

# Sustainable investing overview

APRIL 2024

## Overview and purpose

At Principal Equities, our investment process integrates sustainability considerations in a manner consistent with our fiduciary responsibilities. Consistent with our overall investment philosophy, our focus is on identifying positive fundamental change to enhance long-term returns and reduce risk. Our focus on sustainable fundamental change is at the heart of everything we do as investors. Specifically, we view governance considerations as central to our investment philosophy and process, while the evaluation of environmental and social considerations is an extension of our fundamental change focus and qualitative risk assessment where applicable.

The sustainability of a company's future earnings and risk related to those earnings are key in the evaluation of a company's return prospects, and we recognize that at times the factors impacting these future earnings may be considered environmental, social or governance indicators. The evaluation of sustainability factors is embedded within the fundamental research conducted by our analysts, as we feel they are best placed to determine the importance of such factors in relation to a specific company or industry. Our analysts provide essential insights into industry trends and company-specific considerations. These insights are crucial to the evaluation of sustainable competitive advantages and risks at a company-specific and industry level. Our analysts have discretion to focus on the considerations and concerns that are most important and impactful to sustainable earnings, sentiment, and relative valuation.

Managed appropriately, we believe a focus on where change is delivering sustainable earnings contributes to enhanced long-term returns and reduced risks. There are five key pillars that we are focused on.

1. **Clients first** – we serve clients around the world of many different types, but our heritage and culture are centered on serving retirement plan investors. This is a substantial commitment that requires continual diligence to help ensure that our focus, interests, and incentives are fully aligned with the interests of each client we serve, and the governing fiduciary standards of each jurisdiction in which we operate. This fiduciary mindset has long served as a key distinction of our culture, not only within Principal Equities, but for the overall Principal organization.
2. **Independent assessment** – we see third-party ESG scoring metrics a bit like credit ratings. They may provide useful historical context and background information but are often structurally flawed. The fact that the most popular providers have vastly different ratings on many companies highlights this, as do their obvious structural preferences for large established companies, particularly those based in Europe. We must look beyond those biases, not blindly screen on ratings.
3. **Direction not level** – this reflects the most direct extension of our investment philosophy and what we believe is the key source of alpha opportunities through engagement. In our view, restricting opportunities to well rated ESG companies is not a long-term viable alpha source. Rather, we are focused on identifying companies with scope for improvement. For instance, limiting consideration to

top ESG rankings explicitly disfavors emerging markets and smaller companies – which we believe is an opportunity set that affords the best scope for positive progress. Avoiding those strikes us not only as detrimental to performance, but also to the potential for favorable societal impacts. In the end, we believe proponents of sustainability should focus on change potential to identify the best opportunities to make a real difference.

4. **Alpha of risk reduction** - we believe the avoidance of “bad actors” or companies that knowingly exploit economic externalities at the expense of others is also an important source of enhanced returns, risk reduction and fiduciary responsibility. While we do not advocate overtly screening out entire industries, unless at the direction of clients, our selection criteria embraces the importance of downside risk mitigation. This includes standards for financial stability and quality, corporate governance and ultimately, trust in the companies in which we invest. Companies lacking a strategic commitment to positive and sustainable fundamental change in our view will simply be avoided.
5. **Active Engagement** - our central focus on positive fundamental change and the related principles highlighted above provide a powerful framework for sustainable investing. Our researchers engage directly with approximately 1,500 companies per year on average, through a variety of forums and methods. Such contact is only as useful as the quality of the discussions and questions posed. Rather than demanding specific actions, we take a more consultative approach, sharing our views and preferences on pertinent sustainability priorities, and by beginning the process by simply asking “what is changing?” This tends to foster more constructive dialogue and can be further supplemented formally through proxy voting and other tactics, including the prompt disposition of shares as warranted.

A range of academic research and empirical data suggest that some sustainability considerations may have a material impact on the fundamental attributes and future prospects of companies. Therefore, we consider certain sustainability issues to the extent they have material implications, consistent with our fiduciary duty to help clients achieve their investment objectives and help mitigate risks to their economic interests. Simply put, our focus on “**businesses becoming better**” (e.g., companies demonstrating positive, sustainable fundamental change) is at the heart of everything we do as committed fiduciary investors.

