DO MICROFINANCE INVESTMENTS CONTRIBUTE TO EFFICIENT PORTFOLIO DIVERSIFICATION?

October 2023

Marketing material for professional clients and qualified investors.


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For more than two decades, microfinance investments have been accessible to investors with the purpose of achieving both an attractive risk-adjusted financial return and a positive impact in emerging markets.
A subcategory of impact investments, microfinance has gained recognition as an asset class with several benefits such as low correlation, low volatility, and protection against inflation, making it an appealing choice for investors seeking to diversify their portfolios.

Key takeaways

We believe that microfinance investments offer an interesting asset class to investors who wish to diversify their portfolios while maintaining a high level of efficiency. The resilience and low correlation make the asset class an attractive investment option with favourable risk-return characteristics in a global portfolio. As the need for financial services in emerging and frontier markets continues to grow, microfinance investments are expected to remain an important asset class for investors looking to generate both financial returns and positive social impact.

Microfinance investments offer low correlation, low volatility, and an adjustment to raising interest rates, making them an attractive option for portfolio diversification and enhancement.

Microfinance is a rapidly growing sector, driven by the need to provide financial services to underserved populations and MSMEs in emerging and frontier markets.

Microfinance investments have demonstrated remarkable resilience across different economic cycles and market disruptions, thanks to their low correlation with macroeconomic events and conventional asset classes.

Microfinance investments present attractive risk-return metrics, in particular when compared to traditional asset classes.

Microfinance investments can significantly improve portfolio efficiency, particularly in fixed income-heavy strategies, while maintaining returns and reducing risk.

Robust credit analysis and systematic portfolio diversification are key risk mitigants that support the resilience of the asset class.

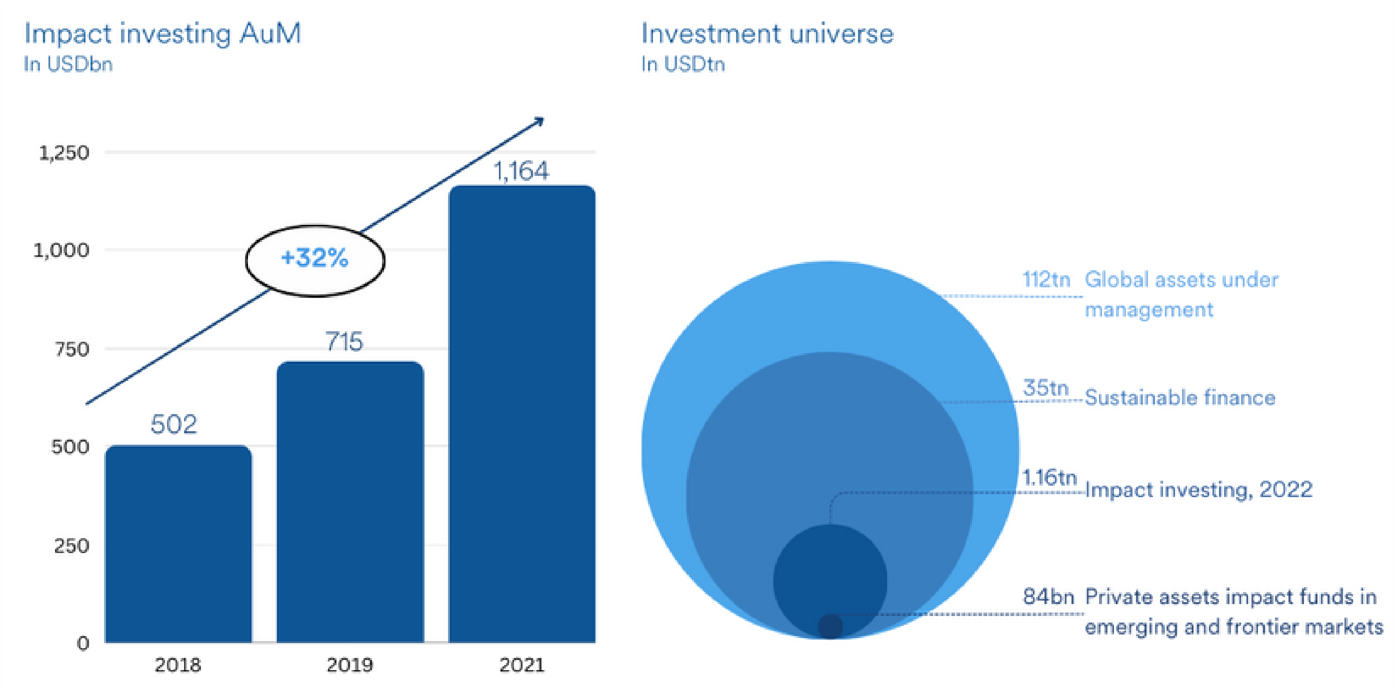
Impact investments in emerging and frontier markets may involve a unique and substantial level of risk, particularly those involving foreign currencies.

