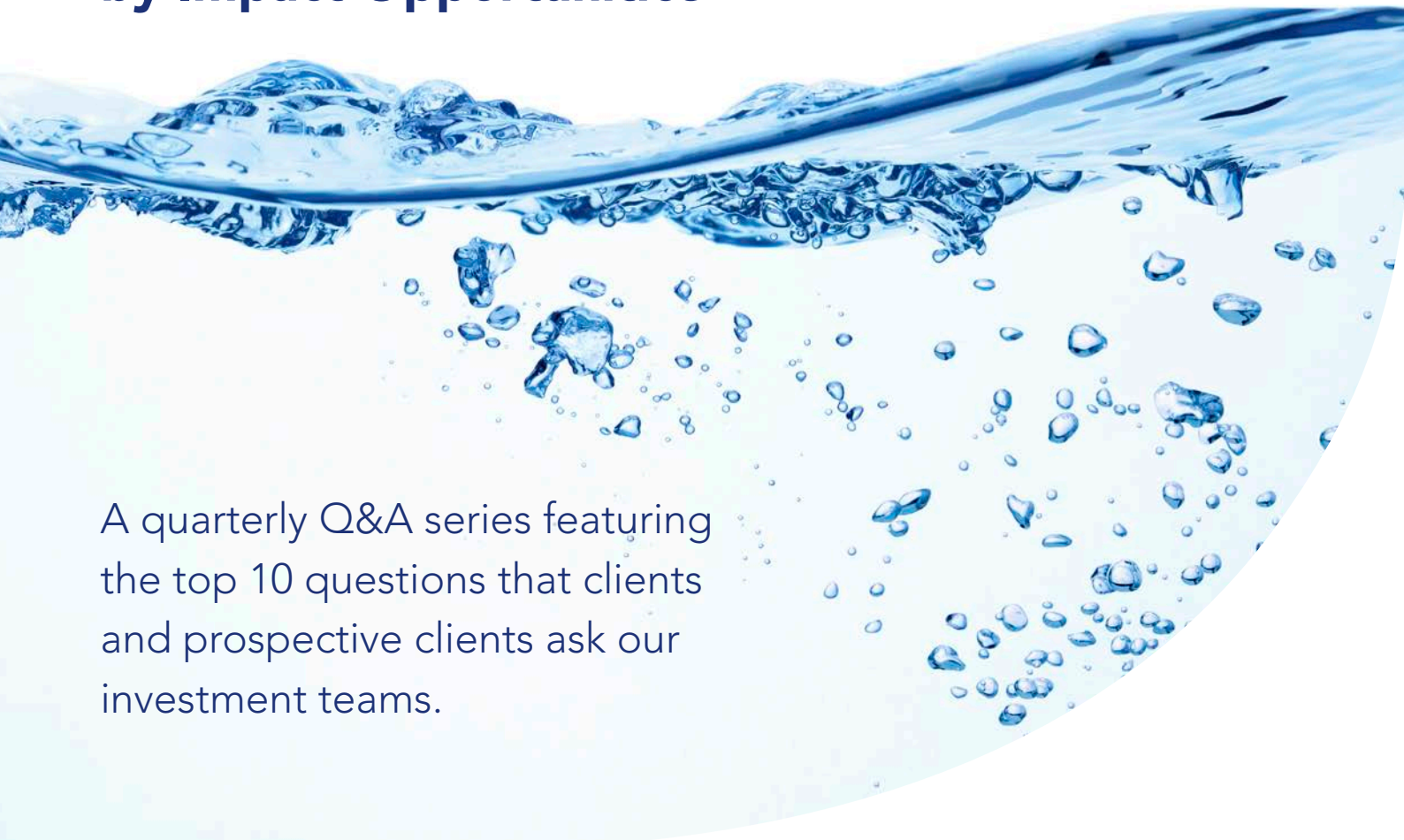


Your Questions Answered

by Impact Opportunities



A quarterly Q&A series featuring the top 10 questions that clients and prospective clients ask our investment teams.

Q4 2020

For professional investors only.

**Federated
Hermes** 

www.hermes-investment.com

1

What is the difference between impact and environmental, social and governance (ESG) investing?

