Investing with faith

Epworth Investment Management Limited
Annual Report 2017

For churches and charities

Epworth
Investing with Christian ethics

Contents

Mission

Our mission, alongside the church, is to seek practical solutions which combine Christian ethics and investment returns.

We therefore aim…

To provide a high quality investment service seeking above average returns;

To follow a discipline in which the ethical dimension is an integral part of all investment decisions;

To construct investment portfolios consistent with the moral stance and teachings of the Christian faith;

To encourage strategic thinking on the ethics of investment;

To be a Christian witness in the investment community.

For more information…

For detailed reviews of our approach to ethics and investment, see the Joint Advisory Committee on the Ethics of Investment's annual report and the quarterly Responsible Investment Review on our website.
www.epworthinvestment.co.uk/ethics

Investing with faith

Epworth Investment Management Limited ('Epworth') is a wholly owned subsidiary of the Central Finance Board of the Methodist Church ('the CFB'). Our experienced team, investment processes and systems are all drawn from the CFB. This strong foundation has allowed us to develop consistent long-term investment performance and a client-focused culture.

However, the greatest thing that we draw from the CFB is our Christian heritage. Our faith is at the heart of everything we do. In the world of ethical investing there are some easy investment decisions to make – for example where humankind is overtly setting out to harm itself or God's kingdom. There are many situations where poor behaviour represents only a small part of a company's activities and much of what it does is beneficial. In these situations we not only have to determine the investment case for participating in a company but also the ethical impact – will our engagement lead to better behaviour or are we giving undeserved credibility to company management?

Our mission statement demands that we act as a Christian witness to the investment community. This is a challenging task that we do our best to meet. We have the guidance of Methodism's Joint Advisory Committee on the Ethics of Investment to help us. Our investment managers look at both the business case and the compatibility with Christian values when forming their investment decisions.

The following pages outline some of the ethical initiatives and challenges that we have worked on in the last year. Your feedback would be very welcome.

David Palmer
Chief Executive Officer
Epworth Investment Management Limited

david.palmer@epworthinvestment.co.uk

Preserving with faith

Preserving our atmosphere
Climate change and the carbon footprint of the companies in which we invest remain a key focus for us. During the year, we became signatories to the Montreal Pledge, an initiative designed to encourage investors to measure, disclose and reduce the carbon footprints of their portfolios. In support of this, we have achieved a significant reduction in the carbon intensity of our Equity Fund over the last three years.

Preserving trust in reporting
We are active in a number of initiatives to improve the transparency of reporting and attitude towards carbon emissions. The CFB became a founding member of the ***Transition Pathway Initiative***, a coalition of asset owners and managers that is working with the London School of Economics to develop tools that measure an individual company's performance in the high carbon sectors.

Preserving ethical criteria
During the year we excluded from our portfolio two Canadian companies that had significant earnings from tar sands exploration. We also voted with other faith groups to encourage a number of companies to improve their emissions target reporting.

Preserving pressure for change
We are also on the steering committee of the ***Mining and Faith Reflections Initiative*** which brings together mining executives and church leaders to pursue a vision for a sustainable mining industry. Over the last year this initiative has led to a visit to mining sites in Colombia, a dialogue on ethics with leading chief executives in the mining industry in Barcelona and preparation for a day of reflection involving Church leaders and executives from the mining industry.

Sustaining with faith

Sustaining awareness

The twin epidemics of diet-related obesity and undernutrition have been major areas of focus for us in 2016/17. The latest data from the World Health Organisation suggests that nearly 40% of the world's adult population is overweight. Of these, 600 million are classified as obese – with stark consequences for public health, as cardiovascular diseases become more prevalent. At the other end of the spectrum over 2 billion people suffer from micronutrient deficiencies. Around 161 million children have stunted growth, with 45% of premature deaths in children caused by undernutrition.

Sustaining pressure on food and beverage providers

Global food and beverage companies have an important role to play in responding to these issues by offering healthy choices, products with less sugar, salt and fats and products that are fortified with micronutrients.

Sustaining progress through action

We are responding to these challenges by encouraging companies to:

- support public and health industry awareness campaigns. This includes an investor coalition letter with ***Farm Animal Investment Risk & Return (FAIRR)*** to improve corporate awareness of the rise in antibiotic resistance in the animal supply chain
- sell food and beverages in a responsible way that does not encourage excessive consumption
- not target children or other vulnerable groups via advertising
- support individuals in making healthy dietary choices.