Contents

The impact angle: a powerful instrument for advancing financial inclusion

Investors allocated significant amounts to impact investments, including microfinance, in recent years. According to a study by the Global Impact Investing Network (GIIN), the total amount invested in this category reached approximately USD 1,164 trillion by the end of 2021. The growth rate over the last years has been around 32% and is expected to continue in the future.[1]

Chart 1: Impact investing - billions to trillions



1 The Global Impact Investing Market report, 2019, 2020; The Global Impact Investing Network, Sizing the Impact Investing Market 2022, 2022-Market Sizing Report-Final.pdf (thegiin.org); Tameo: Private Asset Impact Fund report 2022.
Figures as of December 2022.

Despite the progress made in promoting financial inclusion, a significant number of individuals, approximately 1.4 billion adults worldwide, remain unbanked.[2] The majority of these are women and those with low incomes in emerging and frontier markets. The lack of access to financial services is also prevalent among micro, small, and medium-sized enterprises (MSMEs) in these regions. They face significant financing challenges that can hinder their growth and potential for job creation. This is a crucial issue, as MSMEs are responsible for creating around 70-85% of total employment and contribute nearly 50% of national income (GDP) in emerging markets.[3] The COVID-19 pandemic has further exacerbated the financial exclusion of vulnerable groups and the SDG* financing gap has increased from USD 2.5 trillion annually to around USD 4 trillion as a result.[4]

Investments in microfinance institutions have proven to be successful in extending credit and other financial services to underserved populations and MSMEs. Regulated local financial institutions play a key role in providing access to credit, savings, insurance, trade finance, remittances, and other services microfinance institutions can offer to specific beneficiary groups such as MSMEs.

Furthermore, the rise of digitalisation, digital banking, and digital finance offers a promising means of accelerating financial inclusion. Emerging markets have already demonstrated a high level of digital banking adoption, with an increasing number of individuals turning to fintech applications and e-wallets to meet their financial needs. By providing funding to MSMEs that operate in the digital sector, this development can be further supported, fostering increased economic and social development in these regions.

Microfinance has demonstrated its effectiveness in promoting financial inclusion and reducing poverty in emerging and frontier markets. Chart 1 provides a summary of the impact achieved by the BlueOrchard Microfinance Fund (BOMF) as of December 2022, demonstrating the significant results of this remarkable approach.

2 Worldbank 2022: Global Findex Database 2021 reports increases in financial inclusion around the world during the COVID-19 pandemic (worldbank.org)
3 OECD: Enhancing the contributions of SMEs in a global and digitalised economy, 2017, https://www.oecd.org/industry/C-MIN-2017-8-EN.pdf; UN DESA: MSMEs and their role in achieving the SDGs, https://sustainabledevelopment.un.org/content/documents/25851MSMEs_and_SDGs_Final3120.pdf.
4 OECD, Bottlenecks to access SDG finance for developing countries, 2023, https://www.oecd.org/g20/oecd-g20-bottlenecks-sdg-finance-developing-countries.pdf.
* United Nations Sustainable Development Goals (SDGs)

BOMF Impact Performance Indicators*

Past performance is not a guide to future performance and may not be repeated.

