PORTFOLIO INSTITUTIONAL JULY–AUGUST 2024

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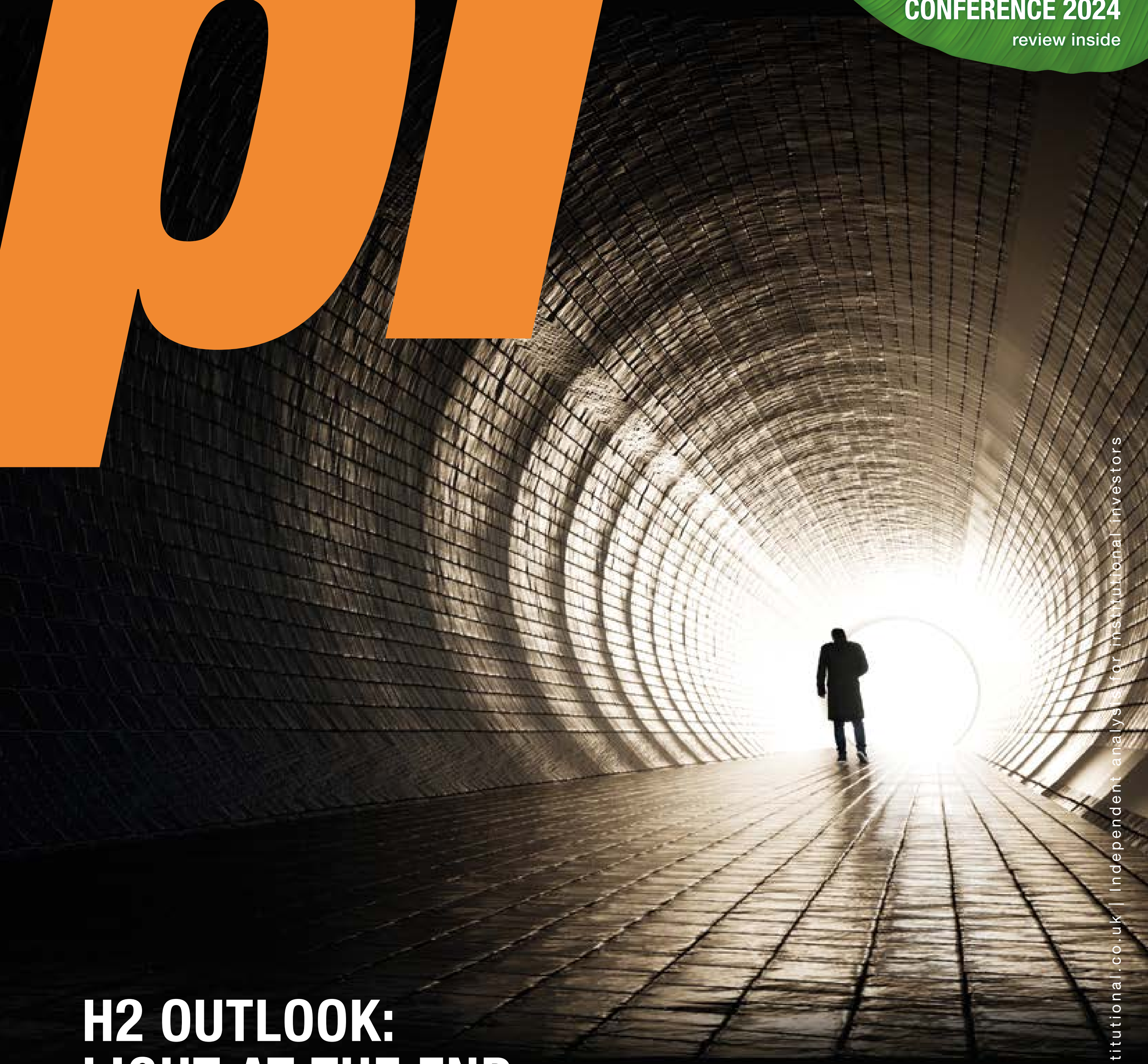
CONFERENCE 2024
review inside



H2 OUTLOOK: LIGHT AT THE END OF THE TUNNEL

COMMODITIES
The magnificent seven

LGPS CENTRAL
Meet the new boss

DIVERSITY
Silent times

Issue No. 135 | www.portfolio-institutional.co.uk | Independent analysis for institutional investors

H2 OUTLOOK: LIGHT AT THE END OF THE TUNNEL?

We have passed the half-way point of the year and what a year it has been so far: a new government, the King and the Princess of Wales treated for cancer, England reaching another European Championship final and Luke Littler making darts headline news.

Economically, there have been glimmers of good news. Inflation has settled at the Bank of England's 2% target and Britain's economy beat the 0.2% expectation for May to end the month 0.4% higher.

The big question is that, as we still have almost half of the year remaining, what can we expect in the second half. How many cuts to interest rates will there be? Will the economy continue to defy expectations? And has inflation really calmed down?

This month's cover story looks at what we can expect in the months ahead. Will there be more clarity than there was at the start of the year when "uncertainty" was the word on most analyst's lips? You can read our take on what could happen in the final months of the year from page 16.

Also in this issue we ask if it is time to get back into commodities given that any natural resource starting with the letter C, such as coffee, cattle, corn and cotton, has enjoyed heightened demand of late (page 20).

We also ask if the market is ready for re-pricings in the bond markets given the huge sustainability risks some stocks are carrying (page 44).

Sticking with the ESG theme, from page 50 we take a look at why the financial services industry has fallen almost silent on the subject of diversity. Is that a bad sign?

Finally, in July our ESG Club Conference returned for a third year and a review of each of our four panels appear in this edition.

My particular highlight was hearing how one asset manager is being innovative with mushrooms. Read all about it from page 24.

Mark Dunne
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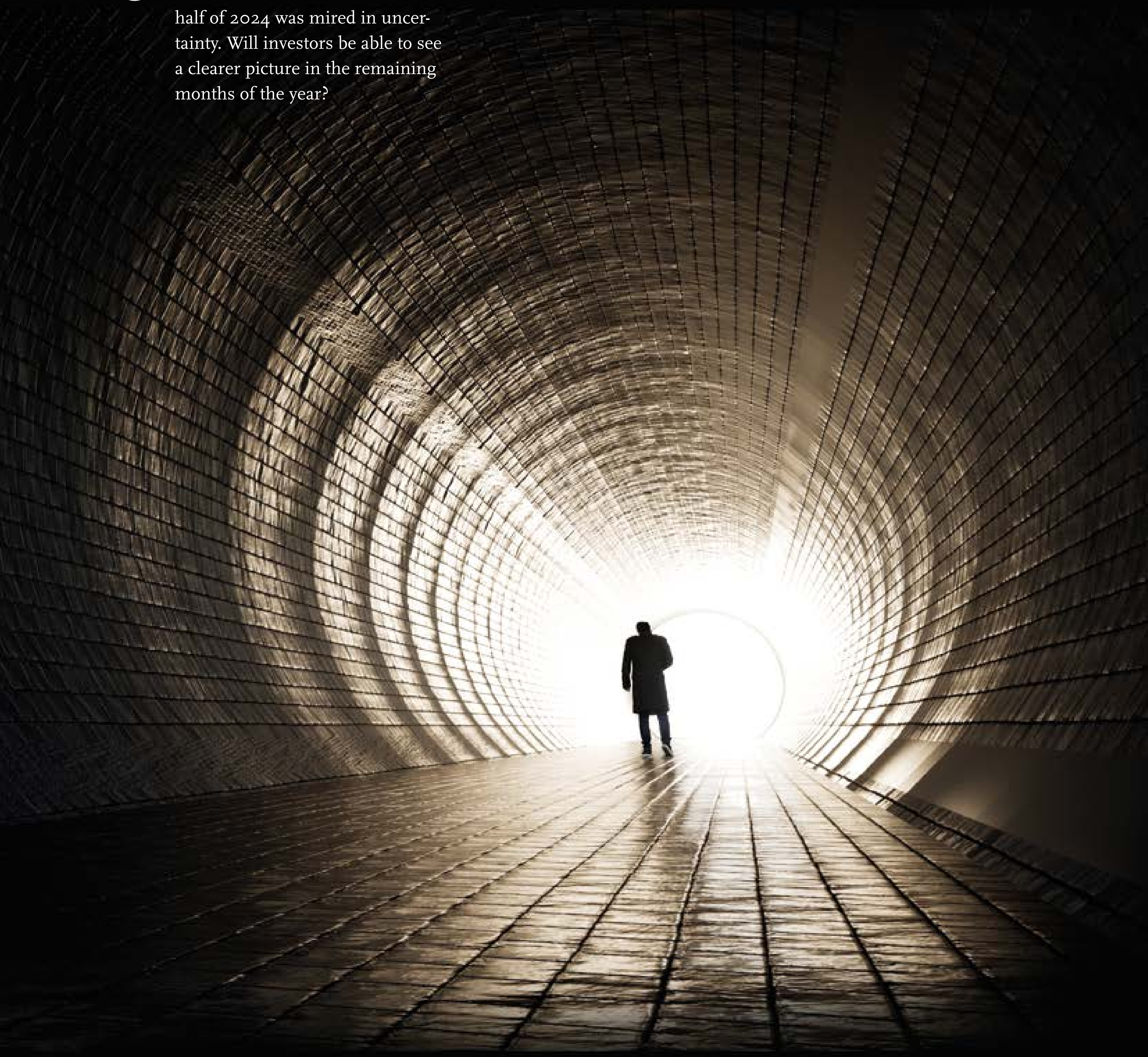
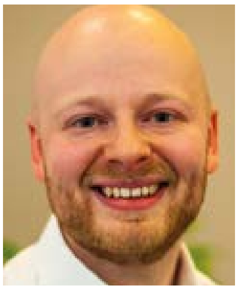
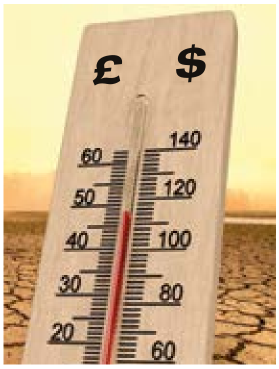



SUSTAINABLE GROWTH
FOR A NEW ERA

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NEW LISTING RULES DIVIDE INVESTORS

Asset owners are not happy at moves to attract innovative companies to the UK, but not all investors are displeased, finds *Andrew Holt*.

The Financial Conduct Authority's (FCA) new rules for the listing of shares have come under fire from leading asset owners, while other investors support them.

The regulator has simplified the listings regime with a single category and streamlined eligibility for companies seeking to list their shares in the UK.

The overhaul of listing rules, according to the FCA, "better aligns the UK's regime with international market standards".

The rules, noted the FCA, "ensure investors will have the information they need to make decisions about their money, while maintaining appropriate investor protections to hold the management of the companies they co-own to account".

The new rules remove the need for votes on significant or related-party transactions and offer flexibility around enhanced voting rights. Shareholder approval for key events, like reverse takeovers and decisions to take the company's shares off an exchange, is still required. But leading asset owners have called into question the validity of the move.

Adam Matthews, chief responsible investment officer at the Church of England pensions board, asked: "In whose interest are the weakening of the UK listings rules announced this morning by the Financial Conduct Authority serving?"

He then added: "In the executive summary [of the FCA's new rules] there is some acknowledgement 'that not all parts of the market will agree with certain features of the final rules for commercial companies' – a mild understatement of the opposition from the part of the market serving the long-term interests of many millions of pension fund members."

Deeply disappointing

Similarly, Caroline Escott, acting head of sustainable ownership at Railpen, expressed her disappointment with the new rules. "UK pension schemes naturally want thriving UK capital markets. As such, we are deeply disappointed with the final UK listing rules and feel an opportunity has been lost to truly make UK capital markets an environment where all the parties necessary to creating long-term value can co-operate and have a voice," she said.

Escott added: "We presented compelling evidence in support of the benefits of robust investor protections, both to the UK as a global financial centre and to outcomes for everyday savers.

"It is a shame that this evidence, and the widely held concerns of investors and consumer representatives, have not been heeded," she said.

She did note though that she was pleased the FCA is "open to our suggestion" of class-by-class vote disclosure at companies with dual-class share structures.

"The methodology for doing so will need to be carefully considered, and we look forward to working with the FCA and others on this," Escott said.

Adding momentum

In contrast, Richard Stone, chief executive of the Association of Investment Companies, welcomed the new rules.

"The new listing rules will add momentum to the drive to make the UK's capital markets more competitive," he said. "Investment companies rely on a thriving stock market and have an important role to play in funding growth.

"They invest in a broad range of assets from UK stocks and shares to infrastructure and private equity.

"The new listing rules support the competitiveness of investment companies, making it easier for them to undertake significant transactions and related party transactions," he added.

Sitting broadly between these two opposing positions is Tom Lee, head of trading proposition at Hargreaves Lansdown. "A successful listings regime which supports our home market is essential. However, making the UK an attractive place to list has to be balanced with rights for shareholders and ensuring that the quality of the market is not diluted.

"We will watch closely as these new rules embed, we have been concerned that the plan to remove shareholder votes on significant and related party transactions would dilute investors' rights," he added.

The FCA has been clear that the new rules involve allowing greater risk, but believes the changes set out will better reflect the risk appetite the economy needs to achieve growth.

The new rules came into force on 29 July.

As you would expect, chancellor Rachel Reeves endorsed the new listing rules. "These new rules represent a significant first step towards reinvigorating our capital markets, bringing the UK in line with international counterparts and ensuring we attract the most innovative companies to list here," she said.

Stone welcomed this statement. "The chancellor's endorsement of these rules confirms Labour's ambition to champion the UK's financial services industry. Public markets are essential to help mobilise private sector investment and kickstart economic growth."

In fact, Stone said more modifications could be made to boost the market further.

"The next step must be for the FCA to fast-track prospectus reform, which will lower the cost of capital raising for UK-listed companies. The FCA needs to act swiftly on this to help accelerate economic growth," he said.

KING'S SPEECH RECEIVES TWO CHEERS FROM INVESTORS

The focus on growth and investment gets a thumbs-up, but pensions policy does not go far enough. *Andrew Holt* reports.

The King's speech, which was delivered in July by King Charles III to introduce the new Labour government's parliamentary agenda, has put some meat on the bones of the government's plans on growth, pensions and potential investments.

Central to the speech was a Pensions Schemes Bill, reaffirming the intent to have schemes play a more significant role in supporting the UK economy through productive investments.

"It is clear that the government wants pensions, and the National Wealth Fund bill (see page 39) to play a role in providing meaningful stimulus to UK productivity, said Calum Cooper, head of pensions policy innovation at Hymans Robertson.

"For this, the pensions industry will need clarity – both a practical road map and clear and attractive opportunities to invest at scale," Cooper added. "Hopefully, this bill will play an important part in stimulating this thinking and direction too. There is a huge societal opportunity in unlocking the productive potential of our £2.5trn of pensions."

"Pension schemes can, and do, play a significant role in supporting the UK economy but there is potential for them to play a more significant role," the government said in a document, released alongside the King's Speech.

Forward looking

Chris Cummings, chief executive of the Investment Association, welcomed the government's focus on securing economic stability and growth and the focus on encouraging investment.

The speech, he said, "offers a forward-looking plan which recognises the importance of partnership with the private sector, and the investment management industry will play an active role in achieving these aims".

"By taking into account the individual needs of investors and the role the pensions system can play in delivering growth, there is great potential to benefit UK households and our economy," Cummings added.

"The proposed Pensions Scheme Bill will be fundamental in taking this agenda forward," Cummings said. "The focus on implementing a 'value for money' framework for defined contribution schemes will place a greater emphasis on value, rather than a narrow focus on cost, leading to improved outcomes for consumers."

In addition, Cummings said he is "pleased" that the government has listened to investors and will deliver on the creation of a new empowered regulator – the Audit, Reporting and Governance Authority (ARGA) – as part of the draft Audit Reform and Corporate Governance Bill.

"Putting ARGA on a statutory footing will provide a boost to trust, transparency and accountability in UK companies, auditors and capital markets and reinforce the UK as a trusted location for investment," Cummings said.

And enshrining the National Wealth Fund in legislation is a "clear signal" from the government of its intent to mobilise much needed capital for green investments, Cummings said.

"The Climate Change Committee estimates that an additional £50bn to £60bn of capital investment will be required every year over the next decade to deliver the UK's net-zero ambitions, and there is an urgent need to build the pipeline of investable infrastructure projects in the UK to support this," he added.

"We strongly support this ambition to channel much needed capital into British businesses and infrastructure projects to cement the UK as a leader in sustainable finance," Cummings concluded.

Business as usual

But for former pensions minister, and now LCP partner Steve Webb, the King's Speech represents little difference in pensions policy when compared to the previous government.

"This Pension Schemes Bill very much represents business as usual when it comes to pensions policy," he said. "There appears to be nothing in the legislation that so far represents a distinctively Labour Party approach to pensions, and a Conservative minister could happily have brought forward this legislation."

> **This Pension Schemes Bill very much represents business as usual when it comes to pensions policy.**
>
> Steve Webb, LCP

This does mean ultimately that any distinctive policies will have to await legislation later in this parliament and may take time to have effect, Webb added.

Although Calum Cooper did express disappointment at one omission in the King's Speech. "Given how important pensions are to everyone it's disappointing to see that the pensions review, promised in the Labour manifesto, was not included in the King's Speech," he said.

"An independently led review, with cross-party support would give us the best chance of providing meaningful change for a generation that will ensure sustainable pensions," he added. "We hope it will be high on the government's agenda and included in the chancellor's budget in the Autumn."

PEOPLE MOVES

Our round up of the latest institutional investment recruitment news starts with the **Church Commissioners for England**, which has appointed **Poppy Allonby** as its new chief investment officer.

She takes up her new role at the body which manages the Church of England's £10bn endowment fund in September, replacing Tom Joy, who will stand down after 14 years.

Allonby joins from T Rowe Price, where she is vice president and leads the firm's sustainability strategy.

Smart Pension has named **Gordon Wilson** as its chair. He replaces Ruston Smith, who stands down after two years, but will advise the £5bn master trust on matters in the UK and Ireland.

Wilson brings pensions and technology expertise to the trust, which includes spending more than eight years at digital transformation firm Advanced as well as leading pension software specialist Aquila Heywood.

London CIV has welcomed **Andrien Meyers** as its first chief proposition officer. The role was created to help deliver the next phase of the £30bn pool's strategy.

The head of pension investments at the London boroughs of Sutton and Kingston brings two decades of experience to the pool, which has included advising the minister for local government.