ESG investing considers financially material environmental, social and governance factors alongside traditional financial metrics in investment analysis and investment decisions.

Impact investing can be defined as identifying companies which can generate positive social or environmental outcomes in addition to financial gains. Impact investors typically use the UN Sustainable Development Goals (SDGs) as the framework for targeting investments. The three key concepts which distinguish impact investing from conventional investing are:



Intentionality: an investor's intention to have a positive social or environmental impact through their investments;



Additionality: fulfilling a good cause beyond the provision of private capital; and



Measurable impact: being accountable and transparent in reporting on the financial, social and environmental performance of investments.

Impact investing can be defined as identifying companies which can generate positive social or environmental outcomes in addition to financial gains.

This document does not constitute a solicitation or offer to any person to buy or sell any related securities or financial instruments. The value of investments and income from them may go down as well as up, and you may not get back the original amount invested. Any investments overseas may be affected by currency exchange rates. Past performance is not a reliable indicator of future results and targets are not guaranteed.

2

How big is the investable universe?

Our benchmark, the MSCI ACWI Investable Market Index (IMI) is broad, with 8,768 constituents across 23 developed-market and 26 emerging-market countries.

The first – and simplest – stage of our process is to filter out companies which don't meet our liquidity criteria (that is, \$5m+ per day). Subsequently, we eliminate the stock opportunities which do not meet one of our nine impact themes (see question seven for more information about our impact themes). We believe that there may be as many as 1,000 companies within the investment universe which have some link to our themes. However, when we check for relatively material exposure and assess for some degree of intentionality, the number of stocks narrows to about 200 names. Assessing broadly for measurability (ability to quantify impact) brings us to around 100 stocks. Of that group about 10 companies are fully researched and closely monitored. We are then ready to add one of these fully researched stocks to our portfolio when they fall to a certain price level, or when there is more upside than one of our existing holdings. The remaining 90 companies are also followed, with new impactful companies coming onto our radar at regular intervals.

We eliminate the stock opportunities which do not meet one of our nine impact themes.

We believe that there may be as many as

1,000

companies within the investment universe which have some link to our themes.

Assessing broadly for measurability (ability to quantify impact) brings us to around

100

stocks.

Of that group about

10

companies are fully researched and closely monitored.



3

How impactful can you be in public markets?

As recently as the early 2010's, impact investing was considered the preserve of philanthropy and private markets. While that is still a big factor today, the sheer scale of public equity markets allows for genuine impact.

The market capitalisation of global public equity markets is about \$60tn¹ – and the estimated funding gap for achieving the SDGs is between \$25-30tn². As such, it is essential that public-market capital is directed towards solving the structural, underserved needs of society.

Equity markets also provide investors with the opportunity to invest in impactful companies in a liquid, scalable and accessible way. As public equity impact funds grow, and as capital is channelled towards impactful companies, it helps to reduce the cost of capital for these companies.

In addition, investors can also be impactful in public markets by promoting change and accelerating impact through active and sustained engagement. Our Impact Opportunities Fund has active, best practice stewardship at its core. We engage, alongside our stewardship team, EOS at Federated Hermes, to help businesses become more impactful for the wider benefit of the society and the environment.

Figure 1. Directing public-market capital to society's underserved needs is an imperative



\$25-30tn¹

Estimated funding gap for achievement of the UN SDGs

\$60tn²

Global equity market cap provides opportunity for scalable access to capital

Source: The UN.¹ UNCTAD World Investment Report, 2014. ² Bloomberg – referencing the market cap of the MSCI ACWI Investable Market Index.

Equity markets also provide investors with the opportunity to invest in impactful companies in a liquid, scalable and accessible way.

¹ Source: UNCTAD World Investment Report, 2014.

² Source: Bloomberg – referencing the market cap of the MSCI ACWI Investable Market Index.

4

Impact assessment or financial analysis: what comes first?

For stocks to be considered for inclusion in our portfolio, passing the impact assessment is vital. That said, the financial investment case is equally important. As such, we only invest in a company that meets both our impact and financial requirements.

