The COVID-19 pandemic has amplified the investment materiality of environmental, social and governance (ESG) factors. In this publication, we outline why we believe companies managing ESG risks and opportunities are built on firmer foundations to brace and survive downturns.

IN THIS ISSUE

Corporates Rise to the Social Challenge 3-4
COVID-19 has propelled corporate social actions to the forefront of ESG analysis and engagement.

GSAM in Conversation 5-6
Alex Edmans, Professor of Finance at the London Business School, tells us how great companies can deliver both social purpose and profit, while we discuss how the pandemic has magnified the importance of shareholder and bondholder engagement.

The Climate Transition Continues 7-8
Despite financial challenges, companies continue to give long-term green investments the green light.

Good Governance in the New Normal 9-10
Unprecedented disruption underscores the importance of good governance for companies, municipalities and sovereigns.
Introduction

The COVID-19 Pandemic Amplifies the Importance of ESG Factors

The COVID-19 pandemic is one of the most difficult tests in modern history and has generated the deepest plunge in economic data on record. Within weeks, non-essential activity migrated from offices to homes and online, while workplaces that cannot operate remotely have ceased or reduced operations for an indeterminate timeframe.

These rapid changes have amplified the investment materiality of ESG factors, as outlined by investment teams from across GSAM in this publication. As companies navigate the challenging environment, the spotlight is on social responses, with corporate actions towards employees, customers, suppliers and broader society moving to the forefront of ESG analysis. Short-term decisions, if managed well, can strengthen corporate foundations to enable survival through the downturn and ensure recovery in the aftermath of the pandemic. Innovative social responses have the potential to build positive brand equity among customers and improve employee morale. Of course, some companies do not have the ability to limit the negative impact on key stakeholders, with cash flows being severely dented by a sharp collapse in demand for their goods or services. As a result, we think good corporate governance in the ‘new normal’ will see heightened focus on capital allocation decisions, particularly those that may undermine a company’s resilience and ability to respond to an unforeseen shock.

Meanwhile, it is imperative that the climate transition continues. We are monitoring how the coronavirus crisis impacts corporate commitments to a decarbonized future. Cash flow challenges may lead to near-term delays in climate transition projects, but over the longer-term, we think companies will continue to give green investments the green light.

We feature an interview with Alex Edmans, Professor of Finance at London Business School, moderated by Sheila Patel, Chairman of GSAM, with oversight of ESG and impact investment initiatives. Alex discusses how great companies can deliver both purpose and profit, as well as his research that has informed the debate on share buybacks.

Finally, although it may seem premature to discuss the post-COVID world, we think actions and decisions taken today can influence long-term investment opportunities and value. We conclude with thoughts on emerging trends, many of which have ties to ESG factors.

Our thoughts are with those affected by the pandemic and we wish good health to all of our clients and readers of this publication.

Having a social purpose is not a luxury; it is critical. The health crisis has sharpened the focus on this view, driving ESG risks to the top of the agenda in our client conversations, with particular focus on the corporate social response towards employees, customers, suppliers, and society.

Sheila Patel | GSAM Chairman, with oversight of ESG and impact investment initiatives

ESG factors are material business issues and focus on the ‘what’ and the ‘how’ of corporate activity. The COVID-19 pandemic has led to greater attention on these factors, as an important input to our assessment of enterprise strength in an ever-evolving business environment.

Hugh Lawson | Head of Institutional Client Strategy and ESG & Impact Strategy; Co-Chair, GSAM Sustainability Council

A stark aspect of the health crisis is its disproportionate impact on lower income segments of populations, who can be both more exposed to the virus and less equipped to withstand economic difficulties. We believe the pandemic has made companies more conscious of their social responsibilities, a shift that could have lasting positive impacts.

Kathryn Koch | Co-Head of Fundamental Equity; Co-Chair, GSAM Sustainability Council
Corporates Rise to the Social Challenge

The pandemic has progressed analysis of social issues from a values-based approach to a key operational question. The health and safety of workers, resiliency of supply chains and prior capital allocation decisions (which may now hinder the ability of some companies to avoid negative impacts such as lay-offs) are some of the social factors being assessed, as outlined in Box 1.

We believe that effective management of social factors has the potential to translate into investment performance, which is why they are embedded in our investment analysis. This is also supported by research, with one study finding that companies with good human capital management benefit from a lower cost of debt, higher credit ratings and lower stock price volatility¹.

The current crisis reflects a stress test for corporates. Financial metrics (such as balance sheet health and liquidity positions) and ESG factors can offer important insights into how equipped an enterprise is to weather unexpected risk events.

