Looking into 2019 with Hermes

2018 was a very exciting year for us. In joining with Federated we have formed a truly global asset manager which means that over the next year we will be able to extend our capabilities further than ever before. A focus for us is being able to leverage Federated's extensive network and bring to them our expertise in ESG investing.

In terms of markets, 2018 saw the first stumble in the long bull run, with the world index down as I write some 12.15%[1] and the ACWI down 13.95%[2] from their peaks in January, reflecting the much deeper correction in emerging markets. 2019 poses challenges for investors. On the one hand, US economic growth remains very much on track for a strong year, with strong earnings, but that implies further monetary tightening; China continues to expand her exports, despite the sanctions (and let us not forget that at over 6% remains ahead of the pack in terms of economic growth), while Europe on the other hand is clearly slowing down at a time when the ECB has no monetary ammunition left to throw at the problem. Politics will continue to dominate, with the prospect of trade wars still in the air and the possibility of a more uncertain policy direction in the US post the midterm elections looming large. Meanwhile, threats of rogue states and cyber security continue to increase with a possible negative impact on markets, while closer to home Brexit remains as a source of uncertainty as does the spending plans of the Italian populist government.

In some ways, we are returning to more 'normal' historic trends with a tension between growth and interest rate hikes and a dislocation of correlating between asset classes and regions, which in turn implies two outcomes: stock picking and asset allocation will reassert their ability to add to returns and the mass moves to index funds and ETFs will probably coincide with a period of their underperformance compared to high active share alpha hunting strategies. Within that trend, we see a growing acceptance of incorporating ESG factors in fundamental analysis as a way of enhancing long term financial returns as well as doing the right thing and meeting a growing wave of investor demand. We believe our strategies at Hermes which all share in being high active share and in integrating ESG and stewardship in their processes are well placed to benefit from these long term cyclical trends. In the meantime, volatility, partly driven by politics, will continue to add to the short term directional uncertainty of markets.

Saker Nusseibeh
Chief Executive

[1] MSCI World Index: -12.15% (Jan 26th to Oct 29th).
[2] MSCI AC World Index: -13.95% (Jan 26th to Oct 29th).

INVESTMENT

There will be three central themes for 2019: (i) an increased focus on all things ESG, particularly climate change; (ii) further boosts to the cause of diversity and inclusion; &, (iii) an end to the bull markets in equities and bonds, ten years in to the former and more than thirty years in to the latter.

The IPCC's timely reminder in October that 2°C warming of our planet may be too much served to re-energise the climate change movement. Many have suspected for a while that the more ambitious 1.5°C target may be the right one, but it may in fact be too late for either. The wonders of science are such that our understanding of the issues and effects of climate change develop every year – the bad news is that the outcome, not a good one, is also better understood.

2018 was the year of the woman: consider the #MeToo movement, the mass protests against the appointment of Judge Kavanaugh to the US Supreme Court, or the critical role played by women in politics (as both politicians and voters in the US midterms, representation in the Mexican congress, or the equal gender split in the French cabinet).

2019, then, is the year for the investment industry to truly pick up the challenge – I firmly believe that social diversity is the last free lunch of diversification – we've enjoyed spreading our capital across asset classes, sectors and geographies, and now we must take advantage of diversity, if for no other than good economic reasons. It simply makes commercial (and investment) sense.

Our investment focus will change in other ways too – absolute will replace relative return, alpha will trump beta, and a long-term investment focus will come to the fore. The next several years will present new challenges, or at least ones not seen for the last ten years. But a long-term horizon will also reveal opportunities perhaps less well-appreciated in the old short-term world.

Eoin Murray
Head of Investment

MACROECONOMICS

Economic growth has lost momentum globally over 2018 and the trend is likely to persist in 2019. Indeed, there are many sources of fragility. First, growth has become less synchronised in 2018, reflecting an accelerating US economy vis-a-vis slower activity across the rest of the world. Available historical evidence suggests such episodes of growth divergence are hardly sustainable. It is therefore conceivable that a more homogenous growth picture will reassert itself sometime next year. The evolution of trade tensions could be key in determining the direction of convergence. In particular, an escalation could trigger convergence via a US slowdown. Further US-driven trade measures have the potential to backfire, offsetting the residual positive impact from fiscal stimulus in 2019.

