WETHERBY
ASSET MANAGEMENT

Impact Investing Digest

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What We're Reading

- **CalSTRS Joins Pensions Divesting From Private Prisons**

  Barron's / by Mary Childs / November 9, 2018

  The Teachers' Retirement Board of the $229.2 billion California State Teachers' Retirement System is divesting from the two U.S. publicly-held companies in its portfolio that operate private prisons, CoreCivic and GEO Group. In recent years the industry has benefitted from several tailwinds, including more stringent immigration policies and harsher enforcement. But after an uproar over Trump administration policies that separated children from their families at the U.S. border, Chief Investment Officer Christopher Ailman started the process for divestment, beginning a review of the companies in question to determine what risks they brought to the portfolio. New York state's pension plan became the first to withdraw fully from the industry when Comptroller Tom DiNapoli sold the last of the pension's shares in private prison companies in July. The next month brought divestment, or votes to divest, from the New Jersey Pension Fund, Trenton, and the Chicago Teachers Pension Fund. New York City and Philadelphia have divested, and Cincinnati may be on its way. The decision affects about $12 million in assets held between CalSTRS's equities and fixed-income portfolios.

- **Tech Workers Got Paid in Company Stock. They Used It to Agitate for Change.**

  The New York Times / by Kate Conger / December 16, 2018

  Silicon Valley technology firms are known for giving stock to their workers, a form of compensation that often helps employees feel invested in their companies. But tech workers are now starting to use those shares to turn the tables on their employers. As many tech employees take a more activist approach to how their innovations are being deployed and increasingly speak out on a range of issues, some are using the stock as a way to demand changes at their companies. At Amazon, more than a dozen employees who had received stock grants recently exercised their rights as shareholders. In late November and early December, they filed identical shareholder petitions asking the e-commerce giant to release a comprehensive plan addressing climate change. Their filing appears to be the first time that tech employees have led their own shareholder proposal, according to activist investors. In the proposal, which will be voted on at Amazon's annual shareholder meeting next spring, employees asked the company's board to say how it would respond to climate change and reduce its dependence on fossil fuels. The moves are part of a broad activist stirring by tech workers this year. Employees at Amazon, Microsoft, Salesforce and Google have publicly objected to who was buying their products and to how certain technologies — such as facial recognition and artificial intelligence — would be used. Last month, about 20,000 Google employees staged a walkout because the company had richly paid executives who had been credibly accused of sexual harassment, leading the company to apologize and end forced arbitration in such cases. Shareholder proposals often gain attention because they are distributed to stockholders and are included in annual proxy statements and they give workers a way to raise their grievances directly to the board, rather than just to managers.

- **Fitch Ratings Launches ESG Relevance Scores to Show Impact of ESG on Credit**

  Business Wire / January 7, 2019

  Fitch Ratings announced the launch of a new integrated scoring system which shows how environmental, social and governance (ESG) factors impact individual credit rating decisions. The new ESG Relevance Scores transparently and consistently display both the relevance and materiality of ESG elements to the rating decision. They are sector-based and entity-specific. Using a standardized and transparent scoring system, Fitch is introducing ESG Relevance Scores across all asset classes, starting with over 1,500 non-financial corporate ratings. This will be followed by banks, non-bank financial institutions, insurance, sovereigns, public finance, global infrastructure and structured finance. Fitch's ESG approach fills a market gap by publicly disclosing how an ESG issue directly affects a company's current credit rating. Fitch is the first credit rating agency to systematically publish an opinion about how ESG issues are relevant and material to individual entity credit ratings. Fitch is initially making all of its ESG Relevance Scores available in the public domain, and will then maintain and publish the scores on an ongoing basis as an integrated part of its entity credit research.

- **Clean Energy Investment Exceeded $300 Billion Once Again in 2018**

  Bloomberg New Energy Finance / January 16, 2019

  Global clean energy investment totaled $332.1 billion in 2018, down 8% on 2017. Last year was the fifth in a row in which investment exceeded the $300 billion mark, according to authoritative figures from research company BloombergNEF. There were sharp contrasts between clean energy sectors in terms of the change in dollar investment last year. Wind investment rose 3% to $128.6 billion, with offshore wind having its second-highest year. Money committed to smart meter rollouts and electric vehicle company financings also increased. However, the most striking shifts were in solar. Overall investment in that sector dropped 24% to $130.8 billion. Part of this reduction was due to sharply declining capital costs. BNEF's global benchmark for the cost of installing a megawatt of photovoltaic capacity fell 12% in 2018 as manufacturers slashed selling prices in the face of a glut of PV modules on the world market. That surplus was aggravated by a sharp change in policy in China in mid-year. The government acted to cool that country's solar boom by restricting access for new projects to its feed-in tariff. The result of this, combined with lower unit costs, was that Chinese solar investment plunged 53% to $40.4 billion in 2018.

