Expectations, ESG materiality and manager selection challenges

In March, **Tell Media Group**, in cooperation with **Barings**, **T. Rowe Price** and **MFS Investment Management**, invited Nordic investors to discuss high yield investing. Tell Media Group founder Niklas Tell moderated the roundtable.

By: **Niklas Tell**

The discussion started out with Niklas Tell asking the participants why you should have a strategic exposure to high yield and what they expect from the asset class going forward.

ERIK BENNIKE: "For us, it's a strategic allocation as we think it will provide decent risk-adjusted returns for the long run. We run a defined contribution scheme with a life-cycle strategy, which allows us to allocate various parts of risk to different age cohorts. While young people can bear a lot of equity risk because they will have a long time to recoup potential losses, we think credit in general fits pretty well with the older members. We base that on the assumption that any potential losses would typically be recouped relatively fast. That has been the historical experience and I would think that probably will be the case in the future as well. We have, of course, been helped by falling interest rates for quite some years, so there might be a slightly longer wait until any potential losses might be recouped in the future. But with yields going up, which is the consequence of falling returns, then there's the mathematical truth that the coupons themselves would allow you to recoup losses if you just have patience."

KATRINE LINDBEKK: "The arguments from our side are fairly similar and we also think that high yield has attractive asset allocation benefits. Gjensidige is non-life insurance company and fixed income is a substantial part of our allocation mix. We see high yield as being slightly less sensitive to rate moves compared to our investment grade allocation, so it can be a good fit to have a strategic allocation to high yield in a diversified portfolio. From time to time, it might be more or less attractive and then we might add to or reduce our weightings. Yields are pretty low now in high yield by historical standards and spreads are not particularly high. I would say we're in a holding period of waiting and seeing."

JUSTIN GERBEREUX: "High yield is one of the only places to get income today. I think some 27 per cent of global fixed income has negative yields today and with the global high yield index, you get a current income of some 6 per cent. It's also a reasonably diversified asset class and roughly only 12 per cent of the asset class was affected by Covid. In terms of diversification for portfolios, it remains one of the higher Sharpe-ratio asset classes. In terms of drawdowns, the worst drawdown in the last 20 years for global high yield was 38 per cent, while it was around 80 per cent for global equities. So you do have some downside protection as well."

MIKE SKATRUD: "Not all high yield is created equal, however. Asset owners have options, for example when it comes to regional allocation. Our global high yield strategy includes the US, Europe as well as emerging markets. Some investors want the emerging market exposure and others don't. On top of that, you can move up and down the quality spectrum, so I think it's really about matching your strategy with the objectives of asset owners."

CHRIS SAWYER: "I would like to pick up on Katrine's point around where spreads are today versus historical levels. If you look at high yield today, you're not comparing apples for apples with high yield from 10 years ago. There has been a pretty big seismic shift in the composition of high yield over the last five or six years to better quality, bigger and more established companies. That, of course, gets reflected in spread levels, because your credit risk is reduced compared to the high yield market of the pre-Lehman era, where it was almost the market of last resort for a lot of borrowers. A spread of 350 bps today is not necessarily representative of a spread of 350 bps some 10 years ago."

NIKLAS TELL: MIKE, YOU MENTIONED DIFFERENT GEOGRAPHIES. WHERE DO YOU SEE THE BIGGEST OPPORTUNITIES TODAY – BOTH FROM A GEOGRAPHICAL POINT OF VIEW BUT ALSO WHEN IT COMES TO SECTORS?

MIKE SKATRUD: "In our global approach, we typically try as a first step to look at where spread levels are relative to each other by regions. At the moment, we feel that there's value in emerging markets for portfolios that can have that exposure. However, we need to be careful because emerging market is a higher beta version of high yield and it's important to not only have a good view on the idiosyncratic credit-specific risks but also a good view on the countries in which these companies operate. If we look at developed markets, we find somewhat better value in higher quality US credit at the moment. In terms of lower quality, we primarily find most low quality in the US with a higher percentage of triple C companies. I would, however, agree that the spread levels in aggregate are fairly compressed at this point. From a fundamental point of view, the combination of large fiscal and monetary stimulus as well as the vaccine progress does, however, create a reasonably supportive fundamental backdrop. But it's hard to argue that high yield in aggregate is a cheap asset class at this point. We're underweight compared to neutral in terms of risk."