We conduct the impact assessment first. This starts with an assessment of whether the company qualifies for at least one of our investable impact themes. Within these themes, each company's impact must be linked to at least one SDG (see figure 2). While the Goals are a useful intellectual framework, creating investment themes linked to the 169 detailed sub-goals of the SDGs illustrates the breadth of opportunity that impact investing represents. This produces a group of stocks that address under-served needs aligned to one or more of our themes.

Figure 2. Linking our investable impact themes to the SDGs



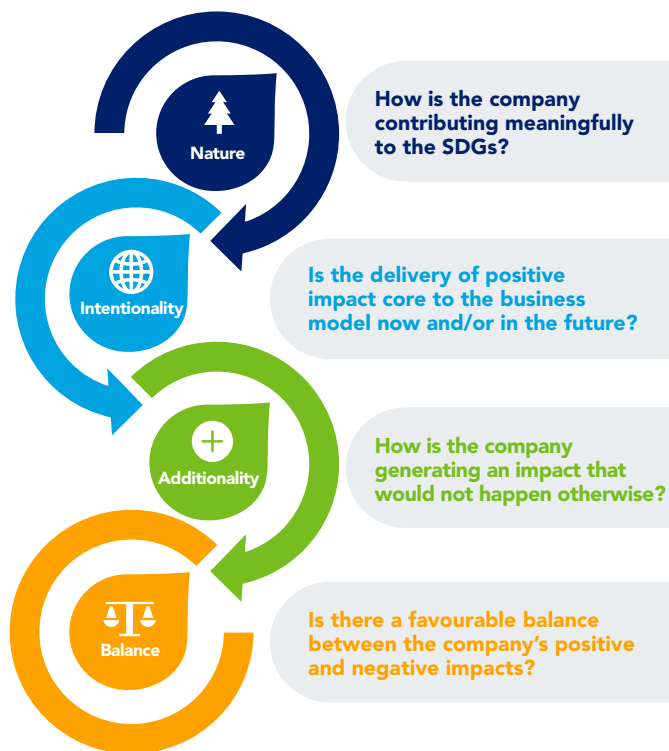
Source: Federated Hermes, as at November 2020.

4

Impact assessment or financial analysis: what comes first?

Exposure to a structural trend is important, but it is only one part of delivering impact, and we undertake further analysis by focusing on four key impact dimensions, as illustrated in figure 3.

Figure 3. Our impact assessment focuses on four key dimensions

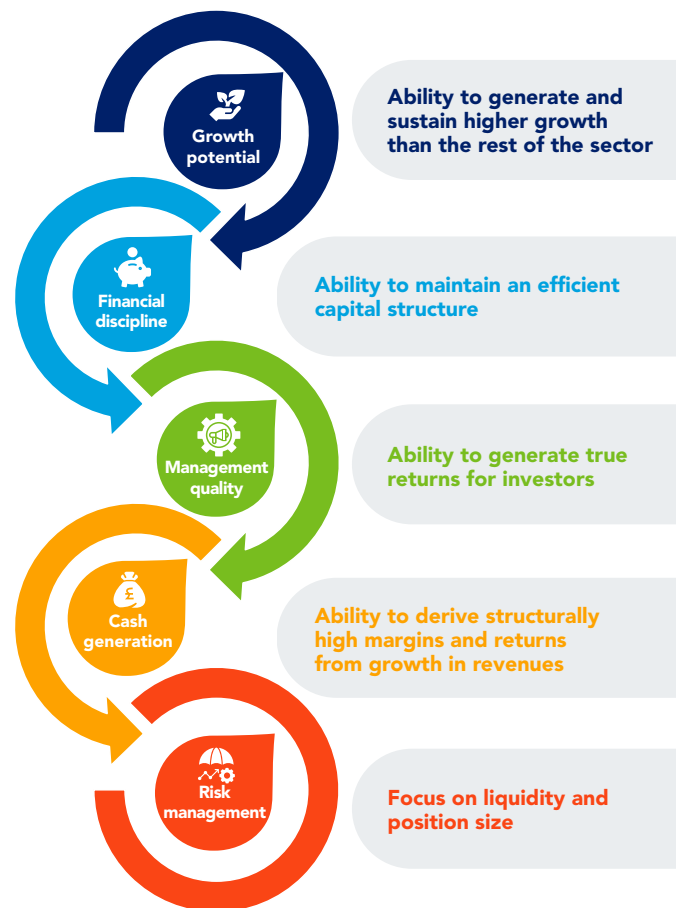


Source: Federated Hermes, as at November 2020.

