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RESPONSIBLE HORIZONS EM DEBT IMPACT STRATEGY
Q&A WITH SIMON COOKE

IN THIS Q&A, PORTFOLIO MANAGER SIMON COOKE PROVIDES SOME HELPFUL INFORMATION FOR INVESTORS ABOUT THE RESPONSIBLE HORIZONS EM DEBT IMPACT STRATEGY. HE OUTLINES WHAT IT AIMS TO ACHIEVE, HOW HE APPROACHES INVESTING AND IDENTIFIES SOME OF THE OPPORTUNITIES HE BELIEVES MAY BE CURRENTLY AVAILABLE, AND THE ASSOCIATED RISKS.

Q1: WHAT ARE THE MAIN AIMS AND OBJECTIVES OF THE STRATEGY AND WHAT TYPES OF ASSETS DOES IT INVEST IN?

We consider the potential scale and scope of creating impact through investment in emerging markets (EM) as huge. The impact opportunity set in emerging market debt (EMD) has grown substantially in recent years. There was more than US$300bn outstanding in hard currency impact bonds as we define below alone as at the end of May 2023[1], and similar to conventional EMD, offering a structural yield premium over similar bonds from developed market issuers.

The strategy has a sustainable investment objective as it aims to achieve positive environmental and/or social impacts while generating a total return comprised of income and capital growth by investing in emerging market debt and debt-related securities and related financial derivative instruments. It invests in issues available in the hard currency opportunity set in EMD, with at least 70% in EM corporate debt, seeking the 'best ideas' from three investment types:

- **Impact bonds**: these are bonds that specify their proceeds will be used to have a positive environmental or social impact. These are commonly known as 'use of proceeds' bonds. Common types include green bonds, social bonds and sustainability bonds.
- **Impact issuers**: these are bonds from issuers whose business activity is expected to contribute or lead to positive ESG impacts. For our strategy, we define this as an issuer with at least 50% of revenue linked to positive environmental and/or social impacts using the UN Sustainable Development Goals (SDGs) as a guide or where at least 50% of their economic activities are compliant with the EU Taxonomy Regulation.
- **Improving issuers:** these are bonds from issuers whose core investment plans (affecting at least 50% of their revenue streams, capital expenditure, or operating expenditure including non-capitalised costs that represent research and development) are compliant with the EU Taxonomy Regulation.

Q2: WHAT IS THE MAIN TARGET AUDIENCE FOR THE STRATEGY AND HOW IS IT DIFFERENTIATED FROM OTHER EMERGING MARKET IMPACT STRATEGIES?

The strategy is aimed at those investors wanting to mobilise their capital to pursue not only potential financial returns, but also to further positive environmental and/or social impacts such as social inclusion, environmental sustainability, and communal prosperity. We believe it is particularly suitable for those investors concerned with supporting long-term positive change in emerging markets, which provides a greater opportunity to make an impact relative to developed markets, while seeking to capture the yield premium we see on offer there.

The strategy is one of the Responsible Horizons impact strategies managed by Insight. It aims to emphasise the best and avoid the worst performers on environmental, social and/or governance (ESG) issues and to avoid certain investments with a negative impact.

Our Responsible Horizons EM Debt Impact strategy is deliberately broad-based. We include other different types of impact bond in the strategy, as well as bonds from impact issuers and improving issuers, rather than adopting a narrow impact focus, such as only buying green bonds.

[1] Source: Bloomberg

We believe our approach is superior. Our strategy is deliberately broad-based, given the wide-ranging needs we see in EM and across three key themes we have identified as **People**, **Planet** and **Prosperity**. We aim to encompass more than just green bonds, by including other different types of impact bond in the strategy, as well as bonds from impact issuers and improving issuers. However, we do so with strict thresholds, aiming to invest only where our analysis shows the majority of the issuer's activity is generating a positive impact, depending on availability and quality of data and certain other factors. We believe that means we can access a broader universe, with potentially higher yields, better diversification, and wider impact, while still attempting to ensure real positive change is achieved.

Q3: WHAT IS YOUR INVESTMENT APPROACH?

As part of how we manage the strategy, we seek to invest in and partner with fundamentally resilient issuers that are focused on supporting or providing solutions to environmental and/or social challenges in EM, while also aiming to deliver attractive financial returns. It is managed in an active, unconstrained investment style. We expect to build portfolios that are well-diversified by issuer, sector, and geography, such that idiosyncratic risk does not overly dominate returns.

