

ESG in Credit: from risk mitigation to performance enhancement?

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WHAT IS ESG?

A set of factors that go beyond conventional financial analysis and seek to capture material issues for equity and fixed income investors. These factors typically include:

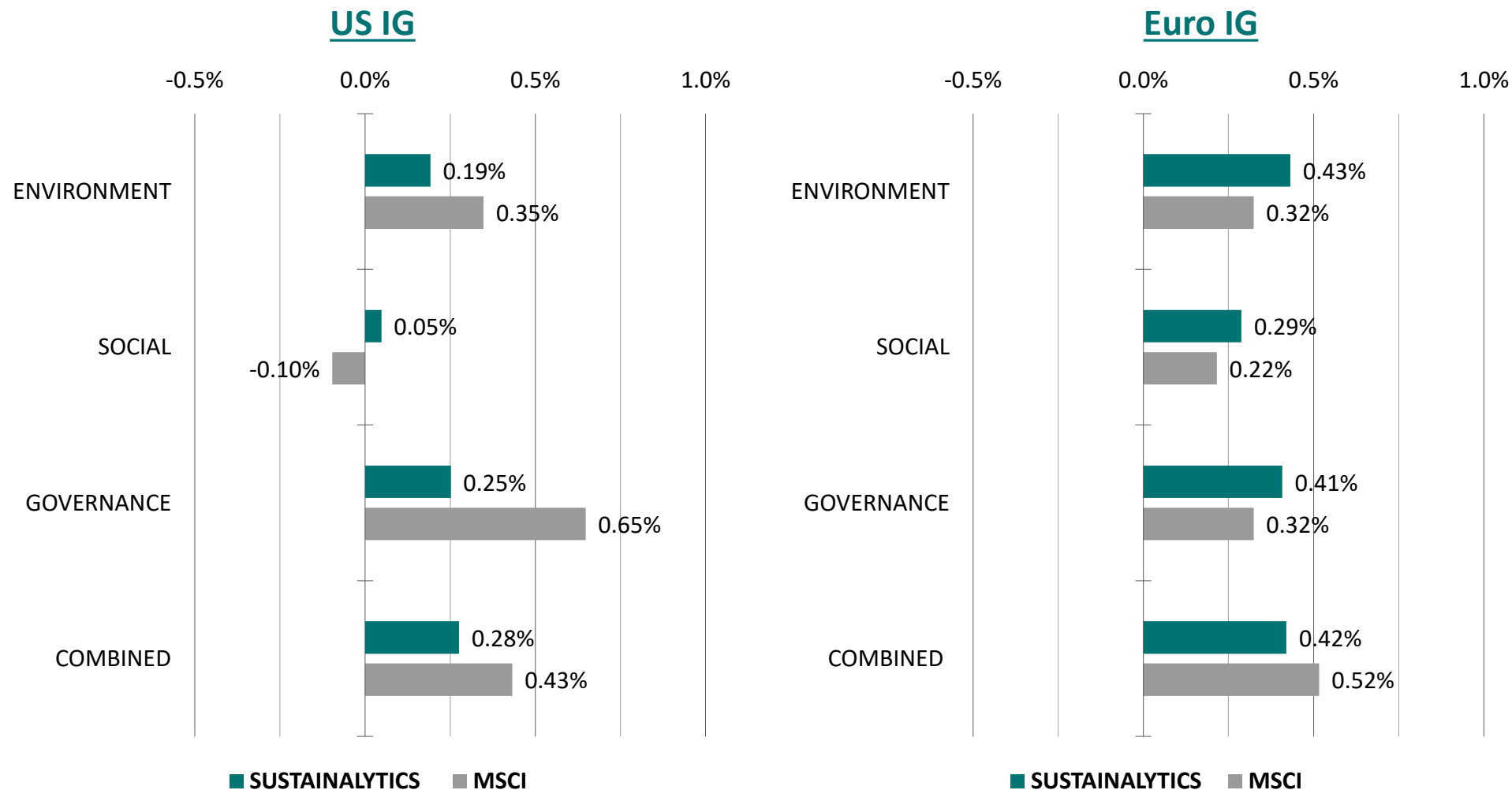
	COMPANIES	SOVEREIGN
Environmental	<ul style="list-style-type: none"> ➤ Greenhouse gas emissions ➤ Pollution incidents ➤ Water scarcity 	<ul style="list-style-type: none"> ➤ Management of natural resources ➤ Transition to a low carbon economy ➤ Adaptation to climate change
Social	<ul style="list-style-type: none"> ➤ Employees and suppliers ➤ Public health impacts ➤ Local communities 	<ul style="list-style-type: none"> ➤ Healthcare ➤ Education ➤ Labor rights
Governance	<ul style="list-style-type: none"> ➤ Board functioning ➤ Executive remuneration ➤ Shareholders' rights 	<ul style="list-style-type: none"> ➤ Political system ➤ Human rights ➤ Corruption

IS ESG IN THE BEST INTEREST OF CREDIT INVESTORS?

1. Can ESG generate performance in a credit portfolio?
2. Does ESG enrich traditional credit analysis?
3. Does a 'tick-box' ESG approach work in credit management?

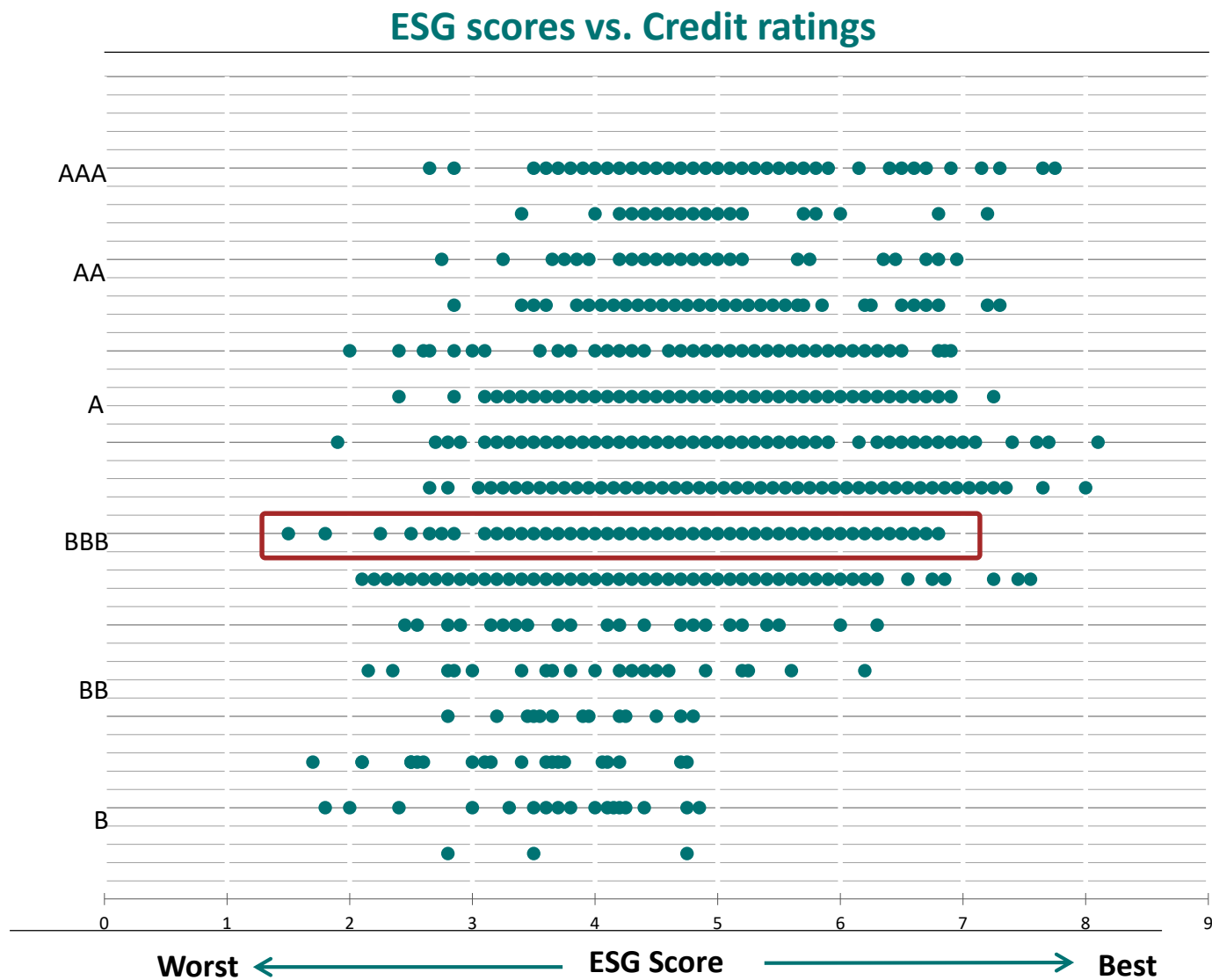
CAN ESG GENERATE PERFORMANCE IN A CREDIT PORTFOLIO?

