

MyConsultant

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Consultant

Kirsten is a Consultant and member of the ESG, Global Equities and Alternative Investment Strategies Research Teams.

Prior to joining JANA in 2009, Kirsten was based in the UK, most recently as an Investment Consultant with London-based asset consultancy P-Solve Asset Solutions. Her role included client servicing and investment and manager research.

Kirsten holds a Masters of Applied Finance from Macquarie University, a Bachelor of Commerce (Economics) and a Bachelor of Arts (Asian Studies) from the University of New England.



Anna Joh

Investment Analyst

Anna is an Investment Analyst, and a member of the Australasian Equities and ESG research teams.

Prior to joining JANA in 2013, Anna completed the NAB Graduate Program which included

analyst roles in Wealth Finance and Wholesale Banking.

Anna holds a Bachelor of Laws and Bachelor of Commerce (Finance) from the University of New South Wales.

The growing role of ESG in Fixed Interest portfolios

Historically, researchers and investors have focused primarily on listed equity markets when considering the impact of Environmental, Social and Governance (ESG) factors on investment returns. There has been relatively limited analysis of the role of ESG factors in other asset classes, including fixed interest. JANA has seen this change in recent years, with a modest but increasing number of research and discussion papers considering ESG factors in the context of fixed interest investment.

JANA recently conducted a survey of fixed interest managers globally, asking a broad range of questions that explored their views and approach to ESG factors.¹

good governance...it is hard to be confident that the management, leadership and integrity will be in place for the other factors."

Relevance of ESG Factors to Fixed Interest Investing

The vast majority of managers that participated in JANA's survey think that ESG factors influence the financial outcomes of fixed interest investments (**Display 1**). This is comparable to the findings of JANA's past surveys of equity managers, and was higher than JANA anticipated at the outset of the survey, given the relatively low profile that has historically been placed on consideration of ESG factors in fixed interest.

Governance is key

While all ESG factors were considered important, managers generally considered Governance factors more likely to influence financial outcomes than Environmental and Social factors (**Display 2**).

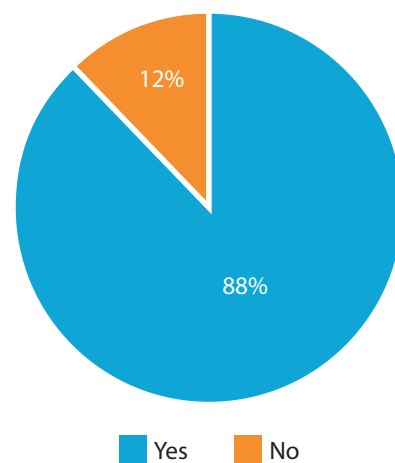
One manager summed up the reason they place greater emphasis on Governance succinctly:

"Ultimately, the Firm considers "G" to be the most important of the three ESG factors. Without

Unique Challenges

It was clear from responses to the survey that fixed interest managers face some unique challenges to incorporating ESG factors in their investment process.

Display 1: Do you think ESG factors influence the financial outcomes (risk and/or return) of fixed interest investments?



¹ JANA's fixed interest survey received 63 responses, including all major fixed interest managers globally and representing approximately A\$9.1 trillion in fixed interest funds under management.

Engagement

Managers considered the inability of bondholders to engage with and/or influence an issuer to be a major hurdle to incorporating ESG in the investment process. Fixed interest managers can meet with company management, but it was generally felt that the absence of a vote is a hindrance to their engagement efforts, in contrast to the equity investor's position. This was seen as a particular problem when demand for bonds is high and issuers can easily raise capital without having to be responsive to bond holders' concerns.

Materiality

While the potential impact of ESG risks to issuers were well acknowledged, determining whether an ESG risk would meaningfully change the likelihood of default was less clear, as was the timeframe in which the ESG risk may occur.

ESG factors in the fixed interest context include, but are not limited to:

Environment

- **Corporate debt:** climate change, energy efficiency, water and waste treatment practices.
- **Sovereign debt:** climate change, natural resource reliance, regulatory framework for waste and water treatment.

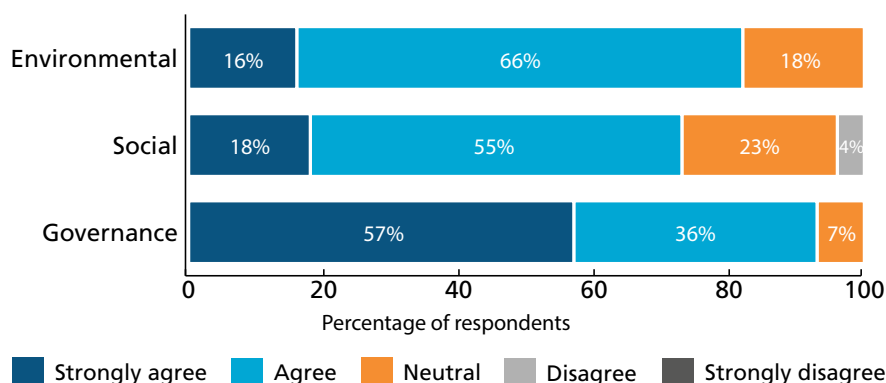
Social

- **Corporate debt:** human capital, workplace health and safety, industrial, community and stakeholder relations.
- **Sovereign debt:** population demographics, human rights, regulatory backdrop for employee and consumer protection, social support framework.

Governance

- **Corporate debt:** business ethics, transparency of company management and reporting, executive remuneration, board structure.
- **Sovereign debt:** strength of legal structures, corruption, sustainability of debt levels, government stability.

Display 2: Please indicate the extent to which you agree/disagree that the following factors influence the financial outcomes of fixed interest investments.



Determining the materiality of ESG factors is arguably more challenging for a fixed interest investor than it is for an equity investor due to the nature of each investment and their position in the capital structure. Whereas an equity investor is exposed to every success or failure of a company, no matter how small, the bond holder is only entitled to a predetermined return stream over a specific time frame. An ESG event would arguably need to be more significant to influence the company's financial position to the extent that it would meaningfully affect the issuer's ability to meet the terms of the bond and thereby influence the value of their bonds, than it would need to be for equity investors to be impacted. In that context, the considerable focus placed on this challenge by fixed interest managers is unsurprising.

Data Availability

Another challenge highlighted by the survey responses was the limited availability of ESG research and access to information. Some managers indicated that there is not enough third party ESG related research and analysis available to fixed interest investors, while others focused on issuer transparency and the availability of ESG-related data that could be utilised for proprietary research, especially in the context of private companies.

While it was a view held by a small minority, some managers indicated they felt the limited supply of ESG research and analysis provides an

informational advantage to those that devote resources to extensive ESG analysis in house.

Conclusion

At the inception of this survey, JANA anticipated that fixed interest managers would be less well versed and less developed in their thinking regarding ESG issues than their listed equities counterparts, on account of the greater focus placed on listed equities to date. This was not the case in practice, with responses indicating that fixed interest managers are increasingly focusing on ESG issues.

The survey highlighted that there are unique challenges faced by fixed interest managers. Availability of ESG information and limited capacity to engage with issuers were commonly cited hurdles. More fundamentally, many managers continue to work through the challenge of determining the materiality of ESG factors for fixed interest investments. However, what is clear from our survey is that managers are increasingly tackling these challenges to incorporate ESG factors into their investment process more comprehensively.

The full survey results are available upon request. Please contact your JANA consultant should you wish to receive a copy.

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