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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Socially Responsive Balanced Fund Outperforms the Benchmark

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SECTOR — GENERAL INVESTING

TWST: Tell us a bit about 1919 Investment Counsel's history and what the business looks like today.

Mr. Bates: As our name implies, we were founded in 1919, so we do have a long, 105-year history, and we're a pioneer in the field of investment counsel. We started in Boston as Scudder, Stevens & Clark back in 1919. Over that 105-year history, although we've changed names a few times, we have really stayed true to our strong investment philosophy and process.

We're about $22 billion in assets under management. We have seven offices from coast to coast, New York being our largest, Baltimore being our headquarters. About 70% of our clients are high net worth families or individuals, and 30% are institutional, typically nonprofit foundations and endowments.

We have a 50-plus-year experience in responsible investing, and we use the umbrella term "responsible investing" to incorporate our work around ESG, values-aligned, and values-based guidelines, and impact, as well. So, we were an innovator and leader back in the early 1970s in the concept of responsible investing.

We manage a mutual fund and have a significant number of both institutions and high net worth clients that incorporate our responsible investing capabilities.

TWST: You noted the firm's 50 years in responsible investing. Why did the firm start including that in your offerings, and how would you describe investor interest in SRI or ESG investing today?

Mr. Bates: The impetus behind our involvement really stems from our DNA, our culture, which is based on listening to clients and customizing client portfolios. Back in 1972, a client that is still a client today — it's an institution, a faith-based organization, a Catholic organization — spoke with us about aligning their endowment with their faith. And because our firm is well known, and at that time was well known, for a high degree of customization, we embraced the concept and successfully worked with that and continue to work with that client.

But then two things happened. One was, we recognized that there was really an untapped opportunity. There weren't that many, if any, firms that had a sophisticated approach towards responsible investing — of course, at that time it was called socially responsible investing — and we recognized there was a need in the marketplace as well. So, we began to invest more in our capabilities, and then we became well known within the field and, of course, continued to gather assets.

You hit on something, too, about where are we today. It's interesting, because there's been a massive amount of evolution over the last 50 years. When we first began, the focus amongst investors was exclusionary investing: Let's avoid tobacco, let's avoid weapons of mass destruction. And so, it was very much about avoidance.

We were an early adopter behind the concept of affirmative investing, as well, and so besides avoiding certain companies for certain practices, we recognized that clients wanted to embrace certain companies that had business practices that had a positive impact.

We began, at least 20 years ago, having the ability to not only exclude companies, but also include companies based on positive impacts. So, as we work with each client or we work on the fund, we're considering both of those factors, both a negative and a positive impact from a company.

We continue to see evolution. There was the evolution of ESG, which in our mind is kind of a cousin to responsible investing. Some people think it's the same thing. To us, it's not. It's risks and opportunities associated with a company based on various factors, and we incorporate that kind of research into our fundamental process, but we see it as slightly different than values-based or impact-based investing.

But we recognized that it was becoming quite prominent in our field, and so we wanted to make sure we understood that evolution and incorporated it in our philosophy and process as well.

We've seen continued evolution, and some backlash against the concepts of ESG. We recognize that we never want to be stagnant, to think that we have it all well understood and can execute perfectly. We recognize that we, as a firm, have to continue to evolve, and the way we do that best is really listening to our clients.

TWST: Let's talk about the Socially Responsive Balanced Fund. Give us kind of a snapshot of the fund, its strategy and the investment process.

Mr. Bates: The fund itself, as the name implies, is balanced, and so the portfolio will typically have between 65% and 70% in equities, the remainder in fixed income and cash.

It's a fund that was early, one of the first in the 1990s — it was 1992 when the fund was initiated and created. Our firm and I began managing it in January of 2007, so I've been managing it now for over 17 years.

We do have a suite of values-based guidelines that we apply. There are five of them. No tobacco. We have a climate-aware approach, which de-emphasizes fossil fuels and really seeks to invest in companies that are positively addressing energy transition.

Finally, diversity, inclusion and justice are issues that affect all companies. As part of our Inclusive and Diversity World theme, we look at how companies handle these issues not only within their own company but also in their community of stakeholders.

