

OUTCOMES
BEYOND
PERFORMANCE }

THE RETURN POTENTIAL OF MULTI-ASSET CREDIT STRATEGIES

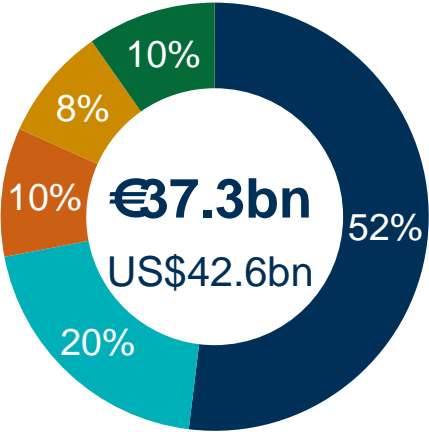
Andrew Jackson, Head of Fixed Income
22 February 2019

For professional investors only


HERMES
INVESTMENT MANAGEMENT

Hermes Investment Management

A diversified platform



Total AUM (millions)	USD	EUR
Equity	22,142	19,369
Real Estate	8,554	7,483
Infrastructure	4,152	3,632
Fixed Income	3,641	3,185
Private Equity	4,148	3,629

€433.9bn
US\$496.0bn
Under stewardship

Please note the total AUM figure includes US\$8.3bn / €7.3bn of assets managed or under an advisory agreement by Hermes GPE LLP ("HGPE"), a joint venture between Hermes Fund Managers Limited ("HFM") and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. US\$24.2m / €21.2m of total group AUM figure represents HFM mandates under advice. Source: Hermes as at 31 December 2018 with the exception of two portfolios totalling US\$4.5m / €3.9m valued as at 30 September 2018.

483 STAFF

Located in:



215

Investment and
stewardship staff

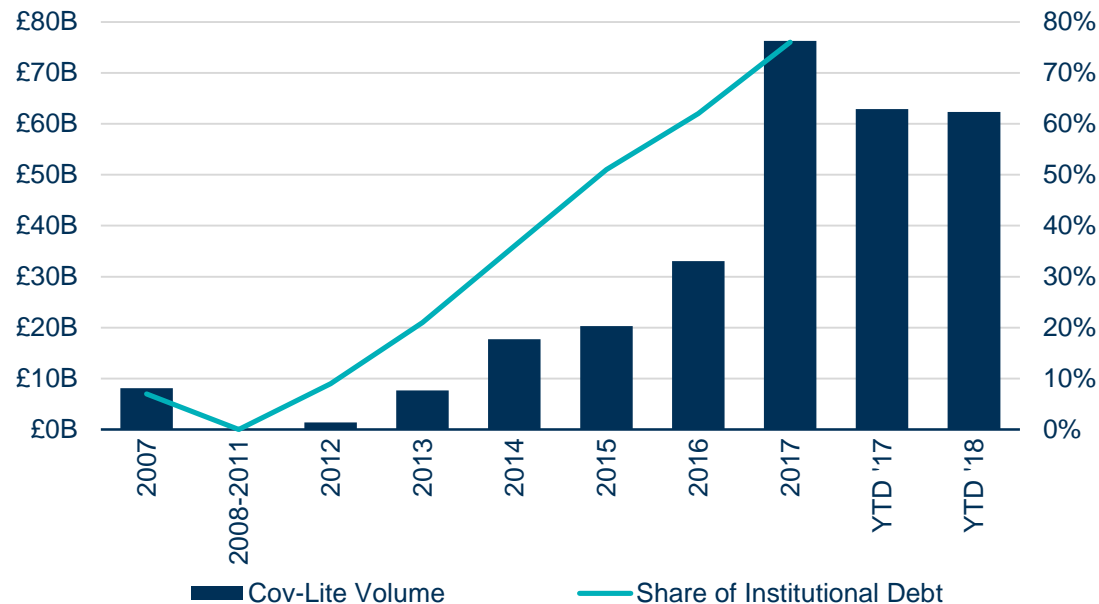


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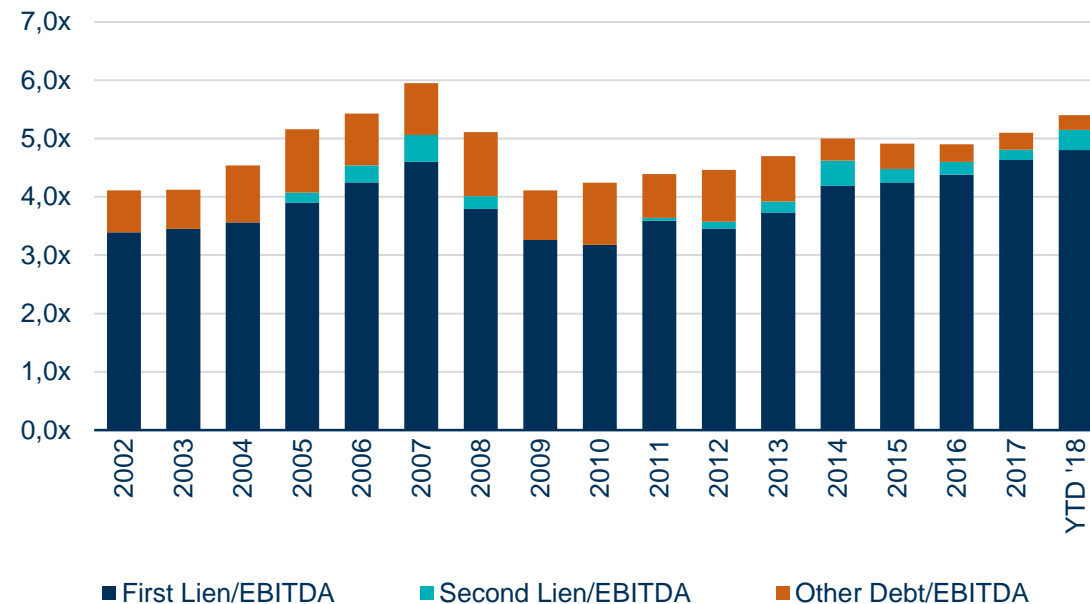
Market context

Credit conditions worsening – end of cycle?

Cov-Lite Institutional Volume: Annual



Annual Pro Forma Debt/EBITDA Ratios



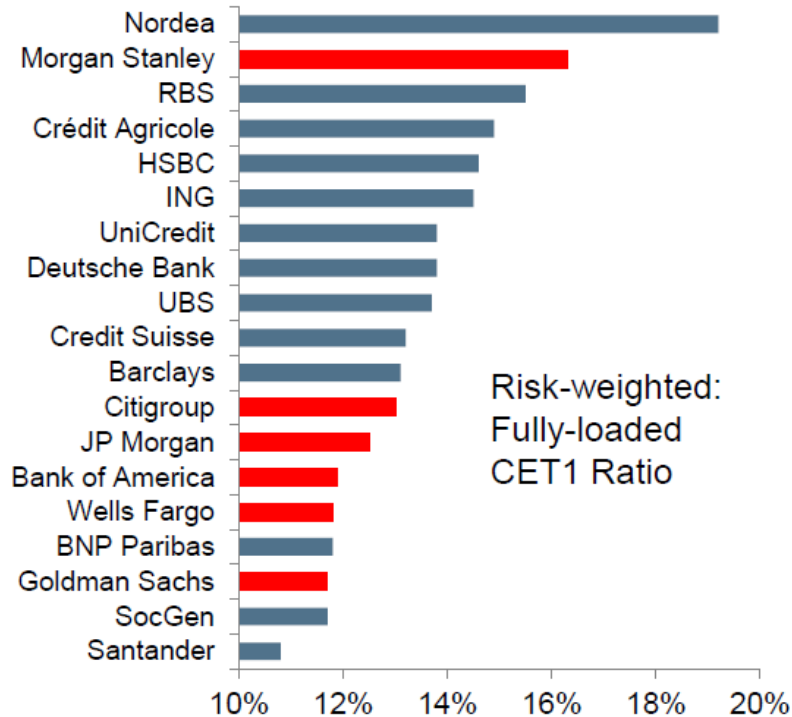
Source: S&P Global as at 30 October 2018. Copyright © 201*. S&P Global Market Intelligence (and its affiliates, as applicable).