We analyze how companies balance actions that impact shareholders and bondholders, along with ‘doing the right thing’ by other key stakeholders such as employees and customers. We recognize that companies which sustain key stakeholder relationships tend to retain competitiveness and exhibit stronger performance in post-crisis years². Our credit research team further assesses how decisions affect a company’s credit quality and ratings. This is important during a downturn as social actions can weigh on credit metrics and lead to a rating downgrade, despite their contribution to long-term value. These considerations are critical for financially constrained companies, while those with healthier balance sheets can afford to take steps to limit negative social impacts. That said, we’ve identified high yield companies that have innovated to deliver social responses.

The corona crisis may serve as an inflection point for more companies to prioritize their social contribution. If companies fail to recognize the value that they can create for, and take from, society, they could lose their social license to operate.

Niamh Whooley
Head of Fixed Income ESG Research

GSAM QIS: Equity Insights Strategies

Our Quantitative Investment Strategies (QIS) team has recently seen heightened client interest in investment portfolio resilience to social pressures and concerns arising from COVID-19. Recent QIS analysis on the importance of social factors revealed higher employee satisfaction—as measured by Glassdoor ratings from Thinknum Alternative Data—can result in better equity returns as shown in the chart on the right; this finding is consistent over time.

Equity returns may be linked to employee satisfaction

Cumulative Excess Return (%) 2011-2019

<table>
<thead>
<tr>
<th>Company Quintile Based on QIS Analysis of Employee Satisfaction</th>
<th>Cumulative Excess Return (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (Bottom)</td>
<td>-16.70</td>
</tr>
<tr>
<td>2</td>
<td>-0.40</td>
</tr>
<tr>
<td>3</td>
<td>0.70</td>
</tr>
<tr>
<td>4</td>
<td>5.80</td>
</tr>
<tr>
<td>5 (Top)</td>
<td>10.50</td>
</tr>
</tbody>
</table>

Source: GSAM, Glassdoor, Thinknum Alternative Data. Based on data for US large cap companies. * Relative to the average return across quintiles. Stocks are equally weighted within quintiles.

¹ The Materiality of Human Capital to Corporate Financial Performance: Investor Responsibility Research Center Institute (IRRCi) and co-authored by Larry Beeferman and Aaron Bernstein with the Labor and Worklife Program at Harvard Law School.
² To save or to invest? Strategic management during the financial crisis (2018); (Flammer, Boston University; Ioannou, London Business School).
Corporates Rise to the Social Challenge

Box 1 Spotlight on Social

**Social-in-time production.** Corporate social innovation in response to the crisis has been uplifting and encouraging. Some auto production has shifted to medical equipment, US communications companies are providing broadband access to students impacted by school and university closures, and fashion houses are sewing hospital—rather than ball—gowns. These actions are the right thing to do if companies have the operational capability, but also have the potential to create positive brand recognition among customers and strengthen employee engagement over time.

**Health and safety first.** Health and safety of employees, while always important, is paramount during a pandemic. Today, these risks are particularly acute for consumer product companies given continued—if not increased—demand for food, beverages, and other consumer products. Health and safety issues can result in large supply-chain disruptions. For example, several US meat processing plants have had to close operations due to virus outbreaks within their workforce. In the UK, we’ve identified a retailer prioritizing the safety of its employees; it closed its online store to reorganize its warehouse for social distancing. However, the crisis has also highlighted shortcomings in some industries. Many large restaurant chains in the US have limited sick pay policies and their employees may not benefit from recent fiscal support which guarantees sick leave for employees of smaller companies.¹

**Capital allocation decisions in the context of crisis readiness.** We are evaluating prior capital allocation decisions, including share buybacks, to ascertain whether they have impacted a company’s ability to retain workers. In our view, the crisis may drive companies to reconsider how resilient they are—from a capital adequacy and liquidity perspective—to risk events, including natural disasters or cyber security breaches. However, we would caution against a ‘one-size-all-fits-all’ view on companies that engage in share buybacks. Research suggests share buybacks can drive long-term value, as discussed further on page 5.

