DECEMBER 2022

HEDGENORDIC
YOUR SINGLE ACCESS POINT TO THE NORDIC HEDGE FUND INDUSTRY

NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

SPECIAL REPORT: ESG & ALTERNATIVE INVESTMENTS

Contents

4 Editor's Note.. ESG & Alts: A long and Wining Road

6 The Need for ESG Harmonization and Convergence

10 Private Markets Investing Through an ESG Lens

14 Against Utopia: The Need for a Pragmatic Energy Transition

20 Navigating the Five Macro Regimes of 2022

26 The Private Market's Role in ESG Transformation

30 Secured Loans with a Strong Flavour of ESG

34 Applying an ESG process to alternative investments

40 ESG Disclosure Tool for Alternative Credit

HEDGENORDIC

INTRODUCTION

HedgeNordic is the leading media covering the Nordic alternative investment and hedge fund universe. The website brings daily news, research, analysis and background that is relevant to Nordic hedge fund professionals from the sell and buy side from all tiers.

HedgeNordic publishes monthly, quarterly and annual reports on recent developments in her core market as well as special, indepth reports on "hot topics".

HedgeNordic also calculates and publishes the Nordic Hedge Index (NHX) and is host to the Nordic Hedge Award and organizes round tables and seminars.

CONTACT:

Kamran George Ghalitschi
Nordic Business Media AB
Kungsgatan 8
SE-103 89 Stockholm, Sweden
Corporate Number: 556838-6170
VAT Number: SE-556838617001

Direct: +46 (0) 8 5333 8688
Mobile: +46 (0) 706566688
Email: kamran@hedgenordic.com
www.hedgenordic.com

Picture Index: Phonlamai Photo---shutterstock, ©-flyfisher---Fotolia.com, Mikael Damkier---shutterstock, Tashatuvango---shutterstock, filip-zrnzevic-q32Rb7w0ui8-unsplash, jason-leung-BUa1LDeT8PI-unsplash, rudy-issa-h2noctyHJqI-unsplash, volodymyr-hryshchenko-6YtOaq-PyHY-unsplash

Editor´s Note…

ESG & Alts: A long and Wining Road

Long, long gone are the days when ESG considerations in investing were exotic tunes from distant corners of the investment universe smiled off by polished-up Wall Street bankers. In fact, there is little doubt ESG is one of the biggest megatrends in investing and will likely be here to stay for good.

Hedge funds, and alternative investment managers, are often at the forefront of out-of-the-box thinking, adapting new technologies, searching for new pockets of alpha generation and walking untreaded paths to meet client demands and position themselves in an attractive niche for investors. Yet, somehow it feels, they were late to jump on the bandwagon when it comes to ESG investing.

www.hedgenordic.com – December 2022

There may be plenty of reasons (excuses?) why. Strategies tend to be more complex with multiple instruments used. Investing in a physical toll road in an emerging market will have very different considerations than trading a futures contract on the DAX or a direct lending strategy in Scandinavia. The ability to use leverage and derivatives, take short positions, and trade on exotic markets will create a different set of headaches for portfolio managers than their colleagues trading European equities long only.

In this edition of "ESG & Alternatives," we want to revisit how alternative investments have progressed in the long and winding road on their ESG journey, and discuss what obstacles still lie in the way.

The publication starts with a discussion on "The Need for ESG Harmonization and Convergence," where Frank Talsma and Iida Pöyliö from RBC Investor & Treasury Services discuss the current state of ESG investment in alternative asset classes, particularly in the Nordic region.

In "Private Markets Investing Through an ESG Lens," Olivia Muir, Head of ESG for Real Estate & Private Markets (REPM) at UBS Asset Management, explains how the complex ESG landscape has evolved and discusses the benefits and challenges of investing through an ESG lens in private markets.

In "Against Utopia," Firmino Morgado and Filipe Bergaña from Man GLG, and Man Group's Jason Mitchell argue that the road to Utopia ultimately leads to nowhere and emphasize "The Need for a Pragmatic Energy Transition." Mark Nash, the Head of Fixed Income Alternatives at Jupiter Asset Management who oversees its global macro strategy, shares his insights on "Navigating the Five Macro Regimes of 2022," as well as discusses the evolving role of ESG in macro strategies.

Moving on, Miguel Zurita and Jörg Höller from AltamarCAM discuss "The Private Market's Role in ESG Transformation," highlighting their desire to push beyond merely playing a participatory role in the progressive adaptation to this new "green" reality. In "Secured Loans with a Strong Flavour of ESG," Alexander Gallotti, Head of Leveraged Finance at Mandatum Asset Management, discusses the attractive features of secured loans, as well as shares more insights about their SFDR Article 9 secured loans vehicle that complements the attractive features of secured loans by having sustainable investment as its objective.

Nina Jahanbin, Fredrik Langenskiöld and Zuhair Khan of Union Bancaire Privée (UBP) then go into the details of "Applying an ESG Process to Alternative Investments." The publication concludes with a summary of a recently-launched "ESG Disclosure Tool for Alternative Credit" by a group of alternative asset managers and industry bodies in the private and broadly syndicated credit markets.

We hope you enjoy the read of this edition of ESG & Alternatives.

Kamran Ghalitschi

PUBLISHER, HEDGENORDIC

www.hedgenordic.com – **December 2022**
HEDGENORDIC

Iida Pöyliö
Senior Associate, Client Coverage – RBC Investor & Treasury Services

> "Investors want to make well-informed decisions, which requires more data and transparent and reliable reporting from asset managers."
>
> Iida Pöyliö

Despite unprecedented growth driven by strong investor demand and net zero commitments, ESG investment remains a much-debated and often controversial topic. With policy-makers strengthening rules around sustainability disclosures, asset managers are focusing their efforts on complying with the new guidelines, yet it is still difficult for investors to compare relevant ESG information to make informed decisions.

DATA-ENABLED ESG ASSESSMENT

HedgeNordic sat down with Frank Talsma, Head of Data and Risk & Investment Analytics, responsible for ESG product development, and Iida Pöyliö, Senior Associate, Client Coverage, Nordics at RBC Investor & Treasury Services (RBC I&TS) to discuss the current state of ESG investment in alternative asset classes, particularly in the Nordic region. One tectonic shift within the ESG arena observed by both Frank Talsma and Iida Pöyliö is the transition from a mainly subjective judgment-oriented assessment of ESG performance to a data-enabled one.

The Need for ESG Harmonization and Convergence

By Eugeniu Guzun – HedgeNordic

"In the past, Nordic investors such as government entities tended to make feelings-based or subjective judgment-based decisions when assessing one's ESG engagement," observes Iida Pöyliö. "Investors want to make well-informed decisions, which requires more data and transparent and reliable reporting from asset managers," she continues. The challenge that asset managers face revolves around how and where to obtain the data to substantiate their ESG efforts. "This can become a differentiating factor when investors are evaluating asset managers' ESG strategies as well as their reporting capabilities," considers Pöyliö.

"Today if an asset manager wants to launch a new ESG-aligned product, it needs to meet high expectations," agrees Frank Talsma. "ESG investing often suffered from vague, poorly defined, and sentiment-based approaches. It needs to become much more fact-based and objective," he elaborates. "A lot of institutional money is looking to invest in ESG funds but the stakes are also high in the wake of greenwashing allegations and other issues," according to Talsma. "The key is to restore confidence in ESG investment products to satisfy the demand and continue the exceptional growth trajectory."

Although the tightening of regulation in the ESG space is presenting asset managers with new data and reporting challenges, these regulatory changes are also creating new opportunities. There are opportunities for asset managers to develop investment products that legitimately address ESG concerns and meet the demands of ESG-conscious investors. "There are challenges but there are also a lot of opportunities that have been accelerated by the recent wave of regulatory measures," confirms Talsma.

Consistent, verified and widely accepted data is crucial in the area of ESG investing, where a lack of mandatory and consistent reporting of non-financial information represents a key barrier to ESG integration. "ESG is an incredibly broad topic but I always start looking at it from a data perspective," says Talsma. "At the core, it's a data problem that needs to be addressed before we can solve other problems like reporting," he explains. There is actually an abundance of data, especially for liquid asset classes, that can be noisy, disjointed, incomplete, inconsistent, or poorly organized. Asset managers face the difficult task of obtaining relevant data across various asset classes that is of sufficient quality. "All of us, including ourselves, our clients, service providers, as well as regulators, are in a learn-by-doing approach. It is an enormous, interesting and very important experiment," concludes Talsma.

REGULATORY EFFORTS

There are increasing regulatory and political efforts to bring more transparency to ESG investing and combat greenwashing to protect investors. "The regulators realized that it's a wild west out there and there is a need to create common rules for ESG investing and reporting," says Talsma. The European Union (EU) is at the forefront of ESG regulation with the introduction of the Sustainable Finance Disclosure Regulation (SFDR) back in 2021, which requires asset managers active in the EU to make detailed disclosures at both the product and entity level.

"We are now getting towards the tail end of the SFDR implementation with immense effort, especially over the last 12 months, to become more structured and better organized around sustainable investing," argues Talsma. This regulation has brought about new classifications, where investment products are labeled under either Article 6, 8, or 9 of the SFDR. "We have seen that this regulation created a push towards Article 8 (light green) and Article 9 (dark green) funds, which comes with several new reporting and governance requirements," elaborates Pöyliö.

Unsurprisingly, one of the big challenges of SFDR is data management and data quality, which is crucial in building representative disclosures. "Data is not going to be perfect and there will be gaps in reports such as the EET (European ESG Template), but this will improve over time," says Talsma. Firms need to clearly label their funds and define their products and strategies with ESG, preferably in an unambiguous language supported by the best and most appropriate data currently available, according to Talsma. "It is important to have the strategy and the tools in place to operationalize SFDR and wider ESG reporting for the future," adds Talsma.

"Approximately only five percent of client funds administered by us are classified as Article 9 and about 25 percent as Article 8 funds," observes Talsma. "The rest of the are Article 6 funds, which do not integrate any kind of sustainability into their investment process," adds Talsma. These figures show the challenge of meeting the Article 9 requirements. "However we are preparing to service a growing number of Article 9 funds over time as the industry is shaping up," argues Talsma.

A related landmark regulation is the EU Taxonomy, which sets out criteria for determining whether an economic activity is environmentally sustainable. "The EU Taxonomy provides a toolbox to help determine what a sustainable investment is," explains Talsma. He also observes that challenges around demonstrating taxonomy alignment have recently contributed to several Article 9 funds to downgrade to Article 8. "The taxonomy currently focuses on certain sectors, but in due time as the EU Taxonomy's objectives are finalized and more economic activities are added, this should contribute to the further proliferation of Article 9 funds," according to Talsma.

Finally, the Corporate Sustainability Reporting Directive (CSRD) is another important regulatory development that will set the standard by which EU companies will report on their climate and environmental impact. "The CSRD is going to be welcomed by the fund industry as corporates will report more detailed and harmonized sustainability data," explains Talsma. This will result in more easily accessible data, increased company accountability, as well as enhanced comparability.

