

# How and where will millennials invest: the missing link between RI and financial education

Breakout 1B

**Brad Barber**, Associate Dean and Professor of Finance, Graduate School of Management, University of California, Davis

**Mikael Homanen**, PhD Candidate, Cass Business School

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Moderated by **Katherine Ng**, Head of Academic Research, PRI

 **PRIn Person**

# **The Modern Portfolio Theory**

Caveats and Improvements

Saphira Rekker & Gaelle Bouton

 [#PRInPerson](#)

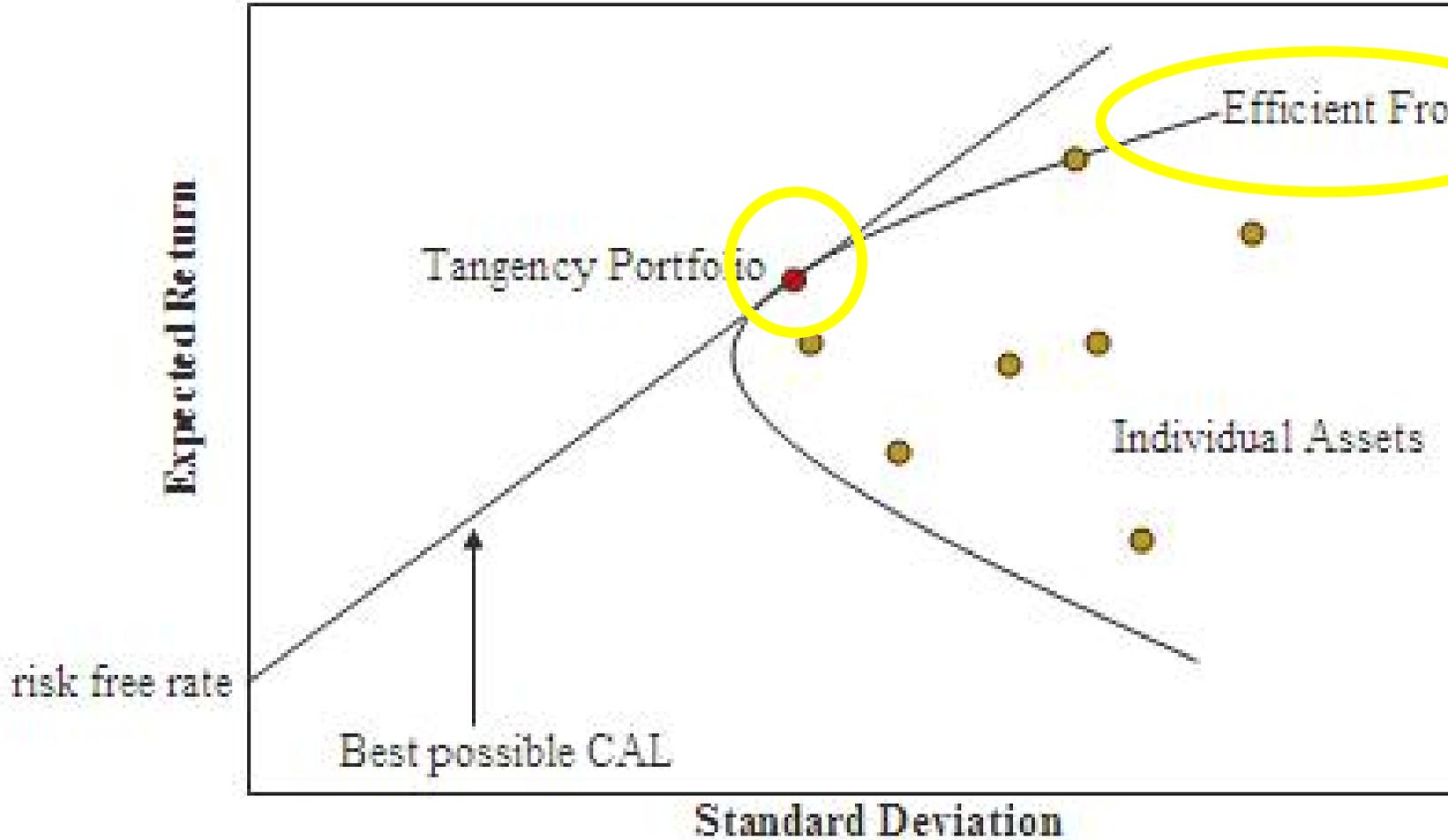
# Waldo/Wally



*"Nobody ever asks: 'How's Wally?'"*

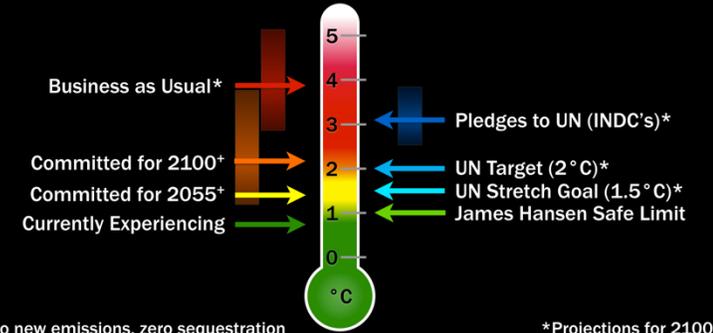
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# MPT



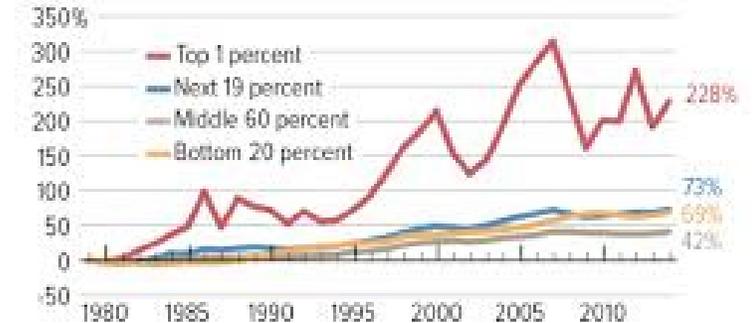
## CLIMATE CHANGE NUMBERS FOR COP21 IN PARIS