Meyers will launch products and services as London CIV moves beyond simply pooling.

Rob Orr has been unveiled as the next chief executive of **Superannuation Arrangements of the University of London** (SAUL). He will replace Sue Applegarth, who retires from the occupational pension scheme for more than 50 higher education organisations at the end of September.

Orr has worked for SAUL since 2010 and moves up from head of technical and communications to take the role.

Dalriada has strengthened its expertise through appointing **Barbara Fewkes** as a professional trustee.

The former partner at Barnett Waddingham boosts the professional trustee firm's governance and scheme funding expertise. Fewkes has also supported trustees through de-risking transactions, will work from the firm's Glasgow office.

Our round up ends with news that professional trustee specialist **Independent Governance Group** has promoted **Dan Gilmour** and **Michael Do** to trustee directors.

CALENDAR

Topics for upcoming *portfolio institutional* events*

October

DC and private markets roundtable

November

Insurance roundtable

March 2025

Private markets conference

*Subject to change

NOTICEBOARD

The defined benefit master trust of workplace pensions provider **TPT** has launched two alternative funds collectively worth more than £800m.

The real assets fund has been seeded with more than £500m worth of private infrastructure, a quarter of which are renewable assets.

The secure income fund holds more than £300m across private credit and secured finance and will be managed by Carne Global Fund Managers (UK).

These are the first of seven funds TPT plans to launch this year.

Access, which manages £40bn of assets for 11 local government pension funds, has invested £300m in sustainable timber.

Part of the mandate has been invested in the Stafford Carbon Offset Opportunity fund, which creates timberland estates and supplies carbon offsets.

The other has been placed with JP Morgan's timberland investor and forestry manager Campbell Global, which provides exposure to the asset class globally.

This natural capital investment diversifies the pool's private market exposures.

Wiltshire Pension Fund has handed a £75m global sustainable equities mandate to **Lombard Odier Investment Managers**.

Meanwhile, we start our de-risking round up with news that the trustees of the **TotalEnergies UK Pension Plan** have announced a £1.2bn agreement with **Pension Insurance Corporation** (PIC). The deal covers the benefits of 5,500 members of the traditional and renewable energy company's pension scheme and is the largest buy-in so far this year.

The insurer is now responsible for all £2.8bn of the scheme's liabilities following a £1.6bn agreement 10 years ago.

PIC has also secured the retirement funds of all members of the defined benefit scheme sponsored by telecommunication company **Arqiva**. The £204m full buy-in covers the pensions of 800 members.

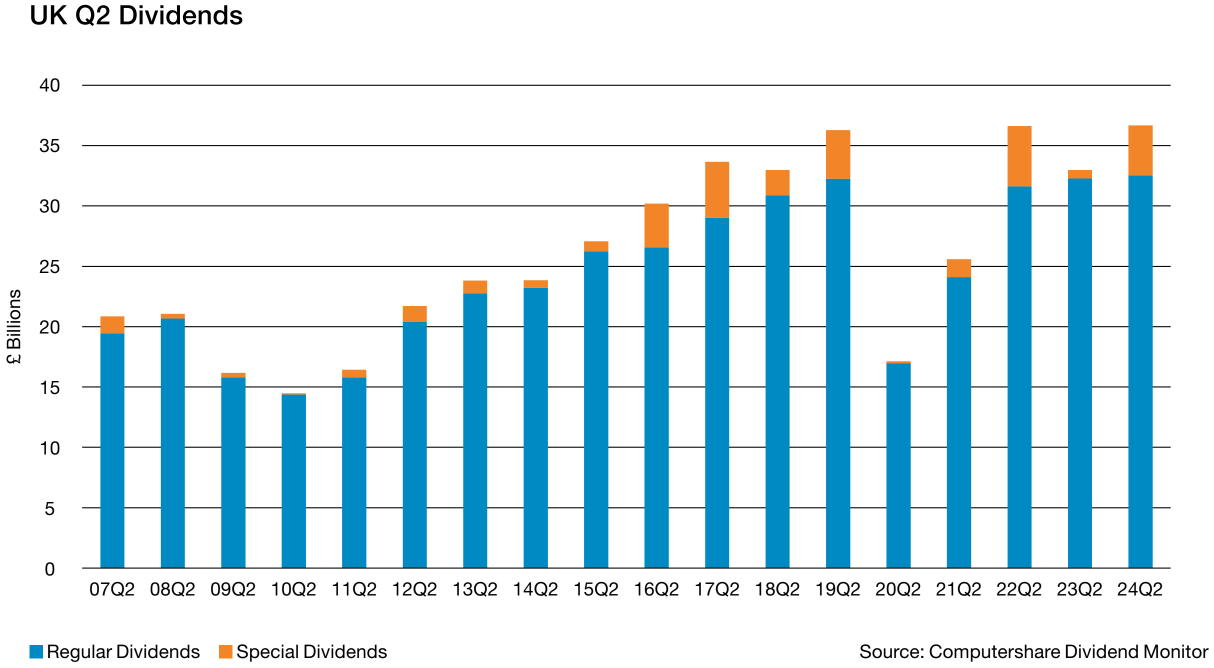
Elsewhere, an £880m bulk annuity transaction has been agreed between the **Rolls-Royce & Bentley Pension Fund** and **Standard Life**. The full scheme buy-in replaces the longevity swap agreed between the scheme and the insurer 11 years ago.

Then there are the trustees of the UK occupational pension scheme sponsored by materials specialist **Sibelco** which agreed a £165m bulk annuity deal with **Aviva**.

Aviva has also guaranteed the final salary pensions of more than 200 workers of European Metal Recycling after shaking hands on a £33m deal.

This was the first such transaction involving the **European Metal Recycling Limited Pension and Life Assurance Scheme**. No contribution from the sponsor was needed as the scheme is in surplus.

THE BIG PICTURE: UK DIVIDENDS BREAK NEW GROUND IN SECOND QUARTER



Source: Computershare Dividend Monitor

Dividends hit a record high despite cuts by miners. *Andrew Holt* reports.

London-listed companies returned a record amount of cash to their shareholders in the second quarter, according to financial services company Computershare.

Payouts rose by 11.2%, year-on-year, to a record quarterly high of £36.7bn.

The figure was boosted by special dividends. The largest of which came from HSBC, which distributed the proceeds from the disposal of its Canadian business.

The underlying growth rate, which strips out these one-offs, was just 1%, but regular payouts still reached a new peak of £32.5bn.

A second consecutive year of cuts from mining companies, which totalled £2bn in the second quarter, reduced the sector's payout by a third, compared to the same period in 2023.

For the remainder of this year, the payouts from miners are likely to fall even further following a steeper-than-expected cut announced by Glencore for the third quarter.

The 'mining effect' means that Computershare has reduced its forecast of underlying growth this year to just 0.1%, down from 1.5% three months ago. This translates into total regular dividends of £88.2bn.

If miners are excluded, the forecast would show double-digit underlying growth this year.

And excluding the volatile mining sector, the underlying increase in dividends was 8.6% in the three months to the end of June, with 16 out 21 sectors recommending higher dividend payments.

At a company level, the median or typical growth rate in the per-share dividend was 5.4%.

Banks made by far the largest positive impact on dividends, distributing £1.1bn more in regular payments compared to the second quarter of last year, as high interest rates continue to support profit margins. As a result, banks are on track to return a record amount of cash to investors this year.

The healthcare sector, where payments are up by a quarter, made the second largest contribution, primarily as a result of strong profit performance at Haleon and GSK.

Insurance, property, industrials and food retail were among the mix of sectors showing good growth. High oil prices continued to support modestly rising dividends from the major oil companies.

The weakest sector was housebuilding, with lower dividends mirroring the tough housing industry and residential sales markets.

Sam Winnard is head of build-to-rent operations at Pensions Insurance Corporation (PIC).

THE SOCIAL VALUE OF PROPERTY

There is considerable social value created through the early lifecycle of a real estate development, including environmental benefits, jobs and skill development. These are all important beneficial outcomes.

However, equally as important when describing the social value of a regeneration project are the health and community, or social fabric, benefits that these developments enable.

In September 2023, we welcomed the first residents into New Vic, a £130m build-to-rent development in Manchester. We built New Vic to provide the cashflows we need to pay the pensions of our policyholders over the coming decades.

Embedding social value into a development is important in this regard for two reasons.

First, we are part of the local community and we want to live and work in an environment that benefits from our presence. Second, it also results in longer duration tenancies without an undue number of vacant apartments, which means smoother cashflows to help pay the pensions of our policyholders.

The best developments provide a welcoming physical environment alongside an engaging on-site team that facilitates an active community.

The starting point for managing a build-to-rent development is the creation of communities. Determining who takes ownership of social value initiatives within these developments is a crucial first consideration. Outsourcing specialists are well-suited to overseeing the operational aspects of day-to-day management but leadership, direction and commitment from the development owner is essential to drive innovation in community engagement over the long term.

The investment need not be large; what matters is the commitment of effort, creativity, time and care. For example, we host weekly “get to know your neighbour events” for new residents and have initiatives including health and wellness events, focusing on a healthy body and mind; a dog walking club; fitness classes; as well as partnerships with local businesses and restaurants. Residents can also contribute to the wider community through various initiatives. For instance, there are ongoing initiatives such as a clothes bank and coffee mornings to support local causes.

It is important to create more of a village – a vertical village perhaps – than a traditional build-to-rent development. New Vic will have a considerable benefit for the centre of Manchester. Having 500 people living on the doorstep of local businesses – our residents are able to buy directly from them through the New Vic app – will support them over future years.

The app also provides a platform for virtual community engagement. As well as booking repairs they may need, booking the on-site amenities, such as the cinema room or private dining room, residents are able to chat with their neighbours, can start groups with those with shared interests and arrange meetups. The residents have also formed a book club, and soon the New Vic football team will kick off its first match.

The feedback we are receiving from our first residents is proving invaluable as we look to open our pipeline of build-to-rent developments over the next couple of years.

We see the social value in having created such a strong community. As we welcome increasing numbers of residents into our build-to-rent schemes we will take this experience and help to shape their communities and with it create significant social value by bringing new life back into our town and city centres.

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EMERGING MARKETS IN TODAY'S WORLD

The term "emerging markets" began life in the World Bank in the early 1980s to change the perception of developing countries and it has since stuck big time.

Over the past four decades, this term has gone on to define an entire branch of the financial industry. It's impacted the way firms are organised and run and you might say has been one of the most successful brands in the industry…until it wasn't.

Zooming out to look at the performance of emerging market (EM) equity indices compared to developed markets (DM) since the inception of the EM "idea" reveals a slight outperformance for EM.

But it hides some huge cycles. With all of that outperformance coming pre-2010, followed by a now 15-year losing streak compared to DM.

Many asset owners, including some prominent UK master trusts, have abandoned the allocation altogether.

As a global asset owner, we define our opportunity set globally and EM is a part of that, but what's gone wrong with EM over the past two decades?

Four things stand out – there is the fact that emerging economies don't tend to emerge. The developed/emerging paradigm doesn't stand up. Over the decades only a handful of emerging countries have moved into the developed categorisation (Portugal, Greece and Israel). A two-state model of development is not accurate for today's landscape and hasn't been true since the 1960s, with a four-state model being a better fit.

Countries like China and India have moved up the rungs of that ladder, but have not, and may never follow exactly the path to development and open markets of today's developed market countries.

The myth that growth translates to investment returns is propagated implicitly or explicitly all the time. EM is where the growth and population will be, so you want to invest in companies listed in those markets. But sometimes it doesn't work like that. Economic growth accrues to non-listed firms, while listed firms are often those whose best growth days are behind them. They also dilute investors unfavourably through new issuance, so even if revenue and earnings grow, earnings per share does not.

Emerging markets hold the promise of a rich variety of markets from commodity exporters to tech innovators across many geographies. The trouble is the main indices have been driven by the performance of one country in recent years: China.

There are reasons to be optimistic on China, but allocators might want to limit exposure to a bet on a single market, and one that is subject to authoritarian rule.

When you look at the countries that form the bulk of emerging market indices and portfolios, these aren't countries at the early stage of development. They are all sitting on the third of four tiers: China, South Korea, Brazil, Malaysia, etc.

The way the index providers handled Russian stocks in the wake of that country's invasion of Ukraine is a new risk hanging over a significant part of the EM space. What happened was a forced de-listing of all stocks at zero value, which had repercussions. If investors assign some probability of stocks going to zero due to a potentially political impetus that is going to drive pricing and the reassessment of that probability may drown out fundamental factors. The superficial "cheapness" of EM may owe a lot to this hard-to-price risk.

Where does this leave allocators who are struggling? We need a new paradigm.

One issue I often find is the market is set up to push products out in recognised packaging without stopping often enough to ask if that's what allocators want. Emerging markets are an example of this.

This could change. New data can be introduced. For example, weighting based on measures of freedom to address autocratic risk. Factor approaches, quant, custom indices and fundamental active can all offer something different.

Another approach would be to redefine EM through the building blocks by looking at regional or country-level allocations. Some characteristics go beyond geographic definitions: maybe thinking in terms of commodity exporters vs importers and debtors vs creditors can help build more robust EM portfolios.

We like the idea of emerging markets, but new ideas are needed to make this allocation work for investors.

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INTERVIEW – RICHARD LAW-DEEKS

"I have noticed how important ESG and sustainability is within LGPS Central – it is the arteries and the veins of the organisation."

The new chief executive of LGPS Central tells *Andrew Holt* about getting to know what makes people tick, blowing his own trumpet, working with the new government and the benefits of playing war games.

You took up the role in June. How have the first two months been?

Very, very busy, but also enjoyable, exciting and fresh. I have focused my time on meeting our eight partner funds. I have already met six of them and will have met the other two by the time this is published. That is the focus for me. Getting to know them, getting to know any issues they have and getting to know where our strengths are.

It is the same with the team, which is about 80 people. I'm joining team meetings. I'm sitting out on the floor, not in an office, so I can get to know people and get to know what makes the organisation tick.

What have been your biggest challenges since you joined LGPS Central?

I have full days and so it has been finding the time to see everyone. I gave myself until the end of July to get to know people. Then it was formulating a plan ahead of acting on it from around September.

Meeting people has been beneficial. I'm excited about the future of the pool. We have some great talent internally, but also externally in the experience we have brought in from asset managers and banks. I'm excited about that.

At Royal Mail we didn't have graduate trainees, but we do at LGPS Central, so we have people who have always worked here. That makes it a young organisation and it is exciting to grow your own talent.

Why did you quit as chief executive of the Royal Mail Pension Plan to join LGPS Central?

I spent nine years at Royal Mail, so the timing felt right. The big draw about LGPS Central is that it is a new organisation. There is an opportunity to shape and mould the culture. It is exciting to be somewhere where there is a growth story, something new, exciting and fresh.

Royal Mail is a 500-year-old organisation. It is all about de-risking: de-risking the governance, de-risking the assets and getting the member data ready.

It is a different proposition at LGPS Central. It has had the growth trajectory over the last six years and is now in a consolidation phase. But it is still very much about what is the future strategy, which is compelling and exciting to be involved with.

What have you set as your main priorities?

First is listening. Listening to the partner funds, to the team and the board to understanding where everyone is coming from. Understanding what I call "the triangulation" of the strengths of the organisation.

The organisation is six years in, so it is already delivering pooling. We have £30bn of assets here. It is time to take stock and work with partner funds to decide what the priorities are.

I cannot reiterate enough how solid I believe the foundations are. Having a new chief executive coming in is an opportunity to take stock to be clear on the future direction. So there are a lot of opportunities.

Do you therefore have a particular vision?

It needs to be driven by the partner funds. If you look at the history of the local government pension scheme (LGPS), it has taken a long time to get to where we are. For pooling to move forward, it is going to be something partner funds need to work together on, and it is very much about the pools working with our partner funds. We want our partner funds to invest with us, we want to be their first port of call, not something they have to do.

Chief investment officer Gordon Ross leaves LGPS Central later this year. Is that part of wider changes within the investment team?

That is not part of a wider set of changes. Gordon has been here for six years and felt it was time to move on.

He has done a great job. He has coached the team and so there is a lot of love for Gordon here.

We have not rushed into announcing a replacement. We are still in that process.

LGPS Central has also appointed Nadeem Hussain as head of private markets and Mark Davies as head of public markets. Are these markets becoming more important for the pool?

They are definitely important. It is interesting where we are in the cycle. Private markets are probably finding it a lot tougher than they did pre-2022, but it is an opportunity [for personnel] to step up. We are proud of that internal development process.

Do these appointments therefore suggest a different investment approach or other changes to the investment offering?

No. We have 27 funds, of which more are in the public markets because that is the nature of the asset class. It doesn't signify any [investment] change. It just signifies change in our internal approach to developing people from within the organisation.

How important is ESG and sustainability to LGPS Central?

I realised it is heavily important in the recruitment process. And for me, it was another big pull factor of the role. It is something I had to drive forward at Royal Mail quite significantly.

I have noticed how important ESG and sustainability is within LGPS Central – it is the arteries and the veins of the organisation. It is core to everything we do here. I have never seen a board dedicate so much time to it. It is important and is important for our partner funds, as it is a huge risk. We take our responsibility seriously for our partner funds.

> **Part of my job will be to go out and speak with the new government and engage with them to find out what they are thinking.**

Also our partner funds like our climate risk reporting service. And everything we do in responsible investment and engagement goes down well.

In recent years there has been a lot for our partner funds to deal with in addressing sustainability and climate change. And this has had members asking questions about the investment strategy, or lobby groups or Task Force on Climate-Related Financial Disclosures reporting. It is something we have been able to add some value.

Trevor Castledine has been appointed as LGPS Central's first chief commercial officer to lead engagement with your partner funds. Why is this role necessary?

For us it was an evolution. It was a role called chief stakeholder officer and some of the pools may still call it that. It wasn't a new role; it was an evolution of a role. The way we see it is that it is not about business development, it is about working with our partner funds: so it is about collaboration.

It has been a case of joining the dots to drive forward our product development. We are, as I say, at that phase now to take stock, review everything we are doing and then drive that forward.

We were looking for someone with extensive experience in the LGPS along with consultancy experience, so they bring that in and help apply that with our partner funds.

Trevor is going to present us well in the market. We need a little bit of that. Some of the other pools have been better at talking about their successes than we have.

So you need to blow your own trumpet more?

It is judgement call. You have to get it right. If you overdo it, it doesn't look great. Equally, if you don't talk about anything, you get people asking questions. Each organisation is different, but it is something you need to engage with.

How is pooling going?