Trade tensions between the US and China are likely to remain in the spotlight, and China will probably continue to slow down in a controlled fashion, also reflecting domestic dynamics and ongoing deleveraging efforts.

At the same time, global financial conditions have tightened, mainly driven by the Fed gradually withdrawing extraordinary post-crisis stimulus. Less accommodating financial conditions, coupled with a slowing China and persistent trade tensions, have created challenges for emerging markets. Stress is likely to remain confined to countries featuring weak fundamentals.

Policymakers –central banks and Chinese authorities in particular – seem to be in control for now, but trade-offs and risks of policy errors are on the rise. Indeed, central banks might face the unpalatable dilemma between re-activating support for sputtering economies and dealing with growing financial imbalances.

Silvia Dall'Angelo
Senior Economist

EQUITIES

Global Equities

The three year US risk free interest rate has moved – and so have investors' options. We have progressed from "there is no alternative" to "there is a real alternative". For the first time since 2007 there is a positive real return investing in three year US risk free bonds. Companies face a higher cost of debt, which makes it less attractive to invest in their businesses. At the same time, tax cuts and a booming US economy has fuelled an increase of over 25% in the S&P500 index over the last two years. Political uncertainty and a potential trade war on the horizon could further increase the cost of doing business. Since the bottom of the market in 2009 we have experienced six corrections and we are currently most likely facing the seventh.

We have been experiencing a narrow market, with the FAANGs explaining most of the stock market returns. However, we believe we are set for a broadening in the market. At the same time as seeing early signs of weakness in the FAANGs, other pockets of the market have very attractive fundamentals.

After a long period of low real interest rates resulting in growth outperforming value stocks we believe value is inexpensive versus growth. For example, we are seeing attractive investment opportunities in the oil services sector and US regional banks. In Japan we are also finding stocks with strong fundamentals at attractive prices. We believe 2019 will be a strong year for investors focusing on a wider range of fundamental characteristics.

Geir Lode
Head of Global Equities

European Equities

Over the past 10 years, there has nearly always been something that has affected sentiment towards European equities and today is no different. The current poor attitude towards the asset class is due to the ubiquitous Brexit negotiations and Italy's fiscal laxity, which has set them on a collision course with the EU. Europe is also highly sensitive to the global economy and the increasing potential for a full-blown US-China trade war has affected the region perhaps more any other developed market.

While much of this is reflected in valuations, investors have become increasingly skittish, highlighted by some extraordinary reactions (both positive and negative) to earnings releases. However, despite the apparent gloom, it should be remembered that Europe is set to deliver another year of earnings growth in 2018.

Looking ahead to 2019, there are a number of concerns that should keep volatility elevated. Chief among them are increasing earnings risk as concern grows that global growth could slow down.

On the flipside, a weaker Euro could provide a useful tailwind for European companies. However, if a slowdown does materialise, the central banks have few levers left to pull, to help stimulate economic activity.

Our mantra of 'the market is not the economy' has rarely felt so apt. When fear is ripe, opportunities emerge and there will undoubtedly be plenty of opportunities for active European equity managers next year. Given the uncertainty, we think the opportunities will tend to reside among structural growers that have a high degree of earnings visibility.

James Rutherford
Head of European Equities

Emerging Markets

The tailwinds supporting emerging markets (EMs) in early 2018 – improved economic resilience and corporate productivity, rising commodity prices and a benign US dollar – have given way to the headwinds of trade disputes, high inflation, spiralling currencies and declining growth rates. It is rough out there, but EMs are broader – and better – than the crisis-stricken economies that have dominated newsflow. We believe that many companies will progress despite the changing winds, and that investors can profit from this. As it stands, the outlook for EM is positive for 2019. The competition from US equities should diminish as the earnings boost from tax cuts runs its course, and large deficits abate the tailwinds the dollar has enjoyed. GEM fixed income is well supported by spread differentials and GEM currencies have corrected enough in our view. EM economies are in good shape overall and earnings growth for next year looks healthy at this point. Finally, most GEM economies are in good shape and are growing a fair amount faster than the developed world, even if, as expected, Chinese growth slows slightly.

