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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Sustainable Large-Cap Investing Through ESG Integration

ANDRE BERTOLOTTI, CFA, is a Managing Partner and Chief Investment Officer at Quotient Investors, LLC, and responsible for all investment research and product development at the firm. Before cofounding Quotient Investors, he was Director of Investment Strategy and Research at DIAM USA, Inc., and Co-Founder and CIO at Innovest Capital Management, Inc. Before Innovest in 1996, Mr. Bertolotti was a Senior Consultant with Barra Inc., a quantitative research firm specializing in risk models and optimization. He graduated from Virginia Polytechnic Institute and State University in 1982, and received his master's degree in engineering from the University of California, Berkeley, in 1985 and his MBA in finance from the same school in 1993.

SECTOR — GENERAL INVESTING

TWST: Please start by telling us a little bit about Quotient Investors.

Mr. Bertolotti: Basically, we are a firm that was founded four and a half years ago, as part of the CalPERS Management Development Program II, and we were seeded with $150 million through two funds from CalPERS. We are set up as an U.S. institutional equity manager with three partners — myself; Julia Peter-Kerr, who is in charge of sales and marketing; and William Yost, who is in charge of portfolio management and trading. We are located here in New York.

We now have grown to over $300 million, and we have several clients. We have grown with a strategy that I'm hoping to speak with you about today, which is our sustainable investment large-cap strategy. We are really pleased to have CalPERS as a partner. They have been terrific supporters and a great partner during these very testing times. So although we launched at a very difficult time in terms of the market and the economy, we are very well positioned today.

TWST: Quotient Investors has three strategies, the large cap, the small cap, and then the ESG strategy. Why is this a good time to invest in ESG, and what makes it attractive?

Mr. Bertolotti: There are a number of reasons ESG investing is attractive. I think the real beginning of this has been the United Nations initiative in April 2006 to bring together the world's largest asset owners, which includes CalPERS, CalSTRS, New York City ERS and many other U.S. investors, but also global investors, to launch these Principles for Responsible Investment, which are guidelines that help owners become more aware of their holdings and more discerning in exactly how they invest and where they invest.

Additionally, CalPERS directed us to look at ESG without any firm mandate, but encouraged us to think about ESG. The research that I did in 2008 and 2009 suggested that for us ESG would be a very good fit to how we invest. I must say, I think a lot of asset owners are continuing their commitment and their support for what ESG is trying to do. So there is certainly that interest. For our part, so for the manager part, we have seen ESG as a very persuasive and strong focus for investing, where we can actually obtain good returns.

Now is a good time to invest in ESG since a lot of different things have come together. It's been a difficult environment for a lot of managers picking U.S. stocks. The interest from traditional investors is continuing, and our performance has been good. So for our part, we're very bullish about sustainable investing and

ESG. We are certainly promoting that strategy in the U.S. to people who care about ESG, and we are also promoting it to people who are not so interested. If you care about ESG, we'll tell you about it, but if you're not interested in ESG specifically, we talk to you about risk and return.

TWST: What does "sustainable" mean to you?

Mr. Bertolotti: There are a lot of definitions going around, including sustainable and responsible. ESG is another one of those terms. For us, when we talk about "sustainable," we are talking about ESG. So it's environmental, social and governance parameters of a publicly listed company, but there is a little bit more to that. For me, and certainly the research I've done, I have seen a very strong link between ESG and all the characteristics of a company that can be considered sustainable.

For example, from a value investor point of view, I think ESG is giving us a higher-quality look at the fundamentals of a company. So the value becomes higher quality when looked through ESG. From the growth theme, ESG is helping us find companies that are more sustainable in their growth process and in their forward-looking prospects. For that and from the point of view of an asset manager, being sustainable means sustainable performance compared to other companies that are not ESG.

Highlights

Andre Bertolotti of Quotient Investors, LLC, discusses the firm's growth through its sustainable ESG investment large-cap strategy. He talks about principles of responsible investing, and the reasons why he is bullish about sustainable investing and ESG. Mr. Bertolotti says ESG has been a great help in finding outperformance in the large-cap sector, is a little bit more resilient to volatility and it has stocks that are more liquid to trade.

TWST: Please tell us about the firm's investment philosophy and strategy, specifically with this fund.

Mr. Bertolotti: In my opinion, quantitative investors have a little bit of an advantage over fundamental investors when it comes to applying ESG in the portfolio. The reason is that quantitative approaches are more effective at unlocking the value of ESG. Unfortunately, there is no theory, no academic sort of guidelines that says, "OK, an ESG company with a rank of five should have a stock price of $27."

