

ESG in Credit: from risk mitigator to performance enhancement?

STEPHANE RUEGG, SENIOR CLIENT PORTFOLIO
MANAGER

07 February 2019

London

FOUR SOURCES OF ESG ACTIONS



- › 'Statoil' changes name to 'Equinor'



- › 7 Scandinavian pension funds disinvested from Ryanair



- › Palm oil within Nutella has drawn significant reactions from public opinion



- › “If Facebook and other online companies will not or cannot fix the privacy invasions, then we are going to have to...We, the Congress.”
Senator Bill Nelson, 10 April 2018

Source: Pictet Asset Management as at 31.12.2018, for illustrative purposes.

Note: Pictet Asset Management (Europe) SA has not acquired any rights or license to reproduce the trademarks, logos or images set out in this document. The trademarks, logos and images set out in this document are used only for the purpose of this presentation.

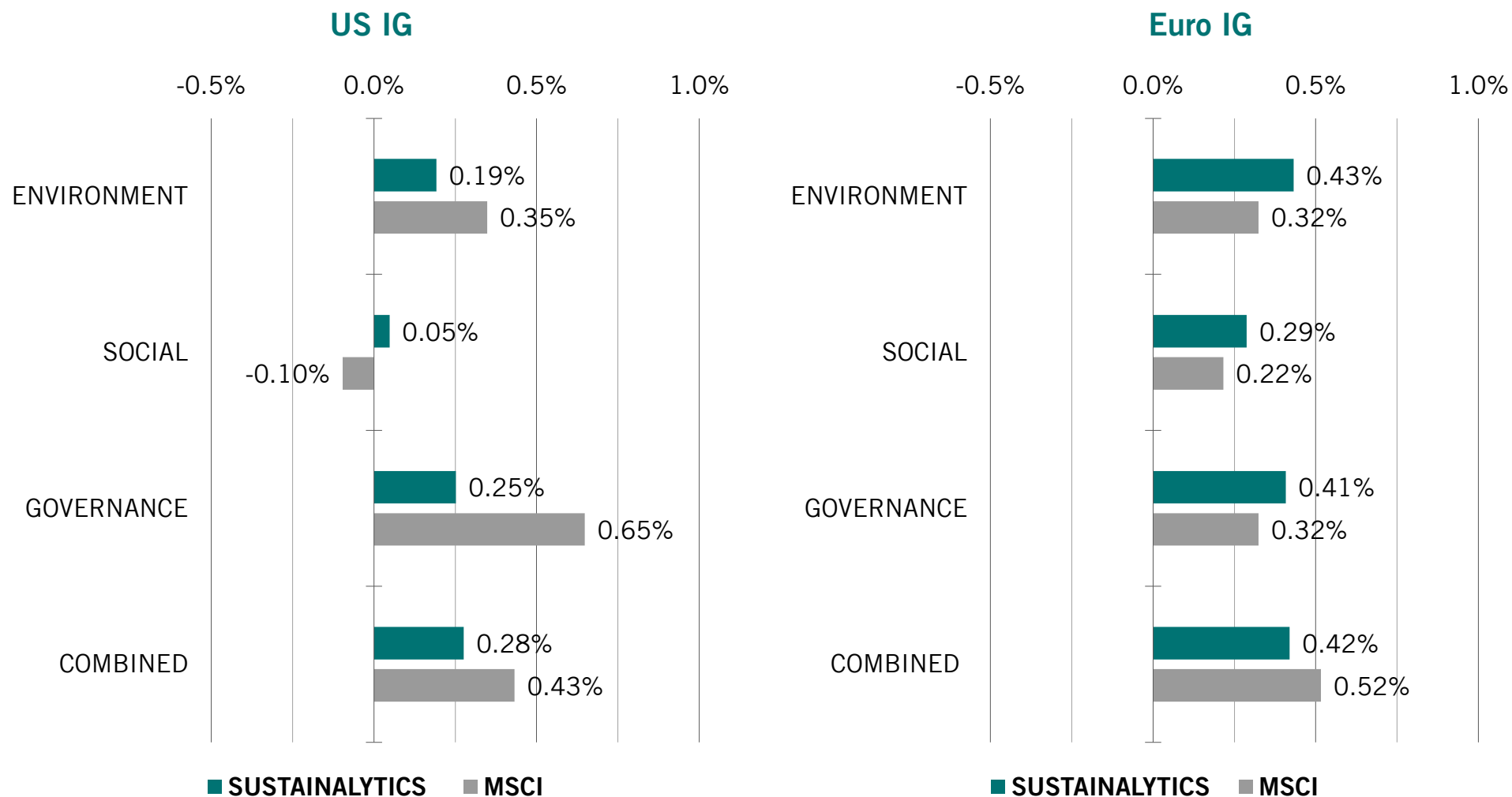
KEY QUESTIONS

1. Can ESG generate performance in a credit portfolio?
2. Does ESG enrich traditional credit analysis?
3. What approach is maximizing the contribution of ESG in a credit portfolio?



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

“Poor governance can lead to spectacular corporate failures”.

UNPRI, Corporate bonds: Spotlight on ESG risks December 2011

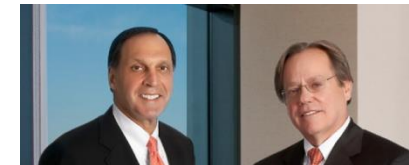


Integrity and business ethics



Evaluation and principled
compensation decisions

LEHMAN BROTHERS



Strong qualified board,
define responsibilities

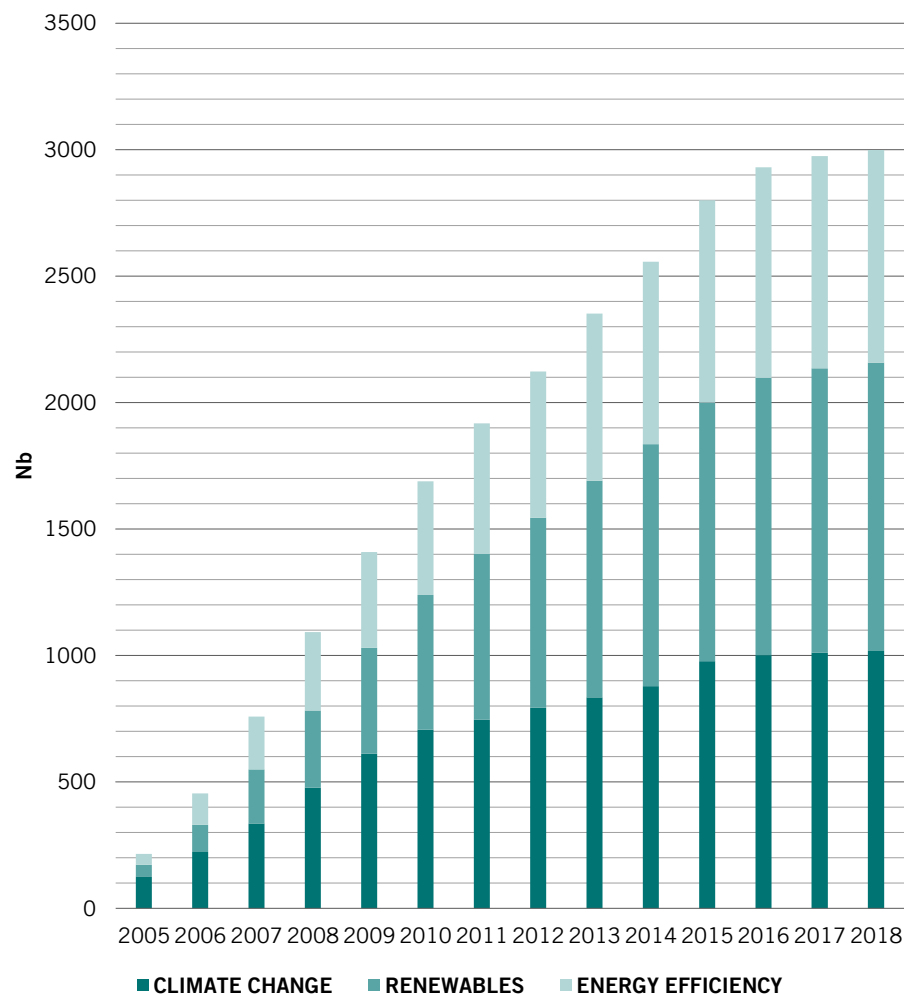
“Good corporate governance is a premise for sustainable business practices”