Indeed, this analysis is a vital part of the process: it creates a framework that ensures the objective and quantifiable assessment of whether or not a company is generating positive impact and is therefore eligible for our investment universe. Every company has to meet the criteria of nature, intentionality, additionality and balance. The threshold level is set deliberately high as we believe that truly impactful companies will enjoy sustained growth.

Once we have ascertained whether a company meets our impact criteria, we then conduct our fundamental financial assessment (see figure 4). We consider many aspects, including the stability of a company's business model, financial position, returns and competitive positioning. We look at a company's income statement, balance sheet and cash flow statement to assess the construction of the accounts, how they have changed and how they could continue to evolve into the future.

Figure 4. Our fundamental financial assessment



Source: Federated Hermes, as at November 2020.

Valuation remains critical, and every stock which meets our impact and financial criteria must also demonstrate considerable upside to fair value before it can be added to our portfolio.

5

What is the market cap profile of the investable universe, and what can clients expect in terms of risk?

Our process and philosophy naturally lead us to small and mid-cap (SMID) companies, as well as some large cap stocks. Our process is based on active stock picking and our market cap exposure reflects this process.

We are benchmark agnostic and therefore do not engineer our positions around the benchmark index. Currently, we do not have exposure to any of the FAMAG (Facebook, Apple, Microsoft, Amazon and Google) stocks or the largest positions in the index as they do not meet our impact criteria. As such, our Fund has almost no exposure to mega caps. Instead, it has a larger exposure to mid-sized companies.

Stock specific risk is the primary source of risk in our portfolio, given its concentrated nature and high tracking error, reflecting the Fund's unconstrained approach. However, we conduct a comprehensive due diligence assessment on each stock and set a deliberately high barrier to entry of new names into the portfolio. In this way, we seek to help manage our Fund's stock specific risk appropriately.

We are benchmark agnostic and therefore do not engineer our positions around the benchmark index.



6

Does the investment strategy open itself up to factor bias?

The concentrated and unconstrained nature of our investment strategy means that factor exposure is inevitable.

The Fund has a natural bias towards growth stocks in the SMID space, reflecting our impact investing process and philosophy. However, we are conscious of factor exposures. For example, in our portfolio, we have exposure to three companies in the wind power industry – Vestas, Siemens Gamesa and Ørsted – but we do not want this exposure to account for too great a proportion of the portfolio. For that reason, monitoring common factor exposures is an important part of our risk management process.

The Fund has a natural bias towards growth stocks in the SMID space, reflecting our impact investing process and philosophy.



7

How did you decide on the nine impact themes?

Our nine impact themes can be traced back to the SDGs. Believing the SDGs are a valuable tool to identify investment opportunities, we developed our SDG Taxonomy – a detailed assessment of the 17 Goals and the 169 targets underpinning them.

This examination enabled us to demonstrate whether an SDG target was something that could be addressed through public equities. If it was, we subsequently considered the breath of investable areas that could help achieve this target, thereby identifying emerging growth opportunities. Through the SDG Taxonomy, we identified 42 of the underlying SDG targets as directly investable through public equities. Once we collated and refined these investable areas, we produced our nine impact themes: energy transition, water, circular economy, future mobility, education, financial inclusion, health and wellbeing, food security and impact enablers (see Figure 5).

Figure 5. Our nine impact themes



Source: Federated Hermes, as at November 2020.

Our thematic approach to impact investing seeks to identify opportunities created by megatrends. One example of our thematic framework relates to our Health & Wellbeing. We start by identifying a megatrend, in this instance noncommunicable diseases (NCDs) – see figure 6.