We are delivering pooling and have made good progress in six years. We have £30bn in assets under stewardship.

The consultation last year tried to compare the progress of each pool, but each has a different model and it was a bit 'apples and pears'. What is evident, is that we have built out great foundations with a broad range of fund solutions, services that are valued by our partner funds such as RI&E, talented people coming up through the organisation. These foundations position us to remain flexible and quick to respond to what may lie ahead.

We want to position ourselves as being first choice for our partner funds. For me pooling is about active collaboration and developing pooled solutions our partner funds want to invest in, as opposed to being forced to invest in.

How would you like to see pooling progress and develop?

There are benefits of pooling. It is tried and tested. It is about the value add we can bring to our partner funds. As I said, we are keen for it to be driven by our partner funds. Not something that is forced upon them by central government.

It will naturally happen as we continue to work together. You need to give it time. It took time for each partner fund to get where they are today and we need to give them time to come together and coalesce around the pools that they have created.

Chancellor Rachel Reeves has some interesting ideas about pooling, such as a potential consolidation. What do you think?

She was talking about internal management, or in-house management capability, and that is a place where pools can add value. But consolidation, is it the right time to be talking about that? What is the perfect size? I have seen different evidence. I would quite like to see debate and discussion around it. I would like to see it driven by the LGPS not by the government.

Has the pool discussed that with government?

No, but there is the National Wealth Fund initiative and we did participate in that. We were engaged with the taskforce set up with Mark Carney. Part of my job will be to go out and speak with the new government and engage with them to find out what they are thinking.

From what I can tell, the National Wealth Fund will be based on an investment-by-investment approach, by what they call "crowding investors". So it will be interesting to see how that is structured and made investible. Much of it is about wait and see, but much of it is also about getting our views across and we have been doing that. It is exciting. I don't think Mansion House is going to disappear.

What do you think of the Mansion House pension reforms from the previous government?

For me, at the time, I had a defined benefit hat on [at Royal Mail] and it was very much about securing those benefits [for the fund]. Whereas, if I had been in this role, I would have seen it a bit different.

Again, it comes back to the partner funds. For them, there is a range of views. For us, it is about what the partner funds want to do and then us facilitating that. I'm not surprised that it is an area of focus for the government, but the opportunities need to be right for the investment strategy.

So you don't mind the government nudging you towards infrastructure, private equity and venture capital as long as it works for you in investment terms?

Yeah. As long as it aligns with the fiduciary responsibilities of our partner funds. We can create a fund, but if none of our partner funds want to invest in it, it isn't going to go anywhere. It needs to be something they have an appetite for. The partner funds own the asset allocation and it is for us to help them with that.

What would you like to see from the new government?

Some consultation would be good. A chance to engage, not just with us, but the whole LGPS. And give pooling a bit more time. They also need to take a long-term view, which would be welcome.

What has been the biggest lesson you have learned in your career?

I'm obsessed with contingency planning. I love war gaming, thinking about different pathways, so throughout my career it is a case of hope for the best, plan for the worst.

We did a lot of contingency planning at Royal Mail. We had cyber incidents, the LDI crisis, a hostile takeover, all stuff that would be covered in war games and then we would develop around that. That is one of the things I'm proud of and glad we did as these things did happen. It is great to be prepared.

RICHARD LAW-DEEKS' CV

June 2024 – present
Chief executive officer
LGPS Central

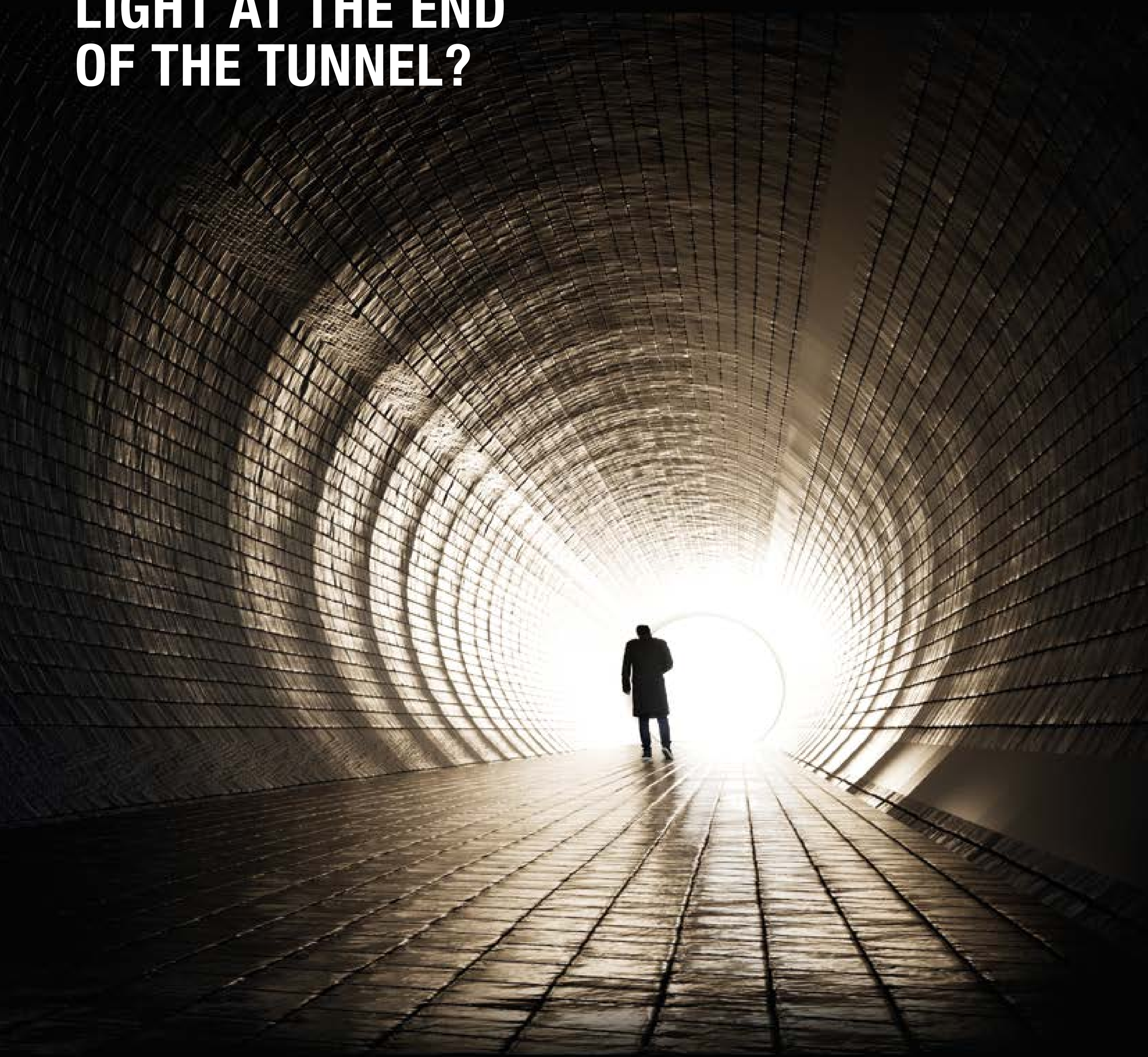
April 2018 – June 2024
Chief executive officer
Royal Mail Pensions Trustees

August 2015 – April 2018
Head of finance
Royal Mail Pensions Trustees

January 2014 – July 2015
Investments manager
Marsh & McLennan

February 2011 – December 2013
Group accountant
London Borough of Hackney

H2 OUTLOOK: LIGHT AT THE END OF THE TUNNEL?



Uncertainty around inflation and interest rates has muddied the outlook for investors. *Andrew Holt* takes a look at whether what lies ahead is any clearer.

As we have moved swiftly into the second half of the year, the debate surrounding inflation, interest rates and the policies of central banks rumbles on. These are issues that have dominated the investor picture for some time.

Much of what has played out this year, particularly in regard to inflation, has been far from what was expected. It has resulted in not just a higher-for-longer outlook, but a higher-for-a-great-deal-longer position, which has created much uncertainty along the way.

Is this now changing (finally)? Inflation globally is falling, albeit reluctantly and slowly. There is a sense that it is coming under control. The fact that the Bank of England (BoE) hit its 2% target in May was welcome news and contributed to presenting a more upbeat picture going forward.

Yet, as with much of what has happened with inflation, this is not clear-cut good news. "Whilst inflation is back down to the BoE target of 2% the underlying data remains a concern," says Paul Flood, head of mixed assets at Newton Investment Management.

"Service sector inflation remains too high at 5.7% driven by wage rises as restaurants and hotels have passed on those demands," Flood adds. "Whilst the headline level of inflation may be down at target, it may not stay there for long."

Even within this brief assessment there is much to cause concern.

Gradual and cautious

It has fallen to the European Central Bank (ECB) to change the narrative. The ECB was the first major central bank to act, with a 25 basis points cut in June to 3.75% – the first such cut it has made in five years.

The cut, on the face of it, looked decisive. But when you look at ECB president Christine Lagarde's comments following the announcement, things become less clear. She was uncommitted on future cuts and suggested the central bank would be keeping a firm eye on inflation.

In fact, the ECB has raised its inflation forecast for this year and next. And with that, an implication that this initial cut may not signal the start of a sustained easing cycle. That is not what investors want to hear, but it is what they have to live with.

"Don't cry 'victory' too soon," says Nicolas Forest, chief investment officer at Candriam. "Lagarde doesn't want to pre-commit to further cuts. She is taking a gradual and cautious approach like the other central banks and will re-assess the situation meeting by meeting."

As a result, Shaan Raithatha, senior economist and strategist at Vanguard Europe, holds the view that interest rates will remain higher for longer. "Part of this is because we believe the neutral rate of interest – or r-star – is higher than commonly believed. This in turn makes the current stance of monetary policy less restrictive," he says.

The theory behind the r-star – which is the real neutral rate of interest that equilibrates the economy – suggests that if a central bank sets the rate below the r-star, then policy is accommodative. Raithatha's point is the opposite to what is currently the case. This is important because it sets the foundation for risk-free and risky asset returns.

To cut or not to cut

Nonetheless, Forest expects two more rate cuts before the end of the year, starting in September, based on inflation effects in services disappearing.

The back seat driver in all of this is the unwanted guest of inflation. If this improves, things start falling into place. If not, we have much to ponder. Des Lawrence, senior investment strategist at State Street Global Advisors, cautions against the inflation picture.

"Although inflation expectations remain quite well anchored, recent hard data has not been entirely helpful to those of a more dovish persuasion – early estimates for the month of May showed inflation increasing by more than forecast by markets," Lawrence says.

This was indeed a blow, even though inflation decreased in that month, but not to the low levels the market expected.

Like with a marathon runner experiencing the final miles as the toughest, we may have entered the final but tough straight in dealing with inflation. "It does remind markets that the last leg of the disinflation journey can be the most difficult – price inflation in services is still running at an annual rate of just over 4%," Lawrence says.

Paul Jackson, global head of asset allocation research at Invesco, presents a more upbeat analysis. "Inflation is still coming down," he says. "If you look at the background detail in US wage inflation it has been falling for more than two years, and that is an important driver of core inflation.

"So core inflation will keep coming down in the US. And it has already done a lot of the downward journey in many parts of Europe," Jackson says.

> **Whilst inflation is back down to the BoE target of 2% the underlying data remains a concern.**
>
> Paul Flood, Newton Investment Management

Will the Old Lady act?

The ECB rate cut switches the focus to the UK and the Old Lady of Threadneedle Street. In June, the BoE was unmoved, keeping rates unchanged at 5.25%. "The ECB decision will raise hopes that UK interest rates will also be brought down sooner rather than later," says Susannah Streeter, head of money and markets, Hargreaves Lansdown.

"The data coming in has been more positive for the Bank of England, indicating that price pressures are easing," she adds. "So an interest rate cut in August is still a real possibility, although the financial markets have not been fully pricing in a cut until November."

When it comes to the Fed, June's Federal Open Market Committee kept rates unchanged. And importantly, seem in no hurry to cut.

Fed chair Jerome Powell did not take the possibility of a September rate cut off the table, but he refused to say specifically how many months of good inflation data is needed to build confidence to cut rates.

All of which makes expectations for a cut, and when, difficult. "The Fed lacks guidance as it has abandoned forecast-based policy making and became extremely data dependent," says Xiao Cui, senior economist at Pictet Wealth Management.

That said, Eric Vanraes, head of fixed income at Eric Sturdza Investments, still believes that the first-rate cut could come before the fourth quarter, in September. "We do not rule out a surprise Fed rate cut at the end of July," he says. "American banks, including the largest, are more heavily exposed to commercial real estate loans than anyone thought.

"Rates, short and long, are not falling fast enough to dismiss this concern," Vanraes adds. "And if the commercial real estate debt wall appears in 2025 while rates are still too high, we risk a Silicon Valley Bank-style crisis at large scale." This presents another potential layer of concern.

And despite the Fed's prevarications, Xiao Cui also says investors should still expect rate cuts from the Fed later this year. "We maintain our call for two rate cuts this year in September and December," she says.

A crucial indication of how things will progress is that there will be three more inflation reports before the Federal Open Market Committee meeting on 18 September, which should give some clearer semblance of where the US economy stands, and the opportunity, or not, for the Fed to go for cuts.

"We expect continued good readings on inflation to enable the Fed to start cutting then, but the risk continues to be that the disinflation path is bumpy and a cautious Fed might need to see more months of good readings to start cutting in December," Cui adds.

The next cut

So who will cut next – the BoE or the Fed? "The ordering [of cuts] is not what I was expecting six months ago," Jackson says, adding that he believes the Bank of England will be cutting in August and for the Fed it could be earlier.

The election will play its part for the Bank of England. "The BoE does have capacity to cut rates with inflation coming down, but with the UK election in mind they will likely delay any decisions until September, when they will also have more data on whether service sector inflation abates further," Flood adds, when speaking ahead of July's election.

But Flood also adds another interesting contextual and historical point. "Most likely the Fed will be first to cut, since the BoE was made independent they have always followed the Fed."

So how many rate cuts can we expect? "I would expect the ECB to cut maybe two to three times this year, the Bank of England perhaps twice and the Fed maybe once, possibly twice," Jack-

son says. "But if we look 12 months ahead, I wouldn't be surprised to see four to five amongst those major central banks."
This presents a pretty compelling picture: one where inflation is duly put back in its box.

Tactical opportunities

Jackson is not alone in seeing light at the end of the tunnel. Pictet Asset Management's chief strategist, Luca Paolini, is a half full glass type of guy. He notes that the prospects for the world economy have improved and interest rates are, he believes, set to fall, which is a positive backdrop for stock markets, at least in the near term.

On this basis, he therefore remains overweight equities, neutral bonds and underweight cash. Pictet's business cycle indicators are sending positive signals about emerging markets and Australia, he says. Emerging markets, not least China, are at the vanguard of the easing cycle, and that is set to support growth.

On the other hand, developed economies are showing more muted economic performance, he adds. "But the eurozone and the UK are showing an improvement in activity," Paolini says. "For now, our signals are neutral for the US economy, which will slow from around a 3% rate of growth to closer to 1%, before recovering back towards potential by the end of the year."

A point worth considering is that in contrast to the decade after the 2008/09 crisis, some, like Vanguard's Raithatha, expect real rates to be positive over the long term, and with it have implications for investors. "This return to sound money provides a solid foundation for equity and fixed income returns over the coming decades," he says.

There are other signs for investors. Daniel McCormack, head of research at Macquarie Asset Management, sees the BoE cutting rates, which means there could be a tactical opportunity in European and UK assets. "Our expectations for the Bank of England suggest gilts could be in for a period of strong relative performance," he says.

"The combination of falling interest rates and an improving economic cycle is likely to be positive for European and UK equities, particularly in contrast to the US where interest rates are likely to stay higher for longer and growth concerns are coming to the fore again after a period of remarkable resilience," McCormack says.

Fiscal support

Outlining other areas for investors to follow, Flood notes the outlook means some long-term structural themes will remain, and beneficiaries of the spending on infrastructure and decarbonisation will continue. "We see companies tied to these themes continuing to benefit from fiscal support for many years to come," he says.

Alongside that, Flood cites bond yields as being more attractive than they have been for much of the last decade, offering a reasonable return as well as diversification from equities in a downturn, helping to provide a balanced portfolio.

"With fiscal spending forecast to continue for a number of years we see valuations in the bond markets as fair, so there remains the risk that yields continue to rise if the US bond market takes fright at the amount of issuance to fund the fiscal largesse," Flood says. "For that reason, we favour other government bond markets, such as Australia, New Zealand and the UK."

There is more to explore when it comes to the yield curve factor. Possibly an obscure element to trot out, but the yield curve tends to steepen during cutting cycles, which can have an impact on investors.

Mauro Valle, head of fixed income at Generali Asset Management, is positive on the short–medium maturities of the euro-yield curve. "As inversion of the yield curve is quite significant and we don't see conditions for a further inversion in the next future, we continue to be positive on peripheral countries, as carry trades and search for yields will continue to be a driver for investor preferences, considering that in the future the euro rates could be lower," he says.

Ultimately though, the picture, it is safe to say, is far from clear. "There are still many questions to be answered and investors will have to continue listening to the data," says Jamie Niven, senior portfolio manager at Candriam.

"We believe the signals are there that we are nearing a more positive path for rates markets, but there are still plenty of bumps which need to be navigated first," he adds.

American banks, including the largest, are more heavily exposed to commercial real estate loans than anyone thought.

Eric Vanraes, Eric Sturdza Investments

COMMODITIES: RIDING THE WAVE OF THE SEVEN Cs

Commodities often rear their head for investors at irregular times. Sometimes it's on the back of events, but there are times when they arrive unexpectedly.

So could the asset class be making a return? Indeed, there is a call for investors to get into cocoa, coffee, corn, crude, cotton, copper and cattle – collectively known as the seven Cs.

