Breckinridge
CAPITAL ADVISORS

EXAMINING RISK FROM A WIDER ANGLE

SUSTAINABLE FIXED INCOME INVESTING

Sustainable investing is neither a niche, nor a willing sacrifice of investment return for the sake of some other goal. Rather, it is a mainstream strategy that integrates extra financial data analysis in order to more accurately price risk in a changing environment.

A NEW WAY TO PURSUE PREDICTABILITY IN AN UNPREDICTABLE WORLD.

Concern is rising among investors. Worries mount that many fixed income portfolios rely on outdated measures of risk and rest on unreliable assumptions about the future. At Breckinridge Capital Advisors, we believe the time has come for investment strategies that rely on a more holistic and realistic view of risk.

What Sets Breckinridge Apart

- Exclusive focus on high-grade fixed income
- Bottom-up credit research
- Broad sustainability integration
- Customized separate accounts
- Operational excellence
- Independently owned firm

Fixed income investors want predictability and rely on traditional credit analysis to reassure them. But the future may be more uncertain than financial statements suggest. Insular management teams, shortsightedness and externalized costs can take an unforeseen toll on issuers and investors. Traditional analysis alone may not be sufficient to determine whether bond investments will be viable over the long run.

At Breckinridge Capital Advisors, we believe sustainable investing is a natural match for fixed income strategies. It offers a long-term perspective aligned with investors' long-term goals and seeks to reduce uncertainty in an increasingly uncertain world. As a fixed income manager with two decades of experience, we manage high-grade sustainable portfolios of corporate bonds, taxable and tax-free municipal bonds, sovereigns, supranationals, green bonds and government agencies. Our broad view of risk goes beyond financial statements and encompasses environmental impact, reputation, governance and potential controversies—perils that can impose unexpected costs on investors and affect borrowers' ability to repay.

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.

SOCIAL RISKS

Failing to monitor supply chains and retain human capital may result in controversies which can damage a company's reputation. Similarly, a municipality that neglects to prioritize education and infrastructure funding may imperil its community's future financial health.

GOVERNANCE RISKS

A company that lacks board independence or compensation aligned with long-term goals may make decisions that disrupt competitive positioning. For municipalities, poor disclosure or failure to plan for long-term liabilities, such as pensions, may heighten credit risk.

A BETTER WAY TO KNOW YOUR BORROWERS.

Sustainable investing requires deeper research than traditional credit analysis, looking to uncover unidentified vulnerabilities that may affect the present and future value of a bond. It goes beyond financial statements to examine the environmental, social and governance (ESG) factors that can help determine the proper price of risk.

Examining ESG criteria adds a new level of rigor to fundamental analysis. It looks to realistically assess the reliability of future cash flows, ability to repay and price of a bond. It also rewards practices that focus on long-term viability through lower costs, lower waste and greater efficiencies.

CORPORATE BONDS: AVOIDING THE COSTS OF UNEXPECTED DISASTER

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 seeds of sudden deterioration.

Regulatory and environmental risk. Long-term investors should be cognizant of long-term externalities. Increasingly strong market reactions to scandals and catastrophes—as well as tightening regulations across a range of issues from carbon emission standards to privacy laws—show that long-ignored externalities are now having a greater impact on companies and their investors.

Controversy risk. Class-action lawsuits and workplace disasters show what can happen when corporations fail to respect fair labor practices, supply chains and the interests of other stakeholders—with serious consequences for an issuer's bond prices. By contrast, the best performers seize opportunities to engage their employees and invest in human capital as well as their communities.

Management risk. Wasteful executive pay and fiscal gimmickry are often signs of poor oversight. Well-governed organizations follow sound practices such as independent board audits and transparent disclosure of both financial and non-financial (ESG) factors.

CO_2

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. Yet, a deeper look 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 identifies best-in-class performers by measuring these practices.

MUNICIPAL BONDS: INVESTING IN SUSTAINABLE PROJECTS AND FISCALLY SUSTAINABLE ISSUERS

In analyzing the sustainability of municipal bond issues, Breckinridge asks such questions as:

Is the project essential? The more vital a project is to a local community, the more likely bondholders will be repaid. In the Great Depression, bonds issued for school construction and water and sewer systems had the lowest default rates (as reported in Albert Hillhouse, *Municipal Bonds: A Century of Experience*).

Does the issuer support its social and economic environment? A community that invests in its schools and environment may strengthen its fabric over time, especially if these actions improve the local employment rate, median household incomes and constituent education levels.

Are governance practices sound? Well-managed municipalities look beyond upcoming budgets in order to avoid future destabilizing events. They adhere to strong financial controls, develop affordable capital plans and closely monitor long-term pension liabilities and principal maturities.