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Market context

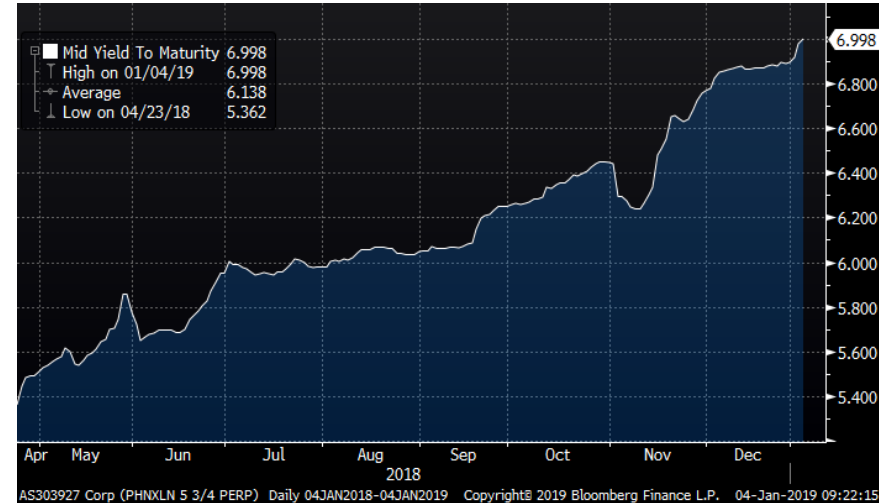
European Financials

Capital progression¹



¹ Source: EBA, SSM, BoE, PRA as at end 2017. ² Source: Bloomberg as at 4 January 2019.

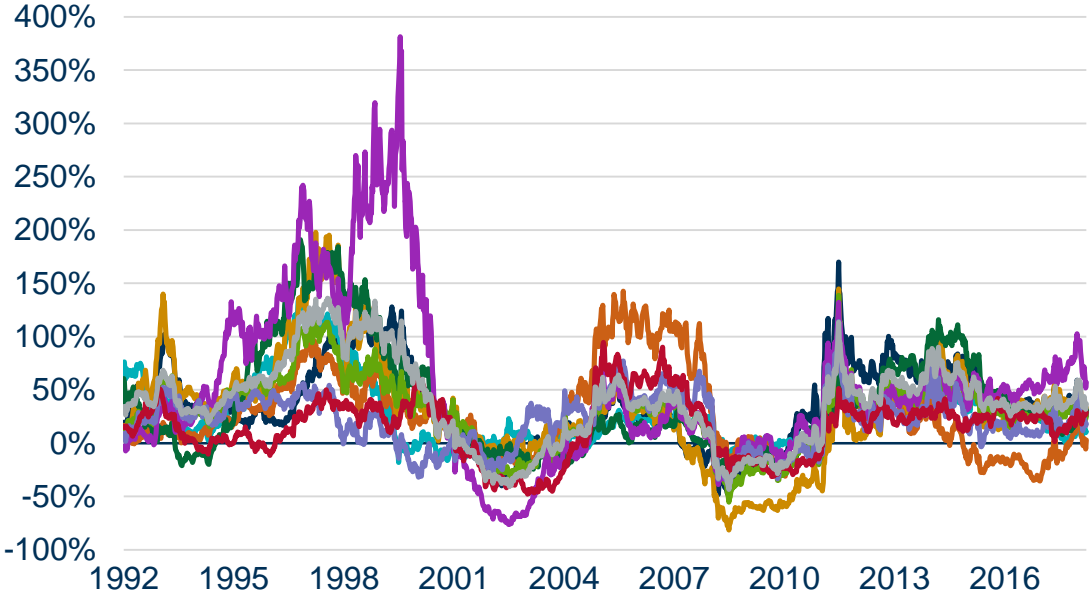
Brexit and Peripheral premia²



- ▶ Phoenix Group Tier 2 Perp issued in April
- ▶ Well capitalised UK specialty insurer
- ▶ Poorly understood and poorly covered
- ▶ Niche = illiquid and volatile

Meanwhile in Equity land...

3 year rolling return¹



PE Normalisation²



Long Run...

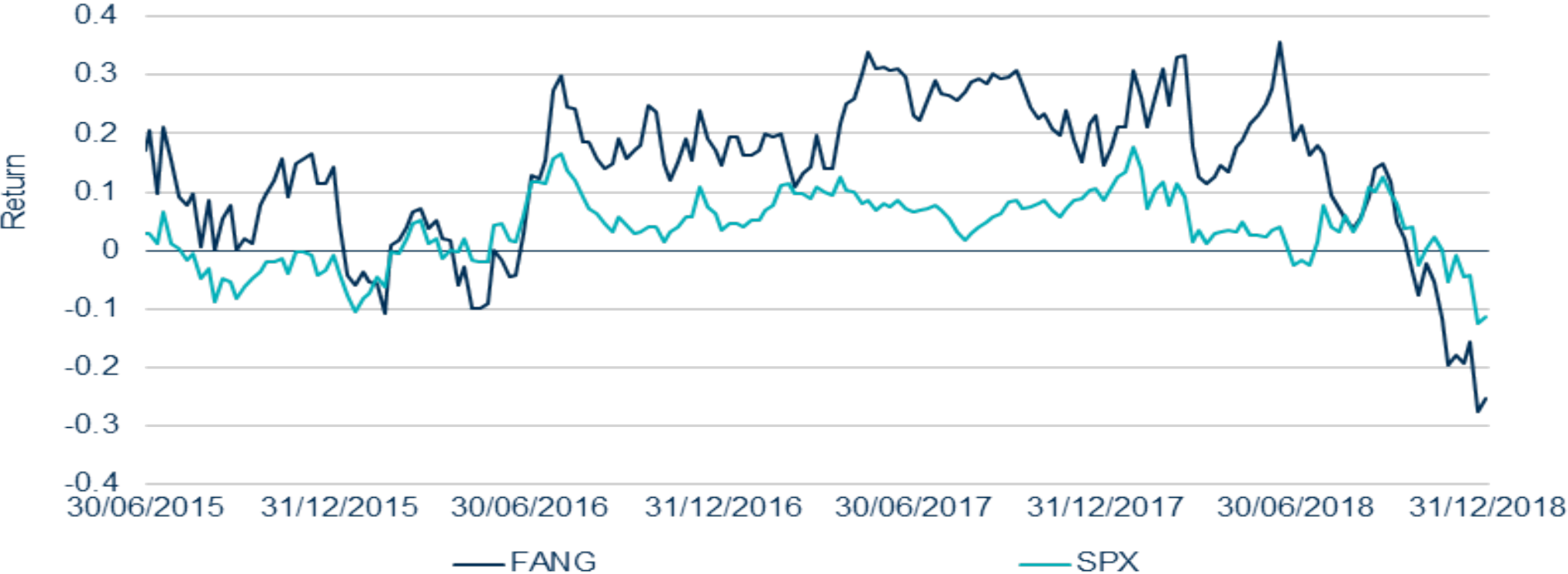
- ▶ Mean 15.73
- ▶ Min 5.31 (1917)
- ▶ Max 29.63 (1999)

Source: Bloomberg and Hermes as at 30 November 2018. ² Bloomberg and Hermes as at 4 January 2019.

Seeing positives in sell-offs

This is not irrational behaviour...

