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# COP26: Banks key to net-zero emissions

Just days away from the COP26 summit in Glasgow, T. Rowe Price's Maria Elena Drew discusses the vital role of banks (page 2)

## Nordea to open ESG hub in Singapore

Nordea Asset Management is planning to open an ESG hub in Singapore – the group's first such outpost outside of its Nordic headquarters.

The hub will allow Nordea to be closer to its clients in Asia-Pacific and better understand how the region's companies are embracing sustainability.

The hub will be constructed around a group of ESG analysts, recruited locally and integrated within Nordea's renowned Nordic-based RI team. Local knowledge and perspectives will add value to Nordea's ESG integration process and enhance the ability of portfolio managers to identify the winners of tomorrow – a key tenet of its ESG 'STARS' fund range.

Nils Bolmstrand, CEO of Nordea AM, says: "Nordea is pleased to establish an ESG hub in Singapore, which will enable us to enhance our local servicing, ESG capabilities, investment platform and distribution reach in the region. Sustainability issues have gained significant interest in Asia in recent years, and investors are increasingly asking for ESG solutions. The time is right to meet that demand."

Nordea's new ESG hub will supplement its local Singapore distribution office, established in 2013. Implementation is set to begin in the latter part of 2021.

# Banks key to net-zero emissions

**Maria Elena Drew**
**T. Rowe Price**

One of the core goals of COP26 is to mobilise the world's financial institutions around contributions to climate finance to help ensure we meet net-zero targets.

As key financers of the economy, banks will play a pivotal role in the transition toward a low-carbon economy through both green financing and efforts to align lending portfolios to the goals of the Paris Agreement.

The world's banking regulators are putting climate risk at the top of the agenda. Climate stress tests are being carried out in several jurisdictions – including the UK, Japan, Australia, and Europe. While there are no concrete announcements from US regulators, the Fed has identified climate change as a risk to financial stability.

So far, more than 50 banks from across 29 countries have signed up to the Net-Zero Banking Alliance, an industry-led initiative convened by the UN, with members committed to bringing portfolios to net-zero emissions by 2050 or sooner.

A key goal of COP26 is securing commitment from developed countries to mobilise climate finance of at least $100bn per year to help facilitate global net-zero. Banks will be crucial, and most leading institutions have now set targets for sustainable and green financing. For example, HSBC plans to provide $750bn to $1trn in low-carbon financing by 2030, while Bank of America plans to upsize its sustainable financing target from $300bn to $1trn.

We believe there is a potential revenue opportunity for banks at the forefront of green financing. Banks may even receive capital incentives in the future, similar to programmes launched by central banks in the past to encourage lending to SMEs. For example, Pillar 1 capital requirements could be lowered for a bank's exposure to green assets.

With increased attention from regulators and growing scrutiny from shareholders and non-government organisations, banks could suffer reputational damage unless portfolios are aligned to the goals of the Paris Agreement. While a lack of standardised frameworks is an immediate challenge, we expect best practices and common guidelines will emerge over time.

*"Banks could suffer reputational damage unless portfolios are aligned"*

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## Stonehorn links with Harrington Cooper

Stonehorn Global Partners has partnered with fund distribution specialist Harrington Cooper to promote the Stonehorn Asia Equity Fund in Europe.

Managing more than $4bn, Stonehorn was founded about three years ago by former members of Macquarie's Asian equities team.

The Stonehorn Asia Equity Fund is a high conviction, long only Asia ex-Japan portfolio – unconstrained in terms of sector, country and market cap. It is also conscious of ESG factors.

Sam Le Cornu, CEO of Stonehorn, comments: "Stonehorn Global Partners' European expansion is taking flight. We are delighted to appoint Harrington Cooper as our distribution partner in the UK, Ireland, Austria, France, and Germany."

Harry Dickinson, managing partner of Harrington Cooper, adds: "Stonehorn possesses all the characteristics we deem critical for success in the asset management business. It is a highly focused, independent, employee-owned boutique, with all motivations aligned to focus on generating positive alpha within the inefficient Asian equity market. Having ESG embedded in the process since inception means it is central to the team's work. Furthermore, there are very few genuinely capacity conscious managers in this space."


# Screening not the answer in ESG

**Alison Savas**
**Antipodes Partners**

The focus on investing through an ESG lens has intensified. But it is not as simple as buying stocks with 'green credentials', or divesting exposure to carbon or stocks scoring poorly on backward-looking metrics.

ESG investing must be forward looking. Intransigent stock screening is not the answer to create change or to generate alpha.

Take power utilities as an example. Many score poorly on a backward-looking basis because of carbon intensity, yet many are investing in renewable capacity because it is essential to the long-term solution to decarbonise economies. High carbon emitters are some of the most important pivot points to decarbonisation and should not be ignored.

For investors there can be significant value in owning companies misunderstood from an ESG perspective. This is where ESG can be a source of alpha, along with creating positive outcomes for society.

*"There can be significant value in owning misunderstood companies"*

The retrofitting of global energy systems designed to run on fossil fuels is a shift unsurpassed by anything since the industrial revolution. While significant progress appears to have been made, fossil fuels still account for about 80% of primary energy globally.

Renewables will continue to rapidly expand in all parts of the world, but we also expect an expansion in global gas consumption over the next decade. Natural gas produces half the emissions of coal per unit of electricity and its importance is being materially undervalued in the decarbonisation narrative. As grids are growing increasingly unstable due to higher penetration of renewables, they are burning more gas. We see two powerful drivers – the first is the replacement of coal, and the second is this balancing act within power grids.

## Gresham House hires manager for BSIF team

Gresham House has further strengthened its sustainable infrastructure team with the addition of investment manager Ana Janine.