Annual return difference between portfolios with high and low ESG scores in the US & Euro IG Market



Source: Barclays 'ESG investing in credit: A broader and deeper look'. Data from August 2009 to April 2018. Bloomberg Barclays Indices, MSCI ESG Research, Sustainalytics

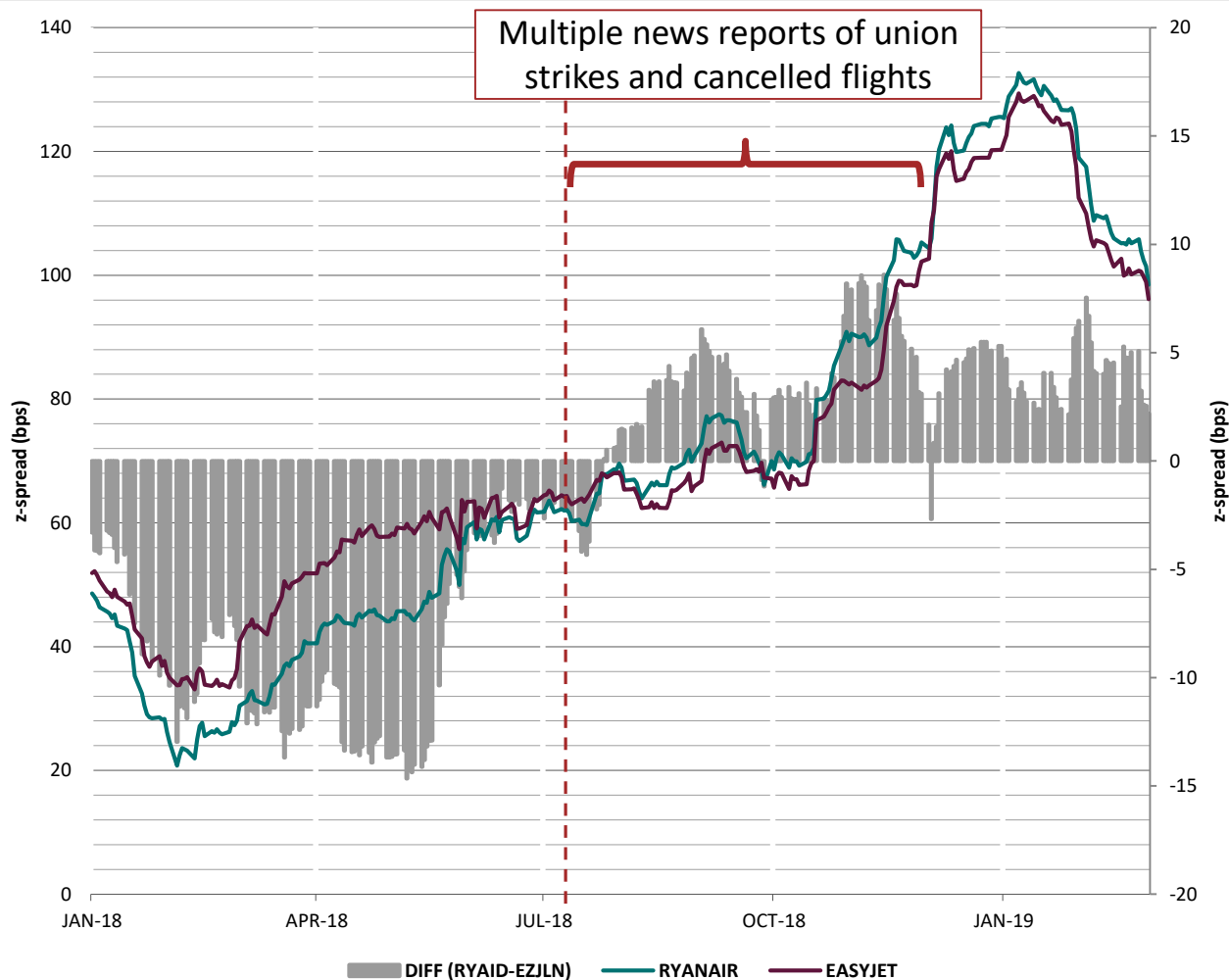
DOES ESG ENRICH TRADITIONAL CREDIT ANALYSIS?



Source: MSCI, Bloomberg Barclays Indices, S&P as of 2016

DOES ESG ENRICH TRADITIONAL CREDIT ANALYSIS?

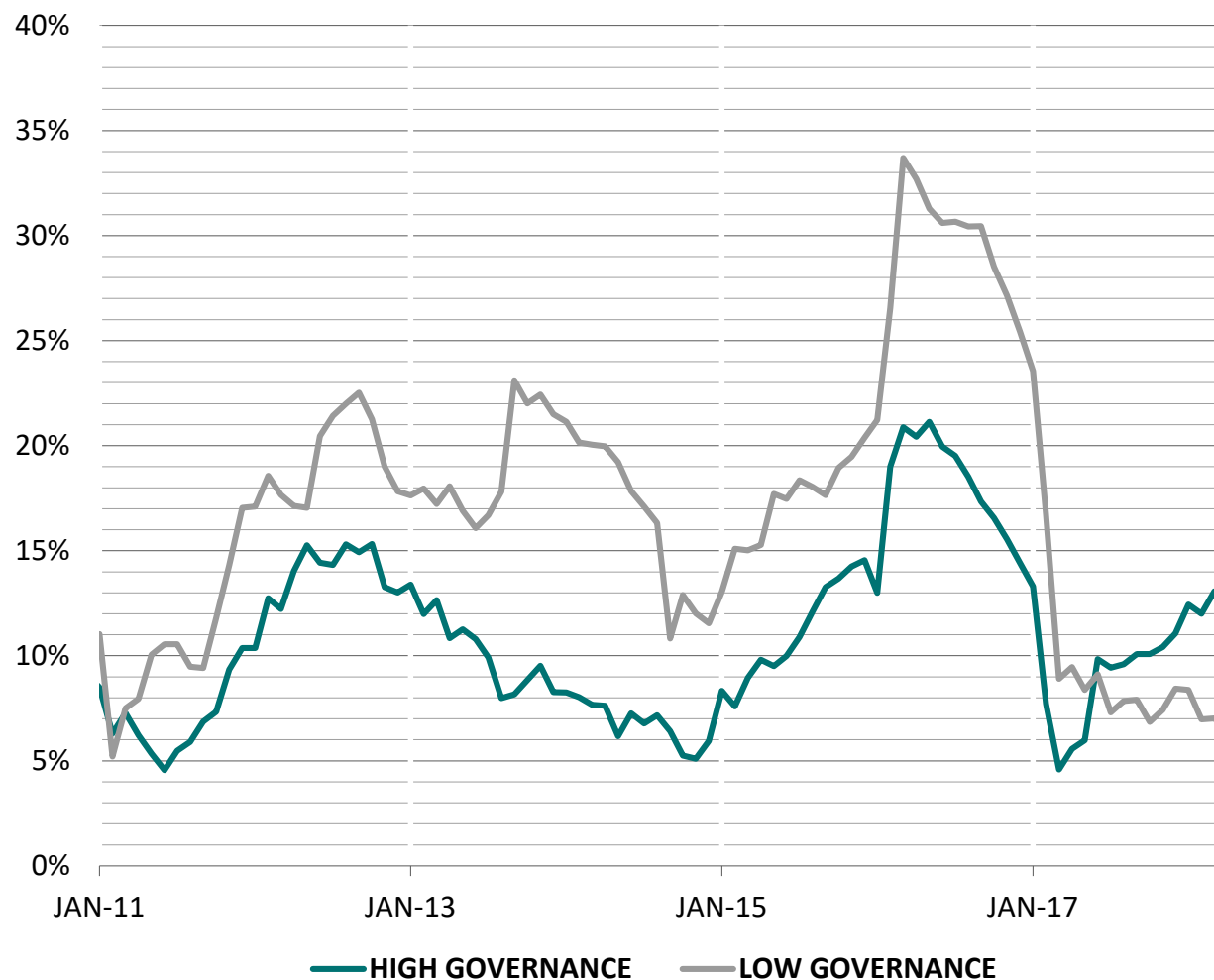
Credit spread evolution between Ryanair & Easyjet



Source: Bloomberg, Pictet Asset Management as of 28.02.2019

DOES ESG ENRICH TRADITIONAL CREDIT ANALYSIS?

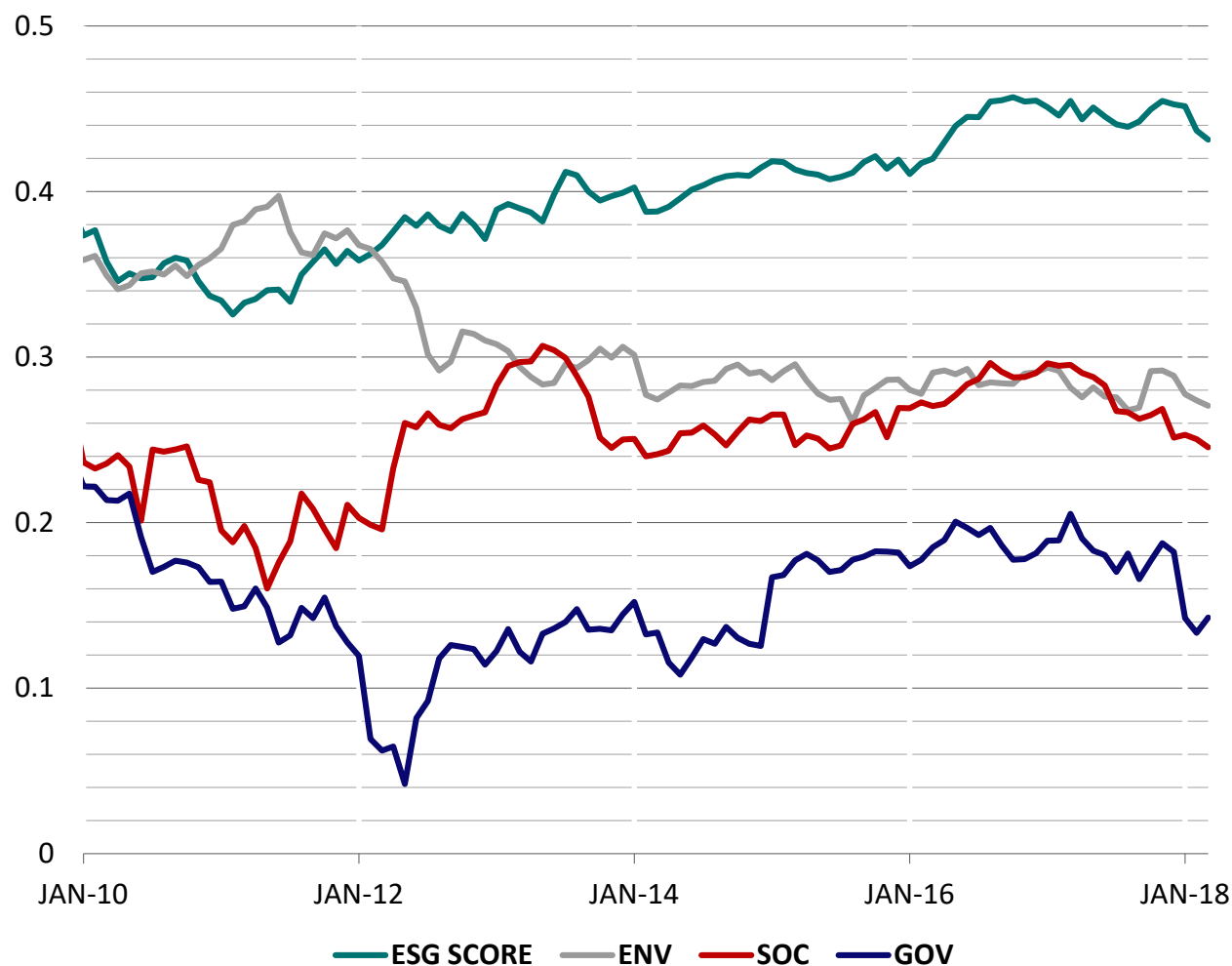
Credit downgrades for high & low governance companies



