

# Five years since launch: An SDG Engagement High Yield Credit retrospective

Doing well by doing good:

19.7%

Cumulative gross performance since inception, versus the benchmark return of

17.0%<sup>1</sup>

“Now is the time for fixed income markets to take heed”

-- the words of Hermes CEO, Saker Nusseibeh, in September 2019 when our team launched its original sustainability strategy – SDG<sup>2</sup> Engagement High Yield. Born out of the success of its cousin over on the equity desk, the Strategy quickly established itself at the heart of our “mainstream” product range when it first launched half a decade ago, including on performance where it has outperformed its benchmark by 270bps since then.

Five years on, the world, and the team, look very different. For a start, at inception we had just one engager. As the Strategy grew, so did the number of companies in the portfolio, and therefore the number of engagers needed. Today, we have seven dedicated analysts contributing to the Strategy sitting in London and Pittsburgh, as well as the nearly 30 engagers in the EOS team – a truly international capability.

We can see this in the engagement track record over the five years since launch. In that time, we have engaged about 180 companies, in virtually all sectors from semiconductors to medical equipment. This has taken us around the world, including dedicated site visits to companies in Europe, France, Spain, Norway, Italy, USA and Brazil. Among the memorable highlights, our engagers have been for a test ride in a 1,000hp electric Hummer and had a sweaty tour of a blast furnace.

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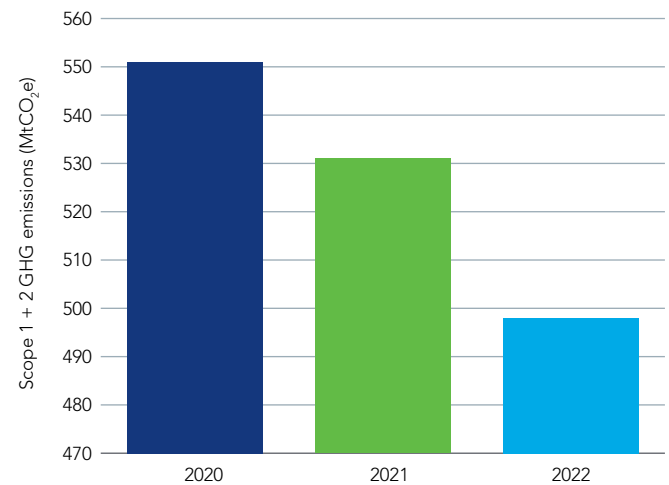
**“The performance since inception illustrates that it’s possible to deliver the objectives of delivering attractive investment performance while simultaneously encouraging companies to create positive change.”**

Mitch Reznick, CFA, Group Head of Fixed Income - London

Of course, it hasn’t all been plain sailing. Some engagements were unsuccessful and dropped out of the Strategy. Sometimes a company was unresponsive (one particular US telecommunications company comes to mind), with others the progress was too slow (a Portuguese bank, for example), while others were actually getting worse (a LatAm oil company). Overall we’ve had about 13 failed engagements.

But we can also point to meaningful progress on the issues that matter.

**Figure 1:** Total scope 1 + 2 GHG emissions for the portfolio decreased 9.7% between 2020 and 2022



Based on reported data from 71 companies. Only includes companies that were held in the Strategy from 2021 to 2023 and disclose scope 1 and 2 emissions for all three periods.

**Lifetime engagement stats**

1,872 engagement actions

180 companies engaged

7 people working on the Strategy

98 completed engagement objectives

**But, for the first time, we can say with some certainty that, on most measures, the companies we are engaging are moving in the right direction.**

This year we calculated the real-world changes that occurred at the portfolio companies over our timeline of engagement. We looked at carbon emissions, water consumption, recycling rates, waste generated, health and safety, renewable electricity and gender equality. Attributing these changes to engagement efforts is a stretch too far – but, for the first time, we can say with some certainty that, on most measures, the companies we are engaging are moving in the right direction. To take just one illustrative example of this, there has been a 9.7% drop in Scope 1 and 2 emissions<sup>3</sup> (see Figure 1). We view this as a step (or, more accurately, multiple steps) in the right direction – even if there is still a long way to go.