UTOPIA: UNIFIED ESG FRAMEWORK

The European Union is moving towards a roster of very comprehensive regulations that are often complex and difficult to implement at a practical level. Other parts of the world are taking similar yet different routes, but all have the same objectives in terms of accelerating the sustainability transition and combating greenwashing. "For investors wanting to make informed investment decisions, a unified framework with standardized and transparent ESG reporting is the holy grail," according to Talsma. "While current efforts led by regulatory and industry groups are promising, we all know that it will take time to fully get there," Talsma emphasizes. "Currently a global unified framework is a bit of a utopia," he adds.

www.hedgenordic.com – **December 2022** HEDGENORDIC

Frank Talsma
Head of Data and Risk & Investment Analytics – RBC Investor & Treasury Services

"We cannot expect that a common standard will just drop out of the sky. It will take time, effort, and conviction."

Frank Talsma

Talsma compares the evolution of ESG standards with the development of common accounting standards. "It took 20+ years of industry debate to get to common accounting standards. We are now dealing with something much broader and more complex, where regulation is just getting started, and where academic models are in their infancy and data sources are inconsistent and lack quality," says Talsma. "We cannot expect that a common standard will just drop out of the sky. It will take time, effort, and conviction."

"As a service provider to a broad spectrum of funds including ESG funds, we are well positioned in the industry ecosystem, both inside and outside the Nordics," says Pöyliö. This provides RBC with an excellent view of what is happening in the market around ESG investing and across the fund industry in general. "As a global service provider to our clients, we continue to keep them informed on the latest market insights and connect them to innovative solutions and approaches to support their requirements," adds Pöyliö. "We are here to support asset managers on their sustainable investment journey including those with specialized investment strategies where conventional approaches do not always work," she concludes.


Olivia Muir
Head of ESG, Real Estate & Private Markets (REPM) – UBS

Private Markets Investing Through an ESG Lens

By Eugeniu Guzun – HedgeNordic

In recent years, environmental, social and governance (ESG) issues have moved from somewhere near the bottom of many investors' priority list up to the top. Olivia Muir, Head of ESG for Real Estate & Private Markets (REPM) at UBS Asset Management (UBS-AM), explains how this complex landscape has evolved, and discusses the benefits and challenges of investing through an ESG lens in private markets.

"We have witnessed the evolution and growth of ESG over recent years, and for many investors, it is now front and center on their agendas and a growing part of the overall picture," observes Muir. She points out science's urgency of considering environmental issues. "We must act fast to combat the most devastating effects of climate change," she insists. The COVID-19 crisis has also emphasized the importance of factoring in ESG issues. "Stakeholders observed first-hand the effects of fragile supply chains, poorly-managed health and safety risks and labor welfare issues, to name just a few other social and governance topics," says Muir.

ESG has evolved from a fuzzy concept to a business, investing, and political priority. The most significant shift, however, occurred when ESG started moving money by shifting capital allocation priorities. "ESG is now at the top of many investors' priority lists for the risks and opportunities that it brings which influence how we manage capital," concurs Muir. "It affects everything the investment management industry is doing and is only going to grow in breadth, depth and importance in the next few years."

ESG CHALLENGES IN PRIVATE MARKETS

As with the wider asset management industry, private

"The material ESG topics and challenges facing different areas of our private markets business vary significantly. Each area requires a tailored approach to ESG."

www.hedgenordic.com – December 2022 HEDGENORDIC

markets have also been experiencing a growing focus on ESG issues in recent years. Although ESG goals are quickly becoming mainstream across the sector, they come with challenges. "The ESG landscape is a complex and fast-evolving field. This is largely due to growing regulation around the world, increasing scrutiny and expectation of transparency of ESG by stakeholders, and a lack of standardization in ESG reporting and scoring, which is especially true in private markets," claims Olivia Muir, ESG Head of Real Estate & Private Markets at UBS-AM.

For the REPM team, the challenges in implementing ESG practices revolve around three key areas: diversity and scale of activities; rapidly evolving regulatory landscape; and a growing set of ESG frameworks, terms and tools. "Our global business includes real estate, food and agriculture, infrastructure, private equity, and private credit investments, plus evolving sectors such as cold storage, energy storage, global living, life sciences," starts Muir. "Each a distinct asset class with a unique set of ESG priorities, challenges, targets, and initiatives in terms of cost, resources, etc.," she elaborates. "Thus, the material ESG topics and challenges facing different areas of our private markets business vary significantly. Each area requires a tailored approach to ESG."

The legal and regulatory landscape governing ESG investments has been driven by global and major regulatory bodies and standard setters, but also by policy responses from individual governments. Therefore, the regulatory landscape is at risk of becoming increasingly fragmented across jurisdictions. This fragmentation adds to the existing challenges associated with the complexity of running global businesses, as well as the rapid pace of change in the ESG universe. "As our business operates globally, we comply with all applicable ESG regulatory requirements which vary in scale and complexity," confirms Muir. "A constantly expanding set of rules, taxonomies, and standards (which are rarely perfectly aligned) renders meeting these requirements a significant challenge, especially as the regulations have historically catered to ESG in the traditional space such as equities and fixed income, rather than private market assets."

The associated explosion of ESG frameworks, terms and tools represents another significant challenge in implementing ESG practices in the private markets space. "Most private market stakeholders will be familiar with the 'alphabet soup' of ESG terms discussed and reported on by investment professionals," states Muir. GRESB, GRI, SASB, TCFD, UNPRI, among others, are just some of the ESG tools and frameworks often used to report and assess ESG performance in private markets. "A lack of consistent standards often gives rise to very different snapshots of ESG performance – a portfolio or asset scoring highly in one framework might score only moderately using another framework," she emphasizes.

"At REPM, the challenge is two-fold as many of our private markets strategies (e.g. our indirect private equity) can't be assessed using these conventional frameworks," continues Muir. "While we see a number of tools and standards establish themselves as 'leaders' in their respective offerings, the future looks likely to remain fragmented from a regulatory perspective. This may hinder the further standardization of reporting/assessment frameworks."

EVOLUTION OF ESG EMERGING TRENDS

As ESG continues to grow in importance and become critical in the near future, so do a range of topics and issues within the global ESG agenda. The growth of regulation and disclosure frameworks is one of them. "Over the next few years there is going to be a barrage of (even more) regulation coming to the industry globally and this is today, and will continue to be, a top priority for all of us in the investment industry, requiring significant time and resource," argues Muir. "The industry certainly hopes that the future will bring some alignment of these many regulations and standards," she continues. "The complex web we find ourselves in today makes disclosure and regulatory compliance an enormous challenge and potential distraction from the hands-on work needed to save the world."

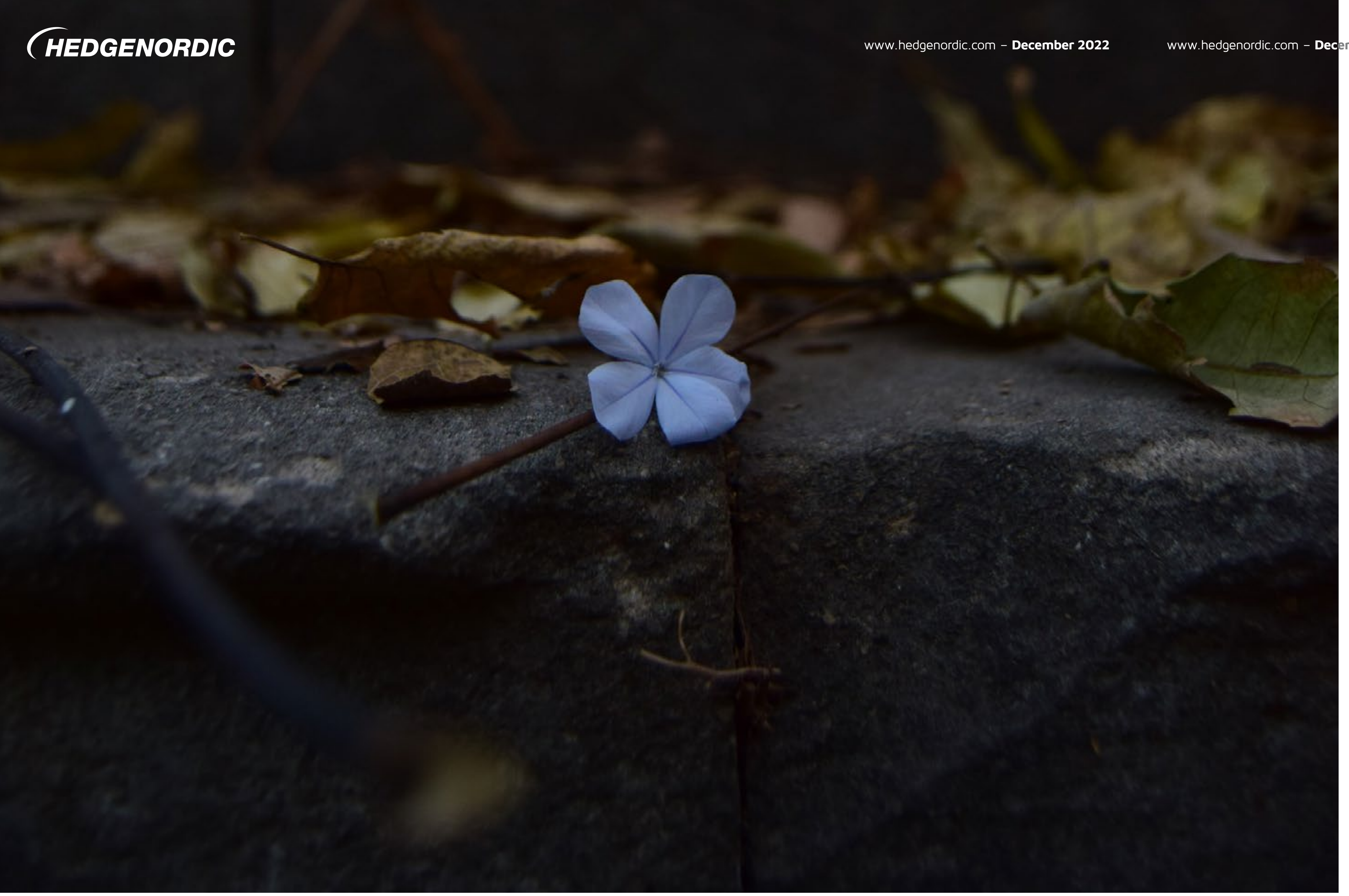
> "At REPM, the challenge is two-fold as many of our private markets strategies (e.g. our indirect private equity) can't be assessed using these conventional frameworks."

At the same time, data will remain the greatest challenge in the ESG transformation journey. "Data is already critical and will only become more important really in every aspect of ESG. Regulation will require even more data disclosure and evidence," explains Muir. "Investors need more data for their own decision processes, regulatory compliance and reporting. Setting targets and assessing progress requires data too, especially transition-relevant data and metrics," she elaborates. The questions of how to effectively collect, handle, manage and monitor that data and how to get the most value out of it are top-of-mind for many real asset and private market players, according to Muir. "On the whole, it remains a relatively manual process, but huge efforts are underway to automate and modernize many of the systems and processes that are widely used in our industry today."

However, innovation stemming from advanced technologies such as machine learning and blockchain capabilities will be repurposed and tailored to solving critical sustainability challenges in the financial sector, including in private markets, considers Muir. "Verification of GHG emissions, ability to detect climate risks, construction of customized ESG-integrated portfolios are just some of the potential use cases of these technologies."