Norges Bank, 2017



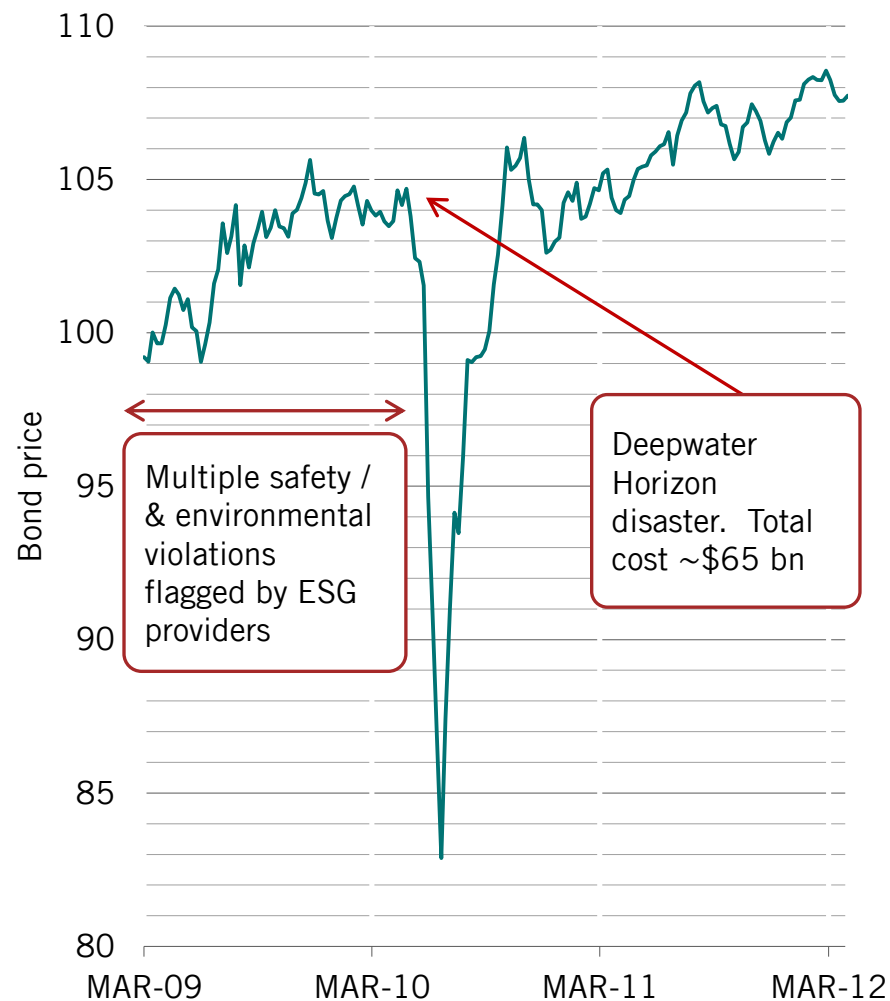
ENVIRONMENT: PUBLIC OPINION AND REGULATORS COMBINING THEIR FORCES

Number of climate change policies in the world



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

A relevant case: BP 2010 Deepwater Horizon oil spill

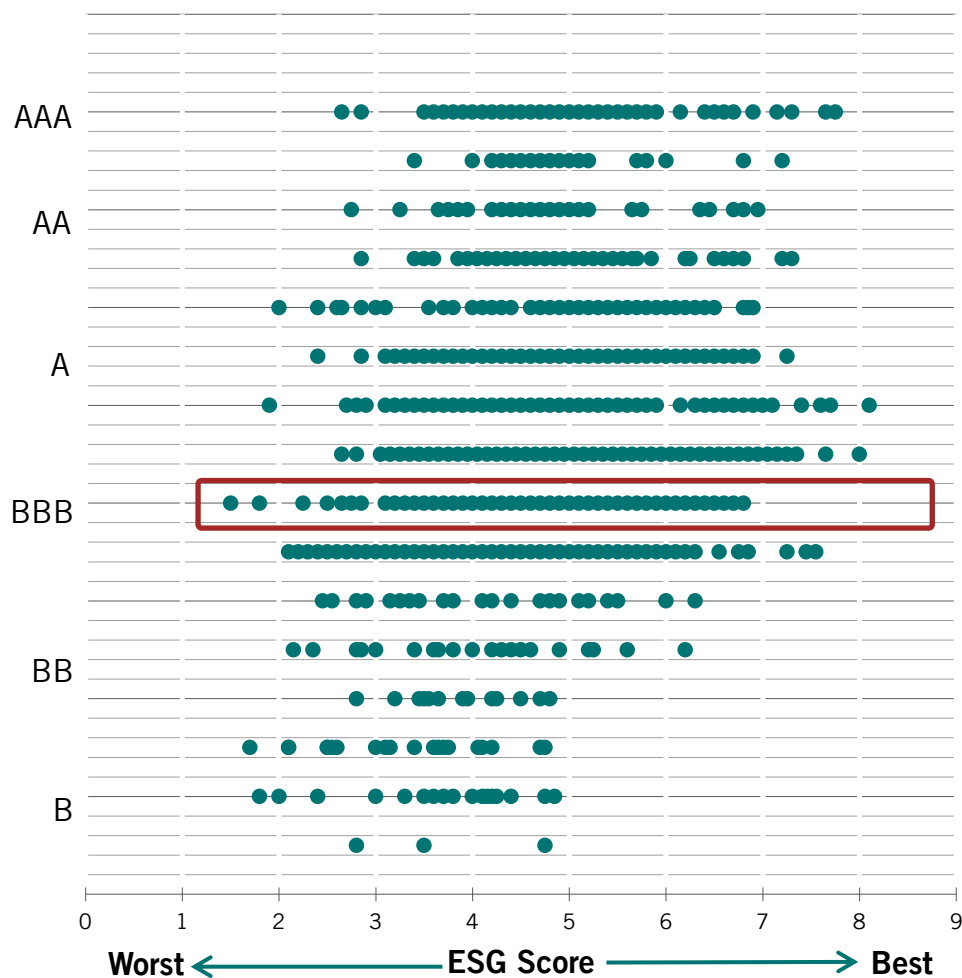


Source: Bloomberg, Pictet Asset Management



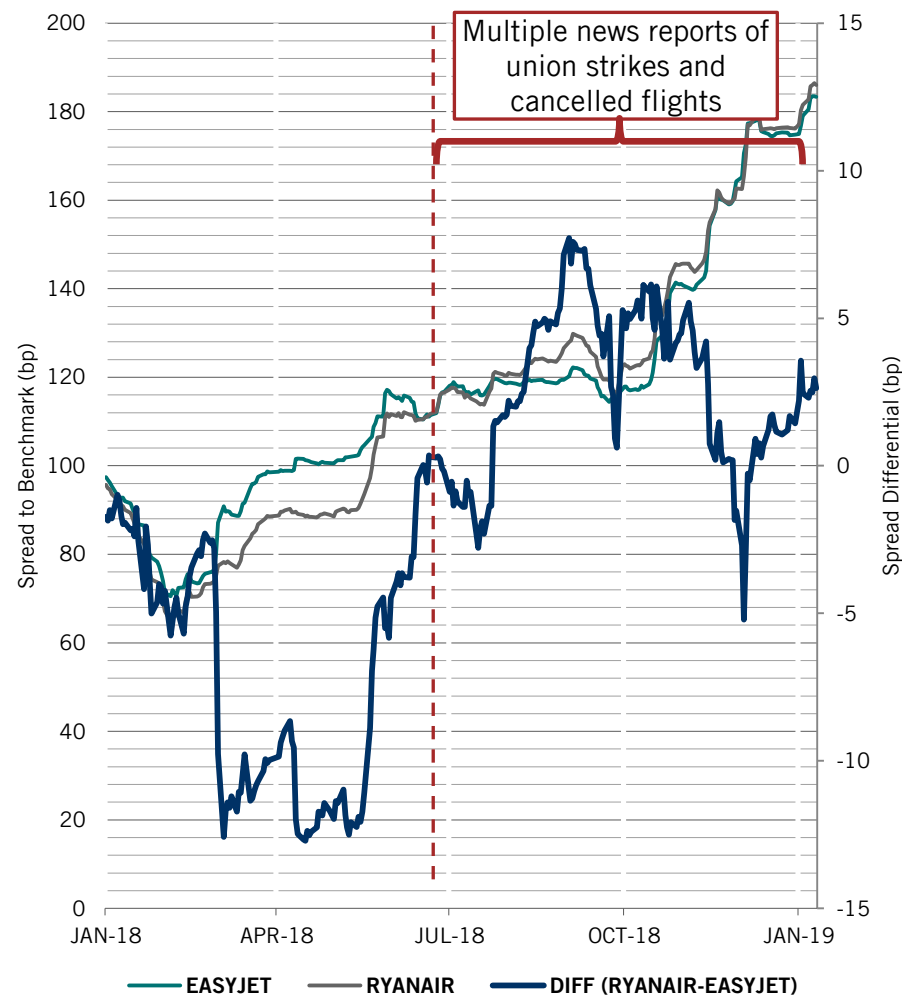
DOES ESG ENRICH TRADITIONAL CREDIT ANALYSIS?

