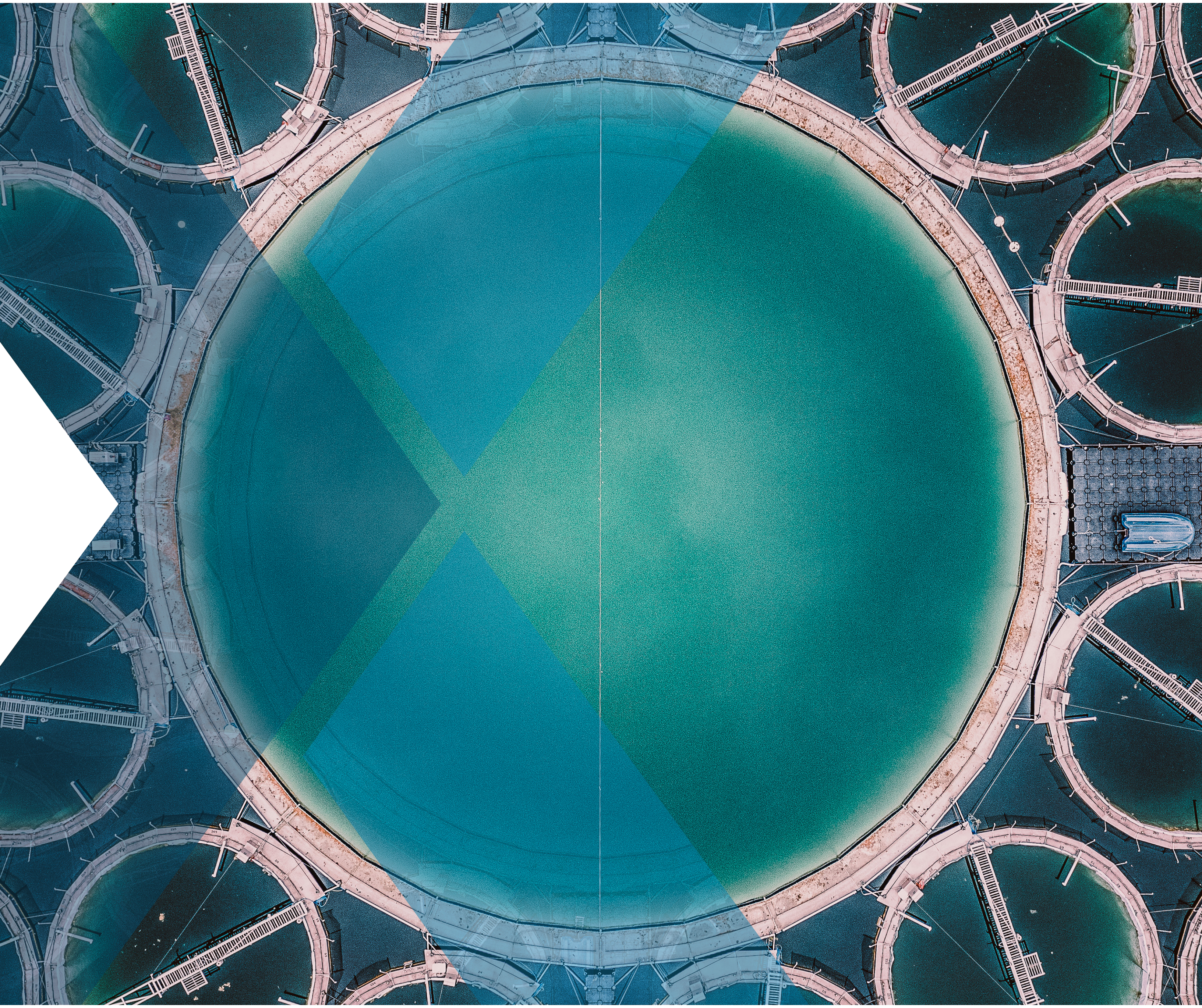
# What is Sustainable Allocation?

