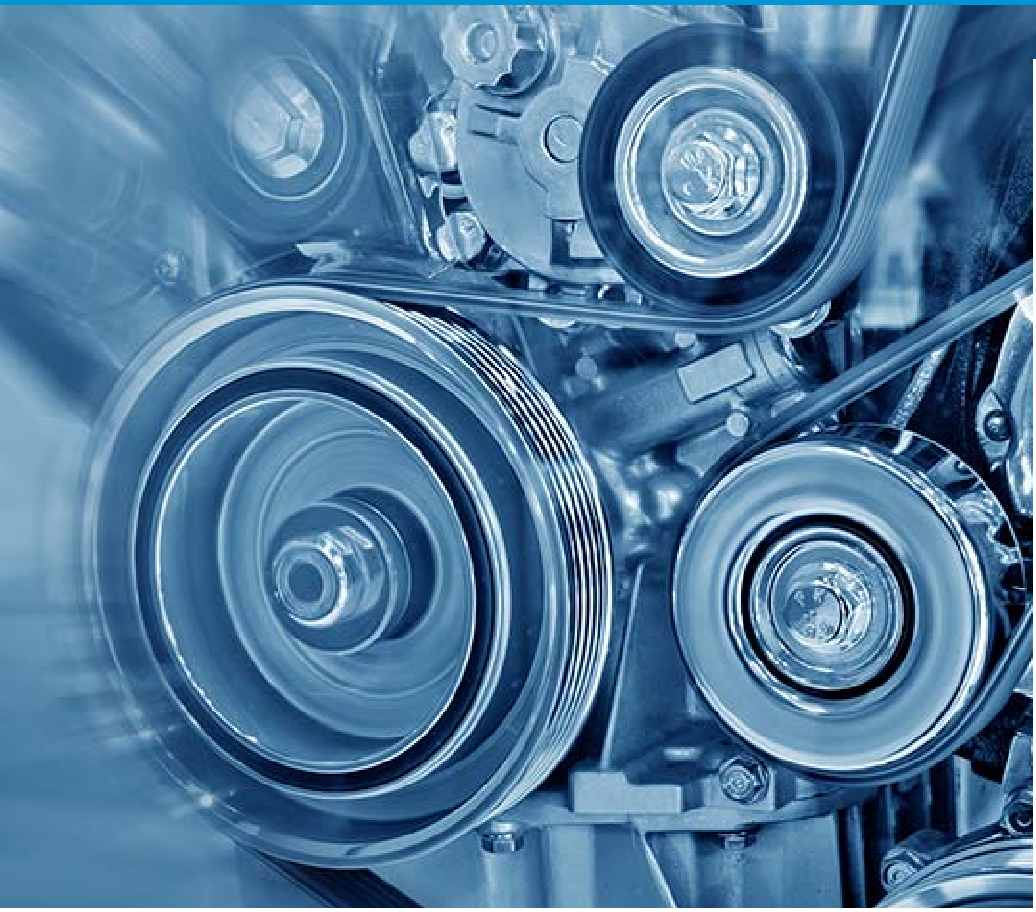
The Cornerstone

Journal of Sustainable Finance & Banking℠

October 2013



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Cornerstone Capital Group

CEO's Letter on Sustainable Finance & Banking

Erika Karp
Founder and Chief Executive Officer of Cornerstone Capital Inc. and former Head of Global Sector Research at UBS Investment Bank

We are pleased to present this inaugural edition of ***"The Cornerstone Journal of Sustainable Finance & Banking."*** *Each month, the* ***"JSFB"*** *will strive to include important perspectives and insights from experts around the globe and across the functions of the financial world.*

In our mission to bring the principles and practices of "sustainable finance" to the mainstream of the capital markets, we will be highlighting some of the leading research in the field of Environmental, Social and Governance (ESG) analysis and integration. At the same time, we will feature Global Sector Research commentary and discussions of the most critical global investment themes affecting corporations and the markets.

Every month, we will hear from a range of leaders including those in Business & Industry, Investment Strategy & Research, Corporate Governance, Media & Communications, Science & Technology, Academia, Human Capital Management, Economics & Geopolitics. At the same time we will offer financial market data and analysis, which, in conjunction with the integration of ESG considerations, is intended to support the pursuit of enhanced analytics in the investment process of many of our clients.

Of note, in the Cornerstone JSFB each month you will see a number of unique regular sections such as our ***"Featured Domain"*** *and* ***"Open Source Excellence."*** *The former will shine a light on business practices, principles and potential business models which can support the drive to a more sustainable form of capitalism. The latter will give executives from among the world's leading corporations the opportunity to share some of their very best practices. This effort is intended to lend greater support and transparency to the hard work of "operationalizing" corporate sustainability (a/k/a corporate excellence). These best practices can be replicated, accelerated, and scaled by other companies and industries as we work towards a more sustainable form of capitalism.*

Each month, aside from regular commentary from our experts on both ***Corporate Governance*** *and* ***Accounting & Valuation****, we will highlight a* ***"Sustainable Standout"*** *initiative or piece of research from across the realm of our coverage. We will offer* ***"Sustainable Product Reviews"*** *submitted by colleagues, and a* ***"Virtual Attendance"*** *section with summaries and information about Events and Conferences of interest to the sustainable finance community. We will also highlight exclusive events and sessions to be hosted by Cornerstone Capital. These sessions are open to all Premium subscribers to the*

JSFB on a first-come, first-serve basis.

Finally, as we launch this first Cornerstone Journal of Sustainable Finance & Banking, we invite our clients and colleagues to give us feedback and suggestions to continue to evolve the product. It is our intention to offer a report which will prove valuable to professionals in all parts of the capital markets and business.

This first edition JSFB is being distributed in its entirety to our broad list of colleagues and clients. Going forward, in order to keep our level of dialogue with everyone strong and open, we will offer the CEO's letter as well as our Table of Contents to all. For the full contents of the report, we invite you to become a subscriber to this new Journal of Sustainable Finance & Banking.

Erika Karp
Founder & Chief Executive Officer

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Market Summary

Overview

Over the past month, investors witnessed only a modest increase in financial market volatility despite concerns that the US debt ceiling and budget negotiations have been governed from crisis to crisis. In hindsight, given the real economic impact of the recent impasse in Washington, the Federal Reserve's "no-taper" surprise was perhaps justifiable. It does however give the market more time to rely on the stimulus to which it has grown accustomed. Of course the US is not the only region where investors are confronted with uncertainty. Across the Pacific, Japanese Prime Minister Abe is tasked with pursuing a hike in the consumption tax, an instrument designed to address Japan's fiscal issues. Some fear, however, that the tax hike will dampen consumer activity and potentially derail the country's nascent economic recovery. China continues to walk an economic tightrope with the goal of rebalancing the economy away from debt-led construction and towards domestic consumption. While the government is offering old-fashioned financial stimulus to key cities and provinces to maintain growth in local economies, it is also signaling the establishment of a new financially oriented free-trade zone in Shanghai, a move that corroborates the government's intention to put China's economy on a more sustainable path longer term. And, just for good measure (and a few more grey hairs), the potential for a re-emergence of volatility in Europe lurks in the background on the possibility of more peripheral bailouts.

With the macro background seemingly littered with tripwires, investors may find themselves questioning the sustainability of the market rally. It appears, though, that recent economic data has been generally encouraging and may be foreshadowing an acceleration in growth. In the US, the NAHB Market Index, an important housing market indicator, is at its highest level since 2005. The widely followed Institute for Supply Management (ISM) Purchasing Managers Index surprised to the upside and the new orders component appears healthy. It's worth noting that ISM has a relatively strong track record of forecasting earnings growth in upcoming quarters. We are also observing some improving economic data outside the US. Eurozone economic data appears to be bottoming and, in certain instances, improving. This is an obvious positive for Europe, but is also an important development for its largest trade partner, China. The improvement is already evident in Chinese exports to Europe which registered year over year growth in two of the last three months, a significant improvement versus the first half of the year. Japanese data has been mixed, though the positively revised GDP gives some hope that the nascent recovery is gaining momentum.

Despite the macro concerns, investors are driving global equities higher as we enter third quarter earnings season. On a trailing one month basis, strength has been broad-based, though emerging markets have outperformed developed markets. A pronounced performance discrepancy remains on a year to date basis, however, with the MSCI World index (proxy for global developed markets) outperforming MSCI Emerging Markets index by approximately 2,000 basis points. Small cap outperformance persisted and the Russell 2000 is now up over 32% year to date, leading the S&P 500 by over 800 basis points. From a sector perspective, performance varied according to the index and region. In the MSCI ACWI (broad index for both developed and emerging equities), telecom, technology and financials outperformed while consumer staples, materials and healthcare lagged. The consumer discretionary sector has been the top performer this year and fundamentals appear to be strengthening on improving labor and housing markets as well as the potential for pricing power due to relatively lean inventories. In contrast, the materials sector has lagged on tepid global growth, especially in Europe and China, as well as a stronger US Dollar.

