STRIVE

The Fiduciary Focus

Investment News From a Pro-Shareholder Perspective

February 13, 2024

This Week: EU pumps brakes on ESG rules; An Eye On Energy talks coal; Strive to host corporate engagement webinar.

Programming Note: In light of President's Day, we'll be publishing on Wednesday next week.

EU Pumps Brakes On ESG Regulations

The EU postponed a vote on new ESG regulations after objections from Germany and Italy late last week.

As we wrote in our recent white paper on the subject, the regulations are slated to be the most stringent ESG regulations ever enacted, requiring companies to identify and take remedial action if they find social and environmental problems ranging from deforestation to inadequate working conditions to water availability issues anywhere in their supply chains. Companies that violate the law face fines of up to 5% of worldwide earnings.

The law had previously drawn criticism in the U.S., as it purports to regulate not just EU companies, but any company with sufficient revenue in the bloc. It's estimated that 4,000 U.S. companies would be directly covered by the EU law, not counting all of the American farmers and small businesses that would be required to comply with the law as a requirement for doing business with covered companies. If a European company sourced leather from a U.S. rancher, for example, that rancher might be required to mitigate his herd's methane emissions or risk losing European customers.

In opposing the regulation, Germany cited concerns that it would impose excessive bureaucracy on companies. And observers have suggested that other countries may follow Germany and Italy's lead. But proponents have not given up yet. The EU Commission has rescheduled the vote for later this week.

Demand for Catastrophe Bonds Surge After Huge Returns

Mainstream investors are flocking to catastrophe bonds after a year in which hedge funds raked in record returns investing in the products, Bloomberg reports.

Catastrophe bonds—colloquially called "cat bonds"—are issued by insurance companies to protect themselves from losses too big to cover. The market has existed for decades, but has increased substantially as companies have upped coverage to insure against potentially catastrophic losses due to climate change.

If a major hurricane, wildfire, or other weather event strikes, cat bond holders could lose much or even all of their capital. If one does not, investors can enjoy outsized profits. Last year, cat bonds achieved 20% returns, corporate bonds averaged 13% and U.S. treasury bonds were 4%.

The surge in popularity in cat bonds underscores how climate change provides not just risks, but opportunities, for returns-focused investors.

Warren Buffet explained as much way back in 2016. In a letter to Berkshire Hathaway shareholders, the famed investor explained why the company was opposing a shareholder resolution on net zero goals:

> It's understandable that the sponsor of the proxy proposal believes Berkshire is especially threatened by climate change because we are a huge insurer, covering all sorts of risks. The sponsor may worry that property losses will skyrocket because of weather changes. And such worries might, in fact, be warranted if we wrote ten- or twenty-year policies at fixed prices. But insurance policies are customarily written for one year and repriced annually to reflect changing exposures. Increased possibilities of loss translate promptly into increased premiums. . . .
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> Up to now, climate change has not produced more frequent nor more costly hurricanes nor other weather related events covered by insurance. As a consequence, U.S. super-cat rates have fallen steadily in recent years, which is why we have backed away from that business. If super-cats become costlier and more frequent, the likely – though far from certain – effect on Berkshire's insurance business would be to make it larger and more profitable.

Unsurprisingly, Warren Buffet's view has once again proved prescient.

Elon Musk Offers To Bankroll DEI Suits Against Disney

Last week, Elon Musk announced that he was funding a lawsuit brought by actress Gina Carano against Disney and its Lucasfilm subsidiary over her alleged wrongful termination from "The Mandalorian" over her conservative political views.

"Disney bullied Ms. Carano, trying to force her to conform to their views about cultural and political issues, and when that bullying failed, they fired her," said Gene Schaerr, Carano's attorney. "Punishing employees for their speech on political or social issues is illegal under California law," he added.

That's trouble enough. But perhaps even more worrisome for Disney is Musk's offer to fund lawsuits for anyone else who has been discriminated against by the company. Just hours later, Musk revealed documents he claimed to receive from an anonymous source within Disney detailing the Mouse House's "Inclusion Standards" for its entertainment content, including mandating that 50% or more of its regular and recurring characters, actors, producers, and/or directors come from "Underrepresented Groups." More lawsuits are sure to follow.

These developments should serve as a clear warning to Disney and other companies that their DEI policies are not the cheap, feel-good PR moves they once believed them to be. Legal and business risks are real. In 2023 alone, dozens of major companies, from Morgan Stanley to AT&T to Kellogg's to Mars faced lawsuits, EEOC complaints, and warnings from attorney generals over their race-based preferences in hiring, promotions and training programs.