FAANG v SPX 6m rolling return

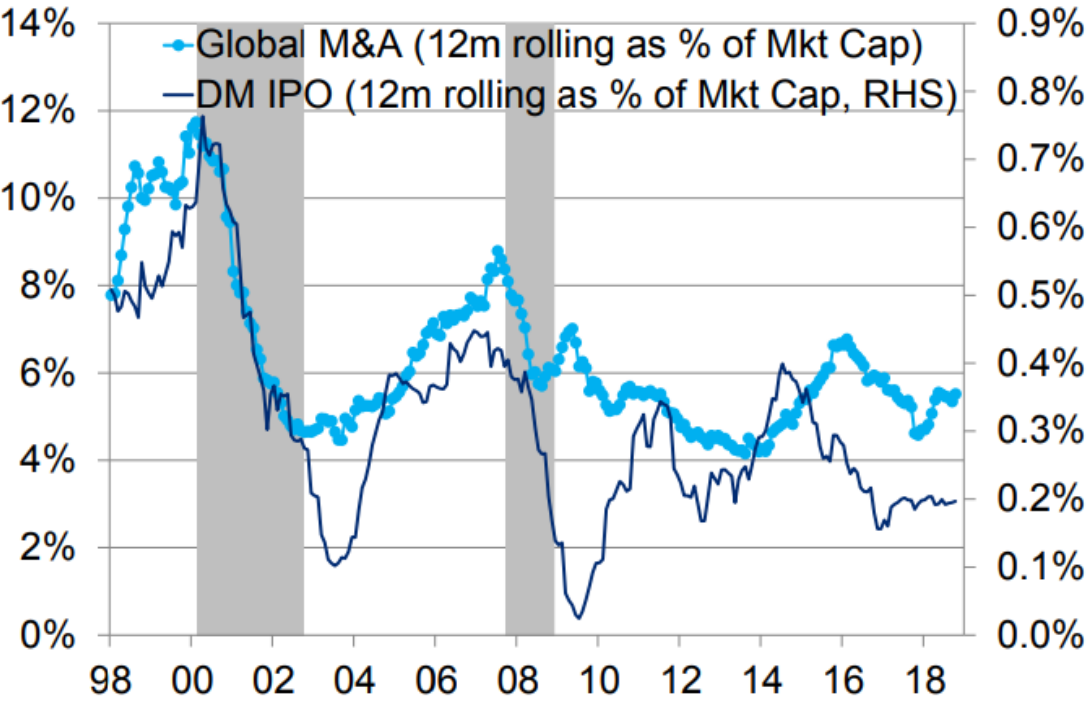


Source: Bloomberg and Hermes as at 31 December 2018.

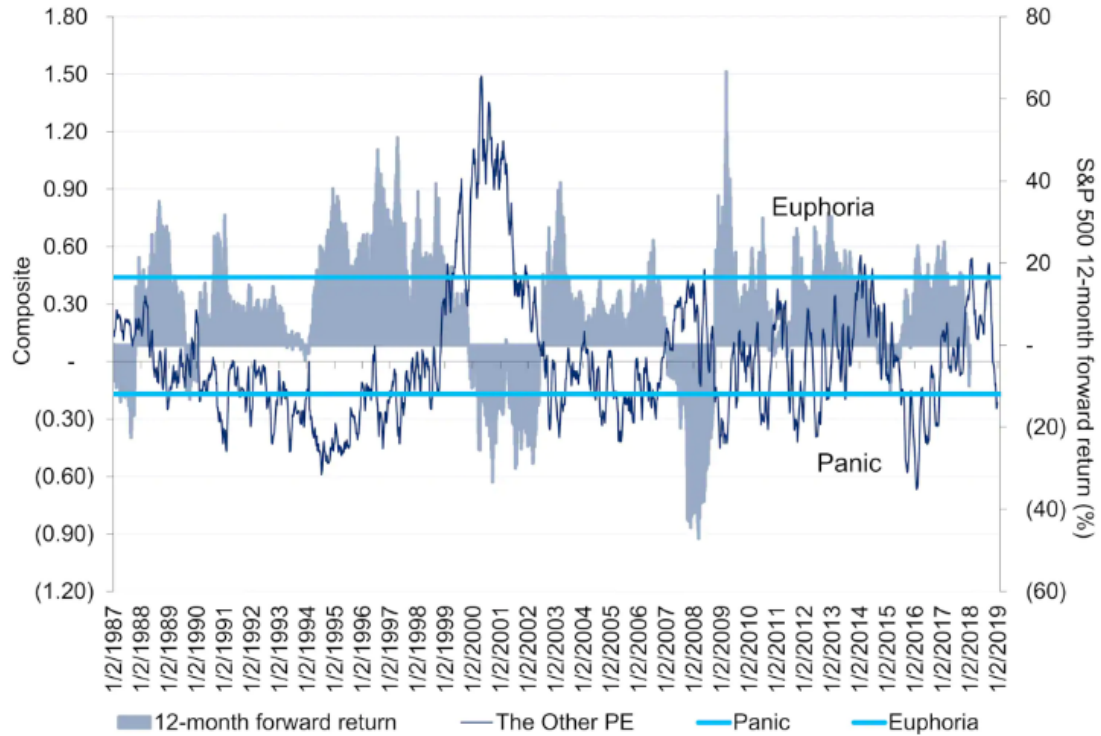
Fundamentals and technicals...

Please don't make me say it!

M&A and IPOs as % of Market Cap¹



Panic / Euphoria Model²



Source: Citibank Research, Dealogic, MSCI as at 29 November 2018. 2 Pinnacle data, Haver Analytics, Citi Research as at 31 December 2018.

Tail risks abound

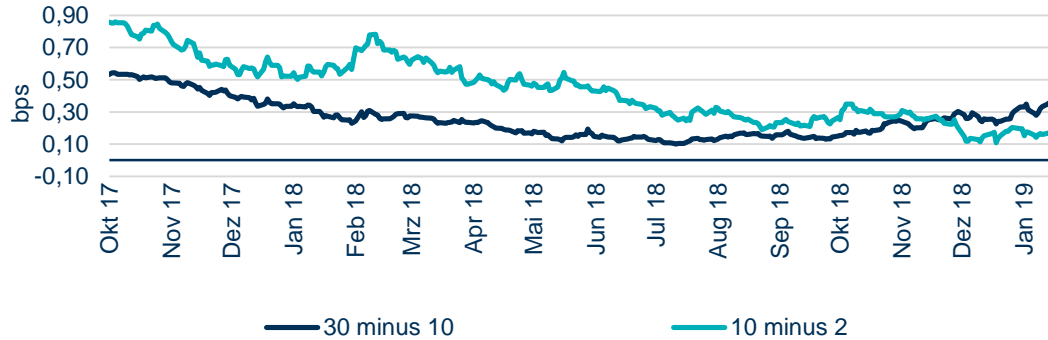
But hedges are **CHEAP!**

Three huge risks on the horizon

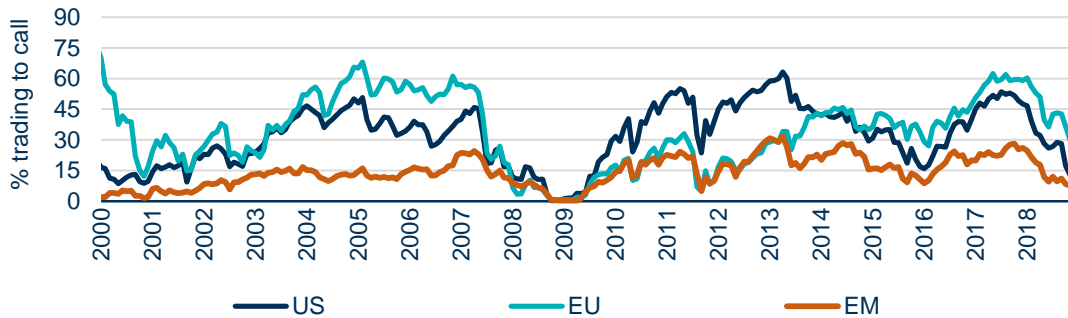
1. Unwind of largest financial experiment in history
2. Populism / protectionism / rule of law
3. Climate change