Gary Greenberg
Head of Emerging Markets

Asia ex Japan

Given multi-decade low unemployment rates in the US and at least anecdotal evidence of rising wages, it is becoming more plausible that the US 10 year treasury yield (an important global risk free benchmark) will rise to 3.5% and beyond, a development that would be bearish for all assets except US dollar cash. We consider this to be a main cause of the current turbulence in global markets. If the US 10 year yield indeed continues to move higher, we expect existing asset bubbles to continue to pop globally. Prime candidates include London and Hong Kong residential property, expensive but low growth 'yield stocks', and expensive growth stocks that have a large proportion of their value comprised of distant cash flows.

Asia ex-Japan stocks, traditionally viewed as a riskier asset class, will not be immune to any continued volatility. However, unlike many other asset classes, Asia ex-Japan stocks (now at a similar level to where they were some eight years ago) are already attractively priced. Thus notwithstanding any continuing short term volatility that would occur if rates continue higher and even in the context of (what we consider to be) a cyclical decline in consumer sentiment, we expect Asian stocks to produce good absolute returns from here over a 5 year horizon, and believe they will outperform most other asset classes.

Jonathan Pines
Head of Asia ex Japan

Small and Mid Cap

Markets are currently going through a period of repricing after a long liquidity-fuelled rise. The repricing is being driven primarily by valuations i.e. the rating – the multiple that investors are prepared to pay – for earnings or cash flows. Investors are more hesitant now that US long term rates have firmly broken their downtrend and trade uncertainty remains. It will therefore take some time before a new level of support is determined for the equities market. Critical in this process will be the ongoing attraction of the equity market versus a better return now on offer from bonds and cash, and within the equity market, the degree of rotation that takes place between sectors. In addition, earnings are under some pressure due to inflation in the cost base of many companies, from labour in particular, and this is likely to be increasingly felt in 2019.

In this environment of increased uncertainty, we fall back on our tried and tested approach of looking for stocks with high barriers to entry and strong pricing power, and buying when they are out of favour. The increase volatility currently in evidence is producing, and will doubtless continue to produce, a number of anomalies that we hope to exploit. Right now, such opportunities are appearing for long term investors in European industrials and in many parts of the UK market – the All-Share yielding above 4% is considered to be a good buying indicator.

Hamish Galpin
Head of Small and Mid Cap Equities

US SMID

While the underlying domestic economy appears robust going into 2019, with many sentiment indicators at or near their highs, we expect an increased level of volatility within the stock market over the coming months. Amongst other worries, investors will be concerned about the timing and pace of future interest rate rises and the effect this reduction in liquidity will have on current asset prices and the prospective company earnings. Set against that, market valuations are acceptable, underlying demand remains strong and significant share buybacks continue. The small and mid cap area of the market also benefits from a higher domestic exposure and, in many cases, innovative companies exposed to structural growth trends. As ever, stock picking will be key and we continue to focus on high quality companies that should benefit if the markets move higher, but equally manage downside risk.

Mark Sherlock
Head of US Equities

Impact Opportunities

The pick-up in volatility that we saw in 2018 affecting a broad range of asset prices is expected to persist into 2019. As central bank-created liquidity found its way into asset markets, boosting valuations across the board, we would fully expect the continued reversal of their monetary policies to have broadly the opposite effect. While we expect to remain in an uncertain macroeconomic environment, amplified by headlines about trade wars and the ongoing debate about whether, and to what extent policy-makers will step-in to counterbalance these headwinds, our investment approach remains unchanged. We continue to look for new ideas that fit within our investment themes that provide emerging growth opportunities arising from a global imperative to meet the 2030 UN Sustainable Development Goals. We would also expect these emerging product areas to therefore be less exposed to geopolitical and macro risks implied by market valuations over the longer-term. If growth expectations recede, these companies should attract a premium valuation as they are less reliant on the cycle. On the flipside, if growth picks up, the markets' failure to correctly price in these emerging growth opportunities should help them continue to deliver earnings ahead of expectations. We believe this approach will be vital in driving positive returns over time, regardless of the prevailing style headwinds or tailwinds and macroeconomic environment.