ESG scores vs. Credit ratings



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

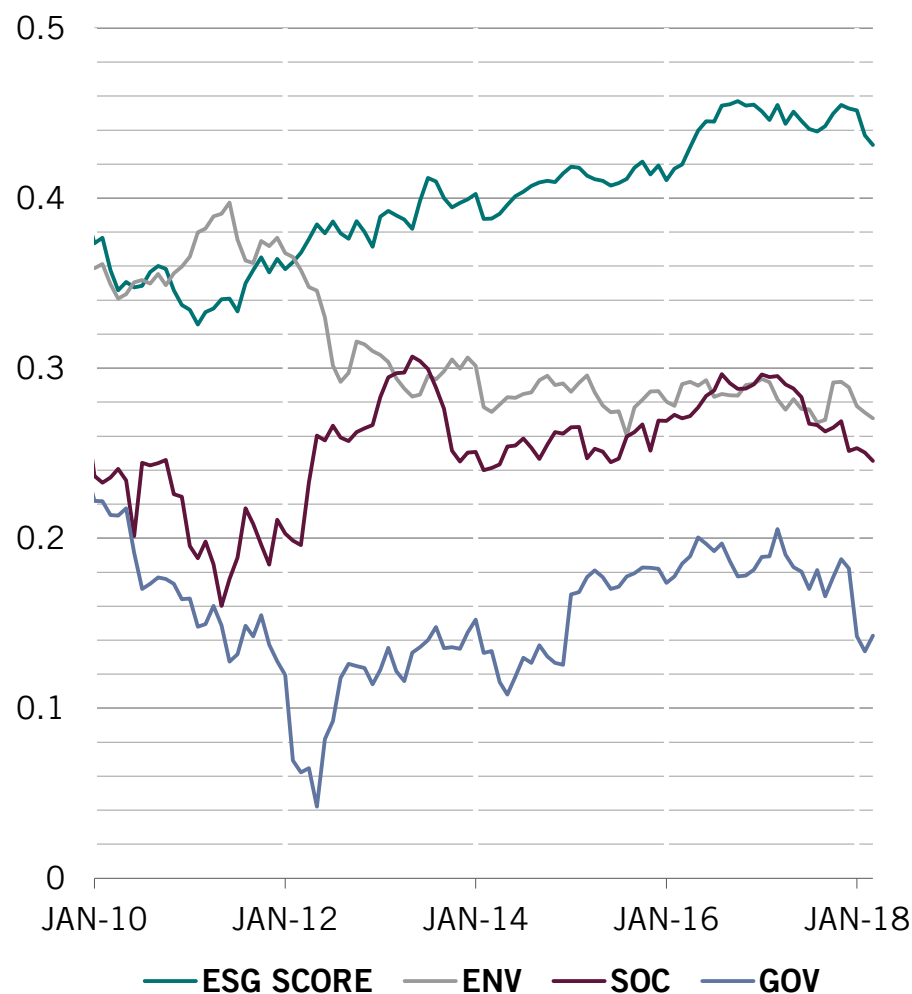
Credit spread evolution between Ryanair & Easyjet



Source: Bloomberg, Pictet Asset Management as of 11.01.2019

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

Correlations between scores of 2 ESG providers



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

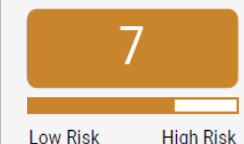
Board Structure **2**

- 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**

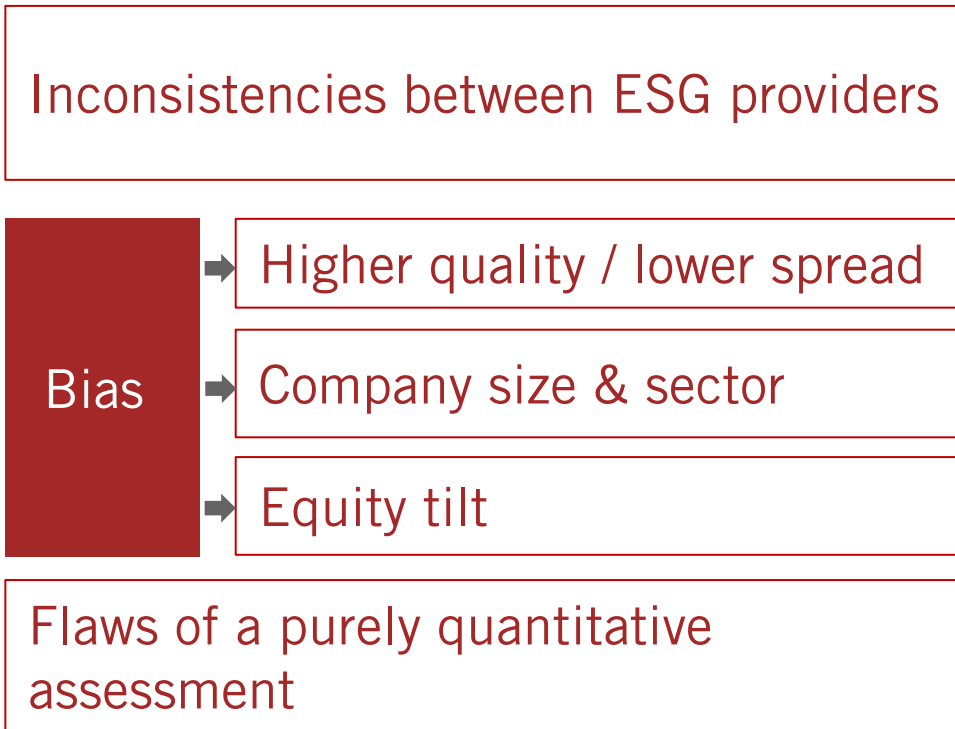
- External Auditor
- Audit and Accounting Controversies
- Other Issues

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

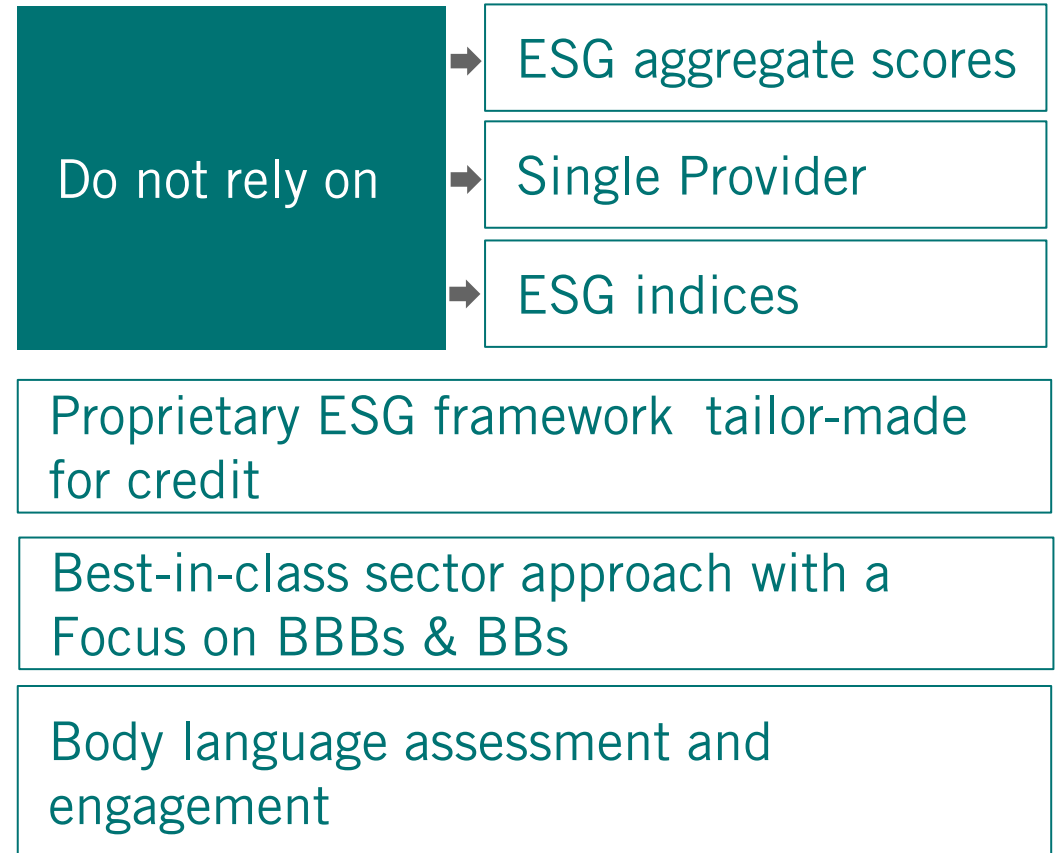
Source: ISS, QualityScore Profile Report as of 2018Q4

