



Multi-sector  
fixed income

# A comprehensive approach to fixed-income investing

ESG integration in Federated Hermes  
multi-sector strategies

## Executive Summary

- Incorporating Environmental, Social and Governance (ESG) factors can lead to discovering credit risk not found through financial analysis alone.
- Federated Hermes' Total Return Bond and Strategic Income strategies integrate ESG factors in their multi-sector approach to building portfolios, with each sector's team tailoring its rating system to the most relevant and financially material factors.
- Our process is bolstered by our in-house active engagement division, EOS at Federated Hermes. These subject-matter experts meet with issuers to gather exclusive ESG insights.

At Federated Hermes, we believe that incorporating ESG factors into our research across asset classes provides greater insight into investment risks and opportunities. There is little dispute that the assessment of ESG factors can reveal important information about a company's practices and leadership. However, extracting value from these insights within a portfolio can depend on how the information is incorporated into the investment process and within the portfolio.

To this end, Federated Hermes' global team of engagement and responsible investing experts provides proprietary ESG data and analytics, which our investment teams use to manage risk and identify opportunities. A key input of our data comes from our leading engagement and stewardship division, EOS at Federated Hermes. EOS's direct engagement with companies is not only important in order to obtain insights into a company's ESG practices, it can also improve an issuer's ESG profile and thereby seek to reduce the issuer's risks over the longer term. Using our engagement insights and other proprietary ESG data, we generate custom "materiality" assessments that focus on the long-term ESG considerations that are financially relevant to each industry.

The investment teams use our ESG data analytics, materiality assessments and engagement in ways that are appropriate to their specific strategies, in support of better outcomes for our clients.

### Proactive ESG integration across sectors

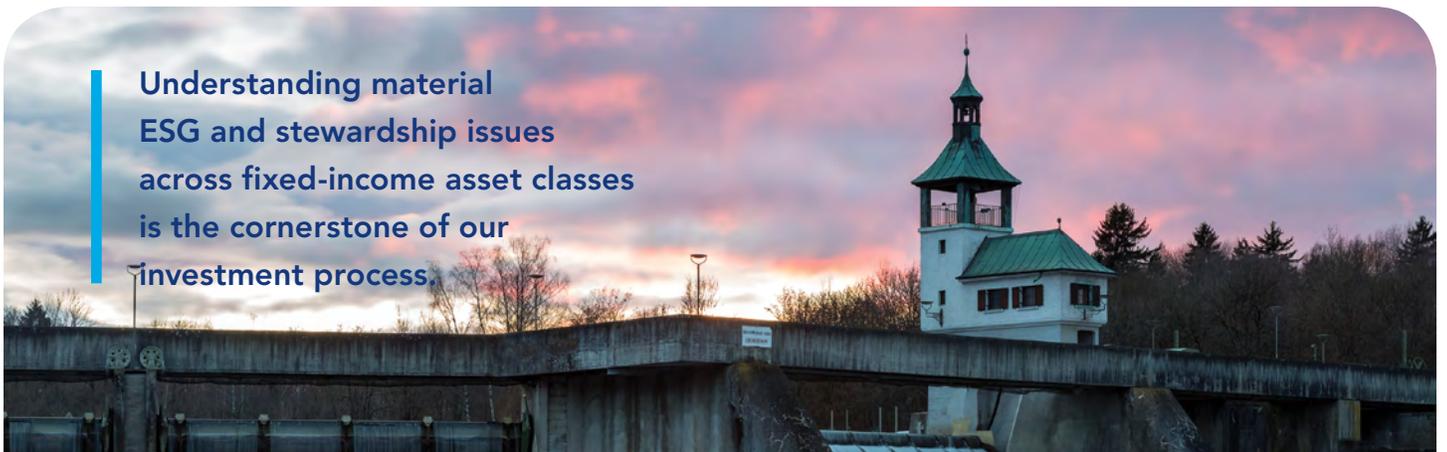
For more than four decades and through many economic and market environments, Federated Hermes has been a leader in fixed-income investing. Our wide-ranging experience is showcased in our multi-sector portfolios. Our diversified and active approach is designed to mitigate risk by allocating assets to a broad mix of bond sectors managed by separate teams<sup>1</sup>—investment-grade corporate, high yield, structured products, tax free and international—based on in-house views of economic and market conditions. It is a dynamic approach with the flexibility to shift allocations to take advantage of opportunities in the fixed-income market. Our Strategic Income and Total Return Bond strategies benefit from the primary research generated by investment managers and analysts working within each of these broad arenas.

Integrating material ESG factors into our rigorous bottom-up, fundamental analysis furthers the goal of mitigating risk, often providing information not found through financial analysis alone. While the crucial evaluation of an issuer's governance and debtholder stewardship stretches across sectors, the relevance of environmental and social factors varies by industry, country and category. This requires a customized assessment for each sector – one that third-party credit ratings cannot supply. Direct engagement with management augments the process and helps determine the compensation required to assume risk, or whether a security should be removed from the portfolio. ESG analysis also helps to identify mispriced securities, i.e. companies with positive ESG momentum, that may not be fully reflected in their valuation.

To date, ESG investing has been primarily associated with equities, but the privileged legal status of bondholders can give fixed-income managers a seat at the table to advocate for change. This is a responsibility we relish.

<sup>1</sup> See chart on page 3 for sectors and security types in which each team primarily invests.

Understanding material ESG and stewardship issues across fixed-income asset classes is the cornerstone of our investment process.



