

Ardea Global Alpha Fund: Article 8, Promoting Environment & Social Characteristics

Mark Pearce, Investment Director | September 2023

Overview

Since the European Union's Sustainable Finance Disclosure Regulation ("SFDR") came into force in March 2021, asset managers have been required to provide more information on the sustainability risks and impact of their investment products sold in the European Union. The level of disclosure depends on the sustainability objective of the products – specifically whether they are classified as Article 6, 8 or 9 under the SFDR.

- **Article 6** covers funds which do not integrate any kind of sustainability into the investment process,
- **Article 8** funds promote environmental or social characteristics within their investment process,
- **Article 9** funds have a bespoke and / or specific sustainable investment objective.

The **Ardea Global Alpha Fund** is classified as an Article 8 product under SFDR, which reflects the promotion of environmental considerations, in particular the development of the "green bond" market via engagement with (sovereign) green bond issuers, actively investing directly and indirectly in green bonds and by actively trading green bonds to facilitate increased market liquidity.

Our commitment to these objectives makes the Ardea Global Alpha Fund somewhat unique as one of only a small number of Article 8 funds focused on sovereign bond investing. This uniqueness reflects the perceived difficulty in

assessing ESG factors associated with government bond markets compared with credit (corporate bond) and equity market assets.

In response to limited literature on the management of ESG risks in advanced economy sovereign bond markets, Ardea is committed to conducting and promoting research that complements existing materials on equities, corporate bonds, and private assets. We have formalised research partnerships with academic institutions with the express goal of understanding how climate and transition risks impact sovereign bond markets.

Sustainability Objective

The Fund's sustainability objective is the development of the green bond market, which we believe will encourage sovereign issuers to increase green bond issuance and other market participants to invest. Our commitment to invest a minimum of 5% of fund assets in green bonds and (importantly) actively trade those bonds will increase both primary and secondary market depth, fostering an awareness of this market and bolstering the liquidity of green bonds. A lack of liquidity in this market is often quoted as the primary objection from investors who are reluctant to support this new and important segment of the bond market.

Ultimately, we hope to broaden the volume and scope of green bond issuance and hence the environmental projects that are funded in this manner.

ESG Integration in the Investment Process

Ardea adopts a 'Pure Relative Value' investment approach to generate alpha that identifies government bonds that are closely related and have similar underlying risk characteristics but are priced inconsistently with each other. An essential element of relative value investing approach is to isolate these positions from unwanted market risks, including those stemming from ESG-related factors, by using a wide range of risk management strategies which allows low volatility returns to be generated independent of broader market movements, including the level or direction of interest rates.

In prioritising ESG integration into our investment process, Ardea has focused on system-wide risks such as climate change and the financial sustainability of governments' fiscal burdens. Given the threat climate change poses to the global economy and the fast materialisation of transition risk, these risk factors are most likely to be material determinants of sovereign bond markets.

Whilst focusing on climate change and transition risks may convey an emphasis on the environment in our ESG integration, we remain cognisant of the potential flow-on social and governance impacts to underlying communities and the broader economy. Through our research, engagement and corporate activities, these important and interrelated factors are further considered.

We strongly advocate for engagement, in contrast to exclusion or divestment, to influence change and encourage long-term value creation.

ESG Engagement

We view engagement with stakeholders including clients, media, debt management offices, academia, and issuers as the most efficient and logical way to promote sustainable outcomes

generally, not just within our industry or asset class. Engagement also broadens the scope to include a wider discussion on ESG issues with the key entities that produce the supply of a large part of the fixed income universe, namely governments.

With an objective to promote the development of the green government bond market, Ardea regularly engages with all major government bond issuers across the markets it invests. This engagement is to:

- help sovereigns better understand the increasing ESG demands of investors,
- convey expectations and concerns on behalf of our clients,
- promote discussions between investors, sovereign issuers, and other stakeholders,
- increase the information provided to the market on ESG matters,
- extract ESG information important for our analysis, and
- encourage ESG data transparency.

Our goal is to further develop our participation in the issuance of different instrument types, currencies, and maturities with a skew towards market segments which need developing. This approach also extends to specific engagement with banks to promote secondary market turnover and liquidity in the global green government bond market.

We record and report on our participation in the primary market and our engagement activities with the issuers and banks (the engagement log). Our goal is to see an improvement year-on-year with respect to our overall engagement and our participation in under-developed green markets (and tenors), and to encourage banks to provide the liquidity needed to foster the development of a green bond market.

We believe that working closely with government agencies and issuers is the only way to successfully develop the (sovereign) green bond market in terms of structure and liquidity.

Measuring Success

The following factors will be considered in determining whether the Fund is attaining the environmental characteristics it promotes:

- i. Positive Screen: the first factor contributing to whether the Fund will be attaining the environmental characteristics it promotes will be an assessment of whether the Fund has successfully and consistently applied its positive screen in the relative value assessment of green bonds over traditional (sometimes referred to as 'brown') bonds which results in selecting green bonds in preference to comparable non-green bonds where the relative value is the same,
- ii. Increase in turnover of green bonds: the second factor contributing to whether the Fund will be attaining the environmental characteristics it promotes will be an assessment of whether the Fund has successfully and consistently increased the Fund's minimum per annum turnover in green bonds each calendar year as a percentage of the Net Asset Value of the Fund; and
- iii. Integration of sustainability risks: the third factor contributing to whether the Fund will be attaining the environmental characteristics it promotes will be through the performance of climate change scenario modelling of the investment universe.

ESG Collaboration

As a specialist investor in advanced economy sovereign bonds, it is critical that we collaborate across the industry to amplify our influence and impact. As such, we:

- support the Paris Agreement and its goals of limiting global warming to 1.5 degrees Celsius compared to industrial levels via economic and social transformation based on the best available science,
- are a signatory to the Global Investor Statement to Governments on Climate Change

More recently, Ardea has been an active participant in the Collaborative Sovereign Engagement on Climate Change, an investor led initiative to support governments to act on climate change.

In addition, we are active participants in the ASCOR Project and are part of the Asian working group. ASCOR (Assessing Sovereign Climate-related Opportunities and Risks) is the first publicly available, and open-source investor framework and database assessing the climate action and alignment of sovereign bond issuers. Finally, Ardea has met the expected standard of reporting to be listed as a signatory to the UK Stewardship code.

IMPORTANT INFORMATION

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