Market Summary

Market and Global Sector Performance

MARKET / INDEX PERFORMANCE

As of 10/18/13 (local currency)	T1M (%)	T3M (%)	YTD (%)	2014E P/E	2014E P/B	2014E Div. Yield
US Equity Indices						
DJIA	-1.64	-0.35	19.88	13.3	2.5	2.4
S&P 500	1.27	3.82	24.41	14.2	2.2	2.2
Nasdaq	3.53	8.74	30.94	16.9	2.7	1.4
Russell 2000	3.62	6.48	32.60	20.5	1.9	1.2
Developed International Indices						
Euro STOXX 50	4.28	11.95	19.32	12.1	1.3	4.0
FTSE 100	0.97	0.86	16.20	12.2	1.7	4.0
CAC 40	2.93	9.3	21.35	12.4	1.3	3.8
DAX	2.65	6.33	16.46	11.7	1.5	3.3
Nikkei 225	0.85	-1.14	42.16	16.6	1.5	1.7
ASX 200	1.64	8.62	19.38	14.1	1.9	4.7
Emerging Market Indices						
IBOVESPA	1.42	16.2	-9.14	13.6	0.9	3.6
Shanghai Comp	-1.22	8.99	1.25	8.7	1.2	3.4
KOSPI	2.14	9.43	2.96	9.3	1.0	1.3
SENSEX	4.99	4.1	8.99	13.3	2.2	1.9
Global Market Indices						
MSCI World	2.54	6.39	22.14	13.8	1.9	2.7
MSCI All-Country World	2.73	6.74	19.36	13.4	1.8	2.8
MSCI EAFE	4.01	9.22	20.68	13.1	1.5	3.4
MSCI Emerging Markets	4.25	9.56	1.18	10.5	1.4	2.9

MARKET / INDEX PERFORMANCE (CONTINUED)

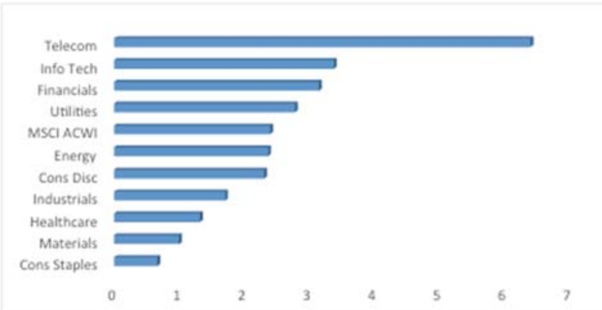
	T1M (%)	T3M (%)	YTD (%)
Fixed Income			
Barclays US Aggregate	0.97	0.93	-1.39
Barclays US Treasury Index	0.59	0.4	-1.69
Barclays Municipal Bond Index	0.62	-0.08	-3.15
Barclays Global Agg. (Unhedged)	2.25	3.15	-1.27
Commodities		Levels	
	10/18/13	**12/31/12**	**10/18/12**
WTI Crude	100.81	91.82	92.1
ICE Brent Crude	109.94	111.11	112.42
NYMEX Natural Gas	3.76	3.35	3.59
Spot Gold	1314.4	1675.8	1743.3
LME 3mth Copper	7245	7931	8220
CBOT Corn	4.41	6.98	7.61
CRB Raw Industrial Spot Index	514.48	530.4	518.21
Currencies		Levels	
	10/18/13	**12/31/12**	**10/18/12**
EUR/USD	1.37	1.32	1.31
USD/JPY	97.72	86.75	79.28
GBP/USD	1.62	1.63	1.60
AUD/JPY	94.57	90.15	82.17
DXY Index	79.65	79.77	79.37

Source: Bloomberg, Barclays. Equity Returns: All returns represent total return for stated period. Dividends and coupons are not included in the DAX and BOVESPA indices. Bond Returns: All returns represent total return for the stated period. Index characteristics: P/E, P/B, and Dividend Yield are based on Bloomberg consensus estimates for the stated period.

MSCI ACWI SECTOR PERFORMANCE

as of 10/21/13

1 Month Return (%)



Source: Bloomberg. Sector returns are based on GICS methodology. MSCI ACWI is a free-float weighted equity index that includes both emerging and developed world markets.

YTD Return (%)

Source: Bloomberg. Sector returns are based on GICS methodology. MSCI ACWI is a free-float weighted equity index that includes both emerging and developed world markets.

U.S. EQUITY STYLE PERFORMANCE

Style box returns are based on Russell Indices with the exception of the Large-Cap Blend box, which reflects the S&P 500 Index. All values are cumulative total return for the stated period including the reinvestment of dividends. The index used from left to right, top to bottom are: Russell 100 Value Index, S&P 500 Index, Russell 1000 Growth Index, Russell Mid Cap Value Index, Russell Mid Cap Index, Russell Mid Cap Growth Index, Russell 2000 Value Index, Russell 2000 Index and Russell 2000 Growth Index.

1 Month

	Value	Blend	Growth
Large	2.4	2.2	2.3
Mid	3.5	2.6	1.9
Small	4.1	3.8	3.5

Source: Bloomberg

Year to Date

	Value	Blend	Growth
Large	25.5	24.4	25.1
Mid	28.2	28.6	28.8
Small	28.3	32.6	37.1

Source: Bloomberg

SECTOR SNAPSHOT – TOP 5 COMPANIES BY MARKET CAP

as of 10/21/13

Company Name	Ticker	Industry	Mkt Cap (US$ Bn)	Currency	Price (Local)	Total Return YTD % (local)	P/E 2013E	EV/ EBITDA 2013E	Div Yield % 2013E
Consumer Disc.									
Toyota Motor Corp	7203.JP	Automobiles	223.2	JPY	6370.00	61.0	11.1	10.1	N/A
Amazon	AMZN	Internet & Catalog Retail	152.3	USD	333.33	32.9	130.6	31.7	N/A
Comcast Corp	CMCSA	Media	123.9	USD	47.44	28.7	19.4	7.8	1.6
The Walt Disney Co	DIS	Media	122.6	USD	68.64	37.9	20.4	11.3	1.1
Volkswagen	VOW3.GR	Automobiles	112.0	EUR	178.15	6.0	8.5	7.5	2.0
Consumer Staples									
Wal-Mart Stores	WMT	Food & Staples Retailing	245.6	USD	75.74	13.1	14.6	8.0	2.5
Nestle SA	NESN.VX	Food Products	234.5	CHF	65.35	13.1	18.9	13.2	3.1
The Proctor & Gamble Co	PG	Household Products	218.0	USD	79.58	20.9	18.5	12.3	3.0
The Coca-Cola Co	KO	Beverages	171.8	USD	38.91	9.7	18.6	13.9	2.9
Anheuser-Busch Inbev	ABI.BB	Beverages	167.0	EUR	75.51	17.6	22.0	12.7	2.3
Energy									
Exxon Mobil	XOM	Oil, Gas & Consumable Fuels	385.1	USD	87.50	3.2	11.7	5.2	2.9
Petrochina Co	857.HK	Oil, Gas & Consumable Fuels	232.0	HKD	9.10	-13.6	10.2	5.3	4.1
Chevron	CVX	Oil, Gas & Consumable Fuels	232.5	USD	120.34	14.0	10.3	4.5	3.3
Royal Dutch Shell	RDSA.LN	Oil, Gas & Consumable Fuels	219.9	GBp	2096.50	2.9	8.8	4.1	5.4
Total SA	FP.FP	Oil, Gas & Consumable Fuels	143.6	EUR	43.87	17.6	8.7	4.0	5.4
Financials									
Berkshire Hathaway- CL B	BRK/B	Diversified Financial Services	289.0	USD	117.20	30.6	18.8	N/A	N/A
Ind & Comm Bank of China	1398.HK	Commercial Banks	226.7	HKD	5.40	4.3	5.8	N/A	5.6
Wells Fargo & Co	WFC	Commercial Banks	225.4	USD	42.76	27.8	11.1	N/A	2.8
HSBC Holdings Plc	HSBA.LN	Commercial Banks	209.3	GBp	688.80	10.2	11.6	N/A	5.0
JPMorgan Chase & Co	JPM	Diversified Financial Services	204.5	USD	54.40	27.2	11.0	N/A	2.8

SECTOR SNAPSHOT – TOP 5 COMPANIES BY MARKET CAP (CONTINUED)