Temperature Increases Above Pre-Industrial Levels



## Income Gains at the Top Dwarf Those of Low- and Middle-Income Households

Percent change in income after transfers and taxes since 1979

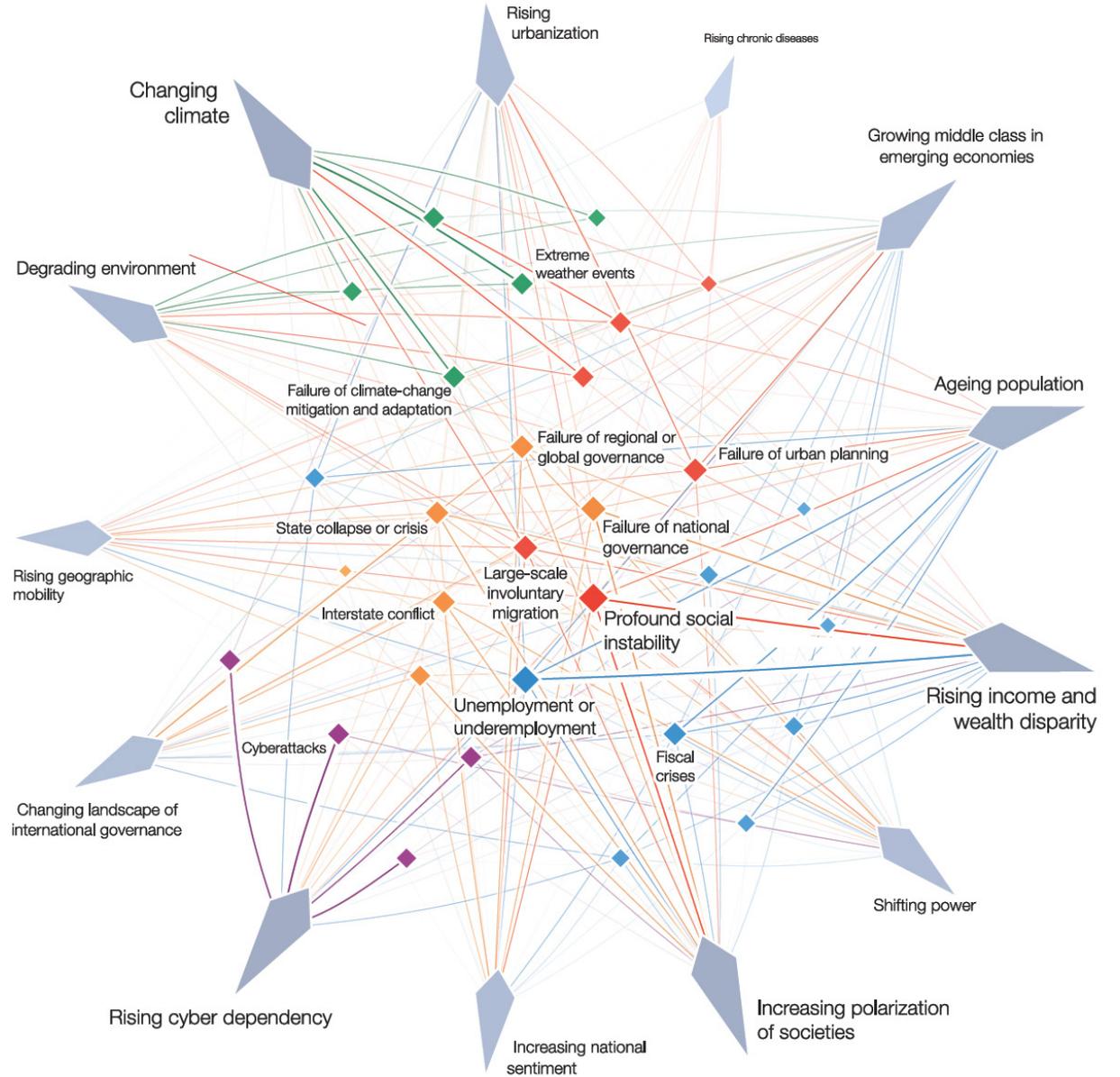
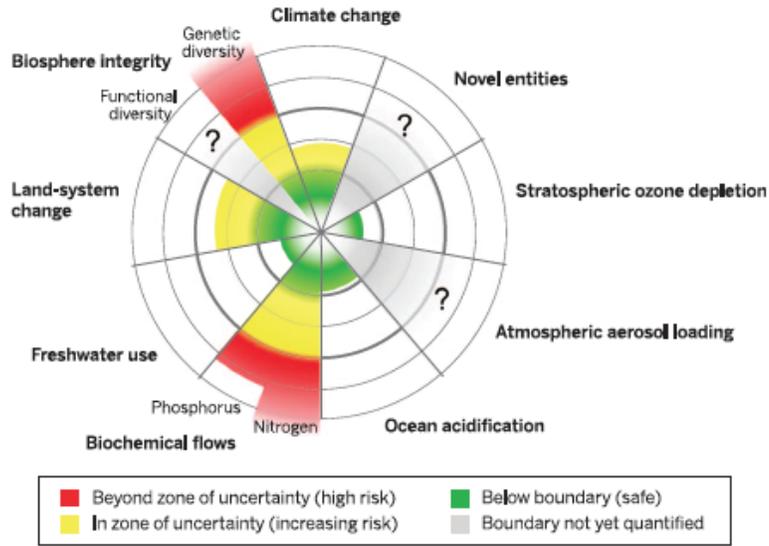


