

Taking Action to Address Climate Change

Today, fossil fuels power much of the world. They also create a variety of environmental problems, none of which cause more concern than climate change. In this issue of The Parnassus View, Mid Cap Fund Portfolio Manager Lori Keith explains the approaches to fossil fuels taken by the Parnassus Funds and shares examples of companies that are working to reduce carbon emissions.

Decarbonization Options for Investors

Approximately 80% of the emissions that drive global warming are directly attributable to burning oil, gas and coal.ⁱ Currently, more than 95 million barrelsⁱⁱ of fossil fuels are consumed globally per day. Burning these fossil fuels is unsustainable for the future, which is why our investment team looks for opportunities to invest in companies that are addressing climate change and avoids oil and gas companies that have poor environmental and social records. We offer clients two distinct approaches to implementing this policy on energy-related investments:

1. The Parnassus Endeavor Fund and the Parnassus Fund screen out all companies engaged in the extraction, exploration, production, manufacturing or refining of fossil fuels, while pursuing investments that support the growth of renewable energy alternatives. Both funds have been fossil fuel free since 2015 and offer diversified portfolios without participating in the energy and utilities sectors.
2. The Parnassus Core Equity Fund and Parnassus Mid Cap Fund invest in utilities and energy sector companies that improve energy efficiency and/or increasingly use renewable sources of energy.

Parnassus strongly supports the shift from fossil fuels to renewables, but we recognize that this is a massive change that will take time. The renewables industry is still consolidating; however, we anticipate the future emergence of larger players with sustainable levels of profitability and persistent moats that we expect will fit our investment criteria.

Despite the absence of opportunities for Parnassus to invest directly in renewable energy companies today, we are finding opportunities to invest in responsible and sustainable companies that are preparing for and contributing to this inevitable and vitally necessary change.

A Fossil Fuel-Free Business that Advances Sustainable Infrastructure

The portfolio managers of Parnassus's two fossil fuel-free funds closely evaluate the performance of each potential holding on a range of environmental metrics, including decarbonization. In addition, they look for opportunities to directly promote the development and deployment of renewable energy projects.

One company that was established specifically to reduce greenhouse gas emissions by financing renewable energy projects is Hannon Armstrong (HASI). This is a small cap firm formerly held in the Parnassus Fund that invests exclusively in energy efficiency, wind, solar and energy infrastructure, including:

- Energy efficiency solutions, such as energy upgrades that result in cost savings for building owners, jobs for the retrofitters and profits for their investors
- Wind and solar projects that are supported by long-term power purchasing agreements with utilities, commercial electrical users and homeowners
- Sustainable infrastructure projects, including power transmission lines, that provide essential services to the public

While the Parnassus Fund portfolio managers sold HASI during the third quarter of 2018 for valuation reasons, it remains a good illustration of a company that is furthering the growth of alternatives to fossil fuels.

Utilities and Energy Companies with Positive Environmental Practices

The Parnassus Core Equity and Mid Cap Fund portfolio managers look for companies that proactively incorporate increasing quantities of renewable power and the infrastructure required to support renewables into their business strategies. These Parnassus funds will also hold

best-in-class companies that provide innovative technology to reduce waste and emissions in the energy and utilities sectors.

One company contributing to the transition to renewables is Sempra Energy® (SRE). Sempra is a utility that is shifting their generation sourcing from coal to cleaner sources of energy, including wind and solar.ⁱⁱⁱ SRE is suitable for the Parnassus Core Equity and Mid Cap Funds. This company incorporates renewables into their electrical generation business and has an opportunity to capture significant earnings growth. Currently, renewables comprise more than 43%^{iv} of the generation capacity for Sempra-owned San Diego Gas & Electric Company (SDGE®), well ahead of the California target of 33%. Soon, SDGE's renewables will exceed 50%, based on goals the company has established.^v

As utilities move to grid technology that incorporates the use of solar, wind and other renewables, Sempra is also incorporating grid-scale battery technology. They have built out one of the largest lithium ion battery facilities in the world and are leveraging that facility to store renewable energy.

On another front, Sempra is collaborating with the California state government—which has committed to creating statewide zero-carbon energy infrastructure—to construct charging stations for electric vehicles. With six of the 10 most polluted U.S. cities in California^{vi} and 40% of California's CO₂ emissions emanating from motor vehicles,^{vii} this project could make a sizeable positive impact on the state's climate.

Parnassus offers clients two distinct approaches to energy-related investments.