JUSTIN GERBEREUX: "We're very overweight loans at this point in time and some 10 per cent of our portfolio positioning is within the loan asset class and that's sacrificing exposure to traditional double Bs. Another factor is duration, which is like a four-letter word as we've seen rates going up. But there are some really interesting upgrade stories where you have rising stars that are moving into investment grade. A name like Netflix, which has been a massive beneficiary of Covid-19 with increasing subscriptions, are now free cash-flow positive, which we didn't think would happen for some time. In companies like that, duration is your friend and you want to benefit from that rising star. So we're looking for some of those idiosyncratic opportunities where you can add a little bit duration and benefit in the long term."

CHRIS SAWYER: "I think over the more medium term, there won't be much difference between Europe and the US. I think the US is likely to get a quicker Covid recovery and maybe we will see better spread compression there in the short term, but rising rates have the potential to offset some of that from a total return perspective. However, as we move further forward, I think both markets are well positioned for spread compression, even from today's levels because defaults are likely to stay low for the foreseeable future. The defaults last year were lower than everybody expected them to be at the start of the pandemic and we all know the reasons why. It means that company cash positions coming into this year are significant and if we do get a period of Covid extension or a delayed vaccine rollout, companies are well positioned to deal with that. That means that the risks of defaults spiking are pretty low."

PARTICIPANTS

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KARSTEN MARZOLL
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Senior fund analyst at SEB in Sweden. He took on his current role in 2017 after spending more than 16 years as a portfolio manager at SEB in Luxembourg. He has previously worked at Geno-Volks-Bank Essen and Deutsche Bank.

NIKLAS TELL: AS INVESTORS, HOW MUCH DO YOU WANT TO DECIDE ON THE ALLOCATION TO HIGH YIELD YOURSELVES AND HOW MUCH OF THAT DECISION DO YOU OUTSOURCE TO EXTERNAL MANAGERS?

ERIK BENNIKE: "A few years ago, we had a global allocation to high yield but we actually changed that into regional allocations. It wasn't because we believe we're better at allocating between the different regions but it was more based on the fact that we found it pretty hard to believe that the best managers in the US would coincide with those in Europe. That was the first observation. The second observation, which I think was the most important one, was that pretty much no global high yield manager really understood emerging markets and we've seen over the years that it has pretty much always been a drag on relative performance. Looking at the current market, we're slightly underweight to both high yield and loans. While we have a steady flow into our scheme, the way we allocate to the asset class tends to be discretionary and for quite some months, we've felt that there should be a better entry point. That has obviously not materialised yet. Another observation is that every time investors ask for high yield ex-something, that's a good time to buy. We saw it during the global financial crisis when people wanted ex-finance and that's exactly what you should have bought. We saw it again during the oil crisis of 2016 when everybody wanted ex-energy and of course you should have bought energy at that point in time. Last year, it was triple C and that has performed really well."

NIKLAS TELL: WHAT ARE SOME OF THE MORE GENERAL CHALLENGES IN FINDING OR RESEARCHING HIGH YIELD MANAGERS FROM A SELECTION POINT OF VIEW?

KARSTEN MARZOLL: "I think the challenge is, of course, to identify those managers that can consistently deliver alpha versus the benchmark. That's a general challenge in fixed income and not only high yield. Therefore, it's also very relevant to compare them with the right peer group. That gives a more holistic picture of the work of an active manager. It seems that a lot of high yield managers like to hug the benchmark and take less active risk than is needed to achieve some alpha after costs. It's also a challenge when managers are not delivering on their investment process but suddenly do things differently."

NIKLAS TELL: DO YOU PREFER MANAGERS WITH CONCENTRATED PORTFOLIOS IN HIGH YIELD?

KARSTEN MARZOLL: "We actually prefer broader and more diversified portfolios when it comes to high yield. Both in terms of names but also in terms of regions and sectors. Another reason is liquidity, which is not what it used to be a decade ago. So even if a very good manager probably can deliver better alpha with a more concentrated portfolio, we prefer a more diversified strategy due to liquidity reasons. Bigger positions in a more concentrated portfolio might be harder to sell when needed in times of higher market volatility. That's a lesson we learnt last year and also during the global financial crisis."