**Workforce strategies that limit the negative impact on employees.** The pandemic has created unprecedented disruption for firms. Workforce reductions may be unavoidable in sectors facing collapsed demand, such as retail, hospitality and travel. However, we have identified positive actions taken by companies to manage changing workforce needs and minimize hardship for employees, without endangering their businesses. For example, one US hotelier has suspended share buybacks, reduced capital expenditures, turned off dividend payments and although it has furloughed employees (unpaid leave of absence), it continues to provide healthcare benefits. Another hotelier has partnered with retail companies—whose activities are deemed essential and are in greater demand—to expedite the hiring process for its furloughed employees for short-term work assignments. We believe these differentiating actions will have important implications as we move beyond the pandemic, as studies have shown that furloughs and layoffs deemed to be unfair can have lasting negative impacts on employee morale, which in turn can impair a company’s overall profitability.²

**Efforts to support customers.** Many US auto insurers are repaying customers’ monthly insurance premiums, while allowing those facing financial difficulties to delay two consecutive payments without penalty. These actions reflect an anticipated fall in car insurance claims due to an extraordinary decline in road traffic. Meanwhile, with small- to medium-sized enterprises (SMEs) experiencing disproportionate challenges, some banks have voluntarily offered forbearance on outstanding loans. Deferral of interest and principal repayments for several months could prove to be a lifeline for many SMEs. For banks, this forbearance is a positive social response, however, it also makes good business sense as company defaults could create a domino effect resulting in much larger losses. Furthermore, banks can actively engage in government fiscal responses, either by extending government guaranteed loans (as implemented across Europe) or by offering loans to fund wage bills and fixed costs (as observed in the US). Participation in these schemes can help limit bankruptcies. Overall, these actions can contribute to economic stability, while also helping to keep the proportion of non-performing loans on bank balance sheets in check.

¹ The US Coronavirus Aid, Relief and Economic Security (CARES) Act guarantees sick pay for workers of companies with fewer than 500 employees.
Q: Alex, in your recent book, Grow the Pie, you conclude profit and purpose are not a zero-sum game. Can you explain this pie concept to our readers?

A: Evidence shows that purpose leads to profit, rather than a company needing to be profitable before it begins to pursue purpose. And if we consider the value a company creates as a pie that can grow in size, that means a company can increase the slice it gives to stakeholders without reducing what is left for shareholders.

Q: I often note that having a purpose is not a luxury: it is critical. How do we encourage more firms to adopt this “pieconomics” philosophy?

A: First, we need to emphasize that purpose is tied to long-term shareholder value and is not an optional extra, but good business. Second, purpose needs to graduate from ‘food for thought’ to ‘plan of action’. Importantly, purpose is about actively doing good—through innovation and creativity—rather than simply avoiding wrongdoing. In addition, it is important to prioritize and specialize in areas where you can add most value. A Harvard Business School study found that companies that try to deliver high value in all areas underperform companies that deliver high value to material stakeholders. For example, an Energy company could close a polluting power plant to curb emissions, however, this would result in job losses. In short, purpose involves defining which stakeholders you can deliver most value to.

Q: In the midst of a health and economic crisis, how can companies struggling to survive contribute to the social response?

A: The corporate response has been tremendous but more clear-cut for some. For example, a consumer goods company can donate hand sanitizer that it already happens to produce. But what if you are a company where no part of your existing pie can be donated? This question highlights the importance of ‘pie growing’, namely, thinking innovatively to create social value. For example, one airline has leveraged its existing commercial relationship with a grocery retailer to locate temporary job opportunities for its furloughed employees.

Q: The decision to furlough employees has attracted criticism for some companies that engaged in share buybacks prior to the crisis. What is your view on this debate?

A: Share buybacks are often portrayed as a corporate action used to inflate executive pay or as an impediment to business investment. However, research I undertook with consultants PwC, commissioned by the UK Government, found that over a ten-year time period, no FTSE 350 company used buybacks as a means to achieve a senior leader’s bonus target. Moreover, evidence shows that although share buybacks benefit stock prices in the short term, the stock price rises even more over the long term. I am an advocate for buybacks given they provide more flexibility than dividends, and do not incur a stock price penalty if cut. Companies should utilize this flexibility in the current challenging environment.

Q: Perhaps you can conclude by outlining why you believe active corporate engagement is important.

A: Good cars have both accelerators and brakes. Activist investors can serve as a sounding board for CEOs and help drive innovation and productivity. This can help to grow the pie, even at already successful firms with smart and entrepreneurial leadership.
Commitment to Engagement and Stewardship in a Crisis

Shareholder Engagement

Even in the midst of a crisis, we remain committed to our Stewardship responsibilities: proxy voting and direct engagement with company management to unlock long-term value. Our Global Stewardship Team has already engaged with over 100 companies globally to understand their evolving response to COVID-19 and we have attended numerous shareholder meetings in virtual format; a first for many, if not all, companies. These engagements are in addition to management meetings conducted by GSAM investment teams.

Our conversations have been centered on measures taken to protect employee health, wellbeing and pay, as well as supplier and customer management. We have also discussed broader stakeholder engagement, social purpose, financial prudence (including executive compensation), and board oversight, preparedness and composition. One positive social highlight of these exchanges is learning of “premium pay” being offered to essential manufacturing employees at a pharmaceutical company.