Company Name	Ticker	Industry	Mkt Cap (US$ Bn)	Currency	Price (Local)	Total Return YTD % (local)	P/E 2013E	EV/ EBITDA 2013E	Div Yield % 2013E
Health Care									
Johnson & Johnson	JNJ	Pharmaceuticals	258.9	USD	91.88	34.1	16.8	10.6	2.9
Roche Holdings	ROG.VX	Pharmaceuticals	236.7	CHF	246.40	38.6	16.4	11.4	3.0
Novartis AG	NOVN.VX	Pharmaceuticals	209.6	CHF	69.55	25.5	15.1	13.1	3.3
Pfizer	PFE	Pharmaceuticals	202.3	USD	30.55	24.9	14.1	8.2	3.1
Merck & Co	MRK	Pharmaceuticals	136.0	USD	46.49	16.7	13.4	9.3	3.7
Industrials									
General Electric Co	GE	Industrial Conglomerates	266.3	USD	26.15	27.6	15.9	9.8	2.9
Siemens AG	SIE.GR	Industrial Conglomerates	111.6	EUR	91.99	19.8	17.0	11.2	3.3
United Technologies	UTX	Aerospace & Defense	98.9	USD	107.93	33.8	17.5	10.9	2.2
The Boeing Co	BA	Aerospace & Defense	92.7	USD	122.92	65.8	18.9	10.5	1.6
United Parcel Service	UPS	Air Freight & Logistics	89.2	USD	94.48	30.9	19.9	10.4	2.6
Info Tech									
Apple	AAPL	Computers & Peripherals	475.6	USD	523.35	0.2	13.3	6.2	2.3
Google	GOOG	Internet Software & Services	337.2	USD	1008.86	42.6	22.9	13.2	N/A
Microsoft Corp	MSFT	Software	291.0	USD	34.93	33.7	13.0	7.4	3.2
Samsung Electronics	005930.KS	Semiconductors & Semiconductor	202.5	KRW	1455000	-4.4	11.1	3.5	0.5
IBM	IBM	IT Services	189.3	USD	173.64	-8.1	10.3	8.0	2.2
Materials									
BHP Billiton Ltd	BHP.AU	Metals & Mining	182.4	AUD	37.05	3.3	13.8	6.9	4.7
Rio Tinto Ltd	RIO.AU	Metals & Mining	101.7	AUD	63.97	-0.2	12.5	6.9	4.1
BASF SE	BAS.GR	Chemicals	93.7	EUR	74.15	8.0	13.7	8.0	3.5
Vale SA	VALE3.BZ	Metals & Mining	85.8	BRL	36.00	-10.2	7.6	5.2	0.7
Saudi Basic Ind.	SABIC.AB	Chemicals	82.8	SAR	103.50	21.6	11.7	6.7	3.9
Telecom									
China Mobile Ltd	941.HK	Wireless Telecommunication Ser	213.0	HKD	82.15	-5.1	10.2	3.5	4.2
AT&T	T	Diversified Telecommunication	187.1	USD	35.22	9.9	14.3	6.3	5.1

SECTOR SNAPSHOT – TOP 5 COMPANIES BY MARKET CAP (CONTINUED)

Company Name	Ticker	Industry	Mkt Cap (US$ Bn)	Currency	Price (Local)	Total Return YTD % (local)	P/E 2013E	EV/ EBITDA 2013E	Div Yield % 2013E
Vodafone Group	VOD.LN	Wireless Telecommunication Ser	179.8	GBp	229.00	53.9	15.2	10.8	5.1
Verizon Communications	VZ	Diversified Telecommunication	144.7	USD	50.55	22.0	18.0	5.7	4.2
Softbank Corp	9984.JP	Wireless Telecommunication Ser	93.0	JPY	7620.00	144.5	20.8	6.5	0.5
Utilities									
GDF Suez	GSZ.FP	Multi-Utilities	60.7	EUR	18.28	22.2	13.2	7.2	8.2
EDF	EDF.FP	Electric Utilities	65.3	EUR	25.68	90.6	13.8	5.2	4.9
Duke Energy	DUK	Electric Utilities	49.9	USD	70.68	14.5	16.4	10.7	4.4
National Grid Plc	NG/ LN	Multi-Utilities	46.5	GBp	770.00	13.4	14.8	9.6	5.9
Enel SpA	ENEL.IM	Electric Utilities	41.3	EUR	3.19	8.1	10.0	6.7	4.7

Source: Bloomberg. The securities in each sector represent the largest companies by market cap in the MSCI ACWI in their respective sectors. Sector classification is based on GICS methodology. Equity characteristics: P/E, EV/EBITDA and Dividend Yield are based on Bloomberg consensus estimates for stated period.

GDP / CONSUMER PRICE INFLATION / RATES

Region/ Countries	Real GDP (% YoY)			CPI (% YoY)			Official Rates			Long Rates		
	2012A	2013E	2014E	2012A	2013E	2014E	2012A	2013E	2014E	2012A	2013E	2014E
United States	2.8	1.6	2.6	2.1	1.5	1.9	0.25	0.25	0.25	1.8	2.8	3.3
Euro area	-0.7	-0.3	1.0	2.5	1.5	1.5	0.75	0.50	0.50	1.3	-	-
Europe	-0.3	0.1	1.4	2.3	1.5	1.6	0.70	0.50	0.55	2.6	2.8	3.1
Japan	2.0	1.9	1.6	0.0	0.3	2.3	0.10	0.10	0.10	0.8	0.8	1.0
UK	0.2	1,4	2.2	2.8	2.7	2.3	0.50	0.50	0.50	1.8	2.8	3.3
Australia	3.7	2.4	2.7	1.8	2.2	2.6	3.00	2.50	2.60	3.30	3.90	4.30
China	7.7	7.6	7.4	2.7	2.6	3.1	6.00	6.00	6.00	3.6	4.1	4.1
Brazil	0.9	2.4	2.4	5.4	6.2	5.9	7.25	9.75	9.75	9.2	-	-
India	5.1	4.9	4.7	9.3	-	9.2	7.00	6.75	6.40	8.2	8.6	8.1

Source: Bloomberg. Estimates are composite of Bloomberg contributor estimates.

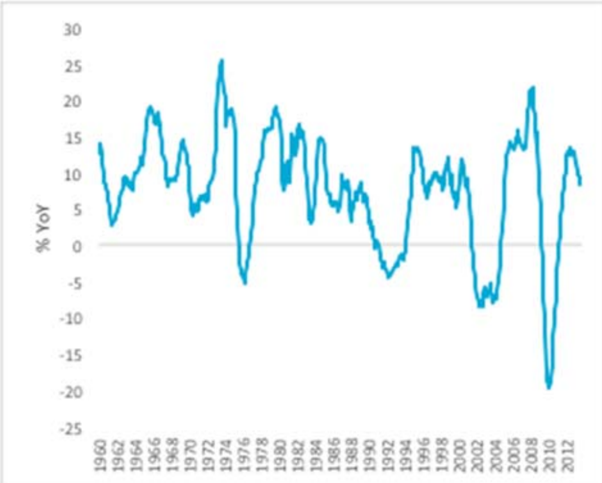
MONETARY POLICY

	Oct-13	Apr-13	Oct-12
Monetary Base growth (YoY)	36.7%	13.8%	-1.7%
M-2 growth (YoY)	6.7%	7.2%	7.1%
Money multiplier (M-2/mon base)	3.01	3.52	3.95
	2Q13	2Q12	2Q11
Velocity of money (GDP/M-2)	1.58	1.64	1.72

Source: Federal Reserve Bank of St. Louis

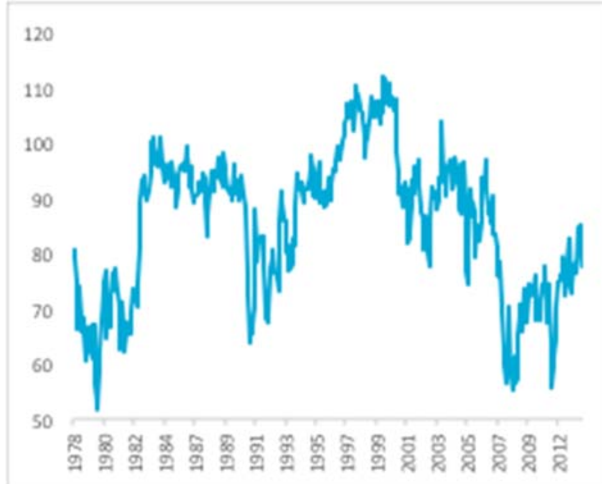
KEY ECONOMIC CHARTS

C&I Loan Growth (%)



Source: Bloomberg

University of Michigan Survey of Consumer Sentiment



Source: Bloomberg

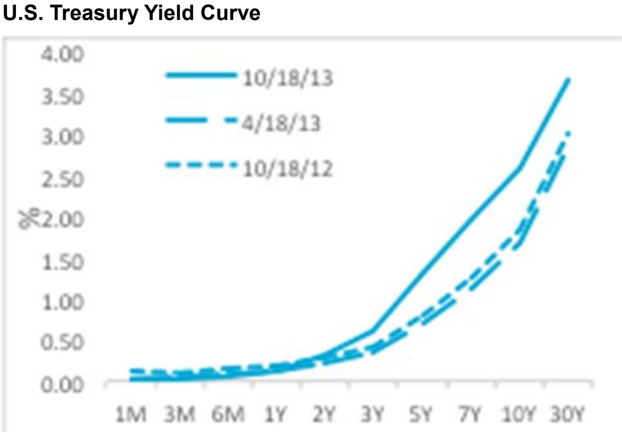
NFIM Small Business Optimism Index

Source: Bloomberg

ISM Manufacturing Purchasing Managers Index

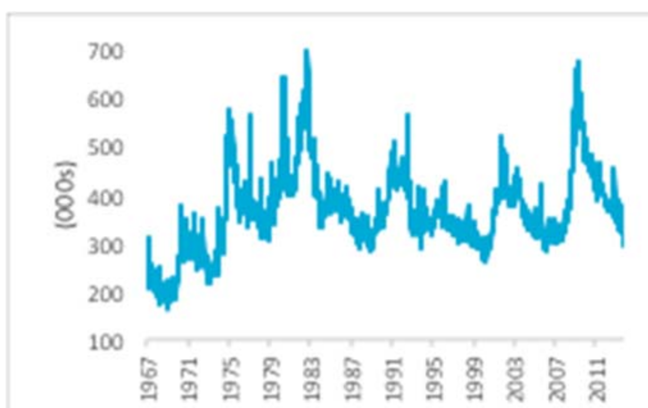
Source: Bloomberg

U.S. Treasury Yield Curve



Source: Bloomberg

U.S. Initial Jobless Claims



Source: Bloomberg

Featured Editorial

"Embrace the Grey"

By Erika Karp, Founder & CEO, Cornerstone Capital Inc. and Dr. Derek Yach, Chairman of the Board of Cornerstone Capital Inc and SVP of Vitality Group, Discovery Holdings Ltd.