KATRINE LINDBEKK: "We aim to have fairly diversified high yield portfolios in order to avoid idiosyncratic risks from individual names. When comparing managers, you must make sure you're comparing like with like because a lot of managers work with different opportunity sets. For example, some mandates will include other asset classes, like loans. In terms of exposure, we like fairly pure strategies and then perform the allocation between asset classes ourselves. I agree that it's difficult to find managers that outperform over time. Managers often have a beta that's slightly lower than the index and therefore it's hard to beat the index over time. We attempt to find a suitable peer group to compare managers across. But it seems that the index itself is quite a hard one to beat."

JUSTIN GERBEREUX: "We were looking at our historical excess return budgets and wanted to understand what sort of return budget you would need to consistently beat the index. When we put the index in the peer group, the return of the index minus ten basis points would get you into the top quartile. So that basically shows that the index is consistently a top quartile performer. That, of course, implies instant liquidity, no trading cost and being fully funded on new issue allocation etc. So I do think that like for like comparison is really important because the benchmark has consistently been the best performer historically and is not replicable."

NIKLAS TELL: IF IT'S DIFFICULT TO FIND MANAGERS THAT CONSISTENTLY DO WELL, DO YOU AS INVESTORS NEED TO SWITCH MANAGERS OFTEN OR DO YOU NEED TO ACCEPT THAT THEY WILL HAVE YEARS THAT MIGHT NOT BE AS GOOD?

ERIK BENNIKE: "I think this is just the nature of the market and it's a fact that we have to live with. Switching around probably won't do you any good and it will just exacerbate the costs. We're not a fan of that strategy. If we hire somebody, we tend to give them a fair chance to prove themselves and that's a minimum of three years. Things can, of course, happen but I don't recall any situations where we've actually terminated a mandate before that time period. You need patience with the alpha generation capabilities and there's also a build-up period for a portfolio, especially if the manager doesn't have a very liquid strategy where alpha is generated by sector bets or macro views but more of a traditional bottom-up strategy. Then, we're not only talking about issuers but also issues. Also, when we talk about bad relative performance, I think that's often more about the benchmark than the managers. Every time we do evaluations, say for the annual review or semi-annual review when we present material to the board, we present benchmark returns but also ETF returns. I think everybody that looks at this from either a layman's perspective or a board member's perspective would think of the index as something you can replicate with pretty much no cost. And that's true about the S&P 500 but it's not true about global high yield or even US high yield. That's why it's important to stress that managers should ideally be measured either against the peer group, which is fair if you can find a suitable peer group, or maybe an investable alternative like an ETF."

NIKLAS TELL: FROM AN ASSET MANAGER POINT OF VIEW, WOULD YOU SAY THERE ARE AREAS THAT INVESTORS SHOULD FOCUS MORE ON WHEN EVALUATING HIGH YIELD MANAGERS?

CHRIS SAWYER: "I think Erik makes a really good point. I think a lot of people really do view the index as something that can be replicated and I don't think they've ever actually taken a good look at ETF performance, which is a reflection of what's actually investable within the high yield space. There was a debate a couple of years ago between active and passive management, assuming that what was happening in the equity space could be applied onto the high yield space, and that just isn't possible. Also, what Erik didn't say but alluded to is that the ETF performance is in the bottom quartile for the most part within the high yield space."

JUSTIN GERBEREUX: "One of the metrics that I like to look at is the quality of the returns. So thinking about the Sharpe-ratio of the returns and also maybe upside and downside capture. As this is an asymmetric risk asset class, it's also interesting to look at avoidance of issues. Everyone's going to make a mistake but it's interesting to see if a manager is able to avoid defaults and big mistakes. These are things that I think can speak to the quality of performance over time and it really is about measuring it over a cycle. I think we've all talked about liquidity issues and Erik is right that you need to give managers a certain runway to allow their process to work."