Market review

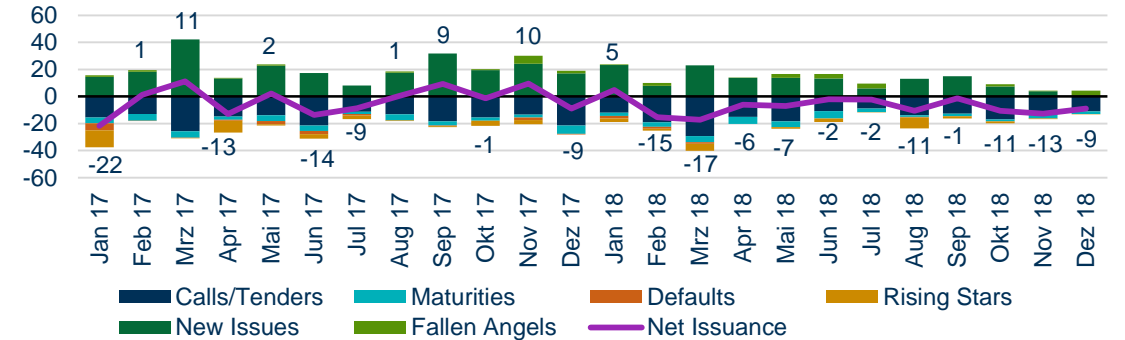
2v10, 10v30 US treasuries¹



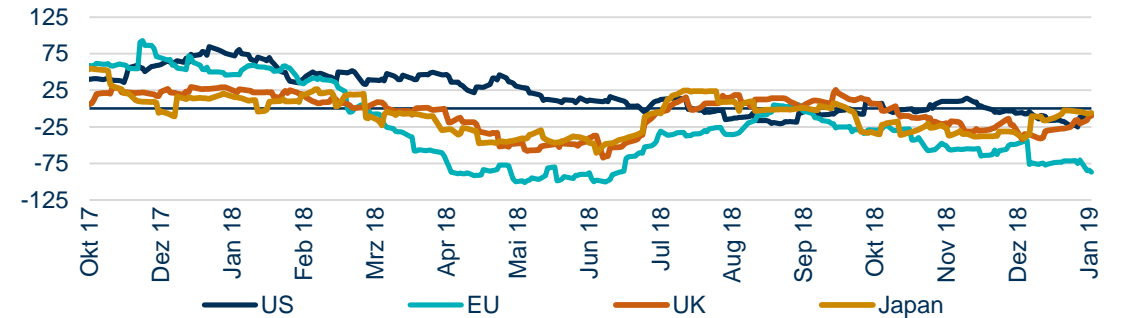
Convexity³



Supply US HY²



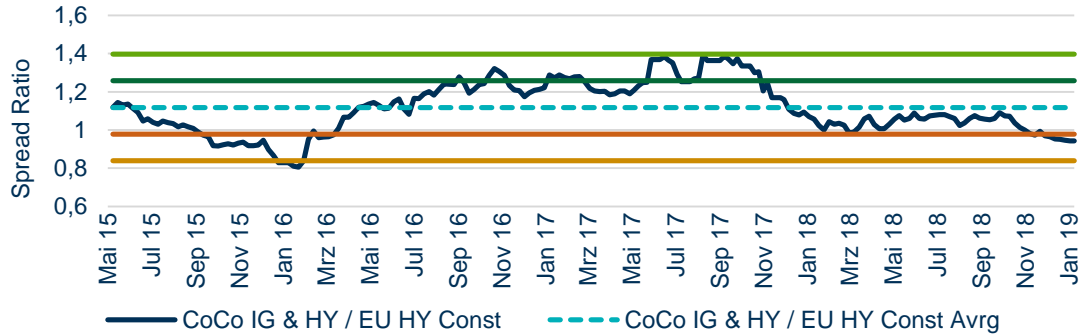
DM Economic Surprise Indices⁴



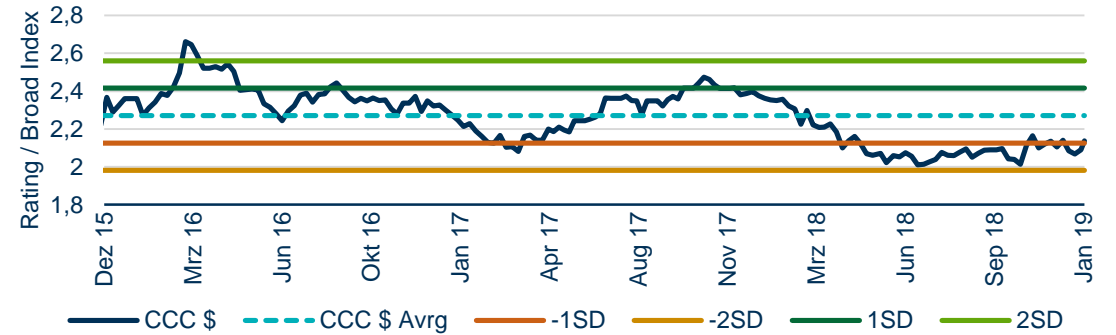
Source: ¹ Hermes and Bloomberg as at 17 January 2019. ² BofA Merrill Lynch Global Research as at 31 December 2018. ³ BofA Merrill Lynch Global Research as at 31 December 2018. ⁴ Hermes and Bloomberg as at 9 January 2019.

Market review (2)

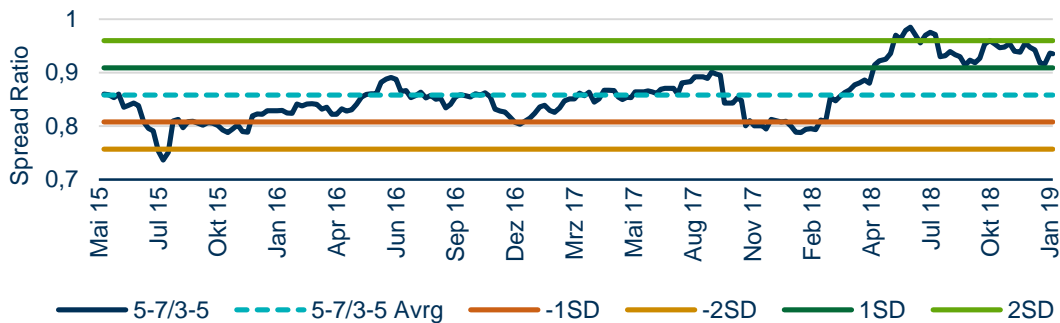
CoCos v EU HY¹



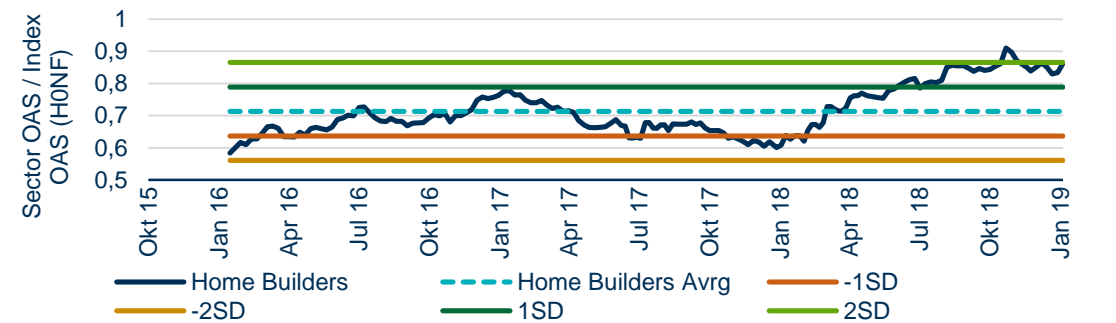
CCC USD²



US HY Curve³



Homebuilders⁴



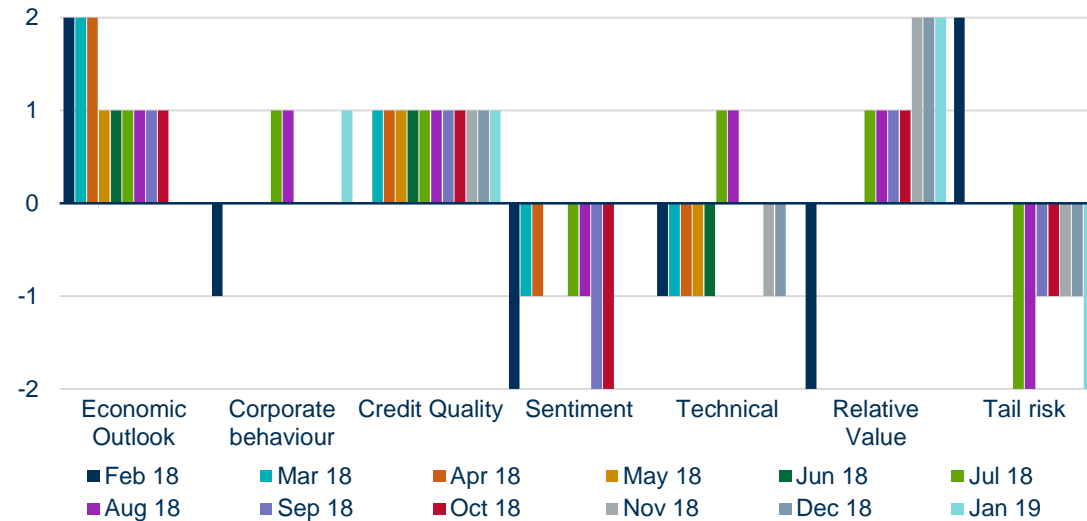
Source: ^{1,2,3}Hermes Credit and ICE Bond Indices as at 8 January 2019. ⁴Hermes Credit and ICE Bond Indices as at 4 January 2019.

