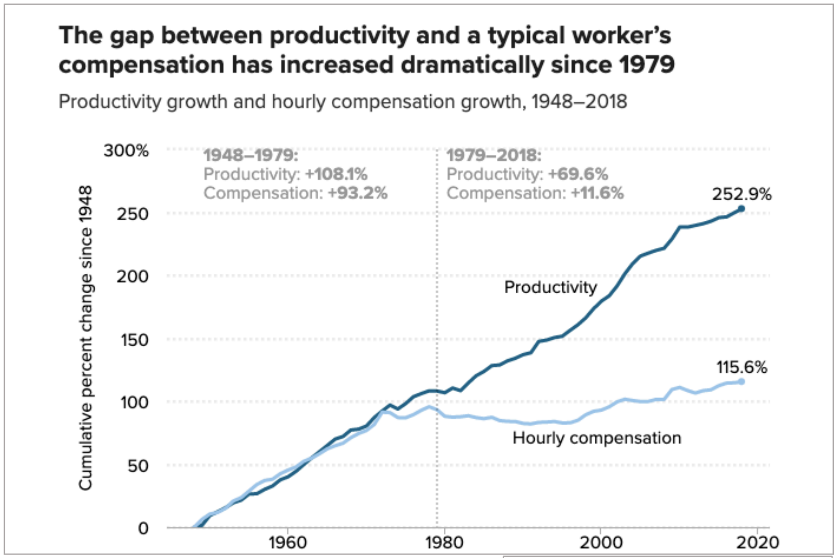
Quarterly Commentary 4Q'19

The year 2019 turned out to be a really good one for investors. In spite of trade wars, political uncertainties, and tangible signs of a potential slowdown ahead, markets around the world rallied. The US-based S&P 500 finished up 9.1% for the quarter and 31.5% for the year 2019, while the global MSCI All Country World Index was similarly up 9.1% for the quarter and 27.3% for 2019. Bonds also delivered solid performance, with the Bloomberg Barclays Intermediate Term Bond Index up 0.4% for the quarter and 6.8% for the year 2019.

This strong year capped off a full decade of basically uninterrupted economic growth and market recovery. The previous decade – the "aughts" – was dismal, of course, involving two recessions and near-zero returns for investors. This decade's recovery from that has been long and slow and notably sluggish, making it harder than usual to read the signals for where we're headed next. It's taken most of the past decade for unemployment to drop from 10% to the current 3.5%, and we still see little wage pressure and very low inflation. This scenario has been rough on many low and middle-wage earners (more on that in a minute) but it's been great for shareholders as stocks have benefited from the low inflation, low interest rate environment. Over the full decade, the S&P 500 was up 256%, or an average of a little over 13% per year. The US markets have performed particularly well throughout the decade, while big companies have outperformed small. Giant US technology companies – Apple, Google, Microsoft, Facebook, Amazon – have commanded the highest returns. At this point, the markets seem poised for rotation, as stocks outside the US are, as a whole, trading at more attractive valuations.

There are signs of slowing from here: weakness in manufacturing, nervous corporate leaders, and recent news that the economies in seven states are actually contracting. Trade war uncertainties still loom and the recent, sudden specter of actual war with Iran of course raises new risks. In the meantime, US GDP growth remains in the 2-3% range, consumers keep spending, and stock prices keep rising.

As the calendar turns to a new decade, we're watching two areas we see as pivotal. First, as noted above, this past decade has been tough on US workers, especially low- and middle-income earners. Despite gains in productivity and the overall economy, wealth inequality has continued to increase as wage growth remains stubbornly low. With shareholder returns high and wage growth lagging, wealth continues to shift from workers to owners. It's a situation that's potentially destabilizing for society and the economy and we're already seeing some of the effects: an increase in "diseases of despair," declines in life expectancy, and the empowering of populist political leaders. Solving this large and growing wealth gap will almost certainly require a shift in public policy and some give-up by those at the top of the wealth spectrum. While a shift in this direction may be disruptive, we see increased well-being that's more equitably distributed across the economy leading to a healthier and more productive workforce, increased innovation, and promising opportunities for investors. Indeed, promoting decent work is an important theme across our current investments, as we invest in companies and other entities that are driving more equitable outcomes for workers, through job creation, education and training, and advancement opportunities for workers of diverse backgrounds.



