

The PODfolio Podcast – Season 2, Episode 3: Heart vs Head: investment outlook for 2022

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ROGER URWIN: I'd like to sort of think that really what we do have in 2022 is lots of profits with purpose but capital P for profits, smaller p for purpose actually that's the reality.

SPEAKER 2: Welcome to The PODfolio, Willis Towers Watson's investment podcast series where we talk to expert guests on hot topics that matter to institutional investors and their portfolios.

LOK MA: Hello, and welcome to The PODfolio with me as your host, Lok Ma. Now, we're fully aware that pretty much all investment podcasts in January go along the lines of looking ahead to the rest of the year and identifying the main market themes, and so on. And we're not above that either but we're going to try and put our own spin on it. So the theme of this episode is heart versus head. And it's about making a distinction between the personal, professional values that influence our decision-making and the more technical things that we consider at a more practical level, which also feed into our decisions.

So to represent our heart, we have Roger Urwin, who leads investment content at WTW and is the co-founder of the Thinking Ahead Institute. That's all about long-horizon investing and maximizing value, not just for the investment industry but also for the end saver as well. So welcome to the show, Roger.

ROGER URWIN: Real pleasure to be here, Lok. Thank you.

LOK MA: So I would see the Thinking Ahead Institute and also Roger for the purposes of this, as representing the heart of our investment approach. Then to represent our head we welcome back to the show one of our senior directors in the asset research team. That team has more of a medium-term horizon and it generates investment ideas for our clients' portfolios which I would say are more rooted in economic views and analysis. Martin Jecks, it's lovely to have you back.

MARTIN JECKS: Thanks, Lok. It's a great pleasure to be here. And hi, Roger.

LOK MA: And likewise I would see the asset research team and also Martin for the purpose of this as representing the head of our investment approach. And of course, I'm doing both of you a big disservice by assigning just one of these body parts to you. In reality, both of you will, of course, deal with both sides of that coin. It's just a way for us to think about the tension that might exist between the heart and head in some places, between our values and more hard-nosed finance if you like, and throw out some interesting ideas.

So starting with you, Roger, I think if we go back even just a few years, the main example of an investor tapping into their values would have been in the area of environmental impact, and that was typically given the dreaded label of a soft factor. So in other words, we'll exclude some of the things that are bad for the environment as long as it doesn't hurt our returns but it's a secondary thing, we don't think about it, analyze it too deeply, and so on. Can you just tell us, first of all, I mean, how much has changed recently in terms of how institutions now bring their values into their investment choices?

ROGER URWIN: Yeah. Thanks, Lok. I think the framing you've done is really good but just to be clear, I'm not an all heart and no head person, as you said. So I am very much both but I do think I'm sort of a bit like a soft heart and a hard head person. So and soft may get a bad rap as it were but I'm a fan of it in the right places and it kind of needs to mix in another body part, a strong back as well.

So on change, as you've asked here, a lot has changed, is changing in our environment in the investment industry. And attention to values is one of those big changes. And values really do matter to all of us and they motivate all of us in both our hearts and our heads. And so with the heart, you have values of I'm going to say kindness and fairness in particular. But specific to our investment industry it's about responsibility getting traction, it's about responsible investing as you've said. And that has been a real factor in recent years.

Now, that's not to forget that there are head values that are really important, which I would call them like smarts as it were and that's like wanting wealth, which is a perfectly reasonable thing. But also wanting sustainability in wealth, the wealth has to last. And as you say, all of this has shifted really because risk and return was everything for the last 50, 60 years, ever since Milton Friedman got that traction with purpose in business-- purpose and business was profit he said basically.

And that overcooked thesis really has sort of in recent times run aground. It's moving to profits with purpose and I particularly like it as purpose drives profits. And we even have the net-zero movement and the net positive business movements now. So net positive for people who don't know the phrase, it puts back more into society, the environment, and the economy than it takes out. That's what a business should have. And that makes the case for something like a better world, a happier people, stronger communities.