In 2019, 73% of our 417 Global Stewardship Team meetings with 363 individual companies were centered on ESG factors, including ESG reporting, social and environmental risks, and board composition. The health crisis has magnified the importance of these discussions. We expect to see an acceleration in shareholder proposals during the 2021 proxy season, with elevated focus on executive pay in an environment of job losses. Currently, only 53% and 47% of MSCI Europe and MSCI US constituents, respectively, disclose executive pay policies that include ESG metrics. As we progress beyond the health crisis, a spotlight on societal inequalities—including the disparity between executive and wider workforce pay—may lead to increased proposals calling for ESG metrics to be embedded in executive pay policies.

Social factors dominate ESG discussions

Since March, social factors have claimed a larger share of ESG issues discussed in COVID-19 related content. Employee health and safety combined with labor practices represent over half of this increased social share, followed by topics such as supply chain management, product quality and safety, and access and affordability. Emphasis on ESG factors will continue to evolve over time, however, we expect focus on social considerations to outlast the crisis.

ESG Topic Share in COVID-19 Related Content

Source: Truvalue Labs. Based on over 100,000 unique information sources and ESG categories as defined by Sustainability Accounting Standards Board (SASB). As of May 6, 2020.

1 Corporate engagements are tracked in our digitized research platform, Fluent. See page 8 of Innovation-Driven Investing (January 2020) for additional details.

Bondholder Engagement

Dialogue with corporate management is an important input to our credit research process¹. Defaults, downgrades and resultant spread widening are dominant risks in corporate bond markets. Through communication with companies we raise ESG matters alongside topics such as the market environment and corporate strategy in order to better analyze credit risks. Engagement with corporates have been amplified by the pandemic, as our credit team seeks to understand how management teams balance near-term cash flow challenges with actions on social factors such as workforce decisions.

Moreover, through engagement we can identify whether a company’s ESG performance is improving or deteriorating. This forward-looking trend analysis enables us to monitor progress towards sustainable business practices.

Similarly, our sovereign economists—who regularly meet with both monetary and fiscal authorities as discussed on page 10—have focused recent discussions with policymakers on measures undertaken to improve both health and economic outcomes. In the EM sovereign space, our interactions range from trade unions and employers’ associations to government officials and supranational entities including the IMF, World Bank and OECD. These conversations often cover ESG topics, including energy and social policies, sustainable infrastructure investments and climate resilience.
The Climate Transition Continues

A sudden stop in global activity has slashed greenhouse gas emissions and air pollution. But the planetary breather is modest relative to the emissions reduction required to curb climate change and will likely prove short-lived, as already observed in China. We think the near-term repercussions are negative, with climate talks and new green policy initiatives being delayed¹. However, once the pandemic is under control, we expect there will be an opening for governments to generate a green economic recovery². We are monitoring private sector commitments to the climate transition. Emissions regulations, customer preferences and declining cost curves support the case for cleaner energy sources. Withdrawals from climate commitments risks loss of market share once growth recovers. However, companies are faced with an intertemporal trade-off between near-term liquidity preservation and medium- to long-term climate investments. Overall, we think sectors with activities that have a large environmental footprint will retain their green investment commitments, as discussed in Box 2.

Investors help to ensure climate risk remains top of mind for corporates

Number of climate-related shareholders’ proposals by region vs. % vote in favor

Less near-term focus on climate change will prove to be a small bump in the road toward a decarbonized world. In fact, green fiscal policies and private sector decisions could smoothen—or even shorten—the path to climate change commitments once the economic recovery takes hold.

Alexis Deladerrière
Head of Developed Market Equities

Though many companies have committed to deploying capital to mitigate longer-term environmental risks, we believe some will be forced to balance liquidity and credit quality considerations against these aims. Overall, we expect most companies will recognize that these ‘green’ investments are secular—not cyclical—decisions.

Stephen Waxman
Head of Global Investment Grade Research

The pandemic provides a new dataset on the resilience of different business models when faced with a stay-at-home economy and an upside-down energy market. This provides us with a unique opportunity to further improve our understanding of how the low-carbon transition might play out.

