ESG *investment* methodology

How we consider ESG risks in our investment processes

Artemis Funds (Lux) Global High Yield Bond
Artemis Fund (Lux) Short-Dated Global High Yield Bond

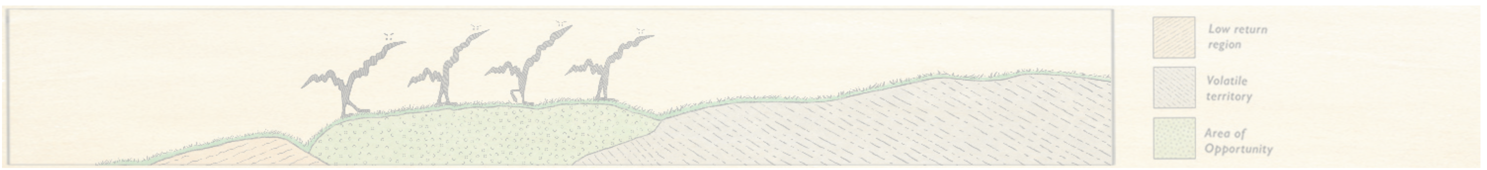
Our approach

The Artemis Global High Yield investment team seeks to integrate fully the assessment of ESG risks into its investment process.

- **Traditional metrics are not enough:** as credit managers, we do not believe that assessment of 'traditional' metrics such as cash flow, leverage, growth, and competitive analysis can be considered complete without examining the overall risks to the assumptions made when generating forecasts or assessing a business model.
- **ESG factors are vital:** we assess ESG factors because they are vital to our credit process, not as an adjunct to it.
- **Fixed income is different to equities:** Fixed income – and high yield in particular, owing to its shorter maturity profile – differs from equities in a number of key areas that, in turn, impact how we integrate ESG considerations, including:

Corporate bonds have a fixed maturity	We do not use this to absolve us from considering long-term impacts beyond a bond's maturity, but it does allow us to take focused exposure to positive change
Bond investors are lenders, not owners, of capital	We have limited scope for engagement with management other than not investing
Corporate bonds have constrained upside but unlimited (i.e. 100%) downside	Our analysis is focussed on aiming to protect capital and as such the impact on cash flows and business models from ESG risks are crucial
Corporate bonds (particularly high yield) are often issued by smaller and/or privately owned firms with limited reporting capacity and lacking in external research coverage.	We rely on our own assessment of ESG risks. External research is useful, but only in the context of wider analysis.

Artemis
The Profit Hunter



Credit and ESG analysis

The funds promote environmental and social characteristics within the meaning of Article 8 of SFDR[1] .

Stage 1: Exclusion lists

We maintain exclusion lists where we believe there is a fundamental ESG-related concern that cannot be mitigated or reconciled.

In our initial analysis of a potential investment, we ensure that the company issuing the bond is not involved in the following activities[2]:

- Tobacco production >5% revenues
- Nuclear power and its supply chain >5% revenues
- Weapons:
    - Any involvement in controversial weapons (nuclear, biological or chemical, cluster, landmines)
    - production of conventional weapons (including firearms), related components and systems >5% revenues
- Fossil fuels:
    - Thermal coal power generation >10% revenues
    - Thermal coal mining >5% revenues
    - Shale oil, oil sands, arctic oil drilling >5% revenues
    - Companies we determine to be in breach of the UN Global Compact principles on human rights, labour rights, the environment and anti-corruption

We do not consider the above-listed items to be the only areas of concern from an ESG perspective. Our stock-specific analysis assesses if there are other potential issues that might preclude investment by the funds.

