Breckinridge
CAPITAL ADVISORS

SUSTAINABLE FIXED INCOME INVESTING

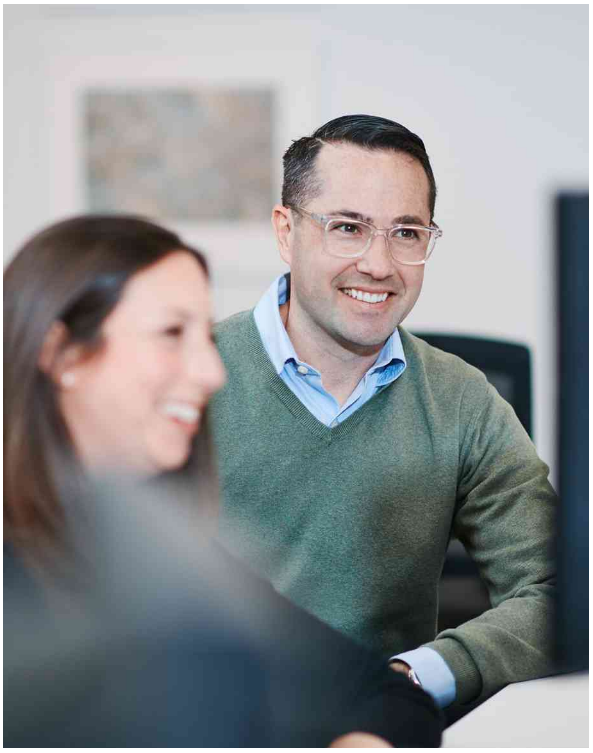
EXAMINING RISK FROM A WIDER ANGLE

Sustainable Investing at Breckinridge Capital Advisors

Breckinridge manages more than $42 billion of fixed income assets for institutional investors and private clients as of March 31, 2022, including more than $8 billion for investors who wish to emphasize sustainability factors or who seek to align their investments with their values via our offerings.

Investors expect reliable income, consistent returns and capital preservation from investment grade fixed income strategies. Our commitment to achieve these client objectives are the foundation of our decision in 2011 to fully integrate environmental, social and governance (ESG) research with fundamental security analysis. At Breckinridge, ESG research is more than simply a product option. ESG risk analysis is intrinsic to our investment philosophy, intended to improve risk-adjusted returns.

Breckinridge analysts seek deeper, more complete insights when evaluating bonds that we believe have these characteristics. Integrating ESG research is intended to expand traditional analysis to include additional risk factors—potentially ones ignored in traditional analysis—deemed to be material.



We believe ESG analysis helps us better understand our investments.