Tim Crockford
Lead Manager

MULTI ASSET

We expect that 2019 will mark the end of this market cycle. We see three major trends transitioning into next year: (1) the de-synchronisation of global growth with the US economy breaking away, (2) the concurrence of gradual reflation and decline in money growth globally, and (3) the escalation and widening of the confrontation between the US and China. We expect the gravitational pull towards US assets to accelerate until the Fed is forced to change course.

Most assets classes have benefited from the massive liquidity injected in the system since the Global Financial Crisis. Reversing such a process will have the opposite effect. Active asset allocation will matter once more and should outperform passive alternatives.

Last year we raised our concern of increased fragility due to the growing importance and complexity of some systematic strategies. Like in October 1987, May 2010, or August 2015, during 2018 the market experienced 'air pockets' – sudden risk-off episodes. While the triggers of these events can be diverse and hard to predict, the ferocity of the market correction is rooted in the crowding of both positioning and investment approaches. The increased accessibility of global financial markets through passive vehicles and years of stubbornly low levels of volatility has pushed many market participants into the same corner. Concurrently, the popularisation of systematic and factor-based strategies means that investors are relying on similar automated approaches. As a result, not only are investors likely to be exposed to similar assets, but they are likely to react to market events in the same way.

Investors should start the new year with a conservative stance, reducing complexity and increasing liquidity in their portfolio.

Tommaso Mancuso
Head of Multi Asset

FIXED INCOME

We exit 2018 more aware of inflation, volatility and temporary sell-offs, and greater dispersion amongst returns. Rates and credit spreads sometimes were correlated, at other times not. For example, the lower end of US HY has generated positive returns in spite of the rates readjustment in the US, while investment grade and high yield in Europe were less favourable. This leaves us facing an investment universe with more obvious opportunities, but potentially more frequent pitfalls.

The effects of unwinding the long-term financial experiment conducted by central banks for the last decade are nearly impossible to predict. We are definitely in the third stage of the credit cycle, but the timing of the final leap into the fourth stage, and the ensuing sell-off, is unpredictable. What is clear at this point is that the underlying fundamentals are adequately robust to withstand the early headwinds we are seeing – such as trade wars, populist policies and geopolitical risk.

However, the stability of the last few years has led to some complacency and issuers have been allowed to increase leverage and remove covenants for the benefit of shareholders, particularly in the leveraged loan space. Emerging markets bonds have repositioned as a surprising safe haven as their perfect storm has already hit, and the combination of low spreads and rates during the last few years means that bonds very clearly take on an attractive convexity profile when some widening occurs. 2019 will be about positive alpha and avoiding negative beta – the good news is that in this world of increasing uncertainty, credit implied volatility remains low compared to its equities peer, and therefore the cost of hedging through options remains attractive.

Andrew Jackson
Head of Fixed Income

Credit

Accommodative monetary policy and strong underlying consumer demand in the US remain, but both have likely peaked. Slower growth, tighter financial conditions and potentially higher inflation make for a year of headwinds. However, we expect that credit metrics will remain strong with the growth in earnings and deleveraging of recent years, particularly in some cyclical sectors, providing a welcome buffer to aid navigation of rougher seas ahead. Escalation of the current tensions between the US and China could exacerbate matters though, as sentiment among both consumers and companies is likely to be highly sensitive to both trade and, of course, central banks' ongoing attempts to tighten monetary policy.

More welcomingly, valuations have already opened up multiple opportunities. Better risk adjusted returns in Investment Grade and the higher rated segment of High Yield are now available, as interest rates and sovereign volatility have caused underperformance this year that is unlikely to continue. Similarly, in the ABS market, better value remains in UK assets as Brexit concerns drive discounts for UK over European ABS. Leveraged Loans, which have so far been insulated from heightened volatility, are likely to become increasingly challenged as covenant light structures and poor convexity weigh.