Our investment team is also impressed by Sempra's very strong record on diversity and forward-looking embrace of technology to better prioritize investments that not only support their environmental efforts but also can improve operating costs. Notably, earnings-per-share growth for Sempra through 2021 is currently projected to be 10–11%, which compares favorably to 5–6% for the S&P 500 Utilities Average. The company considers their significant progress on transitioning to renewables to be a key driver of that growth.^{viii}

Another energy-related business held by Parnassus is MDU Resources (MDU). This company is focused on growing earnings in its two main business lines—regulated businesses, including utilities and pipelines; and construction. Like Sempra, MDU is proactively seeking to step up its generation capacity from renewables. Parnassus

has been a large investor in MDU for some time. We have encouraged MDU to move more aggressively to expand its wind capacity, which has risen substantially over the years we have held the stock.



MDU took the initiative—in states that do not have stringent renewable mandates—to reduce exposure to coal generation and increase the renewable component of its utility segment to 22% through the development of Thunder Spirit Wind farm in 2015. MDU has now expanded this wind project, which is expected to boost the company's renewable portfolio to 27% by the end of 2018.

In the energy exploration and production sector, we search for those technology providers that can help the industry reduce costs, extract more efficiently and implement work processes that are designed to support environmental responsibility. One such company is National Oilwell Varco (NOV). This company has developed more optimal ways to extract oil, particularly for onshore and offshore shale drilling, that are less disruptive to the environment. NOV also has successfully implemented energy-efficiency measures and reduced waste. In addition, the company scores high marks on water conservation practices, including the use of sea water desalination pumps, solar pumps and solar filtration systems.

Active Engagement

As we do with all our holdings, Parnassus conducts ongoing ESG research, monitoring and engagement with our energy-related holdings, including dialog with company management and proxy voting. In the energy sector, we help influence companies held in our portfolios to lower CO₂ emissions, reduce fresh water use, increase energy efficiency, minimize their carbon footprint and consider the long-term impacts of their drilling practices.

A Clean Energy Future

Parnassus looks forward to a smooth, efficient transition to renewable energy. Both of our approaches to investing in energy are designed to support current efforts to decarbonize the utilities and energy sectors and move toward to a carbon-free future.



Lori A. Keith
Portfolio Manager
Parnassus Mid Cap Fund

ⁱ <https://www.ucsusa.org/clean-energy/coal-and-other-fossil-fuels/hidden-cost-of-fossils#.WqmXDejwZaQ> and <https://www.epa.gov/ghgemissions/global-greenhouse-gas-emissions-data>

ⁱⁱ International Energy Agency. Accessed July 20, 2018. Oil Market Report. <https://www.iea.org/oilmarketreport/omrpublic/>

ⁱⁱⁱ Parnassus has a nuclear screen, so we do not hold utilities whose energy is sourced from nuclear power plants.

^{iv} Times of San Diego. Accessed March 20, 2018. <https://timesofsandiego.com/business/2017/11/13/sdge-leads-california-utilities-with-43-of-power-from-renewable-sources/>

^v California Energy Commission. Accessed February 5, 2018. Renewables Portfolio Standard. <http://www.energy.ca.gov/portfolio/>

^{vi} <https://www.usatoday.com/story/news/nation/2017/04/19/most-polluted-cities-california/100615102/>

^{vii} <https://insideclimatenews.org/news/22082017/california-greenhouse-gas-emissions-decoupling-economy-electric-car-culture>

^{viii} <http://investor.sempra.com/events.cfm>

As of 09/30/2018, Hannon Armstrong (HASI) was not part of any of the Parnassus portfolios. Sempra (SRE) represented 2.6% TNA of the Parnassus Mid Cap Fund, 2.1% TNA of the Parnassus Core Equity Fund and 2.3%

TNA for the Parnassus Fixed Income Fund. MDU Resources Group (MDU) represented is 2.5% TNA of the Parnassus Mid Cap Fund, 1.6% TNA of the Parnassus Core Equity Fund.

The views expressed in The Parnassus View are subject to change at any time in response to changing circumstances in the markets and are not intended to predict or guarantee the future performance of any individual security, market sector or the markets generally, or the Parnassus Funds. Mutual fund investing involves risk, and loss of principal is possible.

The Parnassus Funds are underwritten and distributed by Parnassus Funds Distributor, a subsidiary of Parnassus Investments and a FINRA member.

Before investing, an investor should carefully consider the investment objectives, risks, charges and expenses of the Funds and should carefully read the prospectus or summary prospectus, which contains this information. A prospectus or summary prospectus can be obtained on the website, www.parnassus.com, or by calling (800) 999-3505.

PARNASSUS INVESTMENTS®