BRECKINRIDGE SELECTS EVERY INVESTMENT WITH A VIEW TO ITS ABILITY TO SUSTAIN VALUE

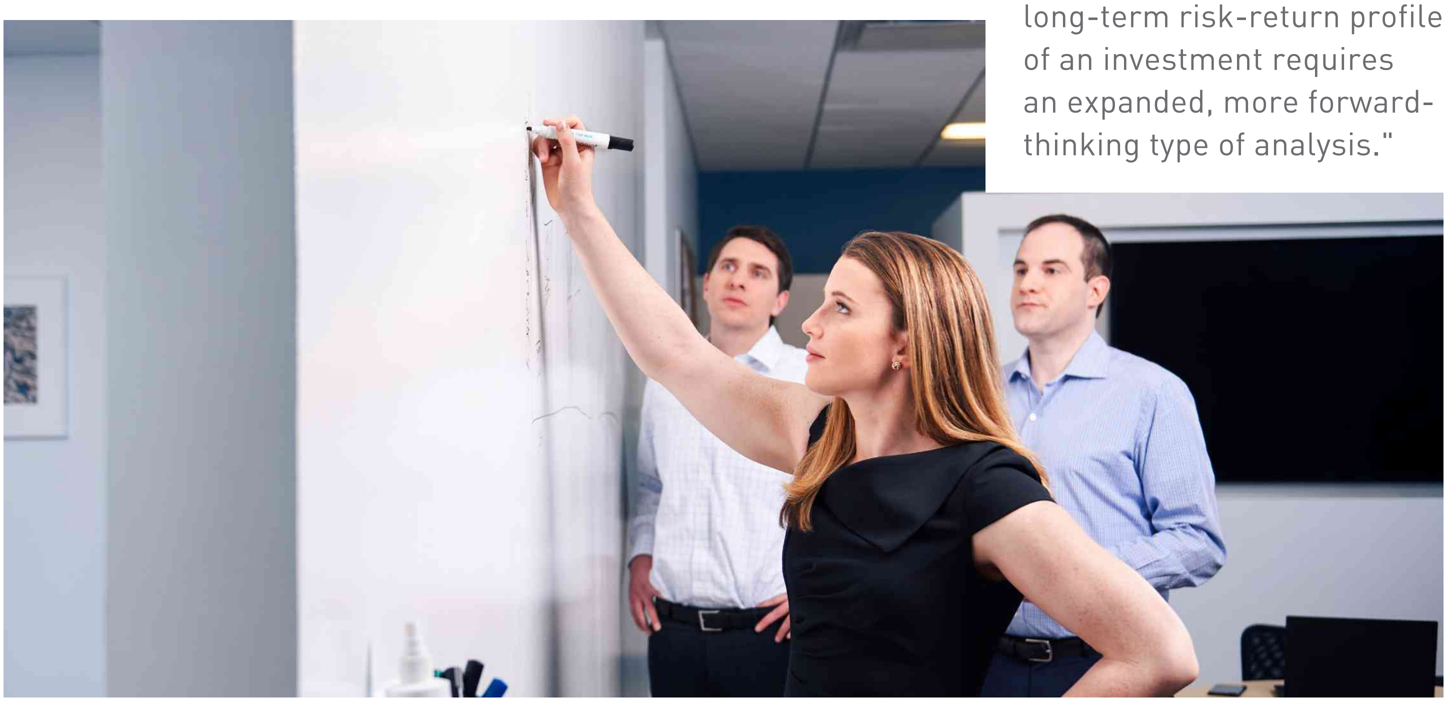
We integrated ESG research into security analysis because we wanted to better understand the long-term sustainability of investments. “Simply put,” says **Breckinridge President Peter Coffin,** “we believe that more responsible bond issuers are less risky over the long run.”

In our opinion, a thoughtful and forward-looking assessment of risk would be incomplete without the inclusion of material ESG factors.

Driven by our research team, Breckinridge integrates material ESG issues to analyze and assess long-term and idiosyncratic risks, which we feel the market may misprice.

We believe ESG analysis complements fundamental financial analysis of corporate, municipal and securitized bonds. Fundamental analysis seeks to measure a security's value by examining economic and financial factors. ESG research adds information and insight that we believe can explore material risks more fully.

"Beyond a more holistic view of credit quality, ESG research is also about time horizon," says **Chief Investment Officer Oggie Sosa**. "Our investment approach is rooted in the idea that understanding the long-term risk-return profile of an investment requires an expanded, more forward-thinking type of analysis."



PURSUING PREDICTABILITY IN AN UNPREDICTABLE WORLD

"Sustainability is not a means of screening out investments. Rather, it broadens our analysis. We think it is additive by revealing non-financial details that help us more-accurately recognize and price long-term risks and costs," says **Matt Buscone, co-head, Portfolio Management.**

ESG analysis considers environmental impact, social concerns, reputation, operational governance and potential controversies, among other factors, that may affect the ability of bond issuers to meet their obligations to bondholders.

ESG analysis can offer additional metrics when taking the measure of a bond's ability to sustain coupon payments and to return investor principal at maturity. We consider this long-term perspective to be aligned with investors' expectations for investment grade fixed income allocations.