Stage 2: Fundamental credit analysis

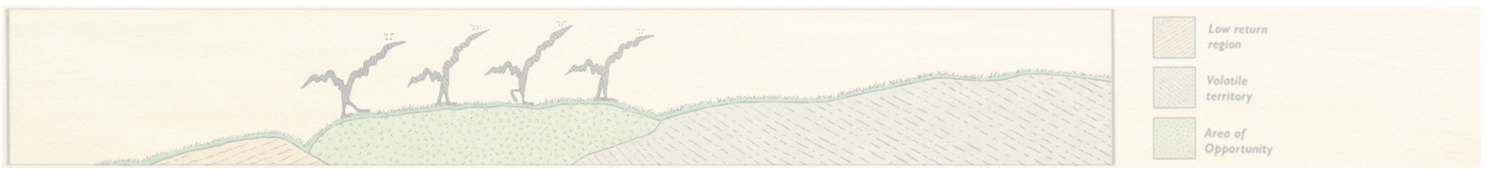
For potential investments that clear this initial screen, the investment team undertakes fundamental credit analysis.

- We produce a financial summary/model of the business with commentary for discussion by the wider team.
- We consider ESG risks alongside 'traditional' financial, covenant and transaction analysis; a non-exhaustive listing of universal and industry-specific areas of risk/focus is included below.

We do not believe a standardised or fully-automated approach to ESG analysis results in effective management of ESG risks within a high-yield portfolio. This is due to the often superficial and backward-looking nature of external research itself, as well as incomplete coverage of the high yield market by external ESG ratings services[3].

Bottom-up analysis	Only by conducting our own bottom-up analysis, tailored to the individual characteristics of each security, can we effectively incorporate ESG into our investment process. We primarily use external research to flag potential issues for areas of further investigation and efficiently gather objective ESG-related data from issuers.
New issues	We use information disclosed in the offering memorandum (usually the point of maximum disclosure) as well as external information and ratings when available. When disclosures are limited, such as when the issuer is small and subject to a leveraged buy-out by a private equity (PE) firm, we examine the credentials of the sponsor firm. We do this as 1) assessing both historic ESG reporting and performance is of limited use given change in ownership and strategy and 2) PE firm disclosures are normally better and more instructive as to the future ESG risk profile of the potential investment.

[1] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector ('SFDR').
[2] Please see the Investment Policy of the Funds for full definition and thresholds for company exclusions
[3] MSCI coverage of 70% and 84% of the Artemis Global High Yield Bond Fund and our Index, respectively. Sustainalytics: 64% and 82%. Data as at 31/07/2021.



Climate change risk

Climate risk, while clearly part of any ESG process, deserves separate consideration as it affects all businesses in some way:

- Either, operations that are directly impacted by climate change
- Or, at risk from increased regulation, customer preference, or other changes in response to climate change

Our analysis focuses on the latter for the simple reason that with a benchmark weighted average maturity of just six years, the long term impact of climate change is unlikely to directly impact a company more than can be currently observed.

- **Societal response:** this is not to say we are unconcerned about the consequences of climate change that will arise long after the bonds are repaid. Rather, we focus on the societal response to climate change as this is the area our process and horizon can, in some small way, influence. Claiming to focus on long-term impacts would in practice 'allow' us to disregard them as they would perpetually be outside the scope of our maturity range.
- **A focus on income-generating businesses:** we rely on businesses being able to generate income and use it to service their bonds. If this is threatened by regulation or any other restrictions, this is a significant risk to our investment case.
- **Regulatory backdrop:** in addition, in most instances corporate debt is refinanced by further debt issuance, so we need to take into account what perceptions and the regulatory backdrop may be like in the near future.
- **Carbon emissions:** we therefore factor-in carbon emissions (both scope 1 and 2 and, when suitable, scope 3) when considering investment opportunities, and favour businesses with low, or reducing, carbon intensity. At a portfolio level, we aim at all times to have the funds' carbon intensity (as measured by scope 1 and 2[4] emissions) to be lower than that of the wider index[5].

Portfolio maintenance

The investment team meets monthly with Artemis' Stewardship team, who provide oversight and deeper analysis and reporting on the portfolio.

- Drivers of changes: a key part of this process is investigating the drivers of changes to external ratings and shifts in momentum, as well as providing points for further investigation.
- Sentiment: we also use TruValue Labs' AI-powered tool to monitor changes in sentiment in global news flow on the portfolios' holdings, which otherwise may be missed by the fund managers.
- Integrated reporting: Our Stewardship team works with our Investment Risk and Oversight function to provide fully-integrated reporting which encompasses traditional financial risk metrics with ESG scores, momentum, and portfolio carbon intensity. This allows us to monitor our ESG risk exposures on an ongoing basis and not just at the time of initial investment so as to ensure compliance with our stated aims.

