STRIVE

The Fiduciary Focus

Investment News From a Pro-Shareholder Perspective

March 19, 2024

This Week: DEI killed the CHIPS Act; Apple pays $490 million to settle suit over China risk; An Eye On Energy examines non-OPEC oil production.

Programming Note: There's still time to sign up for Thursday's webinar with London Business School Professor Alex Edmans on Why DEI Data May Contain Lies.

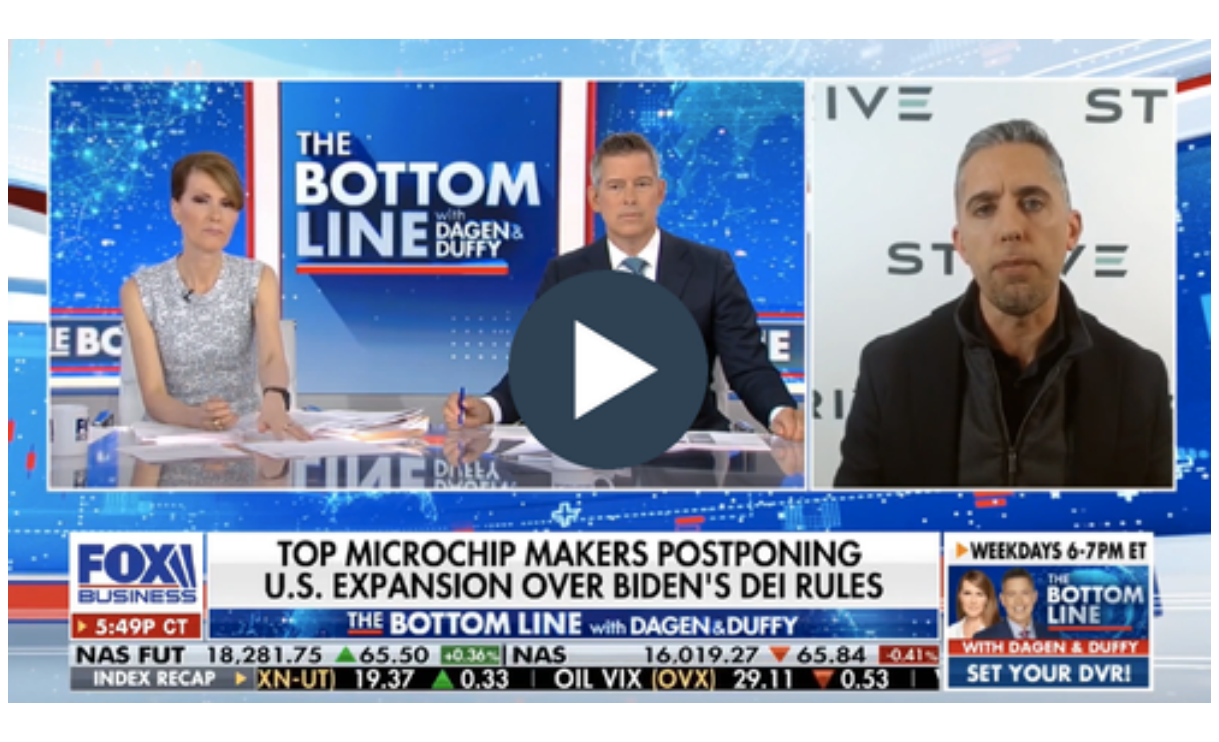
Straight from Strive

DEI Killed the CHIPS Act

Semiconductors are the new oil. With China threatening to take Taiwan by force by 2027, considering that the island produces of over 90% of all advanced microchips, the world needs to step up and increase production in other countries ASAP.

Unfortunately, America's attempt to lead the way — the CHIPS Act — was ultimately more focused on female construction workers, "justice-involved individuals," and diversity quotas. The stipulations not only strangled the CHIPS Act, but they also wasted a lot of precious time, providing more proof of the value-destructive nature of DEI.

