

ESG –Increasingly in the News

ESG & SRI Quarterly Letter

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ESG Considerations in the News

Environmental, Social and Governance (“ESG”) factors received significant coverage in the news in the first quarter. Top news stories included ESG pressures on lending practices at major banks, the establishment of new ESG indices in the market, and companies integrating ESG into their overall business plans and corporate initiatives. The World Bank also released a study on green bonds.

For Shenkman Capital, it is important to reiterate that we view ESG factors as a constant part of the investment process across our strategies, not just something to be considered for a special fund or product. ESG factors can impact the risk and relative value of an investment in many ways. One of the considerations in measuring ESG risks is how missteps or public pressures can rapidly impact a company’s access to capital. Sometimes these pressures may cause banks to avoid lending to certain companies.

In the News: ESG Pressure on Bank Lending Practices

Two of the top news items during the quarter involved ESG factors impacting banks’ willingness to lend to select industries. JP Morgan announced that it would no longer finance the private prison industry. While this industry clearly has the potential to be controversial and has many social risks, it is not a sector that has typically come up on most ESG or Socially Responsible Investing (“SRI”) lists. Organizations described by the press as “non-profit” and “political” published a letter urging JP Morgan and Wells Fargo to stop financing the two largest private prison operators and JP Morgan agreed. While these companies are effectively contractors for the government and do not set policy, this news highlights why understanding both social and related political risk are as critical as governance and environmental concerns. While the bonds of the two main companies continue to trade reasonably well relative to market indices, this news item heightened volatility and raised the focus on their ability to access capital.

The U.K. based bank HSBC also came under considerable pressure from some large investors that want the bank to avoid funding new coal driven power stations. Obviously, this not only impacts utilities but companies involved in coal production and transportation as well. The bank itself had addressed plans to stop funding many coal projects about a year ago, with a plan to wind down even more by 2023. Investors appear to be demanding more. In related news, Glencore announced it would cap its coal production and the Norwegian government recommended its sovereign wealth fund exit upstream investments in energy – though it did not mention integrated energy companies in its

recommendation. All of these news items focus on areas of energy production that have regularly come under scrutiny for environmental risks; however, investor activism on these topics appears to be escalating significantly in the U.K. and Europe. Even if a risk is flagged, simply using a checklist may not be enough. We believe it is necessary to have an analytical team that stays abreast of developments and news around those risks as active management of these factors is critical.

In the News: ESG Indices Developments

While it may be hard to imagine that the world needs additional investment indices, an increasing number of ESG and SRI related indices have been rolled out or are expected to be rolled out. Most notably, JP Morgan introduced an ESG benchmark for high yield credits and S&P Dow Jones announced an S&P 500 ESG Index. Specialized index benchmarks can be important, but we reiterate that while ESG factors can be the basis for a specialized product, we believe they should be embedded in all investments.

In the News: ESG Corporate Focus

We note two companies in the food industry that are increasingly dedicating resources to managing ESG risks and opportunities. Darling Ingredients highlighted ESG factors on its earnings call and also notes them on the front page of its investor relations website. Cott hired an ESG focused executive and discussed the importance of ESG on its earnings conference call.

In the News: Green Bonds

The World Bank, which has raised US\$13 billion through almost 150 green bonds, published a study on green bonds. Not surprisingly the study found green bonds have helped lower costs for companies and have helped reduce greenhouse gases. Green bonds remain a very small portion of the global bond market, but an important tool in investment grade SRI investing. There is an estimated \$580 billion of green bonds that have been sold since 2018 and some estimates expect another \$170-180 billion 2019. The vast majority of green bonds have come from investment grade issuers and the Netherlands is supposed to be the first AAA issuer of a green bond during the month of April. Spain is also reported to be considering issuing green bonds as well.

Conclusion

We believe ESG will be increasingly in the news during the year. While the level of news media coverage on ESG & SRI may ebb and flow, ESG considerations are vital components of the investment process and they should be considered all times. We believe they will continue to impact returns, as corporate focus and investor & customer activism increase.

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