STRIVE

The Fiduciary Focus

Investment News From a Pro-Shareholder Perspective

February 27, 2024

This Week: Google stock plunges amid DEI-driven AI debacle; An Eye On Energy takes on liquefied petroleum gas; Strive asks if your 401(k) is making it harder to retire.

Programming Note: There's still time to sign up for Thursday's 2 p.m. webinar on Strive's corporate engagements. Register here.

Google Stock Plunges Amid DEI-Driven AI Debacle

Google parent company Alphabet saw its stock lose $90 billion in market value yesterday, as the company scrambles to control the fallout from the release of its controversial artificial intelligence program, Forbes reports.

The AI, called Gemini 1.5, immediately drew controversy upon its launch last week after users discovered the program refused to depict pictures and achievements of white people. The criticism soon went viral, as the generator was blasted for spitting out factually and historically inaccurate images of a female popes, Asian Nazis, black Vikings, and "diverse" versions of the Founding Fathers.

Reports emerged that progressive bias is built into all aspects of Gemini, including the main chat program: for instance, it insists it's wrong to misgender someone even to avoid nuclear apocalypse and refuses to write job ads to hire fossil fuel lobbyists. As Elon Musk pointed out, this is especially alarming because Google plans to make Gemini the backbone of all its products, including search and YouTube.

The fallout comes after years of Google's increasingly deeper commitments to DEI, often at the behest of its largest, pro-ESG shareholders. In 2022, for example, BlackRock, Capital Group and DWS all supported a shareholder proposal asking Google to conduct a racial equity audit. Last year, Google released the results of that audit, which praised the company's commitment to "[a]void creating or reinforcing unfair bias" in its AI products, while imploring Google to "build consideration of civil rights principles into the product design, launch, and modification processes" to ensure its AI products "advance fairness and equity."

Gemini, it appears, was the result.

Notably, Strive has long cautioned against companies undertaking racial equity audits, sharing our view that they "tend to increase ... racial division rather than ameliorat[e] it" to the financial detriment of the companies that undertake them.

Per Forbes, Alphabet's stock is now down 1% year-to-date, compared to the double-digit gains of competitors like Microsoft and Meta.

Court To Rehear Challenge To NASDAQ Diversity Rule

In October, we reported on the Fifth Circuit Court of Appeals' decision upholding NASDAQ's board diversity rules. Last week, the Fifth Circuit agreed to rehear the case.

The case centers around the Securities and Exchange Commission's approval of NASDAQ's diversity rules. The rules require companies listed on the exchange to have a minimum number of women, racial, and LGBTQ+ minorities on their boards or explain why they do not. A three-judge panel upheld the new rules, finding the SEC did not violate the Constitution or Exchange Act.

Following the ruling, the plaintiffs asked the court to rehear the case. They wrote:

> [T]he panel held that even though the SEC found no link between a board's race/sex breakdown and its corporate performance, the Rule was nonetheless justified because a few financial activists asked for it.

Notably, the court's decision listed some of those activists by name: Vanguard, State Street, and BlackRock—all three of which support these forced diversity disclosures. Plaintiffs continue:

> Under that circular test, anything is 'material' and can be forcibly disclosed if someone wants it. The SEC could authorize compelled disclosures under the Exchange Act about how many firearms a company's employees own, their political affiliations, what churches they attend, how many abortions they've had, etc. No court has ever adopted such an expansive definition of materiality, which will empower the SEC to act as a junior-varsity Congress unconstrained even by the Constitution.

Last week, in a rare move, the full court agreed to rehear the case. Plaintiffs are "grateful that the entire Fifth Circuit Court of Appeals will reconsider the lower court's opinion," Edward Blum, President of Plaintiff Alliance for Fair Board Recruitment said in a statement. "NASDAQ's rule promotes racial discrimination and polarizing personal disclosures and it is to be hoped that this rule is struck down."

Oral argument is tentatively scheduled for May.