European and Emerging credit now looks attractive versus US credit, especially taking into account the better average credit quality and draconian hedging costs facing international buyers of US assets. Unlike the flat US treasury curve, credit curves remain steep, increasing the potential gains from roll-down – a powerful kicker to return in a late-cycle world where accepting lower quality credit is likely to result in adverse idiosyncratic stories and a sore head.

Fraser Lundie, CFA
Co-Head of Credit

Mitch Reznick, CFA
Co-Head of Credit

Private Debt

With alternative lenders increasing their penetration in the European loan market, 2019 is expected to be a year of continued competition across the region. Whilst the French, Dutch and Spanish markets will continue to be highly competitive in yield terms with high levels of alternative lender penetration, we expect to see increased competition in the German market during 2019. Nevertheless, despite increased fund presence across Europe, it predominantly remains a banking led market.

Yields will remain attractive as competition amongst lenders will be centred on loan terms rather than pricing. Also with strong economic growth in northern continental Europe and uncertainty in the UK over Brexit, we are likely to see a continued rise in the Sterling premium on loans when compared to Euro denominated loans.

The emergence of defaults in certain business sectors, such as the UK retail sector, will drive much more targeted lending in 2019, with some sectors such as business services, IT, healthcare being preferred over other sectors.

Whilst there has been some push-back by lenders in the large cap market over increasingly aggressive loan structures, we believe that weak structures will continue to be an issue in the market in 2019. Discipline will be needed to make sure that diluted lender protections, such as cov-lite, do not become a feature of the SME lending market. However, we believe that senior secured loans in the mid-market in Northern Europe will continue to offer lenders the best protections and risk reward parameters, in 2019.

Patrick Marshall
Head of Private Debt and CLOs

PRIVATE MARKETS

Real Estate

Whilst the positive yield gap between real estate and bonds continues to support the case for relative value for many investors, we remain concerned about the underlying fundamentals governing occupational demand and therefore future income sustainability. Traditional retail outlets continue to be severely challenged by leakages to the internet and demographic lifestyle trends, and technology and environmental considerations are having a similar profound impact upon office demand. Given that approximately 70% of the return from property in the long run is derived from income, understanding these considerations will be the key to future performance.

Our long term responsible approach to investment and positive experiences from the King's Cross development have emboldened us to challenge the conventional approach to benchmarking 'buildings' based upon backward looking parameters; instead we increasingly invest in sustainable 'places' which benefit from enhanced infrastructure, great public realm and an holistic approach to mixed uses that are community-engaged. In this manner, we not only aim to deliver attractive financial returns, but are able to make a positive impact upon both the environment and society at large.

Whilst global capital continues to be attracted to UK real estate, given recent currency devaluation and relative yield gap, we would expect capital values to steadily decline as the yield gap diminishes and key occupational risks increasingly impact upon sustainable rental values ahead. Our conviction to understand the dynamics of these occupational demand drivers ahead will be the key to maintaining outperformance.

Chris Taylor
Head of Private Markets

Infrastructure

As we reflect on just over 10 years since the release of the smart phone and the GFC, we look at the multitude of positive changes that have taken place as a result of innovation. These have driven a number of opportunities, including: *Electrification of transport, technology, artificial intelligence, robotics, big data, gene therapy, next generation vaccines, 3D printing, Internet of Things, autonomous vehicles, smart cities, energy storage, stem cells*.