A balancing act in turbulent times



## Philosophy and mission

Founded in 1998, Impax Asset Management has pioneered investment in the transition to a more sustainable global economy and today is one of the largest investment managers dedicated to this area.

**We believe** capital markets will be shaped profoundly by global sustainability challenges, particularly climate change, environmental pollution, natural resource constraints, demographic changes and human capital issues such as diversity, inclusion and gender equity. These trends will drive growth for well-positioned companies and create risks for those unable or unwilling to adapt. Fundamental analysis which incorporates long-term risks, including environmental, social and governance (ESG) factors, enhances investment decisions.

**We invest** in companies and assets that are well positioned to benefit from the shift to a more sustainable global economy. We seek higher quality companies with strong business models and governance that demonstrate sound management of risk.

**We offer** a well-rounded suite of investment solutions spanning multiple asset classes, aiming to deliver superior risk-adjusted returns over the medium to long term.

**25+ years**
**of specialist investment experience**

**c.300**
**employees in offices globally**

**80+**
**investment team members (UK, US, Hong Kong, Ireland)**

As of September 2023.

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# Introduction

2023 was a strong year for both stocks and bonds, and multi-asset investors ended the year achieving double-digit returns. Regardless of the economic cycle, we believe a balanced approach to asset allocation can produce sustainable risk-adjusted returns.

We ask Steve Falci, Head of Systematic & Multi-Asset Strategies at Impax, for his insight on sustainable multiasset investing that stands the test of time. He outlines his conviction in this approach, where he perceives opportunities for active portfolio management and for diversification.

## Our long-term convictions:

- We believe the fundamental rationale for a multi-asset approach remains intact, with vigilance around risk management and a focus on additional sources of diversification and return.
- We believe embedding the transition to a more sustainable global economy in the structure and holdings of our underlying portfolios can drive better long-term risk-adjusted returns as the sustainable transition accelerates.
- We believe a 'core-satellite' approach to asset allocation can add diversification and potential upside to a balanced portfolio, within investors' risk tolerances.

**Steve Falci**
Head of Systematic & Multi-Asset Strategies

**Andy Braun**
Managing Director, Senior Portfolio Manager

**Tony Trzcinka**
Managing Director, Senior Portfolio Manager

## The 60/40 portfolio has delivered some volatile results over the past 5 years. Do you think it has met expectations?

**Steve:** 60/40 has been touted as a proxy for balanced investing, but really it's a moderate risk strategy. In an environment where both bonds and stocks saw outsized returns, this moderate risk approach has delivered good outcomes, offsetting the challenging results it delivered in 2022.

However, the moderate-risk investor should remain cognizant of managing risk in a more volatile market environment and identifying unique sources of above-market rates of return. These opportunities could be even more meaningful in an environment where returns from equities over the next few years may lag their historical levels.

We believe that discipline in setting asset allocation targets, based on investor risk tolerance and a range of potential economic scenarios, can continue to be an effective tool in managing risk and return in volatile markets.

## Where do you currently perceive more attractive investment opportunities?

**Steve:** While we believe that it will be challenging to achieve returns in line with historical long-term averages, in the short term at least the ability to provide above-benchmark returns to clients is crucial.

First, this could be a market where stock pickers thrive. Often when there is volatility in markets, companies with strong long-term prospects may be sold off to valuation levels that are unwarranted. This provides seasoned, skilled portfolio managers opportunities to purchase stocks or add to positions at attractive prices.

Second, we believe that there is a risk premium associated with investing in areas of the economy that are better positioned for the transition to a more sustainable economic model. We believe embedding this transition in the structure of our underlying core portfolios has the potential to deliver better risk-adjusted returns over the long run. This stems from our conviction that companies and issuers operating in areas of the market that are well-aligned with the transition could be more resilient and better placed to thrive. Our Impax Sustainability Lens helps us focus on the sub-sectors that can benefit from opportunities – and avoid risks – arising from disruptions in four categories: technology, consumer preferences, enterprise responses and regulation. This tool incorporates the investment thesis that drives our choices.