As of 31 December, 2022

48%

BOMF loans provided in local currency

55

countries invested in

165

institutions financed

25.8m

MSMEs supported by FIs in the portfolio

1m

MSMEs supported by BOMF

439

MSMEs supported by BOMF per million invested

USD 13.8k

Average loan size to MSMEs

167.5k

medium

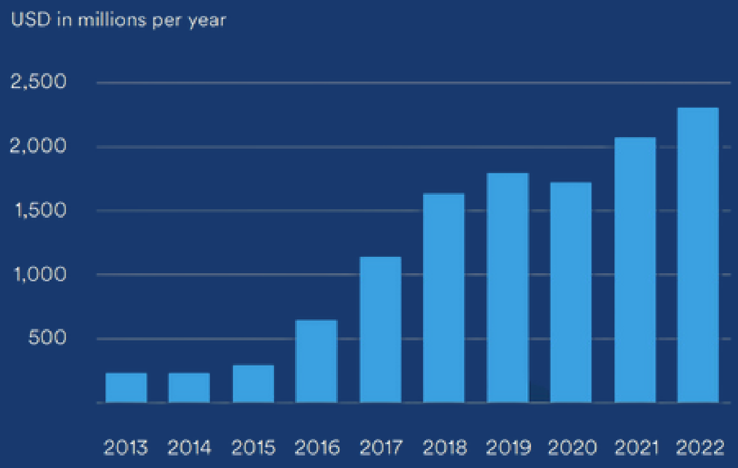
31.4k

small

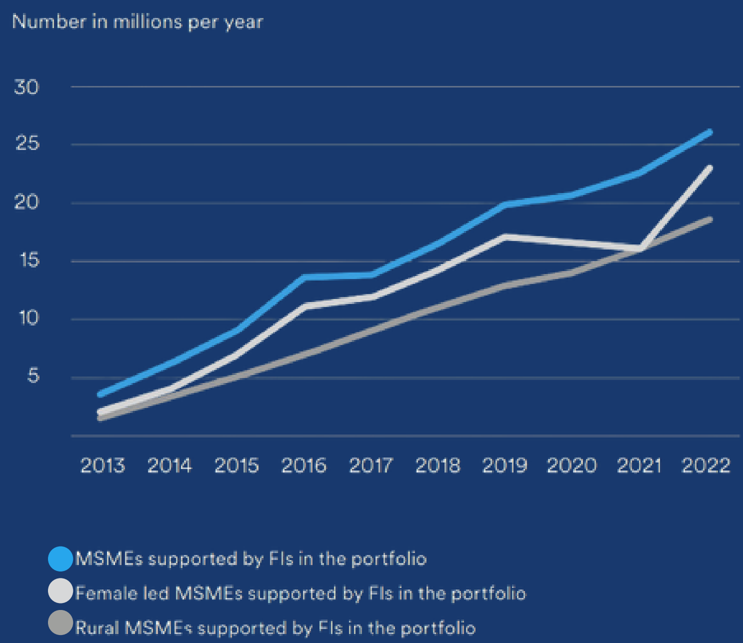
3.2k

micro

BOMF Investment Volume



BOMF Investment Volume



*Source: BlueOrchard Microfinance Fund Annual Impact Report 2022, www.blueorchard.com/wp-content/uploads/2023/04/BOMF-Annual-Impact-Report-2022.pdf.

Jobs Created or Maintained by FIs in the Portfolio

Number in millions per year

126.2m
by FIs in the portfolio

4.4m
by BOMF

Methodology

The size and classification of the underlying MSME clients are based on their loan size at origination (in USD). The following applies:

Microenterprises
if loan is below USD 15k at origination.

Small Enterprises
if loan is between USD 15k to USD 150k at origination.

Medium
if loan is between USD 150k to USD 250k at origination.

For the number of jobs created, the number of MSMEs are multiplied with the average number of employees for each enterprise size category as defined by the IFC.

SDG Alignment

25.8m
MSMEs supported by FIs in the portfolio

25.2m
micro-borrowers supported by FIs in the portfolio

USD 13.8k
average loan size to MSMEs
- Medium: 167.5k
- Small: 31.4k
- Micro: 3.2k

13.7m
rural clients reached by FIs in the portfolio

53%
rural clients reached by FIs in the portfolio

USD 2.3bn
investments in developing countries providing access to financial services

21.3m
female clients reached by FIs in the portfolio

82%
female clients reached by FIs in the portfolio

25.2m
micro-borrowers supported by FIs in the portfolio

595.1k
SMEs supported by FIs in the portfolio

126.2m
job opportunities created or maintained by FIs in the portfolio (estimation based on BOF methodology)

25.8m
MSMEs supported by FIs in the portfolio

25.2m
micro-borrowers supported by FIs in the portfolio:

USD 13.8k
average loan sizes to MSMEs reached by FIs in the portfolio

13.7m
rural clients reached by FIs in the portfolio

53%
rural clients reached by FIs in the portfolio

USD 2.3bn
investments in developing countries providing access to financial services

USD 2.3bn
investments in developing countries providing access to financial services

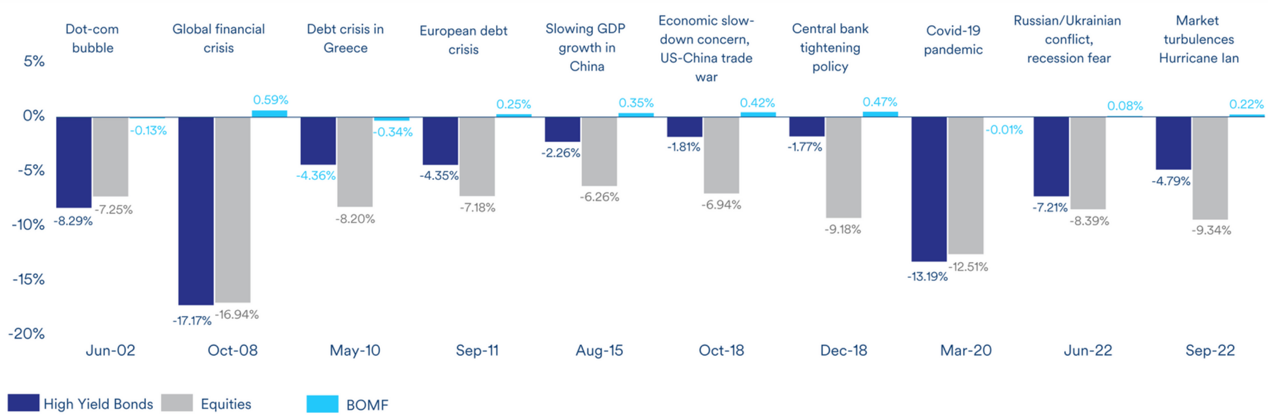
The financial angle: resilient, low correlation

Compared to more traditional asset classes, microfinance investments have demonstrated resilience in the face of major market disruptions. Typically, when the markets come under pressure, correlations tend to rise for traditional asset classes, but microfinance investments have shown to be an exception to this trend.