Applying top-down analysis

Identifying sources of risk and opportunity in credit markets

Monthly credit strategy meeting

- ▶ Reviewing global markets
- ▶ Gauge the influence of technical forces on valuations
- ▶ Headline credit score expresses our overall risk appetite

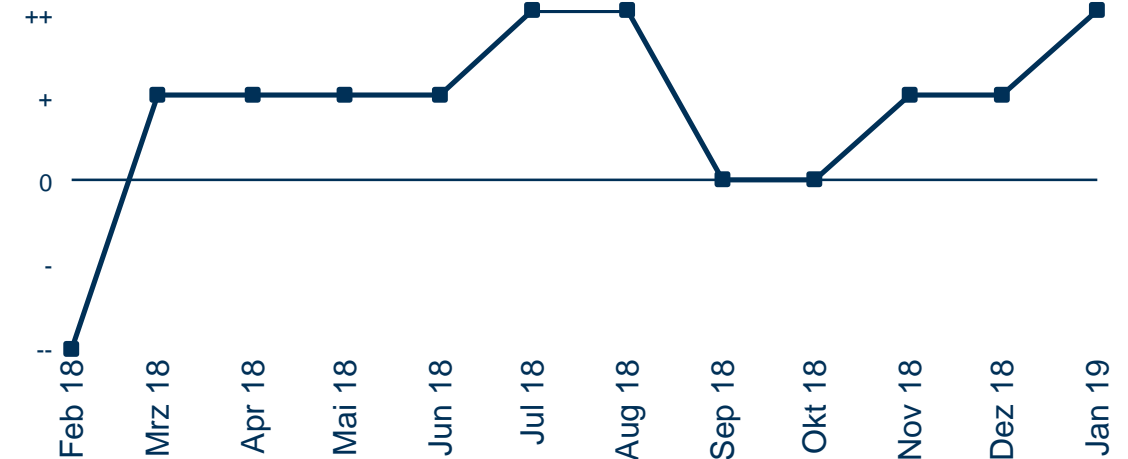


Source: Hermes as at 28 January 2019.

Risk appetite throughout 2017/18

- ▶ Establish appetite for credit risk and how to allocate that risk across geographies, sectors, rating categories, credit curves, etc

Credit risk appetite throughout 2017/18

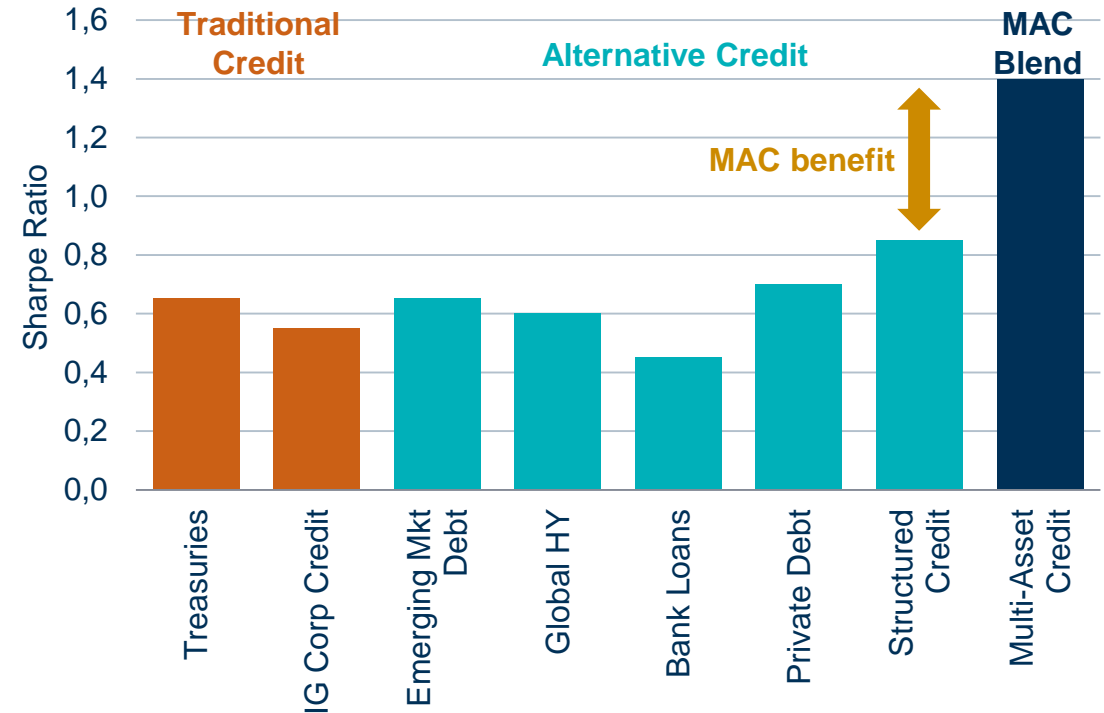


Changes to the credit landscape

Restrictions on traditional lenders have created investment opportunities

Opportunities from landscape developments

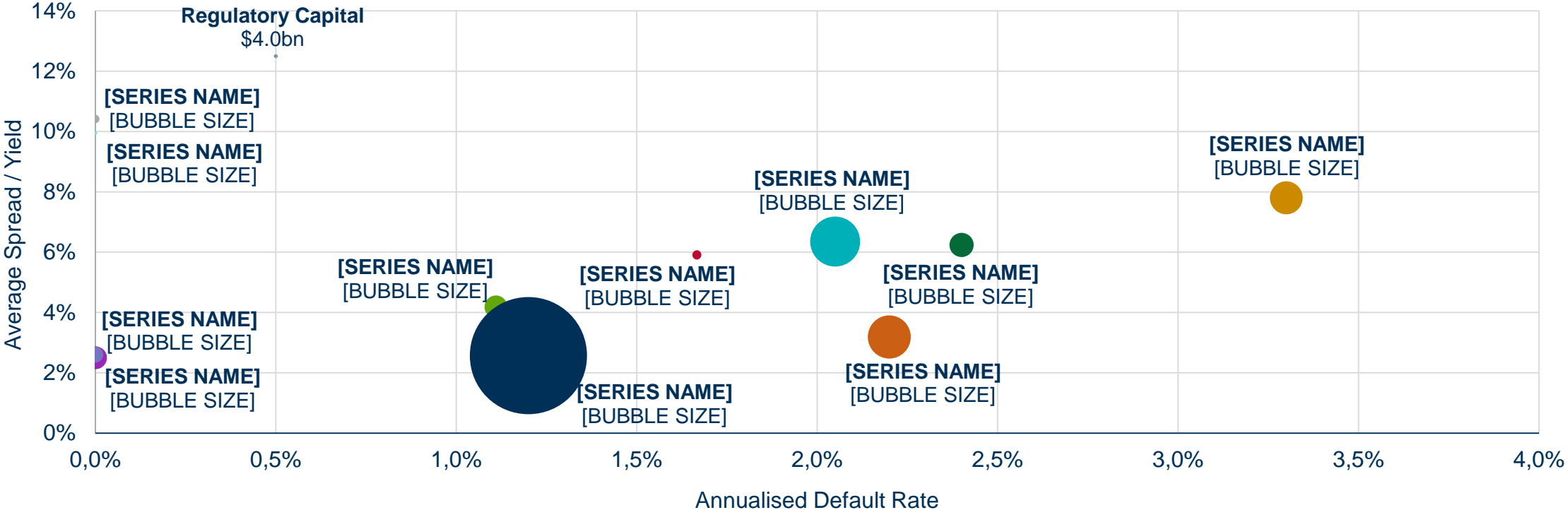
- ▶ Access to attractive areas where regulations restrict traditional lenders
- ▶ Yield premium in risk transfer with banks
- ▶ First mover opportunities in new asset classes
- ▶ Investment/partnership opportunities following rise in alternative lenders
- ▶ Attractive first loss exposures following “skin in the game” for structured credit issuers



MAC strategies provide one way for investors to access these opportunities

Multi Asset Credit provides broader credit access

A spectrum of opportunities available across public & private credit



The value of investments and income from them may go down as well as up, and you may not get back the original amount invested. Any investments overseas may be affected by currency exchange rates. Past performance is not a reliable indicator of future results and targets are not guaranteed.

