QUARTERLY REPORT

SUMMER 2019

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Conscious Capitalism

I live in a very traditional house in the country that was built in 1882. It's seen some renovations and an addition over that time, but it continues to look much as it did when first built. When we moved in six years ago it had no air-conditioning. Like its inhabitants for 134 years, we managed without until the summer of 2016. Then a beastly heat wave and drought that summer finally convinced us that we had to bite the bullet and install central air. Last Saturday the temperature in the Niagara region hit over 40 degrees C with the humidex, a record. Sorry tradition - our summers have changed and are just too hot now to live without A/C.

The subject of climate change, as well as other "ESG" issues (environment, social & governance) was central to many discussions at the annual Responsible Investment Association Conference in Montreal that I attended in April. As I expected there were many great speakers from Canada, the US, and abroad who shared their insights and perspectives on the progress being made regarding ESG factors in investing – that is, how the data on environmental sustainability, social responsibility and good governance is being measured, refined, and applied to the evaluation of investments.

There were two speakers that I found especially compelling. The first was Professor John Ruggie of Harvard University, who served as the United Nations Special Representative on Human Rights from 2005 – 2011. His mandate at the UN was to propose measures to strengthen the human rights performance of the business sector around the world. The result was the Guiding Principles on Business and Human Rights, drafted by Dr. Ruggie, and unanimously endorsed by the U.N. Human Rights Council in June 2011.

In his speech at the RIA conference Dr. Ruggie spoke of the need for governments, corporations, shareholders, and investors to re-evaluate the purpose and function of capitalism in the 21st century. He pointed out that the "shareholder primacy doctrine", that shareholders' value should take precedence over all other stakeholders' concerns, has come with an enormous cost to society. He believes that, in the US, ESG analysis of companies first began to be taken more seriously after the 2008 financial crisis. This movement intensified following the election of Donald Trump in 2016. Since then, the tremendous increase in availability of data with which to evaluate corporations in areas such as exposing weak governance (Volkswagen, Wells Fargo), reducing carbon footprint (oil and gas producers), and supply-chain practices (e.g. child labour in foreign agriculture) has enabled market analysts to more easily anticipate potential risks to shareholder value going forward. Professor Ruggie said that in the 21st century there is a growing emphasis on the "sustainable corporation" as the new model for capitalism. An example he mentioned was Unilever, the British / Dutch consumer goods company, which is committed to growing its business globally in a manner that is sensitive to its impact on the planet, its customers, employees, the communities in which they operate, AND its shareholders. How refreshing!

A similar concept was espoused by another speaker, Erika Karp, founder and CEO of Cornerstone Capital in New York. Ms. Karp's message was about "conscious capitalism", which is driving changes in standards by regulators, (e.g. the SEC), asset managers (big mutual fund companies), stock exchanges, and others who are charged with the responsibilities for authenticity and transparency of disclosures by corporations. While the consistency of the measurement tools is still evolving, there is growing demand from market participants (including you and me, lowly minority shareholders) that the analysis of ESG factors, when evaluating the risks to shareholder value, is not to be treated as just a moral issue – it's actually a critical fiduciary duty.

There is still much to be done. Those of us who are committed to incorporating this extra layer of scrutiny when choosing investments for our clients know that ESG disclosure is spotty, the measurement tools are expensive and inconsistent, and the proportion of the general public that is aware that ESG is "a thing" is small. However, the more time I spend understanding ESG issues as they impact our lives, financially and otherwise, the more convinced I am of their importance. Progress is being made, and it's imperative that it continue.

Now, a brief market summary of the past quarter: After the extreme downturn at the end of 2018, the global markets rebounded stunningly in the first quarter of 2019. Since the end of March, the improvement has continued, though with less momentum. While April continued to see upward movement, the return of trade tensions between the US and China returned, so May saw some pullback. In June this changed to a more positive direction again, and in recent weeks all the major North American indices reached all-time highs.

Much of the improvement has come from the expectation that the US Federal Reserve is poised to reduce interest rates again (with the probability that an interest rate reduction by the Bank of Canada will follow). Meanwhile employment levels here and in the US remain strong, consumer spending is stable, and corporate earnings, while perhaps not as robust as in recent quarters, is expected to be generally positive. Despite the length of the current "bull" market in equities (more than 10 years by most measures), there is little to suggest that it will peter-out any time soon. Barring unexpected events (which are, of course, always a possibility in this world), we believe that continuing to hold high quality, dividend-paying stocks in a variety of sectors and geographies is our best way to manage portfolios going forward.

I wish you all a healthy, relaxing, and (as cool as possible) summer.

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