The BlueOrchard Microfinance Fund (BOMF) is a prime example of this, with a track record of over 20 years in weathering such disruptions while maintaining consistency compared to other asset classes, as demonstrated in Chart 2.

Chart 2: Strong historical drawdown protection

Monthly market drawdowns: Major macroeconomic events since BOMF's launch



Note: Monthly returns, as of 31 May 2023. 1. Highest monthly returns during global macro-events. BOMF performance net of fees. Equities: S&P500 Index, High Yield Bonds: BofA Merrill Lynch Global High Yield Index. The indexes are used for illustrative purposes only and are not the official benchmark of the fund. The Investment Manager invests on a discretionary basis and is not limited to investing in accordance with the composition of a benchmark. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise. Performance data does not take into account any commissions and costs, if any, charged when units or shares of the fund are issued and redeemed. As of June 2023. Source: BlueOrchard, Refinitiv, Bloomberg.

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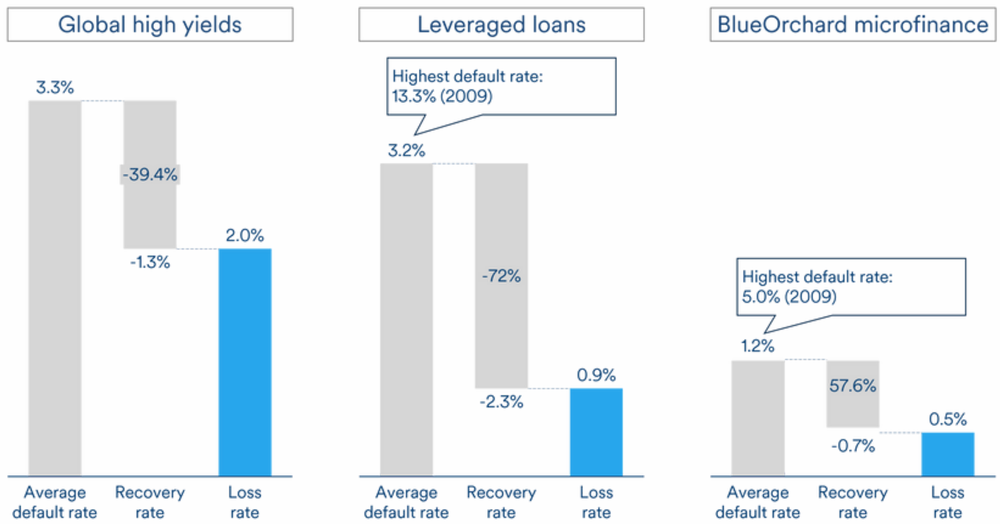
Reasons why microfinance investments exhibit a low correlation with conventional markets and asset classes are multifaceted. Microfinance institutions typically provide loans to small, local businesses that are less affected by global economic trends, as they tend to focus on essential goods and services, the so-called "real" sector. In addition, BlueOrchard hedges currency risk and aims to only include floating loans in its portfolios. The goal of this approach is to ensure that the value of these loans is adjusted in response to changes in interest rates, while avoiding foreign exchange risks against local currencies.

Furthermore, microfinance investments offer high portfolio diversification, as demonstrated by BOMF's portfolio, which consists of loans to 164 microfinance institutions in 54 countries, ultimately serving over 1 million MSMEs (as of 31 August 2023). This broad diversification across countries and regions, combined with the large number of MSMEs financed, results in a low internal correlation of the portfolio with macroeconomic events, as well as with conventional markets and asset classes, low default rates, and reliable performance (see Charts 3, 4, and 5).

Chart 3: Historically low rate of default across microfinance*

Default rates of global high yields, leveraged loans, and BlueOrchard microfinance

Effective diversification and rigorous risk management practices result in low default rates and decent recovery rates.



*As of 30 June 2023. Based on historical data since 2001. Source: BlueOrchard. JP Morgan.

Chart 4: Risk-Return enhancement through decorrelation

Microfinance vs. major asset classes (correlation matrix)*

	LIBOR/SOFR 6m	Global Aggr Bond index	MXWO Index	MXEF Index	Microfinance	Infra	PE	PD	RE	PC
LIBOR/SOFR 6m	1	0.048	-0.074	0.033	0.467	0.146	-0.055	-0.116	0.087	-0.014
Global Aggr Bond index	0.048	1	0.429	0.489	0.16	0.12	0.138	0.084	-0.008	0.114
MXWO Index	-0.074	0.429	1	0.821	-0.015	0.367	0.507	0.514	0.262	0.498
MXEF Index	0.033	0.489	0.821	1	0.031	0.374	0.446	0.47	0.205	0.442
Microfinance	0.467	0.16	-0.015	0.031	1	0.056	0.021	-0.043	-0.016	0.021
Infra	0.146	0.12	0.367	0.374	0.056	1	0.719	0.703	0.71	0.767
PE	-0.055	0.138	0.507	0.446	0.021	0.719	1	0.829	0.701	0.989
PD	-0.116	0.084	0.514	0.47	-0.043	0.703	0.829	1	0.579	0.859
RE	0.087	-0.008	0.262	0.205	-0.016	0.71	0.701	0.579	1	0.772
PC	-0.014	0.114	0.498	0.442	0.021	0.767	0.989	0.859	0.772	1