Tim Verheyden
Quant Equity ESG Researcher

¹ The 2020 United Nations Climate Change Conference (COP26)—planned to take place in November—has been delayed until 2021.
² As also advocated by the IMF (see Special Series on COVID-19 “Greening the Recovery” April 20, 2020) and other policymakers, particularly across Europe.
**Energy:** Companies are bracing a twin oil-virus shock, with oil prices plunging on a collapse in demand and insufficient production cuts. The dominant near-term driver of investment performance is share price, downgrade risks and liquidity challenges. But the drive for clean energy sources remains intact and, over the last year, many oil and gas companies committed to achieving net zero emissions by 2050¹. Achieving this requires investments in clean energy. Renewable project economics remain attractive relative to conventional investment projects, given the availability of tax incentives and lower oil prices. We therefore expect investments in renewables to hold steady even as other costs are cut to preserve liquidity. In the near-term, we think large oil and gas companies with greater financial resources will retain their commitment to climate transition efforts, while lower-rated companies prioritize capital conservation. As we progress beyond the health crisis, we expect competitive renewable energy costs and low interest rates to result in increased investments in decarbonization efforts.

¹ Net-zero refers to achieving an overall balance between emissions produced and emissions taken out of the earth’s atmosphere. The terminology is therefore somewhat interchangeable with that of ‘carbon-neutral’ or with having ‘no negative impact’ on the environment.

**Autos:** The climate transition is a key investment driver for autos. But faced with a precipitous drop in sales and closed production plants, firms are currently more focused on liquidity management rather than environmental efforts. However, we believe that car makers investing in electric vehicles (EVs) are poised to perform well over the long term. Stringent emissions standards, particularly in Europe and China, will continue to steer auto makers towards EV production. Indeed, some European automakers have cut dividends in order to preserve liquidity and in turn EV investments. In addition, we think any fiscal support for the sector will introduce additional incentives to support EV purchases, as observed in China, the world’s largest EV market.

**Aviation:** International travel restrictions have led some airlines to retire older, less fuel efficient aircrafts earlier than planned; a positive environmental development. Conservation of cash is critical given airlines will face trying conditions for longer than other sectors, as travel restrictions will likely be the last component of activity to normalize. This headwind alongside low oil prices may delay the delivery of new fuel efficient aircrafts. That said, we think some airlines will take a longer-term view and, over time, we expect commitments to lower aviation emissions will continue due to both the regulatory environment and consumer preferences.

**Packaging:** Activity restrictions have led to increased online shopping traffic. E-commerce penetration will likely remain higher than pre-crisis levels even as economies normalize; this could serve as a structural tailwind for packaging providers. However, this trend will also have environmental implications. Prior to the crisis, packaging for home-delivered products already accounted for 30% of annual US solid waste generation. Meanwhile, half of all plastic waste ever produced was created in the past fifteen years, of which just 9% has been recycled. The negative environmental reality of plastic has been rising in consumer awareness for some time. Governments have taken action, with policies ranging from plastic bag charges to outright bans on some single-use plastic products. Companies have also responded to the need for sustainable packaging options, pursuing innovation to create alternatives. Health and hygiene concerns may result in greater use of disposable packaging in the short-term, as anecdotally observed in supermarkets and coffee shops where reusable bag and cup use is being restricted. However, beyond these near-term behavioral changes, we expect continued regulatory headwinds for plastic and ongoing innovation in sustainable packaging solutions.
Rapidly changing market conditions underscore the importance of good corporate governance, including operational back-up plans and robust supply chain management. Our governance investment lens includes a focus on how companies are maintaining oversight and risk controls while teams are more dispersed and workforces adopt a new normal.

Governance factors can also offer investment insights in relation to sovereign, municipal and securitized markets. In the sovereign space, progress on governance factors can signal stable and improving economic performance. Governance and management practices are key pillars of our credit analysis of US municipal bond issuers. We review budgetary practices and responsible municipal use of debt; this includes capital raised to strengthen economic performance, social inclusiveness (including spending on healthcare and education) and environmental projects. Governance risk factors also arise in securitized markets, where non-bank mortgage lenders appear insufficiently capitalized to withstand mortgage payment delays or delinquencies as borrowers face economic difficulties. We delve deeper into these considerations in Box 3.

Management of ESG risks can provide downside protection when investing in EM sovereign credit.

Prakriti Sofat | EM Economist

Non-bank mortgage lenders have leaned against calls for higher capital requirements in recent years. However, they now appear insufficiently capitalized to withstand both a temporary postponement of mortgage repayments and an anticipated rise in mortgage delinquencies.

