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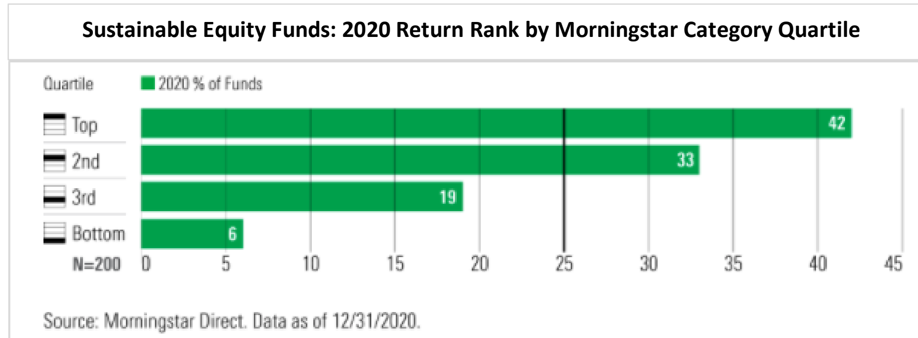
Quarterly Commentary 4Q'20

Goodbye 2020

2020 was an incredible year. Between the global pandemic, massive fires, intense political strife, trade wars, racial injustice and social unrest, and threats to truth and US democracy itself, we've had quite the ride. As we begin this new year, we have a country divided, certainly along political lines, and with big and growing gaps between the haves and have nots.

The markets have been firmly in the "haves" camp. In spite of the dramatic and challenging year just ended, many parts of the economy were undeterred, lots of consumers kept spending, and many companies have been reporting better-than-expected earnings. Investors did well. Sustainability-focused investors did even better. As you can see in the chart at right, Morningstar found that for 2020, 75% of all mutual funds labeled "sustainable" performed in the top half of their peer group. The shifting energy landscape has played a big role here, as oil and other fossil fuels have lagged while clean energy stocks soared. More broadly, investing that considers Environmental, Social & Governance factors – aka "ESG Investing" is increasingly recognized as simply smart investing. (More on this below.)



Overall, the US-based S&P 500 rallied 12.2% for the 4th quarter to end up 18.3% for the full year 2020. The global MSCI All Country World Index was up 14.8% for the quarter bringing its net gain to 16.8% for 2020. The 4th quarter brought a rotation in leadership we'd been expecting – and expect to continue – as small capitalization, European, and emerging markets stocks all outperformed, finally beginning to catch up to the big US stocks that have dominated market performance over recent quarters.

Hello 2021

Since our last quarterly commentary, a mere 3 months ago, in the US alone we've had an election, an insurrection, an impeachment, and an inauguration. We've seen the Senate flip from red to blue, marked more than 400,000 dead from coronavirus, and cheered the remarkable development and quick approval of two vaccines. We've exhaled at the last-minute passage of a lackluster relief bill in December and witnessed President Biden propose a much more comprehensive $1.9 trillion American Rescue Act. The cumulative effect of these recent events has left us in a more hopeful place than we were even a few weeks ago. The country still faces massive challenges – an untamed virus, high unemployment, a weakening jobs picture, widening inequalities, and cultural backlash – but we can now envision that 2021 might indeed bring a more robust and more equitable recovery in the US and around the world. Last quarter, we wrote that "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." That's changed. We've taken some big steps towards recovery.

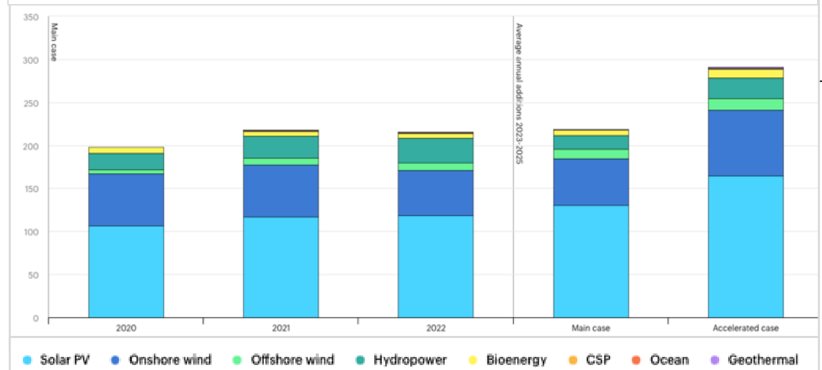
And so analysts and pundits are now raising global economic forecasts and corporate earnings projections for the quarters ahead. Soaring stocks are now trading at significantly above-average valuations based on consensus earnings. But in this time of great uncertainty, those earnings estimates could very well be off. Stock valuations look unusually high if the economy stagnates from here – but could be attractive if earnings take flight in a booming recovery. On the flip side, economic recovery is likely to put upward pressure on prices leading to inflation and higher interest rates. We see few signs of that pressure right now – policymakers have reiterated that recovery and stimulus remain top priorities here and they plan to keep interest rates low -- but the outlook could shift quickly and inflation remains a key risk we're watching for both stocks and bonds.