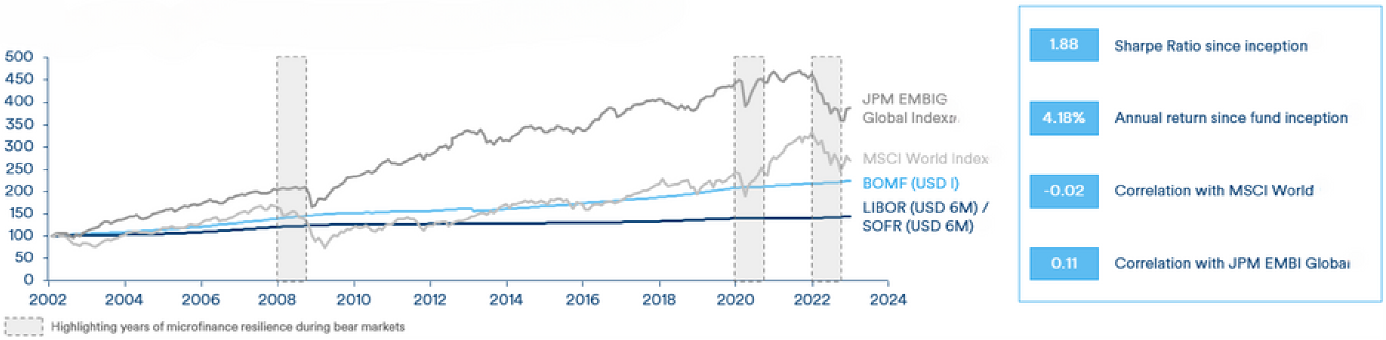
Overall, microfinance investments may offer an investment opportunity for those seeking a combination of attractive, risk-adjusted financial returns and positive social impact, while also serving as a hedge against global economic volatility.

The 20-year track record makes this sector unique in the more recent impact investing asset class, exemplified by the performance of BOMF.

Chart 5: Consistent performance, uncorrelated returns and low volatility

Past performance is not a guide to future performance and may not be repeated

Performance history



BOMF Yearly performance (2013 – 2022)

Share Class	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
I USD	-0.67%	3.78%	3.87%	3.76%	4.02%	4.67%	5.82%	2.37%	2.58%	2.77%
USD LIBOR /SOFR 6M	0.41%	0.34%	0.49%	1.06%	1.47%	2.50%	2.32%	0.69%	0.20%	2.83%

*Data sources: Refinitiv, BlueOrchard, Bloomberg
Assumption: data indexed as of 31-Dec-2022
Legend: Libor/SOFR: tracks the cost of cash, Global Aggr. Bond Index: Bloomberg Barclays Global Aggregate Index, tracks the global investment grade bonds both government and corporate related, issued in DMs and EMs, MSCI World index: tracks large and mid-cap across DMs, MSCI EMs index: tracks large and mid-cap across EMs, Microfinance: Microfinance index (SMX: Symbiotics Microfinance Index.), Infra: Private asset, Global Infrastructure (Burgiss), PE: Private asset, Global Private Equity (Burgiss), PD: Private asset, Global Private Debt (Burgiss), RE: Global Real Estate (Burgiss), PC: Private capital (aggregate of Global Infrastructure, Global Private Equity, Global Private Debt, Global Real Estate) (Burgiss).

Note: For Year 2020 onward LIBOR (LIBOR USD 6M) has been substituted by SOFR (TSFR 6M). 1. Indexed at 100 at January 2002; Performance history for BOMF Class I Shares calculated using realised gross performance of Class P Shares, net of current fees for Class I Shares (until 31 October 2013); from 1 November 2013 effective net performance of Class I Shares. 2. JPM EMBI Global, MSCI World and LIBOR (USD 6M) / SOFR (USD 6M) indices are used for illustrative purposes only and are not the official benchmarks of BOMF. 3. Data as of 31 August 2023, since fund inception 18 September 1998. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise. Performance data does not take into account any commissions and costs, if any, charged when units or shares of the fund are issued and redeemed. Source: BlueOrchard.