"Health is like money; we never have a true idea of its value until we lose it".
Henry Wheeler Shaw
19th century American humourist

Protecting with faith

Protecting the vulnerable from slavery
Following intense lobbying by us and other investors, The Modern Slavery Act received Royal Assent in March 2015. Companies with worldwide turnover of more than £36m are now required to report how they manage the risk of slavery in their business and supply chain. Working with the ***Church Investors Group*** we are engaging with companies on the quality of their reporting and identifying companies that are dismissive of this risk.

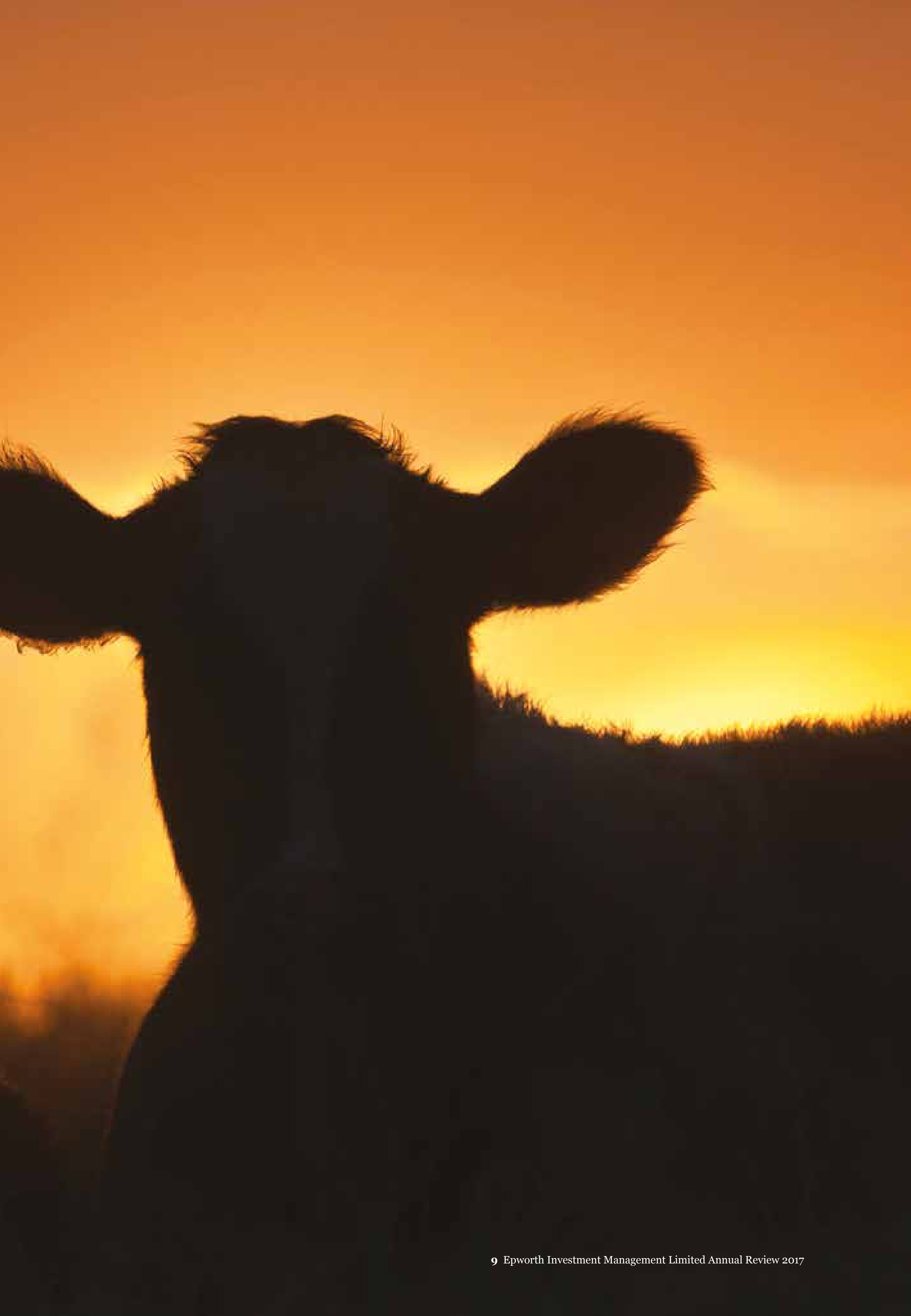
Protecting the young from exploitation
Following allegations in a BBC Panorama programme regarding concerns about the use of Syrian child workers in the Turkish apparel industry, we engaged with the major UK retailers involved. We have seen increased awareness of this issue in company practices and statements.