Another interesting trend within the ESG universe is the rise of social themes and issues, according to Muir. "Historically deprioritized behind environmental topics, the S component of ESG is rising up ESG agendas," she emphasizes. "We expect this to continue and to see significant improvement in quantitative and qualitative measurement in this space."

www.hedgenordic.com – December 2022 HEDGENORDIC



By Firmino Morgado, Filipe Bergaña, Man GLG, and Jason Mitchell, Man Group

Against Utopia: The Need for a Pragmatic Energy Transition

> "The road to Utopia ultimately leads to nowhere. Instead, investors need to support a pragmatic transition."

Utopia, famously, means nowhere. When Thomas More sought to write a satirical book about an imaginary land, he made up a word in ancient Greek: 'ou' – not, 'topos' – place. Utopia: 'Not Place', 'Nowhere'.

As investors, we must deal with the world in its current state. In Europe, the leader of environmental-focused policymaking, we find ourselves requiring ever-larger stocks of coal and other fossil fuels to stave off an impending winter energy crisis. The utopian ideal – a rush towards 100% renewable-powered energy mix – meets the pragmatic reality that we simply do not yet have neither the technology nor infrastructure. Here we have seen the acutest example of the energy dilemma; how can investors, and we as individuals, access energy that is (1) available, (2) affordable, (3) secure and (4) sustainable. To over-prioritise one would be to jettison the other three, unthinkable for any modern fund manager or policymaker. We need to consistently choose the lesser of two evils, rather than pretending a perfect solution exists; choosing cleaner natural gas or even nuclear over dirtier oil and coal; funding polluting miners that underpin the electrification of the economy; investing in the oil majors who are working to become renewables majors.

The road to Utopia ultimately leads to nowhere. Instead, investors need to support a pragmatic transition.

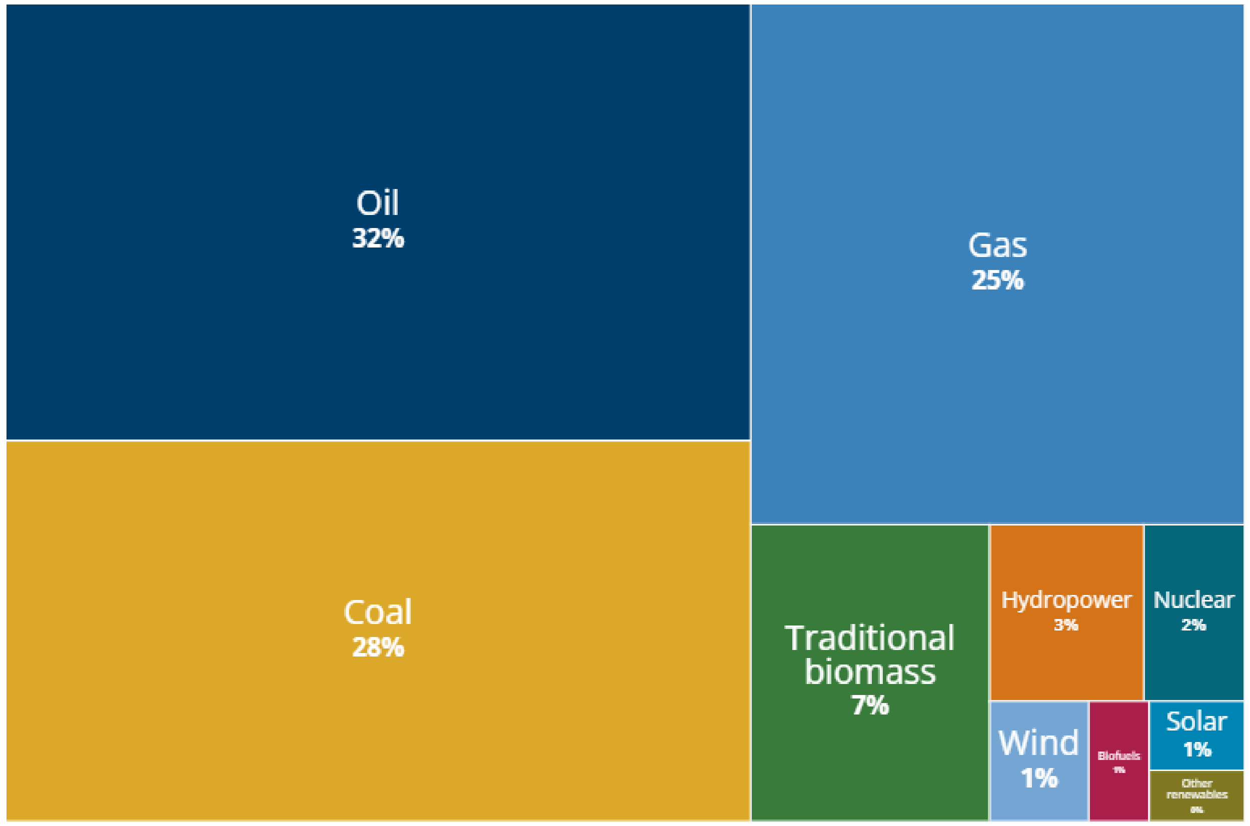
FOUR CRITERIA FOR AN ORDERLY TRANSITION

The first point to stress is that the need for an energy transition remains as acute as ever. To achieve the Paris Agreement's goal of limiting global warming to 1.5 degrees Celsius above pre-industrial levels, it is estimated that we need to cut emissions by 45% by 2030 and achieve net zero by 2050. However, the direction of travel has not been quick enough, with most countries behind on their targets.[1]

The second is that for the target to be achieved, it requires individual consumers to be persuaded to support it. It is no good governments making commitments to curb emissions if their policy decisions actively erode the base of support for pro-environmental policies. For the energy transition to be orderly and effective has to abide to four criteria, ensuring the sustainability, availability affordability, and security of energy supplies. As we have seen this year, if these criteria are violated, support for pro-environmental policies dries up.

The unpleasant reality is that this scenario requires trade-offs. Until we see major technological breakthroughs, the world's energy mix remains reliant on fossil fuel exploitation (Figure 1). Furthermore, the section attributable to renewables contains a great deal of embodied carbon in its manufacturing. The choice is therefore not between good and bad: it is between better or worse.

Figure 1: Global Primary Energy Consumption by Source



Source: Our World In Data; as of 31 December 2021.

MOVING THE NEEDLE

What then, will make the most difference?

In our view, a great deal of supposed ESG activity is misplaced on those stocks which score highly on more superficial ESG data monitoring tools. These are typically capital-light, knowledge intensive businesses which have little-to-no carbon footprint. However, these stocks are not isolated: while their Scope 1 and 2 emissions may be low, they are still enmeshed in the global economy. Nevertheless, by offering more capital to companies whose environmental improvement will only be incremental, we are wasting the leverage that comes from being a shareholder. With finite resources to deploy, we should focus our efforts where they will make the most impactful difference.

For investors to be effective, they need to improve the environmental position of those industries with the worst emissions. This overwhelmingly means power generation, transport, waste and industrials, a grouping which also includes miners.. Collectively, these areas account for around 85% of global emissions. Meaningful reductions in the emissions of these sectors will do far more to meet Paris Agreement goals than amassing a portfolio of stocks which already have high ESG ratings.

www.hedgenordic.com – December 2022 HEDGENORDIC

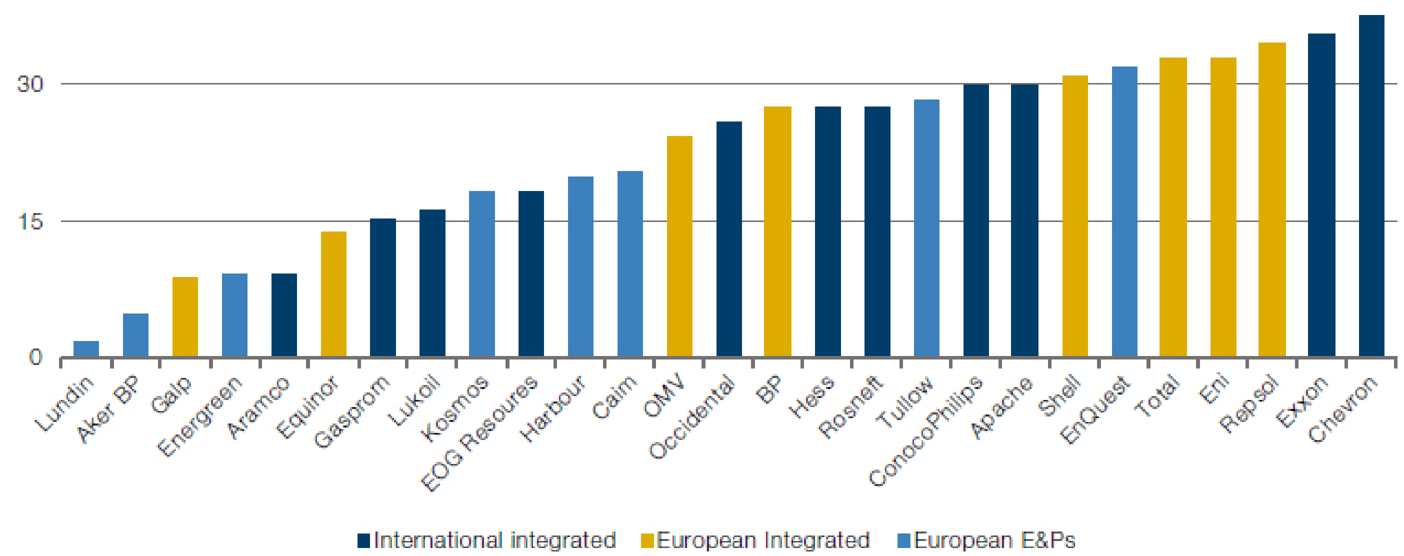
> "... we should focus our efforts where they will make the most impactful difference."

However, engaging with the energy sector is fraught with risk, both financial and reputational. Burning fossil fuels pollutes – there is no escaping this fact. The picture is complicated because some of the biggest renewable energy producers are also the biggest producers of fossil fuels. As such, reputational risk abounds. Prior to 2022, the implementation of ESG exclusion lists has caused both a lack of capital to the sector and a degree of price stagnation amongst oil majors. However, energy companies are not all alike, with great variation in the carbon intensity of production for different firms (Figure 2).

To mitigate the risk, as well drive the energy transition, investors must be selective. While in the short term, the ongoing supply squeeze will likely benefit most energy companies, over the long term we should avoid those firms who are not changing their business models to adapt. Managers should avoid those firms with high emissions per barrel of oil equivalent and a high risk of stranded assets. Likewise those firms with a consistent track record of investing in lower carbon opportunities and renewables should be encouraged with further capital allocations. This means a degree of compromise, replacing coal and oil with a mix of natural gas and nuclear alongside renewables.