CONSIDER THESE POTENTIAL RISKS THAT FUNDAMENTAL RESEARCH ALONE MIGHT NOT HIGHLIGHT:

Our goal is to identify ESG factors that add to the information available to investment analysts. By revealing information that they otherwise might not discern through financial analysis alone, we see ESG factors as meaningful influences on financial performance.

ENVIRONMENTAL RISKS

Failing to manage waste and plan for future resource shortages may ultimately damage a corporate issuer's creditworthiness. Neglecting to plan for environmental regulations and policy initiatives can threaten a public utility's long-term viability. Ignoring the potential influence on prepayment speeds stemming from natural disasters could change risk profiles of mortgaged-backed security (MBS) pools.

SOCIAL RISKS

Failing to monitor supply chains and undervaluing human capital may result in controversies which can damage a company's reputation. A municipality that neglects educational equity, disenfranchises communities, housing equity or underfunds infrastructure may imperil the community's future financial health.

GOVERNANCE RISKS

A company that lacks board independence or compensation aligned with long-term goals may make near-term decisions that disrupt longer-term competitive positioning. Poor or inadequate public reporting or failure to plan for long-term liabilities, such as pensions, may heighten credit risk for municipalities and agencies.

A CLOSER LOOK AT THE MATERIALITY OF ESG ANALYSIS

The relevancy of any ESG factor varies across corporate, municipal or securitized bonds, with sector-specific characteristics influencing materiality. Breckinridge analysts integrate third-party data and their own analysis of financial and non-financial factors to develop forward-looking views.

To evaluate the ESG risks of corporate bonds, we utilize proprietary, sector-specific frameworks based on materiality and comparables analysis supported by data and research from third-party sources such as the Sustainability Accounting Standards Board (SASB)[1] and Sustainalytics. Our analysts also review corporate sustainability reports, ESG reporting and conduct direct engagement with issuers. For municipal bonds, we employ 10 proprietary sector-specific frameworks, aggregating material data from various sources such as the U.S. Census, the EPA, the CDC and others.

CORPORATE BONDS:

Recognizing the costs of unsustainable business practices

In the corporate world, event risk and credit distress can unfold in an instant. Breckinridge closely examines corporate bond issuers seeking to uncover the potential for sudden deterioration.

"ESG research goes beyond the balance sheet to incorporate additional, extra-financial risk factors into traditional credit analysis," says **Nick Elfner, co-head, Research** "We believe our approach to systematically integrating ESG factors in our research process is a differentiator."

Regulatory and environmental risk. Long-term investors should be cognizant of externalities posed by the operations of companies in which they invest. Market reactions to scandals and catastrophes—as well as regulations across a range of issues from carbon emission standards to privacy laws—show that long-ignored activity that affects other parties may negatively affect companies and their investors.

Controversy risk. Class-action lawsuits and workplace controversies can occur when corporations fail to respect fair labor practices, supply chains and the interests of other stakeholders.

The consequences can be serious for an issuer's creditworthiness and bond prices. By contrast, some of the best performers seize opportunities to engage their employees, support and monitor their suppliers, and invest in human capital --including diversity, equity and inclusion (DEI)--as well as their communities.

Management risk. Excessive executive pay and accounting gimmickry are often signs of poor oversight. Well-governed organizations follow sound practices such as independent board representations and transparent disclosure of both financial and material non-financial data, including ESG performance factors.

"ESG research integrated with fundamental analysis helps us assess the price of a bond and the reliability of a bond's future cash flows," says **Jeff Glenn, co-head, Portfolio Management.** "We have found that corporate policies and practices predicated on effective ESG behaviors can enhance a corporation's long-term viability through lower costs, lower waste and greater efficiencies."

CAN A CARBON-INTENSIVE BUSINESS STILL BE "GREEN"?

Transportation and delivery companies are carbon-heavy and a blunt investment screen might exclude them from consideration. The sector requires a deeper look, as it provides an essential service within a global economy reliant on e-commerce.

Additional analysis may reveal strong sustainability practices such as above-average fleet efficiency, robust initiatives to cut carbon emissions and superior disclosure on climate risk.