While the outcome of any lawsuit is always uncertain, companies typically have one powerful weapon on their side: the ability to outspend and outlast their employees in court. Now that the richest man on Earth has volunteered to fund these suits—a man, it should be noted, whose estimated $209 billion net worth exceeds Disney's entire market capitalization—that advantage is now gone.

For Disney and other companies that have embraced DEI, the $200 billion writing is now on the wall.

ESG Investing May Hurt The Planet

"Is ESG investing counterproductive?," asks a new piece in The Globe and Mail.

The piece centers on a study from last year finding that divesting from traditional fossil fuel companies may lead to worse environmental outcomes. The idea is that increasing the cost of capital for "brown" firms incentivizes them to act faster, because investors need to recoup their investments more quickly. That means pulling coal out of the ground more quickly and getting an oil project from exploration to pumping as fast as possible. Ultimately, that makes brown firms browner. Green firms, on the other hand, don't seem to benefit much from access to cheaper cash.

The author explains:

> [I]f sustainable investing successfully shifts capital away from brown firms and toward green firms, it may be making brown firms browner without making green firms greener. The reason is simple when you think about it.
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> Take an insurance company as an example. It may rank well on sustainability metrics, but it can't really get much greener. On the other hand, when a brown firm like a heavy construction materials supplier is backed into a corner by an increased cost of capital, it might lean further into its existing high-pollution operations, or it may even cut corners on pollution mitigation.

The takeaway is that the impact of divestment as an ESG strategy is somewhere between limited and counterproductive. That's not good news for ESG investors or fund managers. Prior research has already demonstrated that ESG investing doesn't increase financial returns. If it doesn't help the environment either, what's the point?

An Eye on Energy

Coal keeps America warm

The world is losing its appetite for American coal, but Americans aren't. Exports are expected to account for only 19% of total U.S. coal consumption in 2024, according to the Energy Information Agency (EIA). However, in this month's Short-Term Energy Outlook the EIA raised its forecast for coal-fired electricity generation in 2025.

This year's cold snaps may have given pause to overly aggressive forecasters. When temperatures are freezing cold, as they're projected to be for 55% of Americans this week, the power industry relies on coal as an important source of its electricity generation-mix to provide the baseload energy needed to keep the lights on and heat running. The EIA recently stated that U.S. coal consumption increased by almost 50% in the electric power sector from December to January.

Still, we can expect U.S. coal consumption to fall by 7% in 2024 and 6% in 2025 as additional renewable energy sources come online and 11 gigawatts (GW) of coal-fired generation capacity is scheduled to retire. To put this into perspective, 1 GW—enough to power 750,000 homes—would require around 2.4 million solar panels.

That's over 8 million homes, almost the size of Michigan's population of 10 million. Speaking of Michigan, a state that aims to generate 100% of its electricity from renewable energy by 2040, January's blizzards interrupted power for more than 150,000 residents. Coal was the main energy source that kept Michigan warm.

Coal still supplies around 20% of our electricity needs, and the integration of more renewable energy into the electric grid must maintain energy security and resilience. Solar and wind energy are at the mercy of the weather, just as people needing heat are, but they lead the growth of U.S. power generation. When the power grid can't deliver power, people's lives are at risk.

Straight from Strive

Strive To Host Webinar On Corporate Engagements

Later this month, Strive's Head of Corporate Governance Justin Danhof will be hosting a webinar to discuss how Strive engaged with companies in 2023.

Danhof will chat with investors about how Strive aims to maximize value for its clients through its engagements. It's an opportunity to learn more about how Strive meets one on one with companies to better understand their perspectives and help companies set aside polarizing ESG commitments to focus on their financial goals alone.

More detail on Strive's approach—including how we think about environmental, social, and governance issues from climate change to diversity, equity and inclusion—is also available in our 2024 voting guide.

The webinar will take place on February 29 at 2 p.m. You can sign up for the webinar here and read Strive's 2024 proxy voting guide here.

Register Now

The Best of the Rest

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

- Zoom latest company to shed DEI department but "remains committed to DEI and ensuring its principles remain firmly rooted in our DNA."
- Deflation risk looms in China as prices fall for consumer goods, food and cars.
- Bank of America rewords climate commitments; no longer includes a blanket ban on financing new coal projects, but vague language leaves investors guessing what the bank's policy actually is.
- EU proposes new rules for ESG ratings; ratings companies must be more explicit about their methodologies.
- BlackRock, Vanguard, State Street, Fidelity splash on lobbyists; Big Four spent $7.8 million on political lobbying to rehabilitate their images after facing criticism for stakeholder-capitalism based investing.
- ESG could cost U.S. consumers as food prices predicted to rise; could lead to global food insecurity, new report warns.

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Who Are We?

Strive is one of the fastest growing asset management firms. Our mission is to maximize value for our clients by leading companies to focus on excellence. **Click here** to learn more.

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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