While we have our eyes on the future; history has its eyes on us*

We are in a time of momentous change and investors have a critical role to play. A lot of the changes we see happening are not new, but Covid has served as both an accelerant and an opportunity to reset. How we choose to use our resources – our ideas, our labor, our capital – now, at this pivotal point may matter more than at most times in history. This is a time for investor impact. It's also a time when the ramped-up pace and scale of transformation means big opportunities for investors, but also some new and different risks – so investors need to pay attention to the shifting landscape. Here, in teaser form, are some key themes we're watching – stay tuned to hear us expand on these themes and others over the coming year:

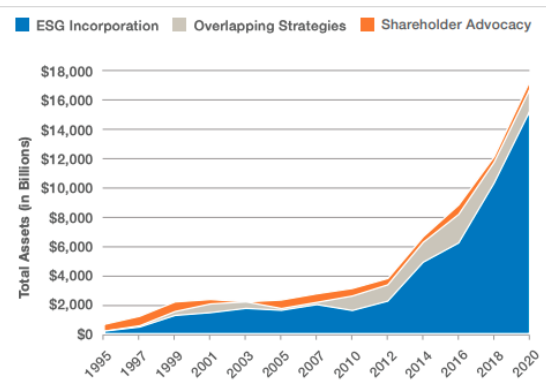
The Great Shift is NOW. The inevitable transition from fossil fuels to clean energy is here and accelerating. For 2020, renewable energy accounted for 90% of all new generating capacity globally, according to The International Energy Agency. Renewables are now, in most cases, the cheapest source of energy and costs continue to fall. With 2020 being among the hottest years on record and the US rejoining the Paris Climate Accord, we think decarbonization will happen faster than expected. ***For investors, we see big opportunities for some and key risks for others as the regulatory context changes.***

Renewable Capacity Additions by Technology 2020-2025 Main and Accelerated Cases



Source: www.iea.org/reports/renewables-2020/renewable-electricity-2#forecast-summary

Sustainable Investing in the US 1995 - 2020



ESG investing is smart investing. On climate and other key issues, leading corporations are acting and transforming ahead of government policy. ESG investors who understand this and are able to develop deep insight into how companies handle material ESG issues are likely to have an edge. The world's largest investors are now paying attention; ***ESG investing has gone mainstream.***

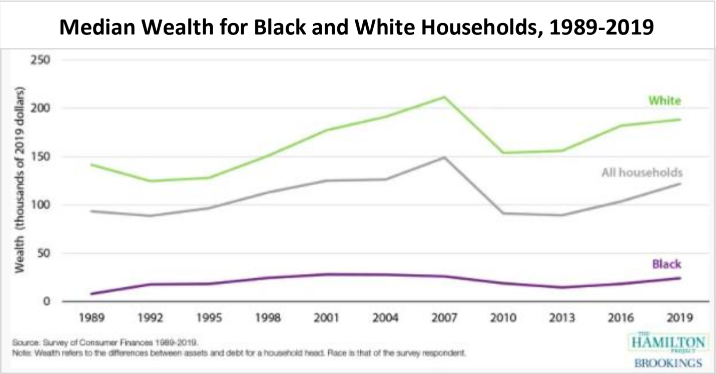
ESG investors are about to get smarter. Now that sustainable, responsible and impact investing account for 1/3 of all assets under professional management in the US ($17 trillion!), investors are demanding better, more relevant information on key ESG issues. At the same time, technology is providing new data sources and real-time insights. For a great example, take a look at Climate Trace (www.climatetrace.org). ***We're about to enter ESG 2.0 and attuned investors will benefit.***

Science saves the day. The scientific innovation that went into the rapid development of the coronavirus vaccines is enabling the world to move beyond the pandemic, while also serving to remind us of the incredible value of basic science and research. Scientific research and development are also at the heart

**Yes, we're quoting the incredible Amanda Gorman! (The line is an excerpt from her inauguration poem, "The Hill We Climb.").*

of combatting climate change. ***For investors, this demands keeping up with scientific and technological innovation; for impact investors, it calls for directing capital to investments in science, research, and learning.***

Racial justice has a long, long, long arc. Between the pandemic and politics, we've had a stark view into just how wide racial and economic disparities are in the U.S. The wealth of white households continues to dwarf the wealth of Black and Latino households on every metric. The truth is that decades of diversity and inclusion pledges and programs from major corporations have not moved the societal needle in any major way. We continue to see a tremendous amount of "cosmetic" diversity in corporate America, which provides very little substantive change for communities of color and leaves us still a long way off from legitimate economic justice. We believe catalytic changes need to come not just top-down from big business, but from the ground up -- from communities, small and innovative businesses, local leadership. There's an enormous opportunity for targeted capital to make a difference in this realm, for all of us. Closing the racial wealth gap could add 4-6% to US GDP by 2028, says research by McKinsey*. ***Investors need to look outside the public markets when appropriate to catalyze change on racial justice, which could boost economic progress all around.***



Giving it back to the people. In this fascinating time of massive challenges, rapid change, and with a federal government that's left some big gaps, leadership has come in unconventional ways. Philanthropists, especially women – MacKenzie Scott, Melinda Gates, Dolly Parton (!) -- have stepped in with massive gifts to fund aid, education, and basic research, in a way forming their own alternative social safety net. In the absence of national policy around energy and carbon, leadership on climate action has come from local governments, business associations, and individual companies who have set their own targets and funded initiatives. In the absence of clear federal regulations around social media and hate speech (which may very well be impossible to dictate), the defense of truth has fallen to technology and telecom giants – who we would argue stepped in with too little too late. Indeed, a lot of this gap-filling has been really uncomfortable and the societal implications aren't yet clear. Going forward, we envision a strong movement to redefine how we as citizens, businesses, and investors intersect with government – to, if you will, take back the word "patriot". As the role of government evolves, ***we're watching for substantive shifts in the regulatory, economic, and tax policy landscape – we're not yet sure how – but we see the context in which we make investment decisions to be changing in major ways.***

In sum, we are living and operating in truly transformational times. As investors, we're paying attention to the shifting landscape and keeping open, nimble minds as we make investment decisions. We're excited to move forward into 2021 and beyond.

* *https://www.mckinsey.com/~/media/McKinsey/Industries/Public%20and%20Social%20Sector/Our%20Insights/The%20economic%20impact%20of%20closing%20the%20racial%20wealth%20gap/The-economic-impact-of-closing-the-racial-wealth-gap-final.pdf*