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

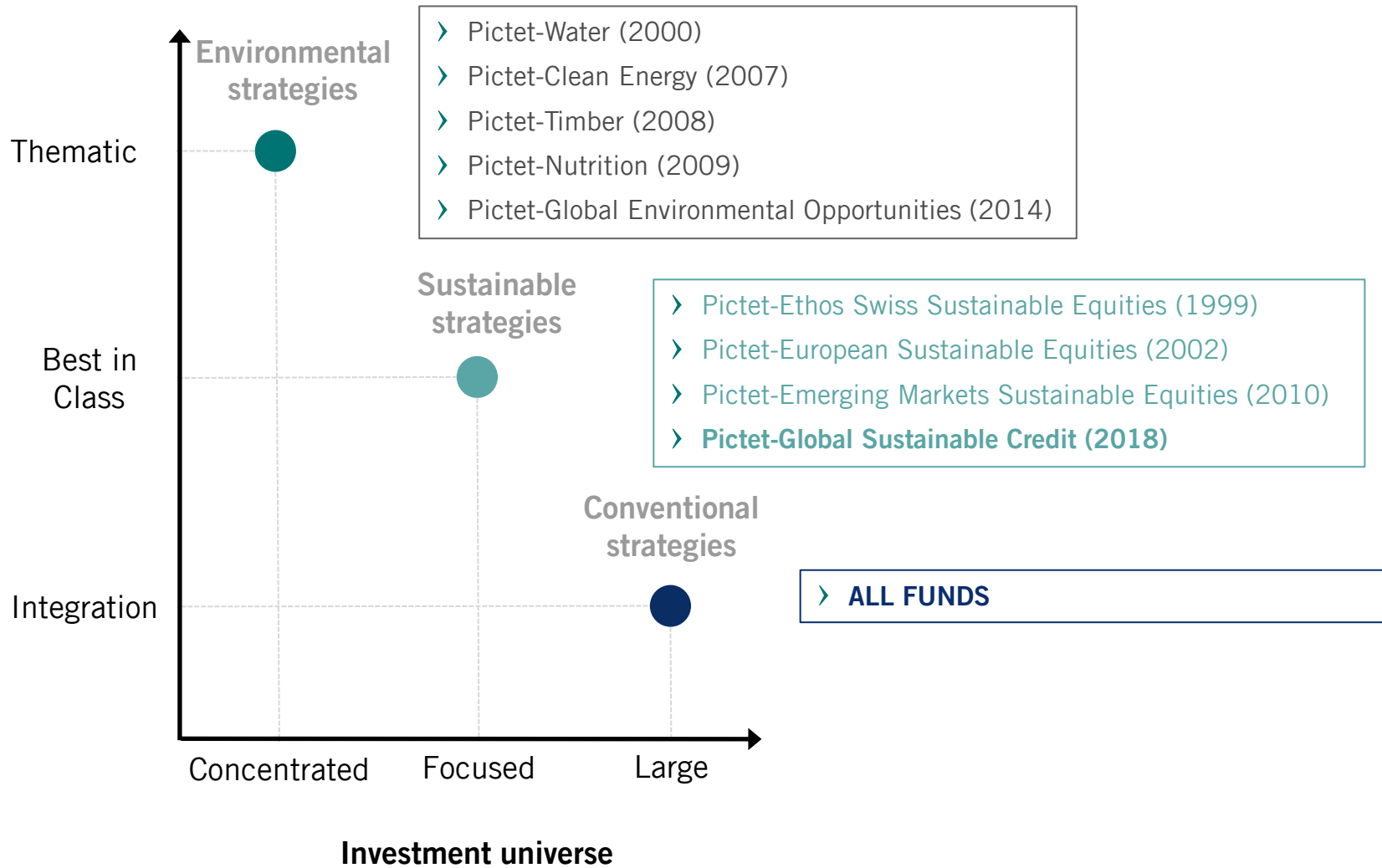
The shortcomings of a 'tick-box' approach



Our solution



RESPONSIBLE INVESTMENT STRATEGIES



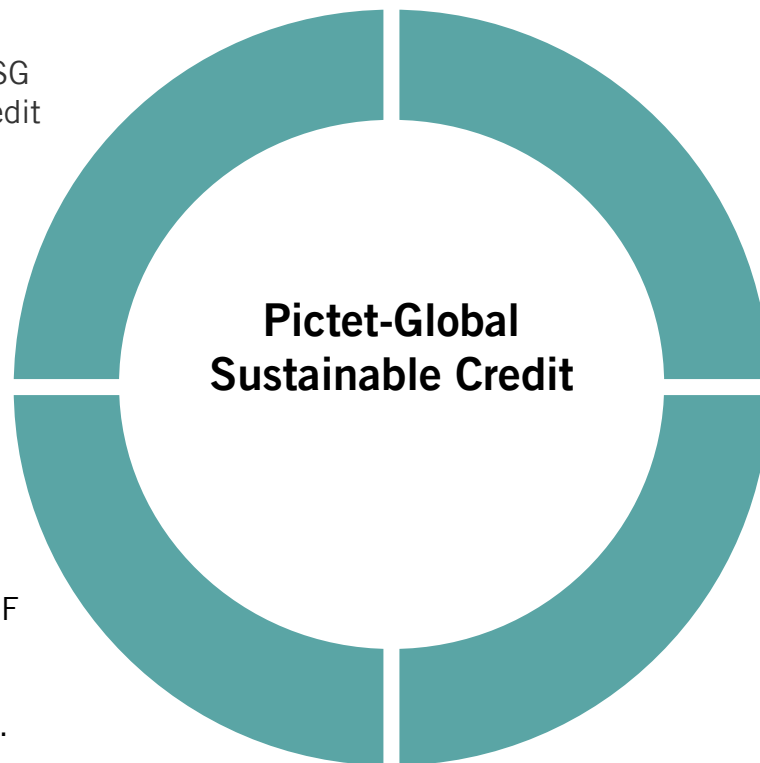
KEY CHARACTERISTICS

Key objective

Select issuers with strong financial sustainability and ESG credentials to navigate the credit cycle and ESG risks

Investment Style

“Best in class” sector approach
 Purely Bottom-up
 Concentrated portfolio
 Focus on BBB-BB
 Low turnover
 Duration target: 5Y +/- 1Y
 No FX exposure



