Fiduscient Advisors, Nonprofit Investment Stewards Podcast
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Taking on ESG Initiatives Amidst Global Turmoil with Habib Subjally

[00:00:00] Welcome to Nonprofit Investment Stewards with Bob DiMeo and Devon Francis from Fiducient Advisors. Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment, foundation or retirement plan investments, this podcast exists to help stewards improve performance, reduce costs, and discover strategies that enable your charitable organization to prosper and advance its mission.

[00:00:26] Now onto the show. Hello, and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo, and it's always good to be joined by co-host Devon Francis. Today's episode is very timely. And for me, personally, one that generates both questions and a lot of curiosity. We are about to tackle ESG.

[00:00:49] But before you're tempted to roll your eyes, feeling you've heard everything about ESG. Know that our expert guest is going to share updates on ESG initiatives [00:01:00] in a world where gas currently costs around $5 per gallon. And where global turmoil presents an entirely new dynamic regarding defense contractors and a lot more.

[00:01:12] Devon, thoughts on today's show? I'm really excited, Bob. We have a great guest here today. His name is Habib Subjally. Habib is a senior portfolio manager and head of global equities at RBC Global Asset Management, where he leads a team of 11 global sector specialists. Habib you started his career in the investment industry in 1994 and has been with RBC since 2014.

[00:01:37] And I just think that today's conversation is going to be very dynamic. We'll give listeners a lot of timely and really relevant insights about the ESG landscape. So, Habib, thank you so much for joining us and welcome to the show. Thanks for having me. It's a real pleasure. Habib, thanks so much. We're really excited as Devon mentioned, and perhaps we can start with you sharing your story [00:02:00] with listeners.

[00:02:01] Really? How did you get to where you are and what led to your passions regarding investing? Ooh. Good question. Um, first of all, I guess the first thing to say is that I have a very international background. My mother was born in Africa. My father was born in India. They met and I was born in, in Pakistan and then the family moved to Dubai, but I went to school and I then came to the university to the London school of economics in London, where I back my wife.

[00:02:34] Whose family comes from Jamaica. So my three daughters are quite confused, but, um, there we are, and it's quite an international background, but when it comes to investing, I guess my formative years, the, the, the real spark for me was when I left university, I trained as an accountant, a CPA in the US context.

[00:02:58] And I would, [00:03:00] I was out on audit all the time. Uh, either audit or consulting. And I was always intrigued by the different businesses that I went into every few weeks. Some businesses, which just felt very slow, very dull, people de-motivated and I was just doing a job. Whereas others had a real buzz about them, where everyone went the extra mile, everyone cared about what was going on.

[00:03:28] They cared about their clients, they cared about each other and that's sort of that difference that, that, that I felt every time. And this was sort of quite tangible. You went into a business and within a matter of hours, you would get that sense, like, wow, this is a really great business. And sort of, I made it my, I guess my life's work to try and figure out.

[00:03:54] What it is that made those great businesses. Because as, as, as an account, and again, as you go [00:04:00] back to your clients, year after year, it was this great businesses that had those great people and that great parts about them, that great culture that seemed to grow and prosper and get more clients and, and it'd be more successful.

[00:04:16] And, and that really intrigued me. That's great. Have you been, wow. Talk about a, uh, an international background. I don't think we've ever, ever had someone with, um, with quite as, uh, quite as much diversity in, in the background of just your own upbringing. So that's really fascinating. So as you know, what we're primarily going to be talking about today is ESG investing.

[00:04:40] And I think many folks have heard the headlines and have seen the statistics, that there is a huge momentum in assets flowing into ESG strategies. So, in your opinion, does the momentum that we've seen in ESG investing represent [00:05:00] just a market trend or do you feel that it's more of a secular change?

[00:05:05] Clearly, there's a lot of momentum at the moment, but I think this is a secular change that, that has taken place, and this is not going away. And frankly, I think the roots of this secular change are in transparency and technology. I mean, look, for 20 odd years ago when I started in this industry, uh, we will.

[00:05:31] Provide our clients, uh, which were typically institutions, endowments, foundations, life insurance companies, pension plans, and so on with quarterly results. And we'd give them essentially, we gave them a number. You gave us this money. This is what we've done with, with your money. And we give them a number and that number would get incorporated amongst a lot of other managers.

[00:05:55] And that would go further down the chain and the ultimate client. Let's call it the [00:06:00] ultimate client Mr. And Mrs. Smith, who are saving for their retirement or who are saving for a particular reason to fund education or to fund research. That, they just got a number basically, three months, six months, perhaps annually, but now with transparency and with new regulations in reporting and technology, they can see what is happening with their money.