Source: Bloomberg, Thomson Reuters, S&P LCD, JP Morgan, Deloitte, Hermes (2017).

Finding relative value across the spectrum

Relative Value Framework Scoring criteria

1. Fundamentals

40%

- Return potential
- Loss given default
- Credit fundamentals

2. Market Factors

40%

- Current value
- Technicals
- Spread Volatility
- Interest rate sensitivity
- Correlation

3. Attributes

20%

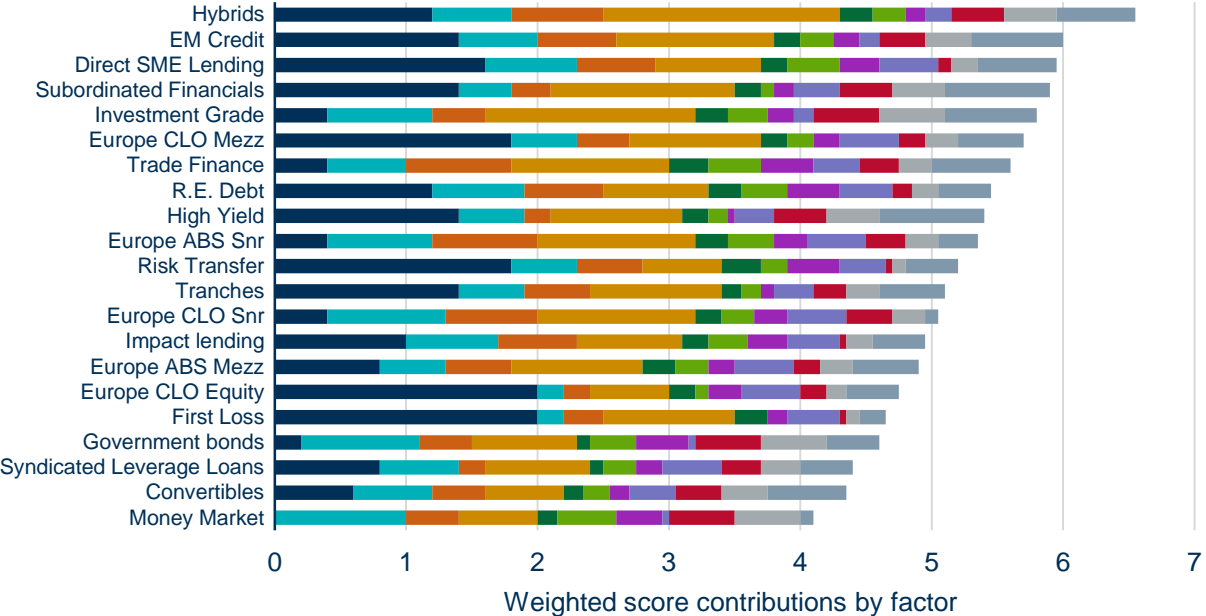
- Liquidity
- Complexity
- Alpha potential

Source: Hermes as at 31 December 2018. For illustrative purposes only.



Factor contributions to relative value

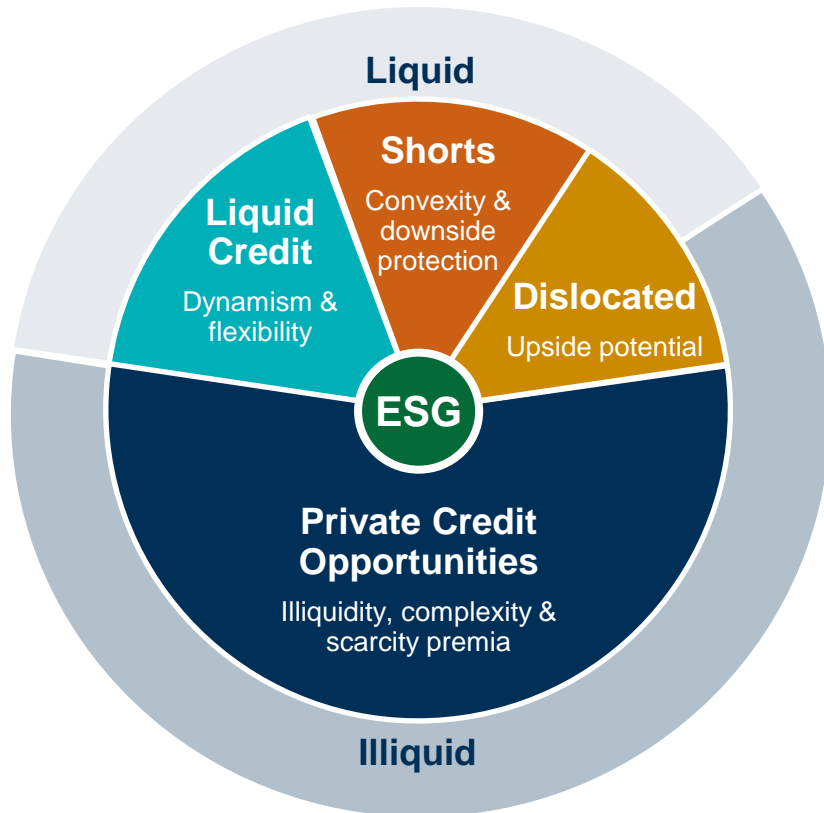
Q4	▲	Q3
1	▲	6
2	▼	1
3	▼	2
4	▲	7
5	▼	4
6	▼	3
7	▼	4
8	—	8
9	▲	14
10	▲	11
11	▼	9
12	▼	10
13	—	13
14	▼	12
15	▲	16
16	▼	15
17	▲	18
18	▲	19
19	▲	20
20	▼	17
21	—	21



- Historic Return
- Loss given default
- Credit Fundamentals
- Value
- Technicals
- Spread Volatility
- Correlation to Markets
- Interest rate sensitivity
- Liquidity
- Complexity
- Alpha potential

Customising Multi Asset Credit solutions

Diversified solutions can be constructed from four major components



1. Liquid

▶ Liquid Credit: long-only best liquid MAC ideas

- Provides agility to exploit market opportunities

▶ Shorts: Dynamic options hedge overlay

- Downside protection by hedging market risk of portfolio

2. Illiquid:

▶ Private Credit opportunities: diversified allocation to private and esoteric credit opportunities

- Target high risk-adjusted returns capturing illiquidity, complexity & scarcity premia and lower correlation

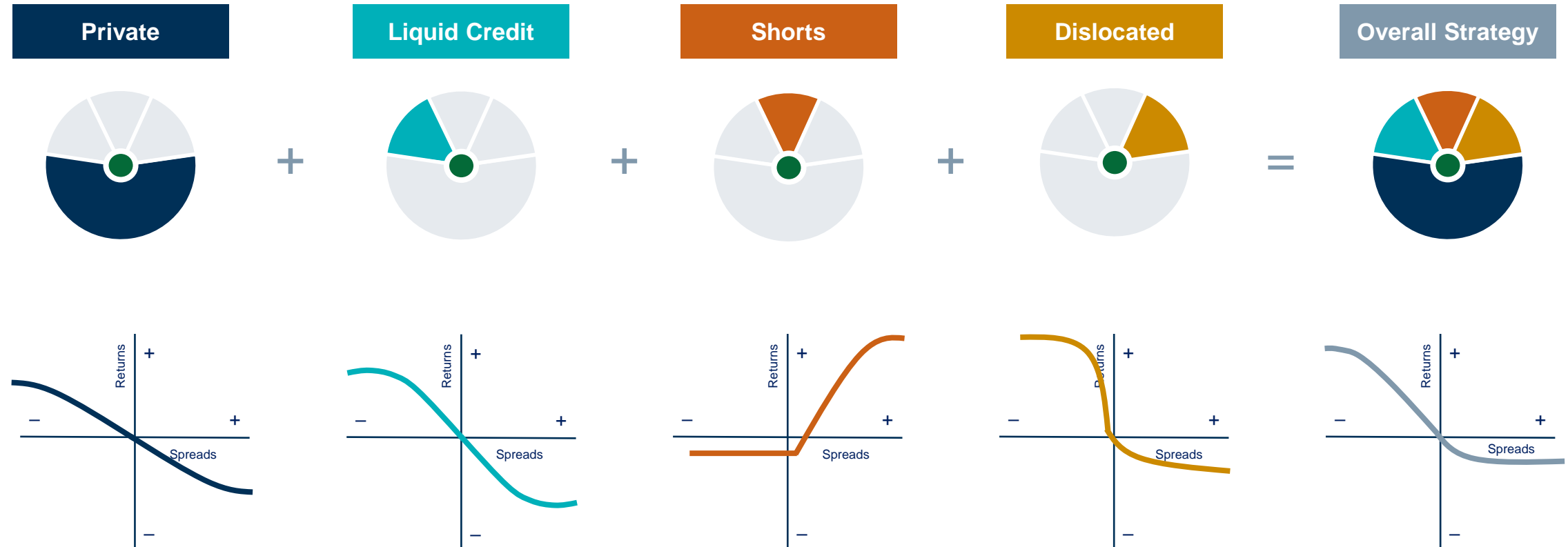
▶ Dislocated: opportunistically sourcing distressed or dislocated assets during a market sell off (liquid & illiquid)

