Gender Equality – With or Without the Federal Government

By Julie Gorte, Senior Vice President for Sustainable Investing

There was a time in human history when size and strength were defining characteristics of a person’s value and of the jobs on which the clan’s survival depended. Today, that’s largely no longer the case, but cultural patterns that developed over hundreds of thousands of years aren’t easily undone. Gender-based inequalities in pay, prestige and power persist, and undoing the bias at the heart of them isn’t something that can be done with the stroke of a pen.

If it were, we might not have a pay gap now. The Lilly Ledbetter Fair Pay Act was signed into law in 2009, strengthening civil rights laws aimed at non-discrimination in hiring and pay. But since the current administration took office, there has been a significant rollback in regulations and laws that were helpful in ending gender-based discrimination. The Center for American Progress catalogued 100 actions that it said were harmful to women and families in the first 100 days of the Trump administration.1 The current Cabinet is about 18.8% female, compared with the U.S.’s 21.7% women/men ratio² in boards among large companies, and less gender-diverse than the past five³ cabinets. Would we expect progress in diversity from such a group? Possibly, but it’s not likely. But for those of us who believe in gender equality, despair is not warranted.

Policy, especially federal policy, is a powerful tool for shaping behavior. Luckily, it’s not the only one.

Reputation is even more of a powerful tool now than it was historically. Among the S&P 500, 84% of companies’ market value consisted of intangible assets in 2015.⁴ What that means, among other things, is that a loss of value inspired by a loss of investor confidence doesn’t have much of a safety net, which we customarily think of as the value of the bricks and mortar assets that make up the company’s value in the case of a fire sale. Wynn Resorts is a poster child for that: after allegations of sexual harassment and assault surfaced there, several Wall Street analysts downgraded the company’s rating, and the company’s share price plunged nearly 17 percent over one weekend.⁵

Having open, inclusive cultures in which success is not limited by gender or race or ethnicity is something that all companies need if they want to prosper, and especially if they want to grow. Companies depend on people of all genders and other stripes as customers, workers, suppliers, investors, and community members. Alienating half of them is not a recipe for competitive success.
Examining a Risk-Focused Approach in Small Cap

The Pax Small Cap Fund crossed the 10-year mark in 2018. In recognition of this milestone, Portfolio Manager Nathan Moser, CFA®, reflects on managing the Fund since its inception in 2008.

Q: What aspect of your investment approach has helped you succeed in managing the fund?

Mr. Moser: I’d say the emphasis on risk management is a point of differentiation, and, over longer periods, this discipline has helped the Fund versus peers. Our philosophy has always been focused on investing in the highest quality companies we can find, avoid over-paying for them and use active management to mitigate risk. We manage with a long-term perspective and seek to preserve investor’s capital during market declines as much as possible.

In my view, all too often investors chase short-term performance and fail to account for the level of risk in their portfolios. Our strategy was developed with a different aim—we seek to provide attractive risk-adjusted returns over the long term.

Q: How did risk management become such an important part of your investment approach?

Mr. Moser: Over my career, which started at the peak of the technology bubble in 2000, I’ve seen two market declines of greater than 45%—with many investors losing significantly more. Boom and bust cycles are a normal part of financial markets, which may be fading from investors’ minds because of how unusually placid and long this bull market has been thus far.

While all investors know they need to focus on the long-term, even for those with the most fortitude, it’s very difficult when you’re watching markets fall sharply. We designed this strategy to mitigate the risk of the small cap asset class, with the goal of allowing clients to remain invested through the inevitable bumps in the road.

Q: What gives you confidence that you can continue to provide strong risk-adjusted results?

Mr. Moser: The small cap market is inefficient, which affords us the opportunity to outperform. I believe that to beat the index and your competition, you can’t look like the index or do the same things your peers do.

Another aspect of our process that is differentiated is the integration of environmental, social and governance (ESG) analysis into our research process. In our view, this helps us identify potential risks and opportunities that our competitors may overlook. When combined with disciplined financial research, we gain additional insights and we believe the result is a higher quality portfolio with less risk.

Q: Over the past ten years, passive investing has increased in popularity. What are your thoughts on the passive approach in the small cap asset class?

Mr. Moser: With respect to small cap stocks, I believe passive investing exposes investors to meaningful risk as the benchmark contains many lower quality companies. In fact, approximately one-third of the companies in the Russell 2000 Index are unprofitable.¹ In an up market, very few investors care to closely scrutinize the fundamental quality of the stocks they own. However, should the inflows to passive vehicles reverse to outflows, I expect we’ll see meaningful small cap index volatility. The reason is because passive vehicles are largely mechanical—when money comes in, they put it to work. As companies in the index grow larger, passive funds buy more regardless of the underlying company’s fundamentals or valuation. Simply put, these vehicles buy more of what’s working—which is what momentum investors do. Passive vehicles now represent a very large part of the market and a shock to the system could cause investors to redeem en masse.