[00:06:29] They can see what their advisor's doing and what the insurance company is doing or what the pension plan is doing and what the asset manager is doing and so on. And they can see what that money is being invested in, and they can now ask questions about whether that money is being invested in line with their principles and their values or not.

[00:06:53] And I don't think this is going away. I think clients are, the ultimate investors are getting the asset [00:07:00] owners in that sense, are getting more demanding and more challenging and they should. It's their money. It's their returns. They care not just about the actual return that is, uh, the financial return that's, that's driven, but at what price that financial return has been generated, and those are very valid questions that people should offer and, and that is being awesome.

[00:07:22] And that is, that in my view has what, is what has driven this big upsurge in ESG.

[00:07:33] Habib, let's talk a moment about fossil fuels and as you're well aware, divestment or avoidance of fossil fuels is long been a hallmark of the E and ESG investing. But right now, very high inflation, a war in Eastern Europe, all of this has led to oil prices not only spiking, but near all time historical highs.

[00:07:54] And what kind of impact is the current environment having on the [00:08:00] conversation surrounding fossil fuels? Yeah. Look, I think there were, there were some in, in, in the industry that advocated, uh, divestment. And I think that they made a very strong case, but the reality is that fossil fuels are going to be around for, for a number of years.

[00:08:22] Uh, we may be at or near peak oil but, uh, that doesn't relate to gas and so on, and we can have these debates. The, I think in my view, we need to be in a position where the fossil fuel industry is here and has a, uh, and it's going to be around for, for a number of years. The real question is what the fossil fuel industry does with those cash flows.

[00:08:52] And we can look at that from a societal perspective, but we can also look at that from a company perspective. I mean, the conversations I have with many [00:09:00] CEOs of fossil fuel companies is what does your business look like in 20 years? I mean, typically, you know, if you're talking about LNG products, projects, those are multi-billion-dollar projects that take, let's say from discovery to commissioning, about 10 years, and then they flow for another 20 or perhaps 30 years.

[00:09:22] So these are 30, 40 year projects. And to commit to something like that, these businesses need to have a clear idea of what, how much demand will be out there for the products and what they're going to do. Uh, I think these are very valid conversations and we need to make sure that these investments, that these businesses are run for the long-term and not just with a rear view mirror, the world is going to be going to be different.

[00:09:55] And you raise the price of gasoline right now, [00:10:00] if anything, and the volatility of the price of gasoline. Um, and, and other energy, whether that's heating, it's about transport. This volatility has a great economic impact. And if we can move to renewable, obviously there's a very strong environmental argument, but there's also a great economic argument that the marginal cost of renewables is, is pretty much zero in many cases, but also that it is a much more predictable, much more stable cost to the economy.

[00:10:35] And, and many industries can then be, will be faced with less volatile inputs, and we'll be able to plan better investments for the longer term. And the same thing for, for consumers. So I think these are complex issues that in my view should not be categorized by divest completely. [00:11:00] I don't want to see it or hear it and pretend it doesn't exist because it will continue to exist.

[00:11:05] The real issue is how these companies transition and how these industries and businesses transition. And this is where I think investors as owners of these businesses have a very important role to play, to hold management to account, and to ensure that the management teams who are running these businesses do have a truly sustainable and enduring strategy that is valid for the next 20, 30 years, because that's the time horizon of this industry.

[00:11:38] I hope that goes some way towards answering your question. It absolutely does. And I'm curious if there are investment themes or specific opportunities that you'd identify and care to articulate? Well, clearly, I, I think there's going to be a lot of [00:12:00] opportunity around the renewable theme, but when you look at many of these fossil fuel companies, the oil companies, they have a huge amount of technology.

[00:12:11] They have capability. They have capital. They have cashflow. They are used to undertaking big, complex capital-intensive engineering projects in hostile environments with a very long-term time horizon. Can those skillsets and those, that human capital be repurposed in, in a more effective way? I think that when you look at these, these entities as businesses and say, well, what is this business going to be in 20 years time or 30 years time?

[00:12:44] Is it still going to be a business that is more valuable than it is today? I think that's going to hinge on whether they can repurpose the human capital and intellectual capital to address what the world looks like in 20 [00:13:00] years time, rather than what it did look like 20 years ago. So, Habib let's shift a bit.

[00:13:08] And I'm so curious to hear what you're hearing from your clients regarding investments in defense weapons and defense contractors, particularly now that there's a war on Eastern Europe? I know obviously it's an incredibly complex situation. So, what are some of the complexities in that area of the market?