[4] Scope 1: Direct greenhouse gas (GHG) emissions which occur from sources that are owned or controlled by the company
Scope 2: Electricity indirect GHG emissions from the generation of purchased electricity, steam, heat and cooling consumed by the company
Source: Corporate Standard, Greenhouse Gas Protocol https://ghgprotocol.org/corporate-standard
[5] ICE BoAML Global High Yield Constrained Index

Contact us

+44 20 7399 6112 www.artemisfunds.com internationalsales@artemisfunds.com

FOR PROFESSIONAL AND/OR QUALIFIED INVESTORS ONLY. NOT FOR USE WITH OR BY PRIVATE INVESTORS. CAPITAL AT RISK. All financial investments involve taking risk which means investors may not get back the amount initially invested. Investment in a fund concerns the acquisition of units/shares in the fund and not in the underlying assets of the fund. Reference to specific shares or companies should not be taken as advice or a recommendation to invest in them.

The fund is a sub-fund of Artemis Funds (Lux). For further information, visit www.artemisfunds.com/sicav. For further information on sustainability-related aspects of the fund, visit www.artemisfunds.com.

Third parties (including FTSE and Morningstar) whose data may be included in this document do not accept any liability for errors or omissions. For information, visit www. artemisfunds.com/third-party-data.

Any research and analysis in this communication has been obtained by Artemis for its own use. Although this communication is based on sources of information that Artemis believes to be reliable, no guarantee is given as to its accuracy or completeness.

Any forward-looking statements are based on Artemis' current expectations and projections and are subject to change without notice.

Issued by: in the UK, Artemis Investment Management LLP which is authorised and regulated by the Financial Conduct Authority; in Switzerland, Artemis Investment Services (Switzerland) GmbH.

General and industry-specific areas of risk and focus

Scope within portfolio	Factors	Key risk
Portfolio-wide	Labour practices	High labour turnover is disruptive. Site safety and efficiency are positively correlated in our experience
Portfolio-wide	Exploitative products	Core belief: firms benefit from providing value to clients. Exploitative business models are inherently unstable
Portfolio-wide	Scope 1 and 2 emissions	Laggards will come under increasing pressure from governments, capital providers, and customers.
Portfolio-wide	History of fraud, disingenuous practices	Significant reputational risk and points to issues in underlying competitiveness of business
Portfolio-wide	Standardised and consistent reporting	Lack of relevant information and 'solving for ESG score' both an issue.
Automotive	Resilience to transition to electrification	Accelerating EV move risks stranded business lines. Positive risk in firms who can adapt
Oil & gas	Stranded asset risk	High production cost assets are likely to become stranded assets as demand for fossil fuels becomes structurally lower over coming years
Oil & gas	Decommissioning policy	Potential for large unfunded costs
Oil & gas	Reliance on exploration/new fields	Creates dependency on future capital provision as well as exposure to future regulation and fossil fuel demand
Industrials	Weapons	Exposure to either controversial weapons or vulnerability to extended future regulation
Financial services	Exploitative debt products	Exposed to risk of regulatory scrutiny and/or disruption by new entrants with superior consumer offering
Electricity generation	Share of coal in power mix	Primary focus of decarbonisation
Electricity generation	Share of fossil fuels in power mix	Need to assess in relation to other greening activities and alternatives
Pharmaceuticals & healthcare	Pricing structure/consumer protection	Concerns around stability of exploitative models, as well as regulatory scrutiny
Gaming	Customer protection/addiction support	Concerns around stability of exploitative models, as well as regulatory scrutiny
Metals/mining	Coal extraction	Collapsing demand and regulatory tightening = decline in asset value
Metals/mining	Controversies	Potentially damaging practices and heightened corruption focus
Packaging	Share of recycled material	Positive risk on customer preference away from plastics, as well as feed-stock costs reducing on recycled supply