Protecting local communities
Total (the oil and gas company) has been excluded from investment since 1997, principally due to its involvement in human rights violations in the building of a pipeline in Burma. Recognising Total's efforts in repositioning itself towards a low carbon economy, we have been working with the company to improve its human rights record. Areas that we have explored with Total's management include the protection of the local populations, payment of appropriate restitution, the resolution of grievances and its long-term strategy for socio-economic development in the region.

Encouraging with faith

Encouraging business to do better
We are supporters of the ***Business Benchmark on Farm Animal Welfare (BBFAW)***. During the course of the year we engaged with several leading UK companies, including ***J Sainsbury*** and ***Whitbread***, that had received falling ratings for their recognition of animal welfare issues. In both cases the Chief Executive Officers of the companies advised us that they are taking steps towards remediation.

Encouraging respect for livestock
In collaboration with ***ShareAction***, we engaged on the important issue of livestock production and the use of antibiotics. We wrote to ***The Restaurant Group*** seeking better disclosures on its policy for the sourcing of animal products and antibiotic use. In response the company confirmed that it is a condition of supply that antibiotics are only used for verifiable disease treatment.



Investment review

Amidst an extraordinary year in politics, there have continued to be grounds for optimism about the global economic outlook. The world economy has been growing at an annualised rate of around 3% and the IMF expects that growth rate to increase to around 3.5% in 2017. Growth has also become better distributed, with steady performance from Europe and Japan and the emerging market economies of Brazil and Russia recovering from recessions. The outlook for the UK looked very gloomy after the country voted to leave the European Union but some of that pessimism was overdone and the economy proved resilient, helped by an interest rate cut and more Quantitative Easing by the Bank of England.

The Brexit vote led to a sustained period of weakness for sterling which drove a surge in the stock market valuations of companies with high overseas exposure in revenues and profits. Underlying global economic conditions also improved the outlook for company profits and together these factors helped drive the UK stock market up by 23% in the year to 28 February 2017. Our policy of having favoured stocks in a balanced portfolio has paid off during the year and the UK Equity Fund, which excludes 15% of the market on ethical grounds, has outperformed our ethical benchmark. Overseas equities had a very strong year, rising almost 40% in sterling terms and our Overseas Fund, which invests conservatively, captured most of this.

The UK Gilt market has seen a roller coaster year, reflecting the swings in sentiment on the economy. In mid 2016, gilt yields reached all time lows as investors took cover after the Brexit vote. By late 2016, major banks and financial companies became concerned about the ability of their internal systems to cope with 'negative' interest rates. As the weakness in sterling pushed up import prices, the question turned to whether a higher inflation rate would be sustained and prompt the Bank of England at least to reverse last August's interest rate cut. The change in emphasis saw a strong first half of the year for Gilts partially reverse itself towards the end of the year. The durations of our sterling bond portfolios have reflected the view that yields appear abnormally low, which has been a drag on relative performance over the twelve months.

Despite the recent strength in the UK equity market, the Brexit decision has increased the level of uncertainty considerably for investors. The snap General Election muddied the waters. The government not only lost its majority in the House of Commons, but the election campaign itself appears to have helped prevent substantial progress taking place with negotiations with the EU. However, it is possible that the composition of the new parliament will prevent a damaging exit deal. This is by no means certain and in the meantime companies may well be pausing on investment decisions or making alternative arrangements, damaging the longer term economic outlook. The next couple of years are likely to see significant swings in sentiment as Brexit negotiations are progressed and reported, and as the potential for new trade deals with countries outside the EU is assessed. This is most likely to be reflected in further changes to the value of sterling, but equity and bond markets will not be immune.

The United Kingdom has not been the only economy digesting an unpredicted election outcome. In the United States, Donald Trump's victory can probably be traced not only to the unpopularity of his opponent, but also to a general feeling of disenfranchisement among the working class and voter protest at inequality, signs of which can be seen across developed economies. President Trump's promises of infrastructure investment, deregulation, and corporate tax cuts prompted a surge in US equity prices. However, the failure of the first real test of his leadership, the replacement of 'Obamacare', has raised question marks over the President's ability to deliver on these other promises. As with the UK, the US equity market is vulnerable to retrenchment from its recent highs but on valuation terms appears more expensive. Meanwhile, the Federal Reserve has continued to raise US interest rates.

Other markets also present challenges. Europe remains in need of economic reform, but any substantial action is unlikely before a General Election in Germany later this year. The European Central Bank is considering reducing the pace of its Quantitative Easing programme but inflation remains low. The Eurozone financial system appears more robust but sovereign and bank bailout issues have not been fully resolved. Asian markets have recently sent mixed signals and much will depend on China's success in curbing excessive borrowing and rebalancing its economy smoothly. In contrast Japan has surprised on the upside as it finally starts to deliver some economic growth even as its government loses popularity.

