PROFESSIONAL INVESTMENT ADVISORY SERVICES

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CONTRIBUTORS

Schroders

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Why “corporate karma” is crucial for your investment returns

The symbiotic relationship between a company and its stakeholders implies a notion of “corporate karma” that can help a socially responsible business thrive in the long term

Sustainability used to be a niche preoccupation, but it is now discussed everywhere. From *“flight shame”* to the gender pay gap, issues related to sustainability have become part of our everyday conversation.

Many of us are trying to do more at a personal level to live more sustainable lives, such as cutting down on single use plastic. But what about our investments?

Our latest 2021 Schroders Global Investor Study survey shows social and environmental issues have become more important to people as a result of the pandemic, and that a growing number of investors are finding sustainable investment funds to be more attractive than ever. We believe money managers like ourselves have a moral imperative to help drive the transition to a sustainable economy, and we can do this by directing more capital to sustainably-run companies and by engaging with the companies we own.

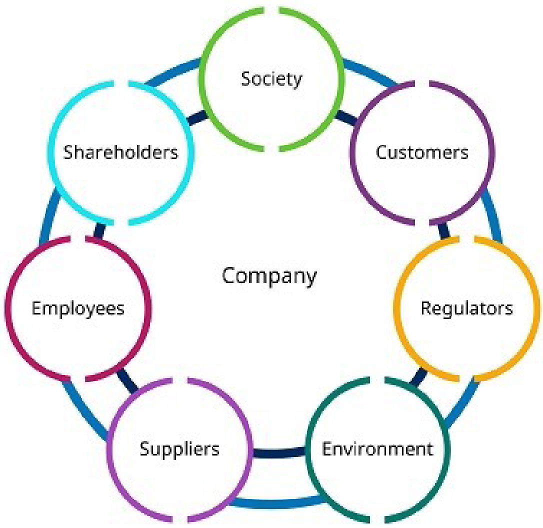
Many investors think there has to be a trade-off between sustainable investing and generating market-beating returns. We disagree. In fact, we believe that it is only by investing in truly sustainable businesses that we can achieve consistent investment returns over the long run.

In our view, the key to sustainable investing is to look at how a company deals with its stakeholders. Companies that are run with consideration for all their stakeholders can deliver better long-term returns and be less likely to experience expensive – even existential - controversies.

What do we mean by stakeholders?

Stakeholders are – as the name implies – any party that has an interest in something, in this case a business. The chart below shows the range of stakeholders in any company; their relative importance will vary depending on the nature of the business. Shareholders are a stakeholder, but just one among many.

Long-term value creation shaped by relationships with stakeholders



The concept of ***"shareholder primacy"*** is one that really took hold in the 1970s. This is the theory that shareholder interests should be the top priority for companies, over and above their other stakeholders. This led to a prevailing assumption that companies should be run to maximise profits for shareholders, regardless of the wider impact.

This way of thinking is becoming increasingly outdated. Maximising shareholder returns while damaging the environment, for example, is increasingly unacceptable to employees, customers and wider public opinion. This reputational damage could deter customers – resulting in a loss of market share - and make it hard to recruit and retain workers. It could also lead to regulators imposing stricter standards or levying fines.

This is by no means an exhaustive list of potential consequences. Clearly all of these outcomes would impact a company's profits – ultimately harming shareholders as well.

Stakeholder relations in the real world

Moving beyond the hypothetical, there have been numerous examples in recent years of companies where mistreatment of stakeholders has had wider ramifications.

A familiar case in the UK is retailer Sports Direct which became infamous in 2016 after reports emerged of 'inhumane' working conditions in its warehouses. Consumers boycotted the stores, resulting in a sharp deterioration in sales and profits, and the share price reached a low of 70% below its 2015 peak[1].

In a more recent case, leading UK ferry operator P&O Ferries sacked 800 British based employees without warning in March 2022, replacing them with agency staff who are paid well below UK minimum wage to operate its ships. The consequences so far include widespread consumer backlash, unions demanding for reinstatement of sacked crew and the UK government confirming that it was reviewing its contracts with DP World (owners of P&O Ferries) and P&O Ferries, and that legal action is being considered over the layoffs[2].

We can also point to companies that have borne the cost of environmental disasters – BP's Deepwater Horizon explosion and oil spill for example, or the catastrophic collapse of a Vale tailing dam in Brazil, killing 270 people in 2019. And those that have incurred reputational and economic damage from customer boycotts over unpaid tax (e.g. Starbucks in the UK), showing that customers are prepared to hold companies accountable for their responsibilities to wider society.

Positive examples rarely hit the headlines, so are harder to illustrate. But there are many examples of companies where, for instance, exemplary treatment of employees has resulted in long-tenured, deeply committed workers, boosting productivity and reducing costs associated with staff turnover.