So sustainability is both better financial outcomes, the returns we need will only come from a system that works, and let's work on that but it's the bonus with some of these net positive spin-offs. So I think sustainability and investment is doing now a good financial values job and a good non-financial values job. So I'll kind of pause there.

LOK MA: Thank you very much. And moving to you, Martin, again, to set the scene, this time last year you gave us the main investment themes that would be influential for 2021 and beyond. And if I recall the three themes you had were around the impact of government financing as a result of COVID, the rise of China, the opening up of that big market for investment, and of course, you also had the increasing importance of sustainability.

So sustainability, already one of the three big themes and you could see the sorts of things that Roger was just talking about in terms of profits with purpose, putting more back into society than you take out. They were already starting to feed into our economic themes. We're now in 2022, what new themes are emerging, Martin? And to what extent is the heart influencing the head in our outlook for this year?

MARTIN JECKS: Yeah. So in terms of the themes, Lok, I describe them as kind of an evolution of last year's. We put slightly different words next to them and China doesn't get as much prominence, not because it's not important but just because we've got limited space and our three themes this year are-- we're calling them prosperity, people, and planet.

Prosperity you might regard as our sort of bread and butter. It's about how do we understand the macroeconomic environment and how can we build and hopefully protect wealth given that understanding? And that's really building on this idea of the policy shift we talked about last year, that we are in a world of extremely easy fiscal and monetary policy but what we're observing now is that policy mix is coming up against some fairly significant pressures and we sort of highlighted these as potentials last year but now that they really have manifested.

And of course, the most prominent of that is inflation and how do you react to that? And so we've developed a framework that people can track inflation. Now, we think inflation will decline. But there are quite prominent upside risks around that. So we need to stay really close to inflation.

And the other thing that we're highlighting this year within this prosperity, i.e., how do you build wealth theme, is the importance of savings. Now, that policy shift has delivered a whole bunch of cash onto household and corporate balance sheets. And what happens with that cash, what happens with that so-called sort of excess savings is really important to our view. Which is fundamentally quite positive actually from a growth perspective, we think that that cash should get redeployed into the economy and help fill in some of the hole created by the pressure on policy to tighten. So that's the first thing.

The second theme is people, and this is a little bit newer and might be quite interesting from a values debate perspective and that's just speaking to our view that inclusion deserves greater prominence in how we understand the world and how we invest in it. And the critical idea here is that there's we think a really clear link between kind of income and wealth inequality, the lack of inclusion within some countries and across countries between various social groups, and lost economic potential.

And because of all those things, there's a growing pressure on policymakers to fix some of those things and release that economic potential. And the basic point is that this is a financial good as well as being I believe, a values or a purpose good. It's a financial good to raise the tide on which we're all floating to increase that kind of economic output.

And the final one is planet. And that's kind of building on some of the things we talked about last year. We had this climate dashboard, how do you track from a top-down perspective the energy and climate transition that is happening? So we build on that a little bit.

But the other idea we introduced this year is this notion that actually, a disorganized transition looks to us to be quite a lot more likely than a more kind of even an organized one. And that has a few implications in terms of kind of asset market and policy volatility and it's not sort of wholly positive from securing that transition either. So those are the three themes.

And I think the second part of your question, Lok, was to what extent are those driven by values? And I think that that's a tricky one. We tend to base our themes and our view of the world on Roger's profits, I'd call it sort of financial imperative. We're trying to understand the world and what is driving it, and therefore, what we and our clients should do with their capital.

However, I think you can see that from the names and from what I've said around sort of the genesis of these things, that values aren't independent and they're not separate from what we're doing here. But we are coming at this from a well, what is the financial imperative here? And I think policy and the pressures on policy is one of the key things where we can observe how society's values are shifting.

LOK MA: And I think with that, we've set the scene in terms of the heart and so the values that drive our investment behavior, and the head, so our economic outlook and implications for future returns. I think now is when I'm expecting maybe the fireworks when we bring the heart and the head together.