Matthew Kaiser | Securitized Portfolio Manager

There has been a substantial uptick in sustainability and social bond issuance linked to pandemic efforts

ESG-related bond issuance has been on the rise in recent years, setting a new annual record of over $276 billion in 2019\(^1\). The pandemic has accelerated this trend. Year-to-date issuance is tracking higher than prior years, with a notable increase in sustainability and social bond issuance, particularly in April as shown in the chart. Last month’s uptick was largely driven by supranational, sovereign and agency issuers as they seek to address COVID-19. Proceeds from social bonds have been linked to projects that address social challenges, including those arising from the global pandemic\(^2\). Social and sustainability bonds\(^3\) have been met with strong investor demand. This includes a new issue from Guatemala, the first EM economy in the Central American region to issue a social bond (as discussed on page 10). We think the policy backdrop and investor demand will continue to fuel supply of ESG-related bonds.

| Gross green, social and sustainability bond issuance |
|----------------------|---------------------------|---------------------------|---------------------------|---------------------------|
|                      | USD Bn                    | Sustainability Bonds      | Social Bonds              | Social or Sustainability Bonds with Use of Proceeds for Pandemic Efforts | Green Bonds |
| Jan-20               | 50                        | 30                       | 10                        | 20                        |
| Feb-20               | 45                        | 25                       | 15                        | 15                        |
| Mar-20               | 40                        | 20                       | 10                        | 10                        |
| Apr-20               | 35                        | 15                       | 10                        | 5                         |

Source: Bloomberg. Excludes issuance relating to general corporate purposes and financing. Includes issuance in all currencies converted to US dollar.

1 Source: Bloomberg. Reflects gross green, social and sustainability bond issuance.
2 As guided in the International Capital Markets Association’s (ICMA) Social Bond Principles.
3 Sustainability bonds are characterized by use of proceeds on a combination of both green and social process (as also guided by ICMA guidelines).
Good Governance in the New Normal

Box 3 Good Governance Helps Companies and Sovereigns Perform Well in a Crisis

**EM Sovereign Credit.** Governance considerations including strength of institutions, political stability, and regulatory quality, are essential for determining both potential growth prospects of EM sovereigns and policy responsiveness in times of stress. Our governance analysis unites objective ESG metrics, such as The Worldwide Governance Indicators compiled by the World Bank, with subjective views informed by our engagement with policymakers responsible for both monetary and fiscal decisions. These policymaker interactions can strengthen conviction in an investment decision or provide new insights that lead us to reconsider our views. Their importance can be summarized with the analogy: a high-spec car will not get very far with a bad driver. Similarly, an EM economy endowed with natural resources or demographic tailwinds will not realize its economic potential under poor leadership. Moreover, governance factors underpin our assessment of debt sustainability, which is an important consideration in the current environment with countries facing weaker growth prospects due to virus containment measures and as a result of lower tourism, slower global growth and—for certain economies—falling commodity prices. Good governance can strengthen policy responsiveness to COVID-19. EM sovereigns can obtain financing from multi- or bi-lateral development partners. They can also access financial markets, with some countries utilizing innovative financing sources. For example, Guatemala recently became the first Central American country to issue a social bond, with proceeds used to fund its pandemic relief efforts. The social bond offering was well received by investors due to the country’s low level of debt, fiscal prudence and low exposure to virus-sensitive sectors such as tourism. Like global peers, Guatemala will face near-term economic challenges, however, we think it has sufficient currency reserves to withstand near-term volatility. Over the medium-term, we think select EM governments will strengthen their governance frameworks and adopt structural reforms to diversify their economies away from over-reliance on a particular commodity export, while COVID-19 motivates raised investments in healthcare infrastructure and technology.

**Municipal Bonds**. US municipalities are experiencing higher unemployment which translates to a decline in their largest revenue source: personal income taxes. Local sales tax receipts will also fall due to the closure of non-essential businesses. Our municipal bond analysis includes assessments of an issuer’s governance and management practices, including sound budgetary practices. We further quantify and analyze outcomes associated with projects, programs or services that contribute to thriving communities. This analysis can uncover stronger credit performance. We expect city and state governments which were in good financial shape prior to the current crisis to be better prepared to respond to economic challenges and we think municipal bonds issued by these issuers will remain attractive.

**Securitized Credit.** Post-financial crisis regulation led many banks to scale back their presence in the US mortgage market and paved the way for greater presence of lightly-regulated non-bank mortgage companies. Today, these ‘shadow lenders’ account for a majority of lending in US housing markets, with a particular focus on mortgages to borrowers with weaker credit ratings. However, they lack the same access to funding available to major banks, and as a result are more exposed to a housing downturn. In recent years, non-bank lenders have leaned against calls for stricter regulations and higher capital requirements. Many of these lenders now appear insufficiently capitalized to withstand both a temporary postponement of mortgage repayments and an anticipated rise in mortgage delinquencies due to the challenging economic environment. In the near-term, we think these dynamics present limited investment implications for the Agency MBS market. However, a prolonged period of economic weakness and therefore continued challenges in the non-bank mortgage sector could pose headwinds for the US housing market over time. In our view, regulatory scrutiny of shadow lenders will likely increase as we move beyond the current crisis, particularly if they receive government support.