For example, UK engineering firm Spirax Sarco spends more than all its competitors combined on training, resulting in a trebling of sales productivity for the average recruit during their first five years at the company[3].

Here in Asia, Japanese company Recruit, whose largest assets are the job recruitment sites Glassdoor and Indeed, stands out both on their relationship with their key stakeholders and their wider commitment to Corporate Social Responsibility which is quite unusual in the Japanese market in particular. The company's mission is to prioritise social value by removing frictions in the labour market and encouraging diversity hiring. Their entrepreneurial culture is also what we find impressive.

We can also think of examples where charitable projects and local investments have drawn support from the local community and authorities; and where a reputation for environmental stewardship is strengthening a brand and drawing in new customers.

Sustainable businesses can thrive in the long term

These examples illustrate that there is a symbiotic relationship between a company and its stakeholders which we like to think of as a kind of ***'corporate karma'***.

However, financial markets still tend to be very focused on the short term. Analysis of many companies tends to focus on their prospects for at most the next two or three years, if not just the next couple of quarters. Conventional financial analysis also struggles to capture non-financial factors, such as corporate culture and stakeholder relations.

This means that the wider market often underestimates and undervalues the resilience of growth and returns that sustainable companies can deliver. We find this very exciting, as it offers an opportunity for investors to exploit mispricing in the market and reap the benefit when those sustainable companies keep beating market expectations.

As investors, we can do our part to encourage companies to be more sustainable – improving outcomes for both our clients and wider society. We engage with companies proactively via conversations with management when we have concerns over the treatment of stakeholders. This includes voting at companies' annual general meetings to signal our agreement or disagreement with management's policies. The Schroders Sustainable Investment Team voted on 1,039 meetings in the fourth quarter of 2021, with 11% of these votes cast against management.

As we approach a ***"stagflationary"*** environment with slowing economic growth and accelerating inflation resulting from Russia's tragic invasion of Ukraine, it is these sustainable companies with enduring stakeholder relationships, solid balance sheets and strong pricing power that are better-placed to ride through this volatile environment and perform well in the long-run.

[1]*Source: Bloomberg. Stock peaked at 809p on 10 August 2015 and troughed at 252p on 26 July 2016. The information contained herein: (1) is proprietary to Bloomberg and/or its content providers; (2) may not be copied or distributed; (3) may not be accurate, complete or timely; and (4) has not been checked or verified by Schroders in any way. None of Bloomberg, its content providers or Schroders shall be responsible for any damages or losses arising from any use of the information in any way.*
[2]*Source: CNBC, March 2022.*
[3]*Source: Company meetings and Schroders analysis*

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Manulife Asia Care Survey

Singaporeans adapted to the new normal, but health and financial concerns remain

The latest Manulife Asia Care Survey[1]. has revealed that more than half of the respondents have accepted that COVID-19 is here to stay and have adopted better financial habits and lifestyle adjustments since the pandemic.

[1] This version of the Manulife Asia Care Survey was conducted via online self-completed questionnaires in eight markets, namely mainland China, Hong Kong, Indonesia, Japan, Malaysia, Philippines, Singapore, and Vietnam. A total of 8,276 people, aged 25 to 60 years old, were surveyed in November 2021. In Singapore, 1,000 people were surveyed. They included insurance owners and those who did not own insurance but intended to buy it.

Better saving habits, but fear of job loss still lingers

Almost half of the respondents (41%) saved more during the pandemic, with the highest group being those aged 25-34 years old, but only 28% have enough savings to last for more than a year in case of job or income loss. This is due to an overall limit on the amount of money people can save, as a third (34%) of the respondents say they saw a decline in their monthly incomes because of COVID-19. They are more concerned about job or income loss (19%) than other consumers in Asia (16%). 30% had cut back on unnecessary or big-ticket expenses to alleviate the impact of COVID-19 and mitigate further financial risks.

Interestingly, 14% of Singaporeans aged 25-44 have started their own business on top of their full and part-time jobs. This trend is especially prominent among the younger segment of Singaporeans, where there is a noticeable trend of increased interest in entrepreneurship.

Increased appetite for Insurance

COVID-19 continues to fuel demand for insurance as people look to stay in control of their health and financial well-being, with over a quarter expressing concern that the local economy will take a long time to recover. In addition, 58% of the respondents said that insurance and retirement planning has grown in importance to them, with more emphasis on retirement.

The survey illustrates Singaporeans' desire to stay in control of their health and financial affairs. Of those surveyed, 88% own insurance, above the regional average (75%). The most popular insurance products in Singapore are hospitalisation (55%), life protection (50%), and critical illness (49%) – with all areas ranking above the regional average. Among the 58% looking to purchase new insurance plans in the next 12 months, endowment/savings insurance (20%), hospitalisation cover (16%), wealth / investment-linked insurance (16%), and health (16%) are the top of the list in Singapore.