Image Caption
©Majcot /Shutterstock

This article is a guest post on [Wall Street Week.]

When Aristotle said "The perfect is the enemy of the good" he was suggesting that his students do an examination of paths towards progress rather than get mired in a single issue. Notably, his words were echoed over the centuries by leading philosophers including Voltaire. That path to progress is not a straight line. And in fact, it is not an unbroken one either. But, were we to expect and insist upon ultimate perfection in each step along the way, we would get absolutely nowhere. Today, the global economy faces extraordinary challenges. We face daunting situations in diplomacy, human rights, infrastructure, education and healthcare, to climate science, economics, demographics, business ethics, and finance.

Complex problems of this magnitude simply cannot be solved sequentially; and they simply cannot be put in terms of purely black and white. To make progress on the major issues of our day, we must have multiple parallel processes and initiatives that allow for an ultimate convergence to the "right" path....or at least to a better path. We must have systems, companies, colleagues and leaders with the capacity to "embrace the grey." And we need a means to applaud, stimulate and reward incremental progress.

Who is to give the definitive answer about what is "good" and what is "bad"? What is "right" and what is "wrong" in every situation and for all time? Most people will indeed have a good sense of where to start on this. But at the same time, often circumstances play a role in the answer to these questions both large and small.

As an example, while the science is clear that tobacco kills, 1.3B people in this world consume tobacco and many will never quit. e-cigarettes, nicotine replacement therapy, and many other means will keep them addicted to nicotine, but off tobacco. If that were to happen, there would be a huge impact at scale in terms of the number of related deaths and also in terms of economic productivity. Is this perfect? No. But it's progress.

Billions of people drink sodas and eat salty snacks fried in saturated fats. Now we have snacks using low and mid-range beverage options (Next, Diet, Max) and low salt, baked snacks, and snacks using heart healthy oils to keep people happy and healthier. These products also help keep businesses profitable and stimulate innovation. This is

Erika Karp *is the Founder and Chief Executive Officer of Cornerstone Capital Inc. and the former Head of Global Sector Research at UBS Investment Bank.*

Dr. Derek Yach *is the Chairman of the Board of Cornerstone Capital Inc. and SVP of Vitality Group, Discovery Holdings Ltd.*

particularly the case if regulatory signals underpin these kinds of efforts... A more progressive path than the “black and white” version of attempted product bans.

When we “embrace the grey,” when we take the time to extract value-judgments and ideologies associated with the challenges at hand, we can make constructive progress. With “grey” the shades can evolve as business and societal demands evolve. With “grey” there can be reductions in massive lobbying resistance and regulatory waste in the economy. With “grey” we can also move towards constructive innovation solutions across sectors ranging from housing and automobiles, to healthcare and insurance.

Circling back to Aristotle, since “the perfect is the enemy of the good,” we argue that “the good” beats gridlock and stagnation hands down. The journey to the promised-land of sustainable living lies way out in the future. We know that many of its characteristics include: affordable renewable energy for all, healthy available nutritious food as the norm, cities which encourage mobility regardless of age and ability, illness prevention that works while treatment becomes a rarity, safe and secure streets and schools, and clean air and water for everyone on the planet.

Getting to that promised-land is proving very very tough. The technologies and innovations in science are beginning to deliver. But as change happens, that the path to progress goes through some very grey zones. But it is in this zone that the real transformation of the status quo begins. Perfection does not exist in this zone. In this zone, the best solutions are not yet clear. Here, there is the necessary parallel processing, urgency, competition, collaboration and innovation which will lead to progress. In this zone, we “embrace the grey.”

Featured Domain

GandhisVoice.com

By Erika Karp, Founder & CEO, Cornerstone Capital Inc.

Each month in the Cornerstone Journal of Sustainable Finance & Banking (JSFB), we will offer thoughts on a "Featured Domain" which is selected from our proprietary "Sustainable Domain Bank". The Cornerstone "Sustainable Domain Bank" contains 2,000+ addresses on the Internet which are an articulation of business processes, business practices, and aspirations for a more regenerative form of capitalism. Many of these domain names have the potential to be developed into business plans reflecting a robust interpretation of sustainable capitalism and finance. In particular, each "Sustainable Domain" captures a principle, or reflects a value inherent in the systematic understanding of the Environmental, Social, and Governance (ESG) imperatives facing businesses and the economy today. Each Domain is intended to facilitate dialogue across functions and sectors of the capital markets; and each is available for collaborative partnership, purchase or transfer should it have particular appeal to Cornerstone clients and colleagues.

Among the most well-known and well-loved sentiments of Mahatma Gandhi is that we should aspire to "be the change you want to see in the world."

For our part at Cornerstone Capital, there are changes we would like to see in the functioning of world's capital markets. We would like to see a system where there is greater collaboration and transparency among leaders in the financial services industry. We would like to see more diversity of thought and perspective in the economic and business decision-making processes across banks and regulators. We would like to see constructive dialogue regarding creative and pragmatic solutions to the financing of economic growth and prosperity. We would like to see diplomacy, compromise and respect for all forms of capital (human, natural and financial) be the new order of the day.

Given these aspirations of Cornerstone, the next step was to ask what any individual can do to help "be the change?" We considered what skills our firm could contribute to making progress in healing the investment banking profession. Could we suggest ways to progress the discipline of finance such that there is a more systematic analysis of both the risks and rewards associated with the Environmental, Social and Governance (ESG) imperatives necessary for capitalism to prosper? Could we offer any tools to facilitate the flow of capital to small and medium-sized enterprises which are pursuing sustainable growth and development? Could we find ways for great corporations to better articulate the extraordinary progress they are making with some of their own business initiatives? Could we help financial experts better serve the needs of their own clients?

And finally, could we find the resources, the partners, the patience, the strength and the courage to leave companies we knew for many years and start a new venture that would reflect our own vision? Could we help to prove beyond a shadow of a doubt that, despite all the daunting challenges, complexities, trade-0ffs and barriers, there need not be a dichotomy between long-term profitability and addressing societal needs? We think so. We hope so.

With that, the Cornerstone Capital Inc. Board of Directors, Staff, and Global Advisory Council aspire to help "be the change we would like to see in the world."

Erika Karp *is the Founder and Chief Executive Officer of Cornerstone Capital Inc. and the former Head of Global Sector Research at UBS Investment Bank.*

Featured Domain

Accelerate the Velocity of Money.com

By Michael Shavel, Research & Business Analyst, Cornerstone Capital Inc. and Erika Karp, Founder & CEO, Cornerstone Capital Inc.

It's been five years since the Global Financial Crisis (GFC). The U.S. housing market is on the mend and stock markets are rebounding, in some cases to new highs. Bank capitalization is much improved and corporate balance sheets are flush with cash. Yet not all is well the economy. Despite the Federal Reserve's best efforts, unemployment remains elevated and economic growth elusive. This apparent dichotomy is inspiring discussion around the financial system, the extension of capital into the economy, and how market forces can adapt to support businesses pursuing sustainable economic growth and job creation.

Image Caption
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In response to the GFC and in defense of its dual mandate, the Fed responded with extraordinary monetary policy in the form of near zero interest rates and several rounds of quantitative easing. While these actions and their ultimate ramifications are debatable, few would claim the Fed hasn't done enough; in contrast, the consensus belief is the Fed is now pushing on a string. As a result of the monetary policy response, banks now have on deposit with the Fed more than $2 trillion in excess reserves (deposits held by banks at the Fed not used to satisfy reserve requirements). With this arsenal of excess reserves, banks could theoretically support over $20 trillion in new lending into an economy whose GDP in 2012 was slightly above $15.5 trillion. Suffice it to say, we are in uncharted territory as it pertains to available ammunition to extend credit into the economy.

It is no secret that the pace of this recovery has been frustratingly weak, especially in light of the aforementioned Fed policy. U.S. real GDP growth is forecast at 1.6% and 2.6% in 2013 and 2014, respectively, versus the long-term average of 3-3.5%. The economy has recovered only about 6.8 million of the 8.7 million jobs lost between the start of the recession and early 2010. The combination of the massive increase in money supply and lackluster economic growth has resulted in declining money velocity (V=GDP/M). Said another way, the rate at which money in the economy is exchanged from one transaction to another is declining. And herein lies a major issue, not just for the U.S., but for economies around the world. Capital which must be available to promote economic growth and prosperity is stagnant.

There are varying opinions on this phenomenon, but at Cornerstone Capital we argue that a key impediment to the efficient flow of capital to SMEs and individuals is the damage that has been done to the faith in capitalism itself. The critical role of finance and banking must be recognized, restored, and facilitated. To see this happen, a concerted effort to drive greater transparency and more collaboration across all functions of the capital markets is absolutely essential.

In pursuing this greater transparency and trust, and in being able to identify, measure and benchmark the best (and worst) practices in the corporate world across all industries, we point to new initiatives and new tools available to do this systematic analysis and evaluation of results achieved through the business practices and processes. With the important work of organizations like the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and in the Sustainability Accounting Standards Board (SASB) in the U.S., leaders can raise their level of consciousness and excellence in responding to massive societal imperatives to achieve improved education and healthcare, access to nutrition and energy, adaptation to and mitigation of climate change, and the need to address both income inequality and social injustice.