## EOS: The engagement advantage

Federated Hermes is one of the largest active managers with a dedicated engagement and stewardship division. EOS at Federated Hermes is a pioneer in engagement, with a 16-year database providing a competitive advantage for the investment-grade fixed-income strategies and our firm. Engagers are ESG subject-matter experts on topics including climate change, human capital management, sustainable supply chains and corporate governance, and are uniquely positioned to assess the ESG progress and momentum of a corporate issuer.

EOS specialists have deep industry-specific knowledge, with extensive experience in particular sectors and on the select companies they cover. EOS engages on material ESG objectives on key environmental, social, governance and strategic themes which comprise 36 unique sub-themes. Engagers provide meaningful insight into a company's willingness and ability to manage ESG risks. By integrating engagers' deep understanding of financially relevant ESG factors, our portfolio managers are better equipped to assess the quality of current and potential holdings. [Learn more about EOS at Federated Hermes here.](#)

### Our proprietary ESG rating system

Our evaluations draw insight from investment managers across five sectors, each using a scoring system appropriate to their market.

Team	Primary focus <sup>2</sup>	Scoring system	Rationale for additional scrutiny
<b>Investment-grade corporate</b>	High-quality corporate debt	Debtholder: D-ESG 1: strong 2: moderate 3: weak	How company management and boards treat bondholders is critical – prompting special consideration when studying ESG factors.
<b>High yield</b>	Corporates, bank loans and equities	Debtholder: D-ESG 1: above average 2: average 3: below average	The increased potential for default and tail risk in this sector makes stewardship of debtholders a primary concern when assessing non-investment-grade securities.
<b>International</b>	Developed and emerging-market corporates and sovereigns	Country/Debtholder: CD-ESG 1: above average 2: average 3: below average	Business practices differ across international markets, making the assessment of a country's standards a crucial guidepost to evaluating its ESG and tail risks.
<b>Structured Products</b>	Mortgage-backed securities (MBS), asset-backed securities (ABS) and commercial MBS	Securitized: S-ESG ESG factors scale of 1-5 1: least relevant to 5: most relevant	Data on the quality of securitized assets and sponsors responsible for collecting the data is limited, demanding additional scrutiny within the broader ESG framework.
<b>Tax Free</b>	Municipals	Municipal: M-ESG 0: neutral -1: weak	Each municipal borrower has its own characteristics – from organizational structure to reporting standards – requiring added emphasis on the governance factor.

<sup>2</sup> All teams may invest in U.S. Treasuries, Treasury Inflation Protected Securities (TIPS) and Government-Sponsored Enterprise (GSE) debt.

## Material engagement objectives



## Active management and the continuing ESG journey

Demographic shifts, outdated management practices, social inequality and ecological disasters are accelerating awareness of ESG factors and their relationship to long-term investment performance. We believe the voices asking to implement these principles across industries and asset-classes will only grow louder.

Active management and engagement can shine in this environment, and multi-sector strategies hope to enhance the investment benefits of both by drawing on the expertise of the entire firm. Relying on the judgment of their colleagues, the investment managers constantly adjust sector weightings to seek alpha and mitigate risk. When analysts know how to evaluate ESG elements in their respective asset classes, the whole project stands to benefit—sharpening our ability to deliver outcomes clients expect.

**For more complete information on Federated Hermes funds, visit [FederatedInvestors.com](https://FederatedInvestors.com) or contact your Federated Hermes sales professional for summary prospectuses or prospectuses. You should consider the fund's investment objectives, risks, charges and expenses carefully before you invest. Information about these and other important subjects is in the fund's prospectus or summary prospectus, which you should read carefully before investing.**

Terminology such as "ESG integrated", "sustainable" or "impact", among other terms, is not uniformly defined across the industry. Investment managers may understand and apply ESG factors in different ways, and that the role those factors play in investment decisions also varies. Therefore, we recommend investors understand the role of ESG factors in a strategy to ensure that approach is consistent with their investment objectives. Like any aspect of investment analysis, there is no guarantee that an investment strategy that considers ESG factors will result in performance better than or equal to products that do not consider such factors. Investing and making buy and sell decisions that emphasize ESG factors carries the risk that, under certain market conditions, the fund or strategy may underperform those that do not incorporate such factors explicitly into the decision-making process. The application of ESG criteria may affect exposure to certain sectors or securities and may impact relative investment performance depending on whether such sectors or securities are generally in or out of favor in the market.

Bond prices are sensitive to changes in interest rates and a rise in interest rates can cause a decline in their prices.

Diversification does not assure a profit nor protect against loss.

High yield, lower-rated securities generally entail greater market, credit/default and liquidity risks and may be more volatile than investment-grade securities.

In addition to the risks generally associated with debt instruments, such as credit, market, interest rate, liquidity and derivatives risks, bank loans are also subject to the risk that the value of the collateral securing a loan may decline, be insufficient to meet the obligations of the borrower or be difficult to liquidate.

International investing involves special risks including currency risk, increased volatility, political risks and differences in auditing and other financial standards.

Prices of emerging markets securities can be significantly more volatile than the prices of securities in developed countries and currency risk and political risks are accentuated in emerging markets.

The value of some asset-backed and mortgage-backed securities may be particularly sensitive to changes in prevailing interest rates, and although the securities are generally supported by some form of government or private guarantee and/or insurance, there is no assurance that private guarantors or insurers will meet their obligations.

Income from municipal bonds may be subject to the federal alternative minimum tax (AMT) and state and local taxes.

There is no guarantee that considering ESG risks will be a successful investment approach.

Alpha measures the excess returns of a fund relative to the return of a benchmark index.

The ESG ratings assigned are one consideration among others as part of the security selection process and do not represent an assessment of the fund itself. The qualitative analysis described does not automatically result in including or excluding specific securities but is used as an additional input to improve portfolio risk/return characteristics.