NCDs, including heart disease, stroke, cancer, diabetes and chronic lung disease, are collectively responsible for almost 70% of all deaths worldwide³. These diseases have devastating health consequences for individuals and threaten to overwhelm health systems. In addition, the socioeconomic costs associated with NCDs are immense. Prevention and control of these diseases is therefore a major imperative. One of the highest incidence of chronic diseases, a subtheme of NCDs, is diabetes – 463m adults worldwide are estimated to have diabetes (see our Impact Report, Q1 2020 for more information)⁴.

Figure 6. How thematic investing works



Source: Federated Hermes, as at November 2020.

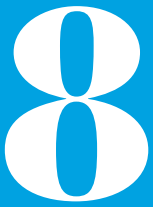
Having identified diabetes as having a high incidence rate, we subsequently seek to find direct exposure to the disease. Within the Fund, we have exposure to Dexcom – a medical devices company – is leading the way in changing the standard of care for glucose monitoring in diabetes through its continuous glucose monitoring (CGM) devices. In doing so, it is seeking to improve the treatment of the illness and reducing the cost associated with the disease.

We then shift our focus to disease prevention – that is, indirect linkages to diabetes through companies that meet our impact and financial criteria. Regular exercise, for example, not only helps to improve peoples' overall health and quality of life, but it also helps to prevent chronic illnesses, such as type 2 diabetes. One of our holdings, Planet Fitness, a leading fitness chain operator, is trying to encourage a healthier lifestyle by making fitness accessible to all with its attractive membership rates starting at only US\$10 per month.

This demonstrates how we use our impact themes to identify opportunities (both directly and indirectly) created by megatrends.

³ Source: World Health Organisation (see: https://www.who.int/health-topics/noncommunicable-diseases#tab=tab_1)

⁴ Source: International Diabetes Federation.



Are you overly exposed to healthcare due to the nature of this fund?

Currently, the Fund has an overweight exposure to the GICS Health Care sector, created from our bottom-up stock selection rather than a sector view.

For us, healthcare has been a productive source of ideas, in part reflecting the enormous innovation and progress that has been made in recent years. Moreover, the intentionality, additionality and measurability are clearly identifiable. In this way, we find lots of ideas within the sector, ranging from innovative plasma therapies and influenza vaccines that save and improve lives to treatments that address obesity.

It is also important to recognise that healthcare is not a homogenous sector, and a breakdown of our exposure to healthcare demonstrates our diversification:



Pharmaceuticals: mature, high cash generative companies with the ability to invest substantially in R&D and help the most vulnerable in society through the provision of heavily reduced and/or free medicines;



Medical devices: fast growing, innovative solutions addressing the most critical diseases through the provision of novel, personalised and less invasive solutions that led to improved patient experiences and lower costs for healthcare systems; and



Life science companies: we consider these businesses to be impact enabler. For example, they produce reagents, antibodies, consumables and instruments essential in R&D and are CDMO's to ensure timely delivery of drugs.

We find lots of ideas within the sector, ranging from innovative plasma therapies and influenza vaccines that save and improve lives to treatments that address obesity.

Indeed, this demonstrates that while optically the Fund is overweight healthcare, we are exposed to very different parts of value chain.

Over time, however, we expect that our thematic and sector exposure will become more diverse as other sectors start to disclose more impact metrics and innovation increases. While patient throughput makes measurability far easier within the healthcare sector, it is inevitable that over time other areas will open up as disclosure broadens and becomes more transparent. As such, we anticipate our exposure to healthcare will become naturally diluted over time.



9

Is there an impact premium on the stocks you buy as funds crowd into a limited amount of stocks?

In 2020, there has been a notable increase in investor interest and flows into ESG and impact-focused strategies. This has raised concern among some investors that valuations for popular ESG or impact companies have become over-inflated. While we understand why some may be concerned, we have a slightly different view.

It is clear that performance and headline valuation between certain stocks and sectors has diverged materially this year – and this is due to a number of factors:

- The pandemic has driven a clear bifurcation between ‘Covid-19 winners’ (for example, tech stocks and e-commerce firms) and ‘Covid-19 losers’ (for example, energy companies and banks).
- Given the economic impact of the pandemic, defensive businesses with predictable earnings and cashflows have outperformed.
- The fiscal and monetary response to the crisis further under-pinned equity valuations, particularly when it comes to interest rates.