Strive CEO Matt Cole and Head of Research Chris Nicholson, Ph.D., recently shed light on this important issue in their article in *The Hill*, DEI Killed the CHIPS Act. The article quickly went viral, attracting the attention of business leaders like Elon Musk and Marc Andreessen, as well as many members of Congress, who are eager to fix the CHIPS Act. Matt also appeared on Fox Business's The Bottom Line to spread the word.



Apple Pays $490 Million To Settle Suit Over China Risk

On Friday, Apple reached a $490 million settlement with shareholders who had sued the company over CEO Tim Cook's comments on China risk, the Wall Street Journal reports.

According to Plaintiffs, the company concealed falling demand for iPhones in China in 2018, painting a dishonestly rosy picture of the Chinese market while downplaying the risks.

Specifically, the suit alleges that during a conference call with analysts in November 2018, Tim Cook told investors that iPhone sales were facing challenges in Turkey, India, Brazil and Russia, but that he "would not put China in that category." By January, Apple disclosed its China sales were in a slump and slashed revenue projections for the first time in fifteen years. Apple's shares fell 10%.

Apple has denied wrongdoing, but the settlement demonstrates that China risk is twofold. First, there are the risks inherent in doing business in and with China. But beyond that, there is the risk of not being sufficiently transparent with your shareholders about what that China risk truly entails. And as the Apple settlement demonstrates, the risks of misleading investors can be nearly as costly as the risks of operating in China itself.

DEI Rears Its Head In Healthcare and Entertainment

Despite claims that diversity, equity, and inclusion is in retreat, the divisive ideology is doing damage in sectors as distinct as healthcare and entertainment.

On Friday, the Wall Street Journal published an article by a nurse who was fired for speaking out against DEI initiatives via his private Facebook page, despite the fact that the author never mentioned the hospital where he worked.

The nurse explained that his employer had repeatedly asked him to participate in "unconscious bias" trainings and sent materials claiming that the U.S. is built on "an ideology of White supremacy that justifies policies, practices and structures which result in social arrangements of subordination for groups of color through power and White privilege." On his Facebook page, he posted that "No employer has the right to invade the unconscious spaces of it's [sic] employees minds in an attempt to reprogram them into thinking certain ways." He was fired less than a week later.

This account follows a piece published by Fox News on Thursday, reporting on how video game companies are catering to DEI activists in order to maintain high ESG scores, rather than focusing on designing entertaining games. In recent years, video game companies have turned to DEI consultants to advise them on "inclusion-focused narrative[s]," which often involves changing, deriding or killing off beloved male characters of the past to make way for pro-social justice content. Unsurprisingly, the move has alienated much of the industry's core customer base, leading to online backlash and boycotts. Yet few in the industry have spoken out about the practice due to a "system of suppression and fear and forced politics that has permeated gaming, comics and movies."

This culture of suppression—pervasive not only in healthcare and entertainment, but in corporate America as a whole—is arguably even more dangerous than the DEI initiatives themselves. Trainings are divisive, and race- and gender-based hiring may hinder companies' bottom lines, but creating a workplace where employees cannot speak up when they see their own company going off the rails is a recipe for disaster.

State Street Under Investigation for Potential "Material Disinformation" Regarding Voting Choice Policy

Last week, a coalition of sixteen state attorneys general sent a letter to State Street alleging the company had engaged in yet "another potential instance of material disinformation," the Daily Caller reports.

Specifically, the letter alleges that State Street is misleading its clients by claiming to offer "voting choice" via eight different policies, even though every single policy prioritizes ESG goals over financial ones.

The letter explains that until December, each of the options offered explicitly pushed ESG goals to greater or lesser degrees. In December, State Street introduced a new policy that votes along with management. But even that policy is pro-ESG, the letter explains, because State Street will continue to oust board members who are not sufficiently ESG-aligned. Accordingly, there is not now and has never been a truly neutral policy for clients who are interested in maximizing financial value alone.

