Q&A:

Federated Hermes

How trade finance plays a key role in multi-asset portfolios

Federated Hermes has been investing in trade finance since 2007 as an uncorrelated alpha source and to reduce reliance on traditional return drivers.

Why Federated Hermes uses trade finance as part of asset allocation:

- **Alpha potential**
  Inefficiencies exist for non-bank investors which can be consistently exploited
- **Diversifier**
  Reduces reliance on traditional return drivers by providing a portfolio of idiosyncratic risks, diversification and potential alpha generation
- **Floating rate returns**
  Coupons fixed over ICE BofA US Dollar 1-Month Deposit Offered Rate Constant Maturity Index resulting in low interest rate risk
- **High income potential**
  Coupons are higher than those of many other short-term debt securities
- **Low volatility**
  Historical annualized volatility has been low
- **Short duration**
  Self-liquidating transactions with a strategy weighted average life of less than 24 months[1]
- **Uncorrelated returns**
  Low to negative correlations with most major market indices and other short duration indices

What is trade finance at Federated Hermes?

- Trade finance refers to loans that provide short-term financing to support the physical flow of goods while using the goods within the transaction as primary security.
- The loan is collateralized by the goods being financed and is self-amortizing from the proceeds of the transaction. Trade finance loans float at a spread over a short duration index, such as the ICE BofA US Dollar 1-Month Deposit Offered Rate Constant Maturity Index.
- The lender uses a number of risk mitigation techniques to reduce risks to an acceptable level, such as collateral management of the goods, permanent control of the title over the goods, ring-fenced cash flows and trade credit insurance.

What are some of the characteristics of trade finance?

- Short-term transactions generally are self-liquidating with a strategy weighted average life of less than 24 months[1], exhibiting low interest rate risk and credit duration risk.
- Transactions are secured by specific assets and make use of risk mitigants to reduce risks to an acceptable level.
- The arranger of a trade finance transaction holds a significant part of the deal on its own books to maturity (originate to hold).

How large is the trade finance market?

- Although the demand for trade finance continues to grow, a complex regulatory environment coupled with a lack of understanding of the asset class has contributed to a global shortage of trade financing.
- Global merchandise trade stood at $16 trillion in 2008 and declined to $12 trillion at the depths of the crisis before resuming its growth to $22 trillion in 2020.[2]
- World trade declined less during the COVID-19 crisis in 2020 than during the global financial crisis in 2009.[2]
- The gap for global trade finance opportunities grew to an all-time high of $1.7 trillion in 2020, a 15% increase from two years earlier.[3]

Why is trade finance an alternatives asset class at Federated Hermes?

- As a short-duration asset class, most banks hold their positions to maturity and thus there is a limited secondary market. Extensive documentation is required; trade settlement occurs in 10-20 days and is considered illiquid. Investments of Federated Hermes' funds into trade finance are limited to a maximum of 15% because of this lack of liquidity.

Why Federated Hermes trade finance?

- We maintain diversification by lead arranger, borrower, region, country, sector and transaction security.
- We have a credit-intensive investment selection process and active post-investment monitoring.
- Our experience. Federated Hermes' trade finance strategy was launched in 2007 and is managed by a dedicated team employing clearly articulated investment guidelines.

[1] Average life refers to the underlying securities held by Federated Hermes portfolios which are not available to the public and are used by the multi-sector portfolios to provide more effective diversification than is available through the purchase of individual securities.

[2] Source: WTO, World Trade Report 2021.

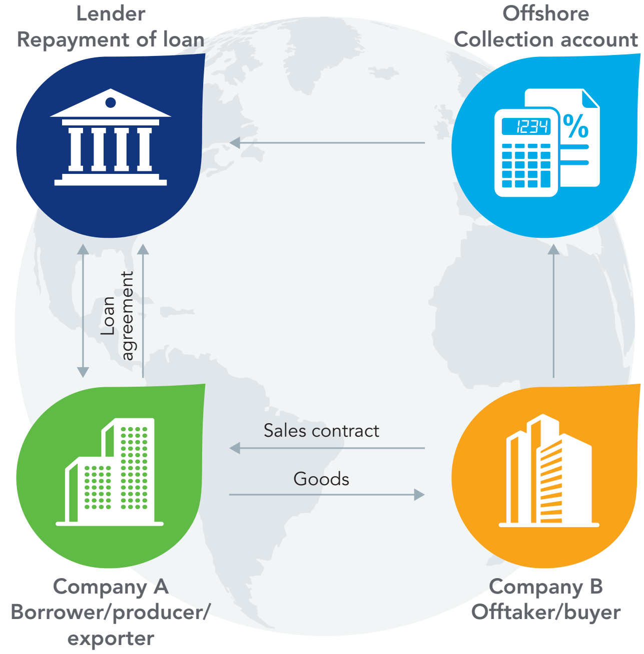
[3] Source: Asian Development Bank, 2021 Trade Finance Gaps, Growth, and Jobs Survey.

Trade finance transaction example

Type of borrowing – Pre-export finance loans

Pre-export finance loans (PXF) allow the exporter of goods to be prepaid for production and sale. This is particularly useful for paying for the costs of production and factor inputs.

- Payments for goods are made to an offshore collection account
- Receipts into this account are used to service debt
- Excess receipts into the collection account are returned to the borrower
- Lenders are generally secured on pledge over the collection account
- Assignments of interest in the commercial contracts
- Acknowledgment from the buyer that payments will be made into the collection account



Key investment team

Ihab L. Salib
Senior Vice President,
Senior Portfolio Manager,
Head of International
Fixed Income Group

Christopher McGinley
Vice President,
Senior Portfolio Manager,
Head of Trade Finance Team

Maarten Offeringa
Vice President,
Portfolio Manager,
Senior Investment Analyst

A word about risk

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.

Trade finance related securities will be located primarily in, or have exposure to, global emerging markets. 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.

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Federated Investment Management Company