Source: Barclays 'ESG investing in credit: A broader and deeper look'. Data from August 2009 to April 2018. Rolling average number of credit downgrade per issuer and per year on the US IG market. Bloomberg Barclays Indices, MSCI ESG Research

DOES A 'TICK-BOX' ESG APPROACH WORK IN CREDIT MANAGEMENT?

Correlations between scores of 2 ESG providers



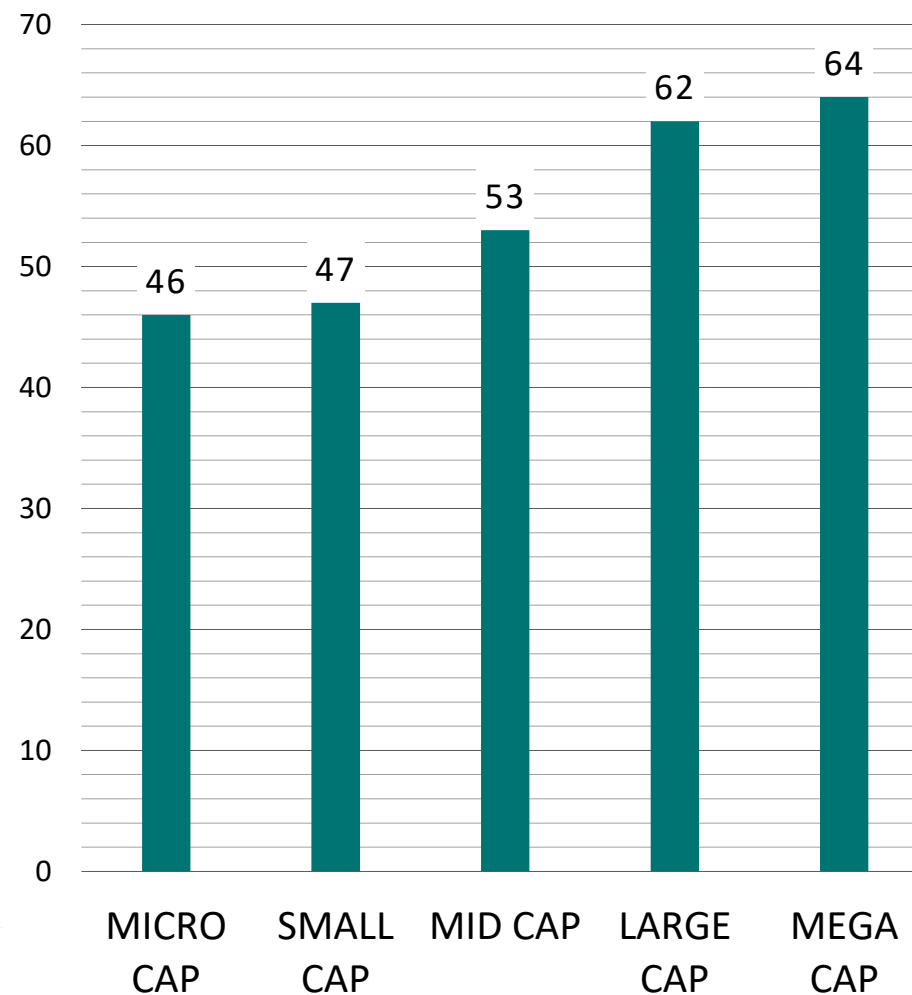
Source: Barclays 'ESG investing in credit: A broader and deeper look'. Data from August 2009 to April 2018. Monthly rank correlations between the E, S, G and ESG scores of the two providers. MSCI ESG Research, Sustainalytics.

DOES A 'TICK-BOX' ESG APPROACH WORK IN CREDIT MANAGEMENT?

Characteristics of high and low ESG portfolios

	LOW	HIGH
Average ESG Score	51	70
Spread over Treasury bonds (bp)	162	131
Rating Quality	Baa1	A2

Average ESG score by market cap

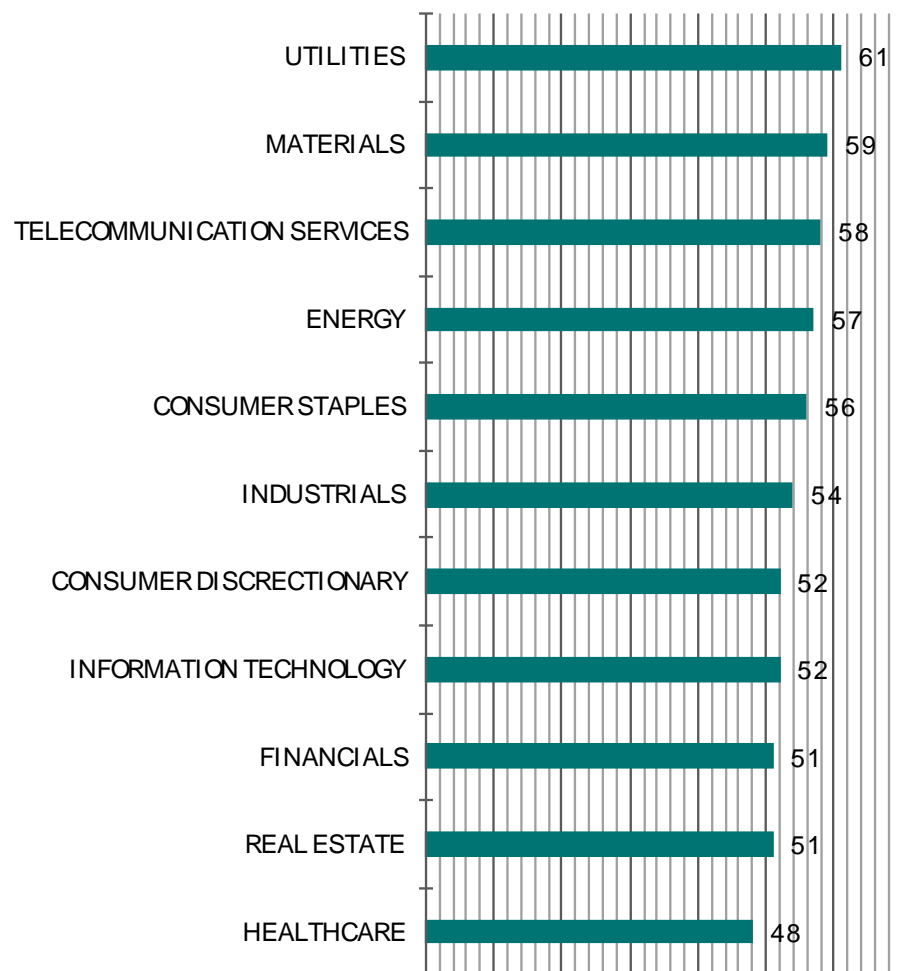


Source: Barclays 'ESG investing in credit: A broader and deeper look'. Average differences in characteristics between high and low ESG portfolios (2009-18) for the US IG market. Bloomberg Barclays Indices, Sustainalytics

Source: ACCF 'The subjective world of ESG rating agencies'; Data for 4150 companies. Sustainalytics.

DOES A 'TICK-BOX' ESG APPROACH WORK IN CREDIT MANAGEMENT?

Average ESG score by industry



Source: ACCF 'The subjective world of ESG rating agencies'. Data for 4150 companies. Sustainalytics

Governance score example

Stanley Black & Decker, Inc. (SWK)

Stanley Black & Decker, Inc. provides tools and storage, engineered fastening and infrastructure, and security solutions worldwide.
www.stanleyblackanddecker.com

REGION
US - S&P5
COUNTRY
USA
INDUSTRY G
Capital Gc

QUALITYSCORE OVERVIEW

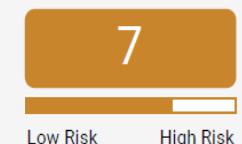
Board Structure 2

- Board Composition
- Composition of the Committees
- Board Practices
- Board Policies
- Related Party Transactions
- Controversies

Shareholder Rights 10

- One Share One Vote
- Takeover Defenses
- Other Issues
- Meeting and Voting Related Issues

QualityScore



Scores indicate decile rank relative to index or region. A decile score of 1 indicates lower governance risk, while a 10 indicates higher governance risk.