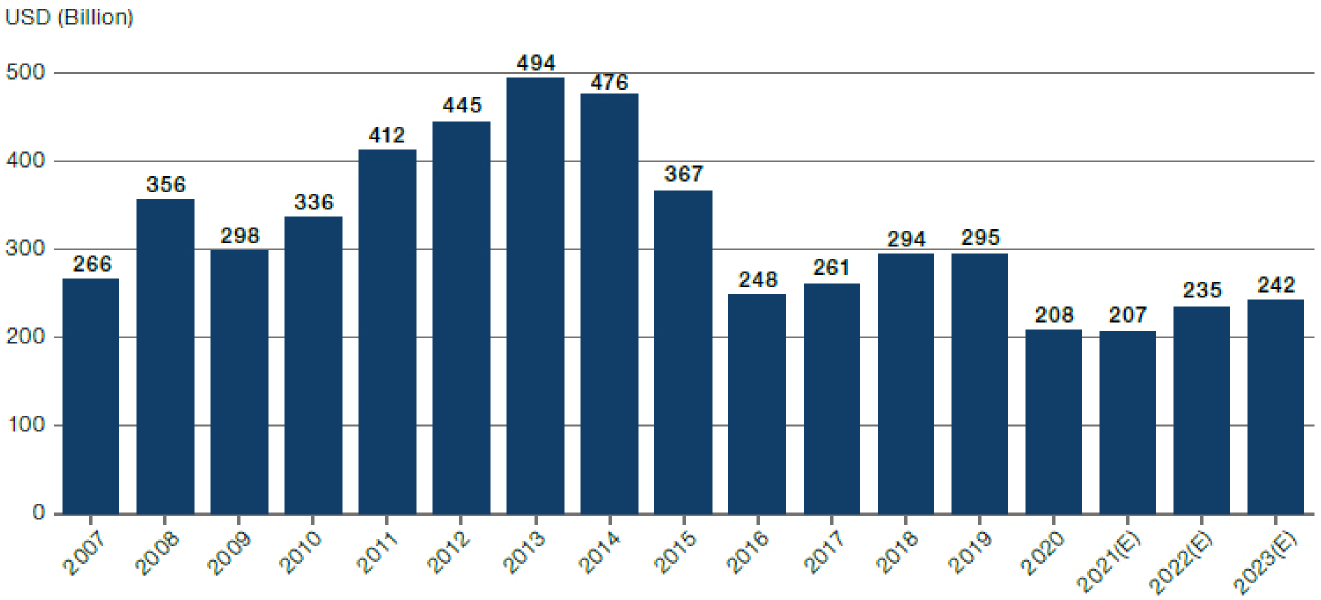
Consider, for example, energy firms with high levels of buybacks. While we do not object to buybacks in

Figure 2: Carbon Intensity of Operational Emissions per Barrel Produced (kg/barrel of oil equivalent)



Source: BofA Global Research as of 2021

Figure 3: Capex Spending Decline in the Oil & Gas Sector



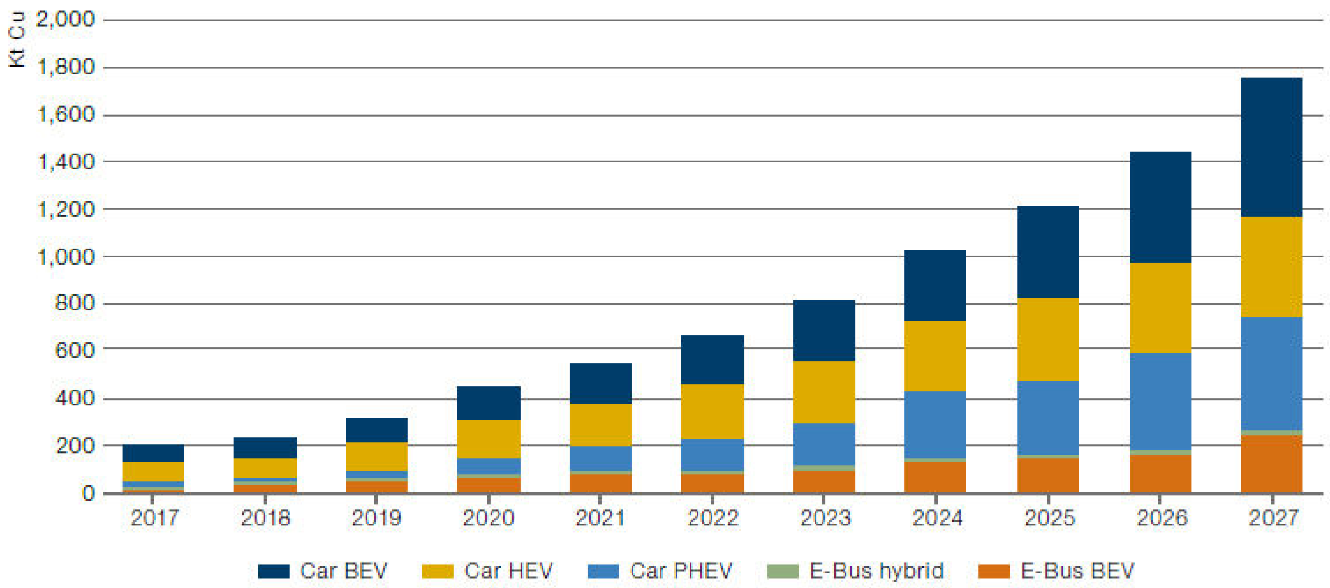
Source: Morgan Stanley as of 2021.

principle, their primary purpose is to return excess cash to shareholders. Firms have excess cash if they have no good opportunities to invest it. As such, energy firms with significant buybacks are effectively signalling they do not wish to invest further. We would look askance at such an attitude: given that capex spend in the sector has been declining, quite clearly there is scope for energy firms to invest in increasing the size of their renewables operations (Figure 3).

Likewise, those firms pursuing a price over volume strategy, and those with non-diversified business models tied to commodity prices should be avoided. Another major source of emissions is industry. Again, an ESG strategy which avoids owning industrial stocks is one without the purchase to encourage meaningful change. While industrial processes will remain resource intensive – in particular with regards to the demand for metals – there are a number of steps that can be taken by firms to ensure that emissions decline. Electrification and general shift away from conventional energy sources has the potential to create significant gains. Likewise, firms which are committed to implementing principles of circularity in their business models will reduce their effect on the environment and should be supported.

The point of electrification brings us neatly to the vexed question of mining. Any transition towards renewable energy brings a coincident requirement for ever greater supplies of battery metals, given the intermittent nature of most renewable methods of energy production. Likewise, there is an increasing demand for circuits. If projected targets for solar power in the US are met, the 262 gigawatts of new installation will require some 1.9 billion pounds of copper by 2027 [2], which is around half of annual global production levels. This excludes projections for products like electric vehicles, which would place further burdens on supply chains (Figure 4). If we are to see an energy transition, there is a clear need for increased capacity in the mining sector. Again, trade-offs have to be made. Miners should be held to high standards of accountability, with dry separation techniques preferred to reduce water waste, and the implementation of rigorous safety standards when construction tailings dams. Those miners who can demonstrate that they take steps to mitigate their environmental impact should be supported; with demand for metals so high, the alternative is that it will be satisfied by those in the industry with no regard for the environment or dangerous artisanal mining, both of which are detrimental from the perspective of ESG.

Figure 4: Electric vehicle Copper demand



Source: International Copper Association; as of 2017.

In our view these principles are equally applicable to long-only and long/short managers. With minor differences in portfolio construction based on mandate – long-only funds excluding poor performers, and long/short funds actively betting against those firms il-equipped to handle the energy transition – asset managers should be able to make a meaningful contribution to encourage clean energy generation.

CONCLUSION

Unhappily for us, we live in an imperfect world. To arrest climate change, we need a rapid energy transition. In the short term however, this involves unpleasant trade-offs if popular support for pro-environmental policies is to be maintained. As such, we need to take a pragmatic rather than utopian approach in putting our capital to work where it can make the most impact: in energy firms, in industry and in mining. Instead of being caught up in utopianism, we need to make hard choices to ensure that we see a smooth energy transition, where emissions come down – and the lights stay on long enough to enable it.

1) https://unfccc.int/news/climate-commitments-not-on-track-to-meet-paris-agreement goals-as-ndc-synthesis-report-is-published

2) Visualizing Copper's Role in the Transition to Clean Energy (visualcapitalist.com)

www.hedgenordic.com – December 2022
HEDGENORDIC

Navigating the Five Macro Regimes of 2022

By Hamlin Lovell - HedgeNordic

Mark Nash
Head of Fixed Income Alternatives - Jupiter Asset Management

Jupiter Strategic Absolute Return Bond Fund (SARB) is a flexible liquid global macro strategy taking long and short positions in sovereign bonds, interest rates, currencies and credit with most exposure in developed markets and an average investment grade credit rating. Non-investment grade exposure is predominantly emerging market sovereigns and some corporate or financial credit in developed markets. "We profit from price moves based on macro, and take low default risk," says Mark Nash, one of three portfolio managers.

The strategy aims for "all weather" returns and has delivered positive performance in 96% of rolling 12-month periods. Through a full cycle the target absolute return on the fund is cash +4% with volatility of 4% and a Sharpe ratio of one. Since inception the strategy has met its alpha target but undershot on volatility and overshot on the Sharpe, while maintaining a slightly negative correlation to global bonds and equities. Some investors especially in Asia use leverage to dial up risk.

The risk target was low for much of 2022 due to the fluid macro backdrop but has started to pick up as the managers build somewhat higher conviction in the latest macro regime, while keeping a close eye on market action and maintaining strict risk management: "We are very flexible with our views because the world is complicated. We quite often change the strategy altogether. We are close to market price action and use momentum signals to help decide if our top down macro view is right. We control drawdowns and defend the portfolio if we are wrong," says Nash, who argues that having only three portfolio managers allows SARB to make swifter decisions than some larger teams that follow slower processes. SARB portfolio construction is assisted by a specialist who translates the broad thematic model portfolio views into positions that carefully optimise for volatility and risk budgets, which helps to hit the Sharpe ratio target.

SARB's top down view since 2000 has been that Covid shifted policymakers towards a more reflationary and well-rounded global economy, supported by deleveraged consumers, and corporates spending more to help constrained supply catch up with robust demand.

Yet within this big picture there can be multiple chapters in just one Gregorian calendar year.

FIVE REGIMES

SARB started 2022 with a view that Covid headwinds were waning due to a less virulent Omicron strain, leading to reflation and higher growth. "This led to short core bonds, yield curve steepeners, long inflation and selected emerging market bonds, and a small short in corporate bonds, for the first two months of the year," says Nash.

After Russia invaded Ukraine, pushing up food and energy prices, the regime changed to one of bad inflation and risk off with more rate hikes and slower growth. "The positioning increased short corporate

www.hedgenordic.com – December 2022
HEDGENORDIC

bonds; maintained short core bonds in Treasuries, bonds and gilts as the bond rally did not make sense, and kept longs in EM resource producers. This phase lasted about three months," says Nash.

By May, energy prices in fiat currency were weakening, and the real yield curve started to flatten and then invert. "Higher yields made it worthwhile own bonds and go tactically long risk over the summer, even if we were skeptical about the "everything rally," continues Nash.

By the end of the summer, US economic data was improving with higher real incomes, and European governments essentially wrote blank cheques to subsidise energy, boosting borrowing needs. "This shifted the focus back to inflation, and SARB reversed to short bonds again," points out Nash.

By October a constellation of factors suggested a move from fiscal instability and bad inflation to higher growth and disinflation created potential for a "goldilocks" soft landing.

