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A paradigm shift in investing – are you ready?

From ESG to advancement in technology, these phenomena will affect our society and economy for years to come

FROM our first days in investment management, we are rightly cautioned against proclaiming, “this time is different”. While market history doesn’t repeat, it does rhyme: the current challenges we face may be new in magnitude but not in kind. Inflation, supply chain woes, asset bubbles, prolonged bull markets, swings between globalism and nationalism, political risk — all of these represent the rough seas that we must navigate as investors.

So, it is an exceptional moment when we recognise several remarkable sea changes that will affect individuals, society, our economy, and the planet for years to come. As investors, we must differentiate between the transient rough seas that are the hallmark of equity investing and the truly rare transformational developments that will become permanent fixtures in our lives.

A paradigm shift

We have identified 3 such phenomena, 3 changes that really are different this time. Collectively, they represent a paradigm shift that will transform the capital markets and how the asset management industry approaches alpha generation. They are:

- Environmental, social, and governance (ESG) influences and investing with a stakeholder mindset
- Diversity, equity, and inclusion (DEI) as an alpha generator
- Advancements in data and technology

Why now? To be sure, the Covid-19 pandemic was a tipping point. It exposed the fragility of the global marketplace and our interconnected world. The pandemic drove change and adaptation on an unprecedented scale and proved that the speed of evolution knows few limits when necessity demands it.

But why are we certain that these 3 developments will weave themselves into the fabric of our industry and that those who don’t adapt to them will be at a marked disadvantage?

Because there is another quiet, slow-moving force propelling this paradigm shift.

Unprecedented demographic changes are amplifying these new perspectives and behaviours. Millennials and Generation Xers rely more on data and technology than their older peers in the baby boom and silent generations, and they have more progressive views on DEI, ESG, and stakeholder capitalism. Their influence will grow amid the largest redistribution of wealth in human history.



Investors now recognise that companies have responsibilities beyond their shareholders. They must expand their focus to all their stakeholders: employees, suppliers, customers, as well as the environment and society at large. PHOTO: REUTERS

An estimated US\$68 trillion is projected to change hands in the United States in the next 2 decades in a “tsunami of wealth assets” that will reshape financial services.

So, while the current generation of investors has opened the door to these changes, the next generation is swinging it wide open. How will this shift influence the asset management industry and alpha generation? Let’s look at each of the 3 components individually.

ESG and the rise of stakeholder capitalism

Rewind the clock 10 years and few mainstream investors were talking about ESG influences like we are today. Once dominated by exclusions-based strategies, ESG criteria are now more robustly applied with the use of company operational information to both reduce risk and seek additional upside performance. The idea that ESG information is economic and potentially material is hardly controversial now. In itself, this represents a profound philosophical leap for equity market investment practitioners.

Key to this paradigm shift is the growing orientation towards stakeholder capitalism. Investors now recognise that companies have responsibilities beyond their shareholders. They must expand their focus to all their stakeholders: employees, suppliers, and customers, as well as the environment and society at large.

A company does not operate in isolation. The economic engine that sustains it must be treated in an honest and ethical manner. If value is to be built over the long term, it must be protected. While the idea of shareholder primacy has historically reigned supreme, asset owners have started to recognise that a company that is not aligned with broader stakeholder interests may face economic headwinds. The definition of fiduciary duty is therefore very much in flux.

How we evolve the economic system to embrace all stakeholders and respect the finite and vulnerable ecosystem in which we operate is critical. The future winners in business and investing will be those who can bend the arc of their companies from where it is to where it needs to be.

Stakeholder capitalism dictates that ESG investing must evolve. True stakeholder capitalism requires that asset managers connect their investment practices not only to company-level characteristics but also to changes in the real economy. This is a daunting prospect for investors. It requires an impact mindset. That means moving past ESG ratings to focus more on how companies interact with their ecosystem and what the resulting implications might be.

Diversity, equity, and inclusion

While DEI is indeed a part of the larger world of stakeholder capitalism, we call it out specifically because of its importance to society and its positive impact on broader company performance.