However, many pressing challenges lie ahead: *Climate change, decarbonisation, security of energy supply, social and economic inequality, trade imbalances, trade wars, cyber security, de-globalisation, fake news, global debt levels, nationalisation, terrorism, extreme weather events, surplus liquidity, asset bubbles, monetary tightening, large scale involuntary migration, ageing demographics, global population levels, modest global growth, diminishing effect of antibiotics, obesity, dementia, populism, single use plastics proliferation, pension deficits and leverage.*

Whether you are a bull or a bear, one thing we can be confident of is the continuing demand for essential services such as water, energy and transport. Whilst the form and method by which such services are provided will inevitably evolve to meet future needs, demand should be stable and grow. This limited demand risk presents a great opportunity for investors in this challenging world. Infrastructure also touches people in their daily lives in a tangible way and investing in infrastructure provides investors with the potential to make an impact. For example, investing in renewable energy can make a positive impact and achieve a reasonable financial return, in a responsible way. At Hermes, we look forward to continuing to assist our clients in making a positive impact and accessing high quality large-scale infrastructure investments, managing them on their behalf in a prudent and responsible manner.

Peter Hofbauer
Head of Infrastructure

Private Equity

Heading towards 2019, we see the investment environment shaped by receding global liquidity, an accelerating economic 'centre-of-gravity' shift, and the continued repercussions of profound societal changes, as manifested in the rise of populism.

The global liquidity and interest rate cycle is turning and investors will need to change their mind-set from ever-looser to tighter liquidity conditions. We expect this to result in higher volatility, including in private equity, particularly in highly levered assets and to create potential pricing challenges at current elevated valuations. We believe that asset allocators, despite recent volatility in Emerging Markets, should pay close attention to the ongoing economic 'centre of gravity' shift. Emerging Markets in Asia, particularly China, not only contribute more to global growth but increasingly provide a deeper pool of investment opportunities – a shift that is being accelerated by technological innovation. Finally, the rise of populism and a more protectionist sentiment around the globe have immediate implications for the management of portfolio companies and due diligence on new investments.

Against this backdrop, and an environment when expected returns across virtually all asset classes are now below realised recent returns, we believe private equity investments, particularly when implemented with a focus on secular growth stories, will continue to be able to outperform public markets. Importantly, we expect a set of megatrends around societal change, sustainability, accelerating technological innovation, globalisation and emerging markets catch-up to have a profound long-term impact on economies and societies. While creating disruption risks for incumbents, these are giving rise to robust secular growth drivers for companies who are exposed to them. This is where we will be focusing our attention during 2019.

Peter Gale
Head of Private Equity and
Chief Investment Office

RESPONSIBILITY, SUSTAINABILITY AND STEWARDSHIP

Responsibility

We expect that in 2019, the clamour of society expressing their unmet needs will intensify.

Companies, investors, auditors, regulators… will all need to justify their existence by describing what they are in business to do and how this serves society's needs. Ongoing issues include climate change, human capital management, diversity in the workforce, cyber security and levels of executive remuneration. For example in 2019, companies will be disclosing under the TCFD (Task Force on Climate-related Financial Disclosures) guidance on how they expect climate change will disrupt their business model and what they plan to do about it.

The prevalence of social media and the consequential ease with which the public's concern can go viral was illustrated in the past 12 months by the #MeToo outcry. This rightly has had an impact on how companies now behave, the processes they have put in place and the scrutiny from watchdogs and the media. Governments with an eye to the voting public are also taking action and having an effect.

A great example in the UK was the legislation for Gender Pay Gap disclosure. Companies are reacting as a result. We should expect more government intervention to reflect their citizens' demands. Further, in 2019 and beyond, the disruptive impact of Artificial Intelligence on businesses, customer service, human ethics and the level and quality of employment is likely to be major and affect all sectors. Industries will need to respond to the societal changes this will bring.

The investment industry is far from immune. As such, we would expect greater pressure for investment management firms to demonstrate their value add and how their governance in its broadest sense is aligned to the client beneficiary needs in 2019. They will also need to show the level and effectiveness of their stewardship activities in creating sustainable wealth in their investments as well as a positive environment and societal impact.

Leon Kamhi
Head of Responsibility

Sustainability

Extreme global weather events continue to exact a rising economic cost and play a role in the social crises effecting some of the poorest regions of the world. The Intergovernmental Panel on Climate Change issued its starkest warning yet that the window of opportunity for limiting the warming of the planet to 1.5 degrees is closing fast. With politics around the world becoming increasingly polarised, the impetus for tackling the systemic issues of our time is stalling, despite an elevated amount of rhetoric on the topic.