So staying with you, Martin, just from what you said prosperity, people, planet, if I try to put a super theme on top of these economic themes that you just described, it would be something along the lines of the values of society as a whole are changing. These are the possible implications from that in terms of future asset prices or returns. And this is how you should invest accordingly. I mean, I don't know whether that's a fair description of what you're saying. And to be slightly provocative deliberately, Martin, do you see

yourself as almost exploiting these changes because you know they're coming, or are you maybe in part driving these changes through your own behavior, or is it a bit of both?

MARTIN JECKS: Yes. So I mean dealing with the second question first. I mean I would describe us as observers of those changes. And so I think that then brings you to the first part of your question, which is, is this about society's values changing? I suppose the first question there is sort of the premise of what you've asked, which is, are society's values changing?

And I'm a little bit on the fence about this one. So one of the things that I think is very observable is the polarization in public discourse, the increasingly sort of fraught nature of debate, the so-called culture war, and lots of one's attitude to, for example, climate change or inclusion and diversity or even sort of wearing face masks comes down to which side of that debate you happen to fall on.

And you know, that polarization doesn't lend itself to like an obvious conclusion about how values are shifting because I'm just aware that one's perception of how those values are shifting might be very colored by which side of that debate you happen to fall on.

And yet I think what we can hang our hat on as so-called observers and hopefully, impartial ones is tracking what's happening to policy. So for example, putting some numbers, which I think all throughout the year, something like 36% of global GDP is produced by countries with a net-zero commitment in law, and about another 50% I think is produced by countries with them in kind of proposed policy. So that feels quite like a consensus to me and evidenced in policy.

And a slightly more micro example, the Fed is now making much more prominent noises around different employment levels within racial groups when defining maximum employment, which kind of speaks to this inclusion and diversity thing. So I think you can identify that shifting societal values view in policy. I think you can observe it and I think you can then think, well, this is happening or likely to happen, what do we do about it? How do we allocate our capital?

LOK MA: And I'm fascinated by what you said, Martin, about whether we're having a shift in values as a whole or whether actually, the two sides of the so-called culture war are actually shifting away from the middle. Because one observation I would make is you don't necessarily even need to share the values we just talked about to tap into those economic themes.

So you may not even believe in climate change or you don't care to do anything about it but the transition to a greener economy at a societal level is happening anyway regardless of how you feel. And so if you don't take that into account, you're still going to get burned. So it's not just your values that are driving your behavior but also everyone else's in a way. So maybe in our analogy, your head is reacting to what the hearts of other people are doing?

And so let's come full circle back to you, Roger. Not that many years ago a lot of us were in a place of saying that some of the nicer outcomes investors can bring about in terms of achieving in your words, kindness, and fairness, they're nice to have. We all want these things, but the fiduciary duty of basically investing other people's money, that means that I must maximize risk-adjusted returns first and foremost. So let me just give you a couple of examples should you take advantage of when oil prices are really cheap when you're investing or how do you feel about hedge funds that deliberately pick up cheaper assets that other people have rejected precisely on ESG grounds but they're well-priced and they might give you a good return. So the classic investment moral dilemma if you like and again, you could present that as a conflict between the heart and the head. Does that conflict still exist in 2022?

ROGER URWIN: It certainly is there as a tension, Lok. Firstly, I really did like Martin's sort of narrative and really he called himself an observer and I think that's the sort of accurate term for reflecting on all of these kind of changing aspects of our 2022 zeitgeist. You see, really we have to understand everything all these moving parts, it's complicated out there and bring that together in a sort of simplification of the picture. I think that's the principle.

