IR+M INCOME RESEARCH + MANAGEMENT

IR+M UPDATE

What's In Your ESG?

March 23, 2018

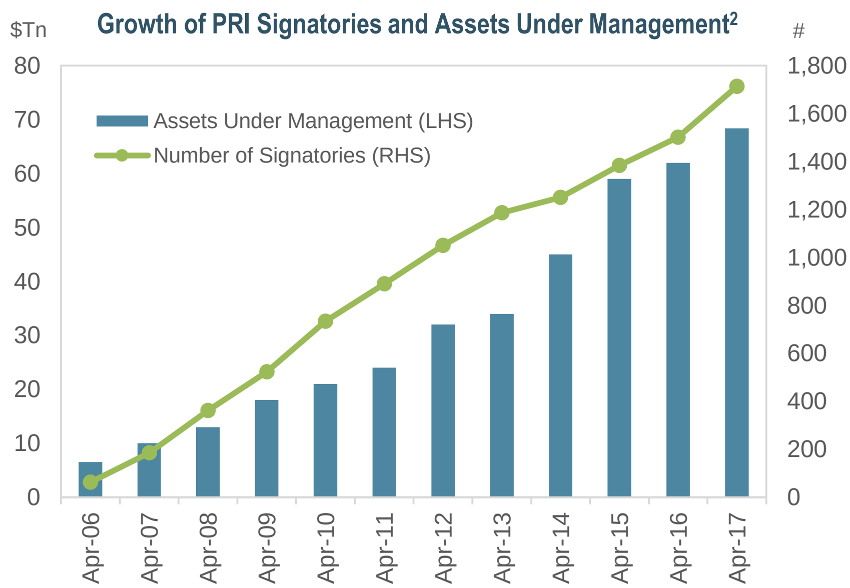
What was a trend is now a movement driven by ethically motivated investors. Equity and, more recently, fixed income investors are increasingly incorporating environmental, social, and governance (ESG) factors into their investment decisions. This change has been sparked by the view that profit and planet may not be mutually exclusive. At IR+M, we believe that ESG integration within fixed income can enhance investment performance and mitigate risk. Our commitment to ESG is evident in our approach to both credit research and corporate social responsibility.

Decoding Alphabet Soup

The alphabet soup that is Responsible Investment (RI) can be difficult to decode. RI includes Socially Responsible Investing (SRI), Impact Investing (II), Thematic Investing, and ESG – approaches that are related, but not synonymous. With SRI, investors use negative screens to intentionally avoid sectors that may be environmentally or socially harmful. With II, investors seek out organizations that effect constructive environmental or social change – and provide a positive financial return. With Thematic Investing, issuers are selected in accordance with a specific theme, such as climate change. In contrast, ESG is a more holistic approach that integrates environmental, social, and governance factors into investment decisions, regardless of investor motivation. By ignoring ESG factors, investors may be overlooking risks and opportunities that could have a significant impact on performance.[1]

ESG Is Here To Stay

Historically, investor concerns over performance have been the root cause of a reluctance to embrace ESG. The view that ESG narrows the investable universe, and violates the fiduciary responsibility to maximize returns, is giving way to the belief that ESG can enhance results. The growth of the ESG mindset is evident in the rising number of Principles for Responsible Investment (PRI) signatories. The signatories, which exceed 1,700 in number and $68 trillion in global assets under management, pledge to uphold the six Principles for Responsible Investment.[2] These six Principles serve as an aspirational guide for those investors who endeavor to integrate ESG issues into investment practice.