### Sustainable Development Goals: A work in progress

This theme – of being on an unfinished journey – is one that plays out if we step back and consider the progress made since the United Nations launched its Sustainable Development Goals programme in 2015. We have now passed the halfway point between then and the stated deadline for achieving the goals, 2030, and it's abundantly clear that we're not where we need to be. Indeed, last year, António Guterres, Secretary-General of the United Nations, gave a dismal summary in response to the UN's review of progress, stating that "the world is far off track".

But not only are we far off track: many of the most vital SDGs are actually trending in the opposite direction, including on climate change, food security, biodiversity and sustainable growth.

There are also positive signs, however. At the 28th COP, nearly 200 countries agreed to transition away from fossil fuels, a development the UN hailed as the beginning of the

end for the fossil fuel era. In Brazil, data from the national space agency showed that deforestation in the Amazon had slowed 34% compared to the previous year<sup>4</sup>.

As the world around us changes, so must our expectations of companies. In 2019, science-based targets were a rarity, with just 315 validated targets. Compare that to 2023, when more than 2,000 companies logged goals under the SBTi<sup>5</sup> in a single year, and the total is now over 5,000. What was once a niche option, reserved for the most ambitious companies, is now the norm, and practically ubiquitous in some sectors.

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So, to conclude, what have we learned from half a decade of combining engagement with the day-to-day reality of running a global high yield strategy? Three core lessons come to mind:

- 1) **Geography doesn't matter.** Good engagements can be found irrespective of where a company happens to be domiciled.
- 2) **Poor governance = poor sustainability.** A minimum level of governance is a prerequisite for taking action on sustainability.
- 3) **Detail, detail, detail.** Quality engagement means knowing the company extremely well. There are no shortcuts.

In September 2024, the United Nations published its [Pact for the Future](#) in which it reaffirmed its focus on achieving the Sustainable Development Goals. As we look forward to the next five years of our fund, we make the same commitment with a sense of pride in our progress so far and hope for the achievements still to come.



<sup>1</sup>Source: Federated Hermes as at 30 June 2024. Performance shown is the Federated Hermes Int'l SDG Engagement High Yield Credit hedged to US\$ Strategy. Inception date: 30 September 2019. Benchmark is the ICE BofAML Global High Yield Constrained Index hedged to US\$. Data is supplemental to the GIPS report that can be found in the appendix. Past performance is not a reliable indicator of future returns.

<sup>2</sup>**Sustainable Development Goals (SDGs):** The SDGs are a set of 17 interconnected goals that were adopted by all UN member states in 2015. They are a universal call to action to end poverty, protect the planet and improve the lives and prospects of everyone, everywhere, by 2030. Learn more here: <https://www.undp.org/sustainable-development-goals>.

<sup>3</sup>**Scope emissions:**

Scope 1, Scope 2, and Scope 3 is a classification system for greenhouse gas (GHG) emissions a firm creates through its operations, energy usage, and the wider value chain.

- Scope 1 emissions – All direct emissions from the activities of an organisation or under their control. Including fuel combustion on site such as gas boilers, fleet vehicles and air-conditioning leaks.

- Scope 2 emissions – Indirect emissions from electricity purchased and used by the organisation. Emissions are created during the production of the energy and eventually used by the organisation.

- Scope 3 emissions – All other indirect emissions from activities of the organisation, occurring from sources that they do not own or control. These are usually the greatest share of the carbon footprint, covering emissions associated with business travel, procurement, waste and water.

