



The Hexagon Briefing: A Global Perspective from HSBC

Episode 9: Activist Investing Practices

August 4, 2021

Please refer to important disclosure at the end of this document.

Jose Rasco

Thank you for joining us today. Before we begin, you should be aware that relevant information relating to this podcast and the products and services we are about to discuss are available at the end of this recording and on our website at www.us.hsbc.com.

Welcome to the Hexagon Briefing: A Global Perspective from HSBC. Each episode, we'll bring you our insights on key financial topics. You can learn more about insights and research offered by HSBC on our website at www.us.hsbc.com.

I'm your host, Jose Rasco, and thanks for joining us today.

Today, we're going to cover the topic of activist investing. How does it play out in both public and private markets? And what does it mean for you? We're joined by Jeff Cherry, Founder and Executive Director at Conscious Venture Lab. And he is here to help me unpack all of that.

This podcast was recorded on Wednesday, August 4, 2021.

Thanks for joining me. And let's go.

Today, you know, for our weekly topic, we'd like to discuss the woman's wage gap. Now you've heard about a lot of social issues, especially over the last couple of years. And what we've seen play out globally is there is unrest within social groups, between genders, between all kinds of religious and ideological groups. Obviously that's not new. What is new is the fact that we have data now to allow people to express their point of view and to express their discontent with what's happening. One of those areas is the women's wage gap. We've heard a long time about how women are paid less. For the same job as a man, even though they're just as qualified as the men. And now we have data from all kinds of groups internationally, domestically that have quantified this phenomenon and have made it clear that in fact, closing that wage gap should not be viewed as a negative, but should be viewed as a positive because we're taking a very large percentage of our labor force and if we are underpaying them and I think that in the U S the number approximates 20%, so women make about 20% less than men for the same job, given similar skill sets.

Now, if you look globally, that number, it really varies. In some countries it's very low, in some countries it doesn't exist. And in other countries it's much higher. So as you can imagine, it ranges and it ranges based on all different kinds of criteria all over the planet. Now, what we've discovered is, and we're going to talk about these themes, these social themes in the sustainability

matrix continuously. And one of the big issues, as I mentioned is women's wage gap is all about the empowerment of women. And we're seeing that women increasingly are being given board seats. They are being included more in the upper levels of management of corporations. Now, obviously getting their opinion and getting their advice. And we've seen repeatedly over the years, that companies that are more inclusive and more diverse, tend to outperform their competitors, which makes all the sense in the world because you're not selling to one group you're selling to the broad marketplace and you have to have inclusive ideas that are diverse because you have to understand how to attack the marketplace as an economic competitor. That is now playing out more in the financial markets.

Now, if you look at this woman's wage gap issue, it has been estimated by all kinds of sources that if we increase wages and we put women at rates that are comparable to those of their competitors from the male side of the equation, a lot of people have said, well, that's going to cause inflation. Well, yes. It's going to raise wages until you get to equality. But the flip side that nobody talks about is that the economy and wages are all done in nominal terms, which means it includes inflation. So yes, we will have some wage inflation or acceleration as you pay women what they are truly worth.

But the other side of the equation is GDP goes up. And as GDP goes up and the economy grows, you also have people who now have more purchasing power. And if you are in tune with that group, which in this case is women, and you are marketing effectively to that group, you as a marketer or as a company, looking for them to buy your stock or bond in the financial markets can benefit because they now have more purchasing power. I've seen estimates that GDP in the US Could be three to \$5 trillion higher than the estimates vary, obviously, and those are big ranges, but that's more than 10%. You're looking at 15, 20% of the economy. This is a big number. So at the end, end of the day, it's a social issue, but it's a social issue that plays out economically and is going to play out in the financial markets. So as investors, you need to be in tune with what's going on, where it's going, and how it can affect us in terms of products and services we buy and more importantly for your investment portfolios. So this is not something that should be viewed as something that could hamper economic and financial performance. It could enhance it and you need to be in tune with those trends so you can invest appropriately based on the risks you're willing to take.

All right. So we're going to stop there, but I think long story short, the empowerment of women and closing that women's wage gap is an imperative for us economically, socially, and increasingly in financial markets, it will have a major effect. All right, guys.

As I mentioned earlier today, we're going to talk about, talk about activist investing and what is it? What does it mean? How's it going to play out in public and private markets and, and what's the opportunity set there for you? So we're going to try to talk about this theme. And we brought somebody who happens to be an expert at that thankfully, and his name is Jeff Cherry. He is the Founder and Executive Director at Conscious Venture Lab. And he is here to help me unpack that and much more. So Jeff Cherry, welcome to the show.