KATRINE LINDBEKK: "I think what Justin just mentioned about upside and downside capture is a good way to understand the style of a manager. For us, it's also important to see that there's no style drift over time. If we have a manager that we know is a low beta manager but then suddenly underperforms in a falling market, that's something that would trigger a conversation. The depth of the credit analysis team of the manager is also important to us when we select a manager. We will sit down with the credit analysts to understand their experience and to talk through some of the more contentious high yield stories: were they exposed to the company and how did they act when they became aware of a situation? It's more qualitative but important to keep in mind."

MIKE SKATRUD: "I think it's important that we as asset managers do what we say we're going to do and that we acknowledge that not every approach to high yield fits every asset owner. I think all the metrics that have been mentioned can help characterise an investment process so that once a mandate starts, there's really a good understanding from the asset owner perspective. If we're in a market backdrop of X, we would expect this high yield strategy to deliver Y type of performance and I think as managers, we need to be held accountable to that. To the extent certain styles of high yield management may outperform or underperform at various times in the credit cycle, we also need to understand how that performance stream stacks up and the debate of benchmark versus ETFs versus competitors is a good one. But we also need to think about whether what we said we would do is reflected, at least directionally, in the performance numbers."

NIKLAS TELL: IS THERE ANYTHING SPECIFIC IN THE ESG ANALYSIS THAT IS PARTICULARLY IMPORTANT WHEN IT COMES TO HIGH YIELD?

KATRINE LINDBEKK: "I think it's fair to say that we're at an early stage of doing ESG analysis in the high yield market but it's definitely a key area that we will be focusing on going forward. Of course, governance has always been high on the

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priority list for high yield managers as these are highly leveraged companies and I would expect active high yield managers to be highly involved in the governance of the companies they're invested in. However, when it comes to environmental and sustainability issues, I think investors and managers should work together to improve our diligence standards going forward. There are also some transparency issues in this area as a lot of ESG data is only available for listed companies and not all high yield companies are listed. Going forward, this is an area that we will increase our attention on but for now, I would say that equities have probably come a bit further along the ESG road."

NIKLAS TELL: KARSTEN, YOU DO A SEPARATE ESG RATING ON MANAGERS AS PART OF YOUR MANAGER RESEARCH PROCESS. CAN YOU APPLY THE STANDARD APPROACH ON HIGH YIELD OR DO YOU HAVE TO TWEAK AND LOOK AT SPECIFIC THINGS?

KARSTEN MARZOLL: "We have an established process that we apply when evaluating all external managers across all asset classes. That said, we of course take into consideration the fact that there are different challenges and obstacles in different asset classes. I agree with Katrine that disclosure of information is one challenge that's very specific to high yield as most of the companies are small or unlisted. We have, however, seen improvements in this area over the last couple of years, which is positive. A second challenge is a general lack of focus on all aspects of ESG. As Katrine mentioned, managers have always focused on the governance side but not so much on the 'E' and the 'S'. Different sectors have typically different ESG areas to focus on and hence, a manager or an analyst needs to understand the specifics when analysing an issuer. Furthermore, the manager should use several available sources to get a holistic ESG view of a company. We want to understand every manager and how they view the ESG challenges and opportunities for each individual company in their portfolio."

ERIK BENNIKE: "I would very much second what has already been said and re-iterate that data is quite a big challenge in this space. I think this is also a place where asset managers can play a role by applying some sort of pressure on data providers and maybe even on companies to provide the necessary data. Another area where managers could help us in this journey would be by increased reporting. It doesn't have to be very complicated to start with. If we would get an ESG rating distribution, it would be a start. I know it probably would have a coverage of some 30 per cent but at least it's a start. Then, it's also obvious that there's a data problem and that in turn would be an incentive to actually getting that fixed. Another important area for us right now is carbon emissions, where we would love to have more information. We need to publish the carbon footprint of our corporate bond portfolios in our annual report and right now we to a certain extent have to resort to sector averages and that's just a very rough measure. We're pushing for this but we would very much like to share the burden of getting more data with some of the managers we work with."