- **World's Biggest Investor Tells C.E.O.s Purpose Is the 'Animating Force' for Profits**

  Bloomberg New Energy Finance / January 16, 2019

  Larry Fink, the investment manager who oversees nearly $6 trillion at BlackRock, set off a yearlong conversation last January when he wrote a letter to chief executives declaring that companies needed to do more than make profits. Mr. Fink wrote that it was crucial that businesses also made "a positive contribution to society" — and that he planned to hold them to account. Coming from the world's largest investor, the letter was seen as an inflection point in the long-simmering argument over the state of global capitalism. Chief executives began explicitly talking about their companies' "purpose" — not just in high-minded mission statements but in government filings and investor reports. Others bristled at Mr. Fink's challenge. Chief executives received a new missive from Mr. Fink that will almost certainly stir up an even louder debate. Businesses, he wrote, cannot merely have a purpose. They must be leaders in a divided world. "Stakeholders are pushing companies to wade into sensitive social and political issues — especially as they see governments failing to do so effectively," he wrote in his new letter. The business world has been tested over the past year, feeling pressure to take sides on everything from climate change to gun control to whether do business with the Pentagon. Executives faced moral questions over working with foreign governments, like the seminal moment when executives had to choose whether they would stand shoulder to shoulder with the crown prince of Saudi Arabia, Mohammed bin Salman, at a conference after the murder of the journalist Jamal Khashoggi.

  BlackRock has used its heft to promote policy change in the past year, including voting for a shareholder resolution that required the gun maker Sturm, Ruger & Company to be more transparent about the safety of its products. In some respects, Mr. Fink is limited in what he can do. Much of BlackRock's holdings are through 401(k) plans in index funds, and the company isn't able to sell specific companies whose policies it might disagree with. But it recently introduced a series of socially responsible investment funds that exclude entire industries, such as tobacco, firearms or coal.

  In Mr. Fink's latest letter, he wrote that he had "no intention" of telling companies what their purpose should be. "Rather, we seek to understand how a company's purpose informs its strategy and culture to underpin sustainable financial performance," he wrote. He also pushed against the notion, long espoused by the economist Milton Friedman, that a company's only social responsibility is its profits. "Purpose is not the sole pursuit of profits but the animating force for achieving them." Executives, according to Mr. Fink, must be prepared to think about social considerations as they encounter a new generation of workers, managers and investors. "With unemployment improving across the globe, workers, not just shareholders, can and will have a greater say in defining a company's purpose, priorities and even the specifics of its business." Employees at Google held walkouts over the company's handling of sexual misconduct allegations against top executives and staged a separate protest that ended its role in the Pentagon's Project Maven, which uses artificial intelligence to interpret video images and could be used to improve the targeting of drone strikes.

Research / Reports

The Alpha in Impact / *Tideline and Impact Capital Managers / December 2018*

This new report is based on Tideline's analysis of nearly 30 financial transactions from Impact Capital Managers (ICM) member investment portfolios. The analysis uncovered 10 unique drivers of "impact alpha," the ways in which an impact objective can enhance or add financial value:

1. *New networks.* Impact alpha investors go beyond the Silicon Valley herd to source investments through other mission-aligned investors, universities, foundations and non-governmental organizations. Going beyond the usual suspects provides a more differentiated set of mission-aligned opportunities.
2. *Deep market expertise.* Tuning into overlooked and untapped markets allows impact alpha investors to see value and execute deals where others don't. Less competitive deals mean more economic upside for managers.
3. *Eye-to-eye with founders.* Mission-driven founders and owners want impact alpha investors. A laser focus on purpose can lead to constructive negotiations, invitations to invest in later rounds and favorable valuations.
4. *Impact trends are business trends.* Impact alpha investors understand values-driven consumers and meeting other human needs. Impact alpha managers can help entrepreneurs hone their value-propositions and design solutions that meet real needs to drive growth in revenues.
5. *Impact is authentic.* Which makes it good branding. Impact alpha investors can help investees tell their impact stories, driving both new revenues and customer retention. Differentiation can mean pricing power for purpose-driven brands.
6. *Impact is a talent magnet.* Impact alpha firms attract and retain top talent which lowers the cost of recruitment and turnover.
7. *All capital on deck.* Impact alpha investors and their portfolio companies align with philanthropic and public funders that can deploy grants, low-interest loans, guarantees, and other alternative forms of financing. Such funding can lower the cost capital and broaden investment sources.
8. *Accounting is destiny.* Good impact measurement practice unlocks business value (see, "Measure Better"). Impact alpha investors drive discipline and efficiency around operational metrics that deliver long-term economic returns.
9. *License to operate.* Impact goals, reporting and transparency help win the hearts and minds of policymakers, advocates and other beneficiaries in sometimes tough operating environments. Favorable policies can bolster the bottom lines of mission-driven companies.
10. *Impact beta.* Impact alpha investors generate data and insights that expose hidden or long-term environmental, social and reputational risks. Such visibility can help optimize supply chains and operations and avert product- and worker-safety problems.