Overall, it has been a strong year for investment returns. Considerable uncertainty remains for all asset classes in the current year. We will remain focused on delivering our unique ethical values, whilst carefully managing risk and looking to maximise returns.

Summary of Affirmative funds managed by Epworth Investment Management Limited

	The Affirmative Deposit Fund for Charities	The Affirmative Equity Fund for Charities	The Affirmative Fixed Interest Fund for Charities	The Affirmative Corporate Bond Fund for Charities
Fund type	Common Deposit Fund	Common Investment Fund	Common Investment Fund	Common Investment Fund
Form of governance	Registerd charity	Registerd charity	Registerd charity	Registerd charity
Charity Commission number	1115887	1087228	1087227	1131752
Trustees/ depositary	HSBC Bank plc	HSBC Bank plc	HSBC Bank plc	HSBC Bank plc
Available to	Churches and charities	Churches and charities	Churches and charities	Churches and charities
Launch date	1 November 2006	31 August 2001	31 August 2001	1 October 2009
Initial charge	Nil	Nil	Nil	Nil
Minimum investment	None	£1,000	£1,000	£1,000
Dealing days	Daily	1st, 11th and 21st of each month	1st, 11th and 21st of each month	1st, 11th and 21st of each month
Frequency of distributions	Monthly	Quarterly	Quarterly	Quarterly
Current yield as at 10 May 2017	0.33%	2.80%	1.71%	2.44%
Management fee excluding VAT	0.20%	0.35%	0.20%	0.30%
Dilution levy	NA	0.30%	0.15%	0.45%
Total expense ratio as at 30 April 2017	0.27%	0.51%	0.33%	0.45%
Fund size as at 31 March 2017	£476.2m	£85.9m	£20.4m	£122.8m
Benchmark	7 day LIBID	90% FTSE All Share 10% FTSE All World ex UK	Composite Gilt & Non Gilt Index	Composite Non Gilt Index

Affirmative funds performance

The Affirmative Deposit Fund for Charities

Investment objective

The Fund aims to deliver higher rates of interest than those usually available in the London Money Markets, whilst maintaining the ability for depositing charities to make withdrawals at short notice.

Investments will be made with banks and other institutions which meet rigorous criteria based on independent credit ratings and size. We spread deposits across a wide range of lenders and risk is further minimised by our credit risk matrix that limits the proportion of the Fund deposited with any single bank or other institution.

Performance

31 March 2017	1 Year %	5 Years %p.a.
The Affirmative Deposit Fund	+0.5	+0.7
Benchmark	+0.2	+0.3

Largest 10 deposits by banking group

31 March 2017	%
Mitsubishi UFJ Trust & Banking Corporation	13.7
Sumitomo Mitsui Banking Corporation Europe	12.6
Santander	11.6
Nationwide Building Society	10.5
Lloyds Banking Group	9.5
Development Bank of Singapore	9.5
Societe Generale	7.4
CIC	6.3
Mizuho Bank	5.3
HSBC	4.8

The Affirmative Equity Fund for Charities

Investment objective

The Fund will seek to maximise long-term total returns through a diversified portfolio. It invests primarily in UK and international equities and is conservatively managed to control risk. Typically we will use direct holdings, but may also use pooled vehicles where appropriate.

The Fund will be invested in line with the Christian ethical principles of the Methodist Church. This may lead to the exclusion of companies in sectors such as tobacco, alcoholic beverages, gaming and armaments. The Fund Manager will also engage with those companies where exclusion from the portfolio is not appropriate, where there is minor exposure to the avoided sectors or other ethical issues are raised, such as environmental performance, corporate governance and social justice.

The Fund Manager will look to vote direct shareholdings in line with our Christian ethical policy.

Performance

31 March 2017	1 Year %	5 Years %p.a.
The Affirmative Equity Fund	+21.6	+9.9
Benchmark	+23.1	+10.3

Largest 10 holdings

31 March 2017	%
Royal Dutch Shell	6.4
HSBS Holdings	5.2
GlaxoSmithKline	4.4
BP	4.1
AstraZeneca	3.4
iShares MSCI KLD 400 Social Index Fund	3.1
Vodafone Group	3.0
Unilever	2.6
Reckitt Benckiser group	2.5
Shire	2.3

The Affirmative Fixed Interest Fund for Charities

Investment objective

The Fund will seek to maximise long-term total returns by investing in a portfolio of sterling based Government and non-Government fixed interest securities.