Separately, we published the 2023 Impact @ Impax report where we summarize the impact delivered by the underlying investments in Impax strategies.


## Where should investors look to pursue additional potential sources of diversification and return?

**Steve:** Alternatives can add diversification and potential upside in a multi-asset portfolio with core allocations to equities and investment-grade bonds, for investors who are not restricted to listed markets.

The private equity market can provide this exposure. Impax has found opportunities in projects that use proven technologies to provide clean energy in developed European markets.

For investors who can only access funds with publicly-traded securities, thematic approaches and/or sub-asset classes in listed markets can also provide additional sources of return and diversification. Some examples are high-yield bonds and listed infrastructure equities.

## Energy as Opportunity: The legacy energy companies have experienced recent gains, but are they poised to benefit from the transition to a sustainable economy?

**Steve:** There is little room for fossil fuel generation in any future that addresses the drivers of climate change. Encouragingly, renewables' share of the energy mix in the EU reached a record 24% since Russia invaded Ukraine,[1] while it recently reached 39% in the UK[2] amid dramatically falling prices for solar PV modules and wind turbines.

Many fossil fuel companies have invested in solar and wind technologies, and some are even investigating carbon capture and storage. But we would caution against seeking short-term gains by investing in oil and gas companies on the back of their recent profitability, fuelled by a crisis in global energy markets.

The energy companies we believe hold promise are not those clinging to stranded assets (which could become economically redundant and lose value much sooner than expected), but those that are adapting and creating new technologies to enable clean, efficient energy production. Indeed, demand for energy efficiency tends to increase with the price of oil.

Future electricity demand is not only a function of the number of global devices, processes and networks powered by electricity, but also of how efficient they are. Among energy efficiency stocks, we believe those focused on products and facilities that store energy at either a grid or building level – including batteries and their components – and those focused on efficient backup power and uninterruptable power supply, can play increasingly prominent roles in new energy infrastructure.

1 CNN, October 17, 2022. https://www.cnn.com/2022/10/17/energy/renewable-energy-eu-climate-intl
2 UK Department for Business, Energy and Industrial Strategy, Statistical Release, September 2022.


# Impax Sustainable Allocation Fund: a strategy to navigate the delicate balance

Launched in 1971, the Impax Sustainable Allocation Fund was the first socially responsible mutual fund in the US.[3] Over 50 years later, the Fund continues to support sustainability and engagement efforts with an enhanced focus on the risks and opportunities arising from the transition to a more sustainable global economy. The Fund strives to deliver competitive risk-adjusted returns by investing across a broad range of equities and fixed income investments, including environmental markets, infrastructure, impact bonds and the gender equity space.

Joining Steve are portfolio managers **Andy Braun** and **Tony Trzcinka**, to discuss the Impax Sustainable Allocation Fund, its underlying holdings, and how they seek to address a range of sustainability issues.

## How does the investment team frame asset allocation in an evolving macroeconomic environment?

**Steve:** As we believe that capital markets will be profoundly shaped by global sustainability challenges, we also believe that historical data may not act as the best predictor for guiding asset allocation ranges when developing our five-year outlooks. Historical data will likely not represent the next five years of economic activity in an evolving macroeconomic environment. As a team, we develop strategic asset allocation ranges each year based on five-year asset class returns across three economic scenarios, representing the 'best', 'base' and 'worst' case possibilities, which help guide our allocation to the Fund's underlying holdings.

**Tony:** For fixed income, the two largest drivers for our three economic scenarios are spreads and treasuries. For both, we look at a series of quantitative and qualitative data to get a baseline of market consensus. From there, we dynamically collaborate as an investment team to discuss what impact we think interest rates, spread reversions and corporate earnings will have on returns over the next five years.

