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ASSET MANAGEMENT

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What We're Reading

- **The Last All-Male Board on the S&P 500 Is No Longer**

  The Wall Street Journal / by Vanessa Fuhrmans / July 24, 2019

  There are no longer any all-male boards among S&P 500 companies. The index's last company without a female board director, Copart Inc., changed that when it announced it had appointed CyrusOne Inc.'s chief financial officer, 61-year-old Diane Morefield, to its board. Hitting this particular milestone within the S&P 500 has taken years. In 2012, one in eight S&P 500 boards was all-male, a number that dwindled to just a handful of companies by the beginning of 2019, according to Equilar, a research firm that gathers data on executives and boards. Overall, 27% of all S&P 500 board seats are filled by women, up from 17% in 2012. Much of the change has come amid pressure from big investors, such as State Street Global Advisors, BlackRock and a number of state pension funds, that in some cases have withheld proxy votes if all-male boards didn't bring in women. A new California mandate requiring all publicly traded companies with headquarters in the state to have at least one female director by the end of this year also appears to be spurring change. In the broader Russell 3000 index the pace of change has been slower. As of the first quarter of 2019, 376 firms in the Russell 3000 still had all-male boards, down from 457 in the fourth quarter of 2018, according to Equilar data. The overall percentage of women on Russell 3000 boards stood at 19.3%, up from 18.5% in the prior quarter.

- **Move Over, Shareholders: Top CEOs Say Companies Have Obligations to Society**

  The Wall Street Journal / by David Benoit / August 19, 2019

  The leaders of some of America's biggest companies are chipping away at the long-held notion that corporate decision-making should revolve around what is best for shareholders. The Business Roundtable said that it is changing its statement of "the purpose of a corporation." No longer should decisions be based solely on whether they will yield higher profits for shareholders. Rather, corporate leaders should take into account "all stakeholders"— that is, employees, customers and society writ large. It is a major philosophical shift for the association, which counts the chief executives of dozens of the biggest U.S. companies as its members. The group, led by JPMorgan Chase CEO James Dimon, is a powerful voice in Washington for U.S. business interests. The Business Roundtable's old statement of purpose espoused economist Milton Friedman's decades-old theory that companies' only obligation is to maximize value for shareholders. "Each of our stakeholders is essential," the new statement says. "We commit to deliver value to all of them, for the future success of our companies, our communities and our country." The change formalizes a stance taken by a number of executives in recent years. Mr. Dimon, for example, has challenged the shareholder-profit focus as too narrow and an impediment to executives' ability to focus on long-term goals. The leader of the nation's biggest bank writes shareholder letters that touch on a range of topics, from corporate governance to politics to economic inequality. Still, the idea that companies have an obligation to society isn't universally popular. Some activist investors and academics have said encouraging companies to focus on a range of stakeholders amounts to grandstanding that misdirects resources. They argue that shareholders, not companies, should be the ones influencing society.

- **The Massive Cost of Not Adapting to Climate Change**

  Bloomberg / by Eric Roston / September 9, 2019

  Slowing the planetary march toward climate catastrophe—and the multi-trillion-dollar investment required to do it—has become a central issue of global and national debate. But there's the equally expensive matter of dealing with the here and now: From historic wildfires to unprecedented hurricanes, global warming has reshaped the lives of millions, with increasingly tragic consequences. While humans must pay to end the burning of fossil fuels, they must also pay to change how they live, invest and build in a climate-changed world. An international commission of government and private-sector officials told countries and corporations that they have 15 months to jump-start reforms aimed at adapting to that changing environment. The Global Commission on Adaptation was formed to help ensure that social and economic systems are hardened to withstand the consequences of climate change. In a new report, the 34-member group, led by Microsoft Corp. founder Bill Gates, former UN Secretary General Ban Ki-moon and World Bank CEO Kristalina Georgieva, concluded that $1.8 trillion in investment by 2030 concentrated in five categories—weather warning systems, infrastructure, dry-land farming, mangrove protection and water management—would yield $7.1 trillion in benefits. The commission calls for relatively low-budget improvements, such as early-warning systems for storms, to larger scale construction projects. For example, disseminating reliable storm information just one day in advance can cut resulting damage by 30%, according to the report; an investment of $800 million might avoid up to $16 billion in annual costs. Meanwhile, initiatives such as providing small farms with drought-resistant seeds have already increased yields in vulnerable nations like Zimbabwe. And in urban centers such as London, climate-friendly infrastructure has led to enormous economic growth. The primary job of London's Thames Barrier is to protect 1.3 million people from flooding. Without its construction, flood risk would have prevented investments that allowed Canary Wharf to flourish. Critical to the 15-month window between now and next year's UN talks is what the report calls a "year of action." It plans to set up pilot adaptation projects to demonstrate how "de-risking" infrastructure plans will both help avert losses and contribute to revenue generation. Among the simplest proposals are also the most potent: "Make risk visible." Once economic actors understand challenges more explicitly, "the public and private sectors can work together to more explicitly price risk in both economic and financial decision-making."