Why taxable municipal bonds?

Despite misconceptions that all municipal bonds are tax-free, they are available in both taxable and tax-free issues. An area of Breckinridge expertise, taxable municipal bonds feature:

- Spreads historically wider than comparably-rated corporate bonds coupled with lower default rates
- Low correlation with corporate debt and equity
- Opportunities to support community initiatives such as healthcare, education and transportation

What happens if the water runs dry?

Water and power utilities issue billions of dollars in bonds each year. Their credit ratings are frequently based on assumptions about a return to historical averages in water supply—an old method that may underweight drought conditions in states in the southwestern US.

While precipitation has brought some relief in recent months, water utilities in California, for example, remain challenged. Groundwater in the state is critically low, and water utilities have received state executive orders to lower consumption by an average of 25%. Due to the required reduction, many utilities are raising rates, dipping into cash reserves or searching for water supply alternatives outside of importing it from out of state. Drought conditions can also create problems for electric utilities that rely on hydropower.

DEBUNKING THE MYTHS ABOUT SUSTAINABLE INVESTING

PERCEPTION	REALITY
Pursues social goals at the expense of investment returns	**Seeks to improve risk-adjusted returns** through better pricing of future uncertainties
Negative screens that bluntly exclude objectionable sectors or activities	**Positive rankings** that seek to direct capital to the best performers and responsible bond issuers
Niche products suited only for sustainability or impact allocations	**Mainstream discipline** for managing core fixed income portfolios
Limited liquidity and higher risk	**Liquid markets** with consistent supply and a large universe
Backward focus on past performance	**Forward-looking analysis** of dormant risks and emerging trends

A COMPREHENSIVE FRAMEWORK FOR SUSTAINABLE INVESTING.

Breckinridge is a pioneer in developing formal frameworks for analyzing ESG risks in fixed income. Our capabilities include rigorous processes, a seasoned team and proprietary technology. We focus on a forward-looking evaluation of risk by integrating environmental, social and governance factors into the credit research process.

Sustainable investing may be the answer for…

Institutional investors with a long-term perspective and a commitment to best practices

Foundation investment officers who want to align their investment strategy with their program strategy

Investment advisors and consultants looking for an opportunity to connect with changing investor values

A RIGOROUS FORMAL PROCESS

Our mission is to find the best. In the corporate bond market, we invest in companies that are improving efficiencies, reducing waste, engaging relevant stakeholders and holding management accountable for performance. In the municipal sector, we look for essential projects undertaken by fiscally-sound, forward-thinking municipalities. We evaluate ability to pay, security structures that protect bondholders, and taxpayer willingness to pay, as measured by a project's focus on health, education or other core government missions.

Our investment approach fully integrates bottom-up fundamental credit analysis with ESG criteria. To evaluate the ESG risks of corporate bonds, we conduct our own proprietary assessments supported by research from MSCI, Bloomberg, Sustainalytics and other third-party sources. For municipal bonds, we employ several proprietary sector-specific frameworks, aggregating data from various sources such as the U.S. Census, the EPA, the CDC and more. By integrating ESG into our assessments of credit quality, we seek to judge whether a bond correctly compensates investors for risk relative to return.

BRECKINRIDGE RESEARCH FRAMEWORKS

Our rigorous process includes an in-depth assessment of credit fundamentals and ESG factors such as:

CORPORATE BONDS

SUSTAINABILITY ASSESSMENT

Environmental
- Toxic emissions & waste
- Water intensity & biodiversity protection

Social
- Human capital development
- Health & safety

Governance
- Compensation structure
- Independent board of directors

BOTTOM-UP CREDIT ANALYSIS

Business profile
- Market position
- Brand

Operating trends
- Margins
- Cash flow

Capital sources
- Leverage
- Liquidity

Proprietary analysis

RATINGS & OUTLOOK

We draw corporate ESG data from a variety of sources, including Sustainalytics, MSCI and Bloomberg and conduct our own proprietary evaluations, including an in-depth analysis of controversy and reputational risks.

Final investment decisions are driven by both sustainability and credit assessments.

MUNICIPAL BONDS

SUSTAINABILITY ASSESSMENT

Economic
- Employment sector diversity
- Rate affordability

Environmental
- Air quality index
- Depth/breadth of sustainability plan

Social
- Graduation rate
- Income inequality

Governance
- Disclosure & transparency
- Evidence of professional city management

Impact
- Essential public purpose projects: education, public transit, healthcare, clean energy, water resources

BOTTOM-UP CREDIT ANALYSIS

Obligation
- Security
- Covenants

Ability to repay
- Tax base
- Liquidity

Willingness to repay
- Essentiality
- Public purpose

Pension liability assessment

Proprietary analysis

RATINGS & OUTLOOK

Final investment decisions are driven by both sustainability and credit assessments.