Sustainable credit analysis can identify best-in-class performers by measuring these practices against peers and industry standards.

MUNICIPAL BONDS:

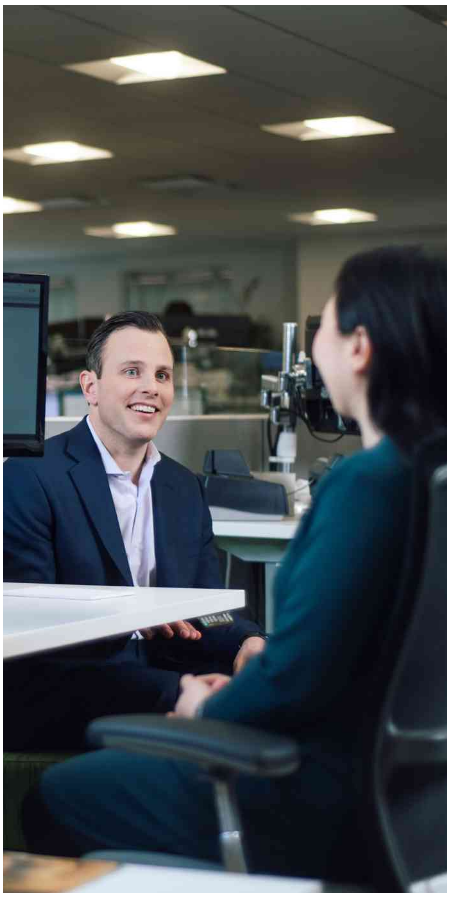
Identifying climate risk and outlier social and governance risks; assessing use-of-proceeds

ESG analysis can provide investors with insights into issuers' climate risk exposure and enables the exploration of outlier social and governance factors in a systematic way. The approach helps us price credit risk.

Climate change poses distinct risks and opportunities for issuers, depending on geography, the built environment, and the local economy. Risks include exposure to rising seas, heat stress, and increasing frequency of powerful storms. Opportunities include job market exposure to emerging clean technologies and forward-looking land use planning or building codes. Climate-induced credit-rating downgrades remain infrequent. However, they are likely to become more common in the future.

Consistent assessment of social and governance characteristics can help highlight outliers. An impoverished and racially segregated school district may exhibit surprisingly strong test scores. An affluent city may have an unexpectedly high degree of political polarization on its city council or obstinately refuse to consider a valuable affordable housing strategy. These kinds of factors are rarely traceable to rating agency downgrades and slowly ripen into material credit risk. However, in our view, factors like these can be relevant, in extremis.

Assessing each bond issue's use-of-proceeds for its societal relevance is also important to gauging credit risk. Traditionally, projects that are highly essential to the communities they serve are resilient through credit cycles. Strong community support is a plus for municipal investors. Notes **Adam Stern, co-head, Research**: "The most significant period of municipal distress occurred in the Depression-era. During that time, bonds issued for school construction and water and sewer systems had the lowest default rates."[2]



SECURITIZED BONDS:

Considering climate risk in mortgage-backed security analysis

Assessing the impact of climate-related risks to prepayment speeds of agency mortgage-backed securities (MBS) may provide insight into their risk/reward profile.

Breckinridge believes that looking beyond traditional data and analysis is a critical part of robust research. Including climate-related risk analysis in MBS research is additive to our evaluation of material fundamental and technical financial risk factors when analyzing agency MBS.

ASSESSING MBS PREPAYMENT SPEEDS FOLLOWING NATURAL DISASTERS

To better understand how climate risk can influence prepayment risk in MBS, the Breckinridge team analyzed the buyout policies of government-sponsored entities after environmental disasters, such as the hurricanes that hit the states of Florida and Texas in 2017. The team researched the effect that these events historically had on mortgage prepayment speeds. Breckinridge compared prepayment speeds six to twelve months after the occurrence of a natural disaster in various geographic regions against national averages. The research isolated the effect of natural disaster-related buyouts on prepayment speeds.