Source: Economic Policy Institute

The second pivotal issue is, of course, climate change. The year 2019 was the 2nd-hottest ever, capping a decade of rising global temperatures that have led to unprecedented flooding, fires and drought across the planet. We've finally begun to see the kind of large-scale response needed from major institutions, as the divest-from-fossil-fuels movement has now grown to $12 trillion in assets and more than 200 major corporations (including many of our portfolio's core holdings) announced they have achieved or will soon achieve 100% reliance on renewable energy. Over coming years we expect rapid acceleration of the movement away from fossil fuels and towards renewables, which are increasingly affordable and necessary. We also see investment opportunities from what we expect to be massive innovation in energy, technology, transportation, food and agriculture, buildings, and design as we work to mitigate global temperature rise and enable resilience against a changing landscape.

In Our Portfolios

With our focus on decent work, clean energy and climate action, Figure 8's stock portfolios delivered competitive performance for both the quarter and the year. The primary contributors to positive returns were our overweight position in the technology sector, the selection of specific technology stocks (Apple, Autodesk, Taiwan Semiconductor), and our redefinition of the energy sector by substituting renewable energy stocks for the lagging oil and gas sector. Quarterly returns were also boosted by strong Individual stock selection in real estate, industrials, and materials, with top contributors including Jones Lang Lasalle on global growth in its real estate portfolio, Allegion on its ability to deliver on a growing demand for physical safety and security, and flooring specialist Interface as it realizes benefits of recent acquisitions and sustainability leadership. Detractors to quarterly performance included general weakness in our stock selection in healthcare, especially among global players facing trade-related weakness in overseas sales, and Nokia on struggles in the evolving 5G marketplace.

During the quarter we harvested losses in Nokia and Sprouts Farmers Market, added new positions in sound specialist Dolby Labs and labor-led Amalgamated Bank, both offering promising growth opportunities, and added to our basket of clean energy-related stocks including inverter specialist SolarEdge, smart meter specialist Itron, energy management player Ameresco and wind power generator Nextera Energy Partners.

Upholding Shareholder Rights

An important part of our work at Figure 8 is helping clients leverage their influence as shareholders through dialogue with corporate management, filing shareholder resolutions, and voting proxies on important social and environmental issues. This powerful set of tools has, over many years, helped create significant changes in corporate practice and policy, on issues including climate risk, water scarcity, workplace equality, and human rights. Now, the rights of shareholders to use these tools are under threat, as the current SEC has – with the blessing of the Business Roundtable and other powerful forces – proposed a new set of rules severely limiting access to the resolution process, particularly for smaller shareholders. Concerned investors, including many large institutional investors along with independent firms like Figure 8, are speaking out. We will post updates here as the new rules are deliberated.

The Sustainable Development Goals (SDGs) are set of 17 goals adopted by world leaders to protect the planet, eradicate poverty and promote global prosperity. Figure 8 has committed to use the SDG framework to define our own social and environmental impact.

In the meantime, we are cheering the hot-off-the-press announcement by Blackrock, the world's largest asset manager, that climate change will now play a central role in its business strategy. This includes a change in its proxy voting policies, to be "increasingly disposed" to support proposals for climate -related disclosures and practices. In 2017, Figure 8 co-filed a shareholder resolution with Blackrock asking for exactly that - a more assertive stance on climate change in its proxy voting practices and elsewhere. At the time, BlackRock pledged to better assess climate-related risks and opportunities, the shareholder resolution was withdrawn, and productive dialogue with concerned shareholders continued. While it's taken several years and pressure from activists on many fronts to reach this new milestone, Blackrock's announcement is an exemplary demonstration of the power of shareholder engagement in action.