Climate change crucial part of derisking portfolio

Buy and Maintain credit portfolios have become increasingly popular in recent years. An integrated ESG portfolio is crucial to its success, according to James Briggs, Portfolio Manager at Janus Henderson.

By *Joost van Mierlo*

The Buy and Maintain credit strategy James Briggs manages, has gained a lot of attention recently. ESG-risks are given a strong focus, because they will materialize in the twenty years or more that some of the corporate bonds in his strategy are being held.

Companies are more willing to discuss their ESG-strategies with different stakeholders, Briggs notes. 'They are making the right sounds, but it is crucial they will deliver on their words.'

Buy and Maintain credit portfolios are increasingly popular. Why?
'I think there are several reasons. An obvious reason is that there is a reduction of trading costs. This is especially beneficial in times of illiquidity which we saw in the period 2009-2012, and again at the beginning of last year with the pandemic. The second reason is the fact that we constantly see these boom/bust cycles in credit. Some sectors get a preferential treatment in the market for certain periods, like TMT in the early 2000s, financials before the Lehman crisis, and energy, oil and gas in the fracking 2015/2016 boom. An index-agnostic approach avoids increasing exposure to these sectors during periods of overexpansion.

Instead of being constantly saddled up with lower quality credit, our approach has a much larger focus on higher quality credit, which is attractive for investors who want to derisk their portfolio. That approach is being supported by regulators.'

Why not just opt for Buy and Hold?
'We are adjusting our portfolios for all kinds of risks, like changes in credit rating, interest rates and foreign exchange fluctuations. There is an intention to hold a credit to its maturity, but there can be all kinds of reasons we want to sell, including attractive offers to buy credits by central banks. With all the possible changes, we try to identify them early on. If there are signals a credit rating is changing, we don't want to wait until it happens, but we will act early. Our approach is not so much tactical, as in an active strategy, but more structural.'

Investors have been focusing on ESG-concerns, especially climate change. In what way does that affect your Buy and Maintain fund?
'We have an integrated ESG-approach for our whole portfolio. There is a centralized search for companies that are industry laggards with regards to ESG-issues, especially for companies that show an inability to adapt. We are talking about real risks here, that might ultimately lead to higher costs of capital.'

Has this led to more influence when you engage with companies?
'There have been several factors that have caused change. In the past, it was easy for companies to dismiss us. They could choose for other investors or for bank finance. But regulators have been insisting for companies to listen to different stakeholders. And as an industry, we have been adding our voices to gain more influence. The Climate 100 initiative is a good example.

But maybe most importantly, it is an issue that unites the equity and the credit desks. With issues like dividends and share buybacks, we might be at opposite ends. The equity team may want issuance of debt to raise dividends, but we generally are in favour of less risk and less leverage. But around climate change and other ESG-issues, all stakeholders benefit from a comprehensive strategy. So we will work more closely together.'

What do you think of a single focus on decarbonization?
'It might be simple to focus on single factor targets, like decarbonization, but that is not the way forward in our opinion. You can create a decarbonized portfolio with a focus on healthcare, technology and financials, but that doesn't really address the issues.

In ten or twenty years, the combustion engine may not exist anymore, but we will still need energy and oil.

We think it's better to have a good actor/bad actor approach, where we will focus on those companies that will help in the transition to a more sustainable world. That is difficult enough. Some investors opt for carbon budgeting, where companies that will produce carbon, get healthy budgets. That makes sense for an oil company like Orsted, that makes the transition into solar and wind.

But what about the air travel sector? Do we really want to stimulate business travel again or do we opt for the continuation of Zoom meetings all the time? That is the kind of discussion we want to have.'

Are clients receptive?
'We believe we have some expertise to share on ESG topics, but we don't believe it is our place to tell asset owners what their priorities are. We will do what our clients request. They have become very savvy when it comes to their wishes in relation to ESG standards. There's not one right approach. There might be cultural differences with regards to issues like tobacco, alcohol and weapons. We can create portfolios that will meet every demand.

It is helpful that we are not mapping our portfolios against any kind of index. There is no tracking error and we are not trying to beat a benchmark. If a client doesn't want to invest in oil, that is fine with us, although it might harm returns in times of rising oil prices. We understand that clients are increasingly balancing conflicting objectives, and the risk adjusted return profile of our portfolio in isolation does not always dominate. It's all about clarity.'

What are the discussions with companies like?
'We prefer engagement over divestment. But there is a limit. When companies are not willing to change, we want to keep the option open to sell. But it's not something we use very often. In a portfolio with more than a hundred different corporate bonds, it might happen only once a year. But it is a stick you need to have.

Most companies understand what is being asked of them. They are making the right noises, but will they also deliver? They are creating an enormous amount of data of which most of it is so granular, it is effectively useless.

There is a great a deal of discussion about what data to use, but the problem is that most of the data that is being used, is backward looking. That is useful, but we want to be forward looking. That is why it is crucial to set year on year targets. That is the main goal for now in our discussions with companies.' ■

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James Briggs

James Briggs is a Corporate Credit Portfolio Manager at Janus Henderson Investors responsible for the Global Investment Grade, Sterling Investment Grade and Buy and Maintain Strategies. Briggs joined Henderson in 2005 as a Credit Analyst and was named a Portfolio Manager in 2010. Prior to this, he was a Credit Analyst with BlueBay Asset Management and a High Yield Analyst with Invesco Asset Management. He has 24 years of financial industry experience.

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