Jeff Cherry

Hey Jose. Nice to be with you again, and thanks for the invitation.

Jose Rasco

Thanks for joining us. Now, Jeff, we've talked to our clients before about the concept of sustainability and, and sustainability has so many monikers, right? It's ESG. It's impact investing. It's SRI. It's 20 different names that goes under it. Often determined by the asset class you're in and often determined by what you're trying to accomplish, but the concept of making or achieving good financial returns and doing the right thing used to be disjointed. They are not anymore. And I know you have been a big proponent of this since I've known you, which is a long time, I think more than a decade, and long story short, the concept of doing good and making good money are no longer disjointed they're together.

Now, the ESG framework for those of you who are not familiar with it is important. And the whole concept of sustainability is really something that goes across markets. And if you think of. Achieving financial success as a family or as a business, the concept of sustainability and developing a business model that is sustainable over multiple generations is really crucial for families and corporations. And it's true for the country as well and for the planet. So what we find is that a lot of companies are now tuning into this as more of us are saying, "Hey, we want to achieve both financial and social gain".

Now, ESG framework is what underlies this whole thing. And clearly the data set is important. So the E is environmental and that's where we're going to talk about the energy transition from the petrochemical space to other things. We're going to talk about wind and solar and geothermal and all kinds of other opportunities in energy creation and in the environment. Carbon Neutrality. How do we trade carbon credits? We're going to get an alt all of these things in future shows, but the environmental portion is obviously huge.

Now, the S is social and we have written about it extensively over the past few months. And that ranges from, in terms of topics, everything from the empowerment of women, the racial issues we have in many countries, not just the US in many countriespriv Socioeconomic differences. So I think it's important to focus on that social issue. And in fact, if you look at what the Biden administration has done in their infrastructure plan, there is a physical component, in other words, bridges, roads, and tunnels. There's a digital component. You know, we're going to 5G, we're going to go to 6G. We're going to use drones and robotics and all the digital things we need to do. And the incorporation of digital security in digital and physical items, right? Because as devices begin to talk to each other more and more every day, you need to have more security. So that's all part of that infrastructure story. And the third leg of that infrastructure story is social. He called it in human infrastructure. We had the digital divide. We have pockets of our population in this country that do not have the requisite tools to go become employed in this new emerging digital economy. And we need to build those tool kits up so that people, can be employed, make more money, and it's the rising tide that lifts all boats. It makes things better for everybody.

The third leg after environmental and social is G, is corporate governance. Right? So if you look at corporate governance is not a new thing, it's been a tool that's been around, you know, generations, right? And investors monitor what companies are doing and how they're managing their books and their business. But now the corporate governance piece is becoming much more activist and much more involved and much more focused on what are you doing with the E, the environmental? What are you doing with social,

diversity, inclusion, board seats? These are all things that are being incorporated now into that corporate governance piece. So that's the data set that sits on top of all these issues.

Now, Jeff, we brought you to talk about one thing in particular, but the whole data set is available, so we could be here for days, I think. But one of the things we saw earlier in the year in the public equity markets was we saw that certain equities were driven to levels that people didn't think they were going to get to. Right. And so we saw a lot of volatility around particular stocks because there were activist investors out there saying, "No, we like this company. We like the way they do business. We like this business model and we're going to drive this stock up because we like it". And they kept the stock prices. And it became very volatile right now. The other piece of this is as not just individuals, but as pension funds and other major institutions, right? Continue to buy into the ESG, sustainability, impact investing concepts. And as the money that pours into these funds and these opportunities continues to rise, you will get more of a shift and Company A verses Company B. And if Company B is doing what people believe in and they, and they do things based on a value set, I'm agreeing with that's the activist alpha that I've been talking about for months.

Jeff, can you give us from your perspective, what do you see in terms of activist alpha in terms of the markets consumers versus the corporate sector? Give us some thoughts, please.

Jeff Cherry

Yeah Jose, as you said, we could be here forever talking about this, but it's really interesting. Something that you said caught my eye and that normally, you know, back in the day when you and I first met, when I was on the street, you know, doing the public equity stuff, we ran a hedge fund. We thought about activist investing as investors that were investing in the company to try and get that company to change their perspective. Right. Change the way that they do business. But now we're getting, you know, different, I think, different colors of different nuance of activist investors. So like you said, a bunch of stocks being driven up to heights that some people didn't think that were sustainable because of investors and how they felt about those companies.