- Potential to provide supernormal returns of 15-20%

Targets cannot be guaranteed.

Tailor Outcome with different pay-off profiles

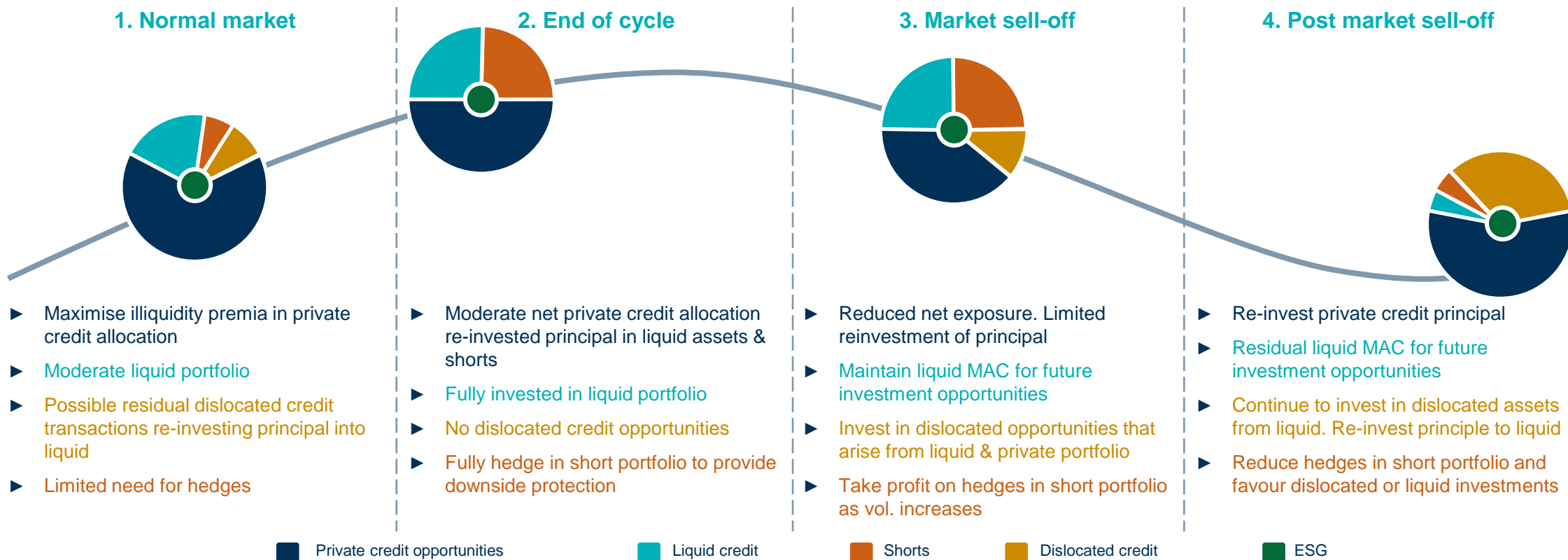
Align to mandate objectives and incorporating current risk appetite



For illustrative purposes only. Targets cannot be guaranteed.

Dynamic to time investments and manage risk

Allocation through the cycle as risk appetite and relative value change



For illustrative purposes only. To be measured over the market cycle. Targets cannot be guaranteed.

Offering sustainable Multi Asset Credit solutions

The different degrees of Sustainable Investing



3 = Integrated

- ▶ Conviction in the belief that ESG factors can have a material impact on financial performance
- ▶ Integrate ESG factors in the investment process/decisions
- ▶ Engage on ESG factors

▶ ***Comes as standard***

4 = Sustainable

- ▶ Equal priority to “returns to society” and “returns to the investor”
- ▶ UN SDGs are the reference to set company objectives and measure change
- ▶ The principal purpose of engagement is to effect positive change on the environment and on society
- ▶ Financial benefits are longer-term

5 = Impact

- ▶ Direct alignment between the purpose of product or service of a company/project and a societal benefit
- ▶ Positive change is clear, measurable, reportable
- ▶ Not exclusively, but more commonly financed with private capital

Suite of open-ended pooled Multi Asset Credit strategies

Offering three distinct investment outcomes

MAC Opportunity

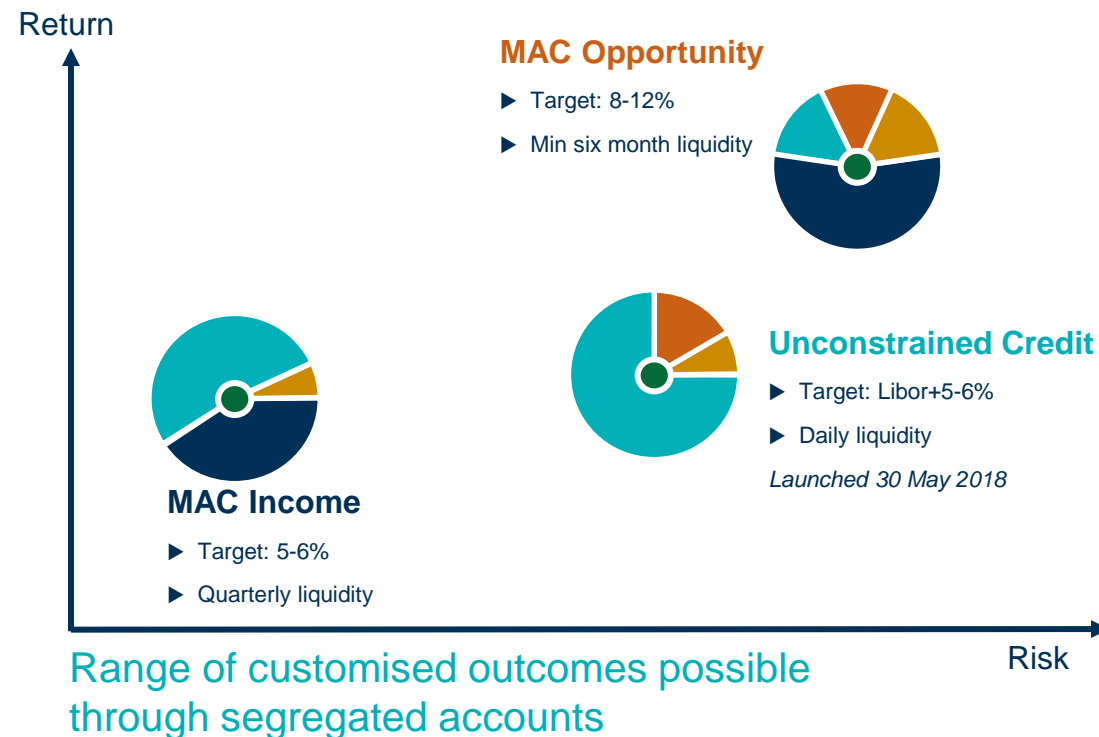
- ▶ Dynamic growth solution allocating across liquid and illiquid credit markets seeking high risk adjusted returns
- ▶ Seek esoteric opportunities where traditional lenders are restricted exploiting illiquidity, scarcity and complexity premia

Unconstrained Credit (Liquid MAC)

- ▶ Unconstrained, high-conviction investment across the global liquid-credit spectrum
- ▶ Optimal convexity and downside protection through options overlay

MAC Income (Secured Finance)

- ▶ Focus on secured cash flows targeting a high recovery on default – average IG rating, senior and/or secured
- ▶ Capture illiquidity, scarcity & complexity premia



■ Private credit opportunities
 ■ Liquid credit
 ■ Shorts
 ■ Dislocated credit
 ■ ESG

Targets cannot be guaranteed.