SOFT LANDING AIDED BY FOUR FACTORS

In the fourth quarter, the fund identified a fifth regime and has made a reasonably sudden shift from net short to net long in developed market interest rates and corporate credit as well as some contingent convertibles issued by banks. Price action was one driver: "price moves in the risk off, long dollar, short bonds trade were running aground even with bad CPI numbers," recalls Nash.

FUNDAMENTALLY, THE TEAM HAVE IDENTIFIED FOUR CONSTRUCTIVE FACTORS.

Nash argues that some central banks have suggested that they will tolerate inflation somewhat above their official 2% targets, in order to avoid recession. This somewhat dampens the most hawkish rate hike scenarios.

The US CPI is improving with some goods price disinflation. There might be some one-offs in medical services, but US rents have surprised on the downside even during the busiest moving period between August and October. Energy prices are coming down in the US and lower natural gas prices are particularly helpful in Europe.

> "We are very flexible with our views because the world is complicated. We quite often change the strategy altogether."

Fiscal policy is becoming more disciplined as the energy subsidies announced over the summer are scaled back, and will cost less with lower gas price. Public spending overall looks less alarming for bond investors.

Supply chains are improving with ISM delivery times coming down, partly thanks to China reopening, and this helps to reduce new and used car prices. China reopening, reducing mass testing and quarantine requirements, and allowing more diplomatic travel also helps to push down the US dollar and improve risk appetite.

The one missing ingredient is more moderate wage inflation. The labour market remains tight, especially in leisure and travel sectors, which could lead to some persistent wage price inflation.

ENERGY EXPORTERS AND IMPORTERS

Yet the portfolio is also positioned to profit from some inflationary trends, directly through owning inflation-linked bonds issued by countries such as Japan and indirectly through commodity and resource producers and exporters, such as Brazil, Mexico and South Africa in EM, which are owned on an unhedged basis, giving exposure to both local currency yields and potential currency appreciation. "Some emerging markets also have a better inflation outlook as they have more labour supply and a larger share of food and oil in their inflation baskets. They were also earlier movers in hiking rates than developed countries," explains Nash.

Another angle on this trade is to buy energy importers that have blown out to very stressed yields, such as sovereigns in Poland, Hungary and Greece. "lower energy prices and fuller storage tanks should help sentiment," says Nash.

If energy prices start to recover (possibly due to one or more of China reopening, OPEC cuts or geopolitics in Russia or the Middle East) this positioning could be tempered perhaps with a short in German bunds.

CONTINUING SHORT POSITIONS

Though the portfolio is broadly long of duration and credit the outlook is not universally benign and there are still some shorts, which both act as hedges for the key long themes and could be attractive absolute wagers.

"The worst risk asset is US credit. The perception of US assets being a safe haven due to the dollar and energy security is now changing. We are short of US high yield credit and short the belly of the US rates curve. US equity valuation seem high and investors are shifting from growth to value leading to better risk/reward in Europe and China, which are starting for a lower base," says Nash.

HIGH RATES FOR LONGER

Nash expects that consensus forward curve terminal US rates of 5.25% are realistic, but is skeptical about the timing of rate cuts priced into the curve. He expects that rates will peak at a high plateau for longer than the market consensus, due to a robust economy. "Excess demand will make it very hard for central banks to start cutting with strong consumers and corporates investing in robots to replace labour. In addition the bond rally is partly a technical short covering move". He is also of the opinion that the inverted yield curve need not predict a (potentially disinflationary) recession in the new economic environment: "It simply reflects high spot inflation".

Nash expects that central banks want to strike a happy medium by avoiding steep rate rises that could cause a severe recession and unemployment, while also avoiding the 1970s resurgence of inflation that came from cutting rates prematurely. This leads to a short in belly maturity Treasuries.

SHORT JAPAN AND UK

SARB expect that Japan will eventually need to tighten in 2023 as the Japanese economy has almost fully reopened and inflation is increasing. SARB is short of nominal Japan bonds as well as owning Japanese inflation linked bonds.

A short in the UK is partly based on the view that the UK trade deficit will force it to pay more to compete for capital.

The above views were accurate in early December 2022 when HedgeNordic interviewed Mark Nash, but of course if another regime emerges soon, many of these positions could be swiftly cut and reversed, and fresh trades could be implemented, as they were in 2022. In addition, the ideas discussed here are broad thematic positioning from model portfolio updates, overlooking nuances such as exact maturities and yield curve trades.

> “The worst risk asset is US credit. The perception of US assets being a safe haven due to the dollar and energy security is now changing.”

ESG UPDATE

ESG is probably most sophisticated and extensive for long only equity strategies, but it does have an evolving role in macro strategies.

SARB is currently disclosing under SFDR 6 but will be transitioning to SFDR 8 in 2023.

The ESG policies including ranking and screening sovereigns on criteria including carbon policy, governance and human rights.

“Egypt is one example of a lower ranked sovereign which led to a divestment in late 2021. Elsewhere in the Middle East, many nations like the UAE benefit from strong governance structures, although often score poorly on freedom of speech and broader human rights. UAE will need to accelerate their transition away from fossil fuels if they are to impress when they host COP28 next year,” says co-portfolio manager James Novotny.

On the corporate side, ESG is less relevant to SARB because it generally does no invest in single name corporate issues (besides some CoCos).

ESG credit indices are not currently used partly due to concerns about lack of liquidity, which is especially important given the liquid trading approach. In addition, the methodologies used to construct some indices can be rather simplistic and do not always align well with Jupiter’s own perspectives on topics such as energy transition.

The Private Market's Role in ESG Transformation

By Eugeniu Guzun - HedgeNordic

> "The private market investor has a lot to say in the sustainable transition."
>
> Miguel Zurita

The field of environmental, social, and governance (ESG) investing has evolved and matured to the point where corporations, politicians, regulators, and investors can greatly accelerate market and business transformation for the better. With the luxury of long-term thinking and commitment, private market investors like AltamarCAM Partners believe they are well-placed to incorporate sustainable investment ideas and steer businesses and industries in the right direction.

"The international and European agenda is currently dominated by challenges such as energy transition and resource scarcity. Very ambitious targets have been set for the next few years, requiring the deployment of billions in additional investments that far exceed the capabilities of the public sector," notes Miguel Zurita, AltamarCAM's Co-Head of Private Equity and chair the firm's ESG Committee. "In this context, private investors play an increasingly important role, becoming the perfect ally to complement public investment and achieve the necessary goals."

Due to the long-term nature of private market investments and the scope to shape the direction of underlying investments, private market investors can use their influence to accelerate ESG commitments and sustain the momentum behind ESG investing. "The private market investor has a lot to say in the sustainable transition," argues Zurita. "At AltamarCAM we are closely following this moment of inflection in the sector, and we want to push beyond merely playing a participatory role in the progressive adaptation to this new "green" reality. Our aspiration is to position ourselves as a driver of change in the industry," he emphasizes. As one of Europe's leading asset managers in private markets, AltamarCAM has invested with over 400 GPs, spanning Private Equity, VC, Private Debt, Infrastructure and Real Estate strategies, and with this reach comes influence and, above all, responsibility. "We maintain very close relationships with the managers we work with," says Zurita. "We strive to raise awareness of ESG issues through continuous engagement with both GPs and LPs."

AltamarCAM positions itself as a responsible investor, integrating ESG criteria in its investments across all asset classes, while also seeking to stimulate innovation within specific sectors tackling global challenges such as energy transition or access to healthcare. The asset manager has launched a real assets fund investing in targeted sustainable megatrends, including the growing need for healthcare, smart cities, digital transformation and decarbonization, among others. Separately, Zurita highlights AltamarCAM's activities in the Healthcare space, where they are going to launch a new direct-investment fund focused on impact investment opportunities. "Our holistic approach allows us to align ourselves with best sustainability practices," comments Zurita. "It also allows us to take advantage of commercial opportunities stemming from a growing appetite among our investors for sustainable funds."

ESG AND INVESTMENT PERFORMANCE

One argument often heard in ESG discussions is that "doing the right things" comes at a cost and dampens performance. A growing body of research

Miguel Zurita
Co-Head of Private Equity, chair ESG Committee – AltamarCAM

however suggests that companies may be helping the bottom line by improving their ESG performance. "At AltamarCAM, we understand the impact ESG factors have on an investment over the long term, which is also determined by the environmental, social, and governance performance," explains Zurita. "For this reason, ESG factors are an integral part of our investment process and are always considered when evaluating potential opportunities. We are building ESG analysis into the investment Due Diligence process, while also giving great importance to our dialogues and ongoing engagement with fund managers and underlying companies, which are key to improving their ESG commitment in the long term."

Businesses and investors alike appear to have realized that incorporating ESG factors into their business models and investment processes is not only a necessary cost of satisfying the modern customer, but also brings financial rewards. One consideration does not need to supplant the other when allocating capital. "As stewards of capital, our ESG approach is characterized by our fiduciary duty to our investors, as well as our sense of responsibility as a company to our employees and other stakeholders," emphasizes Zurita. "We believe that generating strong returns in a responsible and sustainable manner that benefit for example pensioners or insurance premium holders that have invested in it, which is in itself a way to contribute to society and give a clear example of good practice."

ESG AS A MEGATREND

The integration of ESG factors into the investment process has gained momentum over the last decade, with ESG emerging as a key investment theme. "We could say that ESG is a megatrend on its own, which, in addition to dominating the global risk map, has created a range of tailwinds," argues Jörg Höller, Chief ESG Officer at AltamarCAM. "These tailwinds present very attractive investment opportunities."

Höller views the fight against climate change as the main environmental, social, or governance challenge faced by investors. "There is no doubt that the fight against climate change is the main challenge. In this regard, more and more initiatives are promoting

Jörg Höller
Chief ESG Officer – AltamarCAM

> "We could say that ESG is a megatrend on its own, which, in addition to dominating the global risk map, has created a range of tailwinds. These tailwinds present very attractive investment opportunities."
>
> Jörg Höller

transparency and regulatory pressure is leading investors to adopt a much more proactive role in emissions management," says Höller.

AltamarCAM has also been intensifying its efforts around measuring and reducing their own CO2 footprint. "Since 2019 we have been carbon neutral at an operational level. At the portfolio level, despite the inherent difficulty we experience as a fund of funds manager, we conduct climate analyses aligned with international benchmark standards," says Höller. To accelerate its efforts associated with combating climate change, AltamarCAM has adhered to the Task Force on Climate-Related Financial Disclosures (TCFD), the Initiative Climat International (iCI), as well as the Institutional Investors Group on Climate Change (IIGCC). "To face this unprecedented challenge we must engage with the leading initiatives in the field and keep up to date with all the new developments affecting our market," argues Höller.

Going beyond the E and G aspects of ESG, an important issue in the asset management industry under the social pillar is the lack of diversity, according to Höller. "Internally, diversity is one of the most important drivers in our industry," says AltamarCAM's Chief ESG Officer. "This sector has traditionally been male-dominated, and while significant progress has been made, there is still a long way to go," he emphasizes. As of December 2022, 44 percent of AltamarCAM's workforce are women. "We continue to work on formalizing processes and career plans that will allow us to continue improving these statistics," says Höller. "We are also very conscious of understanding and managing diversity in the broadest sense of the term, and are developing specific projects that will enable the identification of all the implications that the concept of "diversity" has for us."