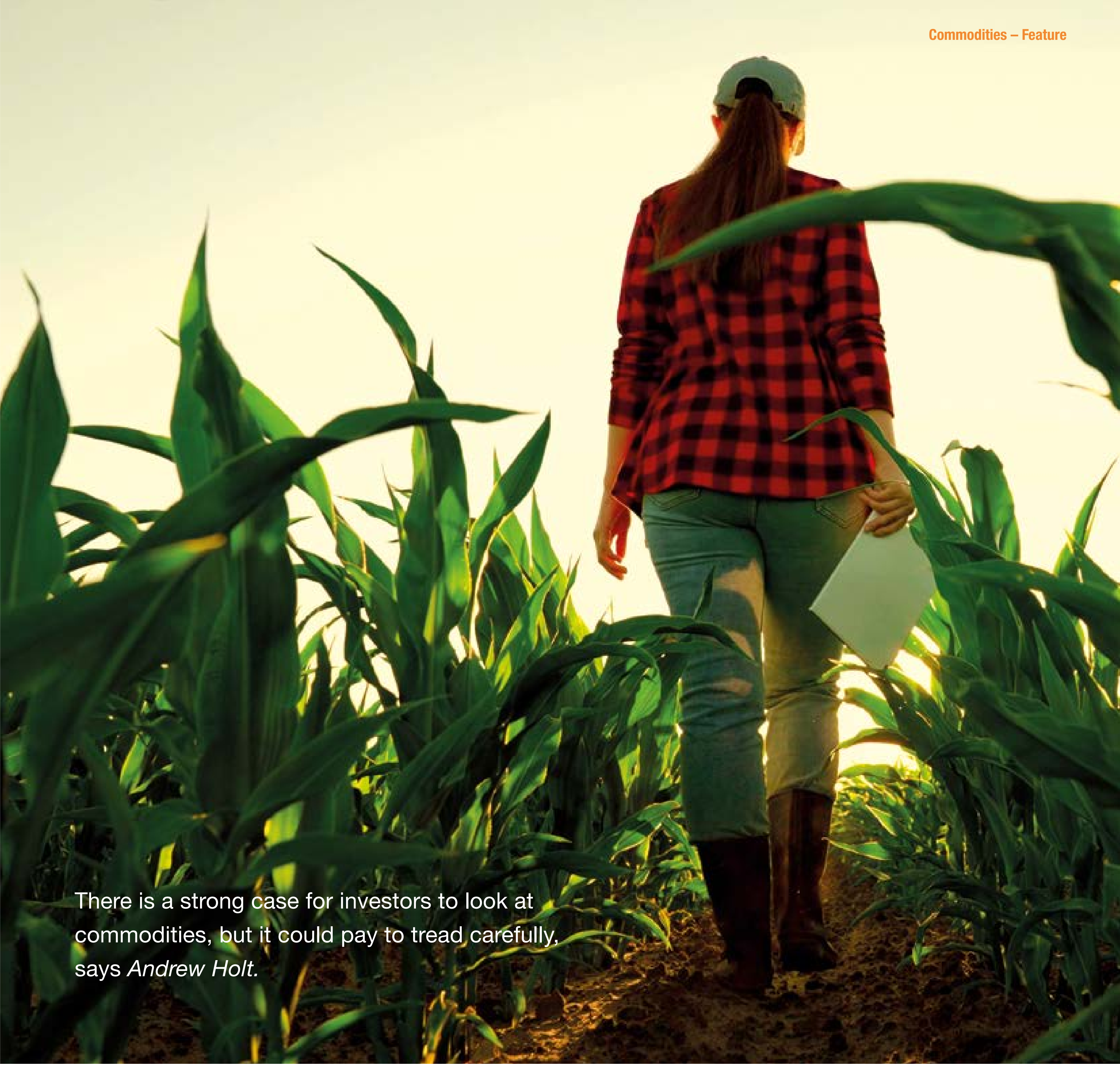
A big advocate of the 'seven Cs' idea is Peter Borish, chief executive of Computer Trading Corporation, who has identified some trends within the asset class. "The seven Cs are relatively consistent that inflation is going to be persistent for longer. You are starting to see some of the seasonal commodities potentially breakout," Borish told Bloomberg's *Wall Street Week*.

There can be no doubt that the numbers support this case. The value of cocoa is up 106.2% year-to-date while cotton has climbed 16.5%. Crude has gained 14.5%, cattle has risen 11.2% and copper has added 5.7%. Coffee is unchanged for the year, while at -10.2% only corn is down.

The Commodity Research Bureau index is up 7.9%. And three commodities: gold, silver and copper are all up around 15%, 20% and 30%, respectively.

Not to be left behind, in its latest report, the European Commission estimates that its sugar production will grow by 5% year-on-year for the 2024/25 season. All, it could be said, are handy numbers.

Such important movements reveal some evident factors at play within the commodities market. Copper is a typical cyclical metal: when the economy is strong, demand for copper tends to be high, and vice versa. Copper is also a key resource in the



There is a strong case for investors to look at commodities, but it could pay to tread carefully, says *Andrew Holt.*

renewable transition, especially in electric car batteries where it is essential, so demand may also have a speculative component.

"Although global growth has not been exceptional this year, I believe the demand for copper stems from markets anticipating that growth will pick up towards the end of the year and early next," says Paul Jackson, global head of asset allocation research at Invesco.

All that glitters

The rally in the price of gold, however, is another highlight. "Given the strength of the dollar and high bond yields, I would normally expect the price to be much lower," Jackson says.

In its mid-year outlook, the World Gold Council (WGC) predicts that gold will remain range-bound over the second half of 2024. It expects falling interest rates in developed markets to continue supporting gold prices, as higher investment flows towards the asset as an inflation hedge.

Along with that, gold could also be used by the global investment community to hedge the ongoing geopolitical tensions. However, the WGC warned of the possibility of a sizable drop in central bank demand or widespread profit-taking from Asian investors that could impact the overall performance of gold in the latter half of the year.

High levels of central bank purchases in response to conflict and geopolitical instability is a likely factor in gold's rise to record highs. "At these levels, gold remains expensive, so I'm concerned it may not be able to continue at this pace. Copper

> **Copper has more of a case for an enduring rise, due to its role in the net-zero transition.**
>
> Paul Jackson, Invesco

has more of a case for an enduring rise, due to its role in the net-zero transition," Jackson adds.

Central banks are playing their part in other ways. "US Federal Reserve policy is gold's main driver," says Warren Patterson, head of commodities strategy at Ing. "There's optimism it'll soon cut rates, but it wants to see more evidence that inflation is a tamed beast. We are expecting interest rate cuts this year, but if it continues its cautious approach, gold prices risk pulling back."

Gold does have many attributes for investors, but one stands out. "Gold offers protection against unpredictable and potentially significant events that can have a sudden and adverse impact on financial markets, economies or geopolitical stability," says Ernst Knacke, head of research at Shard Capital.

"Given the arbitrary nature of the fair value of gold, we believe a technical approach is the most practical and useful valuation methodology to price gold," he adds.

Specifically, Knacke employs a trend following strategy to determine exposure to the commodity based on the strength and significance of the underlying price signals. "The trend remains strong and I would suggest investors increase their [gold] exposure," he adds.

The prospect of the Fed's monetary easing has also benefited silver, which has surged along with gold, up 16% since January to its highest levels since 2021. Silver's advance has come with an increase in exchange-traded fund (ETF) holdings. That contrasts gold, which is yet to see a rebound in ETF demand.

Investor holdings in gold and silver ETFs normally rise when prices gain, and vice versa. There could therefore be plenty of room for investors to buy the gold market. But possibly, as noted, it could be a case of waiting for the Fed to start cutting rates before investors jump fully into the market.

"We expect gold prices to trade higher this year as safe-haven demand continues to be supportive amid geopolitical uncertainty with the ongoing wars and the upcoming US election," Patterson says. He has therefore revised Ing's 2024 gold forecast higher, and now expect prices to peak in the fourth quarter.

Copper craving

Copper is also trading at its highest since the middle of 2022, up 10% so far this year, fuelled by supply risks and improving demand prospects for metals used in the green energy transition.

The main catalyst for copper's rally, analysts have suggested, is the unexpected tightening in the global mine supply, most notably First Quantum's mine in Panama, which produces around 400,000 tonnes of the metal annually.

But there are, almost inevitably, other factors at work. "China's property market has been a major headwind for copper demand, and a continued slowdown in the sector is the main downside risk," Patterson says.

"In the short term, the upside to copper prices might be capped by macro drivers, including ongoing demand concerns in China and lingering uncertainty over US monetary policy," Patterson says. "However, micro dynamics are starting to look more constructive for the metal amid a tightening supply outlook."

Martin Frandsen, portfolio manager at Principal Asset Management, sees a particularly positive future for copper, as the commodity may face accelerating demand during the coming decade.

He then expands on the reasons for this. "Copper is a key component of electrical equipment and renewable energy production, which uses five times more copper versus traditional fossil fuel-based electricity production," Frandsen says.

"As we anticipate an acceleration in demand for renewable energy, we expect this acceleration to flow through to increased copper demand as well," he adds.

Rapid buildout

Frandsen's positive view on renewable energy is due to several factors: continued high demand from the Inflation Reduction Act in the US, Europe's desire to shift away from Russian gas, and emerging economies continued high level of investments into renewables, combined with an accelerating demand for powering the rapid buildout of data centres to facilitate the artificial intelligence (AI) revolution.

"The data centre buildout is particularly important for copper, as it increases the demand due to the electrical equipment in the data centres and indirectly because AI-enabled data centres require materially more electricity," Frandsen says.

"Today, AI-enabled data centres can require as much electricity as 80,000 households, which becomes important as big technology companies largely have signed themselves up for net-zero commitments," he adds.

This means that big technology companies have become some of the biggest financiers of renewable energy. "This equation will be particularly potent over the coming years, where data centres new builds and the retrofitting of existing data centres to become AI-enabled may accelerate the demand for copper," Frandsen says.

The big transition

Nitesh Shah, head of commodities and macro-economic research at Wisdom Tree, says his long-term outlook for commodities is also conditioned on an energy transition taking place: that is, the migration away from fossil fuels and greater reliance on renewables in an effort to reduce greenhouse gases.

"After strong momentum behind the energy transition in 2021 and 2022, investor interest began to fray in 2023," he says.

"2022 marked a high-water mark given the sheer scale of the US Inflation Reduction Act (IRA) that was signed into law – despite its name, the act was a piece of legislation designed to spur investment in green technology."

There are now moves in Europe. In 2023, the European Union adopted its Fit for 55 legislation, aimed to reduce greenhouse gas emissions by 55% by 2030 relative to 1990 levels. It is also on the cusp of signing Critical Raw Materials Act into law, which is similar to the US' IRA – providing tax credits to those on-shoring the supply chain of electric vehicles, wind turbines and other green goods, but, on a smaller scale.

And Cop28 in December concluded with a roadmap for "transitioning away from fossil fuels" – a first for a UN climate conference. Shah therefore argues that the energy transition will bring fundamental benefits to the commodities market.

"Our long-term outlook for commodities is conditioned on the energy transition and we believe that the potential for medium-long term supply deficits in metals will generate a commodity supercycle," he says.

> **AI-enabled data centres can require as much electricity as 80,000 households.**
>
> Martin Frandsen, Principal Asset Management

That offers a scenario where commodities go to another level. A supercycle has been much promised in recent years but failed to fully materialise.

There are other concerns though with the transition and commodities. Emma Cox, global climate leader at PwC UK, warns: "Even if global carbon emissions rapidly decrease, climate disruption poses a serious and growing threat to the world's ability to produce essential commodities – including food as well as materials that are themselves essential to the net-zero transition."

This is a completely different level of threat.

Rate-cut impact

The economic environment also plays into the case for commodities. "After a challenging 2023, commodities appear poised for a breakout as rate cuts come to the fore," Shah says. "The late December 2023 rally provides a glimpse of what could happen when the cuts are delivered."

With commodities there is also, predictably, the strong China factor. While the largest consumer of commodities – China – remains in a tough spot in terms of its economy, many recognise that its demand for commodities remains resilient as it modifies its business model.

"That may mean that some commodities will do better than others," Shah says. "We believe China will continue to stimulate and its ability to do so may improve as other countries around the world loosen monetary policy, as the country is worried about currency depreciation."

But there is another arguably more challenging scenario. Commodity markets may face some form of fragmentation and supply disruption if Donald Trump wins the US presidential election in November.

"A rise in global trade protectionism or a shift in the pathway of that trend is a global macro-economic risk we are watching out for," says Paul Bloxham, chief economist at HSBC for global commodities, particularly concerning Australia and New Zealand. "This would increase the risk of greater fragmentation of commodity markets and create a supply disruption supporting commodity prices," he says.

Then there is the wider geopolitical situation, which is never far behind in influencing the commodities market. "A concern for the market is what happens to Russian pipeline flows to Europe via Ukraine," Warren Patterson says. "Ukraine has made it clear that it has no plans to extend the transit deal with Gazprom, which expires at the end of December."

It amounts to a complex picture. Although investors may benefit from riding the wave of commodities, there are also storms ahead for some parts of the sector.

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Governments change, but the problems they face remain the same. That was certainty the case in July when Sir Keir Starmer walked into Number 10.

Towards the top of his in-tray was the energy transition, an aging population and growing life-style-related illnesses, such as diabetes. Private capital has been encouraged to pick up the tab but it cannot do it alone – the political will is needed to make change happen.

Yet this year the citizens of more than 50 countries vote for their next government and ESG issues could become battle grounds. The EU is an example of where the pro-ESG leadership took a hit, so it will be interesting to see what happens to the green agenda.

On the following pages you can read a review of the four panel sessions we hosted to help investors prepare their portfolios for what could be difficult times ahead.



ESG CLUB CONFERENCE: PROTECTING THE ECOSYSTEM

This year's conference opened with a discussion on an issue that has stepped out of climate change's shadow to become a major theme in sustainable investing in its own right.

Natural capital is the subject of more and more discussions among institutional investors. The importance of a vibrant ecosystem of plants, animals, water, microbes and soils cannot be underestimated as they are the lifeblood that helps keep our planet habitable.

Unfortunately, construction, overfishing and pollution mean that the air is becoming poisonous in some places while there is less freshwater to go around. If investors want to build a sustainable future, they need to help repair hundreds of years of damage to our life support system.

It is unsurprising, therefore, that the topic of natural capital, or biodiversity, opened this year's ESG Club Conference.

Sitting on our panel was Doug Clark, head of investment research at Brightwell – the primary service provider to the BT Pension Scheme. Clark announced that natural capital is a risk that Brightwell considers when managing its portfolios.

For this it uses a framework, which is based around four pillars: portfolio construction, investment managers, stewardship and advocacy.

It then has a series of actions to manage each pillar. For example, portfolio construction involves scenario analysis and stress testing the portfolio against natural capital risks.

"Natural capital is still at an embryonic stage relative to climate change," Clark said, pointing to data as an area that needs improving. "There is a lot of work we can do in terms of stewardship to push for improvements in that area."

Brightwell takes biodiversity loss seriously and for good reason: without successfully tackling nature risk, no matter how big the effort, there can be no net zero as carbon and biodiversity are intrinsically linked.

Fellow panellist Alex Godfrey, investment director of Octopus Investments, said: "Just focusing on net zero and carbon often leads to you not considering the other side of the issue, which is the biodiversity crisis that is going on around us."

Indeed, around $44trn (£34trn) of capital, or half of the world's GDP, is at risk due to its dependence on nature, Godfrey said.

"If you are a portfolio manager or a pension fund and you are not factoring in climate, biodiversity and water, it is a systemic risk to your portfolio," he added.

Danager stocks

The natural world is not safe from any industry as they all negatively impact it to a certain degree, said ShareAction's Alexandra Pinzon, who went on to say that energy and materials, such as plastics, are among the worst culprits, as are food and beverages.

"The production of food puts huge pressure on land," she said. "Half of the habitable land that we have on this planet is devoted to agriculture."

For example, agriculture drives more than 90% of tropical deforestation and less trees means fewer carbon sinks to help clear the gas from our atmosphere.

Agriculture also depletes our water supply with 70% of the water that is safe to drink is used to grow crops. Then there are fertilisers and pesticides, which pollute our air, water and soil, while overfishing is another driver of biodiversity loss.

Pinzon then fired a warning to make sure investors are not missing some of the risks. "It is critical to look at the value chain as a whole, as opposed to focusing on the direct risks associated with a specific industry," she said.

For example, when you source raw materials as part of the manufacturing process, also consider the plastics or chemicals used by the customer when they receive the product. "If you just focus on the direct impacts, you may be neglecting a significant part of the risk for biodiversity as part of that value chain," Pinzon added.

Leave no one behind

Unfortunately, when fighting climate change there are consequences for society. This has led to strategies to produce a "just transition" to stop communities from being abandoned if, for example, a local mine closes and there are scores of job losses. Is the same happening in biodiversity strategies?

Brightwell has three core themes: climate change, natural capital and inequality, which considers the social aspects of ESG. "We don't view those three themes individually, but as overlapping themes," Clark said.

"The critical thing is balancing the issues," he added. "There are clear cut cases where there can be social benefits alongside natural capital and climate benefits, but there are often trade-offs."

For Clark, successfully considering the social aspects of a biodiversity investment involves consistent data to "ensure we are looking at all of the factors and issues".

How to invest

So how do you build a portfolio that protects against nature capital loss or to even restore it?

BlackRock's Christopher Kaminker warns that it could pay to understand that some business models assume that natural resources, such as water, will be infinitely abundant and free. "That isn't going to be the case on a forward-looking basis," he said. "Historically that may been the case, but now they face depletion, policy change – bans on this, prices on that, subsidies for this, taxes on that – and technology change," he added, warning that some of these risks may not be priced into corporate valuations.

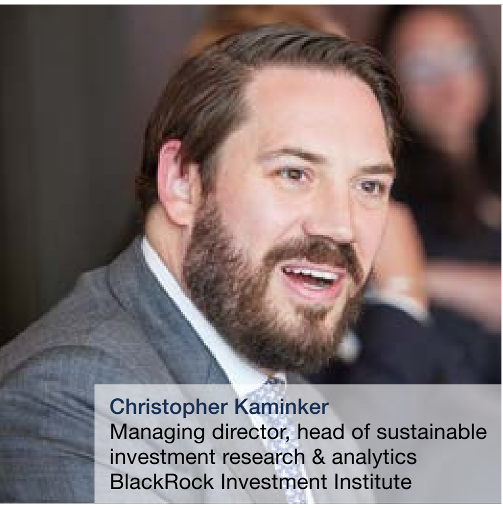
Kaminker looks for the business models that could benefit from technology and policy changing the input costs of, and the availability of, natural capital.

There is, for example, a net-nature restoration law in Europe that targets 20% of land being restored by 2030. "There are companies that are going to win those contracts, and they are impactful, important companies, but most of that is government expenditure, which doesn't have a rate of return on it.

Investors can gain exposure to companies and projects that are working to restore or protect the natural world through the green bond market. BlackRock has identified $330bn (£255bn) worth of such debt.