But there are different factions. So in answer to your question, I'd like to sort of think that really what we do have in 2022 is lots of profits with purpose but capital P for profits, smaller p for purpose actually, that's the reality. And in many respects, we have quite a lot of profits are its type of protagonist. And then investing in bad stuff is our duty as you say because it can make money and that's our fiduciary duty done as it were. And so from that point of view, we have to think is there anything wrong with that as you say? Now, I do see a conflict. And I see something a little bit around this word sustainability in thinking about it that way because we do have sort of coexistence between these different market players as it were. What we have to I think of here is that you have to find new answers to these bad assets and the stranded assets that are coming on the back of the changes in the world and obviously the kind of changes in the balance between fossil fuels and renewable energy sources into the future. Because these stranded assets, you don't want them parked in some opaque private corner of capital markets.

And I think you have to think of different types of leaders here, these different factions. So at one end of it, you actually do have some pretty interesting leaders who are wanting not to be observers but they want to be influencers. And I'll quote David Blood at Generation as a really good example of that type of thinking. And often it's associated with the principles of universal ownership, which basically is saying the returns we need can only come from a system that works, we have to work on the system to make it work.

And then you've got some sort of like-minded but not quite as passionate players, and I'll put Larry Fink of BlackRock into this camp, who is I think a profits with purpose type of person, that's his catalyst framing. And you might have seen his letter recently where he was claiming not to be woke in respect of being too soft in the heart or soft in the head. He was actually saying look, this is for fundamental capitalism reasons that we might be doing that as well.

Now, but the most interesting types are those that are in sort of the bad assets end to start with. So I'm going to quote ExxonMobil, they had a very interesting fight around their board composition last year, which actually is very much about-- it was staking the issues around profitable futures but their future is clearly to be argued over and from that point of view. Who's going to be buyers of their stock is going to be pretty interesting and activist players are going to be playing a part in this.

And there's two companies that are very interesting in the sort of sustainability examples here. So one is Danone and the other is Unilever, where the sustainability propositions of both of these companies have come under fire from activist investors who are staking a pure profits proposition around a business model that actually is saying so much more about sustainability. And to me, those activists have a case but I don't think their activities are that sustainable.

And so from that point of view, I think our system will not do well if too much capital is generated on terms that are kind more interested in what's going to be the profits in the near term as opposed to how those profits relate to their purpose. So this will be played out. And I can only again see this very slow-moving but unstoppable train called sustainability picking up speed because that is the zeitgeist of our time.

MARTIN JECKS: Yeah, look I hope you don't mind if I sort of butt in but--

ROGER URWIN: No, please do.

MARTIN JECKS: I find that really, really interesting and just adding another couple of examples to Roger's there and in what we've been grappling with from a kind of an asset allocation perspective. So one example is listed infrastructure which has for a bunch of reasons I won't go into, looked relatively appealing from an inflation perspective, defensiveness perspective, and so on.

The issue, of course, is that those companies have got a fairly appalling emissions profile. So on the one hand, you've got this suspicion that these might make quite good financial or portfolio investments, on the other, you've got an imperative to control and manage lower emissions. And those two things are in tension.

And then the final element of that tension is actually well, emissions doesn't quite get it. I mean, Roger, has sort of described the world as complex and I think that's exactly it, it's complex from a values perspective as well. So just because a utility company in the US emissions are currently bad, in fact, the way that we can secure the climate transition is to shift those emissions, shift that power production towards a more-- a greener profile and just not investing in that is I think a little bit problematic from a values perspective as well. So I think that this tension very much exists in 2022 and I think it's just going to get worse and worse or more difficult to grapple with because as Roger said, this trend is just going to build.

LOK MA: And from what you both said, the heart and the head really do of course, massively influence each other and the spine as well as you mentioned, Roger. And of course, despite the set of this discussion, both of you will apply both head and heart in the course of your work. That's coming through loud and clear and listeners, please don't come at me to point out that the heart is not biologically involved in making decisions. It's a metaphor, obviously. I did look this up, it's called the cardiocentric hypothesis when people did used to think that your heart controlled your feelings and your thoughts. And so the last thing that I want to talk about, which is related to this coming together of heart and head is an observation that what we think about nowadays as investment professionals and our concerns outside of work are coming together in a way that just didn't used to happen nearly as much. So we or maybe I used to anyway, I used to be like the boffin that talked about equity and bond returns in the office, and then I'd go home and think about completely different things.