Zurita and Höller are proud of the progress AltamarCAM has made so far, and themselves represent two key figures within the wider organisational ESG framework within the business, which counts on a firm-wide ESG committee and steering group in addition to the dedicated ESG team. The results of the latest PRI report on AltamarCAM, which awarded four- and five-star ratings across all reported categories, are testament to what has been achieved. "ESG is at the core of our corporate culture and investment DNA, and is a fundamental characteristic of our role as a trusted advisor. We are convinced that it offers long term financial opportunities," affirms Zurita. "We are doing everything we can to ensure we have the resources and strategies in place to best serve our employees, investors and society as a whole."

AltamarCAM Partners

- A leading independent private asset manager and solutions provider
- AUM: €17b
- +18 years of experience
- Asset Classes: Private Equity, Venture Capital, Life Sciences, Infrastructure, Private Debt
- Office Locations: Madrid, Cologne, New York, Barcelona, London, Santiago de Chile

Alexander Gallotti
Head of Leveraged Finance – Mandatum Asset Management (MAM)

Secured Loans with a Strong Flavour of ESG

By Eugeniu Guzun – HedgeNordic

Secured loans, also known as leveraged loans, represent an attractive asset class to diversify one's high-yield credit portfolio, fixed-income portfolio, and broader investment portfolio. As compared to high-yield or fixed-rate bonds, for instance, secured leveraged loans exhibit limited interest rate risk due to floating rates and offer downside protection due to seniority. In light of growing investor demand and awareness of ESG, Helsinki-headquartered Mandatum Asset Management has launched an SFDR Article 9 secured loans vehicle that complements the attractive features of secured loans by having sustainable investment as its objective.

"There are several features we like about the asset class, including downside protection and the floating rate nature," says Alexander Gallotti, Head of Leveraged Finance at Mandatum Asset Management (MAM). "The loans offer downside protection as they are 1st lien senior secured, which is the highest rank in the capital structure," explains Gallotti. The loans also exhibit limited interest rate risk or duration risk due to floating rates. "The market also typically consists of a large number of high-quality companies that are large, profitable and growing businesses with strong market positions and good diversification in terms of products, geographies, end-markets, and customers."

Although senior secured loans are backed by the borrower's assets, the biggest risk associated with investing in this space remains credit risk. "The biggest risk is the same as for any credit investing in the higher yielding space, be it high yield, leveraged loans, or any other segment. The largest threat to the investment that matters at the end of the day is the risk of default and the associated recovery rate," explains Gallotti.

www.hedgenordic.com – December 2022
HEDGENORDIC

There is also some risk associated with mark-to-market price volatility when liquidity dries up in the secondary syndicated loan market during times of turmoil, acknowledges Gallotti. "For long-term investors, this volatility should not be the main risk on their minds," he argues. "Investors should view mark-to-market volatility as an opportunity to add at discounted levels and hence boost the long-term overall performance. At the end of the day, the biggest concern is that you don't get back the money you'd lent in the first place." After 15 years of experience in this asset class, the team behind the asset management arm of Finnish insurance group Sampo has shaped its approach to assessing and mitigating credit risk.

ASSESSING AND MITIGATING CREDIT RISK

Mandatum Asset Management's investment strategy in the secured loans space has historically been overweight high-quality issuers in defensive sectors, which are often preferred by private equity funds. These include areas such as healthcare, pharma, software, services, and consumer staples. The majority of loan deals across its portfolios are issuers run and backed by reputable private equity sponsors, who have the financial strength in times of stress. "We build a defensive base for the investment portfolio. The defensiveness comes from the senior security in the credit spectrum, the allocation towards the more defensive and non-cyclical sectors, and the hand-picking of the stronger credits," explains Gallotti. "Although our entire product range has a European focus, our Nordic tilt brings some additional defensiveness to the portfolio."

A strong focus on incorporating ESG risks and factors in the investment process and credit selection process further helps to understand and mitigate credit risk. "Our portfolios have an overweight in resilient and typically ESG-friendly industries," says Gallotti. "These ESG-friendly industries also improve the credit quality of the companies and the financial performance in the long run," he continues. "We hence take ESG factors into consideration in our credit analysis process. The analysis of ESG concerns goes in parallel with the credit selection process. As part of this analysis, we are trying to identify potential ESG-related risks for the company in particular and the industry as a whole that could also pose a financial problem for the company at some point."

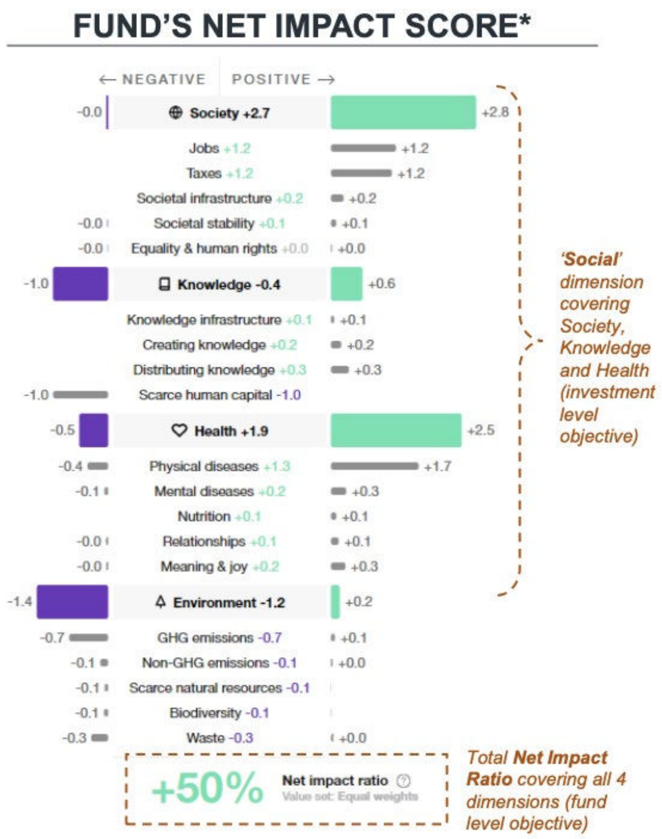
The competitive edge that helps Mandatum Asset Management take a step further in its loan selection due diligence stems from its co-investment structure and philosophy. "Mandatum Asset Management is the asset management arm of insurance group Sampo, and our philosophy of managing clients' assets is characterized by jointly investing in products with Sampo Group's balance sheet assets," explains Gallotti. "When we invest our clients' money, we often also invest Sampo Group funds in the same assets; our integrated investment process aims to identify the best possible opportunities and aligns us with our customers," he emphasizes. While that does not necessarily mean Mandatum Asset Management would have performed a less detailed and careful due diligence if it were not investing Sampo Group's assets, there's empirical proof showing that having skin in the game leads to outperformance. After all, Sampo Group and MAM are eating their own cooking via this co-partnership philosophy.

PRODUCT RANGE, AND ARTICLE 9 VERSION

Mandatum Asset Management manages three strategies investing in the leveraged loans space, one closed-ended, opportunistic fund and two open-ended senior secured loan funds. "We manage close to €700 million across these three funds, with an additional €1 billion+ of Sampo Group's balance sheet assets invested in the same underlying investments," says Gallotti. The most recently-launched vehicle in the secured loans space is an SFDR Article 9 fund with a sustainable investment objective that invests across the European leveraged buyout space. The fund is an alternative investment fund (AIF) for (semi-) professional European clients and focuses on European and Nordic syndicated, as well as club-style leveraged loans.

In addition to having a traditional ESG assessment incorporated into the credit analysis process, Mandatum's Article 9 Senior Secured Loan Fund also quantifies the sustainability objective for each particular investment. "We validate our assessment of the sustainability objective of each investment through a third-party company that helps us in quantifying the net impact of that company's products and services to society," explains Gallotti. "In the other senior secured loan funds, we aim to identify potential ESG risks and then try to understand how likely those are to be headwinds for the company in addition to firm-wide exclusion and ESG policies," he elaborates. "With the Article 9 fund, we not only focus on quantifying the positive outcomes the company achieves, but also measure the possible negative impacts to achieve those outcomes."

> "With the Article 9 fund, we not only focus on quantifying the positive outcomes the company achieves, but also measure the possible negative impacts to achieve those outcomes."



Source: The Upright Project

The Article 9 Senior Secured Loan Fund assesses and measures each investment's net impact on society across four main aspects: environment, health, society, and knowledge. "On a high level, we first assess the negative impact of a company's resources that are used to create a product or service," explains Gallotti. "Then we also assess the positive impact of the product or service across these four categories. On a fund level, we target a net positive impact on all of these four dimensions. Although we focus more on the social dimension covering society, health, and knowledge, we do not neglect the environmental part. It is integrated into the whole loan selection process on top of our credit assessment and other ESG streams we run while assessing an investment opportunity," Gallotti explains.

EXPECTATIONS

Loans have outperformed bonds amid a difficult 2022 for fixed-income investors as a result of central banks' aggressive policy pivot to address rising inflation and the uncertainty of the war in Ukraine. And yet, the current yield to maturity in the loans space is still above the yields offered by high-yield bonds. "The current environment in the secured loans market is very attractive in our view as a result of rising rates and the sell-off in the credit market in general," says Gallotti. "The loan market is offering a yield in excess of 8 percent. If rates continue to rise, that will feed in positively into the returns," he elaborates.

However, successful investing in the secured loans space is "all about credit picking where we try to minimize and avoid pitfalls." Even so, "current yield levels are well above to compensate even for extremely gloomy default and credit loss outcomes, which is not our base case in the first place."

 www.hedgenordic.com – December 2022 HEDGENORDIC

Applying an ESG Process to Alternative Investments

By Nina Jahanbin, Fredrik Langenskiöld & Zuhair Khan – Union Bancaire Privée (UBP)

Nina Jahanbin
Head of Nordics

Fredrik Langenskiöld
Senior Investment Specialist

Zuhair Khan
Long/Short Japan Corporate Governance Portfolio Manager

„As investors, we believe that we have a responsibility to use our influence and industry knowledge over how similar funds and firms are managed to offer constructive guidance to the managers.“

UBP is committed to responsible investing through the promotion of good governance principles and the integration of environmental and social considerations into our investment approach. As a financial intermediary and member of the economic and social fabric, we are determined to channel capital towards responsible investment solutions that offer real potential to generate financial returns, while adhering to sustainable business practices and working to quantify and improve our social and environmental footprint.