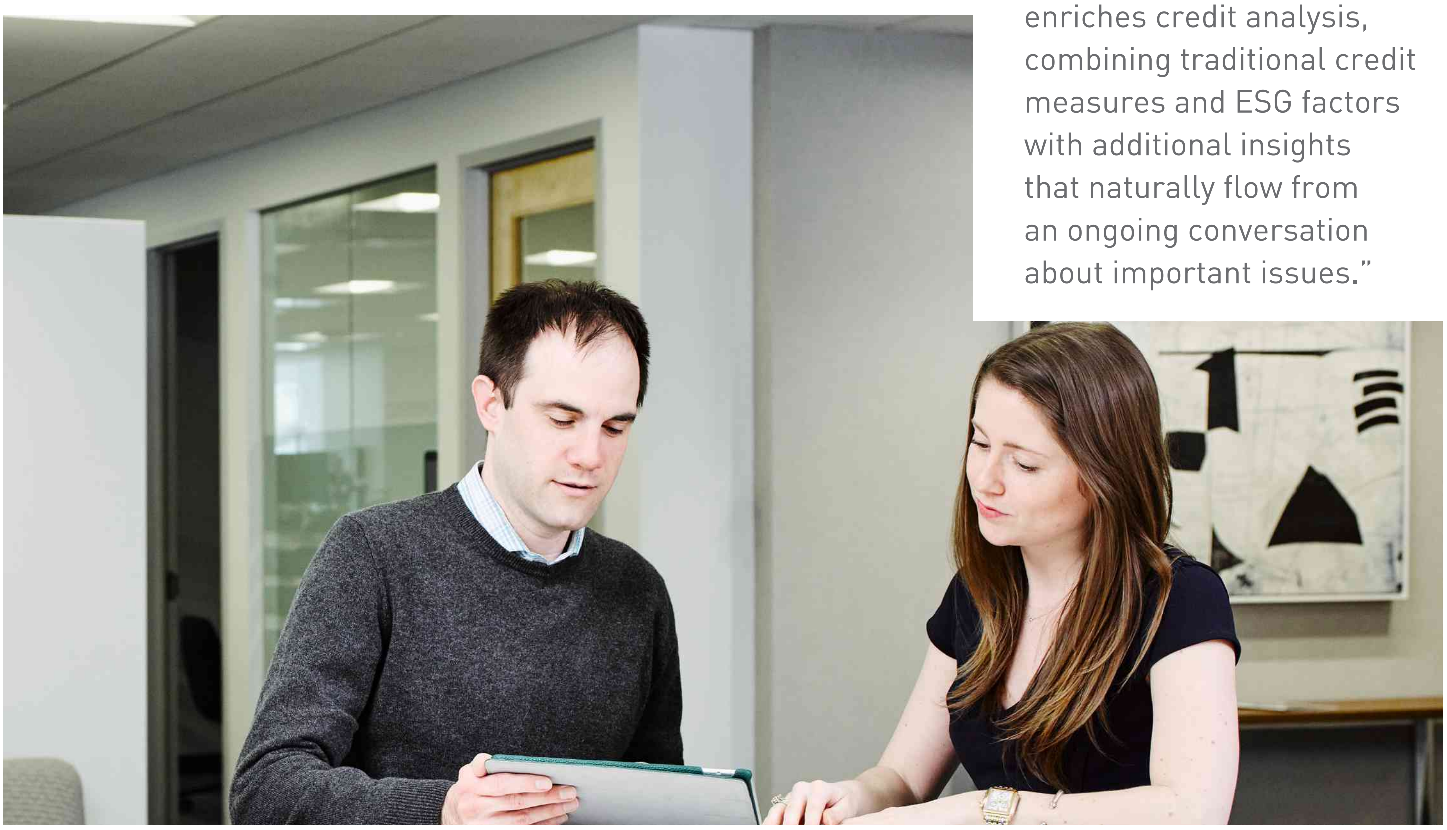
ENGAGEMENT ADDS IMPORTANT INSIGHTS

To better inform our investment decisions and enhance our credit analysis, we engage in direct discussion with bond issuers on ESG issues through an ongoing engagement discipline operated by our research team.