The Fund, which is conservatively managed to control risk, will have an average life of between five and fifteen years and a return similar to that of UK Government securities.

The Fund will be invested in line with the Christian ethical principles of the Methodist Church. This may lead to the exclusion of the debt of companies in sectors such as tobacco, alcoholic beverages, gaming and armaments.

Performance

31 March 2017	1 Year %	5 Years %p.a.
The Affirmative Fixed Interest Fund	+6.4	+4.9
Benchmark	+6.9	+5.4

Largest 10 holdings

31 March 2017	%
The Affirmative Corporate Bond Fund	22.1
Treasury 1.5% 2026	4.9
Treasury 3.25% 2044	4.6
Treasury 3.75% 2021	4.5
Treasury 4% 2022	4.5
Treasury 4.5% 2034	4.2
Treasury 4.25% 2032	4.0
Treasury 3.5% 2045	3.9
Treasury 1.25% 2018	3.5
Treasury 3.75% 2020	3.4

The Affirmative Corporate Bond Fund for Charities

Investment objective

The Fund seeks to maximise long-term total returns through a portfolio of sterling based non-Government fixed interest securities.

The Fund will be invested in line with the Christian ethical principles of the Methodist Church. This may lead to the exclusion of the debt of companies in sectors such as tobacco, alcoholic beverages, gaming and armaments.

Performance

31 March 2017	1 Year %	5 Years %p.a.
The Affirmative Corporate Bond Fund	+7.5	+6.2
Benchmark	+8.1	+6.6

Largest 10 holdings

31 March 2017	%
SNCF 5.375% 2027	3.4
Pfizer 6.5% 2038	3.3
Johnson & Johnson 5.5% 2024	2.7
Commonwealth Bank of Australia 3% 2026	2.7
Lloyds Bank PLC 5.125% 2025	2.5
Bank Nederlandse 5.375% 2032	2.3
World Bank 4.875% 2028	2.2
Nationwide 5.625% 2026	2.2
IBM 2.625% 2022	2.2
Rabobank 5.25% 2041	2.1

Board and adviser details

Board of Epworth Investment Management Limited
Chair: John Sandford MA FCA
Deputy Chair: Peter Hobbs
Chief Executive Officer: David Palmer LLB MBA
Chief Financial Officer: Marina Phillips MSc DChA FCA MCSI

Non executive directors
John Gibbon MA
J Malcolm Hamilton BSc (Econ) FIA
Julian de G Parker FCIB FCOI MIoD ChartFCSI

Other senior officers
Chief Investment Officer: Stephen Beer BA ASIP
Head of Research: Miles Askew
Senior Fund Manager: Matthew Richards
Client Relationship Manager: Christophe Borysiewicz
Head of Business Development: Mark O'Connor
Compliance Manager: Vanessa Meredith
Operations Manager: Chris Field

Professional advisers

Auditors
(appointed 1 March 2017)
Buzzacott
130 Wood Street
London
EC2V 6DL

Solicitors
Pothecary Witham Weld
70 St George's Square
London SW1V 3RD

Bankers
HSBC
4/8 Victoria Street
Westminster
London SW1H ONE

Custodian
HSBC Bank plc
Institutional Fund Services
8 Canada Square
London E14 5HQ

Regulatory statements and compliance warnings
Epworth Investment Management Limited ('Epworth') is authorised and regulated by the Financial Conduct Authority. Epworth is the Investment Manager of The Affirmative funds. The Affirmative Deposit Fund is a Common Deposit Fund and The Affirmative Equity and Bond Funds are Common Investment Funds. They are available to any church or charity unless precluded by a specific provision in its governing instrument.

The Affirmative funds are designed for long-term investors. The value of units in the funds can fall as well as rise and past performance is not a guide to the future. You may not necessarily get back the amount that you invested. The level of income is also variable and investing in The Affirmative Funds will not be suitable for you if you cannot accept the possibility of capital losses or reduced income.

The Affirmative Equity and Bond Funds deal three times a month and you may not have immediate access to the cash value of your investments.

Epworth is a wholly owned subsidiary of the Central Finance Board of the Methodist Church and is a company registered in England & Wales with number 3052894.

Designed and produced by Langsford, www.langsford.co.uk

Printed by CPI Colour which is ISO14001 certified, CarbonNeutral®, Alcohol Free Printer, FSC® and PEFC chain of custody certified. The inks used are all vegetable oil based.

Printed on paper certified by the FSC.

MIX
Paper from responsible sources
FSC® C016486

Epworth Investment Management Limited
2nd Floor
9 Bonhill Street
London EC2A 4PE

020 7496 3636

www.epworthinvestment.co.uk