It has also identified well over 1,000 companies that have activities that protect nature, restore nature or take the pressure off nature. These mainly have business models that are circular, such as those making the water system more efficient or agriculture more precise. "It is about all repair, reuse, recycle and

Alexandra Pinzon
Head of biodiversity
ShareAction



Christopher Kaminker
Managing director, head of sustainable investment research & analytics
BlackRock Investment Institute

Douglas Clark
Head of investment research & solutions
Brightwell

Alex Godfrey
Investment director
Octopus Investments

reduce – all the Rs," he said. "These are valuable business models, and we are operating at scale in that space."
Finally, there is the bio-economy. BlackRock has identified hundreds of companies, mostly in private markets, that are making products from nature. "There is some amazing stuff here," Kaminker said.
One particular company BlackRock has invested in makes leather out of mushrooms. "Mycelium-based leather could be an exciting new biomaterial," he added.

Alternative products

Pinzon added that investors should not forget that stewardship and engagement are ways to improve the biodiversity performance of a portfolio.
"Companies are prioritising better agricultural practices, better water management and reducing pollution," she said.
"That is where I see the opportunity for stewardship as a tool to drive those investment opportunities within your portfolio. Start asking the companies in those key sectors to devote more of their capex to alternative products.
"So that is potentially sitting within your portfolio and you can combine it with options around new companies that are creating, for example, protein based on plants. That is a new market that is trying to find an upside," Pinzon said.

Tipping point

When questioned over how resilient Britain's pension schemes are against biodiversity risk, Godfrey's answer was bleak. "Not very well hedged at all," he warned.
"We are still trying to figure out how biodiversity, nature and climate are overlaid in our pension portfolios," Godfrey added.
"But it doesn't take much analysis to work out if half the world's GDP is directly linked to nature, and you are a pension fund listed across 85 of the world's companies, then you are probably going to be pretty exposed.
"Pension funds are inherently slow moving because they have such a big fiduciary responsibility. But we are on the tipping point, if not past it, where the cost of moving forward faster will be less than the cost of standing still."

Complex and limited

The issue of a lack of consistent data has been raised several times, which makes the task of managing biodiversity risk harder. So how are Brightwell managing the inconsistency?
"Be aware of the limitations of data," Clark said. "It is something that will improve over time."
He then reminded the audience about what happened with climate data, where "huge improvements" have been made over time, although he conceded that it is far from perfect and estimations are still being used in some areas.
"The issue with natural capital is that the data is even more complex," he added. "There is no single metric, like tons of CO_2.
"And water use is another issue. A gallon of water in the UK is different to a gallon of water in some emerging markets."
It is the same issue with deforestation. He cited the example of an acre of deforestation in the Amazon being different to an acre of deforestation in the UK in terms of the impact on biodiversity.
"Don't be too beholden to the data. It will improve, but it will be a journey," Clark said.

A whole new framework

Most frameworks that investors use in this space are principles-based or disclosure-based. BlackRock, however, has developed its own framework which is designed to search for alpha signals.
"It is true that the data space is incredibly challenged, but we found three alpha signals in the space," Kaminker said. "They have to do with water and waste."
Companies that are better at handling water stress are more efficient companies and outperform during times of water stress. "So we lean into those companies on behalf of clients," he added.
It was a similar story with waste. "Companies that are more efficient at closing the loop on waste, creating value from waste are better companies and have higher return on assets."

Leading the way

If there were any regulators in the room, Alexandra Pinzon had a message for them. Governments around the world are spending $1.7trn (£1.3trn) a year on subsiding nature-negative activities, she said.
Pinzon then asked for those funds to be re-directed toward nature-positive practices instead.
Godfrey agreed. "That is a massive swing that needs to happen," he said, before adding that the UK is quite forward thinking in this area.
"The UK government has done an amazing job of trying to push these nature markets," he added, speaking before the election. "We have removed subsidies from nature-negative farming, and the replacement is only for nature-positive food production in the UK. That shift is starting to happen, and that is why the UK is an interesting example of what happens when the government starts to slide their policies and subsidies towards nature and climate positive actions."
Natural capital is a complex but important issue. It is clear that we cannot build a sustainable world without a vibrant ecosystem of animals, plants, water and microbes. It is good to hear that investors are considering and taking action on the issue instead of focusing on climate change.

ESG CLUB CONFERENCE: EXPLORING SUSTAINABLE ASSET-BACKED FINANCE

It costs trillions of dollars each year to achieve net zero, so the financial services industry has to be innovative in filling the huge funding gap. Is asset-backed finance the answer? If so, what do investors need to know?

The sustainable asset-backed finance session proved to be highly informative. When the audience was asked at the beginning of the session how familiar they were with sustainable asset-backed finance only a few hands went up. Asked the same question at the end, just over half the room gave a positive response.

Therefore, one can conclude that the speakers did an excellent job in breaking down the topic.

The place to begin with was defining what sustainable asset-backed finance is. Anand Rajagopal was given that task. "I have seen the market evolve over decades," he said. "Asset-backed finance, as the name suggests, is backed by assets. And they can be a variety of asset types.

"At the core of it, asset-backed finance is a way to boost corporate balance sheets and financial assets like inventory, as banks retreat from the market," Rajagopal said.

In addition, he added: "Hard assets increasingly have a role to play, from infrastructure to transportation to potentially aircrafts and others.

"And last but not least, auto-loans, consumer loans and student loans. That is asset-backed finance in the broadest sense."

It is important to add, Rajagopal said, that the market has historically performed much better compared to the corporate bond market. A good reason for any investor to get involved.

"The reason for that is you have diversified assets [in asset-backed finance] that are standing behind these transactions. So there is no single point of failure."

On the sustainability element, Rajagopal, added: "Sustainable asset-backed finance are transactions that could be public or private, but aim to achieve certain sustainability objectives. These can be environmental, social or broader sustainability led."

Being left out

Taking this on, Malea Figgins said that it was important to note that securitisation as an asset class has been left out of the conversation on sustainability and decarbonisation.

"What this creates is a massive opportunity for sustainable securitised that the market is missing," she said. "We at TCW want to make sustainability and securitisation real as an investment opportunity. And there are ways to do that. Securitisation can offer diversification for a fixed income portfolio and do it in a sustainable way, without sacrificing credit quality, returns or liquidity," she said.

In addition, Figgins said securitisation naturally lends itself to sustainability because it is backed by physical assets. "We can look through the underlying collateral and look for the green, social and sustainable attributes within the securitisation," she said.

This, Figgins argued, is much more tangible than an unsecured green bond where the use of proceeds are going to general corporate purposes, and there is no follow up, or on-going engagement, on how those proceeds are being allocated.

"In securitised we get the data. That is important to note, as it can be used to build the sustainable argument and sustainable portfolio," she said.


Con Keating
Head of research
Brighton Rock Group


Anand Rajagopal
Shareholder assets and private markets sustainability lead
Phoenix Group

The growth argument

Con Keating explored the role of defined benefit (DB) schemes and where they sit within such investments. "DB schemes and pension funds generally in this country are being encouraged to invest in growth assets. This is government policy. The thing to understand about growth assets is you cannot have sustainability without growth. If there is no growth, then very little is sustainable," he said.

So what assets should pension schemes be looking at? "The first thing to understand is that asset-backed finance, whether or not the loans, the transactions you are entering, serve their purpose," Keating said. "In other words, a loan to a company, if that company is using it to invest, to increase their productivity is perfectly sustainable and consistent with a growth strategy."

In addition, leasing, Keating said, is short term, but is attractive to closed pension funds. These though can be depreciating assets. But this can offer benefits. "The attraction to me is as a depreciation asset, as a way of income, to earn the depreciation and the rate of interest applicable for the maturity involved," Keating said. In times of liquidity crunches these are the last assets you should consider selling, he added.

Big opportunities

Expanding on this a little more, Malea Figgins looked at the sustainable asset-backed finance market, and the opportunities within it. She started by citing that the securitised market is worth $13trn (£10trn), the second largest and most liquid market, just behind US treasuries. "Within that only about $300bn (£231bn) is labeled green, social or sustainable," she said.

What this generates is an opportunity for the securitised market to be creative, Figgins said. "In the asset-backed security market we have the solar market, which has dominated more in the US. There have been whispers about Europe getting its first asset-backed security [solar] deal, which is encouraging," she said.

Figgins then added other areas of opportunity. "We are also seeing energy efficient data centres with the first in the UK this year. In residential mortgage-backed securities we get affordability, data and social housing," she said. "Commercial mortgage-backed securities are also a good example, which falls outside the labelled-bond market. Our commercial real estate properties come with a green building certification – which are 25% more energy efficient and with stronger credit fundamentals."

Adding further, Rajagopal offered insight into the types of innovations we are seeing. "What is striking for me in the past two decades is how things have changed materially. It is a very different game that is played today," he said.

In the beginning, it was typically public-backed asset securitisations, he said. "Since then, we have seen banks retreat from the space and in a post-global financial crisis environment leverage has come down, so private asset-backed finance is now $5trn to $10trn (£3.5trn-£7trn) of the around $20trn (£14trn) overall asset-backed finance market."

Looking at the public and private sides, they have changed quite materially, with a focus on the latter, Rajagopal said. "Private opportunities are those that are negotiated on a bilateral basis. It is typically asset managers that are specialised. Some of the things mentioned like green buildings, are promising sustainable assets for the market."

Effective risk and return

Importantly, Rajagopal explained that the structure of the deals, and the collateral cover, can be done in such a way as to suit certain risk-return outcomes and provide certainty of execution as well.

"Not all borrowers have access to public markets in the same way," he added. "That is where private asset-backed finance has gone to a different level."

Keating then pondered assets in this area that investors should

David Favier
Senior portfolio manager and analyst – structured finance
BNP Paribas Asset Management

Malea Figgins
Vice president, fixed income
TCW

be looking at to secure their investments. "It does depend on the type of investor you are talking about," he said. "I would make one important distinction: do I, or do I not, own it."

If investors do not, it can get "extremely messy" Keating added, when you have large pools being aggregated together. "I would personally advocate asset-backed finance as being assets which I own, and invest in," he said. "Assets which I can source the production, and the sustainability of that production. Then assets being used by others that I consider to be sustainable."

Bigger market

David Favier then questioned whether investors can play an important role in increasing the market's volume? "Simply, yes," he said. "We at BNP Paribas are engaging with co-ordinators to push them to be able to issue securitisation with more green assets."

He pointed to the public securitisation market in Europe, specifically looking at the numbers on the green bond side there is \$400bn (£308bn) of assets that have been issued, \$200bn (£154bn) in green loans, but in public European securitisation there is just a few.

"It is not enough. The main topic for every discussion is ESG and the size of asset they can issue," Favier said. "Things are changing. Securitisation is now embedded in the green bond framework, which is a good thing. But we need more. Some barriers do not help. We have to ask the regulators to ease the regulatory costs."

On the issue of regulation, Rajagopal looked at the issue of transparency. "This is where public versus private starts. Traditionally you have had high capital charges and there has almost been this cliff edge capital charge effect. More clarity is needed, and the reform process should get us there."

But he added: "The real test is how you monitor the [sustainable] investments over time. You need annual critical surveillance, accompanied by sustainable and ESG-linked surveillance. To grow the market further, more transparency can only help."

Employing engagement

Moving to an important issue in this regard, Figgins said: "Engagement is how we bring all this to life. It is how we make it real. We get access to better data."

She then added: "And for us, that means engaging across the entire ecosystem. That is public issuers, private issuers, regulatory bodies, data providers and trade associations."

Favier added that when it comes to the reporting of underlying assets, such as carbon footprints, more transparency is needed. "Reporting is my middle name," he joked. "We are in a world of reporting. On securitisation we have higher standards of reporting" he said.

"I say that because if you look at the broader markets you don't have this bunch of data if you are investing in carbon bonds," he said. That said, he added: "In Europe, we do have a step forward to take with more transparency."

In addition, Favier looked at the challenges of securitisation and the energy transition. "We have to look to the US as an example. When you look at the digital transition, the energy transition in Europe and the UK, we have seen data centres publicly financed. But when you look at the money in the coming years to reduce carbon emissions by 2050, it will be a tremendous amount of cash." So the market, by implication, has a key role to play.

Technology, like in many markets, has a part to play in this specific market. "I do think artificial intelligence (AI) can have an impact on the green energy transition because all of us on the stage have at some point talked about data," Figgins said. "And that is where AI comes in to play because we are talking about massive datasets [within asset-backed finance].

"So this is an area that AI can come in and be a real solution."

ESG CLUB CONFERENCE: IT'S GOOD TO TALK

Stewardship is one of the biggest issues in ESG-led investing, but how are companies approaching such strategies to improve outcomes?

There is little point investing in a company with a perfect ESG profile. You are not changing the world. You are not reducing the level of carbon in the skies above our heads, improving access to fresh drinking water or reducing waste.

Only through investing in companies with poor environmental or social practices can you help the economy achieve some of the many global sustainable targets. And that is where stewardship and engagement come in. One of the most important aspects of an ESG-led strategy.

For this panel, Best Trustee's president Alan Pickering kindly agreed to sit into the question master's chair, for which we at *portfolio institutional* are grateful.

No silver bullet

A subject of much debate across the responsible investment industry is, what does good stewardship look like?

"There is no silver bullet to good stewardship," said Vaishnavi Ravishankar at Brunel Pension Partnership.

However, there are some critical factors that she believes the industry needs to consider. First, there needs to be a clear change objective. "The purpose is not information gathering but to have a clear end goal," Ravishankar said.

That goal needs to be consistent and long term as it takes time to build the relationships that ultimately lead to change. Finally, clear milestones need to track progress.

Ravishankar then reminded the audience that it is important to acknowledge that progress isn't always linear and so investors may have to use the different levers available to them in different circumstances. She gave an example of how Brunel successfully encouraged a company to appoint a woman to its board despite previous attempts having ended without success.

"We voted against the chair of the nomination committee at Charter Communications for two years due to diversity concerns. But it didn't result in movement within the company.

"Then we decided to up the ante by co-filing a shareholder resolution with a small group of investors, and that brought the company to the table.

"During the course of the engagement, the company decided to appoint a female director to the board, as well as committed to incorporate diversity within the succession planning.

"That is an example of a successful engagement where we have used different escalation mechanisms to drive change."

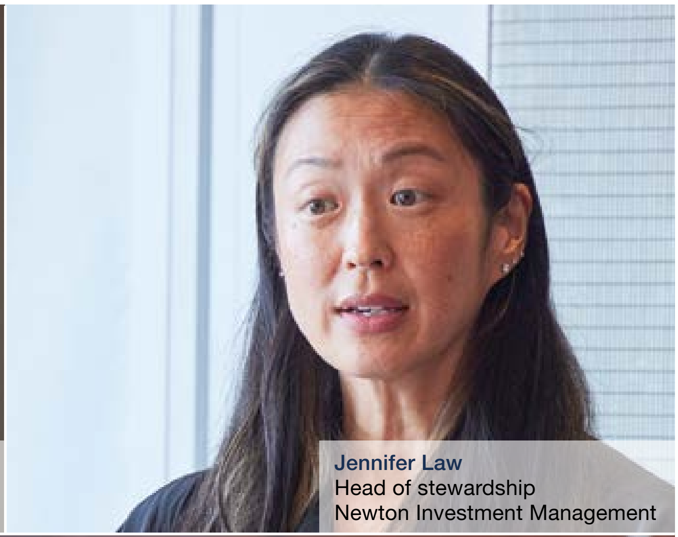
For Ravishankar, it is important to understand that success is not always guaranteed when it comes to stewardship.

"For any investor that has engaged with a technology company around tax transparency, you will know that you hit the wall pretty quickly when it comes to engagement progress," she added. "So it is important to assess what are the other tools that you might want to think about – public policy, engagement or collaborative initiatives."

Focused on outcomes

What stewardship means to Newton Investment Management is not a question that head of stewardship Jennifer Law is often asked. That could point to an assumption that all parties have the same objective and definition of such strategies.

Julia French
Responsible investment team manager
Local Pensions Partnership Investments



Jennifer Law
Head of stewardship
Newton Investment Management

Vaishnavi Ravishankar
Head of stewardship
Brunel Pension Partnership

Leanne Clements
Head of responsible investment
People's Partnership

"Stewardship is often presented as the way that we will precipitate change," Law said. "But then that comes to the question of what is stewardship for Newton? What is it that we are trying to achieve?

"Stewardship for us is the responsible allocation, management and oversight of our clients' capital," she added. "For us, it is outcomes focused and we use it to seek to reduce risk or potentially add value to an investment."

A typical approach is when they believe a risk or opportunity is material, Newton may suggest improvements to a company which could lead to better outcomes that can help the firm meet our clients' investment objectives.

Newton approaches these through three stewardship tools: engagement with issuers, voting at shareholder meetings and advocacy in the wider marketplace.

"Engagement for us is the most central. It is where we can have the most influence," Law said.

"We define engagement as being focused on outcomes. It is the purposeful dialog that we have with issuers to constructively challenge the management and the board on financially material risks."

Big issues

Heading the list of themes and priorities of LPPI Investments' engagement strategies is climate change. "That has been a theme running through our engagements for a long time, but it has a lot more traction, a lot more structure, a lot more focus on objectives from our net-zero targets," said Julia French, responsible investment manager at LPP Investments.

The target for the pool is to pursue greater in-depth awareness, management and reporting on climate change and set targets. "We want to see that within our listed equities, fixed income, real estate, infrastructure, and next year from private equity."

Diversity is another engagement target. The pool wants the companies in its portfolios to have greater female representation in the boardroom. And its efforts appear to be working.

"We have seen that gradually tick up across our entire portfolio," French said. "We had about 28% female representation on boards as an average, and that has moved over to 32%. So as a globally diversified portfolio, that is quite an improvement."

Being honest

ESG is more than just protecting the environment. There are also social factors to consider. So if a stewardship strategy repurposes a company away from coal, for example, which leads to the closure of a mine. Is repurposing those who worked in the mine part of the engagement discussions?

When it comes to addressing community impacts, we are talking about trade-offs. "And we, as an industry, are not in a more honest place about the fact that there are trade-offs," said Leanne Clements, People's Partnership's head of responsible investment.

"I could have done a PhD analysis on the trade-offs of the energy transition and nature-positive economy.

"It is deeply complicated, and we have just started to understand what these mean and what guardrails we want to establish around that.

"This is all very nascent. So we need to just be honest that they exist in the first instance," she added.

Then to make an accurate assessment of the trade-offs, asset owners need to look at these risks as interconnected, not in silos, such as nature-related trade-offs, climate related trade-offs, etc. "If we don't have products and services that reflect the interconnectivity of these things and how they amplify each other that is going to reduce the accuracy on the trade-off piece which is important that we address that."