And then you want it when we talk about this notion of activism, because we're seeing more money go into institutions and institutions are caring, or institutions have to care about what society cares about. So I think that that's sort of where this conversation is going right in that, it used to be, we assessed the question, can you do good and do well at the same time. Now we think that's the wrong question, right? Or wrong way to think about this. We think that the, the right sentiment is if you're not doing good, you're going to be much less likely to do well. That's because this is where society is going. This is what people are because of the internet, because of the aging of society, moving the sort of center of gravity away from what I can get to what I can do and how that center of gravity has then impacted the younger folks in our society. We're all looking at we want to do business with people who we know and we like, and who we care about, who care about the same things that we do. So we're always talking about, wherever I want to work? Who do I want to work for? Who do I want to bring into my community? And now who do I want to invest in? So I think it's a huge wave of that's coming. I have no idea. We talk about there's trillions of dollars moving into this space. That depends on who you talk to. Those numbers are

different, but it's really unsaleable that this is happening and we have to pay attention to it.

Jose Rasco

And, and I think you hit the nail on the head Jeff. Honestly, my first meeting on wall street was a meeting for a very large oil company and Carl Icahn was taking over the company and it was, that was activist investing. Because he felt they had too much cash on the balance sheet and they weren't putting their cash effectively to work. And therefore returns to shareholders could have been better if he were on the board. And that was activist investing then.

Today activist investing to speak to some of those individual issues, women's groups, LGBTQ groups. Look at different minority groups in this country like the Black Lives Matter movement. Or look at Hispanics. Look at Asian Americans. These are groups that are coming together and creating economic change because they're employed and buying products. Right. But to your point, now they're driving change in the financial markets. So can you give us a couple of examples of some of those changes that you've seen in either the public or the private markets.

Jeff Cherry

Well, I think that I'll talk more about the private market because as you know Jose, has that been out of the public markets. Although I do pay attention obviously, but spending a lot more time in the private markets. And I think you look at things like investors are all sort of looking at what's the purpose of this business beyond making money? Is it something I can get behind? Right? Because the investors understand that customers care about that and communities care about that. So businesses that are that lean into purpose are likely to outperform their competitors and create more value. So you have all sorts of, we've gotten in our fund, we're getting people asking us for side letters to report on things like culture and purpose of the organization. And not just carbon footprint. So you're getting all these changes that are happening.

Another one that I just talked about, culture is a huge one, right? Everyone is trying to figure out different ways to understand in the public and private markets, I believe, you know, employee engagement and culture at the organizational level, because we simply believe that back in the 80s, there was a book written at Harvard, the Service Profit Chain, right. And the long story short is you take great care of your employees. They'll take great care of your customers and you make a lot of money. Well, that's really sort of starting to blow up and people are thinking about the organizational culture. How do we interact? How do you know internally? How do the employees interact with each other? How they interact with management, how do they interact with the suppliers? How they interact with customers and that's driving, clearly driving value.

Now lots of people think about that and they shake their head and they say, "Yeah, we've always known about that", but we never really tried the measure. And we're getting much better. First of all, a lot more people are trying to measure it. We're getting better at measuring it. And I think that we're also thinking more critically about what cultures do we want to support? What types of cultures? You know, we're moving away from command and control. We're moving towards more egalitarian and meritocracy and cultures, and there's all sorts of things that are all sorts of different, management models that are blossoming because of this. So I think it's a really interesting question and it's an interesting time to be an

investor because I was having a discussion with someone about this yesterday, that if I have a better way to understand the culture of an organization, I have asymmetric information that other investors don't have. And if we want to go back to the very beginning and talk about activist investors. I haven't, I actually don't think of ourselves, our fund as being activists. But when I think about how you laid this story out in the beginning, clearly we are because we invest in the model through the Conscious Venture Lab accelerator, where we're training companies to think differently about the practice of capitalism and about how they develop cultures and purpose, and if they don't want to operate in the way that we're training them to we're less likely to invest. So in that way, we are an activist investor in the in the traditional, you know, I never thought about it, but in a traditional sense of the word, because we're starting from the very beginning, from day one, we're usually the first professional money into these companies. We're starting from day one saying, "Here's what we want to see if we're going to invest". Right?

Jose Rasco Regardless of whether it's a good idea of product or service, you want to see a certain cultural backdrop that you're going to be comfortable with. In other words.

Jeff Cherry Absolutely. Because you know, what we believe is that, in the, in the private space, we really believe that ideas are a dime a dozen. There's a lot of smart people out there. So we're going to see lots of really interesting ideas. And at the end of the day, the only thing that really matters is execution. And from our perspective, execution is built on culture and purpose.