**Pictet-Global
Sustainable Credit**

Structure

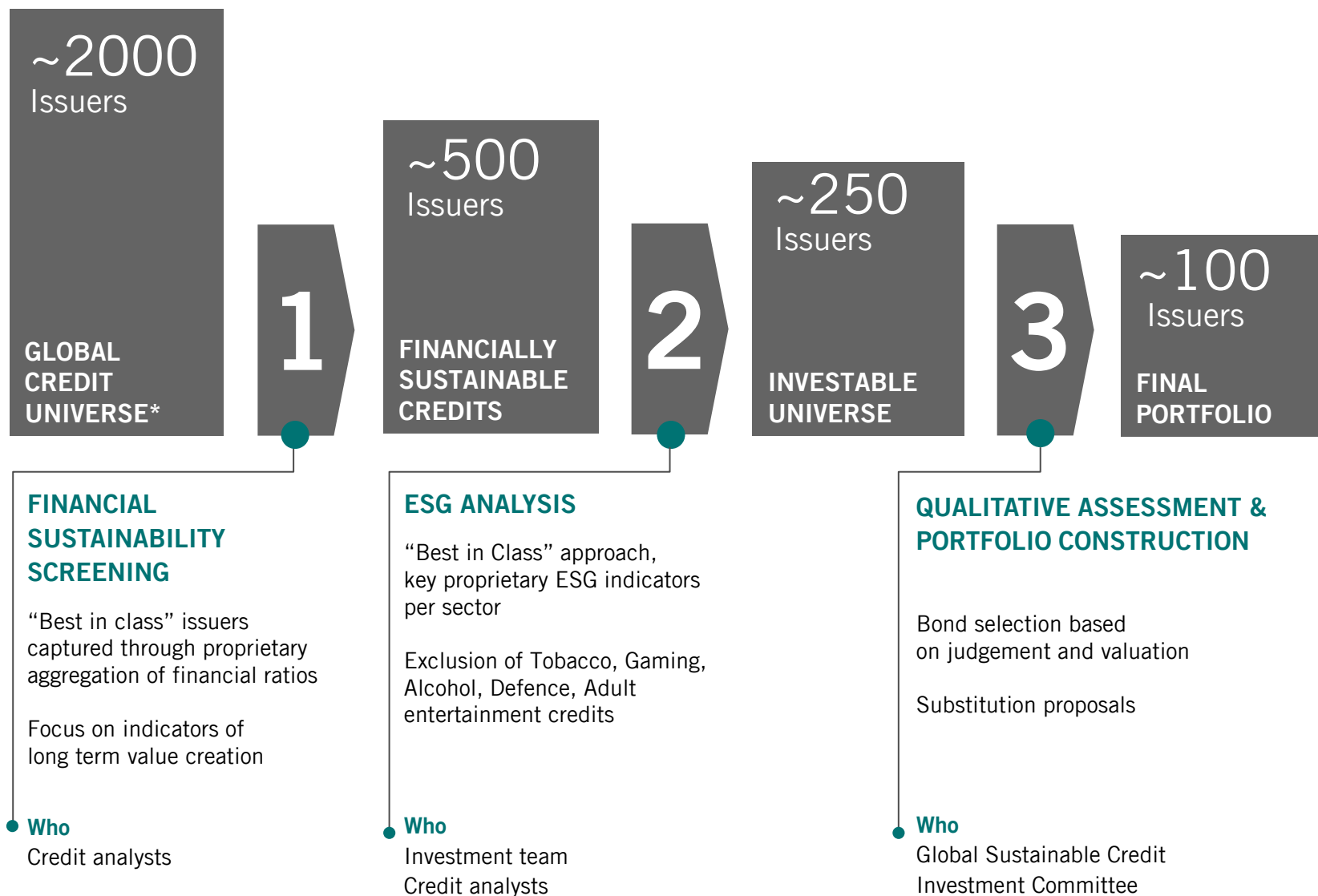
Lux UCITS IV, daily liquidity
 Share classes: USD, EUR, CHF & GBP
 No benchmark
 Management fees. 0.40% p.a.

Key Investment Guidelines

Corporate Bonds only
 Sector exclusion: Defence, Gaming, Alcohol, Tobacco, Adult Entertainment
 Sector: 25% max.
 Min rating: BB- (50% BB max)
 Min issue size: EUR/USD 300mio
 Ancillary use of CDS, Futures, index derivatives

Note: These investment guidelines are internal guidelines which are subject to changes at any time and without any notice. For complete investment rules and limits, please refer to the fund's prospectus

INVESTMENT PROCESS OVERVIEW



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

STEP 1: STRONG & SUSTAINABLE BALANCE SHEET IS BETTER

1



Sustainable free cash flow
High and well-judged capex
Focused R&D
High and robust margins



Share buybacks
High dividend payouts
Low and unstable
operating margins

**Within each sector, we select resilient issuers
with the best ability to navigate the business cycle**

STEP 2: ESG KPI DYNAMIC AND WEIGHTED BY SECTOR

Excluded sectors

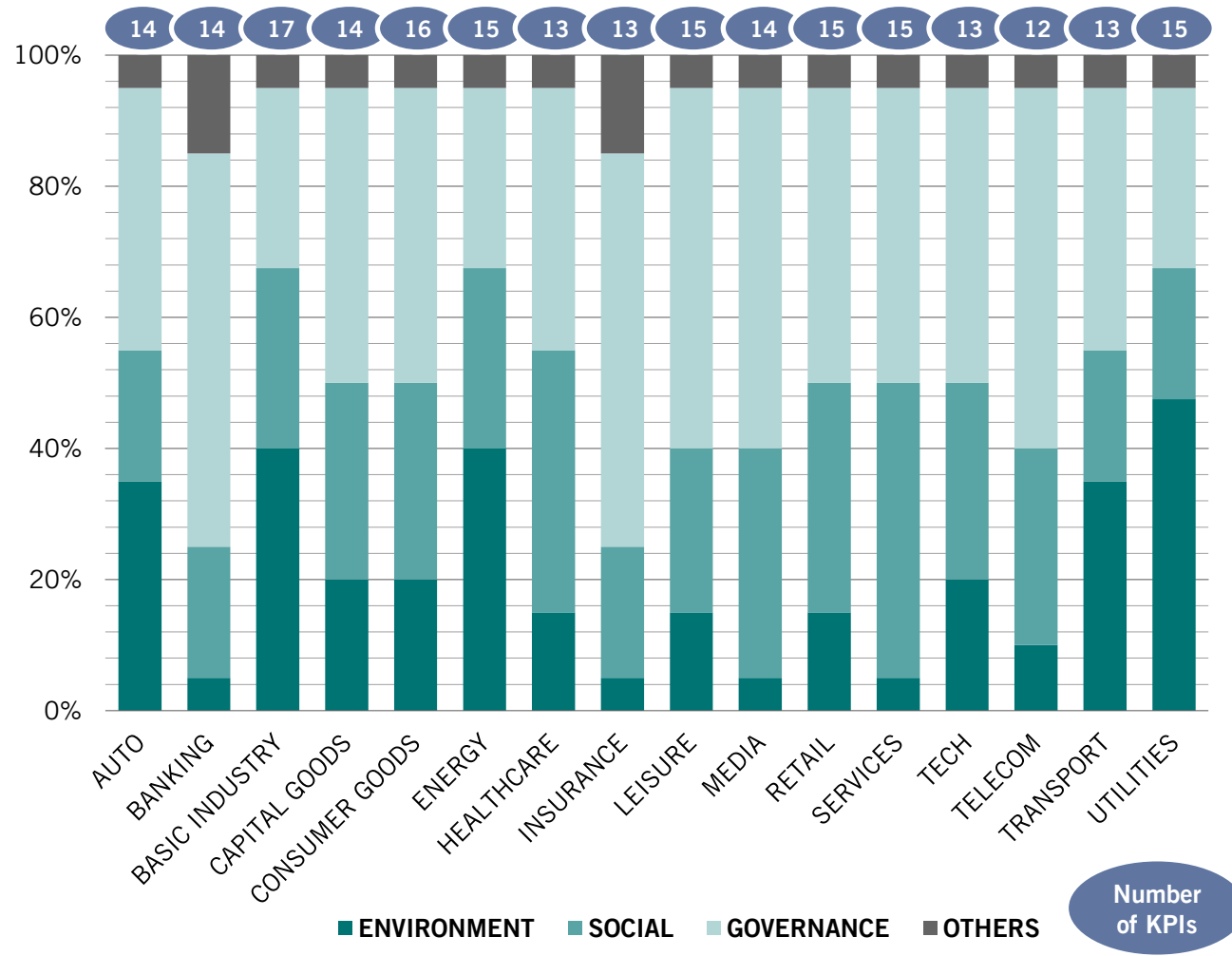
GAMING 	TOBACCO
ADULT ENTERTAINMENT 	ALCOHOL
DEFENCE 	