The inequalities laid bare by Covid-19 and the groundswell of support for social justice movements have propelled issues of diversity and inclusion to the forefront. Sensitivity towards equality and fairness has been growing over recent years, and the demand for a more inclusive society is reaching a crescendo. In parallel, there is a significant and growing body of research that links diversity to improved profitability, better employee retention, and lower investment risk.

Yet, within financial services, for example, change has been too slow. The lack of diversity in decision-making roles persists despite the acknowledgment that diversity leads to better performance.

But the concepts of diversity and inclusion are about so much more than pure business considerations. They build resilience into the fabric of our economy and lead to better outcomes for people, society, and the planet.

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ILLUSTRATION: PIXABAY

With this paradigm shift, asset management firms need to think like technology disruptors and innovators, not monolithic organisations clinging to old and outdated beliefs and practices. To better anticipate the far-reaching effects of swiftly changing views on DEI, companies must empower diversity within their ranks. This is especially true in asset management.

Capital markets participants must drive purposeful outcomes that serve society and develop enduring businesses that thrive by balancing the needs of all stakeholders. To do this, welcoming historically underrepresented groups is not only a benefit but a necessity.

Technology and data

The staggering speed of technological innovation has permeated the economy such that most sectors are now de facto technology sectors. The rise of social media and the emergence of the “digital person” — our online identities — have changed our lives. Access to technology and tech fluency are important determinants of economic success for individuals, companies, and even countries.

Data, for its part, is changing too. We now have access to more data — and more technology — than ever before. But the speed at which data circulates is what is truly transformative. Pair this with the now-decentralised nature of data creation, and data accuracy — or information accuracy — becomes a critical consideration.

Data and tech are changing investing. The asset management industry offers a case study:

New tools like natural language processing and artificial intelligence (AI) more generally can help organise the volumes of unstructured data generated daily. With the velocity of news and the rise of social media, companies have nowhere to hide. New data sources emerge with increasing regularity thanks to lower barriers to entry and the lure of lofty licensing fees.

While these tools are not without their own potential pitfalls, investors who embrace cutting-edge technology and alternative data will have an advantage in investing’s inherently competitive landscape. In a world in which basis points matter, access to data and — most importantly — the ability to find actionable information within that data are essential.

These 3 changes really are different this time. They are new enough, swift-moving enough, and unsettled enough that their potential development paths are more uncertain than those of the known challenges in equity market investing. Those who expect a return to some now-dead version of the pre-ESG, pre-DEI-, pre-AI status quo will not be ready for what comes next. Nor will those weighed down by bureaucracy: they may possess the desire to embrace change but not the practical ability.

The new stakeholder paradigm

What these 3 changes and the demographic shifts that are propelling and amplifying their influence have in common is that we haven’t seen them before. But the silver lining is that big and jarring changes, no matter how disruptive, force us to innovate, to find new solutions and con-

template new opportunities. The investment firms that succeed amid this paradigm shift — what we call the new stakeholder paradigm — will be those that understand the expectations and requirements of new constituents and are nimble enough to pivot to become the architects of their own destinies. Those that are backed into a corner by changes they don’t understand or are unable to address will not survive.

We need to understand and embrace these fundamental shifts. Playing catch-up is not enough and will only result in poor outcomes for investors. We have to lead the way. To thrive in the new era of the stakeholder paradigm requires a different approach and a different type of investment firm.

We need to commit to an investment practice that acknowledges the rough seas of equity market investing but welcomes the evolutionary, even revolutionary, changes amid the shift to a stakeholder orientation, a more inclusive economy, and a faster-paced, decentralised data and technology environment.

We believe the new stakeholder paradigm will lead to better results on ESG issues and in DEI efforts, and data and technology advances will accelerate that progress and ensure accountability. We are optimistic that investing has a bright future, but only truly differentiated firms will succeed.

Heidi Ridley, CFA, and Kathryn McDonald are cofounders of RadiantESG Global Investors, a female-owned, independent asset management firm.