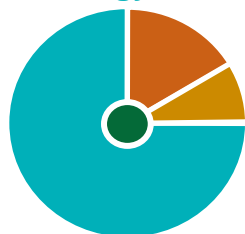
Hermes Unconstrained Credit UCITS Fund

Strategy overview

Performance target¹

USD LIBOR + 5%-6% through the cycle

Strategy description



- ▶ Unconstrained investing throughout the global liquid-credit spectrum
- ▶ Implementing top-down allocations to diverse credit sectors through bottom-up, high-conviction security selection
- ▶ Dynamic options overlay provides a defensive hedge and fulfils rebalancing and risk-management functions

Eligible investments

Developed and emerging market investment-grade and high-yield corporate bonds, credit-default swaps, loans, government securities, asset-backed securities, convertible bonds, preferred stocks, credit-index options, interest-rate instruments and other credit derivatives

Concentration²

Typically 100-150 issuers

Base currency

USD, hedged

Portfolio managers

Andrew Jackson and Fraser Lundie

Liquidity

Daily

Example share classes

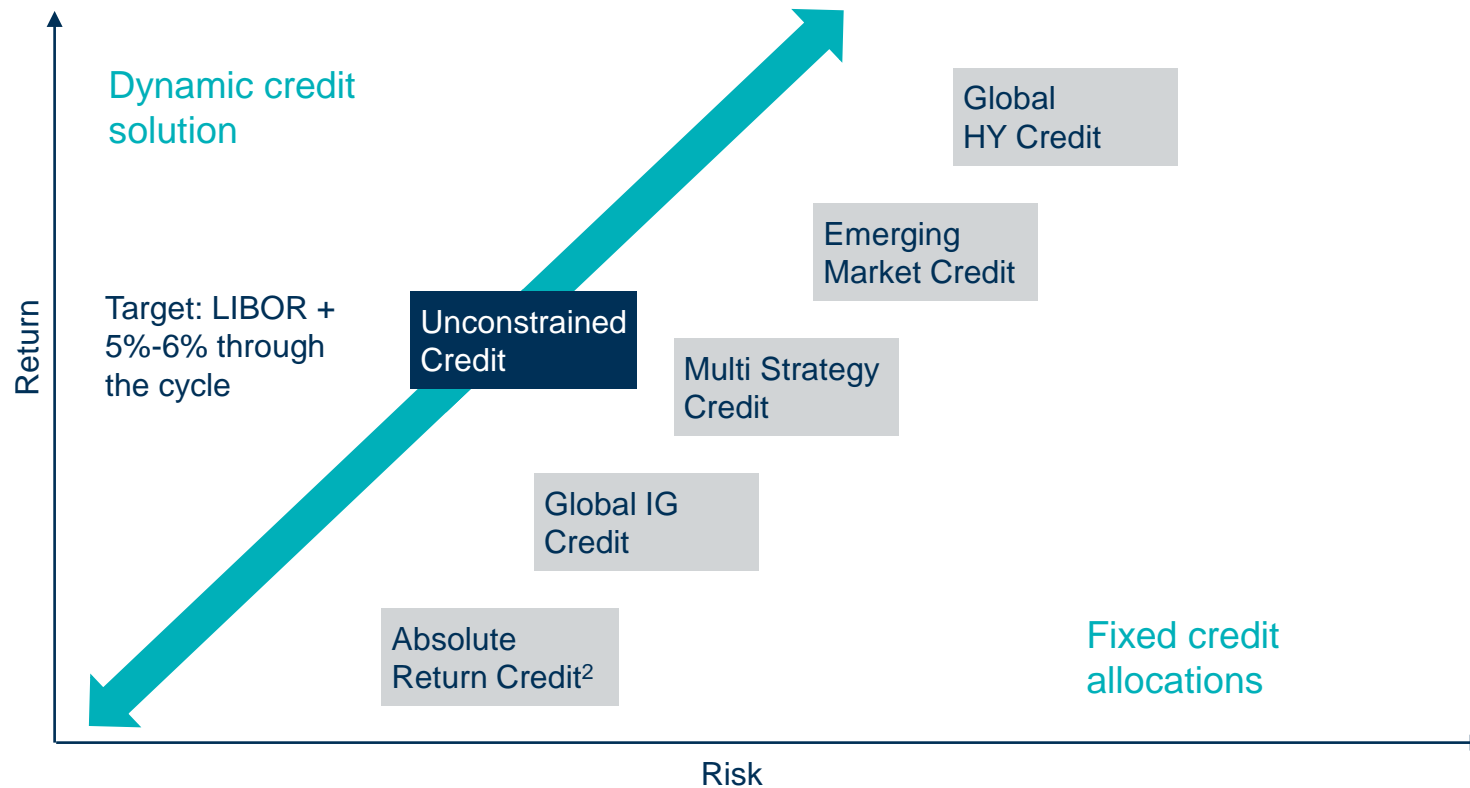
F EUR Hedged Accumulating class (ISIN: IE00BFB40W70)

■ Liquid credit ■ Shorts ■ Dislocated credit ■ ESG

¹ Targets cannot be guaranteed. ² These are internal guidelines for the team, and not absolute limits.

Hermes Unconstrained Credit Strategy

Dynamic credit allocation through the cycle



- ▶ A solution for investors seeking to outsource their full credit exposure, or enhance fixed allocations
- ▶ Asset allocation determined by skilled investors with diverse credit expertise
- ▶ Alpha generated through high-conviction, long-only credit selection
- ▶ Optimal convexity achieved by dynamic options overlay

Source: Hermes as at 31 December 2018. Targets cannot be guaranteed.



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Portfolio manager biographies



Andrew Jackson

Head of Fixed Income

Andrew joined Hermes in April 2017 as Head of Fixed Income. He is responsible for leading the strategic development of Hermes' credit and direct lending investment teams, and developing a multi-asset credit offering capable of accessing all areas of the global credit markets for pension funds and other long-term institutional investors.

Andrew joined from Cairn Capital, where he was Chief Investment Officer. In this role, Andrew was responsible for the development of the asset management business, which included designing new products and managing the investment teams, including strategy, portfolio management and research. He has managed assets across the spectrum of global credit and fixed income. He was previously vice president within the European credit structuring team at Bank of America and has held roles with Fitch Ratings and PricewaterhouseCoopers. Andrew holds a BSc degree in Mathematics & Theoretical Physics from Kings College London.



Fraser Lundie, CFA

Head of Credit

Fraser joined Hermes in February 2010 and is Co-Head of Credit and lead manager on the Hermes range of credit strategies. Prior to this he was at Fortis Investments, where he was responsible for European high yield credit. Fraser graduated from the University of Aberdeen with an MA (Hons) in Economics; he earned an MSc in Investment Analysis from the University of Stirling and is a CFA charterholder. In 2017, Fraser joined the board of CFA UK, a member society of the CFA Institute. Having previously featured in Financial News's '40 Under 40 Rising Stars of Asset Management', an editorial selection of the brightest up-and-coming men and women in the industry, in 2015 Fraser was named as one of the top 10 star fund managers of tomorrow by the *Daily Telegraph*. In 2016, *Citywire Americas* named Fraser number one in their global high yield manager review, and *InvestmentEurope* and *Investment Week* both named the Hermes Multi Strategy Credit Fund top global bond fund at their respective 2017 Fund Manager of the Year Awards.

As at 31 December 2018.

Business Development contact details



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Hermes Investment Management

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

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

Our investment solutions include:

Private markets

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

High active share equities

Asia, global emerging markets, Europe, US, global, small and mid-cap and impact

Credit

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

Stewardship

Active engagement, advocacy, intelligent voting and sustainable development

Offices

London | Denmark | Dublin | Frankfurt | New York | Singapore

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