However, there are plenty of theories and models that relate fundamental data to a fair value price for the stock. So when it comes to pricing a company's financial information, tools, such as the discounted cash flow model or dividend discount model, give a lot of guidance for assessing the stock price, but for ESG there isn't. Quantitative managers have the tools and have the methods that can study this type of data and see how it relates to stock prices.

That has been, for me, the key component, key edge, for Quotient Investors to find out how is the market pricing ESG information. If there are two companies out there and both have the same valuation, which one is more attractive if I also include ESG? So I am looking at a broad spectrum of company information, including ESG. I am looking at fundamental data, I am looking at Street data and market data and ESG data, and I'm combining that, so I am really fully integrating ESG into my process.

In all fairness, ESG is not, alone, strong enough to be of guidance to a portfolio manager. If all you do is ESG, that's not enough. To do a full evaluation of a company, one needs to have a much broader view of the performance of that company. But for us, adding on ESG has been a great benefit. The strategy has outperformance, it has risk control and it has ESG. We think that if this product is favorable for CalPERS, then there could be other investors who would also take a favorable view of this product.

TWST: Does Quotient invest in global companies or are they only U.S.?

Mr. Bertolotti: For the moment we are only invested in U.S. companies. We do have plans to extend this type of ESG integration and ESG investing globally, but for now, we are just U.S.

TWST: What are some of the aspects you like about having an ESG portfolio?

Mr. Bertolotti: An ESG portfolio points me to different holdings than I would find if I didn't look at ESG. This is good because it helps us find really new information. It also points me to companies that are easier to trade, that have more liquidity. We have almost three years of track record for this portfolio. When the market goes bad, this portfolio does not fall as much as other portfolios. And when the market is good, this portfolio rises similar to the others. So it does have a little bit of a resilience when it comes to market volatility, and it does have that outperformance through the post-crisis period. That gives it several characteristics that are very interesting for me.

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At the beginning, of course, we were just trying to outperform the market. But as we go through the experience of trading the portfolio, we are finding these additional qualities that make it a little bit more resilient to volatility, and it has stocks that are more liquid to trade, and all of that is positive. We are looking at the large-cap sector of the U.S. market that a lot of peers in our industry claim is very efficiently priced and hard to beat. For us, ESG has been a great help in finding outperformance in the large-cap sector.

TWST: Are you finding people are looking at investing differently, specifically looking to apply the ESG screen on their investments? Is there an increase in interest?

Mr. Bertolotti: I'd like to say, yes, but I don't think it is happening yet. I certainly like to promote ESG, and we are a signatory to the United Nations PRIs. But in reality, we're finding two types of responses to the ESG portfolio. For many people that have heard about it, they are considering investing, but they are sort of hesitant because sustainable investing or responsible investing in the past has been tagged with an underperformance type of characteristic. The broad feeling out there in the market is that if you do anything other than pick the stocks you want, if you start putting a social screen or something, then you'll underperform. So these types of investors are very encouraged to hear about positive performance, but are not completely aware of the ESG benefits.

Then there is another group of investors who really just don't have any interest in the category. They just want returns. Consultants in our business are gearing up to cater to increasing interest and demand for ESG, but they themselves are really pushing for ESG. They are more responding to what their clients want.

TWST: How is risk managed in the fund?

Mr. Bertolotti: Because we are quantitative, we use risk models and optimization, so we do have some tools to help us manage the volatility of the portfolio. We manage against a benchmark, which is the Russell 1000, and we have parameters from the clients on how far we can deviate from the benchmark.

TWST: Please tell us about your background.

Mr. Bertolotti: I am a Berkeley MBA and I worked at a firm called Barra out in the West Coast, which developed investment analytics, risk models, valuation models. From there, I joined a Japanese bank, the Industrial Bank of Japan, working on a hedge fund that had been launched called Innovest Capital Management. I was with them until this opportunity from CalPERS came up, and then, the three of us decided to lift out from the Japanese bank and set up on our own at Quotient.

TWST: What is the best advice you would give investors? Why consider ESG?

Mr. Bertolotti: I would tell them that it is a different perspective of the market. It is a way of finding value that others are not looking at, and it's a way of investing with a very strong philosophy. I mean, you have the deep value thinking and you have the momentum, trend follower, "The stock is hot, buy it" type of thinking. This is a third way of looking at a stock. We are looking for a sustainable portfolio that over the near term and long term will deliver positive returns, and I think that the most compelling point that we can make is that it is really a way of thinking about your investments, not hit-and-run, not fishing for deep value or distressed or out-of-favor companies. But you can go out and look at really good companies that are sustainable, and that do well with ESG.

TWST: Thank you. (LMR)

ANDRE BERTOLOTTI
Managing Partner & CIO
Quotient Investors, LLC
12 East 41st St.
Suite 1101
New York, NY 10017
(212) 685-4811
(212) 685-4707 — FAX
www.quotientinvestors.com