Jose Rasco Now years ago you were involved, cause you're a lot more scholarly than you give yourself credit for my friend. You were involved with an effort that talked about, and I think the name of the book was Firms of Endearment, looked at communities or consumers, I should say, relative to the corporate sector and companies that quote-on-quote "did the right thing", had lower customer acquisition and retention costs. Is that still a part of this model? Because clearly you're driving cultural change in, in startups. but is there still that mathematical dynamic that, that plays out in this?

Jeff Cherry 100%. We're not doing this just to do it, right? I mean, yeah, we think it's the right thing to do, but we also think it's the right thing to do because it drives performance. So if we think about, you know, if you have great relationships with your employees and you've developed a really sort of dynamic and purpose-built culture, what do we get? We get discretionary effort from those employees. We get them to do more than we paid them for. Right. Everyone's looking for that.

In the old world and the command and control world, we think we get you to do more by just, you know, yelling at you or by putting more rules in place. But we know that that's not the way. So all of these things we do from culture employee engagement, the way we deal with suppliers, right? If we have a very mature, communicated, communicative, and authentic relationship, suppliers, what are we going to get? Our suppliers are more likely to bring us innovation and to take those innovations to our competitors.

So you can look at all of the things that we look at. All of the stakeholders, employees, suppliers, customers, community, think about community. If we are perceived and sometimes, it is perception part of our job is to, you know, the separate, the pretenders from the contenders. But if we're perceived as

being a great community member as an organization, as a company, what do we get? Well, the community doesn't raise barriers to entry, and barriers to entry are expensive. So you can look at all of these things that we talk about, how we treat employees, suppliers, communities, customers, even shareholders. And you can tie that directly back to what we call friction in the business model or eliminating friction in the business model and friction is always expensive. So yeah, absolutely. We're, we're thinking about those things all the time Jose.

Jose Rasco

All right. So we're going to get you an activist investor hat, an activist alpha hat. Now Jeff, let me talk about something else that's near and dear to both of our hearts, which is technology. And if you look at 5G, 6G, the concept is continuous consumption. You and I can be in the same car driving together to the mall and if you look at your phone, not while you're driving, we're in an Uber together. Okay, and we're both looking at our phone, going to the mall. And guess what, you're going to get different ads because you're richer than me and you buy better stuff than me, or, you know, so we're going to get different and that consumer is going to be hit by different ads and different promotional opportunities, which again, speaks to the differences in social mobility, in what your views are, what your value set is. So does technology in fact enable a lot of social change? Because there's been so much negativity about social media and in the invasion of privacy and all that, but could it also enable through these models? And the near-field communications and things where they can distinguish the difference between Jeff Cherry and Jose Rasco. Is that an enabler as well?

Jeff Cherry

Look, I think that you're right about that Jose, right? I mean, there are upsides and there are shadows to everything, all this stuff we're talking about. So if you're talking about technology, I mean, one of the things Raj Sisodia was the author of Firms of Endearment, which I was a consultant on as you pointed out. One of the things that Raj talked about in the book is that a lot of the reasons why this is happening is the transparency that's being driven by technology, social media, the internet. So at the end of the day, that's a really good thing because these organizations can't keep us in the dark, like they may have at one time. Right? I mean, back when you and I were in New York, someone said, "We're gonna raise fees on, ATM fees" and then the Twitter blows up. And then those organizations have to say, "Hmm, well maybe we can rethink this", right? So does this trans, there's a power dynamic, a shift in the power dynamic, right? Where the, where we as society, as consumers, have much more information and that's given us more power. Now, the dark side is right. The shadow is all of the things that we talk about about privacy and the fact that we're being served up different ads and how does that all happen? And I'm sure we've all, we've all experienced that. So yeah, both of those things are happening, but I think, point, on balance, the development of technology has been a good thing for driving organizations to think more holistic, more authentically, about the practice of capitalism and the way we do business.

Jose Rasco

It's funny because last night my wife and I were talking about our dogs who had some digestive issues and we were talking off the cell phone, right? About these new dog foods that the vet had recommended and she picks up her phone and there's an ad for the dog food so it's not big brother. It's everyone is listening, but long story short. So the opportunity, the activist alpha is here. And that's one of the distinguishing characteristics, Jeff, which I talk to clients about all the time. If you think the market's going to be up X percent a year, whatever that is, whatever your bogey is for your investment

portfolio. You have to keep in mind that there are people out there, whether it's the empowerment of women, LGBT, different racial groups, different religious and ideological groups, they are driving social change through economic power and financial market capital raising ideas. And we haven't even talked about NFTs and cryptocurrencies and all those things, which we don't want to talk about, but that world of finance is changing. Decentralized finance is going to change it even more. So the word for the client, that we're telling our clients is activist alpha is here. You will see stocks will be driven by much more than just financial profitability. They will have to be affinity marketing, and they will have to reach out to the community that they want to attract as consumers and investors. Right. Is that a fair summary statement here?