We also engage with thought leaders and organizations focused on ESG investing and sustainability within sectors and beyond investment markets, to gain insights into trends. The conversations are particularly valuable to us because they can provide deeper insight into the integration of material ESG factors in an issuer's decision-making, budgeting and operating processes.

"During engagements, we can ask questions that have emerged from our research efforts," says **Rob Fernandez, director, ESG Research.** "The conversations often bring us a below-the-surface understanding of borrowers. Engagement is one of our most powerful research tools."

"We believe engagement provides us with an opportunity to gain a deeper understanding of ESG factors that matter most to an industry, sector or an issuer," **Tim Coffin, director, Sustainability**, explains. "Engagement enriches credit analysis, combining traditional credit measures and ESG factors with additional insights that naturally flow from an ongoing conversation about important issues."



CUSTOMIZING INVESTMENT STRATEGIES FOR CLIENTS

Customization is key for investors investing for impact. A separate account—through which the investor owns each bond held--offers a key advantage in our efforts to customize portfolios when compared to collectively owned investment portfolios like mutual funds. We maintain robust systems to accommodate a wide range of customizations while seeking to keep portfolios in line with investment strategies.

"We work with advisors and consultants," explains **Chris Day, head, Intermediary Distribution.** "Our goal is to customize portfolios that appropriately align with each client's objectives, risk tolerances, liquidity needs, and mission and values without compromising portfolio integrity."

"Our portfolios can be customized to a range of ESG and sustainability criteria," says **Phil Newell, head, Consultant Relations.** "We are committed to the continuous innovation and evolution of the proprietary systems that allow us to tailor client portfolios. In this way, we can continue to offer clients a high level of customization at competitive fees."

BRECKINRIDGE VALUES-BASED CUSTOMIZATIONS[3]:

SUSTAINABLE
Guided by rigorous ESG research. Selectively invests in above-average ESG performers or essential environmental, social or economic development projects.

ENVIRONMENTAL
Overweights above-average environmental performers financing environmentally beneficial projects.

FOSSIL FUEL FREE
Excludes investment in companies with oil, gas or coal reserves, as identified by MSCI ESG Carbon Metrics.[4]

NET ZERO
Include issuers operating in alignment with the Net Zero Asset Managers Initiative.

FAITH BASED
Avoids issuers that conflict with a client's faith-based values, such as a screen on research institutes that conduct stem cell research.

CATHOLIC VALUES
Selectively invests in bonds that align with a variety of Catholic socially-responsible investment guidelines, including USCCB[5] guidelines.

VICE FREE
Excludes corporations that derive more than 5% of their revenue from tobacco, alcohol, firearms or gaming.

GENDER LENS
Informed by the Women's Empowerment Principles,[6] investments focus on companies that have committed to advancing issues that affect women and girls.

EDUCATION
Overweights issuers prioritizing and advancing education. Examples include higher education issuers and public school districts.

SCREENING
Custom inclusionary and exclusionary screenings based on industry standards, client directive and/or investment policy restrictions on a best-efforts basis.

COMMITTED TO OUR PRINCIPLES

At Breckinridge, our sense of stewardship extends beyond our client portfolios to encompass our community and the larger environment. Sustainability is fully woven into the fabric of our investment approach and business operations, driving investment rigor and long term business continuity.

Breckinridge was a first mover a decade ago when we integrated ESG in fixed income security research. We commit time and resources to advance ESG analysis and broader adoption of sustainability in investments and business operations. Our collaboration with peers, non-government organizations, academics and thought leaders reflects the intentionality that defines our efforts.