Source: Congressional Budget Office

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

# Global risks

Planetary Boundaries &  
World Economic Forum



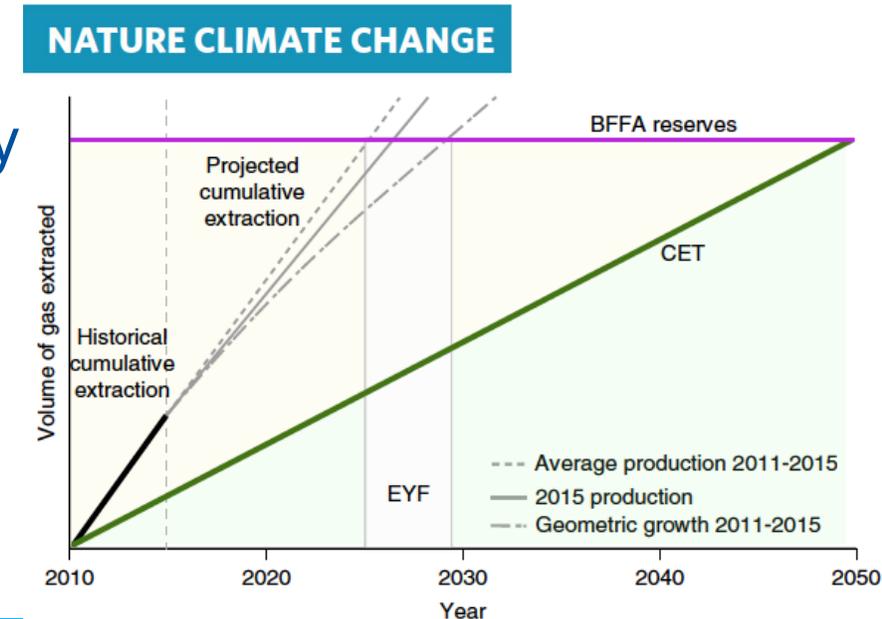
# Limitations

- Investors are “rational” and want the highest return/risk combination
  - Investors will forgo returns for ethical preferences<sup>1</sup>.
- Unsystematic risks seem unimportant; ESG
- What are the **societal impact** of collective investing according to the MPT? (e.g. climate goals)
  - Expectations of returns; time-horizon? Ability to sustain returns? A sustainable economy?

1. Webley, Lewis, & Mackenzie, 2001; Ariely, Bracha & Meier, 2009.

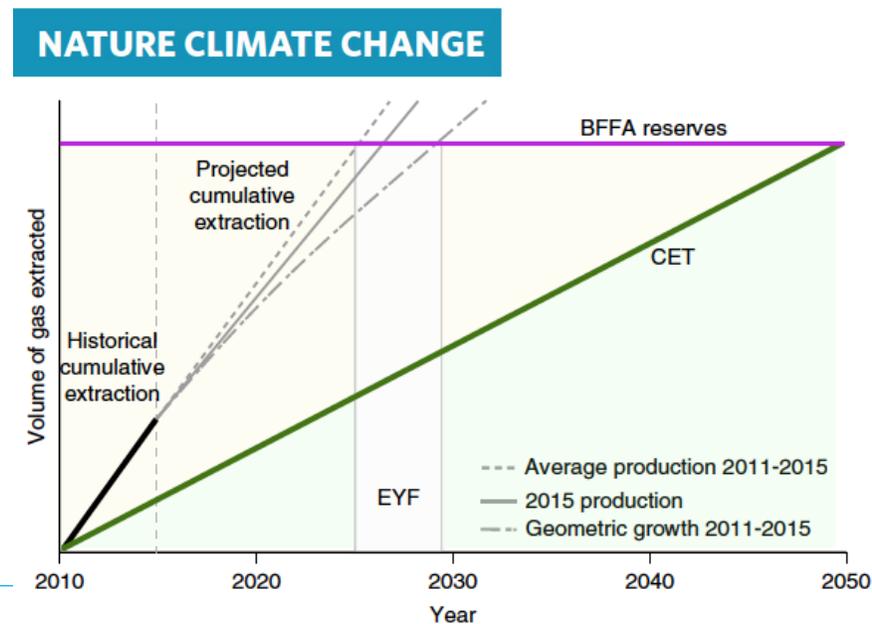
# Improving the curriculum

- **Critical thinking:** Limitations of the MPT
  - Are you “rational”? What do you care about? What is the impact of your investments?
  - Highly important global risks such as climate change, how do they impact society and the economy?
- **Awareness:** Investments shape tomorrow’s economy
- **Broader perspective:** Integration of other sciences
  - Science-based climate targets



# Pipeline Impact on Current Investment Practices

- Critical thinking & Awareness -> increase pool of socially responsible investors
- Broader perspective -> Knowledge and use of other sciences
  - E.g. Energy poverty & science-based targets



## FINANCIAL TIMES

### Oil and gas groups must do more to support climate accord

From Aberdeen Standard Investments et al

Investors are embracing their responsibility for supporting the Paris agreement. It is time for the entire oil and gas industry to do the same.

companies in this sector to clarify how they see their future in a low-carbon world. This should involve making concrete commitments to substantially reduce carbon emissions, assessing the impact of emissions from the use of their products and explaining how the investments they make are compatible with a pathway towards the Paris goal.

### Pressure grows to link carbon targets to the bigger picture

Public scrutiny of companies' carbon emissions has ratcheted up since the adoption of The Paris Agreement on Climate Change in 2015. Under the agreement, almost every country in the world has committed to play an active part in keeping the global temperature rise to 2°C or less above pre-industrial levels.

Against this background of global commitment to climate action, it is no longer considered enough for companies to set arbitrary carbon reduction targets with no connection to the bigger picture. Instead, pressure is growing on companies to cut their carbon emissions in line with the greater global goal.