However, the survey also found out that the main barriers for buying insurance are affordability (38%) and complicated insurance products that are hard to understand (28%). Ideally, two-thirds of the respondents (65%) prefer buying insurance on online channels such as insurance comparison websites (26%) and insurance company websites (20%). Working mums and dads are more likely to look for an insurance company that has strong expertise in all areas when they consider insurance purchase.

Emerging concerns on mental health

There are growing concerns on worsening mental health among Singaporeans, with just 53% saying their mental health is good – higher than Hong Kong (47%) and Japan (43%) but below the region (64%). The survey also revealed that work is the leading cause of burnout in Singapore (46%), which is twice as high as compared to the region (23%). 3 in 5 (62%) have experienced mental health symptoms in the past six months, with the younger generations being the most susceptible. However, Singaporeans are generally open to advice on general health and well-being from medical professionals, with 70% saying they are comfortable seeking professional advice on these topics. Thankfully, 66% view regular physical activities as beneficial in improving their mental health, with walking, hiking, and jogging as their top favourites.

Looking ahead

Clearly, we are still not out of the woods, and COVID-19 will be with us for a while. As Singapore moves towards a post-pandemic recovery, it has shown us that we can't take life or our economic system for granted. We can use this opportunity to take positive action and shape a better future for ourselves and loved ones. It is imperative that we continue to look after our physical health, mental health, and financial health to live a balanced and fulfilling life.

Manulife

Living with COVID-19:

Singaporeans taking control of their physical, mental, and financial health

57% believe that the pandemic will last another year *or* will never end

52% of people in Singapore are comfortable with moving away from a zero COVID strategy and towards living with COVID-19

Taking control of physical & mental health

66%

see regular exercise as a means to *improve* their mental health

Over half

(56%) of respondents in Singapore prefer outdoor exercise

1 *in* 3 people

(34%) are exercising more since the start of the pandemic

More *taking charge* of financial health

28%

have savings to last less than a year in case of income or job loss

41%

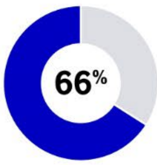
say they have *saved more* since the pandemic

14%

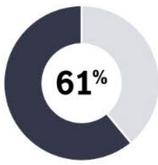
of 25-44 year olds started their own business on top of their jobs

Retirement and insurance are *still important*

of people *already own* insurance



of people age 44 and below are thinking of buying insurance in the next 12 months



find retirement planning important since COVID-19 started

Top *insurance products* Singaporeans are planning to buy:

20% Endowment/Savings

16% Wealth

16% Hospitalisation

16% Health

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PIAS Investment Outlook (Q2 2022)

Author | Mavis Tan, Investment Strategy, Partnership Management, Professional Investment Advisory Services Pte Ltd.

Within the 1st quarter of 2022, global markets were spooked by different headlines that weighed heavily on sentiments **(Chart A)**. First, with nagging inflationary pressures that eventually persuaded central bankers to shift their monetary gears in the hawkish direction. Come February, geopolitical conflicts erupted in Ukraine, sending shockwaves through equity markets with soaring commodity prices and worsening supply bottlenecks. Against this backdrop, policymakers would be even more compelled to act upon the inflationary momentum, with yields spiking and briefly inverting in response to the increased rate hike expectations. **While bond markets are signaling that rate hikes could trigger a recession, a yield curve inversion does not necessarily precede one. Growth expectations may have been slashed but they remain positive. With Fitch Ratings revising its global GDP forecast downwards by 0.7% to 3.5% – Eurozone and US cut by 1.5% and 0.2% respectively – the impact of the geopolitical crisis is expected to be varied across different geographical regions.**

