BLACK LIVES MATTER

JUNE 2020

Social Unrest as Investment Catalyst for Change

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"I think America must see that riots do not develop out of thin air. Certain conditions continue to exist in our society which must be condemned as vigorously as we condemn riots. But in the final analysis, a riot is the language of the unheard… And as long as America postpones justice, we stand in the position of having these recurrences of violence and riots over and over again. Social justice and progress are the absolute guarantors of riot prevention."[1] These words ring as true today as when they were delivered over 50 years ago by Dr. Martin Luther King Jr in his "The Other America" speech at Stanford, as we again experience the pain and anger of social justice denied. For investors, this reveals an urgent imperative for incorporating Social Justice and other ESG considerations into capital allocation and investment decision-making. Capital Drives Change if we take full advantage of the power of the aggregate $250trn invested in the global public markets.

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The events surrounding the COVID social crisis and escalating societal anger linked to racial injustice have many unfortunate consequences. Our nation's already significant income and opportunity disparity has widened dramatically in a matter of weeks. Layoffs have disproportionately impacted minorities and the working poor, with an astonishing 36% unemployment among the lowest quintile of earners.[2] That is a massive segment of society out of work, only some of whom are eligible for unemployment benefits and supplementary stimulus checks. Unemployment not only threatens economic survival, but is also psychologically damaging, with millions of people questioning their purpose and seething with resentment and rage at those who were made whole. Asset owners appear to have been made more than whole, and seem to be profiting from the suffering of others, using the NASDAQ rally to all-time highs as a proxy. This has not been lost on the dispossessed, with riots in many cities focused on burning down well-known brands, including banks, such as the Chase and Union Bank branches burned to the ground in the Mira Mesa, CA riots.

One might question whether politics and societal concerns should even enter the investing realm. At Promethos, we invest with a 360-degree view of all stakeholders, including shareholders, customers, employees, communities, and broader society affected by corporate decision-making. Corporate leaders who understand their mission and impact as greater than just their quarterly returns to shareholders are better able to adapt and evolve to meet the needs of all of their stakeholders, thereby improving their competitive ability to thrive over the long term. Companies that take into account all stakeholders have been shown to have lower risk profiles and lower stock price

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drawdowns.[3] Likewise, companies who source from the entire labor force in an inclusive manner tend to outperform.[4] Furthermore, recent quantitative research indicates that adding ESG factors to investment decision-making proves to be an additive and uncorrelated source of alpha.[5] Our investing endeavor is to deliver superior risk-adjusted performance, and we have long said that using an ESG and social justice lens is the best way to value mispriced risk, and is a much more robust and comprehensive way to differentiate among investments and assess potential for long term success.

The current COVID and social justice crisis has so far funneled investor capital into the largest tech platforms, pushing them to all-time valuation highs despite lack of margin growth prospects. Top of mind are the large social media platforms such as Facebook and Twitter, who add fuel to the polarization fire that undermines social justice. Their algorithms, programmed to identify and reinforce user preferences in order to drive usage and "stickiness," have been shown to create echo chambers and filter bubbles. [6] We like to be around people who agree with us, and the AI behind these platforms can serve up more and more extreme views aligned with a particular way of thinking, often becoming addictive, driving up usage.[7] This can lead investors to think that social media platforms can only grow and become more valuable over time.

In contrast to this extrapolative perspective, we take a comprehensive view, to consider the benefits of inclusion of all stakeholders, and a longer-term outlook for corporate margins. We do not deny the value that technology platforms provide to society, but we also look at their participation in the polarization and undermining of social justice in this country. Some of these business models contribute to the destruction of the middle-class economic engine that would otherwise be the source of their future innovation and growth.

The silver lining is that investors are empowered to mitigate and reverse some of the damage by directing our investment capital to businesses that value social justice, and by using a 360 degree investment lens that considers long-term risks and benefits for all stakeholders. As Anne Frank wrote, "How wonderful it is that nobody need wait a single moment before starting to improve the world."

1. https://www.crmvet.org/docs/otheram.htm
2. University of Chicago, Working Paper · NO. 2020-58, The U.S. Labor Market During the Beginning of the Pandemic Recession, Tomaz Cajner, Leland D. Crane, Ryan A. Decker, John Grigsby, Adrian Hamins-Puertolas, Erik Hurst, Christopher Kurz, and Ahu Yildirmaz, May 2020 https://bfi.uchicago.edu/wp-content/uploads/BFI_WP_202058-1.pdf
3. https://www.morningstar.com/insights/2020/02/19/esg-companies
4. https://hbr.org/2016/11/why-diverse-teams-are-smarter
5. From Performance Tests of Truvalue Labs ESG as a 6th Factor, April 2020 "Factor investing has grown in popularity from the seminal Fama-French factors1 of the 1990s to the proliferation of Smart Beta funds over the past decade. … Extensive testing of Truvalue Labs' ESG Activity Signal shows that it both reduces risk and increases returns when applied to most popular equity benchmarks. This study shows how the TVL ESG factor combines with five well-known quant factors or "risk premia" across a variety of market conditions and geographic regions. It demonstrates that an ESG factor, as measured by Truvalue Labs, can be considered an investment factor in its own right."
6. https://www.psychologytoday.com/us/blog/psych-unseen/201611/fake-news-echo-chambers-filter-bubbles-survival-guide
7. Social Media Disorder Scale: https://www.sciencedirect.com/science/article/pii/S0747563216302059

WHAT MAKES US DIFFERENT

IMPACT: Our portfolios seek alpha and integrate intent to drive social and environmental change.

TEAM: Our CIO's extensive portfolio management experience and scientific background provides a distinct perspective coupled with a team diverse in both thought and culture.

INDEPENDENCE: We are an employee-owned firm. Our interests are aligned with your interests.

ENGAGEMENT: Meetings with companies, letters to management, shareholder collaboration and proxy voting to influence discussions on ESG issues and drive change. **Action**: Co-signed investor statements with 322 investors representing US$9.2T for workers' protections during COVID-19. Working with a large group to deliver recommendations for the Meat Sector during COVID-19.

INVESTING WITH INTENT *because* **CAPITAL DRIVES CHANGE™**

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