So, these are the kinds of positive impact themes that we apply to the portfolios, including the fund, to find great companies that we think are truly great investment ideas, that we think will generate attractive returns, but that at the same time are having a positive impact.

An example would be one particular company that makes the large black corrugated plastic tubes that are associated with water distribution and drainage. You might see them at a construction site, or you might see them at a road construction site, where these massive black corrugated tubes are used.

We became interested in it for a couple of reasons. Our fundamental equity analyst became very interested in the company because of needed infrastructure enhancements. The Infrastructure Investment and Jobs Act, we recognize, could result in tremendous growth among certain infrastructure companies. We also recognize that our roads and bridges and dams and airports are aging. And so, we were interested in companies that could benefit from infrastructure spending. Our analyst was very interested in this company because they are used actively on many construction sites.

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We have a human rights guideline that avoids companies that have bad human rights records. We have a citizenship and labor guideline that takes into consideration various factors around commitments to their employees, diversity and inclusion, those types of factors.

And then we have a weaponry exclusion as well, to eliminate companies that generate significant revenue from weapons of mass destruction. So, those are the guidelines that we apply to both the equity and fixed income assets.

TWST: Can you tell us about a couple of favorite investment ideas from the fund? Why do you like them as investments and how do they illustrate those guidelines?

Mr. Bates: I'll segue into a couple of examples by also speaking to impact investing, because that's an element of the fund, too.

As we conduct our research, we are looking for companies that have a positive impact, and we've identified five different impact themes that we apply to the portfolio.

We apply a guideline around what we call the low carbon future, which is to de-emphasize fossil fuels and look for companies that are really helping with energy transition. We also have a theme called responsible production and consumption, which speaks to companies that are addressing opportunities around recycling or reducing consumption. We have a guideline associated with water — basically, clean water — as a theme, as well. I'll speak to a company associated with that here shortly.

Our final two themes are Global Community and Inclusive and Diverse World. On Global Community we are focused on businesses that have the potential to positively impact global success in creating better outcomes for the stakeholders in their business.

Our responsible investing analysts — and we have three dedicated analysts in house that do research — were also very interested because the corrugated pipes are made of plastic, and the company is actually one of the largest plastics recyclers in the world. They recycle a tremendous amount of plastics, and so that was interesting to us, to keep plastics out of the landfill.

But they are also more environmentally sound; they are much less likely to leak or erode, and so they're better on the environment.

And finally, they are better on the environment because they're much cheaper to transport. Traditional tubing might be concrete, or in the old days even made of bronze; they were massively heavy, and the fossil fuels required to move that heavy load were significant. With these corrugated pipes, they're a fraction of the weight, and so there's tremendous fossil fuel savings in the transportation of this product.

So, add those elements together. We saw that this is a company that's introducing a product that we believe will have great demand, but at the same time has a really positive impact in terms of the environment and in recycling. For that reason, we purchased the company, and continue to hold it today.

Another one I'll mention is in the theme of clean and accessible water. Our analysts who identified this company again identified aging infrastructure and the need for continued enhancements of our water and sewage systems, but many are owned by municipalities and aren't investable. And so, the analyst identified the company as a candidate.

They are actively involved with municipalities to overhaul, improve, and modernize their water infrastructure. It results in significantly lower water waste, and it also significantly improves water quality.

We saw these as two things that align with our positive impact themes in terms of quality of life — having better water — but also a water savings, less waste, less chance for pollution and the like. And so, for those reasons, both as an investment idea and an impact idea, we own this company.

TWST: In the last quarter or two, what stands out from the biggest contributors and detractors for the fund? And do they speak to certain areas where you see, more broadly, good opportunities or areas of weakness or risk?

Mr. Bates: When we look at attribution, clearly the drivers of our outperformance have been our technology exposure; we're slightly overweight to technology, and our health care exposure, we're overweight to health care. And then looking below that at another layer is stock selection within those sectors.

We are a responsible investing fund, and a number of our companies are really identified as positive impact companies, but a company doesn't have to be a positive impact company to be owned. As long as it meets our values-based guidelines, it could be a candidate.

For example, we do not own all of the Magnificent Seven, because we feel that a couple of them do not meet the corporate governance standards we like to see. So, we have benefited from that technology exposure.

And then in health care, we've owned some very strong performers.