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

*KPI: Key Performance Indicator

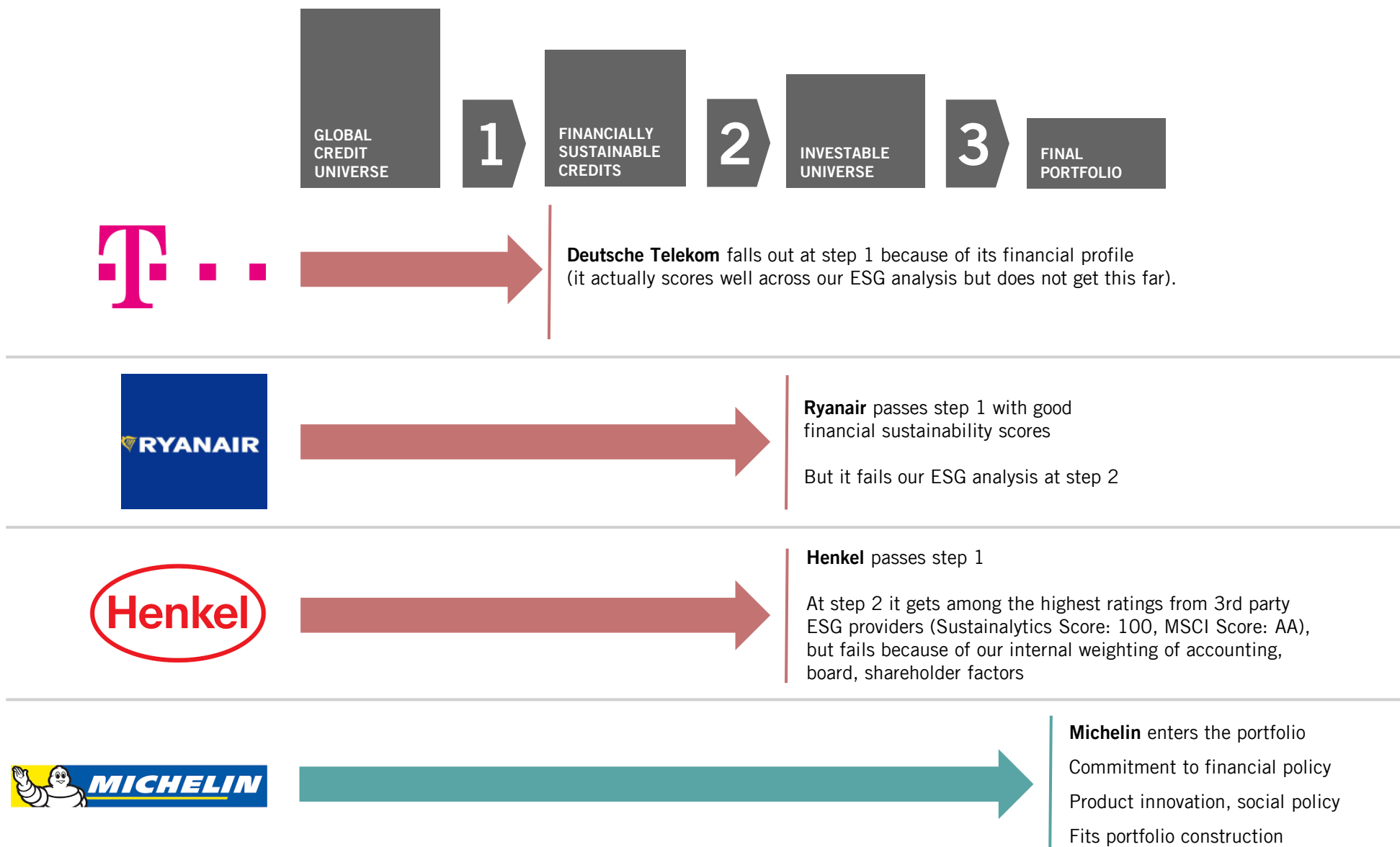
WE SELECT DIFFERENT ESG KPIS FOR EACH SECTOR AND WEIGHT ACCORDINGLY

Proprietary split between E, S and G KPIs by sector



Source: Pictet Asset Management, January 2018

CREDIT EXAMPLES



Source: Pictet Asset Management, for illustrative purposes only.

Note: Pictet Asset Management (Europe) SA has not acquired any rights or license to reproduce the trademarks, logos or images set out in this document. The trademarks, logos and images set out in this document are used only for the purpose of this presentation.



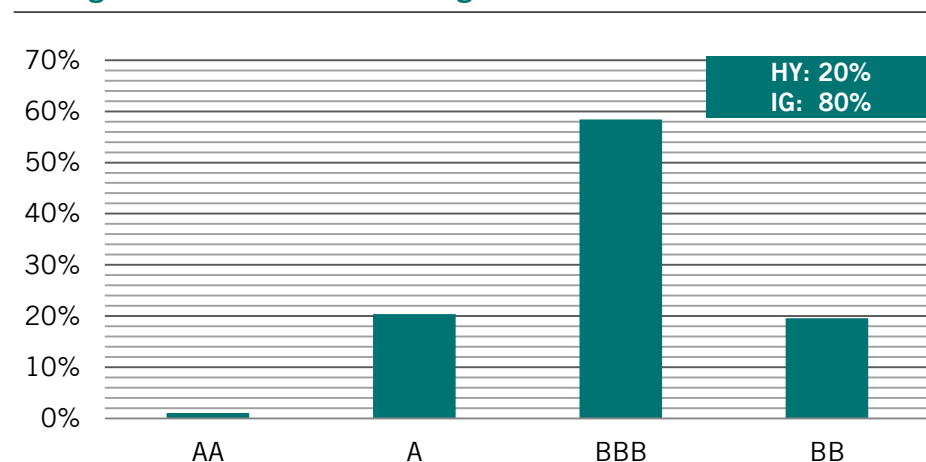
PICTET-GLOBAL SUSTAINABLE CREDIT – CHARACTERISTICS & POSITIONING

Portfolio characteristics

	PORTFOLIO
Weighted modified duration	4.96
Yield to maturity in USD (%)	4.53
Weighted average coupon (%)	3.12
Average rating	Baa2/BBB
Number of holdings	93
Number of issuers	85
Number of sectors	13
Bloomberg code	PEXFHIU

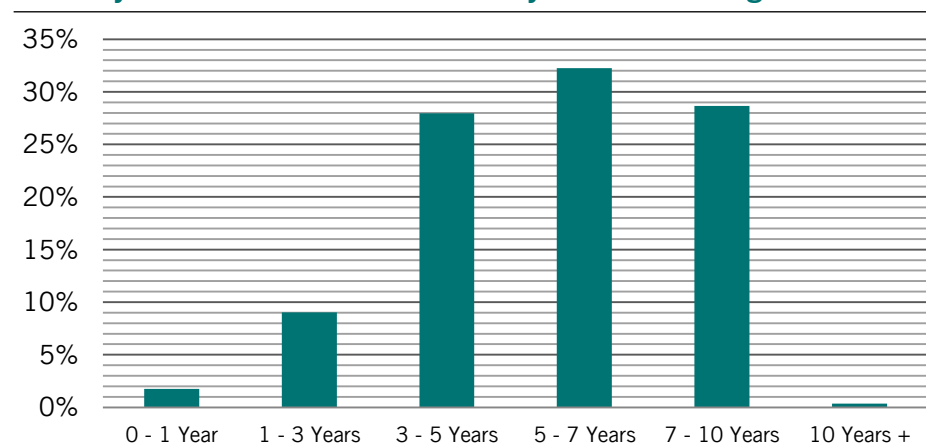
Source: Bloomberg Barclays, Pictet Asset Management as of 31.12.2018.