**Steve:** We use a programming tool to integrate risk, returns and correlations from the three economic scenarios to establish strategic asset allocation ranges that will guide asset allocation decisions over the next year. Because the ranges are formed based on three scenarios of potential returns, they provide guideposts for portfolio rebalancing and help us avoid getting caught up in market exuberance or pessimism.

3 At launch, the Fund's name was The Pax Fund, and as of December 31, 2022 it has been renamed the Impax Sustainable Allocation Fund.

**Andy:** Steve and Tony described the five-year outlook and return estimate that's done on an annual basis. This is supplemented by a monthly macroeconomic analysis that focuses on a shorter-term horizon, looking out over the next three to nine months. We look at a matrix of key economic and valuation indicators and determine their impact on equities (US and non-US), bonds and rates utilizing a five-tier scale. This process helps to inform our tactical allocations and adjust the Fund's overall asset allocation weightings for stocks, bonds and cash, as well as the regional allocations for US and non-US securities.

**When establishing 'best', 'base' and 'worst' case economic scenarios, the Impax Sustainable Allocation Fund's investment team considers:**

Prospective 12-month returns given their nearer-term visibility on economic growth, earnings, interest rates and credit spreads.

The timing and intensity of any potential economic slowdowns or expansions over the next two to three years and their implications for economic growth, interest rates and credit spreads.

The impact of longer-term secular drivers on asset class returns. These can include market structure, the transition to a more sustainable global economy and secular influences on inflation and interest rates.

## What makes up the Fund's underlying holdings?

**Steve:** The Fund can invest in any Impax Fund and is structured around "core" allocations to the major asset classes with "satellite" exposure to focused US and global equities funds. Core funds will generally represent the majority allocation to the asset class and are the primary vehicles for strategic and tactical adjustments. Satellite funds aim to provide diversification and differentiated sources of outperformance, with a target allocation of 2% to 6%. The Fund's current core exposure to each of the main asset classes is represented by the Impax Large Cap Fund for US equities, the Impax Core Bond Fund for fixed income and the Impax International Sustainable Economy Fund for non-US equities.

**Andy:** The US Large Cap strategy leverages a lot of the firm's proprietary sustainability analysis. In addition to the Impax Sustainability Lens, which identifies attractive industries for investment, we use a bottom-up tool, the Impax Systematic ESG rating. The Sustainable Allocation Fund also has differentiated satellite exposures, including to global environmental markets, global women's leadership, global sustainable infrastructure and small-cap equities. This approach seeks to supplement this portfolio's ability to generate distinctive insights (and alpha) from the collective expertise of the Impax listed equities team.[4]

**Tony:** For fixed income, we have allocations to the Impax High Yield Bond Fund and to the Impax Core Bond Fund. The core bond allocation represents the investment grade market and is the largest fixed income holding. This is a diversified, multi-asset class, investment-grade portfolio and is duration neutral. Since we do not try to predict interest rates, we seek to outperform the benchmark from our asset class allocation and issuer selection within a sustainable investment framework. Our allocation to high yield seeks to provide enhanced diversification and is considered a satellite allocation.

**Steve:** A multi-asset approach, with vigilance around risk management and a focus on additional sources of diversification and return, must also include a focus on the transition to a more sustainable economy. We believe that emphasizing the higher opportunity areas of the market while deemphasizing higher risk areas will help deliver competitive adjusted performance over the long term.

4 Alpha is a coefficient measuring risk-adjusted performance, considering the risk due to the specific security, rather than the overall market. A positive alpha reflects higher relative risk-adjusted performance of the Fund versus its benchmark.

The Impax Sustainable Allocation Fund's underlying holdings seek to direct capital to companies that provide sustainable solutions for environmental markets, infrastructure, gender equity and bond proceeds.

## What are some of the sustainability issues that this strategy seeks to address?

**Andy:** As investment managers and allocators, we strive to ensure that both our equities and fixed income holdings are representative of our best ideas for the transition to a more sustainable global economy. The Sustainable Allocation Fund's underlying holdings seek to direct capital to companies that provide sustainable solutions for environmental markets, infrastructure, gender equity and bond proceeds.