Pilot's ESG Lawsuit Against American Airlines Can Proceed

In other legal news, an American Airline's pilot's lawsuit over ESG investments in the company's 401(k) plans is allowed to proceed, a Texas judge ruled last week.

The pilot alleged that American Airlines breached its fiduciary duties by allowing ESG asset managers to manage employees' 401(k) accounts. As the court explained:

> Spence contends that [American Airline's retirement] Plan primarily contains funds administered by investment management firms like BlackRock, Inc. ("BlackRock"). According to Spence, certain managers like BlackRock pursue pervasive ESG agendas. . . As a result, BlackRock's investments harm the Plan participants' financial interests because BlackRock focuses on socio-political outcomes instead of exclusively on financial returns. . . .
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> Taking these allegations as true, the court finds that Plaintiff plausibly alleges at this stage that Defendants violated their duty of loyalty under ERISA by not acting with an "eye single to the interests of the participants and beneficiaries."

The ruling gives judicial endorsement of a core Strive belief: ESG investing violates investment managers' fiduciary duties to focus on financial goals alone. As Strive's white paper on the subject explained nearly a year and a half ago, this duty extends not just to asset managers like BlackRock and Vanguard, but to the 401(k) fund managers that hire them:

> In our opinion, courts are likely to conclude that ESG investment practices are motivated, either primarily or at least in part, by social and political objectives, not solely by considerations of maximizing financial return. Thus [retirement] trustees may neither engage in ESG investment practices nor allocate capital to asset management firms who engage in such practices.

The American Airlines decision marks the first time a court has recognized this legal theory, which could result in massive liabilities. Virtually every large company in America offers a 401(k) plan for its employees, and nearly all of them do so through a pro-ESG asset manager like BlackRock, which has dominated the asset management market. Accordingly, the court's ruling—that a company can be held legally liable for BlackRock's social activism under ERISA—could expose thousands of businesses to similar claims.

Companies Plan to Spend More on ESG in 2024

After a year in which ESG faced significant criticism, companies nonetheless plan to spend more on it, a new KPMG survey shows.

In all, 90% of respondents said they planned to increase ESG spending in 2024.

The survey asked 550 companies about their spending and related plans for ESG in the upcoming year. More than half of respondents were located in the United States, 25% were in Europe, and the rest hailed primarily from Canada and Mexico. The increased spending is likely driven by both shareholder demand and new reporting requirements, Pensions and Investments reports.

Perhaps surprisingly, the consumer and retail sector was most likely to report increasing their ESG budgets for 2024. Ninety-seven percent of respondents in the sector planned to spend more, despite the heightened risks of pursuing ESG initiatives for consumer-facing brands. As the recent Disney, Target, and Bud Light controversies have shown, the pursuit of social and political agendas can be divisive for companies that interact directly with the public, leading to consumer boycotts and reduced sales.

The continued investments in ESG demonstrate that, regardless of shifting terminology, many companies remain committed to the cause.

For BlackRock, No Slowdown on ESG Despite Pushback

BlackRock isn't slowing down on its ESG investment strategies despite its critics, Forbes reported Saturday. Instead, BlackRock may be hoping to use its deep pockets to buy its way out of trouble, the outlet suggests.

There's no doubt that "BlackRock is the worldwide leader in ESG funds," as Forbes puts it. There's also no doubt that the world's largest asset manager has faced record ESG outflows as well as political backlash as a result of its controversial investment strategy. States like Florida and Texas have pulled billions from BlackRock over its stakeholder capitalism approach. Yet rather than return its focus to maximizing financial value to win those mega-clients back, BlackRock may be trying to open its purse strings instead.

As evidence, Forbes points to the "stunning development" earlier this month of Texas's meeting with BlackRock in an attempt to procure billions in funding to update its electricity grid. "There are few disagreements over green investment that a judiciously deployed $10 trillion can't heal," the outlet wryly observed.