Compensation 4

- Pay For Performance
- Non-Performance Based Pay
- Use Of Equity
- Equity Risk Mitigation
- Communications and Disclosure
- Termination
- Controversies

Audit & Risk Oversight 1

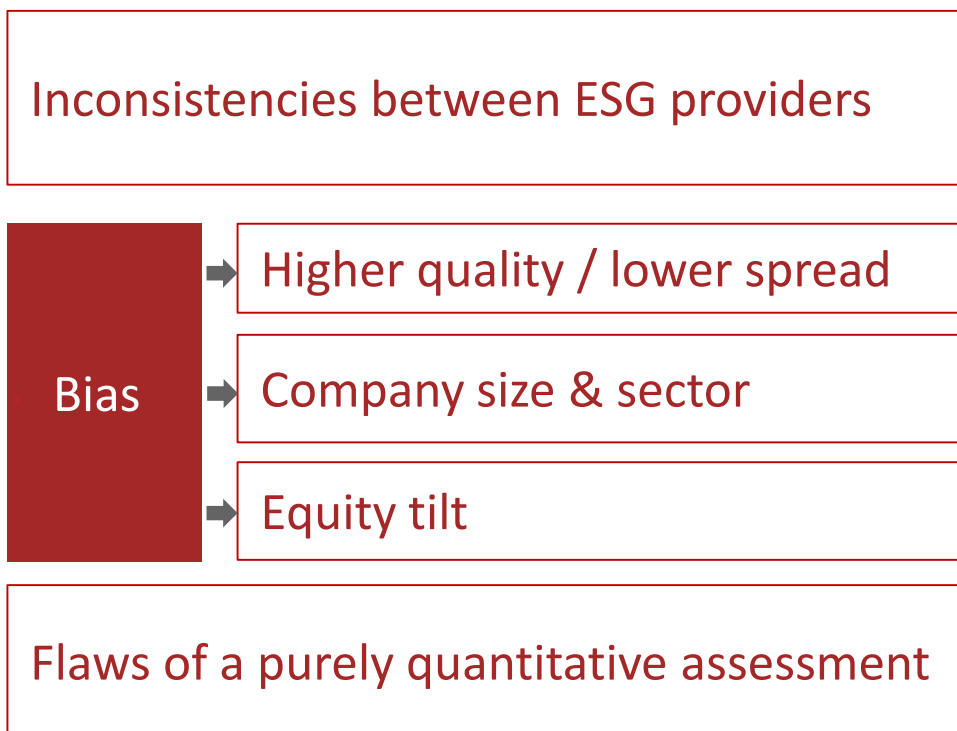
- External Auditor
- Audit and Accounting Controversies
- Other Issues

The total number of points in this subcategory is at the ★ top ■ bottom ● middle of the possible range.

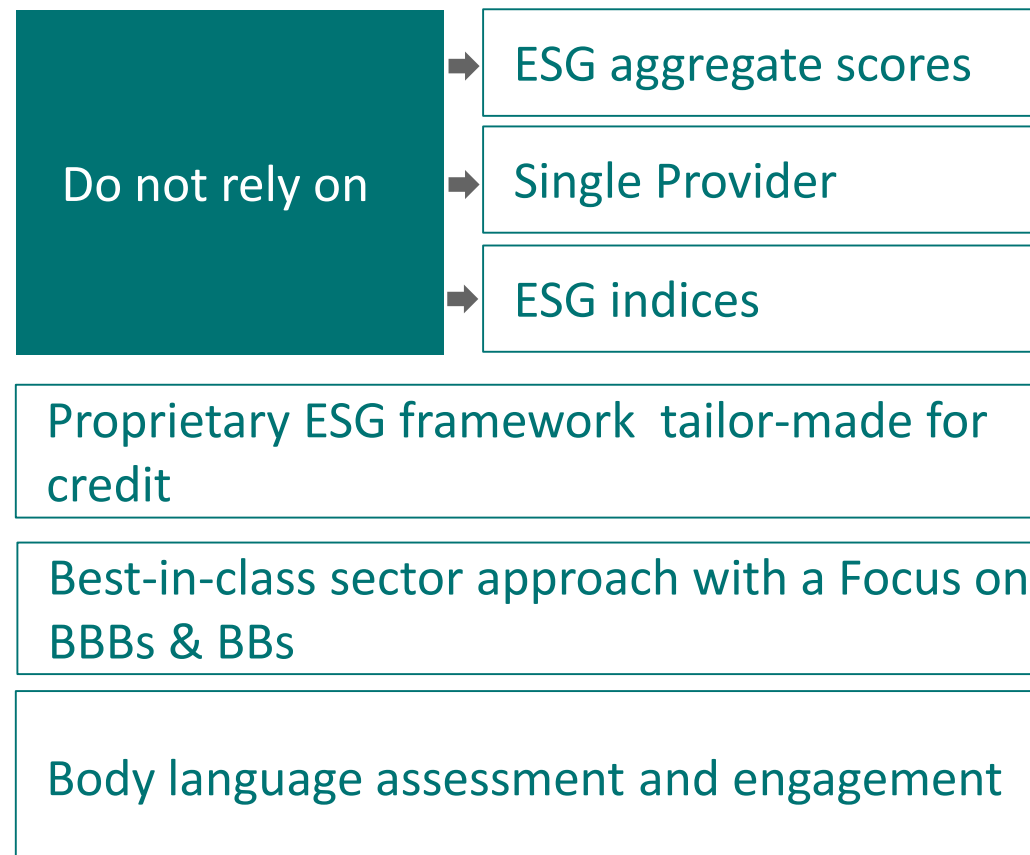
Source: ISS, QualityScore Profile Report

DOES A 'TICK-BOX' ESG APPROACH WORK IN CREDIT MANAGEMENT?

The shortcomings of a 'tick-box' approach



Alternative solution



GLOBAL SUSTAINABLE CREDIT - PROPRIETARY ESG FRAMEWORK

Excluded sectors

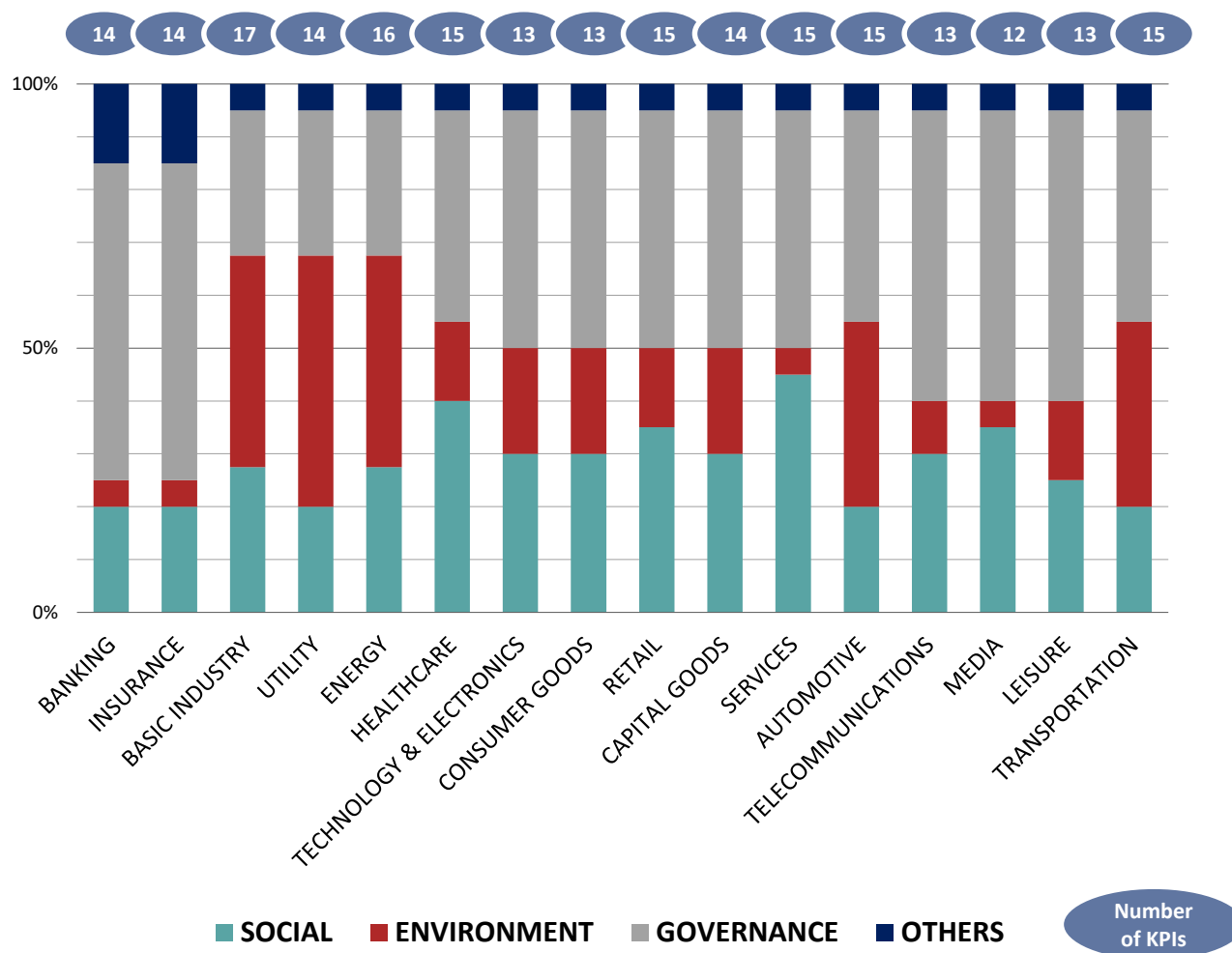


UTILITIES  CO ₂ intensity Renewables Energy storage	CONSUMER  Accounting standards Human rights	AUTO  CO ₂ intensity Electrification	TELECOM  Labour relations Privacy and data security	FINANCIALS  Business ethics Systemic impacts
ENERGY  Energy transition Corruption	BASIC  Water intensity Social responsibility	HEALTHCARE  Innovation management Product quality and safety	CAPITAL GOODS  Health & safety	TRANSPORT  CO ₂ intensity Fuel efficiency

*KPI: Key Performance Indicator

"The Pictet Group implements an exclusion policy on companies involved in the production of anti-personnel mines, cluster munitions, biological & chemical weapons (including white phosphorous) and nuclear weapons from countries not signatory to the Treaty on the Non-Proliferation of Nuclear Weapons (NPT). This policy applies to actively managed strategies (funds and segregated accounts) as well as investments for its own account."