The hire follows the recent successful £100m first close of Gresham House's British Sustainable Infrastructure Fund II (BSIF II), backed by the Worcestershire Pension Fund and Teesside Pension Fund. BSIF II, a direct follow-on to the now fully invested infrastructure strategy BSIF I, targets real assets-based solutions addressing environmental and societal challenges.

Led by Peter Bachmann, the Gresham House sustainable infrastructure team has vast experience in infrastructure investment and development – as well as direct sector expertise in areas such as renewables, clean tech, waste, education, healthcare and fibre.

Working across both BSIF I and BSIF II, Janine's addition will further strengthen the team's focus on six key sub-sectors – resource efficiency, digital inclusion, waste solutions, regeneration, decarbonisation, and health & education.

Janine comments: "This is an exciting time to join Gresham House, as we look to source attractive opportunities to invest in the underfunded mid-market UK infrastructure space."

**Louis Larere**
**Zadig - OYSTER**

# The benefits of 'SARP'

As investing goes green, asset managers are increasingly allocating to growth leaders displaying high ESG scores. Only a handful of rating agencies are in this business – and it is far from a perfect science.

Investors should focus on the use of ESG as a fundamental part of the investment process, not a simplistic filter or shortcut to select the best companies. Furthermore, mere ESG integration should not be equated with sustainable investing.

There are many interesting sustainable investments outside the 'growth' sectors of the market. In fact, many good cyclical or value companies are often overlooked. Our motto 'sustainability at a reasonable price' reflects a new investing world, where exuberance over unrealised potential in green stocks is manipulating valuations.

The sustainability leaders of the future are now in transition – as these companies do not have a green halo bequeathed by ratings agencies, they are trading at very interesting multiples.

Unlike other sustainable funds, we do not use third-party scores that can be manipulated by the data provider or an IR department, and there are no binary questionnaires. In sum, we pay attention to valuation and the price paid for sustainability exposure.

Ultimately the goal is 'sustainability at a reasonable price', whereas other funds seek 'sustainability at any price'.

*"Sustainability leaders of the future are now in transition"*

**YT Boon**
**Neuberger Berman**

# Innovations in Asia

There is no denying China, Asia's largest economy, is undergoing a cyclical slowdown and a strategic reorientation.

However, it is important to remember there are plentiful investment opportunities in Asia – not only in the industrial automation, IoT and 5G themes, but also in the consumption and internet-related themes now taking a backseat in China.

We believe countries like India or Indonesia are the places to look for Asia's new Alibabas, for instance. They are at the stage of economic development China went through 10 or 20 years ago, and digital penetration remains relatively low – but we are already seeing the emergence of local and regional 'super apps' for mobile banking, ride-hailing, e-commerce, food delivery and mobile gaming.

As investors, we can also benefit from embracing Asia's increasingly global cultural innovations. Yes, South Korea is a well-known hub for semiconductors. But it is much better known by millions of fans around the world as the epicentre of K-pop and mobile gaming.

A single online concert by boyband BTS can reach more than 100 million viewers across the world, pulling in tens of millions of dollars from online subscriptions, merchandise, exclusive content and interaction for its parent company. The combination of fandom and faster global connectivity appears to be a rapidly-growing business.

*"Asian digital penetration remains relatively low"*

# Minimal HY defaults in Europe

**Jonathan Butler**
**PGIM Fixed Income**

***"Results show a default rate of 1% over the next 12 months – which remains below consensus"***

During the depths of the Covid crisis in mid-2020, we conducted a bottom-up default analysis across the European HY sector.

At that time, we concluded defaults would remain below 3% over the next 24 months, far less than the consensus. Since then, the economic recovery in Europe has strengthened, corporate earnings have surprised to the upside, and credit fundamentals have continued to improve.

Our analysts recently repeated the exercise, and results indicate a default rate of 1% over the next 12 months – which remains below consensus estimates and would be the lowest rate in more than a decade.

For example, the trailing 12-month default rate peaked at 5.1% in November 2020 and ended June 2021 at 4%, according to Moody's. It expects the default rate to decline to 2.2% over the next 12 months, which is more than double the rate of our analysis.

The coordinated monetary and fiscal policies since the outset of the pandemic have included negative rates, QE, targeted loans, tax breaks, compensation programmes, and furloughs. Moreover, this support boosted liquidity in the capital markets, which allowed companies to recapitalise, but not necessarily by levering up. With the support of equity sponsors and lenders, companies enhanced liquidity, refinanced debt at a lower interest rate, and extended maturity profiles. As a result, the average coupon in the European HY market dropped nearly 50 bps from the end of 2019 to about 3.5% in late July, and maturities were extended in each year out to 2026.

Distressed funds also raised a considerable amount of capital in 2020, which can be deployed to support companies in avoiding default and/or to purchase assets following default. The latter enhances recoveries for creditors. Our default analysis showed a recovery estimate of 48% over the next 12 months. This is on the high side of historical averages in the mid-to-high 30% range.

Corporate performance has also improved as economies emerge from lockdowns. EBITDA growth has rebounded from a 15% contraction and total debt has stopped growing. And the recovery in free-cash flow growth has lifted the free-cash flow-to-debt ratio to the highest level in more than a decade.

In aggregate, the combination of factors has resulted in very few distressed credits. At the end of June, only eight bonds traded below a cash price of 80, comprising only 0.4% of the European HY market. In spread terms, only 20 bonds, or 1.1% of the market, traded with spreads in excess of 1000 bps.

While our short-term optimism is tempered by the tail risk of a Covid mutation or that central banks pre-emptively over tighten policy to address inflation concerns, we believe the European HY market will remain resilient. Full valuations are another short-term consideration, yet over the longer term, active credit selection can continue identifying pockets of value.