But now all the things that we've just been talking about, climate change, inclusion, diversity, the moral values of individuals and organizations as well, COVID, which we haven't touched on very much today, but all of these are also the things that the whole world are grappling with. And I'm also reminded of the description of VUCA, the idea that the world is volatile, uncertain, complex, and ambiguous, all these themes are very much in that category. So any final thoughts from the two of you? And I'll go to you first, Roger, so thoughts either in terms of this blurring of the lines between worlds, between the investment world and the non-investment world, or just generally any other concluding thoughts, things that you would like our listeners to bear in mind over the course of the coming months?

ROGER URWIN: Well, yes, I think you've got it spot on there, Lok. That really this blurring of the lines thing is happening but also I think it's also a good thing because it deals with the world as it is, not the world as we'd like it to be, which is a sort of dumbed-down version. And finance has kind of has tried to be dumbed-down and I think it's cost it as it were. So I think we're now moving into a situation where we have to respect this complex world and deal with it in that state.

And this is really asking for a different type of approach. I mean, for each of us kind of to think a little bit more about work and life as integrated, I think the pandemic has brought that onto everyone so that's one thing, being joined up about it. But I think that the world of leaders that I look out on through business, through finance, through the investment industry, our leaders need to be more joined up. And this is really being more collaborative and finding our solutions with others because we have common problems here. And it's only going to work if you're joined up in your understanding of the messy systems that we're a part of. And it's really built on respect for these multiple strands to the challenges, the multiple people that have a stake in the problem, that's actually referred to as stakeholder capitalism these days but that's certainly happening.

And lastly, that you have to be realistic that there are multiple facets to any solutions here. You're not going to have a silver bullet type answer. And I think that this is difficult for people. So it's a transition that leadership has to make in which we build up these solutions, which are long term as opposed to our normal way of dealing with it, which is kind of really having a lot more regard to short term fixes. And from that point of view, systems leaders like the ones I like in our industry are creating the conditions by which sustainable value creation really can emerge. And so I'm going to close my comments with that sort of positive note that I think we are looking out for new leaders to just do better with the merging of our hearts with our head.

LOK MA: Indeed. And I think you phrased it much better than I did, work and life integrated. I think that that's very much kind of what I was thinking about there. So over to you, Martin, for any final concluding thoughts as well?

MARTIN JECKS: Yeah. I mean, well absolutely, to what Roger just rather elegantly articulated. I suppose what popped into my head in response to your observation that as Roger said work and life have merged. For me, it was always so. And I think to be good at this job you need to understand the world in which you're living in. And that is a great deal more complex than a sort of a mean-variance portfolio optimization thing, which is what I think you're kind of driving at. I think the world is complex and uncertain, and there's a bunch of stuff going on, and values are a key element of that. And that's why I love this job because it's just fun. It's great talking to people like you and thinking about these things. What I'd finish off on is this concept of 3D investment, which Roger and his team has come up with. And if listeners haven't come across that I would really encourage reading around that. It's a very simple framework and it does just point out that the impact we as investors and as humans have is as critical to kind of financial sustainability as your risk-adjusted return. And I sort of believe that in my core, my head as well as my heart.

LOK MA: So thank you very much to both of our guests. Roger, it was lovely to have you on the show.

ROGER URWIN: Well, I've really enjoyed the conversation not least because whilst we have agreed on a lot of things, Martin has given me a lot of food for thought again. And again, he called out what a pleasure it is to be involved in an industry and at an organization that puts thinking at the head of everything. That has happened today. So thanks to both of you.

LOK MA: Indeed. And Martin, great to hear your thoughts as well.

MARTIN JECKS: Thanks. It's been an absolute pleasure. Thank you very much.

LOK MA: And I hope our listeners enjoyed our conversation too. Take care until the next time.

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