So, when we look at attribution, while our sector weightings have modestly enhanced performance, our stock selection is where we really shine and where we've seen significant outperformance versus the benchmark and the peers.

TWST: What do you use as a benchmark for the fund and how has performance compared?

Mr. Bates: It is a blended index that we apply. Relative to peers, we have really excelled, just based on data that we see publicly published, like in Morningstar. We're a five-star-rated fund that has been performing in the top decile for a number of periods.

TWST: Can you tell us a bit about how you integrate green bonds into the overall portfolio, and what you look for in terms of issuers?

Mr. Bates: We use the term "impact bonds," because it's shorthand for green, social, sustainable, sustainability linked, blue — all these different kind of bonds. Of course, green bonds are the largest category; they started 10 years ago, so we saw some issuance starting in 2014, 2015, and that's when we became interested.

Because, for a long time we'd been having a focus on positive impact in the equity portfolio, but it was more challenging to find ways to have impact in the bond portfolio. These impact bonds, these green bonds, we identified as the perfect opportunity, and so we began investing many years ago.

Presently, about 35% of our bonds in the portfolio are impact bonds. These bonds are issued for a very specific project or reason. For instance, if we like a bond we're not lending money just to the issuer, we're lending to the issuer's green bonds projects, which are focused on various green projects around energy efficiency, green building projects, circular economy, and so they're very targeted specifically to environmental impact projects. We thought that was appealing.

Another example, under a social bond, is a large U.S. bank bond. Again, it's not a corporate bond where use of proceeds, the bank can use them at will. The bond proceeds were being used very specifically for affordable building assets. So, again, we thought this aligned really well with our impact — in one case, aligned with environmental impact, and with the bank, with a social and societal impact with affordable housing.

And again, it was really a way that we identified to have positive impact in a client or fund portfolio, and so we have been very active investors for almost 10 years.

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TWST: In addition to the mutual fund, you offer a number of SRI/ESG strategies for separately managed accounts. Would you give us an overview of that part of the business and anything in particular you feel differentiates these offerings?

Mr. Bates: Yes, we do offer five basic strategies. We also are well known for a high degree of customization, so for many of our clients we very much customize the guidelines, and it's not a specific suite of guidelines that are predetermined that they have to fit into. But for those clients that say, "I don't want to necessarily go through the process of self-selecting my guidelines, I just want to look at some portfolios and find one that speaks to me," we do have five candidates.

The first is our flagship and oldest, and that's our Responsible Investing Equity strategy which incorporates five guidelines: environment, human rights, employment practices, weapons, and tobacco.

The second is our Responsible Investing Climate Aware strategy which incorporates the same five guidelines identified in the Equity strategy above, but also applies a rigorous guideline associated with carbon.

We're considering the carbon footprint of every company we might own, with the goal of having a significantly smaller carbon footprint than the S&P 500.

As a result, we have little exposure to fossil fuels or electric utilities that depend on fossil fuels, and we have more pronounced exposure to companies that are assisting in terms of energy transition. What is appealing to certain investors is the additional element of really having a climate-focused portfolio.

The third is Catholic Values, and the portfolio is driven by the guidelines that are established by the United States Conference of Catholic Bishops, or USCCB. They publish specific responsible investing guidelines; November 2021 was the most recent iteration, and it's quite extensive.

A number of factors are considered, including life issues — abortion and contraceptives, for instance — because they're a Catholic faith-focused portfolio. Other guidelines associated with weapons, associated with the environment, associated with human rights, are also evident within that strategy.

The fourth is our inclusive strategy, and here is where we're working with our clients who are focused on opportunity and inclusion, both gender and racial. This doesn't have guidelines necessarily associated with the environment, let's say, or we don't exclude tobacco or weapons per se. That's not the focus of this portfolio.

The focus here is really looking at the businesses and how they promote or exhibit tendencies towards positive gender and racial inclusion, and our internal analysts evaluate each company's record and potential on various factors.

And the last and our newest strategy is our Sharia strategy. We have a number of clients of the Islam faith who, just like Catholics, have their guidelines. The Islamic faith has very clearly pronounced and documented guidelines associated with Sharia. Those guidelines are unique.

