to weapons/military involvement is 107.

Conduct-based exclusions

Companies in any line of business can create a positive impact or destroy their social license to operate.

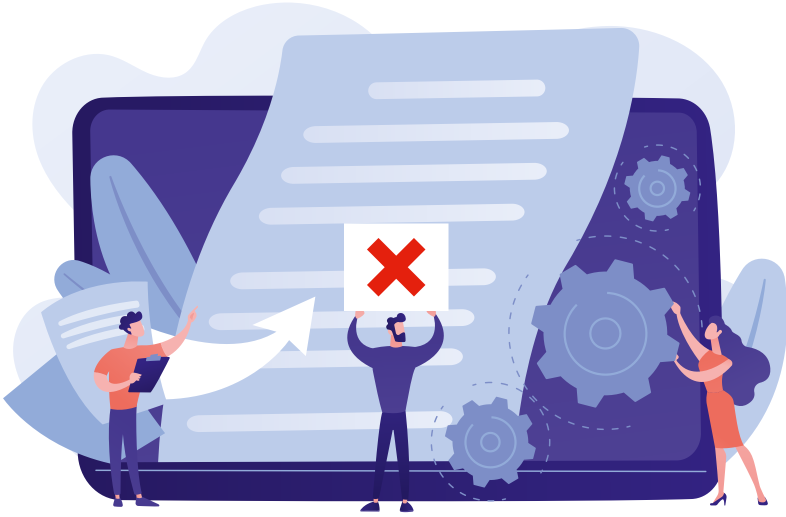
Since we maintain an "owner's perspective," we very strongly prefer to invest in companies that have a positive impact on the environment and society. In order to do so, we first firmly avoid those that violate our rules of conduct, as outlined below:

Rules for conduct-based exclusions

- Companies in violation of the UN Global Compact
- Companies complicit in severe human rights abuses, including labor rights
- Companies which emit significantly more emissions than their peers
- Companies exhibiting poor governance
- Companies lacking ESG information
- Companies involved in adult entertainment

Results

- The current count of companies excluded due to poor conduct is: 42.



Other exclusions

Sustainability concerns are just one of many reasons for our exclusions.

We also exclude certain industries where we do not think we have the expertise for in-depth research. Additionally, we also exclude certain cyclical industries if we consider that the cycle would move against us. We also have a long list of companies that we exclude from our investment universe because our previous research told us that their business model is not compatible with our investment preferences.

Rules
- Exclude industries beyond the team's circle of competence
- Exclude companies where the positioning in the economic cycle is not appropriate
- Exclude companies which don't fulfill our investment criteria

Results
- The current count of GICS codes excluded beyond sustainability concerns is 28.
- The current count of companies excluded beyond sustainability concerns is 399.

How exclusions shape our investment universe

Exclusions are a quick way to shape our investment universe. Since the exclusions are based on our values or past experience, we don't worry that we are missing out on something. Rather, these exclusions help us efficiently find our investment gems.

Twice a year, we engage in a quantitative process we call Screening to narrow down our investment universe. This table is from the Fall 2021 Screening and it shows that our exclusion approach helped us narrow down our investment universe from 98'000 possible tickers (one ticker represents one company) to 43'381 based on our exclusion criteria alone.

Following the sustainability-based exclusions, we further narrow down the investment universe with our financial risk management exclusions. Risk-based exclusions include limiting the companies' debt allowance or ensuring sufficient liquidity in the underlying stock. We then rank the remaining stocks utilizing our proprietary financial and sustainability metrics to narrow down the universe to the most promising 50 companies. At this point, we shift the focus from what we exclude to what we prefer to see in a company. In addition to an attractive valuation as an example on the financial side, we also screen for values we foster and standards we support on the sustainability side.

The final outcome of our screening is a list of 50 stocks exhibiting our preferred characteristics as far as they are quantitatively measurable. We then proceed to rigorously research them to find new investments.

Impact of our exclusions on the investment universe

Exclusions impact in our screening	**Stocks excluded**	**Remaining**
Global universe of publicly traded companies		98'256
Country-based exclusion	45'714	52'542
Industry-based exclusion	2'256	50'286
Exclusion of weapons	107	50'179
Conduct-based exclusion	42	50'137
Other exclusions – company-specific	399	49'738
Other exclusions – industry-specific	6'357	43'381
Available companies for screening		**43'381**

"We want to avoid investing in companies which are active in industries whose negative impact on the environment or society is inextricably part of the business. We also exclude industries where we lack the necessary expertise to make prudent investment decisions. We have no regrets in discarding investment ideas if they don't meet our environmental or social standards."

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