Proprietary split between E, S and G KPIs by sector



Source: Pictet Asset Management, August 2018

GLOBAL SUSTAINABLE CREDIT - CREDIT EXAMPLES



Ryanair passes step 1 with good financial sustainability scores
But it fails our ESG analysis at step 2



Henkel passes step 1
At step 2 it gets among the highest ratings from ESG providers (Sustainalytics Score: 100, MSCI Score: AA), but fails because of our internal weighting of accounting, board, shareholder factors



Michelin enters the portfolio:

- Commitment to financial policy
- Product innovation
- Social policy

Source: Pictet Asset Management as at 31.08.2018, for illustrative purposes.

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LafargeHolcim's 2015 Sustainability Report



INTEGRITY

Means creating an environment where compliance is a central commitment. We have the courage to make the right decisions based on our ethical principles at all times, even when it means foregoing a business opportunity.

Source: LafargeHolcim 2015 Sustainability Report p.9

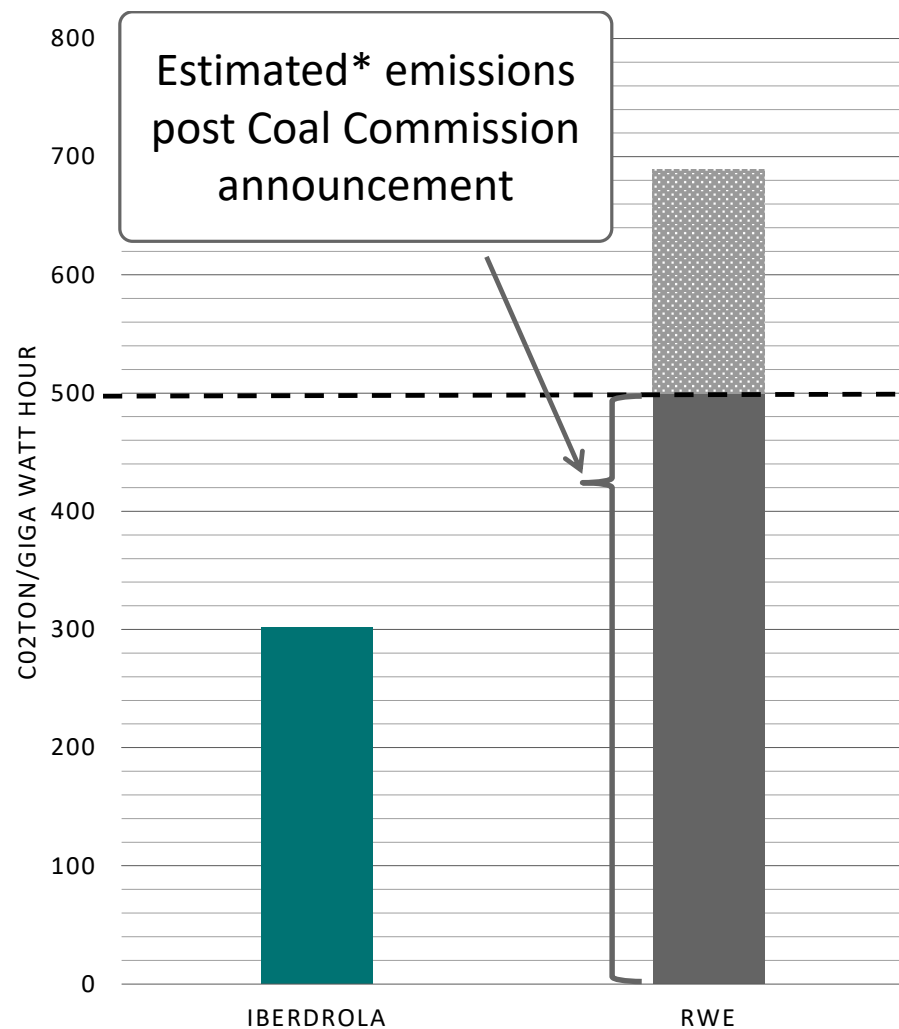
FT on Lafarge potential connections with Daech

LafargeHolcim has previously admitted that “unacceptable measures” had been taken to keep the Syrian plant running, including payments to intermediaries to avoid disruption by local armed groups.

The company added that “selected members of group management” were aware of possible violations of business conduct standards.

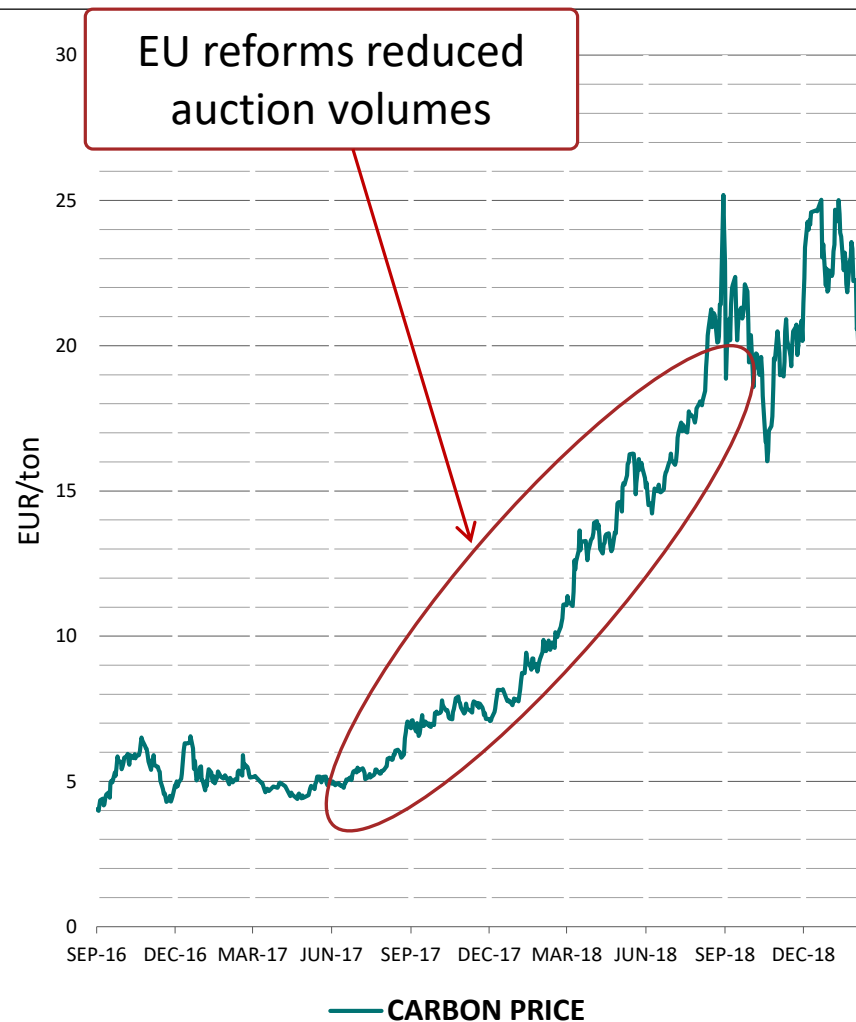
Source: The Financial Times as of 07.12.2017

Iberdrola and RWE: carbon footprint

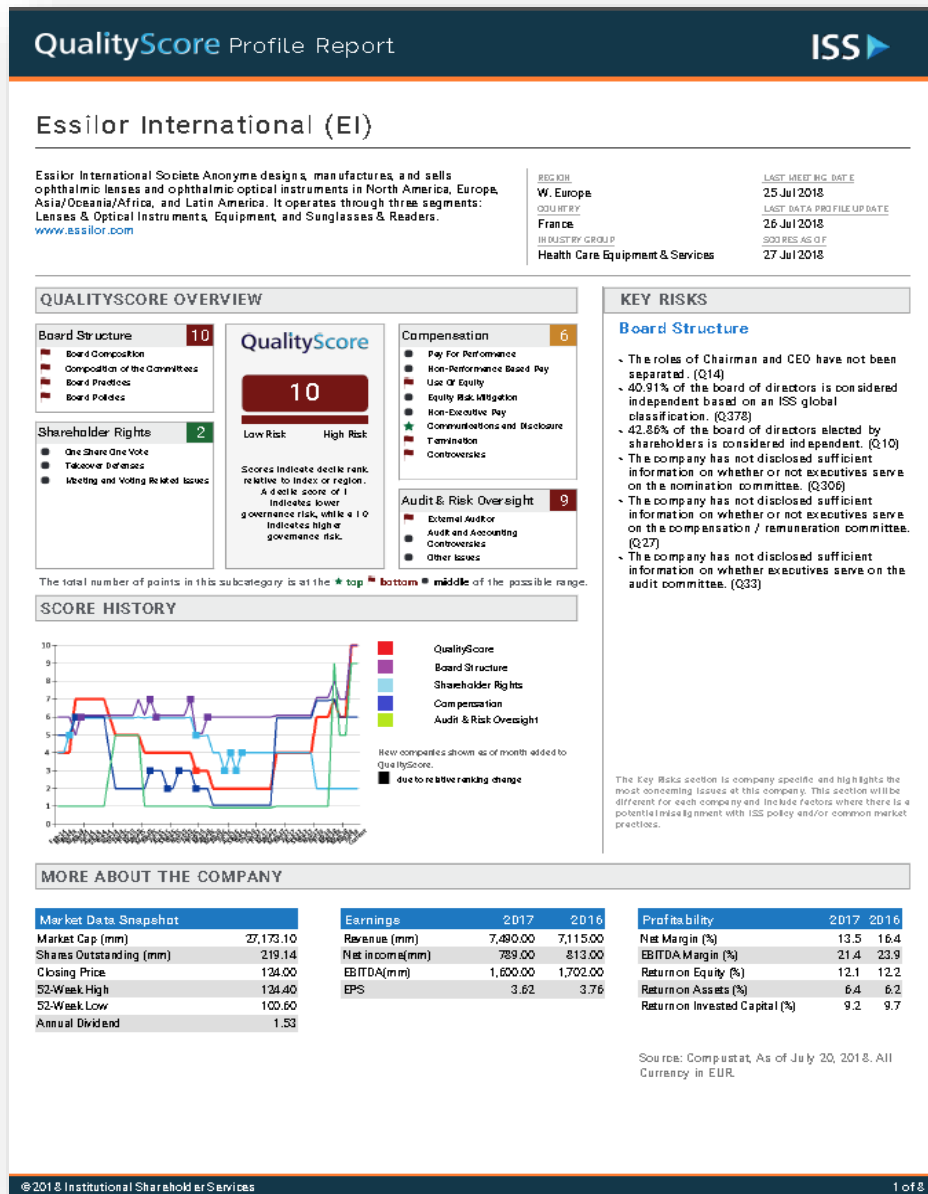


Source: Pictet Asset Management, *Estimation by Morgan Stanley RWE as of 25.02.2019