JUSTIN GERBEREUX: "I think this is the beginning of a very important journey that's occurring in our asset class. We don't think about ESG in terms of a specific asset class but rather in terms of companies and sectors and how we use that insight in our broader fundamental research. We take a combination of a qualitative and quantitative approach. We've set up a standalone responsible investing team and we use the data providers that are out there but there's no simple way to attack this. We have one provider that's covering 90 000 companies and uses AI tools to scrape data to be able to try and find some of this. Then, it's about using individual responsible investing analysts to cover these sectors alongside our traditional fundamental analyst. There's not one simple silver bullet solution. It's difficult, the data is hard to source and you just need to find a lot of different ways to tackle it."

CHRIS SAWYER: "I certainly agree that the biggest data issue is with unlisted companies. Also, those unlisted companies are for the most part owned by private equity, which is something we haven't touched on. We, and I'm sure the other managers on this call as well, sit on various industry bodies in both the US and in Europe and try to lobby these companies to improve data disclosure. Not just directly to the companies themselves but also to their owners, which are the likes of Carlyle, Blackstone, CVC etc. It's a slow process but it's getting traction. For example, the European Leveraged Finance Association recently held a dedicated ESG conference with a lot of players presenting and talking about how they're addressing these issues. We've also seen some of the private equity managers disclosing their own ESG principles and talking about how they're imposing those on their portfolio companies. As we go through this process, it will lead to better data disclosure, which will lead to better monitoring. But it's something that can't happen quick enough. While we're able to carbon score our portfolios today, there's still a high proportion that's done off implied emissions and it would be great to reduce that."

MIKE SKATRUD: "We've been approaching this with a three-step process where the first step is identifying ESG factors, the second step is to determine whether they're material to the credit profile and then the third step is to assess the valuation, incorporating not only the ESG factors but all the relevant factors. Lack of data is certainly an issue in that first factor identification phase but then the second step of materiality is really important. This is where we ask if this is going to affect the company's ability to pay us back. To the extent there are issues of materiality, or there are issues that could be material, this is where we have an opportunity to engage with the companies. We can leverage relationships for listed companies with our equity colleagues and share meetings and push for more transparency and better business practices. Obviously, for the private companies where our analysts have good relationships with the management teams, there's a dialog and we can continue to encourage better disclosure. And then the evaluation piece is important as well. It's not always ESG risks but rather ESG opportunities. We've had a number of situations where our research team has flagged that this is a company that actually seems like it's on the path of making progress, say in an environmental factor. Also, when we've looked at the distribution of our holdings by third-party ratings, to the extent they're available, what we see is that ESG ratings at the moment tend to be a proxy for quality. And in the long run, we would expect the market to differentiate between higher quality and lower quality companies. To the extent ESG inputs can help us in that, it's so much the better."

JUSTIN GERBEREUX: "We've seen a trend recently where we're moving from green bonds to sustainability-linked bonds. One recent issue was an eight-year bond that was callable in year three and it had various sustainability KPIs that needed to be reached by year five or there would be a coupon step up. So we're beginning to see this ESG trend becoming part of structures and while I understand that we're in the infancy of this, some companies may be taking advantage of the demand for ESG. I think it's important that both managers as well as investors have a united front to ensure we're being compensated if companies are not reaching those KPIs and that companies are obliged to actually having to reach those KPIs before they can refund the money."

CHRIS SAWYER: "I think that's a good point and we've certainly seen it bleed into the loan market as well. There has been a bunch of deals done in Europe recently with sustainability-linked ratchets where if they were to hit certain targets, which could be a diversity target for the board of directors for example, the margin goes down and if they don't hit them, the margin goes up. The one bit of scepticism for us is that it's based on internal measurements and there's no quality control. You have to take the management team's word for it and if it's in the company's economic interests to hit a target, I'm sure there's a way to calculate something slightly differently in order to get over that threshold. It's a good idea but we would like to see a third-party audit to make sure that these measures are being used and done in the right way."

KATRINE LINDBEKK: "I agree very much with what has been said. It's a new market and we do need standardisation and some kind of third-party measures to make this a bit more transparent and a more professional market."