Cornerstone Capital Inc. is a new business model. It is a business model intent upon accelerating the flow of capital to sustainable businesses. With a greater degree of transparency, in conjunction with a new breed of business leaders who embrace the diversity of perspective from their colleagues and partners, faith in our system of capitalism can be restored, and the powerful "multiplier effects" of economics can once again be realized.

Michael Shavel *is a Research & Business Analyst at Cornerstone Capital Inc. and a former Research Analyst on AllianceBernstein's Global Growth & Thematic team.*

Erika Karp *is the Founder & Chief Executive Officer of Cornerstone Capital Inc. and the former Head of Global Sector Research at UBS Investment Bank.*

Is Activism Orthogonal or Complementary to Good Corporate Governance?

By Nikos Theodosopoulos, Founder of NT Advisors LLC and former Managing Director, Technology Sector Head and Global Technology Strategist at UBS Investment Bank.

Image Caption
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Recent earnings reports from technology powerhouses of the past couple of decades exemplify that these prior titans are all now challenged by lack of revenue growth and/or margin compression. In particular, Cisco, Dell, Intel, HP, Microsoft and Oracle all either suffered from weak revenue and/or margin results in their most recent respective earnings results. Perhaps the confluence of weak results was coincident with the lack of global GDP growth and indicative that these large companies are all suffering from the "law of large numbers" as they have all become mature companies with exposure to legacy businesses (e.g. personal computers, Ethernet switching and structured databases) that they all helped define and conquer in the prior three decades? If true, however, the boards of these companies have to be cognizant of increasing shareholder activism in the technology industry and that more shareholder friendly actions in the form of increased capital returns to shareholders, potential company breakups and leadership changes will need to be considered in addition to traditional technology management actions such as using M&A to spur growth. The fall from grace of HP prior to Meg Whitman being named CEO was unfortunately an example of a poor use of company cash for M&A, lack of internal investment for innovation and leadership selection choices and raises the question on whether shareholder activism would have helped HP and its board make better decisions in the past.

Recent successes of shareholder activism, which were not originally supported by company boards in large and "legacy" technology companies, have often led to favorable shareholder returns. Such positive stock returns, will likely encourage further activism in my view from not only the traditional activists (e.g. Carl Icahn, Daniel Loeb etc.) but from traditional "long only" investment funds. The positive returns for shareholders in other "legacy" technology companies Motorola, Yahoo and Dell where activists became involved and ultimately led to a company breakup for Motorola, new leadership for Yahoo and a higher acquisition price for Dell in its planned LBO all resulted in favorable returns for shareholders. Carl Icahn's recent tweet regarding his recent investment in Apple, the largest technology company as measured by market capitalization, and favorable discussion with Apple CEO Tim Cook regarding increasing capital returns for shareholders is further evidence of activism taking on the cash rich nature and relatively low valuation of large technology companies.

Nikos Theodosopoulos *is the Founder of NT Advisors LLC, a consulting and advisory firm for the Technology Industry. Prior to founding NT Advisors LLC in 2012, Nikos was a Wall Street Equity Research Analyst for 18 years covering the Technology Sector, primarily at UBS Investment Bank.*

The recent case of Microsoft is also telling in regard to increased activism playing a role in leadership selection and potentially strategy change. The fact that Microsoft is currently the third largest technology company in the world based on market capitalization, is not deterring activism from playing a role at this critical point in the company's history. I recall a few occasions during my career as a technology sell side analyst visiting institutional investor accounts around the same time as Steve Ballmer, CEO of Microsoft. I found it interesting that investors would tell me how they made it a point to tell Mr. Ballmer that Microsoft needed to consider breaking up the company and other actions to enhance shareholder returns, but that such requests were falling on deaf ears. When it was announced that Steve Ballmer would retire from Microsoft on August 23rd, Microsoft's market capitalization rose by ~$20 billion. After the announcement on September 2nd that Microsoft would acquire Nokia's Device and Services business, thus doubling down on its current strategy even as a new CEO was not yet identified, Microsoft shares gave up about $13 billion in market capitalization.

Investors not only saw the acquisition as doubling down on the prior strategy, but also the increased likelihood that Stephen Elop, current Nokia CEO and former executive at Microsoft, would be the next CEO of Microsoft and potentially maintain the status quo of Steve Ballmer's tenure. The opportunity to be heard and play a role in the future of Microsoft, however, was not going to be lost as shareholder activism led to several of Microsoft's largest shareholders are putting pressure on the board of Microsoft to consider a CEO with "turn around" experience rather than someone who is going to just maintain the status quo. It will certainly be interesting to see how the CEO selection of Microsoft develops and how activism will likely play a role in that selection as well as the potential ongoing strategy post the selection.

‘Main Street’ versus ‘Wall Street’, Now in Aluminum!

By Peter Hickson, Founder of Global Materials Advisors Limited

‘Main Street’ versus ‘Wall Street’ - tensions have risen again, this time over the price and availability of aluminum. Consumers claim that the practices of metal warehouses, owned in part by ‘Wall Street’ banks, have constrained supply and inflated costs. The LME warehouse operators counter claim that they are providing a service which has, over many years and many cycles, provided a metal supply more secure, less volatile and at lower overall cost to consumers than would have been the case.

Image Caption
©Sarin Kunthong./Shutterstock. Aluminum ingots at warehouse.

Who is right? In reality - it is another case for ‘embracing the grey.’ The seeds of conflict were sown three years ago when several big financial players moved into the warehousing business - Goldman Sachs buying Metro and JP Morgan buying Henry Bath. In a low interest rate world it is a profitable business to warehouse surplus metal, the bulk of which is aluminum, at a guaranteed warehouse rental of US48c per tonne per day. But it is questionable whether the potential ‘conflicts of interests’ found in funding the users of the warehouses, or in participating in the ‘market making’ that delivers a contango pricing structure where the forward price is higher than the spot price, brings much ‘honor’ to the banking and producer participants in what ultimately appears to be unproductive warehousing.

But there is plenty of aluminum to warehouse. While the world currently consumes 50 million tonne in its auto production, construction and packaging industries, there is still a 1 million tonne surplus each year from over willing suppliers. Excess stocks of about 12 million tonne have been accumulated within LME and other warehouses.

With 40% of the costs, and incidentally the carbon footprint, of aluminum production coming power consumption, its cost base and investment processes can be diffracted by real, or perceived, cost advantages and by socio-industrial agendas. Most of the world’s production growth is coming from the Gulf States and China. China, with 45% of global output, is dramatically developing the far western province of Xinjiang into a 15 million tonne per year producer. The drivers behind the remote province’s surprising aluminum rise are its large but isolated coal reserves, nearly 40% of China’s total, the political need for industrial development in a restless province, relatively low capital costs and China’s surprising technical innovation that comes with it now dominating the world industry. Xinjiang’s, and possibly China’s, biggest challenge is whether there is enough water to sustain this ambitious development.

But despite the global glut of aluminum, consumers are complaining of paying a delivery price premia that has doubled in 3 years ago, peaking at over US$300 a tonne and is near 15% of the LME price of aluminum. The total cost of aluminum to the consumer is the sum of the LME price and the delivery premia. Warehouse companies have actively attracted the surplus metal into their warehouses at record rates, but under LME registration rules they are only required to deliver a minimum outflow. With their business leveraged by maximizing warehouse rental days, there is little incentive to deliver outside the minimum rule. This means that for the US based LME warehouse in Detroit, holding 2 million tonne of aluminum, it has an estimated delivery wait of nearly 15 months; 2 years ago the waiting delivery queues were closer to 6 weeks.

Warehousing business also appears to be an arrangement of profitable convenience with the big metal traders. The traders have been incentivized by the warehouse owners to put their metal into the warehouse with cash offers of over US$200 per tonne, underpinned by a rising premia. The traders then sell their metal under a futures contract in contango which funds the warehousing costs and the profit until the metal is delivered.

The LME, the registration body for LME warehouses, has responded to the apparent conflict by tabling proposals, with the industry participants, to reduce warehouse queues by adjusting future load out rates to match load in rates by mid-2014. Governance and commercial pressures have also seen warehouses owners react by lowering the incentives to attract metal into the warehouse.

But in many ways the warehouse operators and the metal consumers are secondary to the bigger primary economic forces, such as policy-mandated ultra-low interest rates and the undisciplined global growth in aluminum supply. Without low interest rates the 'unproductive' funding of the warehousing of ever larger amounts of aluminum would not be possible; just 2pts lift in the Libor rate would reverse most positions. Similarly it is the artificially low cost of capital and social imperatives in key supply environments that are driving aluminum glut that would reverse in a more rational 'playing field.'

The unwinding of these positions with the eventual return to interest rate normalization is likely see a significant shake out in the aluminum market and its participants, as increased amounts of metal come to the active market, taking both LME and premia prices lower, and eventually leading to a rationalization of market based global supply.

