# UN Global Compact Communication on Progress (COP)

1. **Introduction:** Global Evolution is a signatory of the *United Nations Global Compact*, a strategic policy initiative for businesses committed to aligning their operations and strategies with ten principles in the areas of Human Rights, Labor, Environment and Anti-Corruption. The sections below state our continued support to:
   - the UN Global Compact;
   - the practical actions to implement the Global Compact principles;
   - our measurements of outcomes;
   - as well as how we are communicating and engaging with stakeholders on progress.

2. **Continued support to UN Global Compact:** Global Evolution is pleased to reaffirm our continued support for the UN Global Compact, and we hereby renew our ongoing commitment to the initiative and it's ten principles in the areas of Human Rights, Labour, Environment, and Anti-Corruption.

3. **Practical actions to implement the UN Global Compact principles:** Global Evolution has a strategic commitment to SRI and ESG Sustainability as an integrated part of our approach to investment. Practical actions and concrete processes over the last year to address ESG sustainability in our investment management approach include the following:

   a. **ESG rating simulation model:** Our ESG rating model has been integrated as part of our proprietary IT systems. The model simulates ratings for four themes of our ESG ratings: the Environmental theme, the Social theme, the Governance theme, as well as a Political theme, where the Political theme serves as a political overlay to the Governance component.

      The model has weights for the E, S, G, and P Themes which one can experiment with and assign 25% to each Theme if one decides on equal weighting of Themes. The same is the case for each ESG indicator where there are between 8 and 17 indicators for each Theme.

      The model is therefore a simulation tool with which we can experiemnt with various weights and indicators, and the model is also able to include whether a country has signed and implemented multilateral agreements across the E, S, G and P Themes. The model output provides a holistic overview of the country's ESG performance across Themes and Indicators, and provides us with an E rating, S rating, G rating and P rating, as well as the aggregate ESG rating.

      The method is highly innovative since the simulation model adopts at wide set of indicatorsd and performs the weighting and aggregate automatically base don our views. The model is implemented and in use by our investment management team, and adds significant value in our investment process.

   b. **ESG publications:** Over the past year we have publically published several reports in various media: for example, the World Bank has published our work on ESG dynamics in emerging markets and how that translates to spread dynamicd and returns in sovereign bonds (http://blogs.worldbank.org/governance/putting-price-governance-governance-and-sovereign-risk-resource-rich-emerging-markets).

      Another example is the World Bank sponsored Governance-blog on governance in emerging markets and the relation to natural resource revenues where countries governance performance may be affacted negatively to resource revenues and thus oil prices over that last year (http://goxi.org/profiles/blogs/governance-drives-returns-especially-in-commodity-dependent-count).

A third example is our publication in ESG-magazine.com an how to quantitatively integrate ESG factors in an investment process—a methodology assessed to be highly innovative and thus for general interest in the investment management community.

c. **Negative screening model**: Global Evolution operates with ESG screening from a negative screening perspective where some countries in the universe is excluded due to "ethical" reasons using the following indicators as benchmarks: Political rights; Civil liberties; Democracy; Failed state; and Corruption. Our sovereign SRI screening model, which is part of our proprietary systems, is applied for this purpose. The SRI model is quantitative in nature and serves as a Warning Model for exclusion and inclusion of countries.

d. **Valuation and Rating Model:** Global Evolution operates with two approaches to incorporating ESG factors into the investment process: The Negative screening (our SRI model), and the Positive screening. Global Evolution's ESG approach is systematic and integrated as part of our investment process; we call it an "ESG Overlay" to our investment process. SRI and ESG sustainability are integrated parts of our investment philosophy and investment process.

Global Evolution operates with a quantitative and systematic "ESG Overlay" – considering Environmental, Social and Governance factors. We find a strong business case for considering ESG dynamics as an integrated part of our investment process because ESG dynamics are highly correlated with spreads and returns—*consequently bridging responsible investing with returns!*

Our quantitative Valuation and Rating Model (VRM) estimates and assigns proprietary ESG ratings to countries. Based on such ESG dynamics, the VRM has the power to estimate signals for over/undervaluation for hard currency spreads. In addition, the VRM estimates proprietary credit ratings across countries which have been "ESG-adjusted" because it adds value in terms of the models forecasting power of future spreads. This ESG overlay generates valuable extra-financial information for the investment process.

The positive screening research takes two dimensions: The first involves the variable to be explained which is either the spread or total returns. Emerging markets spreads over US treasuries are examined for which ESG factors that may be related to its variation. In terms of returns, both hard currency and local currency dimension is included together with the FX component.

The second dimension of the research involves the variables that can explain variation in spreads or returns: Here we experiment over time with traditional macroeconomic variables but also E, S, and G indicators. The ESG ratings are proprietary to Global Evolution but estimated based on weighted averages of key E, S, and G indicators. The explanatory power of this model is extraordinarily high, with ALL explanatory variables being statistically significant. In terms of the positive screening, the E, S, and G dimensions are themselves weighted averages of indicators.

However, in our Valuation and Rating Model the weights are estimated using the appropriate econometric method in order to optimize the statistical significance and explanatory power of the model. These estimated weights are key to generating as high performance as possible. Therefore, ad hoc weighting criteria to indicators that deviate from what optimizes the model's forecasting power are generally not recommended in order to optimize returns and generate outperformance with the ESG information applied.