[00:13:33] Well again, another great question. This is a nuanced area that is, that is changing. And up to recently, it was relatively easy for many of our clients to say, you know, I don't really need to think about it too much. I don't, don't like the industry and I don't want to be exposed to it and it was relatively easy to just walk away from it.

[00:13:57] And it was a relatively small part of [00:14:00] the opportunity set as well. That said, I think what we are faced with now in Europe is a very real issue. And much like the, the vaccine, you know, so where the world was faced with, with a problem and a private enterprise, it came, came to the rescue. I mean, you know, at the start of, of, of, of the pandemic, everyone said, oh, it takes about 10, 15 years to, to develop a vaccine.

[00:14:30] Even the optimists like Bill Gates said, it takes two years. And eventually we got it done in about a year. Uh, that said, again, they were like 150 yard vaccine candidates and about four or five kind did the job for the world. I don't know what happened to the others. We have 140 out, uh, but, but, but I suppose this is the, the, the power of private enterprise, right?

[00:14:54] That can, and should come to deal with the big social problems, [00:15:00] uh, of our communities, our countries and our societies. So many of our clients are now taking a fresh look at the defense industry. They can see that there is a national and societal need for defense that has become clearly, sort of brought to their attention.

[00:15:19] And at the same time they see the, the risks inherent in the business model of the defense companies. So., no one is going to criticize a defense company for supplying their own country, their national government with defensive or offensive weapons to meet the needs of, uh, to defend the realm.

[00:15:42] I mean, this is patriotism at its highest level of role and the way we, we all in our respective countries treat, um, treat soldiers who go out to, to, to defend us and to defend our freedom. But given the nature and the business [00:16:00] model of the defense industry, that it's a high fixed costs industry and profit, the marginal profits generated on the marginal sale are immense that the defense industry has a real incentive to sell.

[00:16:16] Uh, that, that product to other governments, and those can be governments that are very close allies of the national country, or indeed further and further out, but they can just get away with it. And I think this is what causes many of our clients so much concern that they don't want to be invested in businesses that are supplying distant governments, that they have very little social or cultural kind of attachment with, uh, weapons and then seeing those weapons used to, to bomb schools and hospitals and other atrocities.

[00:16:55] And, and that, that I think is the balance about how [00:17:00] we implement the kind of requirements and the values of asset owners at a corporate level. And I think this is one of those things that the, the, the defense industry is going to have to address this with, uh, and, and satisfy asset owners. Because ultimately if they want to attract that capital, they will, they will need to, to address these issues.

[00:17:28] But I think that debate is still at a very early stage. Yes, obviously, it's incredibly complex and the landscape is ever changing and hard to know. Um, it's certainly not a black and white issue. So, appreciate your perspective on that. One of the things that we wanted to ask about is ESG integration.

[00:17:49] So ESG integration is one of the most common ways for active managers to incorporate ESG into their investment process. I think about three quarters of active managers [00:18:00] report, uh, some level of ESG integration. So, can you talk a bit about what ESG integration looks like for RBC? Yeah. Okay. So, ESG can be integrated in a number of different ways.

[00:18:14] Uh, you know, many use it as an overlay. Many use it as a screen. I mean, for us, ESG is inherent in our, in our philosophy, our philosophy is very simple, to invest in great businesses at attractive valuations, right? And how do we identify those great businesses? Frankly, it's ESG. ESG is our offices and, and there's a real distinction.

[00:18:41] We see ourselves as investors in businesses, as opposed to traders of securities and many in our industry. If you ask them what defines a great, a great, great investment, the answer you get is a series of financial ratios, right? You get, you know, [00:19:00] high EPS growth, low PE or higher return on invested capital, low price to book, those kinds of answers.

[00:19:10] But going back to my early days as an accountant out on audit, and whenever I, I asked the senior leadership of the business, why that business was a great business, I never got an answer to do with the financial metric. It was always, it's our business model. It's our people, it's our relationship with our employees.

[00:19:29] It's the way we delight our customers. It's the way the loyalty of our suppliers. It's the support we get from our community. It's our brand, it's our reputation. It's these sorts of things that define a great business. And as you can see, many of these are really ESG issues. They are, well, it's certainly the E and the S right, just say, it's, it's all about society.

[00:19:54] It's about employees. It's about customers. It's about suppliers. It's about regulators, [00:20:00] about community. It's about your safety and maintenance and how you look after the environment around you. And these things define a great business. Great businesses then go on to have great commercial success. So they get more customers, more contracts, and that leads to more.