Against this backdrop, it is understandable that certain companies have seen a jump in their headline multiples.

It is also important to note that the increase in flows towards ESG strategies so far this year have largely been directed towards passive funds. Such funds will have large exposures to index stocks which our Fund does not own. Furthermore,

Every stock we own must be attractive from an impact and valuation perspective.

despite the increased interest in public-equity impact investing, there are still relatively few dedicated impact funds. In addition, of those dedicated impact funds, the approaches vary substantially. Given the large universe of stocks – there are 8,700 companies listed on the MSCI ACWI index – the commonality of holdings between these funds is low. According to a recent report by Goldman Sachs, only three of the 50 most commonly owned stocks in global ESG funds are held in our Impact Opportunities portfolio⁵.

Our focus on investing in impactful companies does not take anything away from the price we are willing to pay. Every stock we own must be attractive from an impact and valuation perspective. We consider valuation over the long term – five years – consistent with our investment time horizon. We therefore put far greater emphasis on discounted cash flow models and sum-of-the-parts metrics instead of focusing on more commonly quoted one or two-year forward P/E or EV/EBITDA multiples.

With conviction in our process, we believe that concerns around an ‘impact premium’ are over-stated. Impact investing is still at a nascent stage, incorporating a number of different approaches and processes. We see a broadening of the investable universe given the growing awareness of corporates to their broader societal impact.



⁵ “How have ESG fund favourites changed in 2020,” published by Goldman Sachs in October 2020.

10

What makes the Impact Opportunities Fund stand out from its peers?

By pioneering sustainability and investment since our 1983 inception, the international business of Federated Hermes has been working to deliver long-term portfolio returns from purposeful companies and positive outcomes for decades.

Our Impact Opportunities Fund was a natural extension of our longstanding commitment to deliver Sustainable Wealth Creation that enriches investors, society and the environment – for current generations and those to come. Our vast experience in sustainability and investment ensures we are pioneer in the impact investing space.

As the world faces a myriad of challenges from climate change and biodiversity loss to health pandemics, we believe it is essential to mobilise capital to address the underserved needs of society and deliver strong long-term investment returns. As a pure impact fund, we therefore invest solely in measurable, sustainable impact. Through a combination of thematic and impact investing, we seek to capture opportunities created by megatrends – and our robust process considers a company's impact metrics alongside its financial metrics.

Our vast experience in sustainability and investment ensures we are pioneer in the impact investing space.

Meanwhile, our rigorous impact assessment quantifies the positive impact of each of our holdings. As such, we can demonstrate to investors how their capital allocation has made a contribution to the attainment of the SDG targets.

We believe that integrated and collaborative engagement with companies is necessary to deliver impact, and we are fortunate to have in-house expertise from EOS at Federated Hermes, a global leader in stewardship.

What's more, we define ourselves as patient capital investors because we aim to outperform the broad global equity market by investing in what we deem to be best-in-class companies that seek to create positive, sustainable impacts over the long term. In this way, we aim to invest in future leaders today and capture the growth opportunities of tomorrow.



For professional investors only. This is a marketing communication. This document does not constitute a solicitation or offer to any person to buy or sell any related securities, financial instruments or products; nor does it constitute an offer to purchase securities to any person in the United States or to any US Person as such term is defined under the US Securities Exchange Act of 1933. It pays no regard to an individual's investment objectives or financial needs of any recipient. No action should be taken or omitted to be taken based on this document. Tax treatment depends on personal circumstances and may change. This document is not advice on legal, taxation or investment matters so investors must rely on their own examination of such matters or seek advice. Before making any investment (new or continuous), please consult a professional and/or investment adviser as to its suitability. All figures, unless otherwise indicated, are sourced from Federated Hermes. All performance includes reinvestment of dividends and other earnings.

Federated Hermes Investment Funds plc ("FHIF") is an open-ended investment company with variable capital and with segregated liability between its sub-funds (each, a "Fund"). FHIF is incorporated in Ireland and authorised by the Central Bank of Ireland ("CBI"). FHIF appoints Hermes Fund Managers Ireland Limited ("HF-MIL") as its management company. HF-MIL is authorised and regulated by the CBI.