Breckinridge is a member or signatory of a wide range of industry networks, initiatives and associations. We publish reports and articles on sustainable investing topics in collaboration with other thought leaders. We advocate for best practices in sustainability reporting.

Our partnerships and collaborations allow us to share our intellectual capital with investors and issuers and they strengthen our issuer engagement efforts.

Net Zero Asset Managers Initiative

Climate Action 100+

CDP

CERES Investor Network on Climate Risk (INCR)

Chief Executives for Corporate Purpose

Sustainability Accounting Standards Board (SASB)

United Nations Principles for Responsible Investment

NET ZERO COMMITMENT

In line with our commitment to forward-looking investing, in December 2021 we signed the Net Zero Asset Managers Initiative. The Initiative comprises an international group of asset managers who support the goal of net zero greenhouse gas emissions by 2050 or sooner and whose investing approach is aligned with reaching net zero emissions by 2050 or sooner.

Committing to the Initiative reaffirms our focus on long-term investing and stated mission to facilitate a sustainable flow of capital from long-term investors to responsible bond issuers. Achieving net zero emissions supports long-term risk mitigation, as the global community transitions to a low carbon future.

A COMPANY-WIDE CULTURE OF SUSTAINABILITY

We manage investments and our business for long-term value creation. Our company is an independent, Massachusetts Benefit Corporation and a certified B Corp. We are a private company owned by current and past employees and Board members. This structure and designation support our pursuit of long-term positive impact for our clients, employees and the communities in which we live, work and invest.

"Once we recognized the relevance of ESG factors to the long-term success of a bond issuer, it necessarily followed that Breckinridge would examine its own business in the same manner as we do our investments," explains Peter Coffin. "We work to engage more fully with our own community and stakeholders. Our certification as a B Corp provides the systematic framework for assessing our ESG performance, and our charter as a Benefit Corporation reflects our ongoing commitment to this assessment. We hold firm to our values and our belief in managing for the long term."

Our employee-directed sustainability committee includes members from across the firm. Our Materiality Map focuses our efforts on what is most material to our firm: business ethics, HCM, client experience, risk management, ESG integration in financial analysis, corporate citizenship and operations and supply chain. **Kelly Wight, director, Corporate Sustainability,** describes the map as "a stewardship road map. It helps keep our sight lines further out on the horizon, to help make sure we are innovating and evolving in a way that is in the best interests of our clients, our employees and our communities."

For more insight on our Materiality Map and sustainability efforts, we encourage you to review our *Corporate Sustainability Report*.

We donate 1 percent of gross revenues annually, resulting in more than $4 million in charitable contributions since 2011. In addition, Breckinridge provides every employee with three days of time to contribute their efforts in the community, which generated more than 750 hours of volunteer time in 2020 and 2021.

WHAT RISKS LIE HIDDEN IN YOUR FIXED-INCOME PORTFOLIO?

We ask questions that go beyond financial statements and search for risks that others may overlook.

We believe our sustainability analysis adds rigor to traditional analytical approaches. We seek to broaden the scope of fundamental credit analysis by examining ESG factors that may affect a bond issuer's future ability to repay. By considering these long-term trends, we strive to prepare our clients for the future.

Contact Breckinridge at info@breckinridge.com or cr@breckinridge.com to learn more or for assistance transitioning your current fixed income strategies to a sustainable approach.

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ENDNOTES:

1. SASB is the Sustainability Accounting Standards Board, a nonprofit publishes sustainability standards for seventy-seven industries.
2. Municipal Bonds: A Century of Experience, Albert Hillhouse, 1936.
3. Certain customizations are only available for sector-specific strategies while certain others are available only on multi-sector strategies. For more information, contact Consultant Relations at cr@breckinridge.com.
4. MSCI ESG Carbon Metrics provides oil, gas and coal reserves and emissions data.
5. The United States Conference of Catholic Bishops published its Socially Responsible Guidelines to help Catholic investors fulfill "religious mandate and fiscal responsibilities."
6. For more information on the Women's Empowerment Principles, please see http://weprinciples.org.

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