## Engagement priorities

The integration of sustainability considerations is embedded within the fundamental research conducted by our analysts, as we feel they are best placed to determine the importance of such factors in relation to a specific security or sector. Our analysts provide the essential insights into industry trends and company-specific considerations including pertinent environmental, social and governance issues. These insights are crucial to the evaluation of sustainable competitive advantages and risks at a company-specific and industry level. Our analysts have discretion to focus on the considerations and concerns they feel are most important and impactful to sustainable earnings, sentiment, and relative valuation.

Specifically, we view governance considerations as integral to our investment philosophy and process, and fully aligned with our fiduciary responsibility. Governance considerations are inherently related to shareholder value. Companies demonstrating strong shareholder protections and alignment policies naturally garner premium

valuations over peers with lesser standards. At the same time, improving governance policies and practices provide a basis for improved relative valuation, while governance dilution or deterioration represent an inherent source of risk and valuation compression. Similarly, albeit more nuanced, the evaluation of environmental and social considerations is an extension of our fundamental change focus and qualitative risk assessment.

Our analysts identify and comment on the most relevant “Engagement Priorities” within their company thesis documentation. To promote greater consistency and repeatability across the firm, our research teams have identified specific sustainability pillars for each major market sector. Across sectors, leadership and governance are a key dimension, but other dimensions may differ. For instance, within the technology sector, cybersecurity and privacy protection are key pillars. By contrast, among industrial companies, key dimensions include waste and emissions management, risk mitigation and operating protocols. Most importantly, these issues are considered within the context of their impact on the sustainability of company’s fundamentals which ultimately will drive the timing, amount and certainty of future earnings and cash flows. By aligning our Engagement Priorities with our analysts’ focus on fundamental change, we’re further strengthening our conviction of each investment thesis and related risk considerations.

For our major holdings and prospective investments, our team members assess the sustainability culture and risks and engage with management to encourage and facilitate further progress.

- Sustainability Risk Level – Our analysts assign holdings with a sustainability risk level of either low, medium, or high. In arriving at this designation, we evaluate the company’s relationships with each of its stakeholders – shareholders, customers, employees, suppliers and their supply chains, their communities, and the environment – and identify those key risks that could undermine the company’s existence and the positive change we are seeking. Our analysts collaborate across teams with their industry colleagues to identify best practices and identify emerging issues of concern.
- Sustainability Risk Trend – Our analysts also assign holdings with a sustainability risk trend of either improving, stable or deteriorating. This risk trend designation provides important context to the risk level and informs our tolerance for that risk. Consistent with our investment philosophy we have a strong preference for positive change. We find that improving trends in sustainability risk can also be an important source of alpha potential for our clients.
- Engagement – Our analysts meet with senior executives of our holdings to discuss a range of topics relevant to our investment theses. From our assessment of sustainability risk level and trend we incorporate discussion on the ESG issues of greatest importance to us. From management, we both look for and ask for actions and plans that fit a SMART framework: Specific, Measurable, Attainable, Relevant and Time-bounded. Following our engagement with management, we then re-assess our sustainability risks – a circular process that continues.

Engagement is one of the many elements of our process that influence our holistic view of shareholder value and long-term, risk-adjusted return potential.

Consistent with our focus on fundamental change identification, we place greater emphasis on trends in ESG metrics rather than current levels and scores. Indeed, we caution investors to recognize that mainstream ESG scoring metrics may incorporate significant structural biases. Most notably, they tend to systematically favor large capitalization companies over smaller ones and developed market nations over their emerging markets counterparts. In some regards, this can run counter to the aspirational aims of sustainability engagement, as we

believe companies with below average scores may offer greater opportunities for positive change, and vice versa.

## Engagement policy

Principal Equities began incorporating custom exclusionary screening criteria on behalf of clients in the early 1990's, and we currently support a wide range of mandates with such criteria. Additionally, Principal Asset Management has been a signatory to the Principles for Responsible Investment ("PRI") since 2010s. The PRI works to support a sustainable global financial system by encouraging adoption of six principles and collaboration on their implementation, fostering good governance, integrity, and accountability, and addressing obstacles to a sustainable financial system within market practices, structures and regulation. Over the years, our processes have grown to include engagement with companies on sustainability issues and we believe that direct communication between investors and companies on ESG matters is an important element of the portfolio management services provided to clients. Engagement may help us make decisions that favor actions intended to maximize a company's shareholder value and contribute to our overall research to develop a holistic fundamental view of the company. Our firm takes seriously our commitment to our community and society. We believe that we must take responsibility for educating others and ourselves by addressing a range of issues that influence the wellbeing of our community and society and may enhance shareholder value. As a result, we commit to:

- Engage and collaborate with the companies we invest in using our shareholder advantage to encourage responsible sustainability practices by the company when aligned with our investment thesis of the company.
- Encourage greater transparency by the companies on their sustainability reporting practices.
- Encourage companies to manage risks related to sustainability factors and react swiftly to achieve a competitive advantage relative to peers regarding remuneration, boards/directors, audit issues, regulations, litigations, and other market factors that could impact a company.
- Encourage companies to disclose through public reporting relevant ESG metrics and how it may fit into the company's overall business activities considering such importance will vary significantly depending upon industry and geography.
- Keep records or notes on relevant engagement activities.