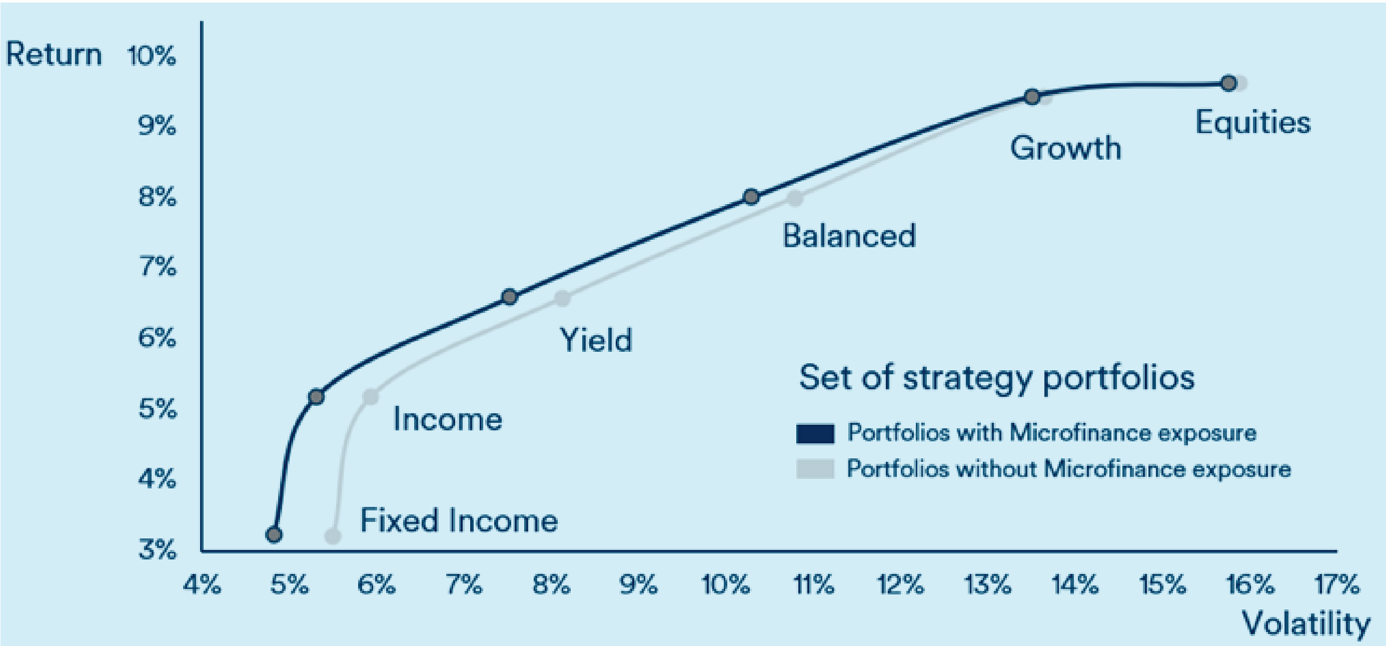
Enhancing the risk-return profile of a portfolio

The characteristics of optimising the risk-return profile by adding microfinance investments makes this specific asset class a well-suited component in a global portfolio composition.

For instance, BOMF, with its relatively high level of liquidity (monthly redemption option for investors) and each position hedged to USD (which excludes the local forex exposure), can be used by many of our investors as a replacement for fixed income investments. To demonstrate the impact of microfinance on portfolio efficiency, BlueOrchard performed simulations to determine the effect of reducing the fixed income component in favour of a microfinance exposure.

The observation period is January 2004 to December 2022 and the fixed income exposure got gradually reduced and replaced by microfinance. The findings demonstrate that there is a substantial reduction in risk while maintaining returns in fixed income-heavy strategies such as, for example, "Fixed Income", "Income", "Yield", and "Balanced". However, in "Growth" and "Equities" strategies, where fixed income allocation is smaller, the effect is less pronounced (see Chart 6).

Chart 6: Low-correlated asset for portfolio stability*



Microfinance aims to enhance portfolio return and variance by offering a low-correlation asset that has the potential to minimise portfolio risks and deliver consistent returns, thereby contributing to portfolio stability.

As a result, incorporating microfinance into a global portfolio can help reduce volatility.

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*Dots illustrate portfolios with and without microfinance exposure. Microfinance is used as a substitute of bonds. Impact in growth and equity style portfolios is less due to the lower overall allocation, assuming a higher allocation would lead to a lower volatility, too, albeit with an impact on the expected portfolio return.

Neutral Asset Allocation without Microfinance Exposure: “Fixed Income”: Cash 5%, Bonds 95%, “Income” Cash 5%, Bonds 70%, Listed Equities DM 8%, Listed Equities EM 7%, Real Estate 5%, Private Capital 5%. “Yield”: Cash 5%, Bonds 50%, Listed Equities DM 18%, Listed Equities EM 17%, Real Estate 5%, Private Capital 5%. “Balanced” Cash 5%, Bonds 30%, Listed Equities DM 28%, Listed Equities EM 27%, Real Estate 5%, Private Capital 5%. “Growth” Cash 5%, Bonds 10%, Listed Equities DM 38%, Listed Equities EM 37%, Real Estate 5%, Private Capital 5%. “Equities” Cash 5%, Bonds 5%, Listed Equities DM 46%, Listed Equities EM 44%.