- **Muni Bonds Face Climate Change. And Investors Are Ignoring the Risks**

  Barron's / by Leslie P. Norton / Sept. 20, 2019

  The municipal-bond market has long been considered a haven. But there's a long-term risk looming in this $3.8 trillion market: Climate change raises the credit risk of an issuer by damaging its assets and tax base. Within a decade, absent efforts to curb emissions, according to BlackRock, more than 15% of the S&P National Municipal Bonds index will come from metropolitan issuers that probably will suffer climate-related losses of 0.5% to 1% of gross domestic product a year. Probable losers include the Gulf Coast, the South Atlantic seaboard, and Arizona. Florida tops the list of danger zones; BlackRock estimates that Miami eventually could lose up to 4.5% of GDP a year. Even inland, climate change will have unpleasant effects. Increased temperatures will drive up heat-related mortality, reduce labor and farm productivity, and boost the risk of wildfires. Then there are the after-effects of storms, which scientists predict will grow more frequent and intense. After Hurricane Maria in 2017, Puerto Rico's population fell by 4% and some businesses left the island or collapsed, shrinking the tax base. While corporations can move their supply chains to adjust, municipalities, for better or worse, are tethered. The nightmare scenario is New Orleans, post-Katrina. The greater metropolitan area lost 50% of its population, property values plunged 22%, and sales-tax receipts fell by a quarter. How complacent are some investors? Consider two revenue bonds due October 2022, one from Jacksonville, Fla., the other from Tulsa, Okla., both for public facilities. Each is rated AA3, and despite Florida's higher climate threat, the "yield-to-worst"—what investors can expect, even if the bond is called away—is lower for the Jacksonville issue, according to HIP's research. The good news is that realism is rising among muni issuers. Leonard Jones, a former public finance investment banker, now helps Moody's assess how climate change affects creditworthiness. Five years ago, he visited issuers in Florida and "not one talked about climate change." Last month, he visited 10 in three days. "Every single one talked about climate change."

- **More Companies Are Making Noise About ESG**

  The Wall Street Journal / by Karen Langley / September 23, 2019

  Big U.S. companies are increasingly talking up environmental, social and governance factors on earnings calls—and betting that investors increasingly concerned with social responsibility will reward them for it. Twenty-four companies in S&P 500 mentioned the acronym "ESG" on earnings conference calls between June 15 and Sept. 14, double the number that cited the term in the first quarter, according to FactSet. That marks a huge increase from just two years earlier, when only two companies referred to ESG in the second quarter of 2017. But it still represents only 5% of the companies in the index. Delta Air Lines Inc. talked about eliminating single-use plastic products from its airplanes and lounges. BlackRock Inc. said sustainable ETFs are a strategic growth area. Oil-and-gas producer EOG Resources Inc. cited its use of recycled production water in the Permian Basin. One contributing factor is a transfer of wealth to members of the millennial generation, who as a group are more focused on sustainability. Investment stewardship groups in the U.S. also are paying more attention to these issues.

Research / Reports

2019 Proxy Season Review *// EY / July 2019*

As the spotlight on board diversity intensifies, the pace at which women are joining boards is accelerating, and a growing number of companies are disclosing the board's racial and ethnic diversity. At the same time, against a backdrop of increased focus on companies' efforts to create long-term value, enhanced proxy disclosures on corporate sustainability highlight how companies are protecting the environment, considering their social impact, investing in their people and promoting diversity and inclusion. Investor outreach, often involving directors, has become a mainstay of leading governance practice among top companies. Overall, investors show notable support for directors and executive pay programs. A growing support for many environmental and social shareholder proposals highlights further opportunity for engagement. This 2019 Proxy Season Review report provides five key takeaways for boards as they reflect on this proxy season and on evolving governance developments:

- *Gender diversity accelerates:* The rate of increase in women-held directorships has doubled, increasing 2% in both 2018 and 2019 to reach 23%, compared to only a 1% rise each year since 2013. All male boards are nearly extinct – across the S&P 1500 just 5% remain all-male. Votes against all-male boards continue to climb – votes against nominating/governance chairs at all-male S&P 1500 boards have tripled since 2016, with those chairs receiving an average opposition vote of 24% this year.
- *Diversity disclosures on the rise:* 45% of the Fortune 100 explicitly disclosed the board's racial/ethnic diversity, up from 23% three years ago. 75% of the Fortune 100 now use a skill matrix to highlight diversity of relevant director qualifications, up from 30% in 2016.
- *Companies voluntarily enhance communication around corporate sustainability and citizenship:* Since 2016, the number of Fortune 100 companies using the proxy to highlight their commitment to corporate sustainability and citizenship has more than doubled.
- *Investor engagement involving directors now standard practice for leading companies:* More than half of Fortune 100 companies said board members were involved in select engagement discussions, up from 29% in 2016.
- *Shareholder proposal landscape continues to evolve, with potential regulatory changes on the horizon:* Environmental and social topics represent half of all proposals submitted to date; support for these proposals continues to climb, averaging 28% so far this year, up slightly from 27% last year and 22% in 2013.