---

1 Municipal bonds are debt securities issued by a U.S. state or local government or territory, or one of their agencies. The proceeds raised are directed toward either general funding for the municipality or a specific project or purpose, such as construction of roads or schools.
ESG Amplified

ESG Thoughts for a Post-COVID World

We are still in the midst of a crisis and unprecedented policy interventions are ongoing. Nonetheless, our forward-thinking investors, portfolio managers and economists are already reflecting on longer-term investment implications of actions and decisions taken today. We see the crisis accelerating emerging trends, many of which have ESG ties and some of which are quoted below.

"The fixed income investment opportunity set is expanding, with greater green, social and sustainability bond issuance; both in the more traditional form focused on the ‘use-of-proceeds’ and the recent evolution of sustainability-linked bond issuances. While governments—particularly in Europe—will continue to focus on strategic investments related to meeting climate goals, the ongoing health crises has put a greater global emphasis on bond issuances associated with sustainability goals."

Michael Kashani | Head of ESG Portfolio Management, Fixed Income

"The post-virus macro story will be told by micro and policy chapters, many of which will have ESG ties. Monetary regimes look set to evolve, promoting medium-term economic stability with consideration of ESG risks. Indeed, central banks in the US and UK have already cautioned against the economic risks posed by climate change, while the European Central Bank has purchased green bonds under its asset purchase programs. Looking ahead, environmentally-conscious consumer spending could be disinflationary, and income inequalities may narrow if policymakers see an opening to invest in education and re-skilling to ensure those losing jobs are equipped for employment in new roles or even new industries."

Gurpreet Gill | Economist

"Even in the midst of a crisis, we remain committed to our Stewardship responsibilities. The pandemic has magnified the importance of proxy voting and shareholder engagement. As we progress beyond the immediate health crisis, a spotlight on societal inequalities may lead to an increase in the number of shareholder proposals calling for social ESG metrics to be embedded in executive pay policies."

Catherine Winner | Global Head of Stewardship

"We’re presented with an opportunity to rebuild economies to be more sustainable and climate-conscious, with better equipped healthcare systems and more equitable societies. ESG factors can ensure our portfolio companies remain on the right side of these shifts."

Luke Barrs | Head of EMEA Fundamental Equity Client Portfolio Management
Views and opinions expressed are for informational purposes only and do not constitute a recommendation by GSAM to buy, sell, or hold any security. Views and opinions are current as of April 28, 2020 and may be subject to change, they should not be construed as investment advice.

Please note that this material may constitute research or an inducement under Markets in Financial Instruments Directive (MiFID). If you are in any doubt whether you can continue to receive or access this material, please consult your professional adviser. If you determine that you cannot continue to receive or access this material, please speak with your usual GSAM contact.

Although certain information has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness. We have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public sources.

Individual portfolio management teams for GSAM may have views and opinions and/or information available from public sources.

This information discusses general market activity, industry or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice. This material has been prepared by GSAM and is not financial research nor a product of Goldman Sachs Global Investment Research (GIR).

It was not prepared in compliance with applicable provisions of law designed to promote the independence of financial analysis and is not subject to a prohibition on trading following the distribution of financial research. The views and opinions expressed may differ from those of Goldman Sachs Global Investment Research or other departments or divisions of Goldman Sachs and its affiliates. Investors are urged to consult with their financial advisors before buying or selling any securities. This information may not be current and GSAM has no obligation to provide any updates or changes.

Economic and market forecasts presented herein reflect a series of assumptions and judgments as of the date of this presentation and are subject to change without notice. These forecasts do not take into account the specific investment objectives, restrictions, tax and financial situation or other needs of any specific client. Actual data will vary and may not be reflected here. These forecasts are subject to high levels of uncertainty that may affect actual performance. Accordingly, these forecasts should be viewed as merely representative of a broad range of possible outcomes. These forecasts are estimated, based on assumptions, and are subject to significant revision and may change materially as economic and market conditions change. Goldman Sachs has no obligation to provide updates or changes to these forecasts. Case studies and examples are for illustrative purposes only.

This MATERIAL DOES NOT CONSTITUTE AN OFFER OR SOLICITATION IN ANY JURISDICTION WHERE OR TO ANY PERSON TO WHOM IT WOULD BE UNAUTHORIZED OR UNLAWFUL TO DO SO.

Emerging markets securities may be less liquid and more volatile and are subject to a number of additional risks, including but not limited to currency fluctuations and political instability.

High-yield, lower-rated securities involve greater price volatility and present greater credit risks than higher-rated fixed income securities.