A unified voice

"Just like any other resource constrained asset owner, we need to be highly selective and targeted in our approach to stewardship," said Brunel's Ravishankar. "We have more than 3,000 companies in our listed portfolio, so it is not always possible to meaningfully engage with all of these companies."

The pool relies on its asset managers in the first instance to help here but collaboration is one way to optimally use its resources to drive the change.

As an example, Ravishankar discussed Brunel partnering with ShareAction and 19 other investors in co-filing a shareholder resolution at Barclays to get them to re-think their financing of oil and gas infrastructure. "Because of successful dialogs that followed, we were able to then withdraw the resolution.

"The company published an updated energy policy that addressed direct financing of new oil and gas infrastructure, which was a positive outcome," she said.

When investors come together to form a coalition, they are sharing not only votes at AGMs, but also research, knowledge and relationships with the target company.

The 'D' question

A lack of data is a common theme no matter what ESG topic you are discussing. So, is it a hinderance to effective stewardship and engagement? Or, as Alan Pickering put the question: is it an excuse for doing nothing?

Clements quickly dashed any thoughts that a lack of data should be seen as an excuse. "In fact, it should amplify your stewardship resource to try and address it at an industry level," she said.

For example, People's Partnership has an ESG maturity map within the priorities section of its responsible investment policy. "The more nascent an ESG issue is, the more stewardship resources we will allocate towards an industry and collaborative engagement. Human rights would be an excellent example of this," she said.

Clements added that the Department for Work and Pensions (DWP) has also recognised in their social taskforce that data is an issue, but that is not an excuse to do nothing. "As a result of that we are involved in an investor coalition to drive better industry standards around human rights data," she added.

This includes liaising with ratings and analytics agencies.

"We have a responsibility to conduct industry and collaborative engagement around these issues," Clements said. "We are not passive actors here. It is the same with policy engagement. We need to be actively contributing to that debate. Same goes for data quality and robustness issues."

Stewardship is not limited to the in-house stewardship and engagement team. An asset owner employs external experts to help achieve its investment aims, so how do, for example, asset managers interact with the stewardship team.

"We definitely consider our asset managers to be our first line of defense when it comes to stewardship," Ravishankar said. "They select our stocks, so we rely on them to manage all portfolio-related risks, including ESG.

"That means we expect them to have the data, the analytics, to support a rigorous ESG analysis, but also demonstrate alignment with, say, our climate framework."

Brunel tries to work with its asset managers in the "spirit of partnership, but that is not to say we don't challenge our managers". Ravishankar points to a project last year looking at asset owner/asset manager alignment expectations. "Following the proxy season, it became quite clear that there were gaps in terms of asset owner expectations of climate stewardship and how it was happening in practice."

A misalignment between asset owner and asset manager is an experience shared by Clements. "Realistically, it is possible that you may not get perfect alignment," she said. "So what do you do with that? You identify how big that gap is and how much you are willing to live with it over an extended timeframe.

"If you find that you can live with it, then you move forward. If you feel it you cannot live with it, and you have reached an impasse, then you have various escalation strategies at your disposal," she added. "You can either reduce the assets with the manager, you can look to an overlay to mitigate against it, or you can fire the manager."

ESG CLUB CONFERENCE: HEALTHY ECONOMICS

The final discussion of this year's conference looked at the importance of innovation in healthcare and where it is most needed.

There is more to improving people's health and their quality of life than producing a little bottle of pills. And the panel we put in front of the audience reflected that.

Investment experts in drug development, societal impact and real estate took the stage to explain why innovation is needed in healthcare and how private capital can drive it.

"We have come a long way with health innovations in terms of making an impact on society, but we need more," said Flora Liu, a portfolio manager for Pictet Asset Management's health and biotech strategies.

From the accidental discovery of penicillin to the global concerted effort of Covid vaccines, the world has come a long way in terms of decreasing the prevalence of infectious diseases. "But chronic diseases are unfortunately on the rise," she added.

Today, seven out of 10 deaths globally are caused by chronic diseases like heart disease, diabetes or obesity. And then there is cancer, a condition in need of treatments that don't kill healthy cells. "We need more innovation in these areas," Liu said.

But as science has largely reduced the rates of infectious diseases, another condition has ascended from the resulting aging populations. Liu points to there being 55 million suffers of Alzheimer's and that there are no therapies addressing the condition. Donanemab has been approved in the US, but "it doesn't slow the progression of the disease enough".

"We need more innovations from biotech or pharma companies in this area before [the number of] Alzheimer's patients more than doubles by 2050," she said.

But this is not just about discovering a cure. "More innovation is needed at preventing the disease," she said. "That means better diagnostics and better screenings are urgently needed. With technologies such as liquid biopsies we are already on the right track to achieve that."

And it appears that interest from the stewards of private capital already exists.

Mark Hall is senior programme manager specialising in place-based impact investing at the Impact Investing Institute, an organisation working to connect private capital to specific challenges, one of which is creating positive health outcomes.

He told the audience that he is seeing more private equity and venture capital interest in areas such as healthcare technology. North Edge Capital is an example of such a firm in that it backs, for example, AI-driven diagnostics.

Hall is seeing a range of innovative investment models, such as social impact bonds, impact funds and blended finance, that are making health more accessible to institutional investors who have not always been able to generate commercial returns from the industry.

Another area of healthcare that could be fertile ground for institutional investors is real estate. Hall said that care homes and supported living are attracting good inflation-linked returns while delivering positive outcomes.

Michael Toft knows all about healthcare real estate. He heads up Octopus Investments' strategy that invests in elderly care and specialist residential facilities in the UK, boasting around 700,000 beds in its portfolio.

Octopus uses institutional capital to address the supply-demand imbalance for higher-quality care homes. This can be blamed on competition for the limited land available and planning delays in the face of an aging population, Alzheimer's and bed blocking in the NHS.
Toft said that "the stark fact is" 70% of care homes in the UK are over 20 years old while 40% are over 30 years old. "So the physical quality of the real estate is restricting the provision of care.
"We are trying to introduce private capital into the sector to develop new care homes that are fit for the future and have the right foundations for the operators to provide that care.
"So institutional capital is an exciting point that we can provide a strong risk-adjusted return while solving one of society's biggest challenges," Toft said.


Flora Liu
Client portfolio manager
Pictet Asset Management


Mark Hall
Senior programme manager, place-based impact investing
Impact Investing Institute

Hidden risks

Completing our panel was Scott Anderson, an investment manager at the Environment Agency Pension Fund. The big question was, when investing in healthcare does Anderson and his team have to consider the environmental impacts of the sector, given who the scheme is sponsored by.
"We have a holistic approach to ESG," he said. "We need to tick off every box – the E, the S and the G – in terms of the investments we are making."
Just ticking the S box is not good enough. It is expected given the industry we are discussing, but healthcare's supply chain carries huge biodiversity risk, which can get hidden under its social benefits.
"It is true that when you look at the overall ESG score, [healthcare companies] come out with a nice positive net impact score," Anderson said. "It is healthcare at the end of the day, and you hope it would do that.
"But when you look at the underlying breakdown, the environmental piece of it can be negative," he added.
Anderson wants investment managers to be aware of healthcare's risks to nature, to monitor them and report on them. "It is often the case we don't get any data on that at all.
"So the engagement piece is important to drive that improvement there," he added. "And that is something we are doing. In terms of new manager selection, we are being much more upfront about that."

Close to home

Shifting back to more general matters, taking a place-based approach could be the answer to creating higher standards of overall health and wellbeing, Hall said.
The social determinants of health and life expectancy include education and where you live. "The built environment is important for that from a place-based lens."

Legal & General have teamed up with the Institute for Health Equity to develop a £3m grant fund to address those issues locally.
"But to scale that to address the level of the challenge of health inequality is going to need higher levels of institutional investment," Hall said, adding that this means urban regeneration that delivers green spaces, walkable routes, green transport and integrated health centres within communities.
Indeed, the Impact Investing Institute is working in partnership with Southampton City Council to bring asset managers, developers and community stakeholders together to develop a regeneration project for a small high street that responds to those challenges.

Informed, not driven

The Environment Agency Pension Scheme aims to invest in unmet medical needs and to improve the quality of, and access to, healthcare.
To prove that this is happening managers have to agree to provide impact data on the assets in the portfolio. The problem is that this has tended to focus on the breadth of impact, so the

Scott Anderson
Investment manager
Environment Agency Pension Fund

Michael Toft
Head of care homes
Octopus Investments

number of patients served. "It is a good metric because you can see that our investment has touched this many patients," Anderson said.

"But our ambition is to get to the point where we can look at depth of impact – how have we benefited the patients."

He conceded that getting hold of that data is not easy, although he is seeing some private market managers reporting on how, for example, a particular drug or technology has changed someone's life.

"If you create an innovation that helps 100 neonatal patients enjoy a healthier life, that sounds a lot more impactful than making a new formulation of paracetamol that is given to 1,000 patients with a short-term mild headache."

Artificial support

Artificial intelligence (AI) is having more and more influence over our daily lives, from organising our next holiday to deciding what marketing messages we see. So could these algorithms help improve the success of medical research? It appears that drug developers are using such tools, but, according to Liu, for healthcare as a whole, it is still in its nascency.

"I do believe that AI has huge potential to make a huge impact to healthcare systems."

Indeed, it can take up to 15 years to get a drug to market and could cost a developer billions of dollars despite facing a success rate of less than 10%. For Liu, AI has the potential to screen and optmise compounds to speed up the development cycle and improve the success rate. It could also improve the outcome of clinical trials by more efficiently analysing patient data.

Another benefit of AI is that it can read images, which makes it ideal to help radiologists to improve the detection of cancer and other diseases through reading pixels on a screen.

"AI is in its nascency but has huge potential to make an impact," Liu added.

"We are already seeing companies looking at it across of prevention, treatment and access."

All in the mind

Since Covid, mental health has been allocated more of the news agenda, so it was not a surprise when the issue was raised during our discussion.

"The Covid pandemic highlighted the need for more investment in solutions to support mental health outcomes," Hall said.

"There is a range of platform apps, in terms of private equity and debt investments, on the mental health side that can be scaled to increase the reach of mental health services."

Hall then highlighted that mental health impact bonds are another place-based route to help fund reducing anxiety or depression in society.

Future fit

To close our discussion on healthcare, Liu tackled what the future of the industry could look like. She started by sharing what she called a "mini prediction" based on the trends Pictet's managers are observing: therapeutics will be more precise, she announced, more personalised.

For example, there will be a better alternative to chemotherapy, which harms cells, whether they are healthy or bad.

She also predicted that technology would play a greater role in medical testing and procedures with robots carrying out surgery, which will be designed to be more minimally invasive.

There will also be a greater focus on prevention, and machine learning will be used in healthcare throughout the value chain.

"I am excited about what the future of healthcare might bring in terms of the potential to invest behind innovative health solutions that make a real difference to patients and societies as a whole.

"So I'm super excited and it deserves a good spot in every institutional investors' portfolio," she added.

pi ESG CLUB

Research claims that climate change, biodiversity loss and other environmental risks are not being priced into bond yields. This month's ESG Club looks at what this could mean for investors.

Members

BlackRock

BNP PARIBAS ASSET MANAGEMENT

LGIM

NEWTON Investment Management

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

NATIONAL WEALTH FUND AIMS TO BRING UK CLOSER TO NET ZERO

The fund has been launched to mobilise private investment.

The UK's new government has been busy setting out its plans to boost the economy, which includes a key initiative to improve our chances of achieving net zero.

The National Wealth Fund, which aims to invest in industries focused on decarbonising the economy, was launched in July by chancellor Rachel Reeves and business secretary Jonathan Reynolds.

Under the government's plans, the fund will bring together key institutions and institutional investors with the aim of mobilising billions of pounds in investment.

Reeves and Reynolds' approach is to align the UK Infrastructure Bank (UKIB), created by Rishi Sunak when he was chancellor in 2021 to help reach the government's 2050 net-zero target, and the British Business Bank which opened a year later as the nation's economic development bank.

The UKIB will allocate £7.3bn of additional funding, so investments can start immediately, focusing on priority sectors such as net zero and with the aim of catalysing private investment at a potentially greater scale.

This funding is in addition to existing UKIB funding.

Pools of capital

As part of this initiative, reforms will be made to the British Business Bank, which is overseen by the department for business and trade, to ensure it can mobilise pools of institutional capital by harnessing its pipeline of investments as the UK's largest venture capital investor.

Further details will be set out ahead of the government's international investment summit, which will be held later in the year. In the meantime, Reeves hopes institutions will get on with delivering financing for businesses and infrastructure across the country. Although how and where exactly is less clear.

In a big photo opportunity in July, Reeves and Ed Miliband, the secretary of state for the department for energy security and net zero, convened a meeting of the National Wealth Fund Taskforce at Number 11 Downing Street to start the work.

Chaired by the Green Finance Institute, the taskforce includes former Bank of England governor Mark Carney, Barclays chief executive CS Venkatakrishnan, Aviva CEO Dame Amanda Blanc, and leaders of other large institutional investors.

Building green

One of those investors was David Vickers, the chief investment officer at Brunel Pension Partnership, who said: "Building a green economy requires a step-change in co-ordination between the government and investors, so that the policy and regulatory environment is truly enabling for long-term investors. The National Wealth Fund comes at a crucial moment in the political cycle to help set that course."

Also present was António Simões, chief executive of Legal & General, who said: "We welcome the ambition of the government to encourage further institutional investment into UK assets, and mobilise more private capital towards the energy transition, and look forward to engaging with the next steps set out in the report."

Another attendee was Paul Thwaite, chief executive of NatWest Group. "This is a major challenge and collaboration across not just the financing but also policy space is critical to deliver it in a way that supports economic growth across the UK," he said.

And Shaun Kingsbury, co-chief investment officer of Just Climate, said: "As private investors we welcome this announcement by the chancellor and look forward to supporting this initiative to encourage public and private capital to work together."

The government will bring forward new legislation when parliamentary time allows to cement the National Wealth Fund in statute, making it a permanent institution at the heart of the country's long-term growth plans.

Dr Rhian-Mari Thomas, chair of the Taskforce and CEO of the Green Finance Institute, added that the taskforce recommendations set out how a combination of "catalytic capital, deployed in partnership with a government delivering policy certainty, can make the UK the destination of choice for global investment".

And she added: "The National Wealth Fund will reshape the way we approach public, private risk-sharing, providing private investors with the confidence needed to fund the technologies and infrastructure needed to drive growth and create new jobs across the UK."

And Amanda Blanc, Aviva's group chief executive, said: "At Aviva we are backing the UK and stand ready to invest even more to help boost growth, create jobs and deliver net zero. We need closer working between government and business to make that happen."

Not present at the event was Nigel Peaple, director of policy and advocacy at the Pensions and Lifetime Savings Association (PLSA). Nevertheless, he made some observations: "In examining the role pensions might play in providing additional investment in UK growth assets, the PLSA recommended last year that the government take steps, alongside the British Business Bank, to improve the pipeline of investible assets available to pension funds." What happens next will be interesting.

As UKIB and the British Business Bank were welcomed when they were launched, and did see some activity, but have failed to live up to their billing.

ESG INTERVIEW – JONNY PAGE

"We are a mission-aligned investor."

The head of social and impact investment at the Esmée Fairbairn Foundation talks to *Andrew Holt* about fulfilling a mission, focusing on community and being idealistic.

What is the Esmée Fairbairn Foundation's approach to impact investing?

We start from a base of how we can use our investment for our mission. We are a mission-aligned investor. We focus on three impact areas: our natural world; a fairer future; and creative, confident communities.

The way we think about how our capital is used is increasingly referred to as the "spectrum of capital". This frames how we can shape investment to deliver on different mandates and each one is a tool in our toolkit to support our strategy.

We have our grant funding on one side, and then as we work across the spectrum, we have our social investment allocation, which is our impact-first investing, where we start with what impact is needed to progress our three aims.

Next, we have impact investing. We think thematically here. We are taking the mission-aligned impact-first investment strategies and deep diving into themes that can generate a compelling return, driven by impact. There are so many exciting themes here, from food systems, to circularity, to nature finance. We are using impact investing to test the potential to achieve market-like returns.

Then we move across to our enhanced sustainability allocation. That is what are, for us, the best-in-class sustainability funds, stemming from our investment policy statement.

Is sticking to those three impact aims restrictive or does it give you a point of focus?

As we go across the spectrum of capital, we think about what is complementary or aligned to our impact aims so that our capital works in the same direction, but the outcomes will be less specific to our detailed impact priorities than our grant funding and impact-first investing. So, our impact themes naturally broaden, but remain aligned. Also, we can expand our pipeline beyond the UK as we move across the spectrum.

In fact, I would argue that the in-depth expertise in the impact areas gives us an edge for traditional portfolio building, understanding opportunities and risk as we transition to sustainability.

When we think about our impact-first investing, it is closely aligned with the foundation's impact roadmap, working in tandem with our grant funding. For example, within our natural world impact area we have nature-friendly farming as a goal. Through our impact-first investment allocation we have invested in Ooooby, a technology that connects local farms and food hubs directly to homes.

Then, through our impact investing, we build out, deep diving into compelling investing opportunities that create an ethical and sustainable food system, from sustainable farming practices to novel food production technologies.

How much of your assets are allocated to social and impact investments?

Our impact-first social investment allocation is £60m, and our impact investment allocation is an experimental £10m. The enhanced sustainability allocation is

targeting 5% of the main portfolio, and the recently re-written investment policy statement has a dual mandate for our target return and a transition to sustainability.

Are you looking to increase those impact and social allocations?

It's worth being clear that just because we have an impact carve out, it doesn't mean the rest of the endowment is not doing impactful work. We are in some exciting impact funds. We have just increased our impact-first allocation and the impact investment allocation is still deploying and driving our new thematic strategy. So, watch this space.

You have touched on the importance of social and impact investment, but could you expand on its importance to the organisation?

There are three elements for us. The first, as I have mentioned, is that they are tools in our toolkit to deliver our strategy.

The second, is a more holistic view: what total impact are we having as a foundation? So, thinking about the impact of the whole of our portfolio as well as our grant funding.

Third, is more outward looking. This is thinking about the financial system and our role in that system as an asset owner. Innovating to solve huge planetary and social issues, internalising externalities and creating a more sustainable and equal financial system – investment has a huge role to play.

At Esmée we want to share what we are doing. We may be small, but we can be the first mover in something to test it out, with the ambition that others will follow.

