Quarterly Commentary 3Q'20

The Divergence Continues

The 3rd quarter of 2020 demonstrated once again the big and growing disconnect between the markets and the "real economy" – that is, the economic reality on the ground for most people, communities, and all but the largest businesses.   There's a lot of talk about recovery – which, as defined by the Oxford dictionary as a "return to a normal state of health, mind, or strength," seems an inaccurate term to use right now with unemployment at historic highs, thousands of small business shuttered, schools unable to operate regular schedules, and coronavirus numbers once again surging across the US and Europe.

We have seen some "less bad" economic indicators. The IMF is now expecting US GDP for the year 2020 to be -4.3% for the US vs. its previous estimate of -5.9%, and global GDP to be -4.4% vs. the prior estimate of -4.9%. Similarly, S&P 500 company earnings that declined 32% for the 2nd quarter (vs. the same period last year) are now expected to decline *only* 20.5% for the 3rd quarter. Weekly initial jobless claims are likewise trending towards "not as awful" coming in at an improved 787,000 in the most recent seasonally-adjusted reading, but remain at historically high levels. In short, we have not yet emerged from this pandemic-driven economic crisis. While it's important to look towards future recovery and to *building back better*, it's also important to recognize that we are not there yet.

Leadership of the Large

Where we have seen recovery is in the stock market, particularly for the largest US companies, where prices have roared back and then some. The US-based S&P 500 rallied 8.9% for the 3rd quarter to end up 5.6% year-to-date. The global MSCI All Country World Index was up 8.3% for the quarter bringing its net gain to 1.8% YTD. Despite the coronavirus resurgence in the US and beyond, stocks are up – with the largest players, big tech in particular, leading the way.

Overall, the economic outlook remains exceptionally uncertain, as the months ahead may bring additional lockdowns and more political discord. In uncertain times, we expect to see market volatility and downward pressure on stock valuations. But we're seeing the opposite now, which only exacerbates the sense of divergence from Main Street. What investors *can* rely on with relative certainty is that interest rates are likely to stay exceptionally low and that there will eventually be additional stimulus to keep the economy going.

What could go wrong for the markets? A significant deterioration in the real economy from here would almost certainly hurt stock prices. Inflation is a significant looming risk over the longer term but we so no signs of that on the near-term horizon. On the flipside, there may actually be more positive catalysts ahead for key parts of the market. A Biden presidency and Democratic Senate – a combination which seems increasingly likely – would accelerate the energy transition towards renewables, increase infrastructure spending, and perhaps bring a more equitable tax structure. We're focused on this scenario as we position portfolios for the coming year.

Against this backdrop, many sustainability-focused stock portfolios have delivered strong performance this year, especially benefiting from the strategy of doubling down on decarbonization. Not owning conventional energy has continued to be a big tailwind, as oil & gas stocks have continued to lag while renewable energy-related holdings have, as a group, outperformed.

Words vs. Actions on ESG

There's also a growing divergence in the world of social investing, between those following an "ESG" approach – integrating environmental, social & governance factors into investment decision-making – and those aiming to invest for social and environmental change or "impact". The two approaches can be – and often are – practiced simultaneously (as we do at Figure 8). However, many impact-focused investors are now voicing concerns that as practiced, ESG is not actually change-making -- and worse, that some asset managers embracing ESG are putting more effort into well-worded marketing and asset-gathering than they are into efforts to reduce carbon emissions and further social justice. We'll be bringing you more commentary on this over coming months – stay tuned.

One glaring example of the misalignment between rhetoric and action among some large US asset managers is how they're addressing climate change. Many of the ESG-labeled funds recently introduced by big firms continue to hold oil and gas stocks. The world's largest asset manager Blackrock, for example, has fossil fuel exposure in every one of its 17 ESG-labeled mutual funds and iShares ETFs (see www.fossilfreefunds.org for more).

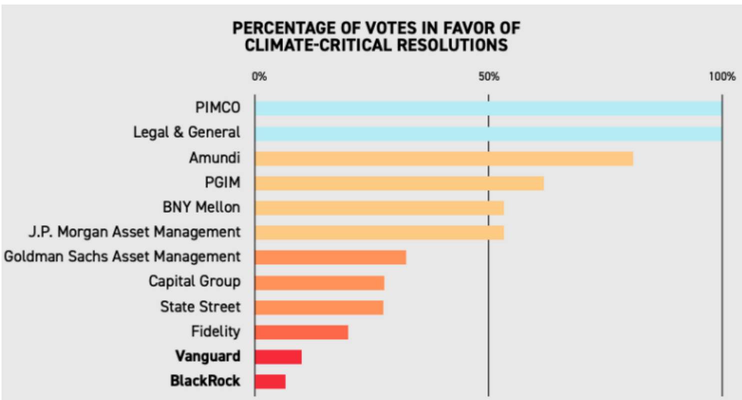

Figure 7: Percentage of Votes in Favor of Climate-Critical Resolutions
Source: Proxy Insight

Additionally, in the 2020 proxy voting season, Blackrock supported only 3 of the 36 climate-related shareholder resolutions identified by Majority Action as "critical"*, including those asking companies to align their lobbying, lending practices, and/or management with the Paris Climate Accord. This is in spite of CEO Larry Fink's stating, in his recent letter to CEOs, that "climate change has become a defining factor in companies' long-term prospects" and that "climate risk is investment risk."
Vanguard, Fidelity, State Street, Capital Group (American Funds), and Goldman Sachs all supported less than half of these critical climate-related proposals. In at least 15 cases, if Blackrock and Vanguard had voted for the proposals, it would have tipped the balance to majority support.

The bottom line: Blackrock and other top asset managers have made some strong statements around climate policy. When it comes to actual change, however, they've supported the status quo. It's time to turn the pledges of these large asset managers – on climate change, on stakeholder welfare, and most recently on racial justice – into action.

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.

*See https://static1.squarespace.com/static/5d4df99c531b6d0001b48264/t/5f6976e5f6b47e5e50c11430/1600747275103/MA_ClimateintheBoardroom_2020.pdf