Rating breakdown (absolute weight)



Source: Pictet Asset Management as of 31.12.2018

Maturity breakdown (Years to maturity - absolute weight)

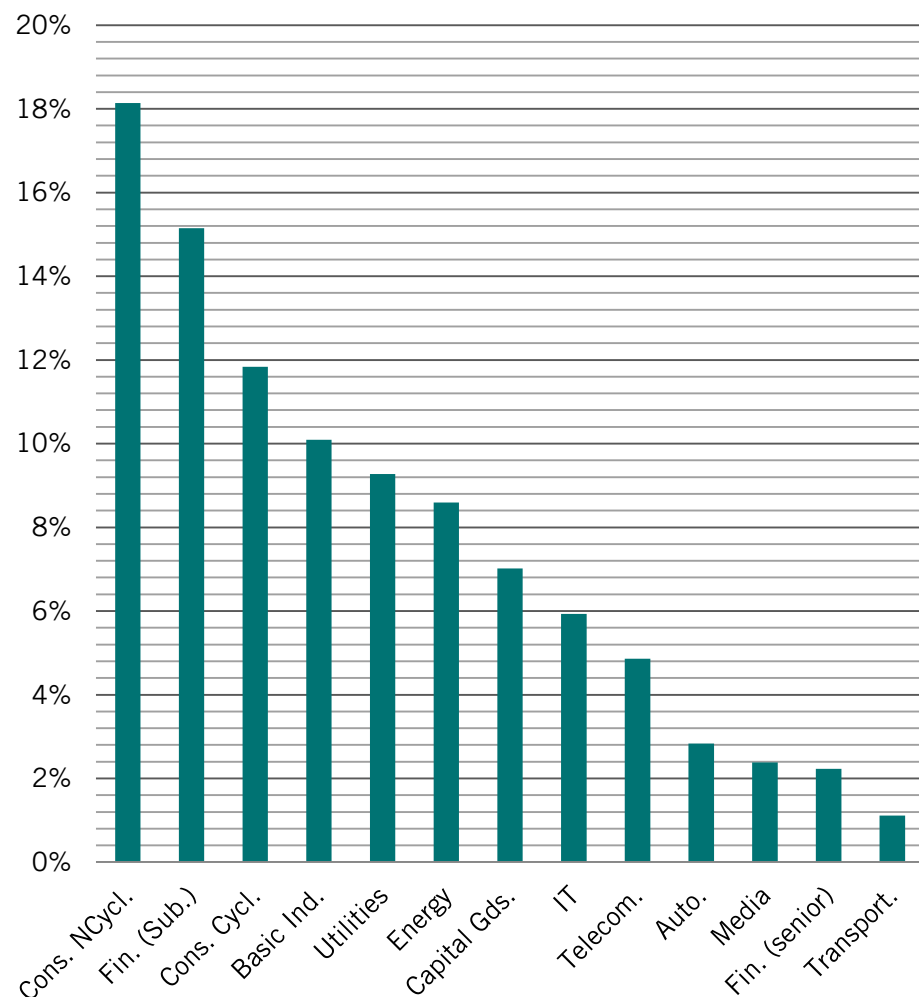


Source: Pictet Asset Management as of 31.12.2018



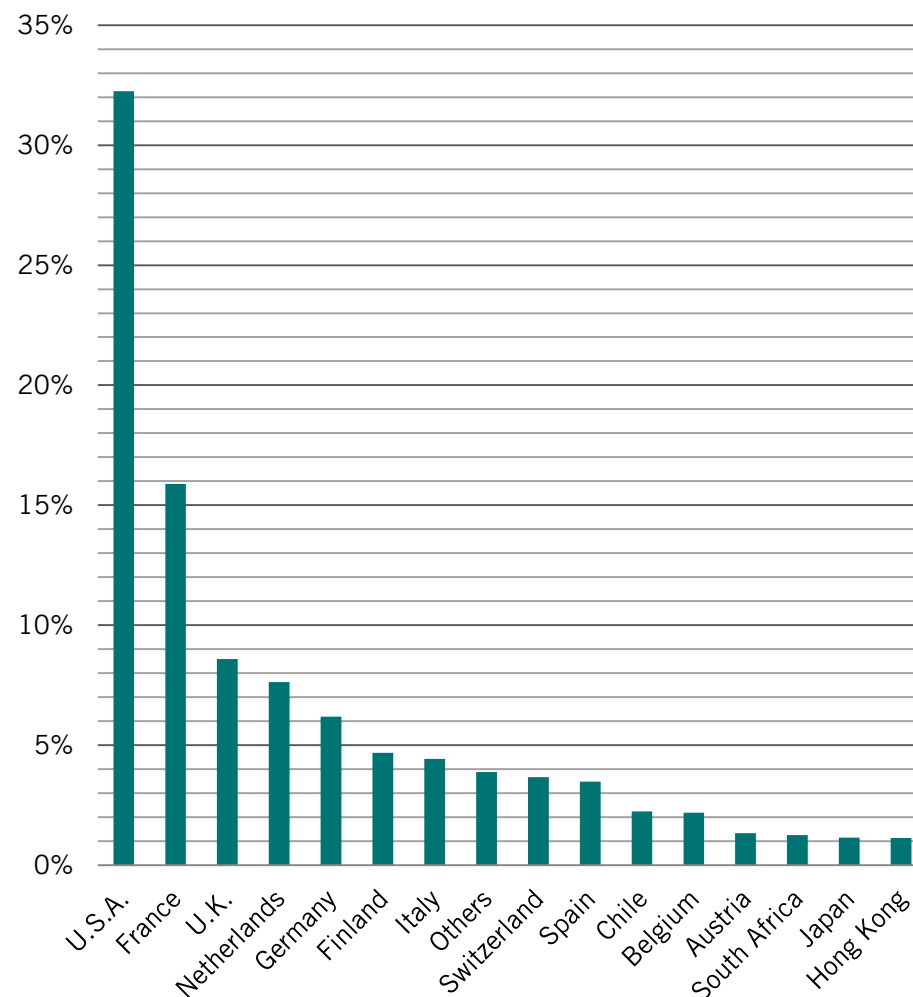
PICTET-GLOBAL SUSTAINABLE CREDIT – CHARACTERISTICS & POSITIONING

Sector breakdown (absolute weight)



Source: Pictet Asset Management as of 31.12.2018. Cash + Forward P&L is excluded and represents 2.49%.

Country breakdown (absolute weight)

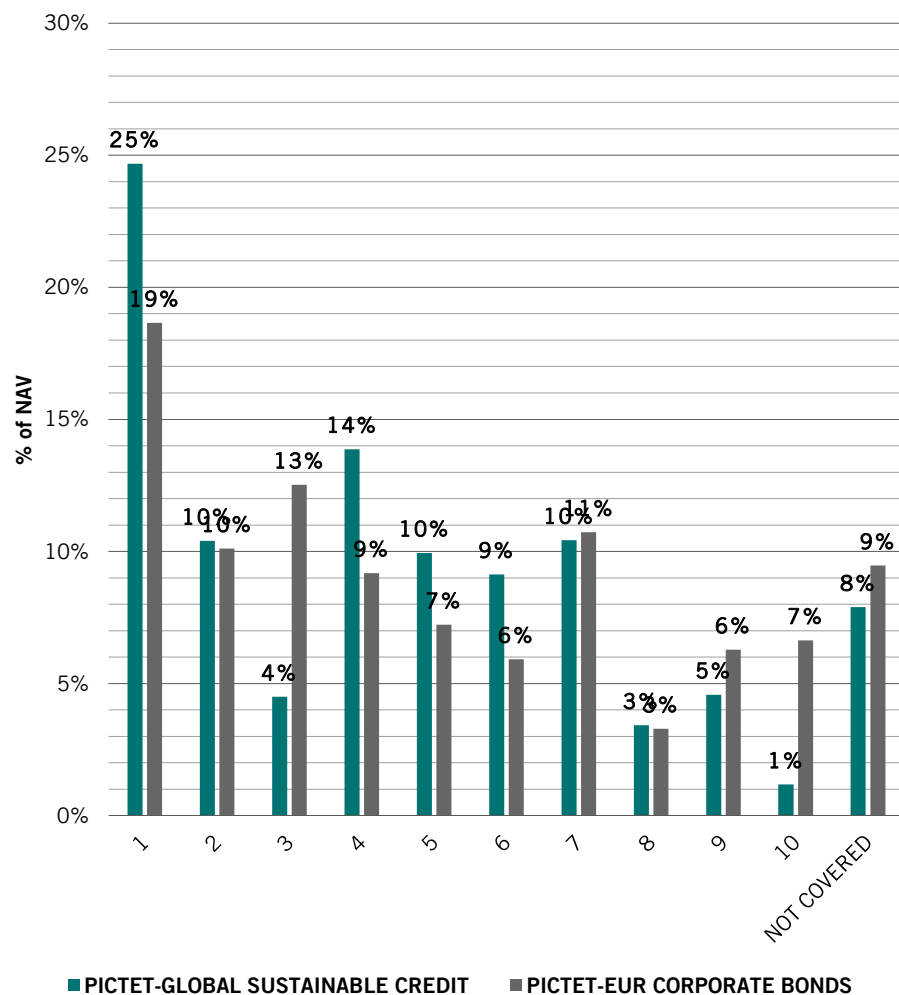


Source: Pictet Asset Management as of 31.12.2018. Cash + Forward P&L is excluded and represents 0.56%.