But maybe there is a silver (grey) lining in this tale of 'Main Street v Wall Street' tension. Aluminum is a metal with strong sustainability credentials, derived from its light-weight nature that is a key to lifting global energy efficiency in transport, and its leadership in global metal recycling. The combination of falling total price, large available stocks and reliable supply - aided by the LME, its warehouse owners and traders, 'Wall Street', – maybe is the catalyst that enables aluminum to dramatically lift its market share in the transport and auto industries; this would be a good 'Main Street' outcome. Furthermore, despite the nearby complaints about aluminum premia, ultimately what down-stream consumers really need is reliable, low volatile pricing that will encourage the confidence and the necessary investment in retooling in this switch to aluminum. This could be the surprising outcome that brings 'honor' to what appears to be conflicting market forces.

Peter Hickson *is the Founder of Global Materials Advisors Ltd. and an Advisory Director at TrafalgarCopley. Peter has over 25 years of experience in Global Basic Materials and Commodities research on Wall Street.*

Open Source Excellence

Three Little Words

By Susanne Stormer, Vice President, Corporate Sustainability, Novo Nordisk

Here's the challenge: If there were one thing that your company uniquely does better than anyone else and which could easily be copied - what would that be, and would you be prepared to share it in open source fashion?

Thus spoke Erika Karp. As always, asking smart questions, expecting simple and pragmatic answers. So here is mine: Carve sustainability in stone where it matters most. In your company's bylaws. And then see what happens. Simple as that. Effective like the enzymes in your detergents.

In fact, it was a painful experience with enzymes that kicked off Novo Nordisk's journey into an uncharted territory now known as the grounds of sustainable business. Our company was cornered by consumer groups challenging the safety of our products, and we were not prepared for their attacks on our open flanks: our products on the shelves in supermarkets across America. This was in the late 1960's and our first encounter with the political consumer.

Since then, we have been challenged and even under siege by critics on several occasions. And today, we embrace each of them as experiences that have helped mature our thinking and strengthen our business, grateful for what we learned in the process.

For those who know our company well, the rest is history. We introduced the Triple Bottom Line as a way of accounting for performance and began to report on more than financials. First environmental impacts, then social responsibility, and next the socio-economics of our business. Our goal is to provide a truly inclusive and interactive picture of the company's performance and position for the future in a 360 degree perspective. In this space we are, thankfully, no longer alone. There is a movement taking the same journey towards more meaningful and more transparent corporate disclosure.

Scrutiny, though, is less about the outcomes, for at that time it is too late to find the alpha value. The gems are found when you understand how decisions are made by a company board and its management. And this is where at Novo Nordisk we still have a USP. A decade ago our board made a really smart decision: It spelled out, in the company's Articles of Association, in the clause specifying the objectives for the company that "The company seeks to conduct its business in a financially, socially and environmentally responsible way."

Three little words with immense impact. They send a strong message to investors, to business partners, to employees and indeed to management that this is how we do business. This is what you can expect of us, and you can hold us accountable for it. We do. And the message is transformative. When we say sustainable, we mean business. We don't claim to be there yet, but what we do claim, boldly, is that saying out loud and clear that responsible business is what can be expected of us in everything we do, was the first, important step. From there onwards, opportunity waves. Three words, one idea, in one serving. Voila!

Susanne Stormer *is Vice President, Corporate Sustainability, Novo Nordisk. Susanne sets the strategic direction for the company's positioning as a sustainability leader and a pioneer in demonstrating the long-term business value of incorporating economic, social and environmental perspectives into its market proposition.*

Enhanced Analytics

A New Value Driver Framework

By David Lubin, Managing Director of S3 and retired as Co-Chairman and Managing Director of Renaissance Worldwide

Image Caption
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At the recent 2013 Global Leaders Summit in New York, Secretary General Ban Ki-moon presented the UN Global Compact's Post- 2015 Business Engagement Architecture, defining the key building blocks that will "help take corporate sustainability to scale and turn business into a truly transformative force in the Post-2015 era". This comprehensive architecture serves as the follow-on to the Millennium Development Goals and portrays a dynamic, open system of interlocking initiatives and processes led by a broad range of stakeholders forming the foundation needed for accelerating positive change.

Among the critical issues addressed by this new architecture is the challenge of engaging the financial markets in understanding the growing significance of sustainability strategy as a driver of innovation and business value. The gap between mainstream investors and leading companies regarding the business value of sustainability is sizeable, understandable, and problematic.

While numerous research studies reveal that a growing number of firms are translating their sustainability strategies into meaningful financial gains, most mainstream analysts and investors have difficulty seeing the relevance of sustainability data to business results. Although many leading companies tell us they are growing revenues from new sustainability-advantaged products and services, improving productivity and trimming costs from sustainability-based initiatives, and reducing sustainability-related risk to revenue and reputation, neither their own financial reporting nor the current sustainability 'data' sets make such important results easy to see and evaluate at the enterprise level.

Historically, sustainability data reporting has served the needs of a small niche of 'socially responsible investors' who were often willing to accept some reduction in returns to invest in accordance with their values. The data that evolved covering dozens of policy, process and impact issues does not easily fit into most mainstream models of company performance and was not designed for that purpose. Many efforts are underway to address this problem, but generally accepted solutions are likely to be many years away.

David A. Lubin is currently Managing Director of S3, and retired as Co-Chairman and Managing Director of Renaissance Worldwide. He served as lead contributor to the UNGC in development of the report entitled, The Value Driver Model – A Tool for Communicating the Business Value of Sustainability

In response to the need to bridge this gap, the Value Driver Model (VDM) is presented as important element in the UNGC's engagement architecture. It's a 'back-to-basics' approach seeks to help firms establish the *relevance* of sustainability to their core business strategies and improve how they communicate the business value of sustainability to investors and analysts.

In the simplest terms, the model recommends that companies seeking investor engagement present direct evidence of how their sustainable business strategies impact the mainstream issues of revenue growth, productivity and risk management. The report [1] makes the case for three simple fact-based, company defined metrics as a useful starting point for companies seeking investor recognition of potential business value.

1. Sustainability-advantaged Growth that measures a company's revenue volume and relative growth rate from products they define as "sustainability-advantaged" in comparison to their predecessors and/or competitors;
2. Sustainability-driven Productivity that measures the aggregate financial impact on a company's total cost structure as reported by the company from all sustainability-related initiatives in a given time period;
3. Sustainability-related Risk mitigation that measures performance over time on the critical few metrics that a company (often in consultation with stakeholders) believes poses a meaningful risk to revenue and reputation.

The UNGC report provides a rich set of case examples of companies who are already using a similar approach to break through to mainstream investors. Seen through the Value Driver lens, DuPont, for example, reports that sales of products designated as 'sustainability-advantaged' contributed 30 per cent of total 2012 revenue (more than 10 billion USD), and are growing at a rate 5.5 times faster than the company overall. In addition, internally generated productivity gains from sustainability-related initiatives saved the company approximately 10 per cent, or 300 million USD, on their 2010 operating income of 3 billion USD. DuPont has also reported significant measured reductions in exposure to key sustainability-related risks to their business, including toxic emissions, water use, and manufacturing process certifications from among a highlighted short list tracked over time.

While it is no doubt true that some investors would question how sales are categorized or savings tabulated, knowing that such significant contributions to growth and earnings momentum are coming from strategies that have sustainability in their DNA, makes it much more likely that investors would conclude that they ‘need to know’ more. If the UNGC’s Value Driver Model helps the leading companies gain leverage from sustainability with insightful mainstream investors, then the rest of the market can't be far behind.

[1] This is a link to the Interim Report. The Final Report expected in December 2013.
http://www.unglobalcompact.org/docs/issues_doc/Financial_markets/ESG_Investor_Briefing/ESGValueDriver.pdf

Corporate Governance Insights

Sustainability Metrics in Executive Pay: The Example of the Energy Sector

By Kimberly Gladman, CFA, Ph.D., Research Director of the Just Capital Foundation. She composed this article while serving as Managing Director for ESG Research at GMI Ratings, an independent provider of sustainability research and analysis.

Image Caption
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Amid growing investor interest in the ways that corporations manage sustainability issues, executive pay plans are receiving heightened scrutiny. Many companies say they value environmental and social performance, but do they structure their financial incentives to focus executives on those goals?

Answers to that question vary widely, both depending on industry and among companies in the same line of business. A look at the global energy sector illustrates how sustainability is tied to pay at some of the companies with the most experience with the practice.

Overall, more than 80% of the world's largest energy companies say that some aspect of sustainability (such as safety or environmental responsibility) plays a role in their executive compensation decisions. About 40% of the companies go further, naming specific metrics (such as Total Recordable Incident Rate or volume of spills to the environment) that they incorporate into pay plans; and over 25% disclose targets they set for performance on those metrics. (These calculations are based on data collected from annual filings released in 2013 for the 43 energy-sector constituents of the S&P 500, plus the 38 non-US energy sector companies in GMI Ratings' coverage universe with market capitalizations above $10 billion.)

However, several factors may temper investor enthusiasm about these findings. First, despite the widespread use of sustainability factors, their impact on payouts to energy executives remains low, since they often determine only a small part of the annual bonus. Moreover, although many investors consider sustainability an inherently long-term theme, sustainability metrics are overwhelmingly used for annual bonuses only, with less than 8% of companies using them in long-term incentive plans. Finally, the effects of these pay plans on sustainability performance may be limited because the metrics used often focus primarily on avoidance of errors, such as worker injuries and fatalities or environmental spills. It is much less common for companies to tie pay to systematic improvements in their routine operational impacts (e.g, a reduction in greenhouse gas emissions or decreased water usage).