Carbon price evolution



Source: Bloomberg as of 28.02.2019



Good overall score with a weakness on governance

- Low score on governance mostly due to lack of board independence
- Good score on controversies
- Good score on product safety
- Good track record on social and environmental factors
- Good quality earning score

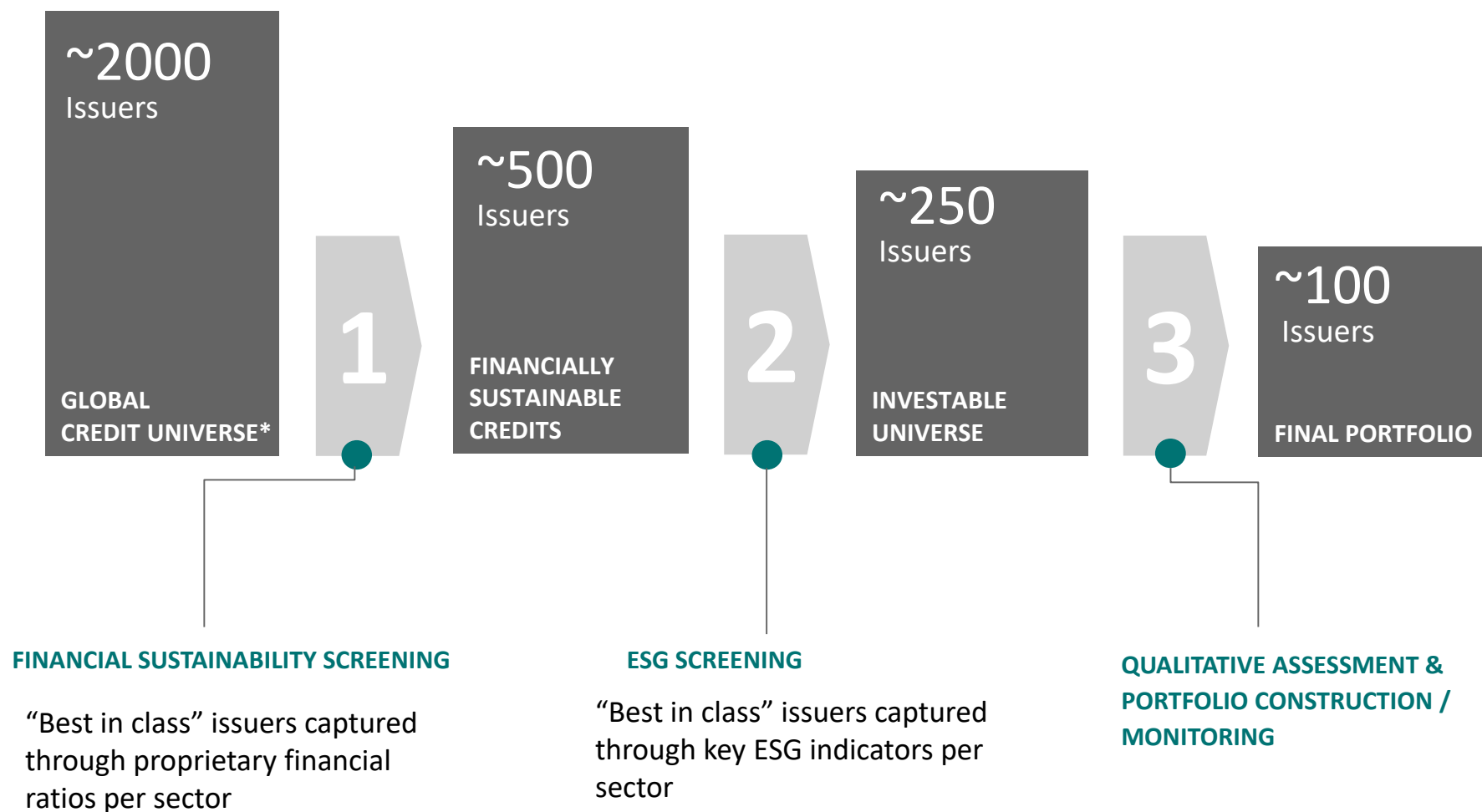
→ Overall above average ESG KPIs vs. peers. Bought and engaged on board audit, compliance and independence.

- **ESG can enhance the performance of a credit portfolio**
- **ESG and traditional credit analysis are mutually reinforcing**
- **The full potential of ESG is better harnessed with a holistic approach comprising financial and ESG factors**

*A strong balance sheet is good.
A strong and sustainable balance sheet is better.*

Appendix

PICTET GLOBAL SUSTAINABLE CREDIT - INVESTMENT PROCESS OVERVIEW



*Companies on the Pictet Controversial List created by the Pictet Sustainability Board are excluded at this stage

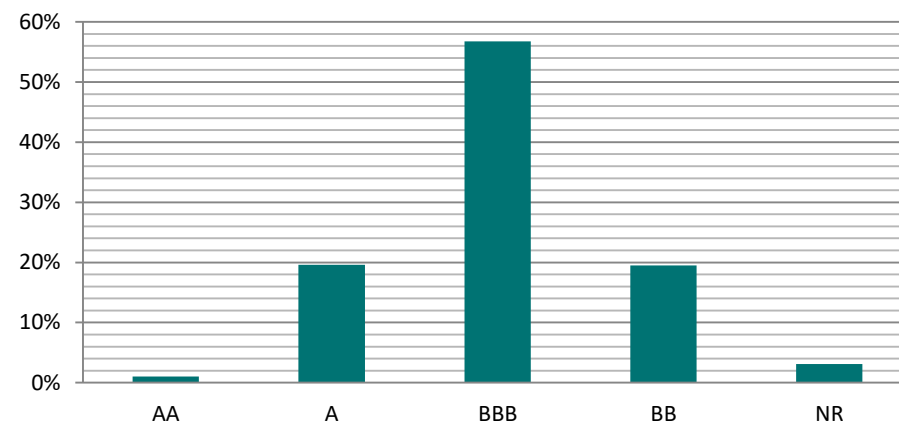
PICTET-GLOBAL SUSTAINABLE CREDIT – CHARACTERISTICS & POSITIONING

Portfolio characteristics

	PORTFOLIO
Weighted modified duration	4.65
Yield to maturity in USD (%)	4.35
Weighted average coupon (%)	3.12
Average rating	Baa2/BBB
Number of holdings	93
Number of issuers	85
Number of sectors	13
Bloomberg code	PEXFHIU

Source: Bloomberg Barclays, Pictet Asset Management as of 31.01.2019.

Rating breakdown (absolute weight)



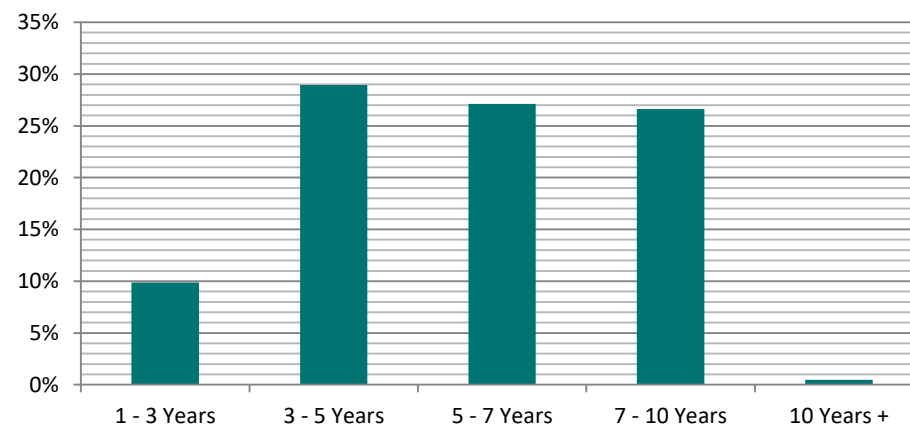
Source: Pictet Asset Management as of 31.01.2019.

Top 10 portfolio issuers

SECURITY NAME	SECTOR	COUNTRY	PTF
Elisa Oyj	Telecommunication	Finland	1.54%
Fnac Darty SA	Consumer Cyclical	France	1.51%
Severn Trent Water Ltd	Utilities	United Kingdom	1.46%
Iberdrola SA	Utilities	Spain	1.44%
Total SA	Energy	United States	1.35%
Tennet Holding Bv	Utilities	Netherlands	1.33%
Int. Flavors & Fragrances Inc	Basic Industries	United States	1.31%
Omv AG	Energy	Austria	1.30%
Albemarle Corp	Basic Industries	United States	1.30%
Boston Scientific Corp	Consumer Noncyclicals	United States	1.28%

Source: Bloomberg Barclays, Pictet Asset Management as of 31.01.2019.