We have implemented this policy with the premise that portfolio management personnel base their determinations of whether to invest in a particular company on a variety of factors, which may include sustainability factors, recognizing however, this will not supersede the primary considerations of risk and return, consistent with our fiduciary obligations. As such, this policy is designed to guide Engagement and not necessarily proscribe specific criteria in making investment decisions.

## Proxy voting policy

Principal Asset Management has adopted and implemented written Proxy Voting Policies and Procedures that are designed to reasonably ensure that proxies are voted in the best interests of those advisory clients who

have authorized us to address these matters on their behalf. Our guiding principles in performing proxy voting are to make decisions that:

- Favor proposals that have the potential to maximize a company's shareholder value, and
- Are not influenced by conflicts of interest.

Our Proxy Voting Policies and Procedures (Proxy Voting Policy) is designed to guide us in voting proxies, not necessarily in making investment decisions; our portfolio management teams base their investment decisions on a variety of factors.

Principal Asset Management creates our own set of proxy voting guidelines which is updated and approved no less than annually by our Proxy Voting Committee. The Proxy Voting Committee utilizes Institutional Shareholder Services, Inc. (ISS) and other external and internal inputs in creating the annual guidelines. In addition to the Principal Asset Management Voting Guidelines (Guidelines), we have implemented sustainable voting guidelines, or other custom guidelines (Custom Guidelines), for certain strategies based on the product type, client preference or desired investment outcome. There may also be voting themes or particular ballots where a portfolio management team decides to diverge from the Guidelines or Custom Guidelines. In such a case, certain procedures and documentation are executed and maintained. In the event that a proxy ballot is received, the relevant Portfolio Manager is responsible for voting the ballot.

A client may authorize Principal Asset Management to vote proxies and may obtain a summary report relating to their account by contacting their relationship manager. A client may also obtain a copy of our complete proxy voting policies, which also contains the Guidelines, and procedures upon request.

ISS is utilized for the administration of all proxy ballots and other record keeping. Principal Asset Management Operations Team works closely with ISS in the execution of these responsibilities. We disclose our voting results via our website and results are updated quarterly.

If an issue is identified which is inconsistent with the interests of our clients, we take the appropriate warranted action in mitigating our exposure to such company and/or as it relates to issues to be voted on by company shareholders, we would vote accordingly. In some cases, this will mean overriding the Principal Asset Management Guidelines and in conjunction with our Proxy Voting Policy will vote an exception. We may also engage and always reserve the option to exit our shareholding. We manage our relationships with investee companies in such a way that it is not made an "insider" and as such seek to avoid being made an "insider" in any discussion with a company or its advisors, in order that we can continue to act in our clients' best interest. As part of our engagement policy, we keep records or notes on relevant engagement activities.

## Risk Considerations

Investing involves risk, including possible loss of principal. Past Performance does not guarantee future return. Equity markets are subject to many factors, including economic conditions, government regulations, market sentiment, local and international political events, and environmental and technological issues that may impact return and volatility.

Integration of sustainability considerations and/or environmental, social and governance (ESG) factors is qualitative and subjective by nature. There is no guarantee that the criteria used, or judgment exercised, will reflect the beliefs or values of any particular investor. Investment teams have a high degree of investment process autonomy and may consider or weight sustainability and/or ESG criteria or factors differently (or not at all). For those teams that consider sustainability and/or ESG factors as part of the investment process in strategies that are not explicitly sustainability and/or ESG-oriented, those sustainability considerations and/or ESG factors are generally no more significant than other factors in the investment selection process, such that sustainability considerations and/or ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio. Information regarding responsible practices or other sustainability metrics, including ESG data, differs by source and may not be accurate or complete. Integration of sustainability considerations and/or ESG factors may present additional advantages or risks, may not protect against market risk or volatility, and under certain circumstances may detract from investment performance. You should not make any investment assumptions based solely on the information contained herein. Information is provided as additional insight into the relevant investment processes and should not be viewed as a change in an investment team's underlying investment objectives, strategies, risk parameters, or portfolio construction guidelines. There is no assurance that any strategy or integration of sustainability considerations and/or ESG factors will be successful or profitable.