As the letter states:

> Until State Street offers a pro-fiduciary, off-the-rack voting option for those seeking to support pro-fiduciary proposals and positions while opposing ESG-aligned proposals, the voting choice program remains inappropriately biased. As of now . . ., the voting choice program is of the Potemkin variety, a ratification of the primacy of partisanship at State Street rather than a genuine opportunity for clients to, at least with regard to their own assets, withdraw from that partisanship.

The attorneys general request that State Street introduce a pro-fiduciary voting policy by no later than the 2024 proxy voting season, and note that a failure to do so will be considered a continuation of State Street's breach of fiduciary duty.

Notably, the letter comes after State Street's withdrawal from Climate Action 100+ earlier this year, demonstrating that regulators will not accept hollow gestures from asset managers that continue to push ESG policies without client consent.

The letter requests a response by April 15.

Are High ESG Scores A Sign of Financial Distress?

Is there a link between high ESG scores and a company's financial distress? A new study by three professors at the German University of Wuppertal finds the answer is "yes."

The authors examined thousands of listed U.S. companies from 2003 through 2022 to determine whether ESG scores were correlated with bankruptcy risk.

The findings were decisive: "this empirical study concludes that financially distressed companies distort their ESG scores upward, a robust finding for the applied ESG scores from Refinitiv, MSCI, ESG Book, and Moody's ESG." The results held even when controlling for several variables, such as the effects of COVID19 closures on businesses.

The authors posit three possible reasons for this correlation: (1) "management's desire to divert attention from financial distress," (2) "the managerial incentive system that rewards ESG objectives that may be easier to achieve than financial objectives," or (3) "the need for lower cost of capital and improved financing conditions that can be achieved through higher ESG scores."

ESG, it turns out, may be not just a form of virtue signaling, but distress signaling too.

An Eye on Energy

Non-OPEC Oil Production Rising

On March 3, OPEC+ announced it would extend additional voluntary cuts of 2.2 million barrels/day into the second quarter of 2024. Russia will cut oil production by 350,000 b/d, its exports by 471,000 b/d, and Saudi Arabia will likely limit upstream investments. Given those cuts, the U.S. and Guyana are on track to impact the global energy market significantly.

The U.S. became the world's top crude oil producer in 2018. In December 2023, U.S. crude oil production hit a record high of 13.3 million b/d. Advances in horizontal drilling and hydraulic fracturing technologies have increased the productivity of U.S. wells. The U.S. achieved this record production despite a 69% decrease in the number of active oil rigs since 2014.

The U.S. Energy International Agency (EIA) forecasts that non-OPEC production growth will average 1.2 million barrels per day in 2025, led by the U.S., Canada, Brazil, and Guyana. The International Energy Forum (IEF) believes non-OPEC growth in 2024 could range from 800,000 b/d to 1.4 million b/d due to shifting political dynamics, technology advances, production and transport costs, security risks, and OPEC+ policy.

Since 2015, Guyana has been home to one of the most significant oil discoveries in the world. Estimates claim that ExxonMobil has led a consortium with 11 billion barrels of recoverable oil in the offshore Stabroek block, expecting to increase production to roughly 1.2 million b/d by 2027.

Exxon is concerned that ongoing Venezuela-Guyana tensions and potential annexation of Guyana would move oil reserves away from non-OPEC and into OPEC+ hands, helping with efforts to keep prices high.

In addition to geopolitical risk, Exxon recently filed an arbitration case regarding selling Hess's 30% stake, its partner in the Stabroek offshore project, to Chevron. Exxon, who already has a 45% stake in the project, is right to signal the promise of its investment in Guyana. Still, it's unlikely it will delay Chevron's purchase of Hess.

Non-OPEC oil production has helped stabilize the oil market despite the war in the Middle East and ongoing attacks in the Red Sea. It must provide the supply needed to stabilize oil prices between 2024 and 2027 for expanding economies in India and Southeast Asia, which will continue to need access to abundant and affordable oil. American innovation and operational expertise will remain needed so that non-OPEC production continues to ensure that energy resources remain secure for all.

Voting Spotlight: Starbucks

Each week during proxy voting season, Strive will highlight one interesting vote from a recent company's annual meeting.