How does impact-first and impact investing fit into Esmée Fairbairn's overall ESG approach, as it seems closely knit?

We don't use the phrase "ESG" too much. Albeit we do have an ESG framework that we work closely with our advisers on. Social and impact investing allows us to do some of the innovative work that then passes up the spectrum of capital.

It seems that traditionally social and impact investing has been low down the priority list for institutional investors. Has that been the case and what do you attribute this to?

Traditionally that is right. Impact investing is perceived to be concessionary. It is critical that we understand the distinction between an impact-first strategy that does not target competitive financial returns, and impact investing where impact can be a driver for performance.

Addressing the first, labelling impact-first social investing as "concessionary" is a major under-sell. It can be concessionary on a financial risk/return basis, but looking holistically across impact, financial return and risk, it is not concessionary at all. It is about what you are optimising for, and what it can catalyse. It sounds pedantic, but language matters here.

Impact investing has at times been wrongly lumped in with impact-first strategies. It is a misunderstanding that many managers labelling their fund as 'impact' are likely to be able to share plenty of stories on. Many impact strategies are set to, in my view, outperform the market. There is a growing evidence base for this.

Do investors sometimes fail to take a long-term view on social and impact investing?

That is where the type of investor matters. Different investors have different mandates.

It is not only long-term investors like ourselves that have to think about the climate risks that will materially impact portfolios. And investors across all mandates have the ability to unlock significant [shareholder and wider stakeholder] value now with an impact-orientated approach.

You have alluded to it, but it seems that social and impact investing is becoming more important to institutional investors: why is that and what's driving it?

Like anything in the investment sector it needs a track record. That is developing now. There are earlier movers now building up 10-plus years of strong experience, which is starting to turn the heads of larger chunks of capital, with something they can back.

Add that to the severity and immediacy of problems around us that capital has a role in. It is hard not to have a conversation about the fact that climate issues are here and now, and inequality is going in the wrong direction. Capital has a critical role.

As one example, Esmée co-funded a piece of work with the Green Finance Institute, the Bank of England, Defra and others to quantify the potential loss to the UK economy from nature degradation. That drives not only risk management, but also presents the question of what opportunities there are to invest in nature restoration.

In which areas of social and impact investment would you like to see more institutional investment going into and why?

There are so many. Investors can be intentional and measure their impact across every asset class. It is a framework to invest rather than a separate asset class. That said, we have a strong focus on ethical and sustainable food in the UK. It is an important example as the food system contributes 25% of global greenhouse gas emissions, 70% of freshwater use and 50% of habitable land use.

Globally, farming is the largest contributor to biodiversity loss. So, this one system is huge in terms of the impact that can be had and there is a significant journey to go on. That journey presents huge investment and impact opportunities.

Where are the gaping holes when it comes to the UK's social and impact investment? How can these be filled?

One that immediately comes to mind are community-led approaches. We see incredible community leadership in our grant funding. But then, there is how that lifts into scaled real estate strategies. The underlying asset may well be the same, but the approach differs.

If you take a community-led approach for place-based investing, you are not only assessing the economics of the asset, but you are looking at say rent affordability, what assets the local communities want and need in that area, and how this contributes to wider community-led regeneration in that place.

A second that comes to mind is that we are seeing a lot of natural capital strategies, which is brilliant. Fund managers are jumping on this. But there is further to go in mitigating for impact risks here: from biodiversity to community wealth building, to the role of voluntary carbon markets and offsets. Addressing impact risks can unlock the opportunities and pull in more capital.

Sometimes though there seems to be a lack of trust between those involved in community initiatives and the investors wanting to supply the capital.

For me, the key is investing the time to build up partnerships to collaborate in places, to build trust so that the capital works to enable community-led change, rather than working against it, and share in the upside, rather than extract it.

Will the change in government be beneficial to social and impact investment?

While we work closely with public bodies we don't do a great deal directly with central government. Although, that said, I would love to have a government where we are working more closely going forward, aligned to the work from the BVCA, UKSIF, Green Finance Institute, Impact Investing Institute, Access Foundation and others.

> **We are using impact investing to test the potential to achieve market-like returns.**

You are also a trustee/adviser of some organisations. How does that feed into your work at Esmée Fairbairn?

In a positive way, I hope. There is the advisory role on impact venture capital and private equity with the BVCA, and roles to practice what we preach around collaboration, such as my co-chair role in the Social Impact Investors Group, which is run by the Association of Charitable Foundations. I also help a social enterprise and ventures' work on their investment and financial strategies.

What are your social and impact investment ambitions at Esmée Fairbairn?

As a foundation we are on the right course: building on our track record in social investment to unlock a holistic thematic-led investment strategy; thinking about how we allocate by asset class and theme/impact class.

And there is the broader ecosystem work. This is how we work together with peers to create an impact-driven financial sector of the future. One that understands and measures its impact and actively works capital for people and planet.

What has been the biggest lesson of your career?

My whole career has been in finance. It's important, as it is humbling, for me to understand that the financial system is a means, not an end, to what we want to create. It is not about that great venture deal that returned X, it is about the impact that the venture had on its customers and wider stakeholders.

Investment facilitates, but it's not the end goal.

Joe Dabrowski is deputy director of policy at the Pensions and Lifetime Savings Association (PLSA).

THE LGPS GATHERS FOR PLSA'S ANNUAL LOCAL AUTHORITY SUMMIT

As the UK's political parties began sharing their manifestos ahead of the general election, representatives of the Local Government Pension Scheme (LGPS) arrived at the Pensions and Lifetime Savings Association's (PLSA) annual local authority conference to reflect on where we are and what the future holds for the scheme. The conference was a crucial moment for the industry to review the LGPS' journey and discuss pressing issues.

The event began with a discussion on the England & Wales Scheme Advisory Board's annual report, exploring the future for schemes in England, Wales, Scotland and Northern Ireland. Key topics included productive finance, pooling and consolidation, with a particular focus on asset pooling guidance – a hot topic at the Department for Levelling Up, Housing and Communities.

The PLSA has been proactive in arguing for the right policy framework to support the orderly transition of fund assets into the eight designated pools. The PLSA and its membership are now examining the relationships between funds and pools and plan, in due course, to publish a paper on this topic.

Recruitment and retention within the pension sector remain a significant challenge, worsened by the pandemic and the shift to remote working, which allows funds to recruit nationwide.

A dedicated session on talent management addressed practical solutions to these challenges, highlighting the importance of attracting and retaining skilled professionals within the LGPS.

Another popular session was the PLSA's retirement living standards. The latest update revealed increases in the amounts needed to fund minimum, moderate or comfortable retirement lifestyles, reflecting changing expectations and the rising cost of living.

For many LGPS members in modestly paid jobs, understanding their potential retirement lifestyle and associated costs is crucial. The working group's proposal, developed through a series of roundtables, aims to enhance member communication and ensure a clearer understanding of retirement planning.

LGPS employers also play a pivotal role, with more than 15,000 active employers in England and Wales, 500 in Scotland and 170 in Northern Ireland. The pressures of the cost-of-living crisis, local authority funding challenges and questions regarding funding surpluses have reshaped the landscape. The conference addressed these issues, exploring strategies to balance the long-term health of the scheme with employer needs.

Looking to the future, the PLSA is working on its vision for the pensions system during the next decade, with the LGPS a significant part of that. The LGPS – the largest funded defined benefit (DB) pension scheme in the UK – faces ongoing and potential future regulatory and policy initiatives. A climate of rapid change and reform has characterised the LGPS during the past decade and is expected to continue.

Discussions covered the shape and size of the pensions sector, future consolidation and the impact of social care, the tax system, demographics and artificial intelligence on pensions.

The panel on LGPS in 2035 delved into securing the best future for the LGPS over the long term.

The PLSA's latest survey revealed key regulatory initiatives expected to impact the LGPS during the next decade, including government demands to invest more in the UK (38%), pensions dashboards (38%), the green transition (35%) and LGPS consolidation (29%).

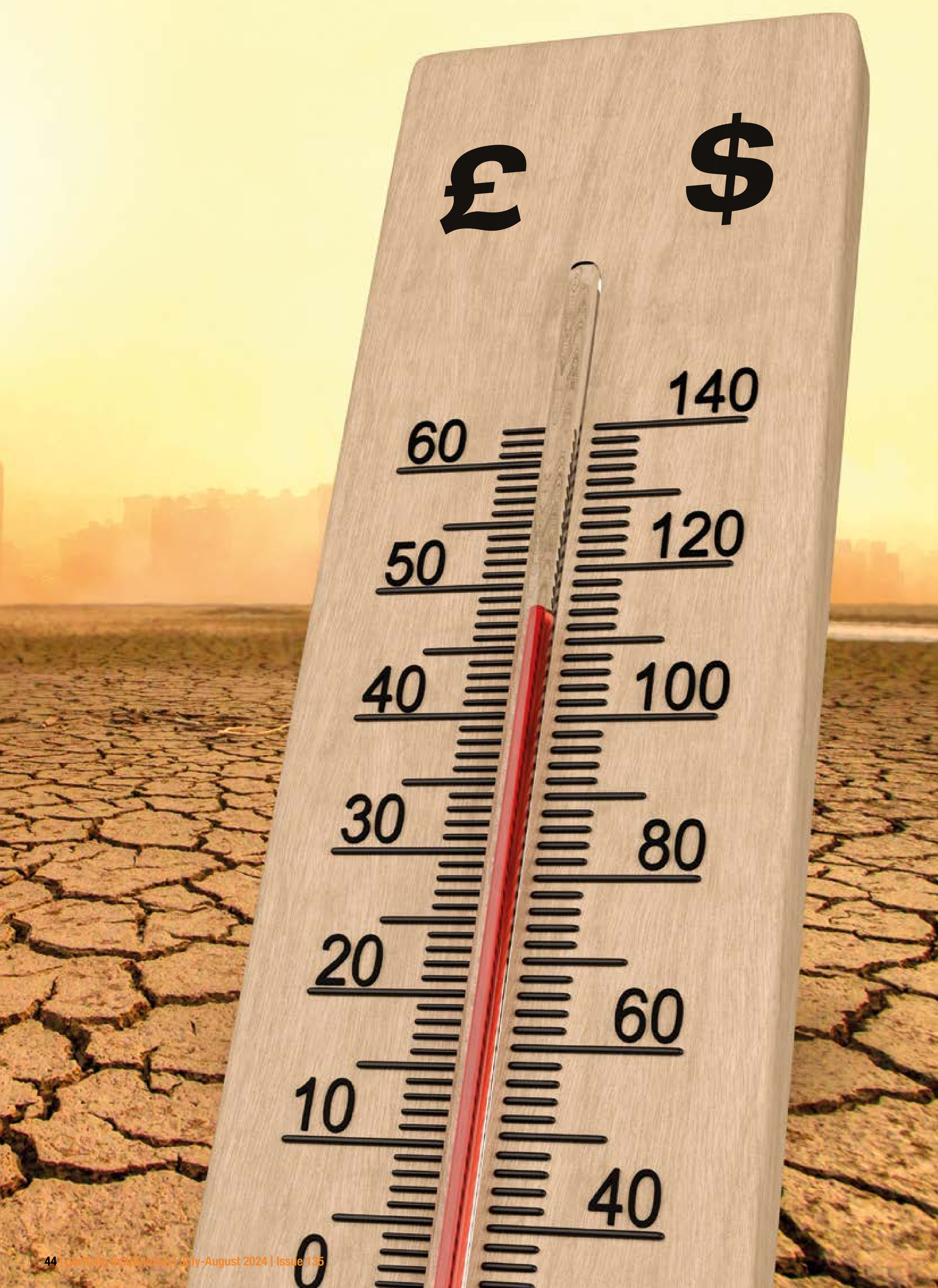
Additionally, two-thirds of those surveyed (67%) believe LGPS funds should become separate legal entities from the authority, and six in 10 respondents (62%) think there should be one regulator for all DB and DC private pensions as well as funded and unfunded public sector pensions. Views on consolidation within LGPS were mixed, with 43% supporting it and 32% opposing it. The main benefits of consolidation are seen to be lower costs (60%), better administration (47%) and improved investments (42%).

The PLSA's local authority conference provided a platform for robust discussions on the future of the scheme, addressing immediate challenges and long-term goals.

The participation and engagement of attendees, alongside the support of speakers and sponsors, underscored the collective commitment to the success and sustainability of the LGPS.

The event not only reflected on past achievements but also paved the way for a promising future in local government pensions.

PENSIONS AND LIFETIME SAVINGS ASSOCIATION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SUSTAINABILITY AND DEBT: GET READY FOR A RE-RATING

When it comes to bonds, the higher the risk the more a borrower pays. So has the market overlooked something? *Mark Dunne* takes a look.

Cargill serves the world breakfast, lunch and dinner.

The food giant puts eggs in McDonald's' muffins while its meats, oils, sweeteners and salts are used in kitchens across 125 countries.

These products helped Cargill to collect $177bn (£136bn) in revenue last year. This was 7% more than in the previous 12 months and highlights its growing influence over what we eat.

However, the company faces some tough headwinds, which could mean handing over more of those revenues to fund its vast operations through debt.

The issue is that Cargill, along with many others operating in the agriculture sector, carries huge environmental risks. And how sustainable a company's practices are could impact how much it pays to be funded by debt.

The theory is that the better aligned to global temperature targets a business is the tighter its cost of capital will be. Yet it appears that some of these risks are not priced in.

Research into the impact of climate and other environmental risks on bond ratings and, ultimately, on pricing has been conducted by several organisations, including the European Central Bank, the International Monetary Fund and the Principles of Responsible Investment.

Also examining the link between sustainability and funding spreads is the Anthropocene Fixed Income Institute.

"Our core research thesis is that climate risk, and now by extension nature loss risk, is not priced into fixed income spreads," says Josephine Richardson, the think tank's head of research.

Cargill is an example of a corporate which could be vulnerable to a re-rating over its environmental practices. Two of the ingredients it cultivates are soy and palm oil – major culprits in the destruction of the rainforest and, therefore, biodiversity loss.

There is growing political pressure on companies to stop harming our climate and the natural world in the pursuit of profit. If, for example, such political will leads to the introduction of legislation designed to halt such practices, it could trigger mispricings in the credit markets.

One such event is the European Union's new deforestation laws. The EU Regulation on Deforestation-free products (EUDR) comes into force at the end of December, by when companies trading certain products within the bloc need to prove that their supply chains do not cause deforestation.

Although Cargill has set a target to remove all deforestation from its supply chains by 2030 the company could be vulnerable to a re-pricing in the debt markets. Indeed, the EU's deforestation law appears to be a "significant" credit-relevant event, Richardson says.

Research published by the think tank believes the market is concerned that Cargill, which carries more than $50bn (£38bn) of debt, may not hit its deforestation target.

"Given limited underperformance in Cargill bond spreads since the regulation was announced, these supply chain-driven risks do not appear to be fully reflected in market pricing. For holders of Cargill's bonds, this may present pricing risks as well as an opportunity for engagement," Anthropocene's research read.

The costs associated with that legislation could be relevant for a stock's rating but are not priced into the fixed income market.

"[EU deforestation] regulation is being enacted as we speak, so we view that as very much a near-term catalyst for repricing," Richardson says.

The introduction of carbon taxes, for example, could be another price-altering event and should be taken seriously. "I'm not saying that regulation necessarily brings additional costs, but they tend to be a mechanism to incorporate some of the unpriced costs of lots of unsustainable practices," Richardson says.

Not steep enough

Not all environmental risks manifest themselves in bond spreads in the near term. Some are already present but may not be considered a material risk for decades.

One example is oil and gas, a sector which carries huge transition risk. Anthropocene's research shows that the steepness of oil and gas bond curves does not change based on production intentions. So expectations that demand for oil and coal will fall in the coming years, as renewable sources of energy become more productive and reliable are not priced in.

"Over five years the transition isn't going to be a driver of oil and gas credit performance," Richardson says. "But over 30 years, companies which are actively engaging in exploration have unrealistic demand and price scenarios.

"That is going to be a credit-relevant event in 30 years' time and so that should have a steeper bond curve, but we don't see that at all," she adds.

Anthropocene presents this to investors as evidence that aligning portfolios to net zero is "a sensible investment decision".

"If more investors align to net zero that would deliver a differentiated cost of capital, which would drive behavioural change. That would be a key lever to some of these actors," Richardson says.

"If oil and gas companies have to pay more for their long-dated debt, then they probably wouldn't be drilling for oil as much," she says, adding: "Pricing is a motivator and an incentive for change."

A dirty business

Another issue that could trigger price moves in the debt markets is divestment. Despite engagement being the preferred route for many investors to solve environmental and social problems, some practices are firmly on the exclusion list.

One such product is oil sands, or bitumen, which produces three times more pollution than traditional fossil fuel extraction and processing methods. It also creates toxic waste and poisons our drinking water.

"Now, whatever you think about oil sands, if significant pools of capital have made an algorithmic decision to exclude issuers who meet certain thresholds, there is going to be a clear negative flow on that name, so you can suggest it is going to be negative for the bonds spread," Richardson says.

A different approach

It appears that there is a need for greater awareness of what could happen in the fixed income markets if more investors start factoring in the environmental risks corporates are carrying into their decision-making.

Unfortunately, the approach to assessing ESG risk in debt portfolios is not a standard research consideration as it is for some other asset classes.

"The materiality of what credit investors care about is different to what equity investors care about," Richardson says, pointing out that stewardship and responsible investment is often focused on equities.

Bondholders may not have a say on who sits in a corporate's boardroom like shareholders do, but they can still catch the attention of companies that they believe need to change.

The people investors with sustainable strategies are trying to influence are frequently funded by debt. This typically means heavy infrastructure, energy, sovereigns and state-owned entities. So debt is a way to engage with "dirty" companies and industries to help create impactful change.

A big opportunity here is refinancing. Lenders may not get a vote at the AGM, but issuers come back to the market every five years or so to ask for more money. This gives lenders some influence. If companies don't make progress on any requested changes, they should be considered a higher-risk investment and therefore have to pay more for the debt or not be offered it at all.

But for Anthropocene, this is about targeting those who are not running sustainable mandates. It is about making this approach to risk management a mainstream consideration. "We can work harder on the financial arguments of why these things aren't necessarily about promoting sustainability, just about promoting good businesses that are going to be longer and stronger credits over the long term," Richardson says.

"Our theory of change is around supporting the relationship between cost of capital and sustainability. If better sustainability gets you a better cost of capital, then people will be more sustainable.

"We are not necessarily directly trying to make people be more sustainable," she adds. "We are trying to support sustainability being correlated with cost of capital, and then that will make people be more sustainable."