[00:20:18] Great financial success, which is greater revenues and cash flows and margins and earnings and EPS and all of that. And that leads great share price performance, but that's the order of causality. Great businesses have these great extra financial ESG characteristics that drive great commercial success and drive great financial success.

[00:20:46] That drives great share price success. So for us, we look at ESG as, as a, uh, as, as, as an alpha source, it helps us identify great businesses that will be [00:21:00] successful in, in the future. And, uh, you know, we, we look for businesses that create these extra financial assets. Think of that as, I'll give you a very simple example.

[00:21:12] Think of a business that is investing in the future. Investing in R&D costs money. Your short-term profits are, are lower and not only are your short-term profits low, but your margins are lower. Your return on invested capital is lower, but that R&D is what is going to sustain you in the future in the next 3, 5, 10, 15 years.

[00:21:39] Alternatively, there are businesses that, and we see this all the time, that cut R&D to, to meet short-term earnings targets. In our view, all that is doing is borrowing from the future. You're creating a, a liability really that is not on your balance sheet in any way, shape or form, but you [00:22:00] are borrowing from the future and that cutting of R&D.

[00:22:05] To the extent that you've got R&D, your profits are higher, your margins are better. Your cash flows are better, and your return on invested capital is better. And that may make this business look, look wonderful, especially in a long cycle business that has, eight, 10 years cycles. Uh, the first few years, you know, these businesses might look great.

[00:22:25] And, and if you take a purely financial view to, to these businesses, you say that's fantastic. What a great CEO. But in the long run, this is a much less valuable business because it just won't have new products and their customers will be terribly disappointed and will ultimately be, will look for different suppliers.

[00:22:46] So hopefully that gives you an idea that the way we think about ESG, we integrate it into our, I mean, it is, it is the source of our ideas, is a source of [00:23:00] investing, and the source of our returns. Habib, just to unpack that a little bit more, and we're not looking for a specific stock recommendation here, but I think of energy or autos.

[00:23:14] And if you think of a company like Tesla, right? With, with really groundbreaking initiatives and such, but then you talked about established mature companies and you certainly have many of those in the automobile sector. How do you assess, and maybe more so, is it possible for some of these established entities to really evolve?

[00:23:39] Maybe they weren't first mover in EV, but with their established frameworks and such, can they evolve and really have a common role on a go-forward basis, and be it electronic vehicles or other areas? Yes, of course they can evolve. And the reality, Bob, is that when you look back at [00:24:00] history, and we spend a lot of time doing this, it's fair to see very few incumbents.

[00:24:06] You know, that were leaders in, in the, uh, in the industries at that and where the industry faces a discontinuity, very few of the previous leaders, uh, go on to be successful in the next generation. So, I think that is, that is fair to say that that the odds are against them. And, and hence, it's fair to have a degree of skepticism.

[00:24:30] But, eh, that's not to say that that is impossible. We have seen companies turn around, we have seen companies reinvent themselves. Uh, there, there are, I mean, you know, let's not forget companies like Apple where leaders, they then went downhill. Got it, got the whole Steve Jobs back and reinvented themselves.

[00:24:55] Uh, you know, IBM, I'm old enough to remember. IBM really reinvented itself a few times. [00:25:00] Microsoft, arguably people said, had missed the cloud. They caught up fairly rapidly, the number two player in cloud today and so on. So I think there are plenty of examples of businesses being able to reinvent themselves.

[00:25:17] It comes from management having a long-term time horizon and being prepared to make some really tough decisions. Uh it's not easy. I will be the first to, to say, uh, I mean, it was easy, many would have done so. Uh, when you look at the history of, of any industry, uh, I mean, just look at the internet, right?

[00:25:43] I mean, you know, it started off with, um, I dunno, Netscape and AOL and Yahoo and Google, you know, I mean like each stage in that process, AOL the terminal, uh, you know, in sort of 2000, I remember AOL [00:26:00] was the leader. They had the most engineers, they had the biggest brand, the most customers, the biggest R and D budget.

[00:26:07] And yet Yahoo came along and superseded them and then Yahoo were in that position. And then Google came along and superseded them. So, no one has the, the entitlement to, to be at the top of the pile in any industry forever. But that's not to say that companies cant reinvent themselves. And there are many examples across many sectors that have reinvented themselves.