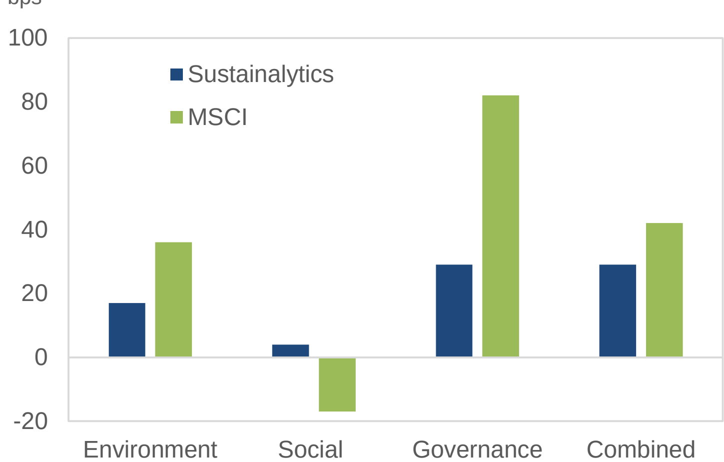
The Power Of The Purse

The drive to integrate ESG into investment decisions has been gaining momentum. In 2016, $8.1 trillion of US professionally managed assets – 20% of total – were invested in ESG portfolios; in 2014, it was $6.2 trillion.[3] The growth may be attributed to the fading belief that ESG hampers investment results. It may also be in response to a seismic shift in who controls the purse. An estimated $30 trillion in wealth will transfer from baby boomers to their heirs, which include 90 million millennials.[4] Women, who could control two-thirds of private wealth by 2020, are another emerging economic powerhouse.[5] These demographics are keenly interested in responsible investing. 86% of millennials, and 84% of women, believe in using wealth to advance positive change and endorse corporate social responsibility.[6]

[1]Principals for Responsible Investment (PRI). [2]PRI as of April 2017. [3]Forum for Sustainable and Responsible Investment. [4]Investment News. [5]Time Magazine. [6]Morgan Stanley Institute for Sustainable Investing, Sustainable Signals 2017. The views contained in this report are those of IR+M and are based on information obtained by IR+M from sources that are believed to be reliable.

The Growing Fixed Income Agenda

Portfolios with Higher ESG Scores Outperform[8]



Equity investors were early adopters of ESG, but fixed income investors, who represent 8% of PRI signatories, are narrowing the gap.[7] Fixed income investors are inherently focused on mitigating risk, which is the crux of ESG investing. After long supporting equities, emerging quantitative evidence has validated the benefits of ESG within fixed income. According to a Barclay's study, US investment grade corporate bond portfolios with higher ESG scores outperform those with lower ones. The study, which focused on a seven-year time frame, used both Sustainalytics and MSCI as the source of the ESG scores. With Sustainalytics and MSCI, the higher tilt ESG portfolios outperformed the lower tilt ones by an average of 29bps and 42bps, respectively, each year.[8]

How IR+M Does ESG

Our incorporation of ESG factors into the investment process pre-dates becoming a PRI signatory in 2013. By signing the Principles, we formalized our commitment to integrate ESG factors into our bottom-up security selection process. For each issuer, our analysts evaluate the three ESG pillars, which are sub-divided into 9 themes and 30 issues. We use external providers for ESG data and rankings, and conduct proprietary, sector-level benchmarking for key metrics. Additionally, we are actively engaged with issuers' senior management teams. As fixed income investors, we do not have shareholder voting rights. Therefore, we use meetings with management to foster a dialogue on all matters, including those related to ESG. Ultimately, it is this mosaic theory that helps us determine issuers' long-term sustainability.

Themes and Issues Differ by Sector[9]

Environmental (E)	Social (S)	Governance (G)
Climate Change	**Human Capital**	**Corporate Governance**
Greenhouse Gas Emissions ▲■●	Labor Relations, Mgmt, Inclusion, & Diversity ▲■●	Board ▲■●
Climate Change Risk Mgmt ●	Employee Health, Safety, & Well-being ▲■●	Compensation ▲■●
Natural Resource Use	**Product Mgmt**	Shareholder Rights ▲■●
Water and Wastewater Mgmt ▲■●	Product Safety and Quality ■	Audit ▲■●
Biodiversity Impacts ▲●		**Corporate Behavior**
Waste		Business Ethics ▲■●
Waste and Pollution ▲■●		Anti-Competitive Practices ▲■●
		Corruption & Bribery ▲■

▲ Independent Energy ■ Media Entertainment ● Utilities

Beyond our investment process, we have a cross-functional ESG committee, with members from the investment, product management, client service, and compliance teams. The committee is focused on advancing our ESG capabilities as a fixed income asset manager. We also have a Sustainability Task Force, which advocates reducing our carbon footprint at the office and at home. Our firm's commitment to ESG is all-encompassing.

ESG investing is moving up the agenda for fixed income investors. At IR+M, we believe that it is our fiduciary responsibility to incorporate ESG into our investment decisions. By integrating ESG factors into our bottom-up security selection process, we feel that we can generate enhanced performance with reduced risk. Our commitment to ESG is pervasive, and extends to our pledge to be strong corporate stewards for our clients and community.

[7]PRI as of April 2017. [8]Barclays, Sustainable Investing and Bond Returns, November 2016. [9]Chart is for illustrative purposes only, and is not a complete list of all categories considered. As of March 2018, the views contained in this report are those of IR+M and are based on information obtained by IR+M from sources that are believed to be reliable. This report is for informational purposes only and is not intended to provide specific advice, recommendations for, or projected returns of any particular IR+M product.