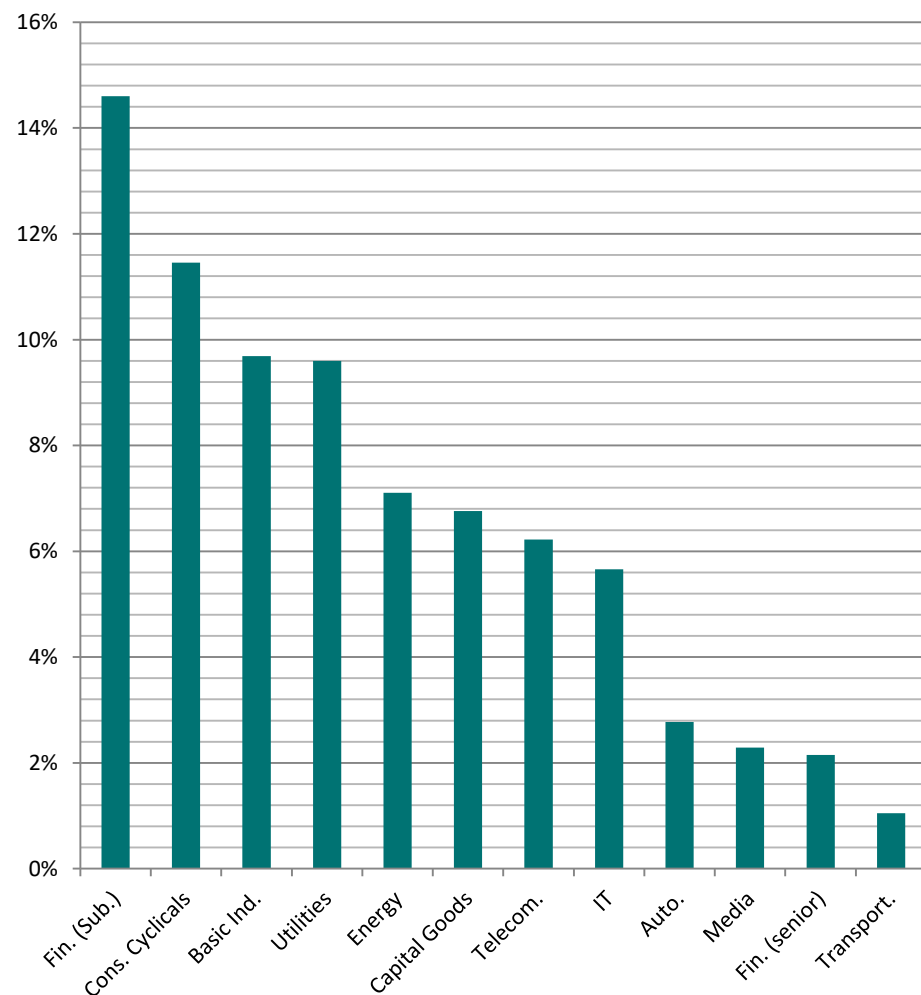
Maturity breakdown (Years to maturity - absolute weight)



Source: Pictet Asset Management as of 31.01.2019.

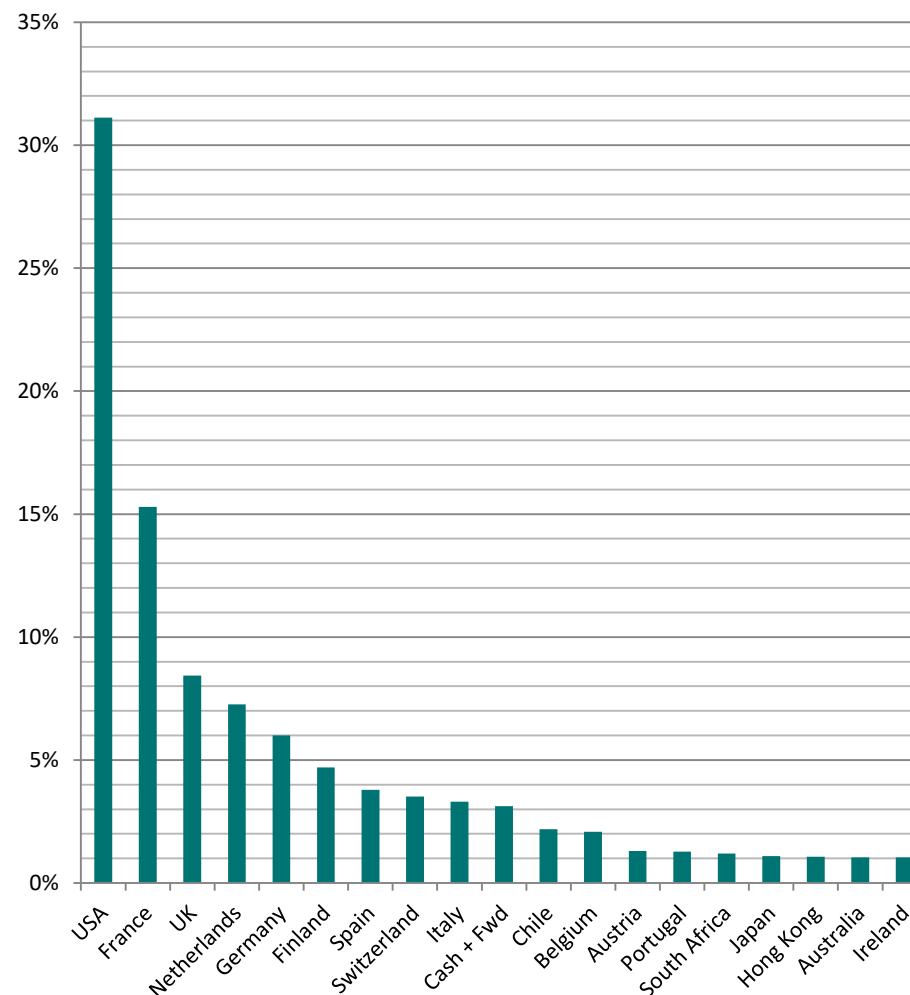
PICTET-GLOBAL SUSTAINABLE CREDIT – CHARACTERISTICS & POSITIONING

Sector breakdown (absolute weight)



Source: Pictet Asset Management as of 31.01.2019. Cash + Forward P&L is excluded and represents 3.12%.

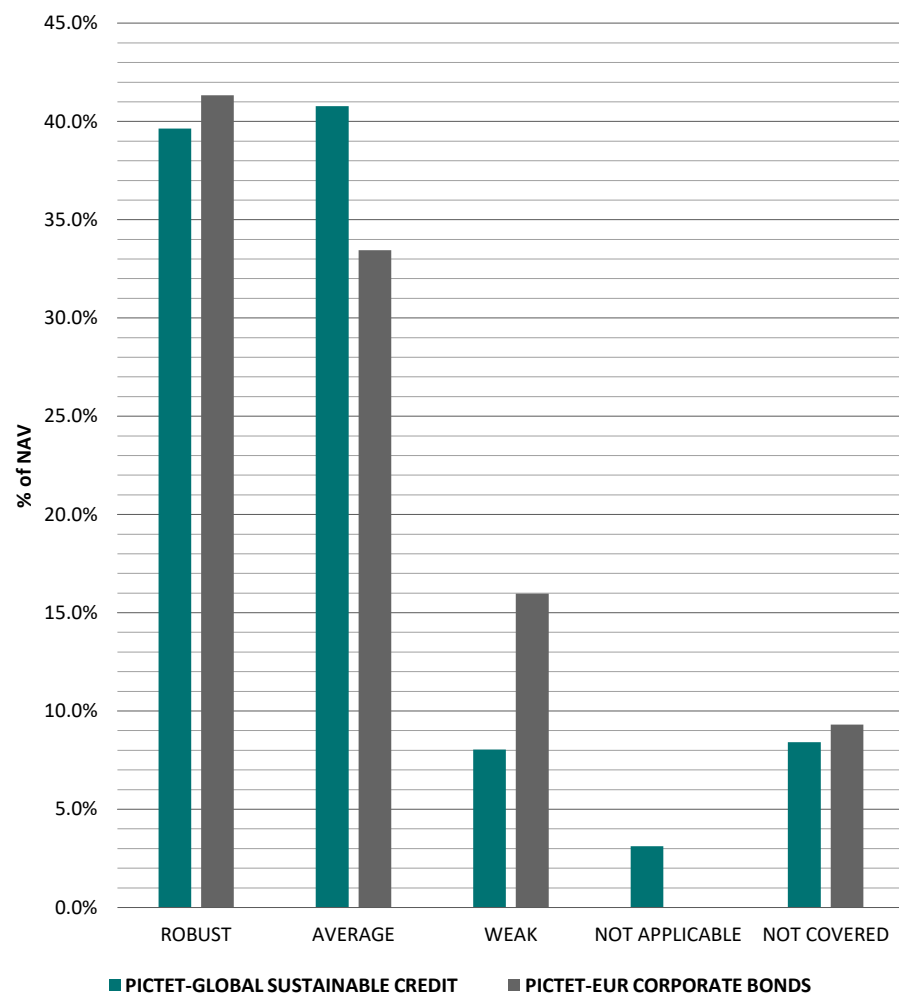
Country breakdown (absolute weight)



Source: Pictet Asset Management as of 31.01.2019. Cash + Forward P&L is excluded and represents 3.12%.