Neutral Asset Allocation with Microfinance Exposure: “Fixed Income”: Cash 5%, Bonds 83%, Microfinance 12% “Income” Cash 5%, Bonds 58%, Microfinance 12%, Listed Equities DM 8%, Listed Equities EM 7%, Real Estate 5%, Private Capital 5%. “Yield”: Cash 5%, Bonds 35%, Microfinance 15%, Listed Equities DM 18%, Listed Equities EM 17%, Real Estate 5%, Private Capital 5%. “Balanced” Cash 5%, Bonds 15%, Microfinance 15%, Listed Equities DM 28%, Listed Equities EM 27%, Real Estate 5%, Private Capital 5%. “Growth” Cash 5%, Bonds 5%, Microfinance 5%, Listed Equities DM 38%, Listed Equities EM 37%, Real Estate 5%, Private Capital 5%. “Equities” Cash 5%, Bonds 1%, Microfinance 4%, Listed Equities DM 46%, Listed Equities EM 44%.

Risk considerations for BOMF

Counterparty risk
The Fund may have contractual agreements with counterparties. If a counterparty is unable to fulfil their obligations, the sum that they owe to the fund may be lost in part or in whole.

Credit risk
A decline in the financial health of an issuer could cause the value of its bonds, loans or other debt instruments to fall or become worthless.

Currency risk
The Fund may lose value as a result of movements in foreign exchange rates, otherwise known as currency rates.

Emerging markets & frontier risk
Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty, operational and liquidity risk than developed markets.

Interest rate risk
The Fund may lose value as a direct result of interest rate changes.

Liquidity risk
The Fund invests in illiquid instruments, which are harder to sell. Illiquidity increases the risks that the fund will be unable to sell its holdings in a timely manner in order to meet its financial obligations at a given point in time. It may also mean that there could be delays in investing committed capital into the asset class.

Market risk
The value of investments can go up and down and an investor may not get back the amount initially invested.

Microfinance risk
Microfinance involves the provision of credit to microentrepreneurs and microenterprises in developing countries, many of whom have incomes below the applicable poverty level and little or no previous credit history with commercial or other lenders. These micro-loans typically are not secured by any collateral or other type of traditional guarantee. There is no assurance that the micro-clients will be able to repay the micro-loans to the microfinance institution, and as a consequence, the Fund may be adversely affected.

Operational risk
Operational processes, including those related to the safekeeping of assets, may fail. This may result in losses to the fund.

Performance risk
Investment objectives express an intended result but there is no guarantee that such a result will be achieved. Depending on market conditions and the macro economic environment, investment objectives may become more difficult to achieve.

Sustainability risk
The Fund has the objective of sustainable investment. This means it may have limited exposure to some companies, industries or sectors and may forego certain investment opportunities, or dispose of certain holdings, that do not align with its sustainability criteria chosen by the investment manager. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.

Tax risk
The Fund and its returns may rely on certain available tax efficiencies at the inception of the Fund which may be subject to changes in tax treatment or interpretations. Any change in the actual or perceived tax status or exposure of the Fund or its investments as well as in tax legislation, practice or in accounting standards could adversely affect the anticipated level of taxation.

Valuation risk
The valuation of private asset investments is performed on a less frequent basis than listed securities. In addition, it may be difficult to find appropriate pricing references for private asset investments. This difficulty may have an impact on the valuation of the portfolio of investments. Certain investments are valued on the basis of estimated prices and therefore subject to potentially greater pricing uncertainties than listed securities.

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The Fund has been passported under the Alternative Investment Managers Directive (“AIFMD”) and can therefore be marketed in the EEA to Professional Clients in the following countries: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Liechtenstein, Luxembourg, Netherlands, Norway, Spain and Sweden, Switzerland, and United Kingdom.

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Subscriptions may only be made on the basis of the Fund’s legal offering documents which can be obtained from BlueOrchard Asset Management (Luxembourg) SA on request.

The representative in Switzerland (“Swiss Representative”) is 1741 Fund Solutions AG, Burggraben 16, 9000 St. Gallen, and Bank Tellco AG, Bahnhofstrasse 4, 6430 Schwyz is the paying agent in Switzerland. The prospectus for Switzerland, the key information document, the articles of incorporation and the annual and semi-annual reports may be obtained free of charge from the Swiss Representative.

An investment in the Fund entails risks, which are fully described in the Fund’s legal documents.