Last week, Strive voted for a proposal asking Starbucks to analyze the congruency of its "human rights policy with its actions, especially in countries in geopolitical conflicts or under oppressive regimes." The proposal cites concerns over Starbucks's operations in China, where the company continues to grow despite geopolitical risks that may ultimately hurt the company's bottom line.

These concerns echo those that Strive raised in the letter it sent to company execs last fall, in which Strive called on Starbucks to develop and disclose a China risk mitigation strategy. Because Strive continues to believe that these risks are financially material to shareholders, and because Starbucks's has not yet disclosed how it plans to address them, Strive supported the proposal.

Strive in the News

Bloomberg highlights Strive's efforts to end DEI-linked executive pay

Last week, Bloomberg reported on Strive's efforts to end the corporate practice of tying executive bonuses to meeting diversity, equity, and inclusion goals following Starbucks's decision to drop any explicit reference to DEI in its pay policy.

In 2023, Starbucks tied 30% of executives' bonuses to non-financial factors including DEI; in 2024, Starbucks announced that it would be reducing that to 25%. It also replaced strict numeric quotas for blacks, indigenous and people of color with fuzzier language about "belonging goals" and as-yet unspecified "representation improvement targets."

As Bloomberg notes, Strive has been outspoken in calling for the elimination of ESG-linked executive compensation:

> Strive Asset Management . . . sent a letter to Southwest Airlines Co. in August warning it to end its executive compensation incentives for environmental and social goals. The group has also met privately with about a dozen large companies on the issue, according to Justin Danhof, Strive's head of corporate governance, declining to name the companies.
>
> Strive plans to release a detailed report later this year, after the proxy season ends, he said in an interview, adding Strive voted against compensation plans and the chair of compensation committees "at every company where there was ESG/DEI in the compensation plan."

While Starbucks's changes appear to be a step in the right direction, Strive will continue to oppose such executive compensation plans until the portion of executives' bonuses tied to financially irrelevant factors is 0.

The full article is available here.

The Best of the Rest

Additional stories about ESG investing, company happenings, and more.

- Academics question studies on ESG and financial performance; "We ended up accepting supporting evidence uncritically," one researcher told Bloomberg. "What bothers me most is the squelching of critical voices."
- Shell revises climate targets, but remains committed to net zero by 2050 even though company admits that "[a]chieving this ambition will mean reducing sales of oil products, such as petrol and diesel."
- Impax's gender-lens fund is lagging; asset manager slashes number of companies in fund to try to reverse underperformance.
- Sierra Club sues SEC over climate rule; argues that the SEC is not only permitted, but required, to force companies to compile, audit and disclose non-financially material information on environmental issues.
- Court temporarily halts the SEC's climate rule in separate case brought by fracking companies, who argue the SEC lacked any authority to pass environmental regulations and they would suffer irreparable injury if climate disclosure rules were allowed to go into effect.
- Governance issues gain prominence in this year's proxy voting season as shareholders seek more accountability from boards.

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What Makes Strive Different?
While many asset managers push companies to focus on other stakeholders such as employees, suppliers, the environment and society at large, we live by a strict commitment to shareholder primacy — the belief that **the purpose of a for-profit corporation is to maximize long-run value for investors. Click here** to learn why shareholder primacy is so important.

How Does Strive Maximize Value?
Our corporate governance team engages with the companies in which our clients are invested to advocate for the pursuit of excellence in corporate America. We are aggressively apolitical when it comes to utilizing our corporate governance tools and demand that companies focus exclusively on delivering long-term financial value for investors. The corporate governance team also determines how to cast our shareholder votes at annual meetings and special elections, evaluating each proposal through the lens of maximizing financial return.

Our research team conducts deep analysis of macro economic trends, market developments, and industry- and company-specific metrics to identify potential risks and opportunities for our clients. We then incorporate the results of this research into our engagement and voting strategy, and share it with our clients in the form of white papers and market research reports so they can make the most educated investment decisions possible.

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Strive, 6555 Longshore St, Dublin, OH 43017, United States