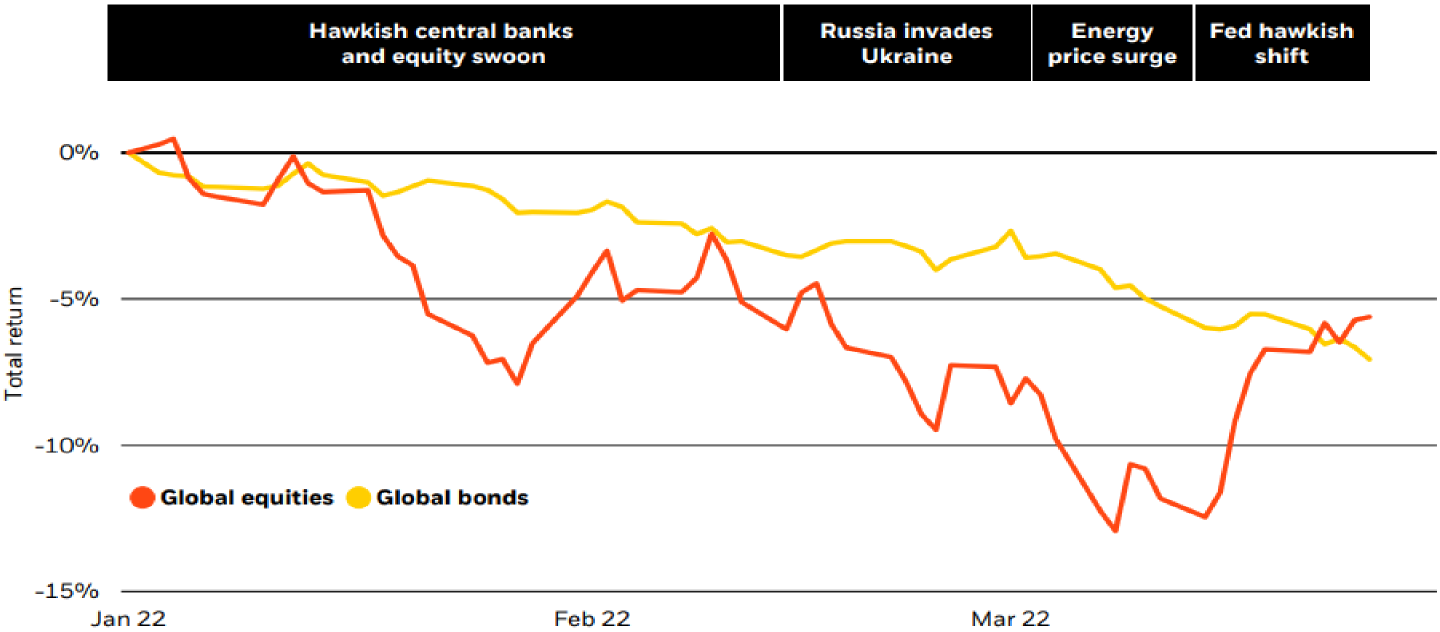
Europe is especially vulnerable to the ongoing military clashes – the region is particularly hard hit by higher energy prices, supply chain squeeze and its geographical proximity to the conflicts. Prior to the war, the era of pandemic stimulus is scheduled to end in March and ECB's interest rate decisions are already facing tests from rising inflation. With the onset of war and Europe's ban on Russian oil that further fuelled the inflationary flame, additional ECB asset purchases and rate hikes delays are on the cards and these policies are feared to plunge the region into stagflation. Should Putin impose a retaliatory cut off gas supplies, which forms 40% of Europe's total gas imports, energy prices would soar with lingering inflation that could inflict a recession. **With this in mind, we have dialled down our outlook on Europe as we prefer to stay away from the direct impact of the further escalation of the geopolitical tensions and the potential of policy mistakes.**

Across the Atlantic, while the US economy is less directly affected by Russia's offensive in Ukraine, its equities market is similarly challenged by inflationary woes and supply chain disruptions**. However, the impact of inflation was probably more pronounced on parts of the market that has pricier valuations, as we witnessed expensive growth stocks sinking with the prospects of more aggressive rate hikes.** As real yields rise, higher borrowing costs could cause a further divergence of value and growth stocks and with that, **we lean towards a value and quality tilt in our portfolio management.**

With the pandemic almost behind us in most parts of the world, China remained on the other side of the pandemic and may not enjoy the reopening tailwind with recent lockdowns in Shenzhen and Shanghai. To further dampen investors' confidence, China-US relations had been tested with threats of US sanctions

Chart A | War, Energy Shock And Fed's Pivot In A Single Quarter

Global Equities (MSCI ACWI Index) and Bond Total Returns (Bloomberg Aggregate Index)



Source | BlackRock Investment Institute, Mar 2022

should China support Russia's military operations in Ukraine, while Chinese ADRs had been beaten down by the prospects of US delisting. However, contrasting with other major economies, China's inflation data remains in check and policymakers have ample policy ammunition to stimulate its economy. **As such, while we are mindful of China's near-term volatilities, we remain cautiously optimistic about China's long-term growth potential, given its leaders' willingness to achieve its economic growth target and the availability of policy tools to prop up its markets. As for other parts of Asia in the Emerging Markets, we favour their attractive valuations and the recovery of private consumption, coupled with higher growth expectations than developed economies.**

While chronic inflation with hawkish central bank reactions may curtail global growth, we do not expect an imminent recession given that earnings growth is still expected in 2022, albeit a more muted one from 2021's extraordinary recovery. Selective equities remain attractively priced, compared with other assets such as fixed income. Geopolitical tensions are expected to be prolonged with **sentiments fluctuating with the escalation (and de-escalation) of the war, but we would not expect periods of volatilities to be behind us immediately. We, therefore, turn our emphasis on downside and volatilities management with a focus on value and quality-skew and encourage investors to stay invested in a well-diversified portfolio.**

Source | Figures extracted from BlackRock Investment Institute, March 2022

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