UN Global Compact Communication on Progress (COP)

"it's not about growth; its about sustainable growth!"

Ole Hagen Jorgensen,

Research Director, Global Evolution

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.

Global Evolution has a strategic commitment to impact investment and ESG sustainability as an integrated part of our approach to investment. In terms of our ESG integration approach, we have incorporated ESG dynamics across our investment process through various proprietary quantitative econometric models. For the full universe of emerging and frontier market countries, we construct proprietary ESG ratings, ESG-adjusted credit ratings, as well as statistical valuation signals for sovereign credit spreads and currencies based on ESG dynamics. In all modesty, we consider ourselves as being at the forefront of ESG sovereign research and ESG sovereign investment integration. We continue to play an active role in the public domain through our ESG research agenda and our close collaboration with the World Bank, the UN, and other relevant stakeholders.

Financing the debt that provides macroeconomic sustainability and goes into promoting productivity, and raising infrastructure, such as electricity production, health, water, security, transport, and school systems, has a significant impact on reducing poverty levels. At Global Evolution, we have conducted extensive ground-breaking research into the relationship between sovereign debt investing and Environmental, Social, and Governance (ESG) indicators. There is a clear correlation between the sovereign funding costs and ESG dynamics, with governance, unsurprisingly, the most prevalent. By not integrating ESG dynamics into investment decisions, investors sacrifice essential information. Furthermore, through 25-30 country missions annually, we conduct extensive on-the-ground dialogue with policy makers discussing strategies to optimize their funding strategies to promote the swiftest and most sustainable economic development.

The importance of ESG considerations: At Global Evolution we recognize the importance of Environmental, Social and Governance (ESG) considerations for investors and advisors globally and continue to help our investors achieve their individual ESG goals. A strong, integrated, and active ESG approach has become a prerequisite for investment managers to operate in today's market, but certainly also an important selection criteria for many institutional investors. Through our significant quantitative research effort, we have found that there is a strong business case for considering ESG dynamics as part of the investment process. ESG dynamics are highly correlated with returns – consequently bridging ESG with returns! Global Evolution is an active signatory of UN Principles for Responsible Investment and UN Global Compact and continuously publishes research on the relevant subjects of ESG dynamics and investment process integration. Global Evolution is also appointed Chairman of the Board at the UNPRI Advisory Committee on Credit Ratings (ACCR) which actively takes ESG factors into account.

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 extended to focus on variables under direct government control. In this sense our proprietary ESG ratings are based on "policy" variables that simulatneously reflect our corporate values across the E, S, and G sustainability spetrum and are also under government control. The process for quarterly revision of our ESG ratings and sovereign screning process is updated accordingly.

Our proprietary ESG model is a simulation tool with which we can experiment with various weights and indicators. 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, and G rating, as well as the aggregate ESG rating. 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 the US-basede CIO Magazine has published a comprehensive note and cover story about our proprietary ESG Integration approach of E, S and G indicators into our valuation modeling: http://www.ai-ciodigital.com/ai-cio/april_2017?pg=36#pg36. Our website has been updated with the Impact Investing branding which reflects our values and approach to responsible investing with an aim to leaving a legacy of impact investing in Emerging and Frontier Markets. In partnership with our investors, we are committed to leaving a legacy of impact investing, which assists in the process of lifting nations out of poverty.

c. **Valuation and Rating Framework:** Global Evolution operates with two approaches to incorporating ESG factors into the investment process: The Negative screening (our ESG model), and the Positive screening. Global Evolution's ESG approach is systematic and integrated as part of our investment process. SRI and ESG sustainability are integrated parts of our investment philosophy and investment process. Our quantitative Valuation and Rating Framework (VRF) estimates and assigns Proprietary Credit Ratings to countries and it incorporate ESG dynamics. Partly based on ESG dynamics, the VRM has the power to estimate signals for over/undervaluation for hard currency spreads. The framework has been extended to include not only hard currency strategies but also local currency strategies by the launch of FX and Real Effective Exchange Rate models that partly depend on ESG dynamics. In addition, the VRM estimates proprietary credit ratings across countries which have been "ESG-adjusted" because it adds value in terms of the models explanatory power of future spreads and exchange rates. 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 spreads, exchange rates and 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 exchange rates: Here we experiment with traditional macroeconomic variables but also E, S, and G indicators. The ESG ratings are proprietary to Global Evolution but estimated based on key E, S, and G indicators. The explanatory power of these models are extraordinarily high, with all explanatory variables being statistically significant.

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 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 as a "marketing stunt" but actually modeling it and integrating 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 spreads, exchange rates, and total 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 excel 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*. Consequently, our credit ratings capture at a monthly 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.

d. **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 VRF 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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