Impact is woven through relevant aspects of the strategy, which aims to target the themes of People, Planet and Prosperity we have identified and mapped to each of the UN SDGs and the EU Taxonomy. Relevant potential investments are subject to our impact assessment framework analysing ESG performance, impact alignment, and impact reporting. We aim, where appropriate, to assign relevant key performance indicators (KPIs) for each holding to track their impact performance over time. At least 50% is invested in impact bonds, with the remainder invested in bonds from impact issuers or improving issuers and other assets, such as cash. Where possible, we plan to report periodically as we track impact alignment, activity, and outcomes.

Q4: WHERE DO YOU SEE THE MAIN OPPORTUNITIES AND RISK ACROSS EMERGING MARKETS IN 2023?

Globally – not just in EM – markets continue to be driven by macro concerns: growth, rates, inflation and geopolitics. We do not expect this to change in the short term, but we believe impact investors need to look at the next three to five years as their investment horizon, not the next three to six months.

As we look out toward the longer term, we are positive on EM corporates. Over the past year, EMD has been significantly repriced, both versus its own history and versus developed markets. EM corporate debt spreads are now at, or close to, historical wides versus comparators, offering one of, if not the highest duration-adjusted yield available in fixed income markets. Yet outside some particular areas, EM corporate fundamentals appear at their strongest in a decade, and many companies have been actively repurchasing their debt over the past year.

We have seen a substantial increase in impact-related issuance, presenting opportunities aimed at reducing poverty, providing affordable and clean energy, and connecting people to the internet for the first time, transforming lives and, in our view, creating a more sustainable world. We believe that the combination of tangible impact alongside supportive valuations, fundamentals, and technical factors, creates what may be a very attractive entry point for impact investors with a long-term view.

Within an asset class as large and varied as EMD – by our estimates about US$4tn in hard currency debt from 100 countries across five continents[2] – we maintain that investors should always be selective. We expect certain frontier sovereigns to encounter problems due to the volatile macro environment, rising interest rates, and reduced funding windows. We are cautious on China in impact strategies given the political, social and economic trends we observe, and the potential implications for impact investors, but elsewhere the current broad-based market dislocation is creating myriad possibilities for active, long-term impact investors like Insight.

Q5: ARE THERE ANY TYPES OF INVESTMENTS THAT YOU EXCLUDE FROM YOUR STRATEGY?

The strategy will exclude investments we believe are misaligned with, or causing significant harm to, one or more of our environmental and social objectives. That means we will not invest in issuers materially involved in sectors we consider to be unsuitable for the strategy's objectives, such as gambling, tobacco, or defence. The strategy will exclude issuers judged to have high carbon risks, or breaches of internationally accepted norms on such subjects as bribery, labour rights or environmental impact. For issuers involved in environmentally sensitive industries, such as coal power generation, or oil and gas extraction, the strategy will only take exposure via impact bonds where we believe the issuer has a clearly defined, long-term plan to address its environmental impact and the instrument issued meets our ESG criteria. Similarly, for issuers generating more than 5% of revenues from involvement in nuclear power generation, the strategy will only take exposure via impact bonds which do not specifically fund nuclear activity, and where the issuers fulfil nuclear and environmental safety requirements. Other exclusions and restrictions may apply, and information on those may generally be found in the prospectus and guidelines of any fund applying the strategy.

[2] Insight Investment estimate as at 31 May 2023.

Q6: HOW CAN FIXED INCOME INVESTORS BEST SUPPORT SUSTAINABLE INVESTMENT OUTCOMES IN EMERGING MARKETS AND HOW CAN THEY BEST AVOID SO-CALLED 'GREENWASHING'?

In our view, for EMD, impact bonds provide an excellent core allocation for investors seeking such outcomes. These are bonds that specify their proceeds will be used to have a positive environmental or social impact. To have a meaningful positive impact in EM, we believe investors should also look more broadly, to those issuers whose very business model or investment plans will generally generate positive environmental and/or social impact, which we have named impact issuers and improving issuers. This widens the type of impact, the geography of impact, and the investment universe to best support sustainable investment outcomes.

In order to avoid 'greenwashing', we believe it is critical managers perform rigorous impact analysis. Since we started analysing impact bonds in 2017 to the end of 2022, roughly 20% of all impact bonds we have analysed failed our impact assessment framework, meaning they would be excluded from this strategy. We are keen that portfolios following this strategy demonstrate alignment with the themes of People, Planet and Prosperity. We have set the bar high, but consciously so[3].

IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

Any target performance aims are not a guarantee, may not be achieved and a capital loss may occur. The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies over time, and/or prevailing market conditions and are not an exact indicator. They are speculative in nature and are only an estimate. What you will get will vary depending on how the market performs and how long you keep the investment/product. Strategies which have a higher performance aim generally take more risk to achieve this and so have a greater potential for the returns to be significantly different than expected.

Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialize or vary significantly from the actual results. Accordingly, the projections are only an estimate.

Portfolio holdings are subject to change, for information only and are not investment recommendations.

ASSOCIATED INVESTMENT RISKS

ESG

- **Investment type:** The application and overall influence of ESG approaches may differ, potentially materially, across asset classes, geographies, sectors, specific investments or portfolios due to the nature of the specific securities and instruments available, the wide range of ESG factors which may be applied and ESG industry practices applicable in a particular investable universe.
- **Integration**: The integration of ESG factors refers to the inclusion of ESG risk factors alongside financial risk factors in investment analysis and research to judge the fair value of a particular investment and may also include the monitoring and reporting of such risks within a portfolio. Integrating ESG factors in this way will not typically restrict the potential investable universe, but rather aims to ensure that relevant and material ESG risks are taken into account by analysts and/or portfolio managers in their decision-making, alongside other relevant and material financial risks.
- **Ratings**: The use and influence of our ESG ratings in specific investment strategies will vary, potentially significantly, depending on a number of factors including the nature of the asset class and the structure of the investment mandate involved. For an investment portfolio with a financial objective, and without specific ESG or sustainability objectives, a high or low ESG rating may not automatically lead to a buy or sell decision: the rating will be one factor among others that may help a portfolio manager in evaluating potential investments consistently.
- **Engagement activity**: The applicability of Insight firm level ESG engagement activity and the outcomes of this activity relating to buy, hold and sell decisions made within specific investment strategies will vary, potentially significantly, depending on the nature of the asset class and the structure of the investment mandate involved.
- **Reporting**: The ESG approach shown is indicative and there is no guarantee that the specific approach will be applied across the whole portfolio.
- **Performance/quality**: The influence of ESG criteria on the overall risk and return characteristics of a portfolio is likely to vary over time depending on the investment universe, investment strategy and objective and the influence of ESG factors directly applicable on valuations which will vary over time.
- **Costs**: The costs described will have an impact on the amount of the investment and expected returns.
- **Forward looking commitments and related targets**: Where we are required to provide details of forward-looking targets in line with commitments to external organisations, e.g. Net Zero Asset Managers Initiative, these goals are aspirational and defined to the extent that we are able and in accordance with the third party guidance provided. As such we do not guarantee that we will meet them in whole or in part or that the guidance will not evolve over time. Assumptions will vary, but include whether the investable

[3] For more information, please see the Responsible Investment page on our website.

universe evolves to make suitable investments available to us over time and the approval of our clients to allow us to align their assets with goals in the context of the implications for their investments and issues such as their fiduciary duty to beneficiaries.

Insight applies a wide range of customised ESG criteria to mandates which are tailored to reflect individual client requirements. Individual investor experience will vary depending on the investment strategy, investment objectives and the specific ESG criteria applicable to a Fund or portfolio. Please refer to the investment management agreement or offering documents such as the prospectus, Key Investor Information Document (KIID) or the latest Report and Accounts which can be found at www.insightinvestment.com and where applicable information in the following link for mandates in scope of certain EU sustainability regulations https://www.insightinvestment.com/regulatory-home/sustainability-regulations/; alternatively, speak to your main point of contact in order to obtain details of specific ESG parameters applicable to your investment.

Fixed income

- Where the portfolio holds over 35% of its net asset value in securities of one governmental issuer, the value of the portfolio may be profoundly affected if one or more of these issuers fails to meet its obligations or suffers a ratings downgrade.
- A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.
- The issuer of a debt security may not pay income or repay capital to the bondholder when due.
- Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.
- Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.
- Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.
- Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.
- The investment manager may invest in instruments which can be difficult to sell when markets are stressed.
- Exposure to international markets means exposure to changes in currency rates which could affect the value of the portfolio.
- Where leverage is used as part of the management of the portfolio through the use of swaps and other derivative instruments, this can increase the overall volatility. While leverage presents opportunities for increasing total returns, it has the effect of potentially increasing losses as well. Any event that adversely affects the value of an investment would be magnified to the extent that leverage is employed by the portfolio. Any losses would therefore be greater than if leverage were not employed.

FIND OUT MORE

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