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To be sure, there are some companies who give sustainability factors a prominent, or even pivotal, position in their pay plans. For example, Talisman Energy awards 30% of its annual bonus based on health, safety and environmental (HSE) performance; Cobalt Energy allocates 25% of its bonus to such factors in normal years, but overweights them to 75% if a serious negative HSE event occurs. At ConocoPhilips, Technip, and Total, three-year deferred pay vests in part based on HSE factors. At Tullow Oil, long-term shares vest based on financial measures, but pay out only if environmental and social performance is satisfactory. Finally, BP, in response to its disaster in the Gulf of Mexico, has tied pay to sustainability in multiple ways. Safety and operational risk management account for 30% of the annual incentive; one-third of the annual bonus is deferred for three years and vests contingent on demonstrated safety and environmental responsibility; and one-third of performance shares for the 2013-2015 period vest based on the achievement of strategic imperatives that include process safety.

It's important to note that the plans described in annual regulatory filings may give an incomplete picture of how pay committees think about sustainability and pay. This is especially true outside the US, where disclosure is less detailed. But US committees may also be incorporating sustainability factors into their subjective evaluations of executives, or their discretionary bonus decisions (as, for example, when Chevron cut bonuses last spring due to safety problems). Nevertheless, the filings provide a sense of companies' overall approach to incentivizing sustainability performance through pay---revealing both the substantial progress that has been made, and how much work remains to be done.

Valuation & Accounting

Things We Can Kick…And Things Which Are Precious

By Janet Pegg, Head of Valuation & Accounting at Cornerstone Capital Inc. and former Managing Director and Analyst of U.S. Accounting Research at UBS Investment Bank

Image Caption
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When I discuss acquisition accounting to clients, I explain how tangible assets and identifiable intangible assets are recorded at fair value. I explain that tangible assets are basically things you can kick - such as inventory and property, plant and equipment.

Identifiable intangible assets are those things you can't kick, but can put a name to - such as patents, copyrights and customer relationships. After recording liabilities at fair value, the excess of the purchase consideration over the fair value of the acquired net asset is recorded at the last intangible - goodwill.

Google completed the acquisition of Motorola Mobility in May 2012. Of the $12.4 billion purchase price, 70% was allocated to intangibles - patents and developed technology, goodwill and customer relationships. Under U.S. GAAP, only acquired intangible assets can be acquired (with the exception of software.) Self-created intangibles are not recorded. For some companies, this results in significant amounts of valuable assets not be recorded on the GAAP financial statements.

Apple has completed numerous acquisitions, and its July 29, 2013 balance sheet shows approximately $6 billion of intangibles. However, when you compare Apple's market capitalization of $422 billion to the book value of $123 billion, it indicates that the market estimates there could be an additional $300 billion of unrecorded intangibles.

There are been numerous calls for companies to record and value their intangible assets. However, the idea has met with resistance due mostly to concerns about the ability to properly value these intangibles.

If we assume that the majority of tangible assets and liabilities are recorded at close to fair value, the market inherently values a company's intangibles through the stock price. As noted above, if the company were to be acquired, after recording tangible assets and liabilities at fair value, intangible assets would be recorded at fair value. Any unallocated purchase consideration would be recorded at fair value. So, the majority of the excess of a company's market capitalization over its GAAP book value can be attributed to unrecorded intangible assets - both identifiable and goodwill.

Janet Pegg is currently the Head of Accounting & Valuation at Cornerstone Capital Inc. and former Managing Director and Analyst of U.S. Accounting Research at UBS Investment Bank. Janet is an II-ranked Analyst.

When accountants record intangible assets acquired in an acquisition, the valuation methods are typically based on discounted cash flow. As the market typically values companies based on expected future earnings, the market is essentially doing the same thing as the accountants. The market values the company has a whole based on future earnings expectation. The excess of a company's market capitalization over its recorded net assets is the amount, at that point in time, that the market values the unrecorded intangibles.

However, having one block of unallocated market premium being attributed to unrecorded intangibles is not very useful to users of the financial statements. Information of the nature of the intangibles, as well as their expected lives, is needed to fully understand their value to the business.

However, like with so many things in life, the value of an intangible is in the eye of the beholder, and can change daily. There have been concerns that any mandatory valuation and recognition of intangibles would be difficult for companies to do, and users of the financials might question the company's results. In addition, the recorded values could quickly diverge from current market values.

In essence, when analysts and investors determine their expectations about a company's future earnings prospects, they are valuing the intangibles. With their knowledge of a company's business and processes, they are making assumptions about the future earnings contributions from the intangibles. They deduct the costs of realizing these contributions (through research and development, royalty payments, salaries, and the cost of tangible assets needed to realize the intangible's value,) and determine a price target for the company.

Then, as expectations about a company's future earnings changes, the value of the intangibles is adjusted and results in a new price target for the company. Different users of the financial statements will have different beliefs as to the earnings prospects of the company, and therefore different beliefs as to the value of the intangibles. This results in different analysts having different price targets or bidding wars when a company is a potential acquisition target.

Rather than having companies provide point-in-time valuations of intangible assets, what investors would find more useful is increased disclosure of the assets, both tangible and intangible, that contribute to the company's earnings process. With this additional information financial statement users would be able to better understand how intangibles contribute to a company's valuation, and as importantly, how the value of the intangibles could change over time.

Sustainable Product Review

The Universal Pictures Film: "42"

By Erika Karp, Founder & CEO, Cornerstone Capital Inc. , Michael Shavel, Research & Business Analyst, Cornerstone Capital Inc., and Matthew Daly, Research Product Manager

In the middle of the recent film "42" by Universal Pictures, the Brooklyn Dodgers Owner Branch Rickey played by Harrison Ford says to his partner at the opening game of the 1947 Major League Baseball (MLB) season: "Another opening day Harold...All future, no past." This movie, an homage to legendary barrier-breaking baseball player Jackie Robinson, can be viewed as either Hollywood at its best, or at its worst. Like the comment by Rickey, there can be tremendous optimism and opportunity ahead. But, the simple statement goes nowhere in capturing the complexity and agony that goes with any civil rights and social justice movement.

Major League Baseball has indeed made strides towards embracing diversity as with other great institutions. And, Jackie Robinson is an incredible icon for this progress. But there's still a long way to go. What the film "42" does capture particularly well, is the fact that the institution itself is vastly better off for having evolved. It's better off for having, albeit kicking and screaming, embraced greater diversity. When asked why he took the actions he took in bringing Robinson to MLB, Rickey aptly said: "For the love of baseball."

For the love of the institution, he embraced the power of difference and the power of challenging the status quo. Notwithstanding the fact that to many of our readers outside the US, the passion for the great American pastime is completely incomprehensible, we argue that the film has a great message for the world's capital markets and for the discipline of finance. For the love of capitalism, we argue that "42" highlights the inextricable link between diversity, excellence, and sustainability. Embracing the extraordinary talents of Jackie Robinson raised the bar for the entire game.

Image Caption
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The same potential exists for capitalism and for corporations as we begin to break down silos. It is silos which dampen creativity, productivity, innovation and long-term excellence. Just like Robinson's batting average, the empirical proof is very much at hand. As an example, in a report from last year entitled "Gender Diversity and Corporate Performance" by the Credit Suisse Research Institute, CEO Brady Dougan highlights some striking results from the analysis. Having tested the performance of 2,360 companies globally, the research shows that corporations with women on their Boards achieved a higher than average ROE, lower gearing, better than average profit growth, and higher P/BV multiples over a period of more than half a decade.

The report cites some key reasons including: greater overall efforts by the staff, a better mix of leadership skills, access to a wider talent pool, a better reflection of the consumer decision-maker, improved corporate governance, and heightened risk aversion. This research is entirely consistent with numerous other studies done in the past few years (including those of Catalyst and GMI Ratings).

In citing the work of Professor Catherine Phillips of Columbia Business School, it echoes our own thoughts reflected in an article in "Wall Street Week" Diversity: Painful, but Profitable."

When seeing the story of Jackie Robinson unfold in the film "42", and wearing a lens of the capital markets, we circle back to Credit Suisse CEO Brady Dougan's comment on his firm's research: Diversity offers "another metric for scrutinizing corporate governance." He further argues that the trend towards greater gender diversity will be "manifested as stability in corporate performance and in share price returns."

Finally, in a further confirmation of the extraordinary value of embracing diversity, we note the recent retirement of Mariano Rivera after 19 seasons and 5 World Series with the New York Yankees. Rivera is the "The Greatest of All Time." He holds every relevant pitching record in MLB history. Rivera is also the last player who will every wear the number "42" in Major League Baseball. MLB has decided to honor the great Jackie Robinson by retiring Robinson's number "42". Imagine if Rivera, the son of a Panamanian fisherman, had been denied access to the game. Imagine the loss. Thank goodness we do not have to.

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Sustainable Standout

The 3% Solution: Driving Profits Through Carbon Reductions

By Chris Fowle, Vice President, Investor Initiatives, CDP

Chris Fowle *is Vice President, Investor Initiatives at the CDP.*

This report from WWF and CDP identifies novel approaches for the private sector to realize significant cost-savings achieved through boosting energy-efficiency measures and transitioning to low-carbon energy sources. In the process, the US corporate sector will be able to cut carbon emissions by 3% annually to achieve the 2020 carbon reductions scientists say are needed to avoid dangerous climate change. Written and researched with CFOs in mind, The 3% Solution provides answers that businesses and sustainability stakeholders can translate directly into commercial strategy. (For more on The 3% Solution, visit https://www.cdproject.net/CDPResults/3-percent-solution-report.pdf.)