Additionally, every underlying holding in the Sustainable Allocation Fund uses a series of proprietary tools developed at Impax to systematically integrate environmental, social, and governance (ESG) criteria into idea generation, company research, portfolio positioning, and risk management. These tools include the Impax Sustainability Lens, the Impax Gender Score, the Impax Systematic ESG Rating and our internal fundamental ESG research. We use these tools to help identify companies we believe are best positioned to benefit from the transition to a more sustainable global economy. This includes companies that provide products and services to address sustainability challenges, have diverse teams associated with improved decision making, and take steps to manage material sustainability issues and make their organizations more resilient.[5]

**Tony:** Part of our sustainable investing framework for fixed income is our allocation to impact bonds, where the proceeds have a common purpose of generating a specific positive environmental or societal outcome. Impact bonds can include green, social and sustainable bonds. While overall bond issuance has been down, the Core Bond Fund is not restricted to buying only corporate bonds: it can also purchase asset-backed securities, sovereign bonds and government-related taxable municipal bonds. I think that we'll continue to see expansion in the issuance and type of impact bonds. In my view, gender-themed and biodiversity impact bonds are poised to be the next big areas for growth.

5 Julie Gorte, Ph.D, Impax Asset Management, September 2021: "The Business Case for Diversity: 2021 Update"

## Important information

Impax Asset Management is investment adviser to Impax Funds.

Impax Funds are distributed by Foreside Financial Services, LLC. Foreside Financial Services is not affiliated with Impax Asset Management. Branch Office: 30 Penhallow Street, Suite 400, Portsmouth, NH 03801 603-431-8022.

**You should consider a fund's investment objectives, risks, and charges and expenses carefully before investing. For this and other information, call 800.767.1729 or visit www.impaxam.com for a fund prospectus. Please read it carefully before investing.**

Investments involve risk, including potential loss of principal.

Performance data quoted represent past performance, which does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For most recent month-end performance information, visit www.impaxam.com

**RISK**

The Impax Sustainable Allocation Fund is a fund-of-funds. The funds' allocations may change due to market fluctuations and other factors.

Equity investments are subject to market fluctuations, the fund's share price can fall because of weakness in the broad market, a particular industry, or specific holdings.

Emerging market and international investments involve risk of capital loss from unfavorable fluctuations in currency values, differences in generally accepted accounting principles, economic or political instability in other nations or increased volatility and lower trading volume.

Funds that emphasize investments in smaller companies generally will experience greater price volatility.

Yield and share price will vary with changes in interest rates and market conditions. Investors should note that if interest rates rise significantly from current levels, bond fund total returns will decline and may even turn negative in the short term. Mortgage related securities tend to become more sensitive to interest rate changes as interest rates rise, increasing their volatility. There is also a chance that some of the fund's holdings may have their credit rating downgraded or may default.

The Fund is actively managed. The investment techniques and decisions of the investment adviser and the Fund's portfolio manager(s), including the investment adviser's assessment of a company's ESG (Environmental, Social and Governance) profile when selecting investments for the Fund, may not produce the desired results and may adversely impact the Fund's performance, including relative to other Funds that do not consider ESG factors or come to different conclusions regarding such factors.

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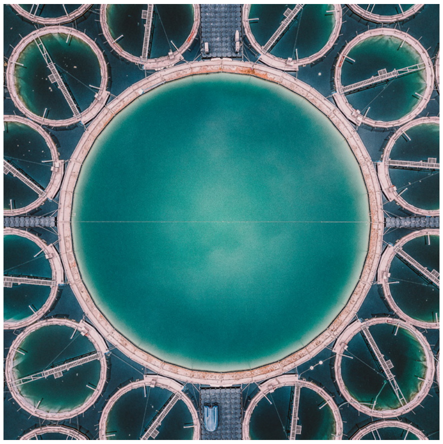

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