Q: What are some of the things you’ve learned over the 10-year period of managing the Fund?

Mr. Moser: I’ve learned many important lessons over the past ten years. I would highlight the importance of having an effective sell-discipline as one of the most critical. That is, having a plan on specific valuation levels or under what circumstances we exit a position. The sell discipline is a key element of our strategy and we see it as an important driver of strong risk-adjusted returns. Over the years the process has become better structured, more consistent and I am continually looking for ways to improve that facet of my decision making.

A broader lesson I’ve learned over my career is that as markets evolve, investors have to as well. One of the outcomes of the shift to passive investing is an increase in the persistence of stock trends, both up and down. To the extent that stocks are moving lower on deteriorating fundamentals, we feel it’s more important now than ever to exit.

Q: Anything else that you would like to share?

Mr. Moser: While milestones are a good time to pause and reflect, we remain committed to our approach and passionate about the opportunity that lies ahead. As we embark on the next ten years, I would like to thank all our investors for their confidence and continued support.

¹ Source: Bloomberg as of 4/17/2018

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Pax successfully withdrew pay equity shareholder resolutions at three companies in the financial services and technology sectors following their commitments to take proactive steps toward enhancing pay equity disclosure and to close unexplained pay gaps. Pax targeted companies in financial services and technology because these industries have among the highest gender pay gaps, have struggled to attract, retain and promote female employees and are where women are more likely to leave at midcareer.

In late 2017, Pax filed shareholder proposals at Discover Financial Services (Discover), HP Inc (HP) and KeyCorp requesting that the companies identify whether a gender pay gap exists among their employees, and if so, outline steps being taken to reduce the gap. At the time of the filings, none of the companies had any public disclosure related to pay equity.

Pax withdrew its proposals when the companies agreed to publish commitments to pay equity, alongside detailed information on their processes for managing pay equity. In addition, KeyCorp has published the results of its most recent pay analysis on its website. To read the press release visit paxworld.com/pax-world-funds-persuades.

Pax Climate Change Proposal Sees Strong Support at Old Republic

Climate change is critically important in the insurance sector. That’s why in 2017 Pax World Funds filed a shareholder resolution at Old Republic International Corporation (“Old Republic”), asking that the insurance company establish board oversight of the risks and opportunities posed by climate change. Two primary proxy advisory service providers, Glass Lewis and ISS, both recommended that shareholders support Pax’s proposal. At the Old Republic annual general meeting in May 2018, Pax’s shareholder proposal on climate change received strong support of 48%.

As active owners, about one-third of our engagement activities were related to climate risk in 2017, which includes filing shareholder proposals, direct dialogue with portfolio companies, voting proxies in accordance with our ESG criteria and supporting public policy initiatives that promote climate risk transparency.

To read more about our proposal at Old Republic, visit paxworld.com/old-republic.

Pax World Impact Report 2017

Pax released its 2017 Impact Report in April. The report reviews our progress as an asset manager committed to sustainable investing principles and as a business that seeks to operate in a manner consistent with the environmental, social, and governance (ESG) standards we integrate into our portfolios. To read the Impact Report, visit paxworld.com/impact_report.

Investors are more interested in gender than they ever have been before, judging by things like proxy voting and engagement. BlackRock, the world’s largest asset manager, recently has signaled in its proxy voting guidelines that all-male boards are not acceptable, and noted that boards should have at least two women on them. Pax has been voting like that for years, and we know our impact will be multiplied if other investors vote similarly. Another large investor, State Street, reportedly voted against directors of 400 companies whose boards were all-male. Moves like these show that mainstream, as well as sustainable investors, are aware of the research that links women in leadership to superior financial performance, and are prepared to act on that knowledge with proxy votes.

Gender equality is also an economic stimulus. McKinsey reports that the global economy could be $12 trillion to $28 trillion larger by 2025 if gender gaps were reduced (the lower number) or eliminated (the higher one).

These kinds of strong economic and financial drivers give investors reasons to care about gender equality, and to use their tools—investments, proxy voting, and engagement—to achieve that. And none of that has anything to do with policy. Policy can be a headwind or a tailwind, but compared with the economic and financial reasons for advancing gender equality, policy is more of a gentle breeze than a gale, no matter which way the winds blow.

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5. https://www.wsj.com/articles/blackrock-companies-should-have-at-least-two-female-directors-1517598407