Some have overlap. There's strong environmental focus, there's strong human rights focus, there is an avoidance of weapons and tobacco, for example. But there are other Sharia principles that are very unique, for instance, not owning companies that derive significant revenue from lending is an example of a Sharia principle, so we're not going to own traditional banks.

So, the Sharia principles are unique to the Islamic faith, but because there are clients and prospects who really want to stay true to their faith, we're able to craft a high-quality portfolio aligned with their faith.

TWST: You noted earlier that there has been a certain degree of backlash against ESG investing. What would you say to skeptics or critics about the benefits of ESG and socially responsible investing, why it's important to your clients, and how it affects the underlying investment performance?

Mr. Bates: The backlash wasn't totally unexpected. We are a country and a world with various views, competing views, and conflicting views at times. And ESG is no different in that there are those that are strong proponents, and those that are strong skeptics. Certain states, as I'm sure you've seen, have promulgated certain rulings, and we've seen certain organizations put pressure on companies associated with some of their practices. So, it's not surprising.

We respect that all investors and shareholders have the right to their own views and to express those views and work towards influencing corporate behavior. Again, we're not surprised, and we're not begrudging those that are pushing back on ESG.

What we are finding, for the most part, is that companies are by and large really committed to ESG at some level — because they see it as good business practices. It's not necessarily social engineering or anything; the companies that we speak with say, "this really is good business, and that's why I'm doing this."

For example, the E for environment, a company that says, "if I can avoid having a toxic spill, then that will be good for my bottom line. I'm not going to get fined. I won't have lawsuits." We have seen examples of companies that have almost been bankrupt due to environmental disasters.

Also, "if I can invest in ways to reduce my energy consumption in my factory or my office building, why wouldn't I? I'm going to be spending less money ultimately. If I can install those solar panels and the payoff is really great, why wouldn't I do that?" So, companies have committed to that E.

In terms of the social, we've seen many companies feel a strong commitment to really reflect society because society is their end customer. They want to make sure they hear from various voices, whether it's gender or racial voices, within their company. With more diverse opinions, more diverse views, many companies we speak with think they can have better outcomes.

They also think, "if I treat my employees well, maybe they'll work harder, they'll be more loyal, they'll stay here longer, so of course I want to treat them well and have great benefits. Of course I'm not going to participate in human trafficking, or pay a non-living wage, or disenfranchise indigenous peoples. Why would I do that? That would be bad business."

Lastly, the corporate governance factor, which gets less attention, but governance is all about good governance. Having a separation of the CEO and Chairman, or having staggered terms, or having reasonable pay practices — again, these are just good business practices that history tells us bear fruit.

So, by and large, the companies that we work with continue to embrace the ideas of ESG — again, not because they're social justice warriors, but because they think it's good business.

In terms of performance, our position has always been that these kind of companies are better run. They are more focused on risk and opportunity. They're typically of higher quality in terms of balance sheets and market share and competitive position. And so, they're more likely to outperform over time.

Our strategy, I think, really bears that out in that our fund is top decile, not against other responsible investing balanced portfolios but against all balanced portfolios in the marketplace. And so, our contention is that you can have great performance but also invest in high-quality companies that have really high-quality business practices.

TWST: What do you see in the next decade or two for ESG and SRI investing? What is changing or evolving and what might be on the horizon?

Mr. Bates: The way we try to discern that is by listening to our investors and our clients, and often the next generation. For our high net worth direct clients, we typically work with multiple generations, including younger generations — Gen X, Gen Z — and hear what is important to them, as well.

I don't see anything necessarily unique emerging yet. I do see a very strong commitment to diversity and inclusion. I hear a lot of commitment around climate change. And I think — and this is kind of emerging — the broader question around biodiversity is becoming a more pronounced, larger theme in investment portfolios. It's not just about climate change or water, but really the bigger question of biodiversity.

I don't want to say it's just more of the same, but it's really restating those commitments to the same kinds of values, with maybe just a little bit of a shift.

I would say that there is more interest in positive impact. Negative screening is almost table stakes now, especially with clients who say, "yes, I expect you to do that, that seems pretty easy." The value add, the expectation, really is evolving more towards seeking out gamechangers, companies that really are having a measurable impact on the world, whether it's an environmental impact or a social impact.

TWST: Thank you. (MN)

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