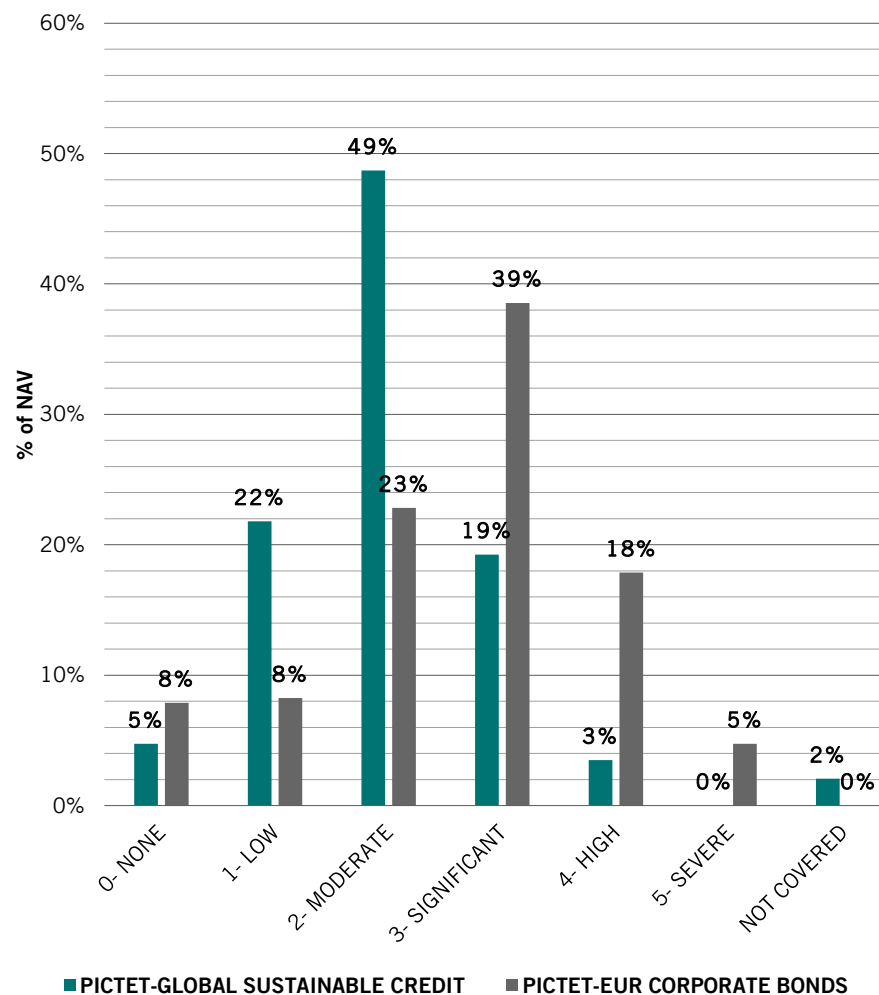
PICTET-GLOBAL SUSTAINABLE CREDIT – ESG SCORES

Corporate governance



Source: ISS as of 25.01.2019

ESG Controversies

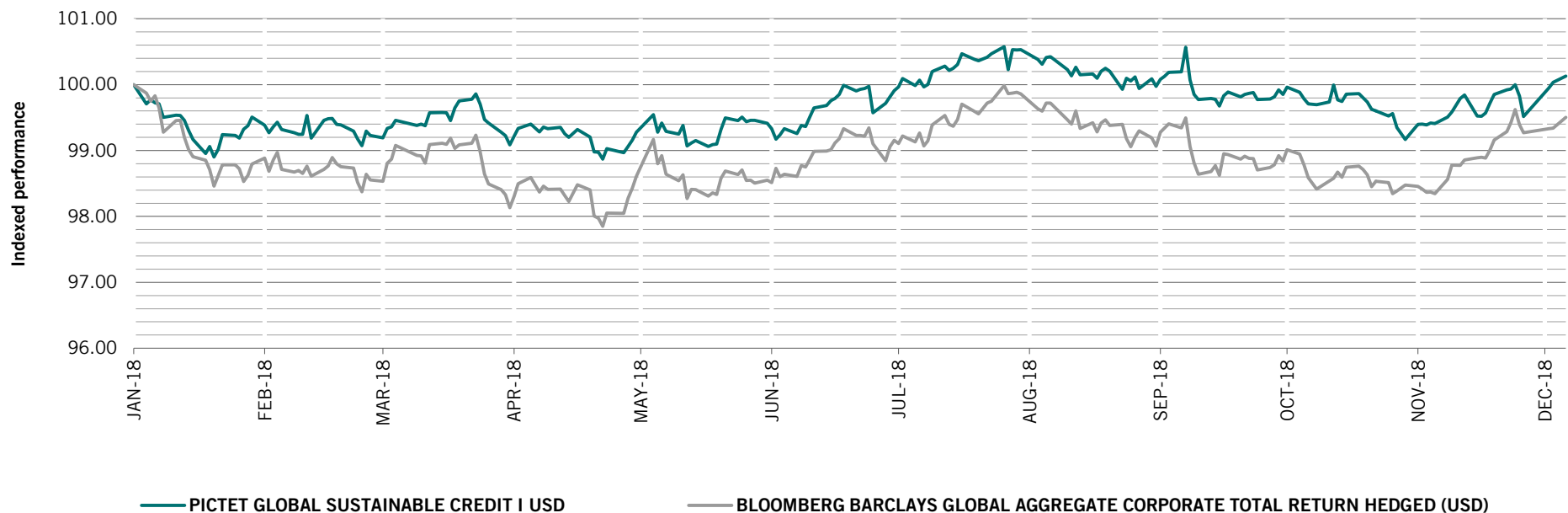


Source: Sustainalytics as of 25.01.2019



PICTET-GLOBAL SUSTAINABLE CDT – PERFORMANCE (I USD) AS OF 31ST DEC 2018

Performance since repositioning as of 26.01.2018



Source: Net Asset Value, Pictet Asset Management as of 31.12.2018.

Detailed Performance history (Repositioning as of 26.01.2018)

	PTF (%)	REF INDEX ¹ (%)
Cumulative performance	0.13%	-0.50%

¹ Bloomberg Barclays Global Corporate

Source: Net Asset Value, Pictet Asset Management as of 31.12.2018.

CONCLUSION

- 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

For more information

PICTET ASSET MANAGEMENT
www.assetmanagement.pictet

This marketing material is issued by Pictet Asset Management (Europe) SA. It is neither directed to, nor intended for distribution or use by, any person or entity who is a citizen or resident of, or domiciled or located in, any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation. Only the latest version of the fund's prospectus, KIID (Key Investor Information Document), regulations, annual and semi-annual reports may be relied upon as the basis for investment decisions. These documents are available on www.pictetfunds.com or at Pictet Asset Management (Europe) SA, 15, avenue J. F. Kennedy L-1855 Luxembourg. The information and data presented in this document are not to be considered as an offer or solicitation to buy, sell or subscribe to any securities or financial instruments. Information, opinions and estimates contained in this document reflect a judgment at the original date of publication and are subject to change without notice. Pictet Asset Management (Europe) SA has not taken any steps to ensure that the securities referred to in this document are suitable for any particular investor and

this document is not to be relied upon in substitution for the exercise of independent judgment. Tax treatment depends on the individual circumstances of each investor and may be subject to change in the future. Before making any investment decision, investors are recommended to ascertain if this investment is suitable for them in light of their financial knowledge and experience, investment goals and financial situation, or to obtain specific advice from an industry professional. The value and income of any of the securities or financial instruments mentioned in this document may fall as well as rise and, as a consequence, investors may receive back less than originally invested. Risk factors are listed in the fund's prospectus and are not intended to be reproduced in full in this document. Past performance is not a guarantee or a reliable indicator of future performance. Performance data does not include the commissions and fees charged at the time of subscribing for or redeeming shares. This marketing material is not intended to be a substitute for the fund's full documentation or any information which investors should obtain from their financial intermediaries acting

in relation to their investment in the fund or funds mentioned in this document.