The Fund has the objective of sustainable investment within the meaning of Article 9 of Regulation (EU) 2019/2088 on Sustainability-related Disclosures in the Financial Services Sector (the "SFDR"). For information on sustainability-related aspects of this fund please go to https://www.blueorchard.com/sustainability-disclosure-documents/
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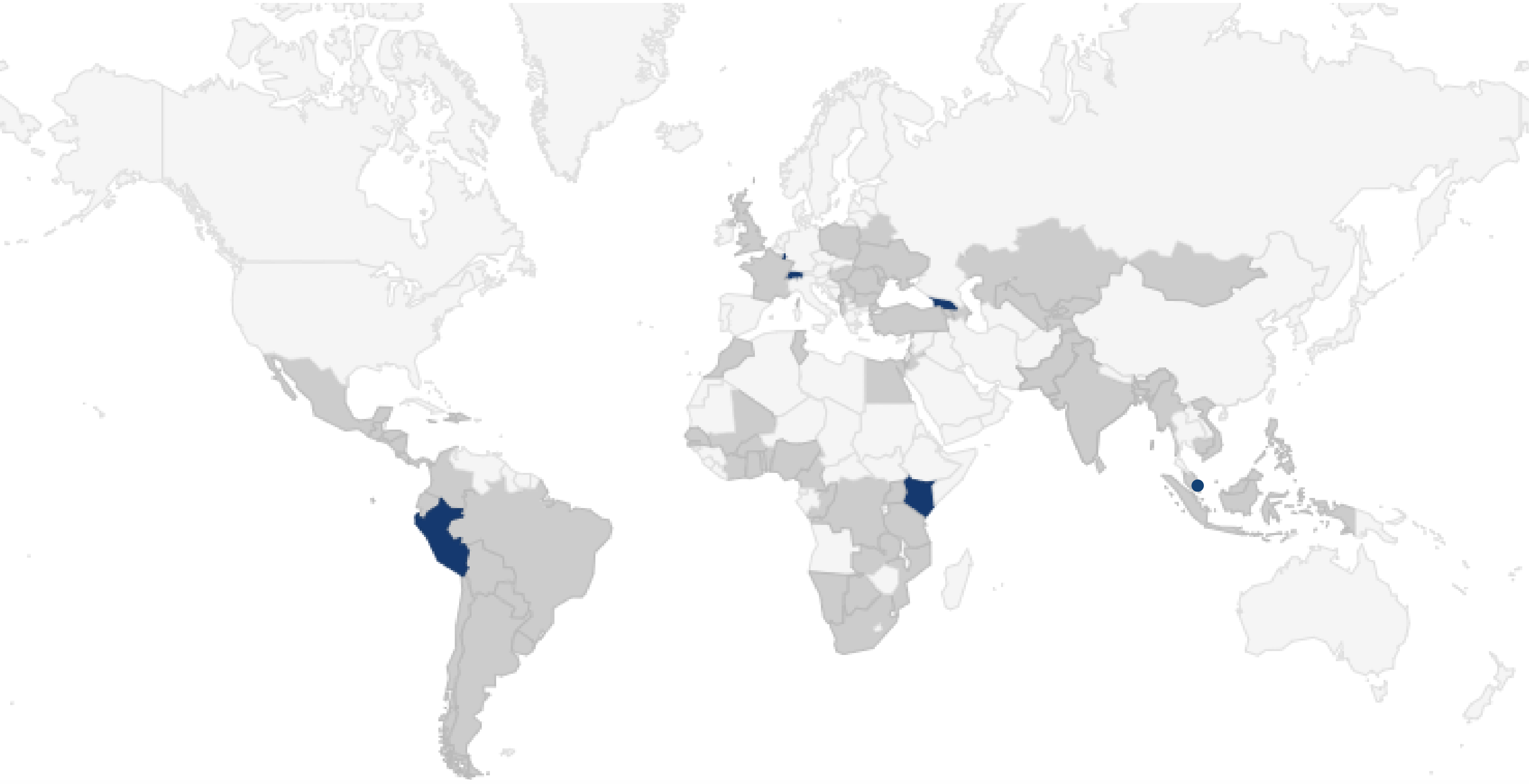
About BlueOrchard Finance Ltd

BlueOrchard is a leading global impact investment manager and member of the Schroders Group. As a pioneering impact investor, the firm is dedicated to generating lasting positive impact for communities and the environment, while aiming at providing attractive returns to investors. BlueOrchard was founded in 2001, by initiative of the UN, as the first commercial manager of microfinance debt investments worldwide. Today, the firm offers impact investment solutions across asset classes, connecting millions of entrepreneurs in emerging and frontier markets with investors with the aim to make impact investment solutions accessible to all and to advance the conscious use of capital. Being a professional investment manager and expert in innovative blended finance mandates, BlueOrchard has a sophisticated international investor base and is a trusted partner of leading global development finance institutions. To date, BlueOrchard has invested over USD 10 billion across more than 100 countries. Over 280 million poor and vulnerable people in emerging and frontier markets received access to financial and related services with the support of BlueOrchard as of December 2022. For additional information, please visit: www.blueorchard.com.



● Countries invested in since inception of BlueOrchard ● BlueOrchard has7 offices on 4 continents: Peru, Kenya, Georgia, Singapore, Luxembourg, and Switzerland

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