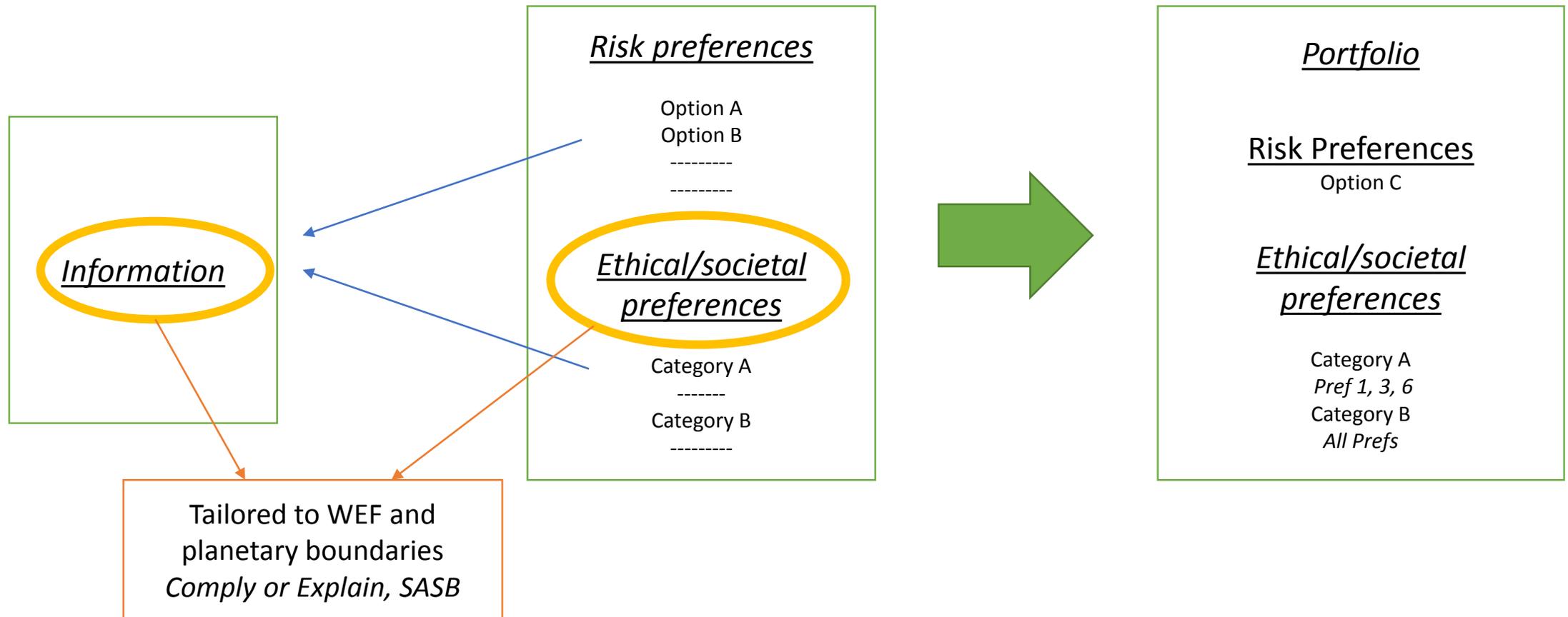


*Adrian King*

**KPMG Global Sustainability Reporting & Assurance Leader and Partner, KPMG Australia**

# Investment industry preparation

- Integrate ESG in the risk/return equation



# **A material model for the responsible investor**

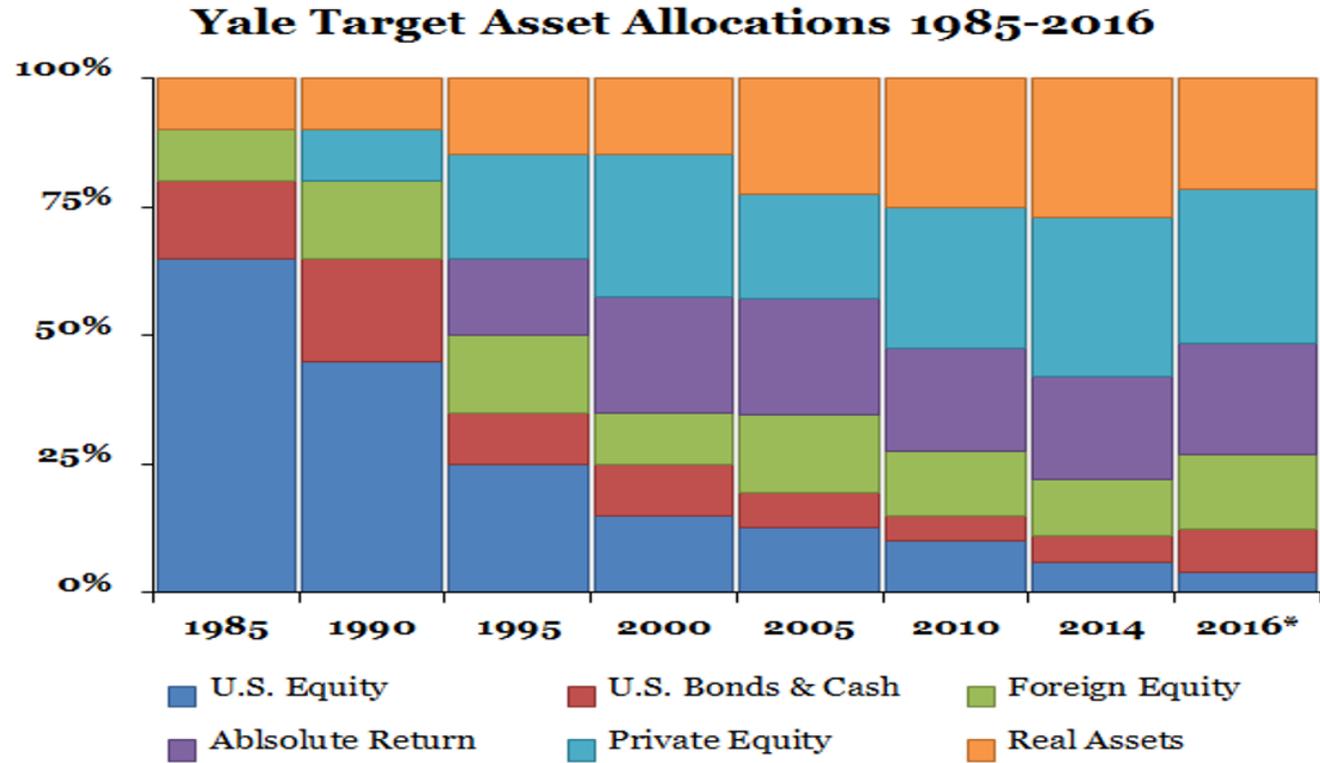
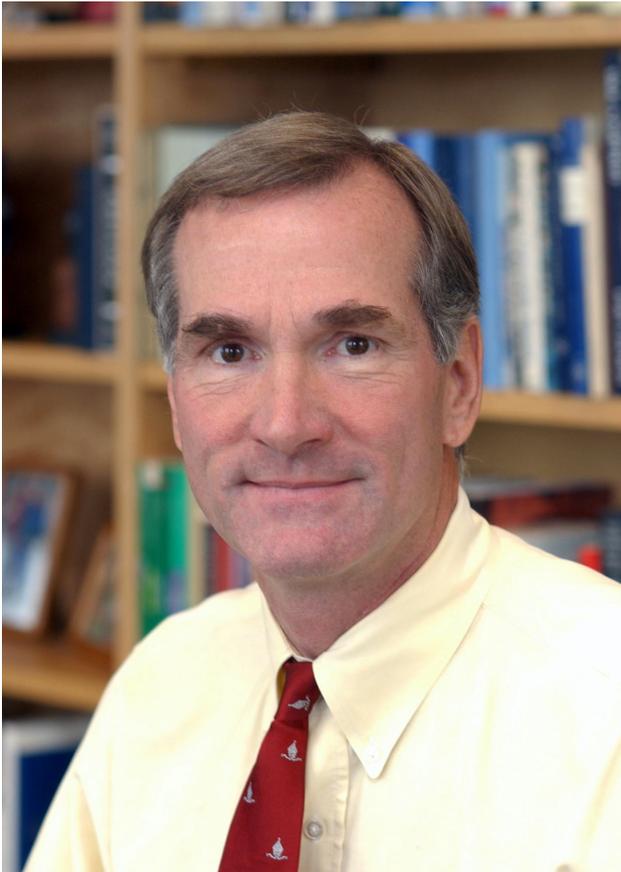
Matthew Worthington-Smith, University of Cape Town

# The context

A model informed by South African insights



# 1. When and where is MPT most useful in practice?



Source: Yale University Endowment annual reports. Note: These allocations are for illustrative purposes only and not recommendations. Endowments are perpetual institutions and individuals are not and thus allocations need to be adjusted for non-perpetual entities.