Jeff Cherry I think a 100%, I would go back to something we said in the very beginning that if you're not doing this, you're going to be less likely to do well. Right. I say, if you're not doing good to me, less likely to do well, but exactly as you've just said it, Jose. That this activist alpha is here and it's here to stay because of all of the transparency, all of the technology, all of the things that we care about. Those things are moving in this direction. So if organizations are not paying attention to that, they're going to pay a price. And the ones who are paying attention to that are going to be much more competitive in their space. And that's where the activist alpha comes from.

Jose Rasco And they will be rewarded in terms of the economic marketplace, sales, profitability. And also in the financial markets, private equity, as well as public markets.

Jeff Cherry Absolutely.

Jose Rasco All right, my friend. Listen, we could keep you here for days. We will invite you back in the fall as you're always insightful and engaging. So thank you for your time. And we look forward to continuing this conversation in the next couple of months.

Jeff Cherry Always great to be with you, Jose. Thanks for having me. And I'm happy to come back anytime.

Jose Rasco Thank you. All right. Well, that was a great conversation with Jeff Cherry, who, you know, again, Founder and Executive Director of Conscious Venture Lab. And I think it's important to reiterate to you guys that what is being discussed here is the concept of activist alpha and what is changing in society. People are not willing to be spoken to anymore. They're speaking to the companies that they want to buy products from. They're speaking to the companies they want to invest to. So we're not going to be passive and sit back, we're going to be active and speak, and that is manifesting itself in the marketplace. And you can see it every day with the use of social media and these new technologies that are just beginning to be deployed. You will see more and more individually focused and targeted products and services that speak to individual groups via income strata, whether it's religious, ideological, gender based, LGBT. I've talked about this a million times and even different racial groups. And you'll see it work out in the economy. But we are more and more going to see that factor into how we value the investments we put our money into. We are going to, my catch phrase with investors has always been, "Let's get to the point where your money is working harder than you are", and now people want their money to drive change, the change they believe in. That's the activist alpha. We've seen it

play out in public markets. We've seen it play out in private markets and it is just beginning. Something to keep an eye on, something we'll keep coming back to, but do not discount it because it is there and it should help drive financial market performance. As we go forward. All right. So thank you for your time.

Thank you for listening to the Hexagon Briefing, A Global Perspective from HSBC. I'm your host, Jose Rasco.

HSBC Bank USA N.A. and or its affiliates, HSBC offers these audio podcasts and the opinions expressed therein are for educational purposes only, and they should not be considered professional or investment advice. Any opinions or other information correspond to the date of this recording and are subject to change.

The information contained in this podcast does not constitute an offer to buy or sell any securities or investment products. You should carefully consider all relevant factors when making investment decisions, and you are encouraged to consult with your independent advisers prior to investing.

For a comprehensive review of your personal finances, always consult with a tax or legal adviser before making any financial decisions. Neither HSBC nor any of its representatives may give legal or tax advice.

Copying, publishing, distributing or reproducing the presentation materials, including audio recordings in whole or in part is strictly prohibited.

HSBC refers to HSBC Bank USA N.A., HSBC Securities (USA) Inc. and HSBC Insurance Agency (USA) Inc., HSBC Bank USA N.A. provides banking products and services.

HSBC Private Banking is the marketing name for the private banking business conducted by the principal private banking subsidiaries of the HSBC Group worldwide. In the United States, HSBC Private Banking offers banking services through HSBC Bank USA N.A.

HSBC Securities (USA) Inc., member NYSE/FINRA/SIPC provides investment products and services and is an affiliate of HSBC Bank USA N.A. HSBC Insurance Agency (USA) Inc provides insurance products and services and is a wholly owned subsidiary of HSBC Bank USA N.A.

Investments, annuities, and variable life insurance products are not a deposit, not FDIC insured, not guaranteed by the bank or any of its affiliates, and may lose value.

If you are not a US resident. Please read the specific cross-border product and service disclaimers, which are available on the cross-border disclosure page of our public website at www.us.hsbc.com/crossborder.