New Energy Outlook 2019 */ Bloomberg New Energy Finance / August 2019*

Focused on the electricity system, Bloomberg New Energy Finance's New Energy Outlook (NEO) combines the expertise of over 65 market and technology specialists in 12 countries to provide a unique view of how the market will evolve. Key findings:

- *The Old World Will Move the Fastest:* Most regions are moving toward cleaner energy generation but not at the same pace. Europe is forecast to be almost fossil fuel-free by 2050. The U.S. lags the world.
- *In Asia, Coal Will Rise, But Fall Again:* Coal-fired electricity will peak in China in 2027 and in India in 2038.
- *Most New Gas Power Will Be On-Demand:* Peaker plants, which are more responsive to changing needs, will push growth.
- *The Money Is Headed for the Windmills:* Over the next 30 years, the world will invest about $2 trillion in new electrical capacity from fossil fuels and more than $11 trillion in zero-carbon technologies.
- *$4 of Every $10 Spent on New Capacity Will Go to Asia:* The region will get $5.8 trillion in new capacity investments through 2050, roughly three-quarters of which will go to China and India.
- *Battery Investors Go Big:* State programs and lower costs will encourage investment in utility-scale.
- *Where Green Power Is Cheapest Today:* Clean (and dirty) energy prices vary globally. Coal is costly in the U.K.
- *The Debt Market for Sustainable Projects Has Exploded:* Green bonds have driven sustainable debt issuance since 2012. Last year, financial, corporate, and mortgage-backed issuers accounted for two-thirds of sales.
- *Green Technologies to Grow More Affordable:* The relative costs of solar and wind will fall well below those of coal and gas.
- *Not Everyone Is Participating In the New Energy Boom:* The number of U.S. solar jobs has climbed 159% since 2010, but women are disproportionately left out of the clean energy workforce—and underpaid within it.

Corporate Boards – North America: Gender Diversity Is Correlated With Higher Ratings, But Mandates Pose Short-Term Risk / *Moody's Investors Service / September 2019*

This analysis of 1,109 publicly traded North American companies found that companies with boards of directors with greater gender diversity tend to have higher credit ratings. Key findings:

- There is a positive relationship between board-level gender diversity and a company's credit quality. However, this correlation is not viewed as causational. There may be a range of other factors that explains why boards of higher-rated companies have greater gender diversity.
- The five companies that Moody's rates Aaa have the most gender diverse boards among rated companies, with women accounting for an average of 28% of their corporate directors. Women generally make up approximately 25% of the boards of companies rated Baa1 or higher, with gender diversity largely declining by rating category to less than 5% for Ca-rated companies.
- Higher-rated companies also have more women occupying C-suite executive positions, as nearly 25% of the executives at Aaa-rated companies are women, versus around 10% for Ca-rated companies.
- Moody's considers a board with less than 30% gender diversity as being one of many indicators that stray from the standards it defines as a credit-friendly board.

Climate Change and Corporates */ Deutsche Bank Research / September 2019*

This new research quantifies how much climate change matters to the stock market. To analyze the stock impact of climate change, Deutsche Bank programmed its artificial intelligence platform, α-DIG, to map company stock prices after reading the five million pages of company announcements released by the 1,600 MSCI World companies over the last two decades, along with every Dow Jones news article written over the period. Key findings:

- Small climate change news makes a difference. Companies that are the subject of positive climate change news, and make positive announcements, have seen their stock outperform the MSCI World Index by 0.8 percentage points per year, outperformance of 15%.
- The improvement in news and announcements matters the most. No matter the baseline, greater amounts of positive press and company announcements over the preceding 12 months lead to returns of 1.4 percentage points over the MSCI World index, outperformance of 26%.
- Increasingly negative climate change news causes a stock to lose 0.3 percentage points relative to the MSCI World Index, underperformance of 5%. This is irrespective of whether the stock was previously seen as being strong or weak on climate change.
- The underperformance is far more pronounced in periods when equity markets rise. The underperformance is recouped, to an extent, when equity markets fall.
- The usual suspects (energy, materials, utilities) are not the sectors most sensitive. Rather, it is technology, consumer staples and healthcare.
- Those stocks most sensitive to improvements in newsflow are utilities, consumer staples and industrials.
- Stocks most sensitive to a deterioration over the preceding 12 months include those in the technology, financials and real estate sectors.