"Business as usual" is no longer an option. Is 2019 going to be the year that investors and companies fill the void in policy making increasingly left by governments? While markets fret about the consequences of the end of Quantitative Easing, the damage wrought to demand and profits by the Global Financial Crisis will be nothing compared to the economic and social fallout of degrees of warming. The rise of sustainable investing gives us hope that the investment community is recognising the threat.

To be a success, this needs to go beyond conveniently labelled products and must deliver real change in corporate behaviour through active and purposeful stewardship of client assets. Better and more standardised reporting of the material risks and opportunities in company activities will be a starting point. This can drive real changes in supply and demand for more sustainable products and services. Only by changing the balance of positive and negative impacts in the entire value chain can we deliver a more resilient and prosperous world for all.

Andrew Parry
Head of Sustainable Investing

EOS

The amended European Shareholder Rights Directive is anticipated to drive substantial industry change by creating greater investment chain transparency not least in company engagement, extended rights and the removal of barriers to exercise those rights. If implemented effectively across member states in Q2, it should positively impact the sustainability of EU companies and economies.

As the lead engager for 27 out of 161 companies under the Climate Action 100+ initiative, representing $32 trillion of assets under management, we look forward to leveraging our engagement relationships to enhance corporate governance, action and transparency on climate matters.

Utilising the three pillars of the UN's Guiding Principles on Business and Human Rights, we will continue to challenge companies on their responsibility to avoid human rights infringements and address adverse impacts. Scrutiny of cobalt supply chain management is set to continue and we will engage with companies and the relevant ecosystem to press for greater progress.

With some research estimating that the economic costs of antimicrobial resistance could be as significant as the impact of the financial crisis, we will push companies to consider this risk in their policies and incorporate it into their scenario planning. Calling for public reporting on antibiotics use will also be a part of our engagement objectives.

We will continue to press for increased board diversity, looking to influence the nominations process early on, promoting the use of board evaluations and widening the talent pool. Crucially we will also focus on diversity below the board level, using relevant data such as pay gap disclosures in the UK.

Dr Hans-Christoph Hirt
Head of Hermes EOS

Policy

Expanding and mainstreaming green and sustainable finance continues to be a focus for UK and EU financial policymakers and regulators in 2019.

In the UK we can expect new obligations on pension trustees, legally requiring them to take ESG factors including climate change into account in their investment strategies. In Spring 2019, the Government will launch its response to the Green Finance Taskforce and more policy initiatives can be expected to follow. The first of these will likely come from the Prudential Regulation Authority and Financial Conduct Authority finalising enhanced supervisory expectations on regulated firms, pushing companies to incorporate a forward-looking strategic approach to managing climate change risk, making it become part of their ongoing business models. Further to this, new requirements for board level oversight; clear risk management frameworks; use of scenario analysis; and disclosures on how these processes work are expected as well.

Enhanced disclosures will also continue as a theme in the EU once the Sustainable Finance Action Plan becomes law, along with developed obligations on the asset management industry, and possibly banks, to disclose how ESG factors are integrated into investment and remuneration processes, can also be expected. Furthermore, new obligations on index providers to disclose assumptions and methodologies used for sustainable and Paris Agreement-aligned indexes will come into force. Lastly, I expect that the sustainable taxonomy envisaged by the Commission will prove more contentious, with legislation being pushed back into late 2019 or 2020.

Ingrid Holmes
Head of Policy and Advocacy

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HERMES
INVESTMENT MANAGEMENT

OUTCOMES
BEYOND
PERFORMANCE

HERMES INVESTMENT MANAGEMENT

We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries by providing world class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world.

Our goal is to help people invest better, retire better and create a better society for all.

Our investment solutions include:

Private markets
Infrastructure, private debt, private equity, commercial and residential real estate

High active share equities
Asia, global emerging markets, Europe, US, global, small and mid-cap and impact

Credit
Absolute return, global high yield, multi strategy, global investment grade, unconstrained, real estate debt and direct lending

Stewardship
Active engagement, advocacy, intelligent voting and sustainable development

Offices

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