Trillion-dollar market

It is not just those investing in conventional forms of debt who need to be aware of the environmental risks' issuers carry.

The materiality of what credit investors care about is different to what equity investors care about.

Josephine Richardson,
Anthropocene Fixed Income Institute

> **If better sustainability gets you a better cost of capital, then people will be more sustainable.**
>
> Josephine Richardson,
> Anthropocene Fixed Income Institute

Investing in a bond that has a sustainable label – those named green, blue, social or sustainable – does not necessarily mean you are not exposed to ESG risks.

And it seems that investors will have plenty to consider from companies wanting to improve their environmental and social performance given that the market for sustainably labelled bonds could breach $1trn (£770bn) this year for only the second time, S&P Global Ratings believes. This comes after it came within touching distance of the landmark last year at $980bn (£754bn).

If this prediction of the market this year proves to be accurate, it could mean that bonds designed to make the world greener or to reduce inequality would be 14% of the global debt market.

In another positive development, S&P reports that sustainable debt's growth trajectory will now mirror that of conventional debt after outpacing it for some years.

This is a sign that the sustainable debt market is maturing, believes David Oelker, a director and head of ESG investment in EMEA within global fixed income at BlackRock. "Even now we are hearing in the US that their treasury borrowing committee has discussed potentially issuing green treasury bonds," he says. "That shows you how far into the mainstream this asset class has gone," he says.

Closing the gap

If the $1trn worth of sustainable bonds hits the market this year as expected and is used to fund additional green investments, then "that has to be moving things in the right direction", Richardson says. "Unfortunately, it is well researched and reported that the funding gap, especially in emerging markets, is still huge. So it's great, but more is needed," she adds.

Indeed, to achieve net zero, $7.3trn (£5.6trn) of investment is needed annually by 2050, according to research from law firm A&O Shearman. "The extent of the capital needed is still significant," Richardson says.

Most sustainable-labelled debt focuses on use-of-proceeds, so if you lend them money they could use it to buy a wind farm. "Unfortunately, there is still a challenge around the overall pricing of this debt," Richardson says. "Some people say it has a 'greenium', but does it? I'm not sure.

"And it is hard to justify that those bonds should have a tighter spread, because they are, from a credit point of view, the same. Why would you, if you are an investor, and you believe in the transition of a company which is building a wind farm, accept debt that notionally is used to fund the wind farm, rather than the total debt when you have no superior claim over that asset? So it is quite hard from a pricing point of view," she adds.

But what impact will this year's expected level of sustainable debt issuance have on the transition to a low-carbon economy? Oelker finds it difficult to put a figure on this until the market achieves greater scale. "This is an asset class that is growing through regulatory support and through focused investment from funds," Oelker says.

"We need to have a broadening out of that, to get to a stage where you can put numbers against the impact that you are funding," he adds. "We are still building the infrastructure for that.

"Until you get to that point, it is difficult to put a number on it."

This asset class is diverse, which could help it reach the scale needed. It is not only about use-of-proceeds bonds. There are also sustainability-linked bonds, which don't function at project level, but where the issuer sets certain KPIs within these bond frameworks. So, for example, chemical or cement companies will work to reduce their emissions to an agreed level in a bid to secure the capital.

"There are parts of the green bond market that are financing greater renewable energy capacity or grid improvements, and that is fantastic. We want to finance that, though increasingly we are seeing genuine transitioning projects from hard to abate sectors that we are excited about" Oelker says.

"That is important provided that these projects put the issuer onto the right path," he adds. "So the issuer doesn't have to be green, but the projects have to be genuine. They can't have a negative environmental impact."

Looking for the substance behind the label is important to make sure that the risk is suitably priced. "We do not consider every bond self-labelled green to be a green bond," Oelker says. "And we have processes to assess a bond's shade of green."

It is clear that pricing in the debt markets, be it for traditional forms or specialised areas, is not considering all the risks and so investors should expect re-ratings.

pi DIVERSITY HUB

Diversity was once a buzzword among the leaders of the financial services industry, but they are not buzzing about it anymore. Does this mean they have quietly ditched the strategy, or is it a sign that the issue has matured? This month's Diversity Hub takes a look.

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DIVERSITY PROJECT LAUNCHES NEW INVESTMENT INITIATIVE

Potentially ground-breaking project seeks to explore the connection between cognitive diversity and investment success. *Andrew Holt* reports.

The Diversity Project – an initiative to create a more diverse and inclusive UK investment industry – has announced a new research project that aims to add value to all within the investment world.

It will examine the business case for cognitive diversity and inclusive cultures in the investment industry through a project that will develop existing academic work on cognitive diversity.

The project will explore this in connection with the performance of investment teams and test whether case studies bear out connections between a team's cognitive diversity, the inclusiveness of the team culture and investment performance.

The hope is that these findings will help firms build the best-performing teams.

The motivation for this project is the desire to improve the performance of the investment management industry through a better understanding of the linkage between cognitive diversity and the performance of teams.

There is clearly more work to be done to identify any linkage between the composition of a team, the way team members interact and the team's output.

Ongoing failures, said the Diversity Project, suggest groupthink still prevails even if a company's board and management teams are demographically diverse.

"We are aware of existing rigorous primary research suggesting proper cognitive diversity can lead to better team performance, although also situations where it can be a hindrance," read the Diversity Project's research proposal report. "We would like to explore this in connection with the performance of fund management teams and see if case studies bear this out in the investment industry."

Open research

The outcome could provide radical new research into diversity and investment and how issue is assessed and used within the industry.

"We are looking to examine the business case for cognitive diversity and inclusive cultures in the investment industry. We are entirely open to what the research reveals," the report added.

In this regard, the project has a four-pronged approach.

One, to explore the linkage, if any, between cognitive diversity and the performance of investment teams.

Two, highlight approaches that can help create strong-performing teams within investment firms. Three, how to avoid or mitigate the risk of groupthink. And four, explore any difference in outcome in situations where diverse perspectives are shared and challenged.

"We hope that the research will provide the basis for creating these outcomes, but again accept that we may not be able to demonstrate any or all of these," the report said.

As part of this, the Diversity Project has created a number of questions to address to which the project would like assistance from the investment community in addressing.

One, how can cognitive diversity be measured? And how does this apply to investment teams?

Two, is there a linkage between cognitive diversity and the success of an investment team? The project defines success for these teams as risk-adjusted investment performance.

Three, what are the critical additional factors that might enhance or detract from the team's performance? And again, do any of these apply to a greater or lesser extent for investment teams?

Four, are there specific risks which cognitive diversity mitigates, for example, groupthink, risk of investment underperformance or loss from excluding ideas?

And five, is there a linkage between cognitive diversity, plus other factors, and an investment team's success, and can it be demonstrated that this is more than mere positive correlation?

Portfolio progression

This comes as the Diversity Project launches its third iteration of its Pathway Programme for portfolio managers.

The latest track will include 10 participants and focus on specialised sessions on exchange-traded funds, equities, derivatives, fixed income, data and modern trading platforms.

It will include new team members as mentors: Shyla Hoenigschmid-DeVeaux and Emma Hamilton.

Hoenigschmid-DeVeaux has spent more than 10 years as a portfolio manager at JP Morgan and was a founding chairperson for the EMEA section of the AWM Black Leadership forum.

Launched last year, the programme aims to create a pathway for more women to become portfolio managers.

It has the support of more than 40 investment firms and is led by Diversity Project chair Helena Morrissey.

"This is a programme brought to the industry by the industry based on what fund managers know it takes to succeed," Morrissey said. "Shyla's experience as a recent portfolio manager will be invaluable here and we are delighted to welcome Shyla and Emma to the team."

Hoenigschmid-DeVeaux added: "The Pathway Programme is a first of its kind opportunity to truly level the field and increase access for women into these important roles within the investment industry."

WHATEVER HAPPENED TO DIVERSITY?

It's all gone quiet on the diversity front in financial services. But the silence does not tell the whole story, finds *Andrew Holt.*

It was not long ago that diversity was on the tongue of most chief executives in the financial services industry. Companies and investors, spurred on by political events, were united and vociferous in the call for greater diversity within their organisations.

Such talk has now gone somewhat quiet. And when it is spoken about, it is usually critical in nature. So has diversity fallen off the corporate and financial agenda?

Taking this position as a starting point: was all the talk about diversity nothing but noise? Could it be that financial organisations were never that committed to diversity, that they only went with the political tide when that tide was strong. Now that the politics of diversity has dissipated from the public discourse there is no need to pamper to it so much.

Although it could be that this premise is wrong. That although there is not as much noise surrounding diversity as there once was, it doesn't mean there is nothing being done within financial institutions to address it.

On this, Annelise Sauter, ESG and equity diversity and inclusion manager at Better Society Capital, says the drive is still there. "While some organisations might be more politically tied, I believe financial services as a whole will continue to shift towards accepting and accelerating equity, diversity and inclusion."

Going mainstream

It is a question Emma Douglas, senior stewardship analyst at Brightwell and co-chair of the Asset Owner Diversity Charter, addresses in more detail. "Has diversity fallen off the corporate agenda, or has it become more mainstream and more integrated into firms that there is not so much to shout about," she says.

"It has certainly not fallen off asset owner agendas," she adds. "We at the Asset Owner Diversity Charter continue to welcome more signatories, year-on-year."

The charter does indeed have almost £2trn in assets under management signed up to the charter. "So I would say it's not insignificant," Douglas says.

A point shared by Sophia Singleton, president of the Society of Pension Professionals. "Media attention may have dwindled, but diversity and inclusion hasn't fallen off the corporate agenda, and rightly so," she says.

And Sauter adds: "Given that people are the lifeblood of the financial services industry, good equity, diversity and inclusion practices are just good governance, people management, investment and customer experience practices," she says.

So on this evidence, asset owners may not be talking about diversity as much, but that is because they are getting on with it. Another example that points in this direction is when the Asset Owner Diversity Charter held a conference on the issue around 100 people attended in person, with more online. "So diversity may have been quieter in the media, but people and organisations have been getting on with action to progress diversity, equity and inclusion (DEI) ambitions," Douglas says.

New faces

Leaning into this interpretation of how things are progressing, Reboot, a working group of senior financial services professionals, revealed earlier this year that diversity is increasingly becoming an important part of UK fund managers winning business.

It is a trend Douglas and the Asset Owner Diversity Charter are seeing. "For an asset owner awarding a new mandate, DEI will usually be part of the manager selection process," she says. Although the evident problem here is that fund managers could take a tick-box approach to diversity, that is having enough diversity to win business, but ultimately nothing changes, except a few faces.

"Doing diversity well leads to better idea generation, so it cannot be done tick boxy," Douglas says.

Another point shared by Sophia Singleton. "Increasing DEI isn't simply the right thing to do. Diversity, coupled with inclusive practices, broadens the skills base, increases innovation, reduces groupthink, can reduce staff turnover and helps better reflect the society we serve," she says.

The less sexy stuff

Another reason to suggest that things haven't gone quiet on the diversity front is that, as well as the Asset Owner Diversity Charter, there are initiatives within the pensions industry focusing on the diversity agenda to drive it forward as an important issue.

Last year The Pensions Regulator (TPR) published diversity, equity and inclusion guidance for pension schemes' governing bodies and employers. And this year, TPR published its first trustee diversity and inclusion survey.

It revealed that 24% of trustees are female, compared to 52% of the general population, and 5% from an ethnic minority background, compared to 16% of the general population. "Improving the diversity of trustee boards and promoting inclusion should be a next step," Singleton says.

The Diversity Project, a cross-company initiative championing a diverse UK investment and savings industry covering asset owners, investment managers, actuaries, trustees and wealth managers, has also taken off. The project has more than 100 members representing £13trn in assets under management.

But returning to the asset owner-asset manager dynamic, there is a big difference in terms on the importance of diversity and the size of asset manager. "It varies from manager to manager in how they deal with the issue," Douglas says. "It can make a big difference, wether you are big global organisation or a small boutique. For the smaller managers it is even more important, because the culture generated within your firm is so fundamental to its success."

Another indication towards the narrative of diversity being important is an increase in more managers completing the Asset Owner Diversity Charter questionnaire. "That, in part, is because of more signatories requesting it," Douglas says. "So asset owner signatories to the charter and managers who are recipients of the questionnaire, means [asset managers] have to fill it out on an annual basis." This in turn creates a more holistic picture of what is happening on DEI within the investment industry.

And things have moved on within the debate, with organisations having to move with this, Douglas says. "At the outset, DEI was about the ambition. We had the leaders of all these organisations setting out their ambitions, which is what needed to happen.

> **Media attention may have dwindled, but diversity and inclusion hasn't fallen off the corporate agenda, and rightly so.**
>
> Sophia Singleton, Society of Pension Professionals

"But the next thing is about policy and actual action," Douglas adds. "How are you going to implement it – the less sexy stuff. What are organisations doing on a day-to-today basis to progress the diversity, equity and inclusion agenda."

But how does that translate into reality and what does it mean for respective organisations? "The reality is if DEI is carried out properly, and in an effective manner, we, as asset owners, believe that, and research shows this, that you get better idea generation, better retention of staff and ultimately better business results," Douglas says.

And this is, of course, the central tenet of why diversity is important in the first place.

Hiring and retaining

There are though other aspects to the diversity challenge. "The key aspect in all of this is the inclusion piece – it is super difficult," Douglas says. That is to say, making companies truly inclusive. "Good companies are improving their recruitment process, and there has been significant progress in the early careers area – so more junior employees are from more diverse backgrounds," Douglas adds.

This has proved harder, probably understandably, at the more senior level. "There has been slower action there," Douglas says. "But it is also about the development and retention piece. That is where firms are starting to focus now," she says.

The time taken to promotions for different groups is something the Asset Owner Diversity Charter is heavily focused on. "That is a company's retention piece and bolsters the senior representation over a period of time," Douglas says.

The charter also revealed many firms were offering mentoring programmes for diverse groups as part of improving this situation, but bizarrely none were tracking these programmes. “So they had no idea about take up rates or the success of those programmes. Yet it was a key part of the policy to develop and retain diverse talent,” Douglas says.

Don’t discrimination

But there can be said to be another drawback within the diversity debate and that comes from the advocates of diversity themselves who, sometimes, despite their best intentions, have been their worst enemy.

A case in point is the statement made by Amanda Blanc, Aviva’s experienced chief executive, who told a Treasury committee last year that there is no senior non-diverse, that is white male, hire made at Aviva without her personal approval. That looks, noted numerous critics, like discrimination, rather than a commitment to diversity.

It is here, where diversity could be seen as almost an obsession for its own sake. One where it begins to fall down as an effective tool to improve financial organisations. Diversity after all should exist as a basis for improving how a business or investment organisation is run, and that alone. Not as an ideology pursued for its own dogmatic purpose.

“We need to be mindful to take everyone along on the diversity journey,” Douglas says. “So do not alienate people, and certainly do not discriminate against anyone.”

Real benefits?

The other big question is whether focusing on diversity in a business context produces any real tangible benefits – despite all the talk that it inevitably does. Earlier this year, a report by the Inclusion at Work Panel, a group of private and public sector experts, found that many practices, including diversity training, had little to no tangible impact in increasing diversity or reducing prejudice.

Kemi Badenoch, the business secretary under the previous Conservative government, who commissioned the report, stated that many diversity and inclusion initiatives had been counter-productive despite millions of pounds having been dished out by companies on such plans.

Critics of Badenoch pointed out in turn that she was politicising the issue. But diversity, by its nature, is political. And it has become politicised to some small or large degree, on all sides.

There is a valid question to be asked about how some diversity training programmes benefit. For example, such initiatives on white privilege and gender identity, which are often offered as part of diversity programmes. How can these help investors make better investments and achieve a better return?

When it comes to the politics of DEI, Douglas has some practical advice. “Diversity is about firms getting things right, having that diversity of opinion, and should not just be about virtue signalling,” she says.

Diversity evolution

Another challenge is the simple fact that the diversity debate is continuously evolving. Douglas highlights the next point of concentration for diversity, as it has shifted from focusing on gender to ethnicity.

“Socio-economic background is the next big focus. We have adapted questions in the taskforce’s questionnaire this year following the [City of London Corporation’s] Socio-economic Diversity Taskforce recommendations,” she says. “The socio-economic side of things needs to be addressed.”

It could be said that this should have been the starting point in the diversity debate. As sticking to a focus on more women, or even greater ethnic diversity, you could achieve change, but in reality getting little difference on what existed before. For example, you could replace a public-school Oxbridge educated white male CEO or CIO with a public-school Oxbridge educated white female, which would lean towards greater female diversity, but is hardly a great leap forward in diversity in any other measurement.

To highlight the socio-economic bias within British corporations, Douglas notes that when it comes to CEOs of UK organisations overall, 52% are from higher socio-economic backgrounds, but within finance, this figure increases to a whopping 89%. This will be a huge challenge to address.

From here diversity can still make a strong claim to be relevant to financial organisations and investors alike. And the sound of silence on the issue is not necessarily an indication of institutional investors pushing it out of sight.

But there is clearly, as the socio-economic argument highlights, much to be done. A point not lost on Sophia Singleton. “Much has been achieved, but much more change is required,” she says.

We need to be mindful to take everyone along on the diversity journey.

Emma Douglas, Brightwell

THE FINAL COUNTDOWN

22.7%

The institutional investment allocation to residential property in 2023, up from 6.6% 10 years earlier.

Source: INREV

3.8%

The decline in real estate assets managed globally to €3.7trn in 2023, down from €3.9trn a year earlier.

Source: INREV

58%

The level of alternative investment managers who believe they need to invest in technology to manage the compliance risks they face in the next two years.

Source: Ocorian/Bovill Newgate

£10bn

The rise in the aggregate surplus of defined benefit schemes during May to £468.8bn.

Source: Pension Protection Fund

2.5%

The forecast rise in the global debt pile to a record $8.38trn in the current financial year.

Source: Janus Henderson

€84.6bn

The inflows into Europe's ETFs during the first five months of 2024.

Source: LSEG Lipper

30%

The level of British pension funds and insurers which intend to make a "significant" investment in onshore wind energy in the next five years.

Source: AlphaReal

$4.3trn

The global institutional investor exposure to the debt and equity of fossil fuel companies.

Source: Urgewald

77%

The rise in the digital assets under management in exchange-traded products globally to $87.9bn from $49.5bn in the year to early July.

Source: Fineqia International

Quote of the Month

"Labelling impact-first social investing as 'concessionary' is a major under-sell."

Jonny Page, head of social and impact investment at the Esmée Fairbairn Foundation