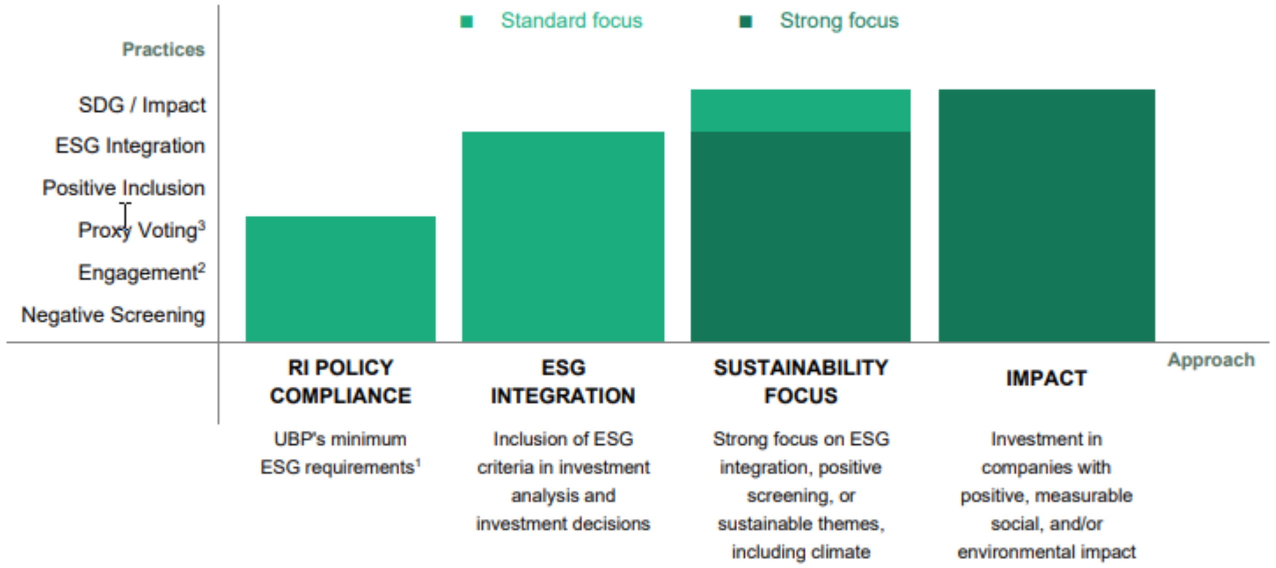
After initially focusing on the integration of ESG principles into our traditional asset franchises, we progressively broadened our scope to include alternative investments. As a pioneer in the field of alternatives, with investments dating all the way back to the 1970s, it felt natural to apply ESG principles to alternatives. We did so by implementing a dedicated ESG policy to our Alternative Investment Solutions (AIS) investment process, as well as by launching two long/short equity strategies. We believe that both risk management and alpha generation are enhanced by integrating ESG factors.

INTEGRATION INTO OUR DUE DILIGENCE PROCESS

Our investment team is aware of the opportunities and risks that ESG factors pose and actively consider these throughout its investment process. As investors, we believe that we have a responsibility to use our influence and industry knowledge over how similar funds and firms are managed to offer constructive guidance to the managers. When selecting managers, ESG factors come into consideration at two levels: 1) the practices of the manager's company and 2) the manager's underlying funds' investments.

At the manager's company level, we look to discuss any measures the firm has in place to run their own firm according to ESG principles in terms of all three factors. As a minimum, the firm should have a) signed the UN PRI, or is planning to do so shortly; b) disclosed its environmental policies or provided a review of the environmental impact of the firm; c) disclosed social policies or provided a review of hiring and training practices which aim to improve the firm's diversity and inclusion, and; d) displayed strong governance practices and disclosed their conflicts of interests policy.

When reviewing the investments for ESG characteristics, we first review what is possible within the strategy, as not all of them can be analysed from an ESG standpoint. If the strategy can be analysed for sustainability, we would look to see, amongst other things, what analyses are being carried out, who does these, how much these rely upon external providers



For illustration purposes only.
[1] Applies to all UBP's AUM, excluding cash, Wealth Management's execution-only services and investments in third-party funds.
[2] Not applicable to Wealth Management. Applicable to client holdings upon request.
[3] Ibid.

and what their proxy voting and engagement policies are. This covers both ESG analyses of underlying securities and sub-strategies, but it is also to consider the risks posed by such factors, such as insured or uninsured loss from climate change.

We are not excluded from investing in funds which have no or limited ESG considerations at firm and/or fund level, especially for some strategies that would be materially impacted by their implementation. However, as a minimum, the fund should consider sustainability risks. AIS will document the findings and encourage the manager to improve their processes where possible.

UBP'S EXCLUSION LIST

The UBP Exclusion List comprises companies in sectors in which UBP-managed funds are excluded from purchasing; these are primarily focused on the weapons-, fossil fuel- and tobacco-related industries.

Where AIS is investing in a customised or single-investor vehicle, or creating a UBP fund, the investment scope will be subject to the UBP Exclusion List.

For third-party funds approved, the team will periodically monitor the fund's exposure to UBP exclusion list.

> "One of the biggest challenges in integrating ESG into a fundamental equity strategy is sourcing consistent, high-quality emissions and ESG-specific data."

Shareholder alignment

Since Sept. 2014, the top quintile of companies with high shareholder alignment (i.e. share ownership by the board directors and share-based incentive compensation plans) have outperformed the market by over 5% p.a. Over the same period, the bottom two quintiles have underperformed by 2-3% p.a.

Outside influence

Companies with high (low) levels of outside influence (i.e. power held by independent directors on the board) tend to outperform (underperform) and return more (less) cash to shareholders in the form of both dividends and share buybacks.

Allegiant shareholders

Companies that are not protected by allegiant shareholders tend to outperform whereas those protected by corporates and insurance companies tend to underperform.

Scandal red flags

- A very low level of share ownership by inside directors
- No board committees or insider controlled board committees
- Independent directors that lack business experience
- Meaningful net-debt and low margins

All the factors outlined above are analysed and monitored by two independent teams, namely Investment Due Diligence (IDD) and Operational Due Diligence (ODD). The result of this process is the assignment of an overall ESG rating of positive, neutral or negative. The rating is a joint qualitative assessment made by the ODD and IDD teams.

TWO LONG/SHORT STRATEGIES INTEGRATING ESG FACTORS

In addition to the policy implemented during the fund-selection process, UBP has also launched two long/short equity strategies with a focus on ESG factors. As mentioned above, given the relative lack of clarity of the SFDR when it relates to alternatives, we feel that long/short equity is the strategy which is the most straightforward in terms of integrating ESG criteria, which is why we have started here.

The first strategy was launched in 2020 and focuses on Japanese corporate governance with a market-neutral approach. The premise is simple: since the implementation of the Corporate Governance Code in 2015, local and international investors have increasingly been focusing on the more proactive companies who have implemented changes, while shying away from obstructive companies, which are slow to implement these changes. The criteria that are considered include board structure, shareholder composition and corporate scandals. Based on years of data collection, the investment team will select long positions that showcase high governance scores, solid fundamentals, and attractive valuations while shorting companies with low governance scores, weak fundamentals and unattractive valuations.

There are currently strong relationships between the governance metrics outlined in the chart above and share price performance. Although these relationships are intuitively expected, what is surprising is their strength, systematic nature and persistence.

The second strategy was launched at the end of 2021, in partnership with Bain Capital Public Equity and is a global long/short strategy with a responsible investment approach. The strategy engages in three main areas of focus, which apply to the long book: the first relates to sustainable growth and reducing climate impact, where the companies' energy efficiency and natural resource conservation, as well as greenhouse gas (GHG) emissions targets are monitored; the second relates to diversity, equity and inclusion, where the investment team promotes diverse leadership and board representation, advocating at least two female directors in particular; the third is based on the company's ESG transparency and disclosure, engaging with companies that

Bain Capital's engagement focus areas:

Climate

- Energy efficiency and natural resource conservation
- Science-based greenhouse gas (GHG) emissions targets

Diversity

- Board and executive level diversity
- Workforce composition disclosure (EEO-1 data)

Transparency

- ESG/sustainability reporting material issues (e.g. workpla health and safety, GHG emissions, supply chain management, etc.)

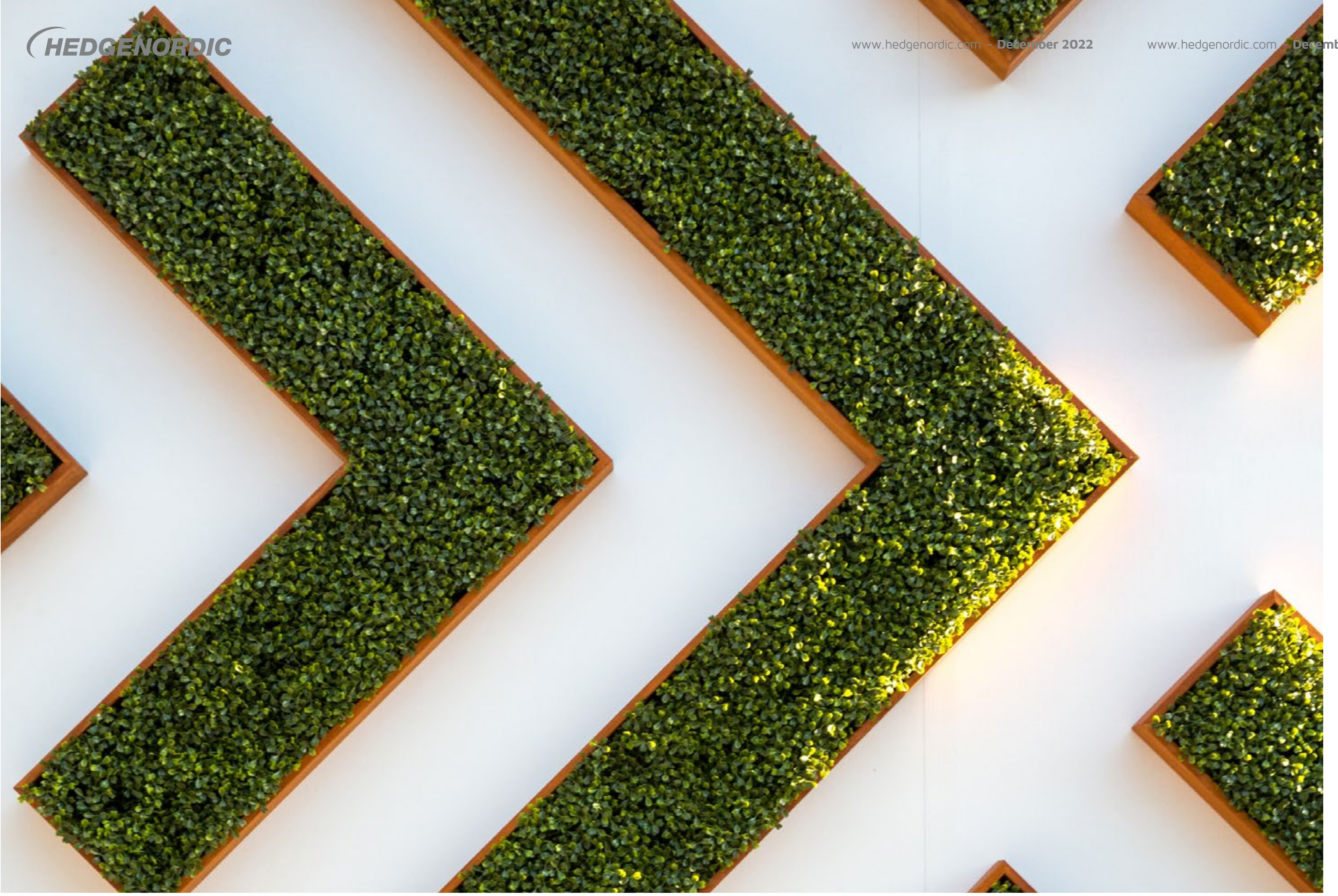
Source(s): UBP, Bain Capital LP.

provide insufficient disclosure on material ESG factors. On the short side, the team focuses on investment opportunities where ESG considerations may negatively impact the forward earnings power of the company's operations.