The Growing Market Investors Are Missing / *Morgan Stanley / December 2018*

This new survey of over 200 gatekeepers of capital examines the funding landscape and why the funding gap facing female and minority entrepreneurs in the U.S. exists – from the perspectives of both investors and entrepreneurs – and offers a series of actionable steps investors can take to close the funding gap. Key findings:

- If the number of women and minority-owned businesses and revenues was proportional to their percentage in the labor force, those businesses would have generated an additional $4.4 trillion in revenues.
- Investors are not only less likely to be exposed to women and minority-owned businesses than to male and non-minority businesses, they aren't working to increase the diversity of candidates they consider. Nearly 40% of men say that investing in women-owned businesses is not a priority at all, compared to only 7% of female investors. Similarly, 31% of white investors say they do not prioritize investing in minority-owned businesses. Investors report being less likely to connect to the sectors that female and multicultural entrepreneurs serve. 47% investors cite an entrepreneur's sector as a compelling reason why they invest, but that number drops to 36% for women-owned businesses and 33% for minority-owned owned businesses.
- Investors judge women and minority entrepreneurs by different standards; displaying confidence is disproportionately important for women and minorities. 24% of investors say that a confident applicant is important when considering a women-owned business, and 23% say the same when considering a minority-owned business, compared to only 14% when considering businesses in general. The same pattern is true for needing to deliver a convincing pitch.

The Alpha and Beta of ESG Investing / *Amundi Asset Management / January 2019*

This new research on the impact of ESG investing on equity asset pricing finds that when an alpha strategy is massively implemented, it becomes a beta strategy. In Europe, the mass mobilization of institutional investors regarding ESG investing has impacted demand mechanisms, with a subsequent effect on prices, thereby also triggering a performance premium. The study focused on the period 2010-2017 and used Amundi's proprietary ESG scores and Environmental, Social and Governance (E,S and G) sub-components to screen portfolios. The analysis was conducted for passive, active and multi-factor portfolios for Europe and North America, among others.

- Between 2010-2013, being a responsible investor would have tended to penalize both active and passive European and North American portfolios. Between 2010-2013 only Environmental-focused passive investors in the Eurozone would have enjoyed outperformance, while effects of Governance-focused and Social-focused portfolios on performance were neutral or negative.
- From 2014-2017, responsible investing was generally a source of outperformance in the Eurozone and North America. In the Eurozone, all pillars (E, S and G) and ESG score integration displayed positive returns, with the Governance pillar dominating. In North America, ESG investing during the 2014-2017 period also displayed positive returns, although the Environmental component is the largest winner.
- Amundi's study identifies several performance generation mechanisms, demonstrating that stock prices integrate ESG-related information at different levels. These mechanisms are dependent on the geographic region studied, the ESG focus, the ranking (best / worst-ranking or all gradients) and the period studied. All-in-all, the best-in-class stocks have been consistently remunerated in Environmental-focused portfolios across North America and the Eurozone between 2014-2017.
- ESG-induced performance improvements must be implemented carefully: there is a tipping point beyond which ESG score improvements reduce the investment universe and hence, can negatively impact diversification and performance. When improving the ESG score of a portfolio, the investment universe is reduced which can lead to a reduction of the diversification if the constraint is too strong.
- Responsible investing has become a beta strategy in Eurozone (as ESG is a risk factor), but remains an alpha strategy in North America (as ESG is not a risk factor). Introducing ESG as a factor into a multi-factor approach of portfolio construction adds value by improving the diversification in Eurozone, but not in North America.
- ESG screening does not necessarily improve drawdown management. ESG screening did not significantly reduce the maximum drawdown of portfolios for both the 2010-2013 and 2014-2017 periods.
- To seize the benefits of ESG investing for the portfolio profile, passive investors need to accept additional, yet controlled, tracking error compared with capitalization-weighted benchmarks. Beyond accepting additional – yet controlled – tracking error, combining ESG with passive investment may imply the need to design ESG-based Strategic Asset Allocation.

Upcoming Events and Conferences

- **Sorenson 2019 Winter Innovation Summit**
  February 6-8, 2019 / University of Utah / Salt Lake City, UT

  The summit is a cross-industry event in social impact, innovation and investing. The 2019 summit brings together policymakers, funders, nonprofits, and social entrepreneurs to explore the future of social innovation across the globe. Justina will be speaking on a panel focused on impact investing and Opportunity Zones.

- **Institutional Investors' 3rd Annual Impact Investing Forum**
  March 19-20, 2019 / Four Seasons Hotel / Boston, MA

  This year's forum will examine the potential and challenges facing the impact investing field and will focus on the "how" of next steps forward. Justina will be speaking on a panel regarding the changing impact investing landscape and exploring the range of issues about which wealth managers need to be informed in order to keep pace.