An investment in real estate securities is subject to greater price volatility and the special risks associated with direct ownership of real estate.

The portfolio risk management process includes an effort to monitor and manage risk, but does not imply low risk.

Foreign securities may be more volatile than investments in U.S. securities and will be subject to a number of additional risks, including but not limited to currency fluctuations and political developments.

Prospective investors should inform themselves as to any applicable legal requirements and taxation and exchange control regulations in the countries of their citizenship, residence or domicile which might be relevant.

United Kingdom and European Economic Area (EEA): In the United Kingdom, this material is a financial promotion and has been approved by Goldman Sachs Asset Management International, which is authorized and regulated in the United Kingdom by the Financial Conduct Authority. Switzerland: For Qualified Investor use only - Not for distribution to general public. This document is provided to you by Goldman Sachs Bank AG, Zürich. Any future contractual relationships will be entered into with affiliates of Goldman Sachs Bank AG, which are domiciled outside of Switzerland. We would like to remind you that foreign (Non-Swiss) legal and regulatory systems may not provide the same level of protection in relation to client confidentiality and data protection as offered to you by Swiss law.

Asia Pacific: Please note that neither Goldman Sachs Asset Management International nor any other entities involved in the Goldman Sachs Asset Management (GSAM) business maintain any licenses, authorizations or registrations in Asia (other than Japan), except that it conducts businesses (subject to applicable local regulations) in and from the following jurisdictions: Hong Kong, Singapore and Malaysia. This material has been issued for use in or from Hong Kong by Goldman Sachs Asset Management (Hong Kong) Limited, in or from Singapore by Goldman Sachs Asset Management (Singapore) Pte. Ltd. (Company Number: 201329851H) and in or from Malaysia by Goldman Sachs (Malaysia) Sdn Berhad (880767W).

Australia: This material is distributed in Australia and New Zealand by Goldman Sachs Asset Management Australia Pty Ltd ABN 41 006 099 681, AFSL 228948 (‘GSAMA’) and is intended for viewing only by wholesale clients in Australia for the purposes of section 761D of the Corporations Act 2001 (Cth) and to clients who either fall within any or all of the categories of investors set out in section 3(2) or subsection-5(2CC) of the Securities Act 1978, fall within the definition of a wholesale client for the purposes of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA) and the Financial Advisers Act 2008 (FAA), and fall within the definition of a wholesale investor under one of clause 37, clause 38, clause 39 or clause 40 of Schedule 1 of the Financial Markets Conduct Act 2013 (FMCA) of New Zealand (collectively, a “NZ Wholesale Investor”). GSAMA is not a registered financial service provider under the FSPA. GSAMA does not have a place of business in New Zealand. In New Zealand, this document, and any access to it, is intended only for a person who has first satisfied GSAMA that the person is a NZ Wholesale Investor. This document is intended for viewing only by the intended recipient. This document may not be reproduced or distributed to any person in whole or in part without the prior written consent of GSAMA. This information discloses general market activity, industry or sector trends, or other broad based economic, market or political conditions and should not be construed as research or investment advice. The material provided herein is for informational purposes only. This presentation does not constitute an offer or solicitation to any person in any jurisdiction in which such offer or solicitation is not authorized or to any person to whom it would be unlawful to make such offer or solicitation.

Canada: This presentation has been communicated in Canada by GSAM LP, which is registered as a portfolio manager under securities legislation in all provinces of Canada and as a commodity trading manager under the commodity futures legislation of Ontario and as a derivatives adviser under the derivatives legislation of Quebec. GSAM LP is not registered to provide investment advisory or portfolio management services in respect of exchange-traded futures or options contracts in Manitoba and is not offering to provide such investment advisory or portfolio management services in Manitoba by delivery of this material.

Japan: This material has been issued or approved in Japan for the use of professional investors defined in Article 2 paragraph (31) of the Financial Instruments and Exchange Law by Goldman Sachs Asset Management Co., Ltd.

Environmental, Social, and Governance (“ESG”) strategies may take risks or eliminate exposures found in other strategies or broad market benchmarks that may cause performance to diverge from the performance of these other strategies or market benchmarks. ESG strategies will be subject to the risks associated with their underlying investments’ asset classes. Further, the demand within certain markets or sectors that an ESG strategy targets may not develop as forecasted or may develop more slowly than anticipated.

Confidentiality

No part of this material may, without GSAM’s prior written consent, be (i) copied, photocopied or duplicated in any form, by any means, or (ii) distributed to any person that is not an employee, officer, director, or authorized agent of the recipient.

© 2020 Goldman Sachs. All rights reserved. Date of first use: April 28, 2020.