ERIK BENNIKE: "I think to some extent, I actually prefer the old standards of green bonds, sustainability bonds and social bonds, because these are 'use of proceeds' bonds rather than sustainability-linked bonds. There's, of course, a certain amount of subjectivity for all of these and if you're not comfortable with them, then you're probably not comfortable with the company in the first place. What I think is more interesting and important with the development of these new bond concepts is around signalling, because it's a little bit cumbersome. Not only to issue them but you also typically will need some kind of a committee that reviews projects and you would need more reporting than you otherwise would. So I think the commitment to actually go down this road and make the effort to issue these types of bonds is probably what matters more than whichever measure is being used. The only thing about the measures in the sustainability-linked bonds are whether they're ambitious enough. I think one of my favourites was one just issued a few weeks ago with a company that had as its only KPI that its MSCI ratings shouldn't go below a certain threshold level. And the rating threshold was what it already was at today, so that doesn't seem like a very ambitious strategy from an ESG point of view. So I think the problem with sustainability-linked bonds in comparison to the 'use of proceeds' bonds is that you need to be a lot more thorough when you go through them. What are the KPIs and are they ambitious enough or is this just trying to tap into a market to have another 10 per cent of available investors that can buy the bonds?"

MIKE SKATRUD: "I think we're in the early days of a very long game in terms of how capital is allocated or not allocated to different enterprises. We've talked a lot about our roles as asset managers and asset owners but another player in that mix are the intermediaries: the investment banks. We've seen banks shy away from industries that don't score as well in terms of ESG metrics, such as private prisons in the US. The energy sector is another where there obviously are environmental concerns and that's currently a huge source of revenue for the intermediaries. I think over time we'll carry into a broader discussion of who gets capital and who doesn't."

NIKLAS TELL: WHAT'S KEEPING YOU AWAKE AT NIGHT AS FUND MANAGERS IN THIS SPACE – OR WHAT KEEPS YOU BUSY WHILE IN THE OFFICE? ARE THERE ANY DARK CLOUDS THAT YOU KEEP AN EYE ON?

MIKE SKATRUD: "There are the known risks and then there are the unknown risks and in some ways, I think the worries are what we don't know. However, I think we all agree that the near-term fundamentals look ok given all the stimulus out there and the progress we're making to reduce the Covid threat. But the reality is that there certainly has been quite a bit of debt incurred by various governments and there's the potential for asset bubbles. Longer term, we're just going to have to see how that plays out. In the near term, the focus on underlying rates is consistent with what we see investors doing in the early stages of an economic recovery – trying to sniff out any inflation and wondering if that's going to derail things. We've seen a lot of investors rotate out of longer dated investment grade corporates into high yield based on the fact that there's a bit more of a spread cushion there. To date, that has actually played out reasonably well with the first uptick in rates. The question going forward will be what happens if we have another 50 basis point increase in US treasuries. Will the high yield asset class be able to cushion that type of rate increase? The answer is probably not. I think there's certainly a probability of negative total returns in longer duration parts of high yield but to the extent the credit outlook is generally favourable, it should be a self-correcting mechanism. If we do get higher rates and higher yields, that should attract some interest at some point and we probably revert back to a reasonable equilibrium. Because again, the fundamental backdrop is not bad at the moment."

NIKLAS TELL: YOU MENTIONED HIDDEN RISKS, WHICH BY DEFINITION ARE UNKNOWN, BUT WHAT COULD SOME OF THESE RISKS BE?

MIKE SKATRUD: "I think there's always the potential for geopolitical risk in various parts of the world and we also see glimpses here and there of reverse factoring and off balance sheet liabilities. There are little signs here and there that not every part of the market is healthy. Also, if you go back to last year, we saw some dysfunction in the treasury market and if it were to become dislocated in unexpected ways, that would certainly create more of a risk-off posture."

CHRIS SAWYER: "There has been a lot of focus around interest rates so far this year and more so in the US than Europe. What people forget is that high yield is a quite short duration asset class – it's sub five years on average – and high yield actually performs pretty well in a rising rate environment. Yes, you get the initial sell off as the inflation phase comes in but inflation is coming because the economic conditions are improving and you shouldn't forget that the main risk you're running in high yield is credit risk. If economic conditions are improving, the conditions for the companies you're lending money to are improving and spreads are going to compress. We've seen it time and time again. I do think you will see spread compression coming through. It just might be a little bit jumpy along the way."