The Gigaton Challenge

To keep the rise of global temperatures below 2°C, the US corporate sector must reduce total annual greenhouse gas emissions in 2020 by 1.2 gigatons of CO_2e from 2010 levels. This amount is equivalent to annual reductions of approximately 3% per annum across the US corporate sector.

The 3% Solution shows these reductions can be achieved through cost-effective measures alone, generating savings of up to US$190 billion in 2020 for the US corporate sector, excluding utilities. Between 2010 and 2020, that amount grows to up to $780 billion in potential savings.

Companies can capture these unrealized savings from three primary types of activities:

1. Improved energy efficiency through behavioral or management changes
2. Energy efficiency through technology improvements, and
3. Deployment of low-carbon energy, particularly rooftop solar power

$190 Billion in Unrealized Savings in 2020

WWF's analysis of CDP data in the report produced three key findings about these profitable opportunities which can be achieved with current technologies and policies:

- **Low-Carbon Investments Produce Higher Returns.** Seventy-nine percent of US companies in the S&P 500 that report to CDP earn a higher return on their carbon-reduction investments than on their overall corporate capital investments.

Similarly, those companies with carbon reduction targets secured 9 percentage points higher overall ROI than their peers without targets.

- **The 3% Solution Allocates Financial Benefits, Not Environmental Burdens.** Some sectors will have an opportunity to reap greater savings based on their share of the potential US$190 billion of profitable investment opportunities. Sectors with higher reduction targets have greater potential profits than sectors with lower targets.

- **Modest Increase In Capital Expenditures Is Needed.** While the opportunities are significant, most companies are not investing enough to capture them. These savings could be fully realized if the corporate sector devoted 3 to 4 percent of its capital expenditures to emission reduction investments (excluding utilities.)

The 3% Solution is a Limited Time Offer

The 3% Solution is a limited time offer. If US business acts now to reduce emissions by 3% annually through 2020, they will not only capture significant cost-savings, but also put us on the pathway to curbing dangerous climate change. Waiting until 2020 would be costly for companies and the climate, requiring businesses to make (on average) a 9.7% reduction annually to meet the IPCC's minimum 2050 target. Waiting until 2030 is not an option; the US business community will have already emitted too much carbon to be able to avoid the serious consequences from increasing global average temperatures by 2°C above pre-industrial levels.

Going Beyond the 3 Percent

In addition to the US$190 billion of savings opportunities, specific actions by utilities, customers and suppliers could add up to another gigatonne in reductions in 2020. Utilities could reduce their emissions by 0.4 GtCO2e just by focusing on the lowest cost activities with significant carbon reduction potential. By helping consumers to reduce home energy use, add residential solar power and avoid transportation emissions from commuting, utilities and the corporate sector could further accelerate emissions reductions by an additional 0.6 GtCO2e in 2020. Together, these emission reduction opportunities add up to a potential 2.2 GtCO2e, which if achieved would be almost double what is required to deliver the 3.2% annual reductions necessary to meet the IPCC's minimum 2020 target.

Virtual Attendance

Dow Jones Private Equity Analyst Conference, September 2013

By Erika Karp, Founder & CEO, Cornerstone Capital Inc.

Twenty years ago Dow Jones hosted its first "Private Equity Analyst Conference." At this year's event, held at New York's Waldorf Astoria Hotel, an exceptional group of Private Equity (PE) executives reviewed the evolution of the industry over the past two decades. Speakers including Charles Kaye of Warburg Pincus, David Mussafer of Advent International, and David Rubenstein of The Carlyle Group, highlighted the extraordinary growth of the business from a time when raising a $400M fund was ground-breaking, to today's market where $10B funds seem almost a regular occurrence.

While the Partners from the various firms articulated their respective strategies ranging from a focus "across the breadth of the corporate maturity stack" to "deep specialization on a sector basis", one message came through loud and clear from across the presenters: complexity has increased dramatically across the board. Whether dealing with political economics in the US, the regulatory challenges of foreign owners doing business in India, China's ability to execute an economic transformation over the next decade, or a new definition of the state of incorporation based upon globalization, complexity now rules the day.

The complexity cited by these capital markets professionals is further heightened by the massive societal imperative to find solutions to global crises including poverty, education, healthcare and climate change. The good news from this conference is that PE appears to be doing more than its share to shepherd growth, innovation and optimism. As an example, we saw Advent raise the largest ever Latam fund in Brazil, which is participating in the world's largest ever for-profit education company. And, we consider Terry McGuire of Polaris Partners advising venture capitalists regarding the dynamics of affordable healthcare and the extent to which there will be attractive investment opportunities.

Further at this event, Erik Hirsch of Hamilton Lane highlighted the critical need for technology to help manage the huge demand for an onslaught of data. And, critical to igniting the growth of their portfolio companies, is the ability to manage all this data in such a way that they can capitalize on the biggest trends in technology. Mike Bingle of Silver Lake categorized these trends as the cloud, mobility, mobile/social, video, and mobile data. To invest in these trends, while there may not be pure plays, investors need to look for the second and third derivative opportunities. He looks for business model shifts and transformations to source opportunities.

On that last subject of the evolution of business models, the stakes are enormous and the opportunities abound. Over the course of this Dow Jones event, among the most incisive questions coming from attendees was the following: "So many deals these days seem to be PE to PE. Where's the creativity?" Our take-away is that the creativity is captured in transforming business models to capture growth trends. In fact, in the Private Equity industry itself, a big evolution is the pace at which we are seeing private alternatives to the public markets in financing the needs of growth companies. In fact further, Carlyle's David Rubenstein argued that we will ultimately see the ability of non-accredited investors participate in PE. The investor base is changing. So must business models.

Erika Karp *is the Founder & Chief Executive Officer of Cornerstone Capital Inc. and the former Head of Global Sector Research at UBS Investment Bank.*

Upcoming Events

Global ESG Calendar

Date/Time	Event	Location	Information
10.28.13 – 10.30.13	SRI: The Conference on Sustainable, Responsible, Impact Investing (formerly SRI in the Rockies)	The Broadmoor Colorado Springs, CO U.S.A	http://sriconference.com/
10.31.13 *10:00am - 12:00pm EDT*	CDP Global Water Forum 2013	Virtual Roundtable	https://www.cdproject.net/en-US/Pages/global-water-forum-2013.aspx
11.12.13 – 11.13.13	UNEP FI Global Roundtable and also Sustainable Finance Week	Shangri-La China World Hotel, Beijing, China	http://www.unepfi.org/grt/2013/
11.14.13 – 11.15.13	TBLI Conference™ Europe 2013	Swissotel Zurich, Switzerland	http://www.tbliconference.com/
11.19.13 *8:15am - 4:15pm EST*	Boston Security Analysts Society: Sustainable Investing: Moving From the Margin to the Mainstream *Cornerstone Speaking Event*	Metro Meeting Center 101 Federal Street, 4th Floor Boston, MA 02110 U.S.A.	http://www.bsas.org/store/events/registration.aspx?event=111913&expand=TRUE
11.21.13	Sustainability Leaders Forum	Hotel Russell London, United Kingdom	http://www.sustainabilityleaders.net/home
11.21.13 – 11.22.13	World Forum on Natural Capital Edinburgh 2013	Edinburgh International Conference Center Edinburgh, Scotland	http://www.naturalcapitalforum.com/
11.28.13 *8:30am – 7:30pm AEST*	RIAA Responsible Investment Conference – 'Making Responsible Investment Count'	Australian National Maritime Museum Sydney, Australia	http://www.responsibleinvestment.org/2013riconference/
12.4.13 *11:00am - 12:00pm EST*	US SIF 'Policy Developments: A Year in Review in Europe and the United States'	Webinar	Open to members only. http://www.ussif.org/conference
12.10.13 – 12.11.13	Responsible Investor: RI Americas 2013	Bloomberg MPR Auditorium 731 Lexington Avenue New York, NY 10022	http://www.cvent.com/events/ri-americas-2013/event-summary-f4b0766bf10c4c6bba4bc42785d8a262.aspx
3.5.14 – 3.6.14	Responsible Investor: RI Asia 2014	Tokyo Stock Exchange Tokyo, Japan	http://www.responsible-investor.com/events/events_page/ri_asia_2014/
4.30.14 – 5.1.14	Ceres Conference 2014 'The Future is Now'	Westin Waterfront Boston, MA U.S.A.	http://www.ceres.org/conferences
5.19.14 – 5.21.14	US SIF Annual Conference *Cornerstone Sponsored Event*	Capital Hilton Washington, D.C. U.S.A.	www.ussif.org/conference
5.29.14 – 5.30.14	TBLI Conference™ New York 2014	United Federation of Teachers Headquarters	http://www.tbliconference.com/

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whartonmagazine.com/blog/sustaining-selling-success/

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Harvard Business Review | HBR Blog Network "Why Go it Alone in Community Development?" by Andrew MacLeod – June 2012
http://blogs.hbr.org/2012/06/why-go-it-alone-in-community-d/

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www.whartonmagazine.com/blog/writing-the-verses-of-sustainable-investing/

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