<sup>4</sup>[Deforestation in Brazil's Amazon drops 34% in first half 2023 | Reuters](#)

<sup>5</sup>The Science Based Targets initiative (SBTi): Established in 2015, the SBTi is designed to help companies to set greenhouse gas (GHG) emission reduction targets in line with climate science. The initiative defines and promotes best practices in emissions reductions and includes a team of experts to provide companies with independent assessment and validation of their targets.

## Appendix: GIPs performance data

### Schedule of Rates of Return and Statistics

Composite: **Federated Hermes SDG Engagement High Yield Credit Hedged to USD**

Index: **ICE BofA Global High Yield Constrained (USD Hdgd)**

Periods ending: **30 June 2024**

	Returns (%)		
	Composite Gross Return	Benchmark	Composite Net Return
Q2 24	1.08	1.44	0.92
YTD	2.95	3.52	2.61
1 Year	11.04	11.44	10.32
3 Years (Annlzd)	1.40	1.16	0.74
Oct-19 – Jun-24 (Annlzd) <sup>^^</sup>	3.86	3.36	3.18

Year	Annual Returns (%)									
	Composite Gross Return	Composite Net Return	Benchmark Return	*Composite 3-Yr St Dev	*Benchmark 3-Yr St Dev	No of Portfolios	**Dispersion	Composite Assets (Million)	Firm Assets (billion)	
2019	4.04	3.87	2.90	N/A	N/A	<5	N/A	276.3	40.2	
2020	7.94	7.23	6.48	N/A	N/A	<5	N/A	680.6	585.7	
2021	2.87	2.20	3.04	N/A	N/A	<5	N/A	1,855.3	634.2	
2022	(9.51)	(10.10)	(11.38)	12.00	11.19	<5	N/A	918.0	627.4	
2023	11.24	10.52	12.97	8.63	7.81	<5	N/A	1,369.8	720.0	

<sup>^^^</sup>Represents composite inception period. See page 2 for additional notes to the schedule of rates of return and statistics.

\*Represents the 3-year annualized standard deviation for both the gross composite and the index returns. Statistic is used to measure the volatility of composite returns.

\*\*Standard deviation is calculated using gross returns. Standard deviation is not applicable (N/A) for any period if fewer than five accounts are in the composite for that period. (See footnote 5)

The composite includes all discretionary portfolios following the SDG Engagement Global High Yield Credit Hedged to USD strategy run by the Federated Hermes Global Credit team (London Office) and has an inception date of 1 October 2019. The objective of the strategy is to exceed the return of the benchmark over a rolling five-year period whilst delivering positive societal impact aligned to the United Nations Sustainable Development Goals (“UN SDGs”). The strategy may invest in a broad range of assets, either directly or through the use of derivatives, (including, but not limited to, equities, equity-related securities, Eligible CIS and/or financial indices, futures, options, swaps, debt, fx and money markets). The strategy through its investments in FDIs may be leveraged. The composite’s benchmark is the ICE BofA Global High Yield Constrained Hedged to USD Index, which is designed to measure the debt market performance of global high yield debt. The benchmark contains primarily USD and EUR issues. The Index is rebalanced on the last calendar day of the month and the return is calculated on a total return basis. This composite was created in November 2019. Performance shown for 2019 is for a partial period starting 1 October 2019. Federated Hermes claims compliance with the Global Investment Performance Standards (“GIPS®”) and has prepared and presented this report in compliance with the GIPS® standards. Federated Hermes has been independently verified for the period of January 1, 1992, through March 31, 2024. The verification report is available upon request. A firm that claims compliance with the GIPS® standards must establish policies and procedures for complying with all the applicable requirements of the GIPS® standards. Verification provides assurance on whether the firm’s policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS® standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. The management fee schedule for this strategy is 0.65% per annum. Gross of fees returns have been calculated gross of management/custodial fees and net of reclaimable withholding taxes, but after all trading commissions.

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Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns and, where possible, to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes Investment Management are now undertaken by Federated Hermes Limited (or one of its subsidiaries). We still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important strategies from the entire group.

## Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

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