Consequently, this research area is important as an overlay to our investment process. This area of research is virtually non-existing in the literature on sovereign bonds in emerging markets, and we seem to be the only asset manager in the market doing rigorous and econometric research on ESG and bond performance in emerging markets—while being able to integrate our research findings systematically into our quant valuation models.

In terms of our key research findings, quantitative estimates for the following correlations are integrated into our quantitative Valuation and Rating Model (VRM):

i. ESG improvement that leads to spread tightening
ii. ESG improvement that leads to positive returns with only limited increase in volatility;
iii. ESG improvement that leads to credit rating upgrade;
iv. G (Governance) improvement that lead to bigger effect on GDP growth in EM vs. adv. economies

These findings are crucial to reflect as coefficients in our quantitative Valuation and Rating Model which explains a significant part of the variation in emerging markets spreads. We include such non-financial dynamics to enhance the explanatory power of the model for forecasting purposes.

In our view, this is a proper approach to really integrating ESG dynamics into an investment process—and not merely discussing the importance of ESG dynamics but actually modeling it and integration the dynamics in valuation models to the extent that ESG dynamics has explanatory power of the financial variables one is interested in. Such financial variables are yield sptreads and returns, and in emerging markets for sovereign bonds these are highly correlated with ESG dynamics, as our research clearly illustrates, which is why investors sacrifice substantial information if they do not integrate ESG data into valuation modeling—an econometric exercise that we believe we excell in performing.

With statistical significance, ESG improvements also lead to bigger increase in returns than in volatility, providing investors with higher risk-adjusted returns when they take ESG dynamics into account in their investment process. Our estimates illustrate the importance of integrating ESG factors into the investment process in order to secure higher *risk-adjusted returns*.

Our proprietary credit ratings are, as mentioned above, adjusted for political dynamics which is a central component in the "G" in ESG. In that sense, the credit ratings are ESG-adjusted in order to reflect how political developments and policies guide countries on a more sustainable development path.

Consequently, our credit ratings capture at a quarterly basis the directions countries are taking with regard to sustainable development. And this to a significantly more nuanced degree than traditional credit ratings that do not include political and policy dynamics which lead them to sacrifice important information on sustainable development that should guide creditworthiness and, thus, credit ratings.

e. **ESG Policy and Research Approach:** Our *Global Evolution ESG Approach* provides an over-arching perspective of our research approach to systematically integrate our ESG Policy in our investment process. It furthermore, more broadly, describes our ESG research ambitions and interaction with stakeholders.

Our broader *Global Evolution Research Programme* illustrates the interplay between our research and our investment process. The Research Programme includes various research projects including some on ESG dynamics, both from a quantitative and qualitative perspective and from a top-down perspective across emerging and frontier market countries and from a bottom-up country-specific perspective.

Our Global Evolution ESG Policy encapsulates our corporate commitment to ESG sustainability and SRI in the context of UN Global Compact. We find a strong business case for considering ESG dynamics as part of an investors investment process since ESG dynamics is highly correlated with returns—consequently *bridging SRI with returns*!

Global Evolution continues to enhance and develop its *ESG Research Program*. The research program and the ESG models incorporates variables to assess performance on each of the four areas; human rights, labour, environment, anti-corruption, which is why our models are all-encompassing in that sense and delivers a full-fledged approach to assing the environmental, social and governance parameters adhering under the ten principles.

4. **Measurement of outcomes**: Our ambition includes the development and incorporation into our investment process of proprietary ESG models, as well as instigating a complementary ESG Research Program to inform the investment process and ensure that best practice from investment cases will be extracted for ongoing screening and research purposes. These qualitive targets have succesfully been met within the timeframe we had defined in the context of our ESG Research Program which continuously incorporates lessons from market trends and developments.

   Our proprietary VRM model which incorporates ESG dynamics is interdependently linked to the ESG Research Program to continuously enhance the screening and investment process. The models and its output for investment decisions are proprietary in nature.

   Furthermore, in terms of our research on the causality between sovereign bond yields and ESG ratings, countries with higher ESG ratings perform dynamically better in terms of return on investment. This testifies to the important issue that funds incorporating ESG analysis in their investment decision making are likely to outperform traditional funds over time.

5. **Communicating and engaging with our stakeholders:** Our corporate communication is both internal to employees and board members as well as external to stakeholders such as clients and afiliated consultants as well as the media and other stakeholders.

   With our continued growth, we are increasingly aware of the role we play in the markets, economies and societies in which we practice. Our engagement with stakeholders on the ten principles and our proprietary apoproach to ESG modeling and country investment selection is consequently essential to our business operations.

   In client meetings, we continuously stress the significance of our dedication to the Global Compact principles reflected in our choice of ESG factors in our proprietary modeling. In addition, we experience that the interaction with our clients is also cross-directional since clients increasingly display this focus and seek discussions on these important issues.

   Consequently, our ESG deliberations and careful analysis as part of the investment processes will play a central role in our screening and portfolio allocations going forward.

Yours sincerely

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