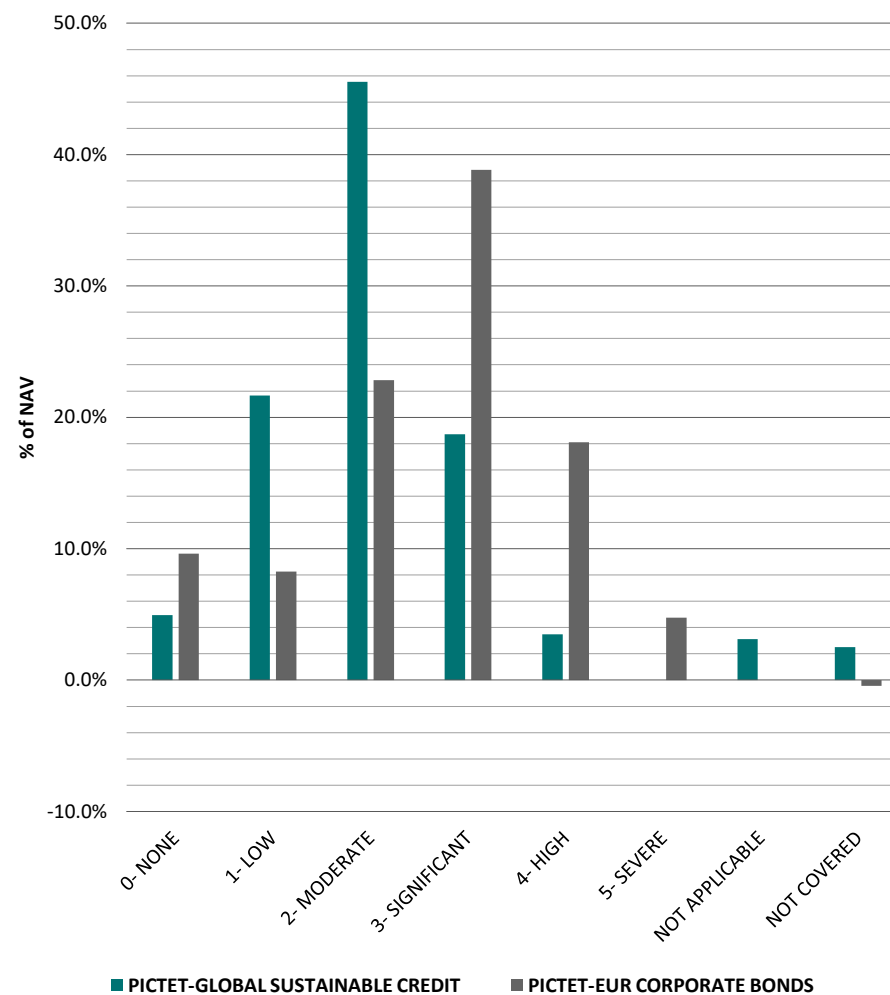
PICTET-GLOBAL SUSTAINABLE CREDIT – ESG SCORES

Corporate governance



Source: ISS as of 31.01.2019
Not Applicable: Cash, FX forwards, index derivatives and bond futures

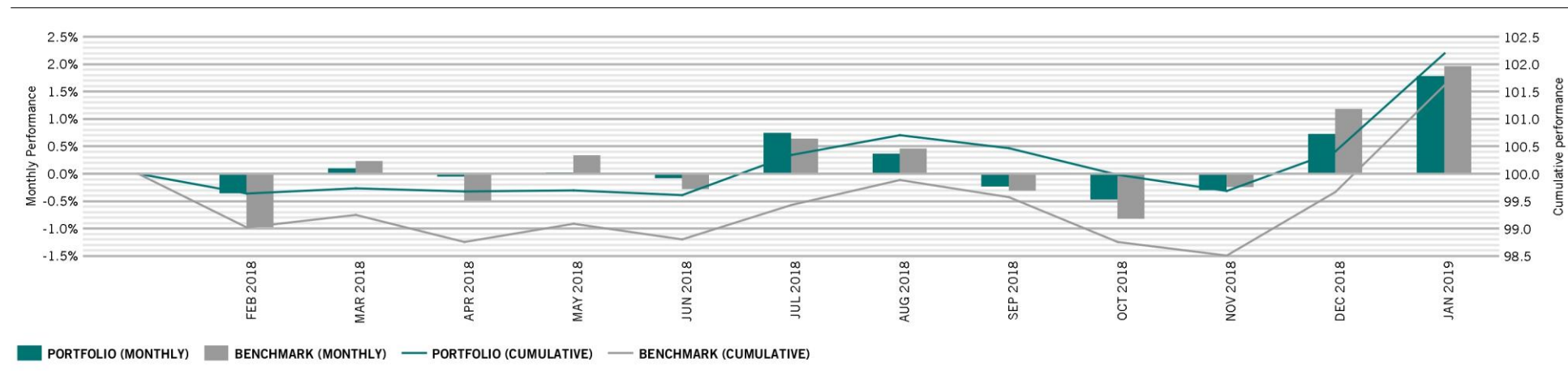
ESG Controversies



Source: Sustainalytics as of 31.01.2019
Not Applicable: Cash, FX forwards, index derivatives and bond futures

PICTET-GLOBAL SUSTAINABLE CDT – PERFORMANCE (I USD) AS OF JAN. 31ST 2019

Past 12-month performance



Monthly performance (%)

	PORTFOLIO	BENCHMARK	EXCESS RETURN
Jan 2019	1.78	1.96	-0.18
Dec 2018	0.73	1.18	-0.45
Nov 2018	-0.30	-0.25	-0.05

Quarterly performance (%)

	PORTFOLIO	BENCHMARK	EXCESS RETURN
Q4 2018	-0.06	0.10	-0.16
Q3 2018	0.86	0.78	0.08
Q2 2018	-0.13	-0.45	0.32

Annualised performance (%)

	PORTFOLIO	BENCHMARK	EXCESS RETURN
1Y	2.19	1.62	0.57
Since inception	1.91	1.45	0.46













Calendar year performance (%)

	PORTFOLIO	BENCHMARK	EXCESS RETURN
YTD	1.78	1.96	-0.18
2018 (26.01)	0.13	-0.50	0.63

Source: Pictet Asset Management as of 31.01.2019.

ESG DATA SOURCES

- Each provider was selected for its leading edge on specific ESG datasets

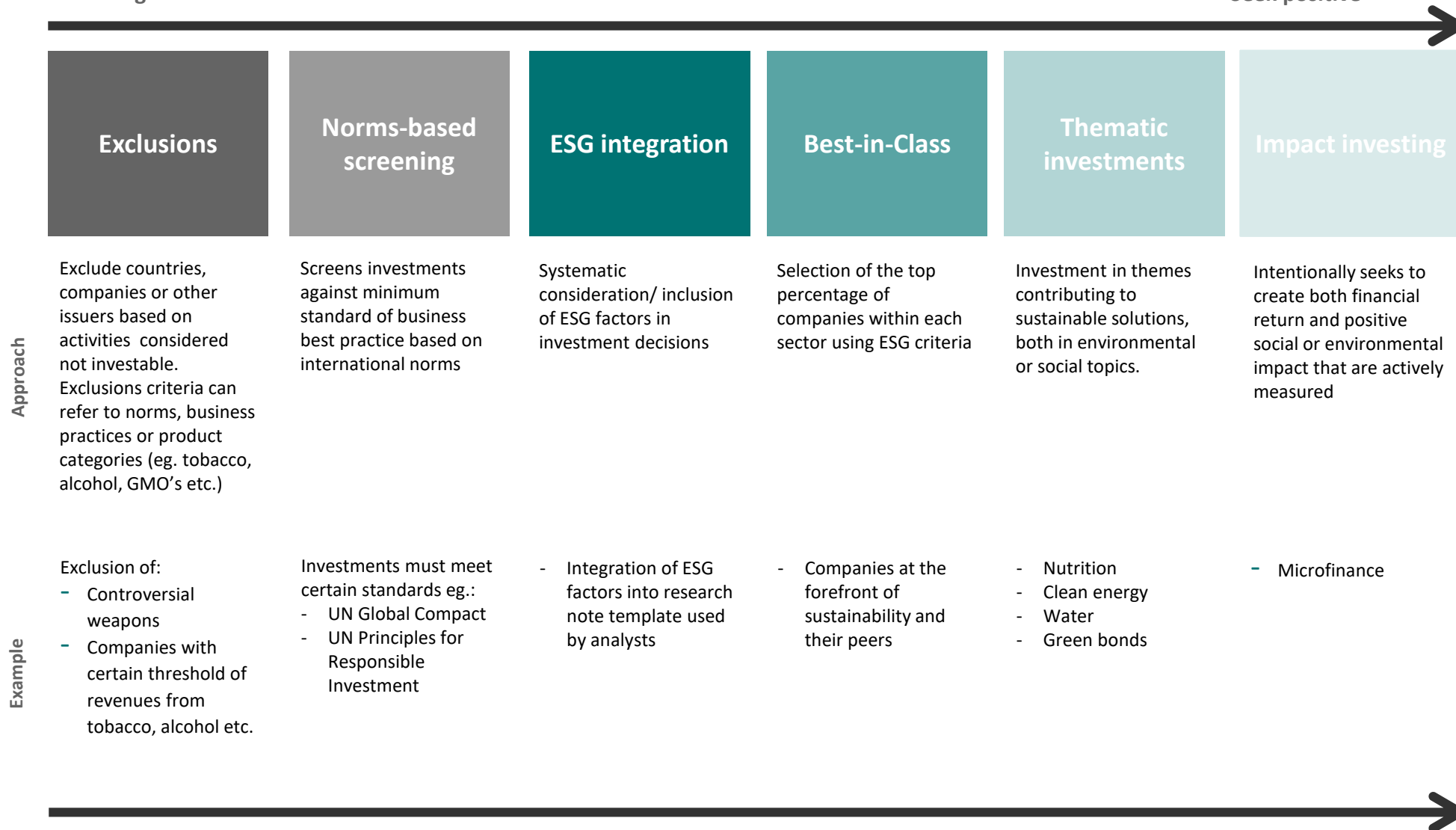
RESEARCH PROVIDERS	LEADING EDGE
 	Corporate governance and proxy voting research
 	Creative accounting
 	ESG Ratings & Controversies, Activity-based screening
	Controversy news flow
	Carbon data, Fossil fuels, Green Economy
	Environmental and social indicators
 	Country ESG data
	Corporate Engagement

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Source: Pictet Asset Management – September 2018

THE SIX FAMILIES OF RI STRATEGIES

Avoid negative

Seek positive



Active Ownership (Engagement & Proxy Voting)

The six approaches are not mutually exclusive, as more than one approach can be used with the same investment vehicle.

Source: Pictet Asset Management – September 2018

For more information

PICTET ASSET MANAGEMENT
www.assetmanagement.pictet

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