One of the biggest challenges in integrating ESG into a fundamental equity strategy is sourcing consistent, high-quality emissions and ESG-specific data. The investment team uses a multi-pronged approach, evaluating all long equity positions based on company disclosures, third party ESG reports, and news publications for ESG performance and severe controversies. Information is cross-referenced with MSCI ESG manager and RepRisk to ensure data quality. The investment team may also engage with an individual company, advocating for improved transparency and data disclosure to assist with the investment decision making process.

THE FUTURE

The process of integrating ESG factors into alternative investments is still in its infancy, with very few actors and investment strategies available in the space. The lack of a clear regulatory framework from the SFDR and the fact that several strategies can hardly roll out ESG criteria without materially impacting their implementation, along with the concerns about greenwashing, could be some of the reasons why. However, investor demand, especially in Europe, will continue to encourage alternative managers to enhance their ESG frameworks. As a pioneer and one of the largest allocators in alternative investments in Europe, we are willing to use our ESG expertise that we have developed in-house over the last ten years within the long-only world and to increasingly apply it to alternatives, offering clients innovative investment solutions which transparently integrate concrete and measurable ESG factors.



ESG Disclosure Tool for Alternative Credit

By Eugeniu Guzun – HedgeNordic

> "This new industry-led initiative will reduce the burden on borrowers while improving the materiality and comparability of ESG disclosure for investors."
>
> Jiří Król

Asset managers seem to be becoming increasingly frustrated with the lack of standardized and comparable environmental, social, and governance (ESG) data. As sustainable reporting becomes mandatory, measurement is both necessary and inevitable. Quantifying the ESG impact of private market investments is uniquely challenging due to limited and inconsistent ESG data.

In the private credit markets, the responsibility for building consistency in ESG data disclosure has fallen to a group of alternative asset managers and industry bodies in the private and broadly syndicated credit markets. An industry initiative has brought together leading alternative lenders and industry bodies to promote greater harmonization and consistency of disclosure of key ESG indicators by borrowers. This industry-led initiative is carried on through the ESG Integrated Disclosure Project (ESG IDP), which has designed a template for ESG-related disclosures for both private companies and credit investors. The ESG IDP is led by the Alternative Credit Council, which is the private credit affiliate of the Alternative Investment Management Association (AIMA), as well as the Loan Syndications and Trading Association (LSTA), and the United Nations-supported Principles for Responsible Investment (PRI).

"SMEs and mid-market businesses require a more proportionate approach to ESG disclosure than large public corporates," argues Jiří Król, Global Head of the Alternative Credit Council. "By simplifying and harmonising existing market practices, this new industry-led initiative will reduce the burden on borrowers while improving the materiality and comparability of ESG disclosure for investors."

The entire ESG ecosystem has been moving towards greater harmonization on the topic of disclosure, and the private credit space is no exception. "Investors and regulators have made it clear that the status quo is untenable, and the credit market recognizes the need for harmonized ESG reporting," confirms Tess Virmani, Executive Vice President and Head of ESG at LSTA. "Harmonization is the critical next step in improving the availability of consistent, reliable ESG information and furthering the responsible growth of ESG in credit markets."

OVERLAPPING STANDARDS AND FRAMEWORKS

The increasing interest in ESG among investors and asset managers alike has similarly intensified regulators' focus on the ESG space. The number of

ESG disclosure standards and frameworks continues to grow, seemingly complicating the journey toward achieving a globally-recognized set of standards and a unified framework. The PRI, one of the world's leading proponents of responsible investment, has created an ESG Factor Map that outlines substantial overlapping of many competing ESG standards and frameworks. According to Carmen Nuzzo from the PRI, the ESG Integrated Disclosure Project represents one more step towards achieving harmonization in the private credit space.

"Taking the cue from the PRI's ESG Factor Map, which pointed out the substantial overlapping of many competing ESG standards and frameworks, this new template will allow private creditors to have a 'bigger voice' during the investment process," says Carmen Nuzzo, Head of Fixed Income at the PRI. "It will streamline ESG information collection, whilst providing opportunities for meaningful conversations with borrowers," she continues. "Its success now requires adoption, which we strongly urge, together with the other ESG IDP supporters."

THE ASSET MANAGERS

The ESG Integrated Disclosure Project (ESG IDP) has also brought together leading lenders in the private and syndicated credit markets to promote this greater harmonization and consistency of ESG indicators. Founding partners of this initiative include Apollo Global Management and Oak Hill Advisors who, along with the ESG IDP's Executive Committee, will spearhead efforts to promote the adoption of the ESG IDP template across the market.

"The ESG IDP represents an important step in addressing ongoing ESG disclosure challenges in the private credit markets," argues Michael Kashani, Head of ESG Credit at Apollo and the inaugural Chair of the ESG IDP. "We believe that this harmonized approach will increase the availability of ESG disclosure for both LPs and GPs."

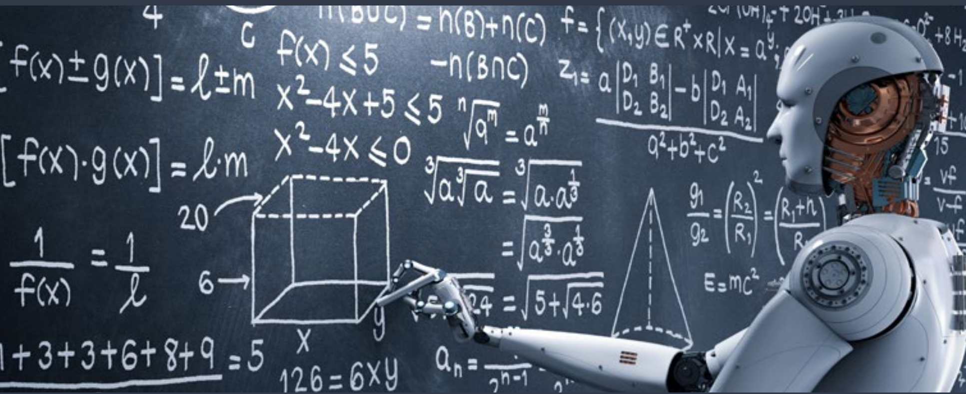
Jeff Cohen of Oak Hill Advisors goes on to emphasize that "the ESG IDP applies a credit lens to the globally-recognized SASB standards to prioritize the subset of ESG factors most likely to be core to a company's operations and, as a result, beneficial to lender underwriting." According to Cohen, who is Head of ESG & Sustainability at Oak Hill Advisors and the inaugural Vice Chair of the project, "the ESG IDP aligns with sponsor interests and addresses questionnaire fatigue felt by companies."

The ESG IDP is also supported by a coalition of market stakeholders including CDP, the ESG Data Convergence Initiative, and the Loan Market Association. "Reliable and accurate ESG information is vital in order for investors to channel capital into sustainable activities and companies," concludes Gemma Lawrence-Pardew, Head of Sustainability, Director – Legal, Loan Market Association. "The ESG Integrated Disclosure Project provides a clear and transparent approach for the disclosure of ESG information, and provides clarity to companies regarding the information investors need."

> "Investors and regulators have made it clear that the status quo is untenable, and the credit market recognizes the need for harmonized ESG reporting."

Tess Virmani

“Your single access point to the Nordic Hedge Fund Industry”



www.hedgenordic.com

GENERAL TERMS AND CONDITIONS

These are the terms and conditions which govern the use of „HedgeNordic Industry Report“, an online magazine edited and distributed by electronical means and owned, operated and provided by Nordic Business Media AB (the “Editor”), Corporate Number: 556838-6170, BOX 7285, SE-103 89 Stockholm, Sweden.

DISCLAIMERS AND LIMITATIONS OF LIABILITY

1. The Content may include inaccuracies or typographical errors. Despite taking care with regard to procurement and provision, the Editor shall not accept any liability for the correctness, completeness, or accuracy of the fund-related and economic information, share prices, indices, prices, messages, general market data, and other content of „HedgeNordic Industry Report“ (“Content”). The Content is provided “as is” and the Editor does not accept any warranty for the Content.

2. The Content provided in „HedgeNordic Industry Report“ may in some cases contain elements of advertising. The editor may have received some compensation for the articles. The Editor is not in any way liable for any inaccuracies or errors. The Content can in no way be seen as any investment advice or any other kind of recommendation.

3. Any and all information provided in „HedgeNordic Industry Report“ is aimed for professional, sophisticated industry participants only and does not represent advice on investment or any other form of recommendation.

4. The Content that is provided and displayed is intended exclusively to inform any reader and does not represent advice on investment or any other form of recommendation.

5. The Editor is not liable for any damage, losses, or consequential damage that may arise from the use of the Content. This includes any loss in earnings (regardless of whether direct or indirect), reductions in goodwill or damage to corporate.

6. Whenever this Content contains advertisements including trademarks and logos, solely the mandator of such advertisements and not the Editor will be liable for this advertisements. The Editor refuses any kind of legal responsibility for such kind of Content.

YOUR USE OF CONTENT AND TRADE MARKS

1. All rights in and to the Content belong to the Editor and are protected by copyright, trademarks, and/or other intellectual property rights. The Editor may license third parties to use the Content at our sole discretion.

2. The reader may use the Content solely for his own personal use and benefit and not for resale or other transfer or disposition to any other person or entity. Any sale of Contents is expressly forbidden, unless with the prior, explicit consent of the Editor in writing.

3. Any duplication, transmission, distribution, data transfer, reproduction and publication is only permitted by
   i. expressly mentioning Nordic Business Media AB as the sole copyright-holder of the Content and by
   ii. referring to the Website www.hedgenordic.com as the source of the information.

   provided that such duplication, transmission, distribution, data transfer, reproduction or publication does not modify or alter the relevant Content.

4. Subject to the limitations in Clause 2 and 3 above, the reader may retrieve and display Content on a computer screen, print individual pages on paper and store such pages in electronic form on disc.

5. If it is brought to the Editor’s attention that the reader has sold, published, distributed, re-transmitted or otherwise provided access to Content to anyone against this general terms and conditions without the Editor’s express prior written permission, the Editor will invoice the reader for copyright abuse damages per article/data unless the reader can show that he has not infringed any copyright, which will be payable immediately on receipt of the invoice. Such payment shall be without prejudice to any other rights and remedies which the Editor may have under these Terms or applicable laws.

MISCELLANEOUS

1. These conditions do not impair the statutory rights granted to the readers of the Content at all times as a consumer in the respective country of the reader and that cannot be altered or modified on a contractual basis.

2. All legal relations of the parties shall be subject to Swedish law, under the exclusion of the UN Convention of Contracts for the international sale of goods and the rules of conflicts of laws of international private law. Stockholm is hereby agreed as the place of performance and the exclusive court of jurisdiction, insofar as there is no compulsory court of jurisdiction.

3. Insofar as any individual provisions of these General Terms and Conditions contradict mandatory, statutory regulations or are invalid, the remaining provisions shall remain valid. Such provisions shall be replaced by valid and enforceable provisions that achieve the intended purpose as closely as possible. This shall also apply in the event of any loopholes.