[00:26:35] So one of the biggest challenges within the ESG space is lack of consistency of ESG data. So there are no universal reporting requirements. There's very low correlation of ESG scores between data providers. How do you at RBC handle this issue and more broadly speaking, do you see an industry solution somewhere on the horizon? [00:27:00]

[00:27:00] You know, there is such a proliferation of different ESG data providers and data standards. And I think we will get some, uh, consistency there. And again, it's, it's a sort of an alphabet soup of acronyms, you know, whether it's science-based targets or TCFD and Saxby, and it looks like we are going to get some.

[00:27:24] Standardization in, particularly in terms of carbon reporting and things like that. But that said, I think this is a, this will always be an area that requires judgment and expertise. These are long horizon issues where it's very easy to make a commitment and to have a lovely website and, uh, a great report, uh, with lots of targets and lots of lovely words and pictures of kids running around in Meadows and so on and so forth.

[00:27:58] But with very [00:28:00] little substance behind it, it's all in the execution. So, I think as far as investors are concerned, we will, we, we need better information that obviously makes life easier, but we also have to accept that what we are trying to assess is, in many senses, the personality of a business and the intentionality of that business, what is this business really trying to achieve?

[00:28:30] Are they just trying to achieve short-term gains and tell us investors and the rating agencies and the whole ESG community, you know, tell them what we want to hear, get, you know, get, get us off their back so that they can carry on with the short term profit maximization? Or are they really after long-term value creation and, and there's a real difference between value extraction and value creation.

[00:28:58] And I think this is, for [00:29:00] us, what we, as investors need to evaluate. We need to evaluate intentionality. We need to evaluate purpose. We need to evaluate culture. And this is hard. We have to talk to lots of different people and formulate judgements. These will always be judgments. We will not be right.

[00:29:20] We will make mistakes along the way. After all, management teams are very skilled. You don't get to be a CEO of a global company by, uh, by not being a good presenter. You know, you, you are, you have convinced, you have great presentation skills. You have lots of resources behind you, and you're able to put together a great story for us.

[00:29:46] It is not about what good happened, might happen. What they want you to think is going to happen, but what is most likely going to happen? And that, those are judgments that we as investors cannot shy [00:30:00] away from. So, I think the data will improve. The information will improve, but it will never be completed.

[00:30:10] We are always going to be required to make judgements about the future. And that is about assessing management and the intentionality. That's a key part of it. Absolutely. Well Habib, thank you so much. Do you have any final thoughts that you wanted to share with the listeners or if folks want to learn more about you or more about RBC, where might they go to do that?

[00:30:35] Sure. Well, I think in terms of final thoughts, I mean, one, one thing I do think is going to be very important for the next decade or so is, and that is human capital management. I mean, if, if it wasn't always important, but now with the labor shortage, human capital management up to recently was considered, you know, for IT engineers and [00:31:00] programmers and coders and, and all of that.

[00:31:03] But this phenomena has spread to nurses, to teachers, to doctors, to hospitality workers, to delivery drivers and so on. What is going to differentiate, and in my view, a business's ability to meet the needs of its customers and is going to be able to attract and retain employees and to motivate employees.

[00:31:32] That is going to be a real challenge. Uh, the, the days of treating labor as a factor of production that you have to pay the minimum amount to, to attract the marginal hour. Those days are over. It's about loyal workers who are going to be with you for, for the long haul, who are going to build up expertise and satisfy your customers and your clients.

[00:31:56] I think that's going to become a big issue and it's going to become a [00:32:00] big differentiating factor for those businesses that succeed and fail. Sorry. So that was just, just me as an investor. That is, that is something that is, uh, has really been capturing our thoughts recently. To find out more about us, um, global.RBCgam.com, our website, uh, there's quite a lot of information out there, otherwise connect via LinkedIn.

[00:32:27] And we'd love to hear from you. Well, Habib, thank you so much. These are so complex and nuanced topics and you have shared such thoughtful perspectives and we really appreciate your time and your expertise. So thank you so much for joining us. It's a pleasure. Thanks for having me. Thanks so much happy. That was really terrific.

[00:32:46] And we'll include all of that information in the show notes. And frankly, on this topic of ESG, Fiducient just released our guide to mission-aligned investing, our own Devon Francis coauthored that guide. And it's an absolutely wonderful [00:33:00] resource that provides an extensive overview of our approach to helping clients align their assets with their values.

[00:33:07] And frankly, what to keep in mind as investors explore the landscape of ESG. We'll include that in the show notes as well. So to all you good stewards, thanks for investing time to help your nonprofits prosper. We'll connect with you soon on the next episode. Thank you for listening to the Nonprofit Investment Stewards podcast.

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[00:33:49] Always seek the advice of qualified professionals familiar with your unique circumstances.