## Important Information

The information contained herein reflect the views and processes of the Global Equities teams of Principal Asset Management. Separate and distinct processes and practices are followed by other equity teams, including Principal Aligned, Principal Edge, Principal Dynamic Growth, Principal Real Estate Securities, Principal Listed Infrastructure and other entities and affiliates of Principal.

This material covers general information only and does not take account of any investor's investment objectives or financial situation and should not be construed as specific investment advice, a recommendation, or be relied on in any way as a guarantee, promise, forecast or prediction of future events regarding an investment or the markets in general. The opinions and predictions expressed are subject to change without prior notice. The information presented has been derived from sources believed to be accurate; however, we do not independently verify or guarantee its accuracy or validity. Any reference to a specific investment or security does not constitute a recommendation to buy, sell, or hold such investment or security, nor an indication that the investment manager or its affiliates has recommended a specific security for any client account. Subject to any contrary provisions of applicable law, the investment manager and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided.

This material may contain 'forward looking' information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

This material is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

This document is intent for use in: •**The United States** by Principal Global Investors, LLC, which is regulated by the U.S. Securities and Exchange Commission. •**Europe** by Principal Global Investors (Ireland) Limited, 70 Sir John Rogerson's Quay, Dublin 2, D02 R296, Ireland. Principal Global Investors (Ireland) Limited is regulated by the Central Bank of Ireland. Clients that do not directly contract with Principal Global Investors (Europe) Limited ("PGIE") or Principal Global Investors (Ireland) Limited ("PGII") will not benefit from the protections offered by the rules and regulations of the Financial Conduct Authority or the Central Bank of Ireland, including those enacted under MiFID II. Further, where clients do contract with PGIE or PGII, PGIE or PGII may delegate management authority to affiliates that are not authorised and regulated within Europe and in any such case, the client may not benefit from all protections offered by the rules and regulations of the Financial Conduct Authority, or the Central Bank of Ireland. In Europe, this document is directed exclusively at Professional Clients and Eligible Counterparties and should not be relied upon by Retail Clients (all as defined by the MiFID). •**United Kingdom** by Principal Global Investors (Europe) Limited, Level 1, 1 Wood Street, London, EC2V 7 JB, registered in England, No. 03819986, which is authorised and regulated by the Financial Conduct Authority ("FCA"). •**In United Arab Emirates** by Principal Global Investors LLC, a branch registered in the Dubai International Financial Centre and authorized by the Dubai Financial Services Authority as a representative office and is delivered on an individual basis to the recipient and should not be passed on or otherwise distributed by the recipient to any other person or organization. •**Singapore** by Principal Global Investors (Singapore) Limited (ACRA Reg.No.199603735H), which is regulated by the Monetary Authority of Singapore and is directed exclusively at institutional investors as defined by the Securities and Futures Act 2001. This advertisement or publication has not been reviewed by the Monetary Authority of Singapore. •**Australia by Principal Global Investors (Australia) Limited (ABN 45 102 488 068, AFS License No. 225385), which is regulated by the Australian Securities and Investments Commission and is only directed at wholesale clients as defined under Corporations Act 2001.** •This document is marketing material and is issued in **Switzerland** by Principal Global Investors (Switzerland) GmbH. •**Hong Kong SAR (China)** by Principal

Asset Management Company (Asia) Limited, which is regulated by the Securities and Futures Commission. This document has not been reviewed by the Securities and Futures Commission. Other APAC Countries/ Jurisdictions. This material is issued for Institutional Investors only (or professional/sophisticated/qualified investors, as such term may apply in local jurisdictions) and is delivered on an individual basis to the recipient and should not be passed on, used by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc.

Principal Asset Management<sup>SM</sup> is a trade name of Principal Global Investors, LLC.

Principal Equities is an investment team within Principal Global Investors.

© 2024 Principal Financial Services, Inc. Principal®, Principal Financial Group®, Principal Asset Management, and Principal and the logomark design are registered trademarks and service marks of Principal Financial Services, Inc., a Principal Financial Group company, in various countries around the world and may be used only with the permission of Principal Financial Services, Inc.

MM10841-06 | 04/2024 | 3487167-042026