BlackRock's critics have already been viewing its supposed retreat from ESG with a skeptical eye. "Victory toasts were muted" at the Conservative Political Action Conference last week. "I'm definitely willing to have an early evening martini to celebrate," Scott Shepard, a free-market activist, told Forbes, "but I'm not willing to get Super-Bowl-Sunday hammered."

The news of BlackRock trying to buy peace with Texas may be even more sobering.

An Eye on Energy

United States Liquefied Petroleum Gas (LPG) and Propane Trade

United States shale wells don't just produce oil and natural gas (LNG)—they also pump out liquefied petroleum gas (LPG). The U.S. became a net exporter of LPG in 2012, with terminals and infrastructure mainly located on the Gulf Coast, allowing the U.S. to compete with Saudi Arabia and Qatar.

According to the U.S. Energy Information Agency (EIA), propane exports hit records, averaging over 1.7 million barrels per day (b/d) from November 2023 to February 2024. Propane is a by-product of natural gas processing and refining and the most-exported petroleum product by the U.S. Global demand for propane is high because of its use as feedstock in petrochemicals and heating and cooking fuels.

LPG use rose to an all-time high in December. The U.S. benefits from this due to emerging international demand. LPG cargos have moved from the U.S. Gulf Coast to Asia and were also needed to meet European demand after the EU took measures to reduce LPG imports from Russia.

U.S. LPG spot prices are currently 90 cents per gallon, up from 70 cents/gal in September. In the past, this has given U.S. exports a competitive advantage since fixed-destination contracts linked to a spot price provided flexibility in diversifying cargo anywhere in the world.

But the Panama Canal drought and the Red Sea militia attacks are impacting the export costs and security of the supply of LPG commodities. The Nigerian government declared an immediate suspension of LPG exports to help reduce the increased cost of cooking gas. Very large Gas Carriers (VLGCs)—that primarily carry propane—are unable to transit through the Panama Canal and must go around the Cape of Good Hope, a journey that adds 21 days for a total of 48 and makes our contracts less flexible in their ability to divert cargo.

President Biden's recent temporary pause on pending permits for new LNG export projects will also hurt our position as a reliable LPG exporter if unresolved. While it's unlikely that it will interfere with our ability to supply our allies with LNG or LPG in the near term, the uncertainty surrounding permitting approvals will harm near-term investment decisions needed to maintain U.S. leadership in upstream oil and natural gas production.

Straight from Strive

Is Your 401(k) Making It Harder to Retire?

That's the key question Strive CEO Matt Cole asks in his new Washington Times piece. Unfortunately, the answer appears to be "yes."

As the piece explains, "For years, America's largest retirement fund managers have been using their inside position as a large shareholder in companies to push those companies to go green, use paper straws, and invest in soy burgers instead of maximizing your returns." This activism hurts would-be retirees in different ways. It may drain their retirement accounts, since ESG investing tends to underperform. It also makes everyday life more expensive, as gas, food, and travel prices skyrocket as a result.

"Fortunately, pro-American capitalists are fighting back," Cole writes. And Strive is proud to be part of that fight, particularly now that it offers 401(k) products focused on maximizing shareholder profits.

Read the full article here.

The Best of the Rest

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

- U.S. Chamber of Commerce sues California over climate disclosure laws; argues that forcing companies to disclose emissions data violates the Constitution.
- Congressional Black Caucus pushes CEOs to recommit to DEI; cites debunked McKinsey study to claim that "research makes clear that corporate DEI efforts improve profitability and performance."
- Foreign investment in China reaches 30 year low; health of Chinese economy called into question.
- Climate advocacy group launches campaign against shareholder primacy; the group, called "Unlocking America's Future," "focuses on the whole ESG umbrella, instead of just the 'E,'" Axios reports.
- Big Three expand self-described "voting choice" policies that limit investors to broad, mostly pro-ESG policies; programs may provide some optionality, but "[i]t's not true shareholder democracy," the New York Times reports.
- SEC has dropped scope 3 emissions from climate disclosure rule according to unnamed sources; agency likely concerned about legal challenges to the proposed rule.

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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.