Further information on investment products and any associated risks can be found in the relevant Fund's Key Investor Information Document ("KIID"), the prospectus and any supplements, the articles of association and the annual and semi-annual reports. In the case of any inconsistency between the descriptions or terms in this document and the prospectus, the prospectus shall prevail. These documents are available free of charge (i) at the office of the Administrator, Northern Trust International Fund Administration Services (Ireland) Limited, Georges Court, 54- 62 Townsend Street, Dublin 2, Ireland. Tel (+ 353) 1 434 5002 / Fax (+ 353) 1 531 8595; (ii) at <https://www.hermes-investment.com/ie/>; (iii) at the office of its representative in Switzerland (ACOLIN Fund Services AG, Leutschenbachstrasse 50, CH-8050 Zurich www.acolin.ch). The paying agent in Switzerland is NPB Neue Privat Bank AG, Limmatquai 1/am Bellevue, P.O. Box, CH-8024 Zurich.

Issued and approved by Hermes Fund Managers Ireland Limited ("HF-MIL") which is authorised and regulated by the Central Bank of Ireland. Registered address: The Wilde, 53 Merrion Square, Dublin 2, Ireland. HF-MIL appoints Hermes Investment Management Limited ("HIML") to undertake distribution activities in respect of the Fund in certain jurisdictions. HIML is authorised and regulated by the Financial Conduct Authority. Registered address: Sixth Floor, 150 Cheapside, London EC2V 6ET. Telephone calls will be recorded for training and monitoring purposes. Potential investors in the United Kingdom are advised that compensation may not be available under the United Kingdom Financial Services Compensation Scheme.

In Singapore: This document and the information contained herein shall not constitute an offer to sell or the solicitation of any offer to buy which may only be made at the time a qualified offeree receives a Federated Hermes Investment Funds Public Limited Company prospectus, as supplemented with the global supplement, the relevant fund supplement, and the relevant Singapore supplement (the "prospectus"), describing the offering and the related subscription agreement. In the case of any inconsistency between the descriptions or terms in this document and the prospectus, the prospectus shall control. Securities shall not be offered or sold in any jurisdiction in which such offer, solicitation or sale would be unlawful until the requirements of the laws of such jurisdiction have been satisfied. For the avoidance of doubt, this document has not been prepared for delivery to and review by persons to whom any offer of units in a scheme is to be made so as to assist them in making an investment decision. This document and the information contained herein shall not constitute part of any information memorandum. Without prejudice to anything contained herein, neither this document nor any copy of it may be taken or transmitted into any country where the distribution or dissemination is prohibited. This document is being furnished on a confidential basis and solely for information and may not be reproduced, disclosed, or distributed to any other person. This document has not been reviewed by the Monetary Authority of Singapore.

In Spain: The information contained herein refers to a sub-fund (the "Sub-Fund") of Federated Hermes Investment Funds plc (the "Company"), a collective investment scheme duly registered with the Spanish Securities Market Commission ("CNMV") under number 1394, the website www.cnmv.es may be consulted for an updated list of authorised distributors of the Company in Spain (the "Spanish Distributors"). This document only contains brief information on the Sub-Fund and does not disclose all of the risks and other significant aspects relevant to a potential investment in the Sub-Fund. Any investment decision must be based solely on the basis of careful consideration and understanding of all information contained in the Company's latest prospectus, key investor information document ("KIID") and the latest half-yearly and audited yearly reports. The Spanish Distributors must provide to each investor, prior to that investor subscribing for shares of a Sub-Fund, a copy the KIID translated into Spanish, and the latest published financial report. All mandatory official documentation shall be available through the Spanish Distributors, in hard copy or by electronic means, and also available upon request. It is advisable to obtain further information and request professional advice before making an investment decision. BD006840. 0009963 11/20.

Federated Hermes

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 to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes now form the international business of Federated Hermes. Our brand has evolved, but we still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important new 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

For more information, visit www.hermes-investment.com or connect with us on social media:

