Thoughts on Responsible Investing in Alternatives

We believe that Responsible Investing requires an innovative, holistic and integrated approach that, if done well, can lead to improved investment outcomes over the long term.

In this paper we set out our approach to Responsible Investing when considering Alternative Investments and provide some examples of how this works in practice across our range of solutions.

Fulcrum Initiatives

At Fulcrum, we have developed a vision for Responsible Investment that has three core pillars:

Innovative	Driving positive change
Holistic	Thinking outside the box
Integrated	Working as one team

Importantly, these pillars reflect the size and shape of our business. We feel that a clear understanding of our place in the investment ecosystem and having a strong culture are key to maximising the effectiveness of our Responsible Investment efforts.

We continually evolve our approach to Responsible Investment, initially becoming a signatory to the UN PRI in 2015 through to embracing industry initiatives such as the Institutional Investors Group on Climate Change (IIGCC), ClimateAction 100+, Taskforce for Climate-related Financial Disclosure (TCFD) and the UK Stewardship Code.

Driven by our culture of research excellence and the desire to be at the forefront of knowledge, we have recently enhanced some of the detail embedded in our approach to integrating ESG and identifying sustainable investments in our Alternative Solutions business.

Responsible Investing in and across Alternatives

When we developed our Diversified Liquid Alternatives offering in 2018, we felt that much of the work on Responsible Investing in Alternatives was theoretical and that there were a relatively limited number of readily implementable solutions.

Since then, the investment landscape has changed dramatically and we have seen a surge in new fund launches promoting some form of Responsible Investment, although most noticeably on the topics of climate change. Existing strategies have re-branded or adapted their approach to promote the

Innovative	Holistic	Integrated
Driving positive change	Thinking outside the box	Working as one team
Thought Leadership Contributing new ideas that move the industry forward	**Stakeholders** Applying the "multiplier-effect" through third-party interactions	**Cohesive** Embedding thinking throughout the whole of Fulcrum
Action Selective adoption of genuine change	**Asset Classes** Integration of thinking across asset classes	**Inquisitive** Constantly seeking to challenge the accepted norms
Evolution Through action and adoption comes further change	**Time Horizons** Assessment of the impact of RI over a range of time periods	**Ambitious** Desire to be at the Frontier of Investing

use of non-financial data in investment decision-making and opportunity sets have been repositioned to 'screen out' certain sectors. Although this has resulted in greater choice and some compelling investment opportunities, it has also led to a vast volume of greenwashing. With that in mind, how do we assess if an investment is truly responsible in the complex world of Alternatives?

Our investment process is driven by our Impartial Implementation approach. This is our framework for selecting the most suitable implementation route (internally or externally managed, passive or active) for a particular idea, taking into account trade-offs between returns, risk, sustainability considerations and costs. Not only do we score each investment's sustainability characteristics using a proprietary system (see steps 2 and 3 of our investment process below for more detail), but we also adjust our return and risk assumptions based on our extensive due diligence. This process results in two key benefits:

- **It prompts us to proactively seek out investment opportunities with positive scoring sustainability characteristics e.g. clean energy and recycling companies or third-party managers who themselves have strong sustainability characteristics.**
- **It provides a very clear audit trail for marginal decisions, where our sustainability scores can be very influential.**

To provide further context, below we outline the four stages of our investment process and how Responsible Investing is considered at each stage:

1. Strategic Asset Mix

This sets out the baseline asset allocation framework that underpins our solutions and considers long-term secular trends, market size, investment efficiency and a range of other factors. It is at this stage where we may consider the potential sustainability of an asset class and whether the opportunity to invest remains attractive over the long term. We ask ourselves questions such as "Is there a future for the oil and gas industry within Natural Resources?"

2. Dynamic Idea Generation

For all potential investments, we develop views on the 'Key Ingredients for Competitive Advantage', which includes our primary decision-making tool for Responsible Investment.

We make a qualitative assessment based on the granular details of how an idea is designed, constructed and implemented with sustainability in mind, and whether this could lead to improved risk-adjusted returns.

Our assessment includes business and investment-level aspects as well as a review of the following areas:

Firm Approach & Mandate Design: This includes business commitment, ESG philosophy, current and evolving ESG credentials, approach to stewardship, diversity and inclusion, as well as the overall level of experience in implementing ESG considerations. We are also very interested to learn how and why a particular mandate has been designed the way it has, and we will explore in detail the specific business rationale for the launch of a particular product or solution.

Asset Allocation & Portfolio Construction: We discuss adjustments that may be needed to capital market assumptions or climate factored scenario analysis, which can in turn help us to make our own adjustments too.

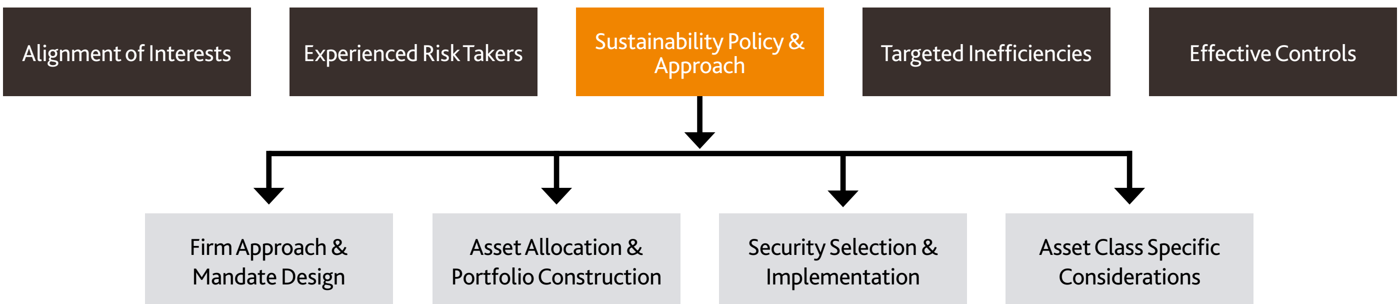
Security Selection & Implementation: We review materiality assessments, engagement prioritisation, voting records, linkage to UN SDGs and data provision.

Asset Class Specific Considerations: Finally, we consider factors specific to a particular asset, which we discuss later in this paper.

Each of the four aspects of 'Sustainability Policy & Approach', outlined in the chart below, are scored on a scale of 1-4 (1 represents poor and 4 represents a leading score) and aggregated to form an overall Responsible Investment view on any given idea in our research pipeline.

3. Portfolio Construction

It is here that we apply our Impartial Implementation approach and we do this by applying 'Four Key Factors' in order to



Idea	Sub-strategy	Target Net Return	Sustainability Adj.	Diversity Factors				Sustainability	Terms and Conditions	
				Target Volatility	Sustainability Adj.	Geography	Equity beta	Aggregated Score	Fees (OCF)	Liquidity
Manager 1	High Yield	4%	-	8%	-	US	0.3	4	30bps	Daily
Bespoke Theme 1	Agricultural Technology	6%	-	15%	-0.25%	Global	1.0	4	0bps	Daily
Manager 2	Securitised Debt	4%	-	10%	-	Global	0.3	2	85bps	Monthly
Co-investment 1	Clean Energy	10%	-0.25%	20%	-	Scandinavia	0.5	4	50bps	3-5 years
Objectives	**15-20**	**Cash + 6-8%**		**8-12%**		**Diverse**	**0.5**	**Aim to improve averge scores over time**	**Manage within agreed cost and liquidity parameters**	

Source: Fulcrum Asset Management LLP. For illustrative purposes only.

enable holistic investment decision-making. All potential investments are scored across these four factors, and this enables us to assess the relative trade-offs between ideas. When it comes to adjusting our return and risk assumptions, based on sustainability considerations, we apply caution and are conservative with any adjustments given the difficulties inherent in measuring the impact of ESG factors in a quantitative manner. Any adjustments are based on a combination of statistical analysis and academic research. This step also allows us to have the option to veto any investments we may feel uncomfortable about, for example those investments with a Sustainability score of 1, and it enables the Sustainability score to be a powerful tool for marginal decisions.

4. Monitoring and Risk Management

Our preferred approach to Responsible Investing is to engage with stakeholders. We believe this is critical in achieving a positive outcome for those involved, and therefore we do not automatically rule out a poor scoring direct investment or third party manager, particularly if we can identify the right steps are being taken to innovate and improve. This is assessed on an ongoing basis, as part of quarterly updates and annual reviews.

Case Studies

Investors often believe that sustainable investment options are more expensive or can be detrimental to returns though we have found that this is often not the case. The following two examples highlight leading innovators in their respective fields and, having reviewed all implementation options, both scored highly when measured across our 'Four Key Factors' approach.

Sustainable Listed Infrastructure:

Infrastructure has some of the highest carbon-emitting companies and we were keen to proactively seek out a more sustainable, long-term approach. The strategy we invest in looks to combine long-term valuation and quality stock analysis with an analysis of how sustainable the underlying companies are.

We were the first external investor in a newly launched sustainable listed infrastructure fund, and as a result we achieved a compelling fee deal. This female managed strategy scores highly on diversity factors at both an investment and portfolio construction level, reflecting the importance we place on including a range of decision makers with complementary experiences and backgrounds in our portfolios.

ESG integrated High Yield:

High Yield debt is one of the sub-strategies in which underlying companies are more prone to environmental, societal and governance issues, particularly in the traditional energy sector. As a result, our objective was to find a manager where ESG was truly integrated into their research process with individual companies being scored on this as well as more traditional valuation criteria. We were a day-one investor in a new fund launch from a long-established, female owned boutique manager that looks to explicitly integrate ESG in all decisions.

Asset Class Specific Considerations

In the below table we highlight some of the specific considerations we review for each asset class in our liquid alternatives opportunity set:

Asset Class	Key Considerations	Impact
Real Estate	GRESB credential	The GRESB ("Global Real Estate Sustainability Benchmark") credential is key in the Real Estate sector as it sets the tone for how these assets are developed, perform and managed.
Infrastructure	Climate scenario analysis	Climate scenario analysis is key to measuring transition and physical risk due to temperature impact, and the eventual risk of stranded assets, which in turn can lead to adjustments in position sizing.
Natural Resources	Engagement prioritisation	The philosophy and approach to working with energy majors is critical within natural resources and reflects how voting rights are used as a tool to enact longer term change.
High Yield	Paucity of data	Active engagement with smaller companies to encourage greater consideration and transparency of ESG-related issues, particularly new issues where greater support is required.
Emerging Market Debt	Social & Environmental policy	Government action and support for the financial and physical wellbeing of its population and environment is critical. Green bonds and engagement during the price discovery phase of new bond issues is a key mechanism to encourage improving behaviour.
Securitised	Lending and mortgage servicing standards	Engagement with lenders and servicers to reduce the prevalence of predatory lending practices.
Convertibles	Creditor rights	In the absence of voting rights, where a manager is reviewing a new issue, engagement on bond terms to encourage greater ESG transparency and improving practices, especially where they are made 'private.'
Quant Hedge Funds	ESG risk influence	ESG data availability and reliability are common issues that are improving, however the ability to measure ESG impact quantitatively is in its infancy.
Fundamental Hedge Funds	Shorting ESG laggards	Understanding the due diligence and reasoning behind the decision to short a stock vs. engage is key in assessing the sustainability of returns over the long term.
Event Driven	Transaction announcement threshold	Assessing minimum ESG thresholds in place to initiate a position could lead to improved risk-adjusted returns.

In conclusion, as the Responsible Investment landscape continues to evolve at pace, alongside greater reporting transparency from corporations and governments, a robust framework is required to enable holistic integration. We aspire to continue building out our key considerations over time to improve risk adjusted returns.

Contact us

T: +44 207 016 6450
ir@fulcrumasset.com

Fulcrum Asset Management LLP
Marble Arch House, 66 Seymour Street, London W1H 5BT