JUSTIN GERBEREUX: "Firstly, I completely agree with Chris. We were looking at the 11 months where the blended treasuries lost more than 1 per cent and in nine of those 11 months, high yield had positive returns of about 50 basis points. However, when an unknown risk appears and people want to allocate away from high yield, the technicals in this asset class are brutal and we'll definitely see an overshooting on spreads. I think that's fantastic because it provides a wonderful buying opportunity but if you're liquidating, it's really hard to buy at the same time. So I think technicals are what really makes me worried, especially as we're all sort of having the same view on what's attractive within high yield and why."

ERIK BENNIKE: "My problem is that I've been worried about inflation for so many years that it's difficult to tell that story to my colleagues again. But I'm an economist by training and looking at the combination of monetary policy and the fiscal policy and the fact that it's a global phenomenon does make me a little bit worried about inflation. Especially because everybody got caught up in the story of the 'new normal' and it seems that it has been accepted as a fact. I think that's also why people are talking about 2 per cent as the ceiling and again, as an economist, if we're going back to the old, 2 per cent is not normally the ceiling. There's a long way to go and the only question is how fast we're going to get there and that's also what's going to determine the volatility of financial markets for years to come."

KARSTEN MARZOLL: "Inflation is, of course, one important part of the discussion but it's not the only one. From my point of view, what could be a challenge is if interest rates and inflation rise too fast. We've discussed that high interest rates and high inflation also means the economy is doing well, which should be good for the companies. That's probably true for most business models, as long as this increase of interest rates is not too dynamic. But there could be business models, which have been built on very low interest rates or zero interest rates, that would have problems – especially within high yield."

MIKE SKATRUD: "I would like to hear from our selector participants what they've seen that they like and what they've seen that they don't like when they perform ESG due diligence on managers.

KARSTEN MARZOLL: "What we're seeing at the moment is that we're back to where we started some 10 years ago with many managers focusing on exclusions and only investing in the best-in-class companies. That's fine but we would rather see managers taking a more holistic view and also look at companies that are in transition or are improving from an ESG perspective. Making these laggards net-zero or low emission companies would have the biggest positive impact for our environment, so they need support on their transition journey. However, there's a trend towards green financing and companies issuing debt with KPIs and covenants linked to their sustainability progress. It's likely that we will see much more of that also within high yield. So we would like managers not only to focus on the risk side of ESG but also to see opportunities from investing in companies that are improving."

NIKLAS TELL: MANY INVESTORS WANT TO LOWER THE CO2 FOOTPRINT OF THE PORTFOLIO BUT IT DOESN'T HELP THE WORLD IF EVERYONE JUST INVESTS IN NETFLIX AND NOT IN CEMENT OR IN STEEL MANUFACTURERS, WHICH ARE BUSINESSES WE NEED AS WELL. HOW DO YOU BALANCE THAT?

ERIK BENNIKE: "That's a very good question and we're struggling with that part of the equation a lot. Fundamentally, we like the idea that to change the world, you need to engage with the companies. You would need to invest in companies that are on the right trajectory but might not be perfect from the beginning. On the other hand, there are external expectations for our portfolio to look better than the benchmarks or the rest of the market when it comes to CO2, for example, and those two interests can be conflicting from time to time. They don't have to be but they can be and I don't really have the answer to that. When it comes to asset managers, I would say that we've moved away from just ticking a couple of boxes in an RFP. That was ok a couple of years ago but we've definitely moved beyond that now. Asset managers need to see ESG as an opportunity and reporting is an important first step because it's hard to do something if you don't know what you're already doing today. It could probably be summarised into a one pager for your portfolio. It would send a great signal to potential investors that you're mindful of this, taking it seriously and actually spending resources to do the calculations and show them to potential and existing investors."

JUSTIN GERBEREUX: "I would agree with what everyone has said and that this provides us with a unique opportunity. As managers, we can't just look at the best actors but also those that are being forced to improve or are trying to go down the improvement road and work alongside them and focus on our investment thesis. It's not just about investing in green bonds or sustainability-linked bonds. It's about finding companies that want to get onto that path and then help them along the journey. Portfolios cannot be built just on zero carbon footprint companies. You're going to have to find the ones that are providing us with targets to improve and keep them beholden to those targets over time."