We have developed 8 sector-specific frameworks to assess sustainability for municipal bonds. The frameworks were created utilizing data from a number of governmental and non-profit organizations and through collaboration with industry experts.

INTEGRATING INNOVATIVE AND PROVEN ADVANTAGES.

Breckinridge's ESG frameworks reinforce our investment approach and philosophy to preserve capital and provide reliable income for our clients.

Breckinridge at a glance

Firm

- Founded in 1993
- Independently owned
- High-grade fixed income strategies for institutional and private clients through a national network of investment consultants
- Registered Massachusetts Benefit Corporation
- Certified B Corp

AN EXPERIENCED, COLLABORATIVE TEAM

For a manager of high-grade portfolios, Breckinridge has a deep bench of talent. Our investment professionals contribute perspectives from a diverse range of backgrounds, including investment management, government and law. To add additional depth, our firm-wide investment committee offers interpretive guidance on the market.

CUSTOMIZED SEPARATE ACCOUNTS

Breckinridge manages every client portfolio independently in a separate account. We have invested in internal systems that allow us to offer a high level of customization, enabling our clients to set portfolio parameters that are consistent with their objectives, risk tolerances and values. We also firmly believe that a separate portfolio is a far better solution than a mutual fund for a high-grade fixed income strategy. By owning bonds directly in a separate portfolio, an investor can look beyond short-term market fluctuations and rely on a predictable cash flow from principal and interest payments. Direct ownership is especially critical when markets are volatile, mutual fund flows turn negative and liquidity is challenged—the very times when investors rely most heavily on fixed income allocations to add a measure of stability to their overall portfolios.

CONTINUOUS INVESTMENT IN OPERATIONAL EXCELLENCE

Breckinridge is constantly enhancing the systems, technology and business processes that are the backbone of our operations. Our commitment to operational excellence is the common thread that connects every aspect of our business from research, trading and portfolio management to information management and client service. We recognize that the portfolios we manage are often the bedrock of our clients' investments and we understand the importance of executing at the very highest level. Breckinridge is committed to continuously strengthening our systems and processes to improve our accuracy, responsiveness and overall investment management capabilities.

Looking to invest with impact?

The principles of sustainable investing can be used to construct portfolios that are guided by an investor's sense of stewardship. Investing in responsible companies rewards good actors and best practices, while buying municipal bonds can support sectors that address specific social or environmental challenges, such as transportation, healthcare, infrastructure and education. For foundations or educational institutions, we believe a sustainable approach can align investment goals with program goals, helping increase social impact without sacrificing return potential.

COMMITTED TO OUR PRINCIPLES.

At Breckinridge, our sense of stewardship extends beyond our client portfolios to encompass our community and the larger environment.

A COMPANY-WIDE CULTURE OF SUSTAINABILITY

Sustainability is deeply ingrained in our culture, and we follow the same path that we advocate for others. We have established corporate governance, environmental and social charitable committees comprised of members from across the firm. The groups are tasked with mobilizing our staff to scrutinize our practices, identify areas of risk and brainstorm ideas for improvement. Breckinridge is also a current member or signatory of a wide range of industry networks, initiatives and associations, including but not limited to:

Certified B Corporation

United Nations Principles for Responsible Investment

CDP

CERES Investor Network on Climate Risk (INCR)

The Forum for Sustainable and Responsible Investment

The Association for the Advancement of Sustainability in Higher Education

Renewable Choice Energy

Interfaith Center on Corporate Sustainability (ICCR)

Sustainability Accounting Standards Board (SASB)

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.

Breckinridge's sustainable analysis adds rigor to traditional analytical approaches. We broaden the scope of fundamental credit analysis by examining the environmental, social and governance 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 and protect the risk-adjusted return potential of their portfolios.

Contact Breckinridge today to learn more or for assistance transitioning your current fixed income strategies to a sustainable approach.

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A PIONEER IN MANAGING RISK—BEFORE IT IS RECOGNIZED

2004	**Bond Insurance** Warned investors about the risk exposure being taken by traditional bond insurers.
2006	**Auction Rate Securities** Alerted regulators to unrecognized risks.
2006	**Leveraged & Derivative Securities** Cautioned investors on mispriced risk in leveraged fixed income strategies and derivative securities.
2010	**Pension and Other Post Employment Benefits (OPEB)** Established framework for assessing the effects of municipal pension and OPEB liabilities on credit quality.
2011	**Bond Mutual Funds** Warned investors that unprecedented inflows into bond funds are unsupported by market liquidity—creating added risk to shareholders of funds.
TODAY	**ESG Risks** Advocating sustainable analysis as a new and more rigorous lens for examining risk.

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