## 2. What are the limitations of MPT?

### The black swans of tail risk

Lonmin



Steinhoff



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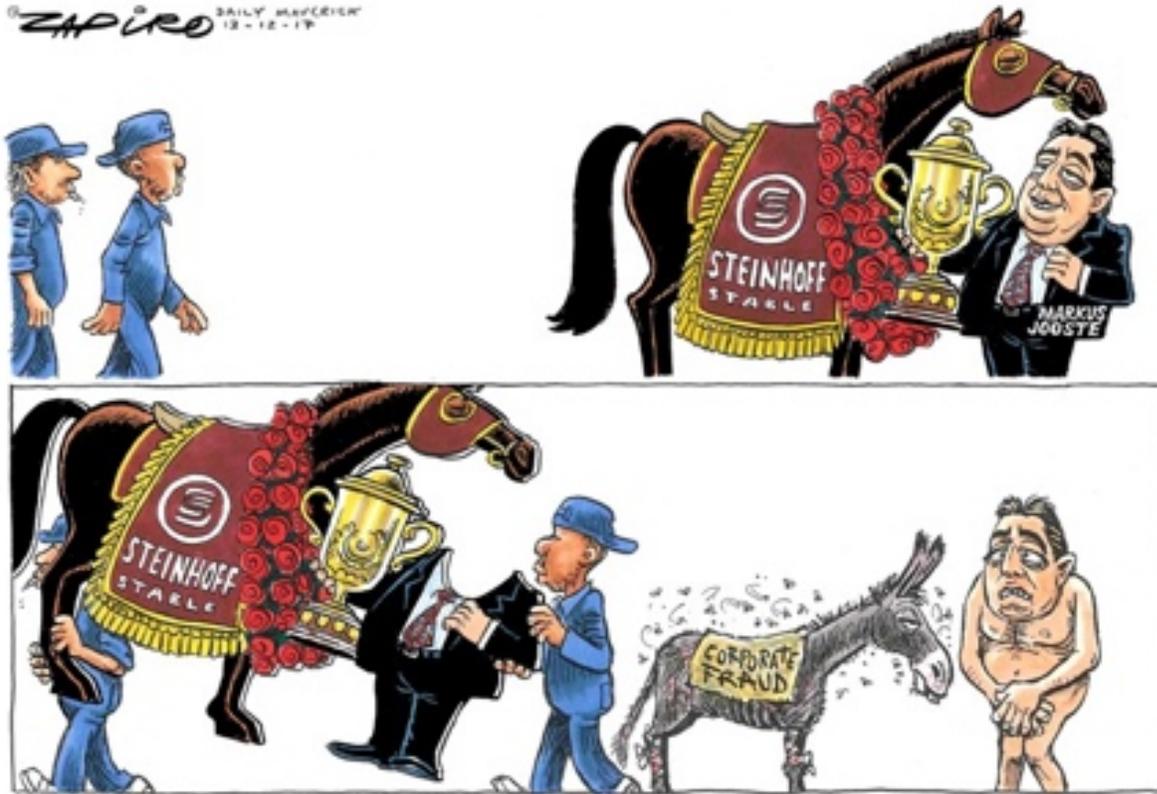
### The Marikana Massacre at Lonmin mine



- The Marikana Massacre took place on the 25<sup>th</sup> Anniversary of the nation wide miners' strike (August 2012)
- 47 total deaths including two security guards
- The Farlam Commission was initiated to investigate the lead up to the massacre
- The reasons for the tension between the miners, mine owners and trade unions were due to a lack of engagement by the mine owners with workers seeking higher pay given their appalling working conditions as well as the lack of community development around the mines.

