

Interview with Portfolio Manager Torben Frederiksen

Nordea 1 – European High Yield Stars Bond Fund

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Please note that the conference call occurred on the 4th of November 2020. All market commentary and information refers to the period before then.

Key takeaways

- With Covid-19 cases again on the rise, this is a complex and potentially volatile environment for credit investing. Opportunities are still present, but on a bottom-up basis.
- ESG integration plays a crucial role in European high yield, with these metrics just as important as other financial considerations.
- It is not only investors scaling up the focus on ESG. Companies, as well as policymakers and regulators, are all moving in a greener direction.

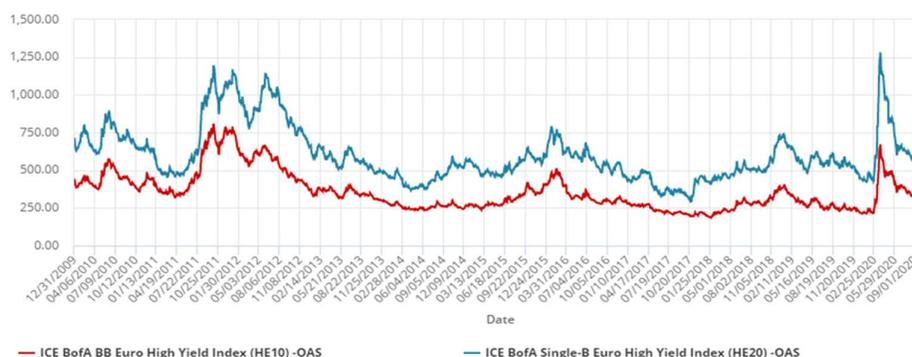
With virus cases once again on the rise in Europe, are you concerned about the impact on credit markets?

We are clearly in the second wave of Covid-19, and restrictions have once again appeared across Europe. However, this is not a “full-stop” scenario. While the situation is fragile, my base case is we will not witness drawdowns like in March, when spreads spiked massively and rapidly. There was far more uncertainty about the virus and the potential response back then, and we have since seen the power of government support over the course of the year – which is likely to continue. In addition, we are getting closer to the development of a vaccine.

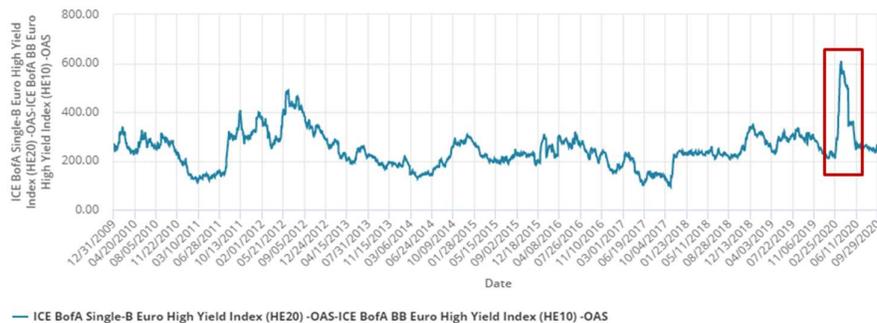
How are corporates navigating this challenging environment?

Numbers for the third quarter were quite positive, better than many market participants expected. While areas such as hospitality are undoubtedly facing an extremely difficult situation, many other businesses are continuing to operate and muddle through at lower volumes. Should we witness renewed signs of panic, we will stick to our bottom-up process and look to take advantage of the dislocation. This is what we did in March, when many B-rated names were indiscriminately sold off.

Spread between BBs and Bs jumped to highest level in more than a decade



Source: ICE. The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.



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Does ESG add value in the credit space, and has the Covid-19 crisis altered the focus of companies in your universe?

With the ESG efforts undertaken by our investment team, as well as Nordea's 18-strong Responsible Investments team, we are able to obtain robust ESG profiles of the companies we invest in. These insights certainly add value. The more information on ESG risks and opportunities we receive, the better. As for recent corporate action, ahead of the Covid-19 pandemic, I did hold fears a major crisis – in whatever form – would alter the focus of companies away from long-term ESG themes to simple short-term survival. Pleasingly, this has proven not to be the case.

As we strive for a more sustainable future, how important are government initiatives?

They are incredibly important. There has been a lot of support from governments, with the European Green Deal setting the scene for major investments in sustainable projects. This support has been beneficial for areas such as the automotive industry. In addition, investors are making their voices heard, with strong flows coming into ESG-focused funds, both in equities and on the fixed income side. Companies have recognised this, and we could see further changes in corporate behaviour as a result.

You just touched on corporate actions in relation to ESG. Are we already seeing strong responsibility and sustainability momentum?

Definitely. In our everyday discussions, companies are aware of the importance of ESG factors, and it is a strategic issue for many groups. Even if this is just talk, awareness is the first step to real action. Nevertheless, there are many examples of companies undertaking genuine positive action. Drax, which has been in the process of transitioning to green energy production for some time, is one such name.

There are unique challenges to ESG-focused investing in the high yield credit market. How do you navigate this?

You are right, there are challenges when it comes to high yield investing in relation to ESG. If a name has an external ESG rating, we will dissect it and look to understand the analysis. However, a key difference is we look across sectors in our evaluation of business models – while rating agencies go sector-by-sector. This means rating agencies classify good and bad companies within the oil and gas sector, as well as good and bad companies within the healthcare space, for example. But if you look across sectors, you could easily find a bad healthcare company that is far superior to a good oil company in terms of ESG. Therefore, it is important to do your own business model analysis and not simply rely on external ratings.

In any event, we undertake the same process, whether the company has a rating or not. What we do is evaluate companies from two angles – the probability of ESG events occurring, and the implications of such an incident. This provides a solid understanding of the ESG risks faced by a company. Our Responsible Investment team also utilises a lot of this information in its company engagement efforts.

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