## 2. What are the limitations of MPT?

### The Steinhoff implosion

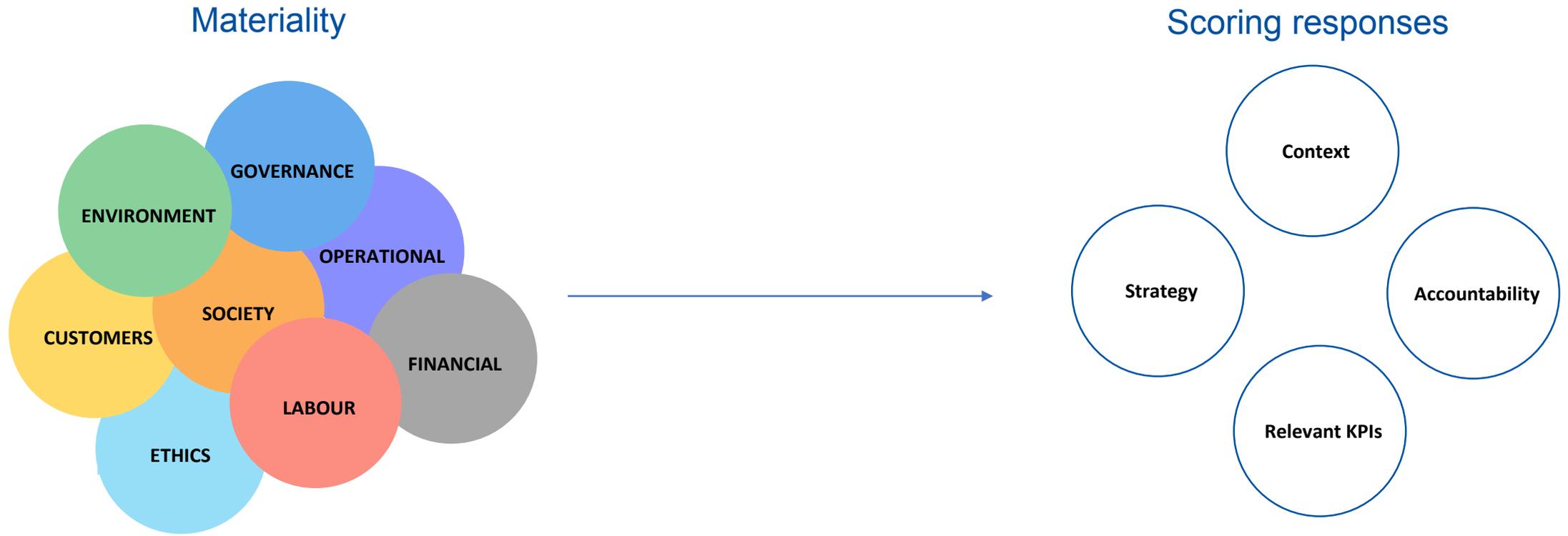


- Possibly South Africa's largest corporate meltdown
- Steinhoff wiped out R200 billion rand (approx. \$13.25bn) during December 2017
- The scandal arose over the auditors refusal to sign off on the financial statements and the subsequent resignation of the CEO Markus Jooste.
- This added to the scandals South African auditors were dealing with at the time, which included KPMG being complicit in the State capture.

### **3. How can these limitations be addressed to improve traditional financial education?**

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A Material Model for the responsible investor



## Steinhoff

Category	Issue	Materiality	Leadership response					Total score
			Context	Accountability	Relevant KPIs	Strategy	Average score	
Governance	Board Balance	30	-10	-8	0	-8	-6,5	-195
Labour	Fair labour	30	2	3	-2	-3	0	0
Customers	Treatment of customers	27	-5	-5	-3	-2	-3,75	-101.25
Environment	Bio-physical impact	25	3	4	4	2	3,25	81.25
Customers	Product suitability	25	-3	-2	-2	-1	-2	-50
Societal	Industry equity	24	-2	0	-3	-3	-2	-48

## **4. How do you believe current investment practices will be impacted by the changes in the knowledge and capabilities of the talent pipeline?**

- Allocate capital to more maturely managed firms

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- Allocate capital to more maturely managed firms
- Leaders will have to apply their minds to better standards of reporting
- Better ESG integration through broader research

## **5. Three main actions the investment industry could take to be prepared for this change.**

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1. Online structured training for current investment professionals
2. Developing a crowd-sourcing platform for gathering materiality information
3. Elevate the proposed model to industry standard whereby it can gain acceptance across the global market

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## **Considering the two presentations in terms of likelihood, innovation and strength of impact, which is the future for responsible investment?**

- Presentation 1: Saphira
- Presentation 2: Matthew



# PRi in Person

## Join us for the Welcome Reception

Coaches depart at 18.45. Please gather at the hotel check in area from 18.30.



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