

June 14, 2019

Dear clients and colleagues,

This week we attended the 2019 CalPERS & CalSTRS Diversity Forum in Sacramento, California. CalPERS (The California Public Employees' Retirement System) and CalSTRS (The California State Teachers' Retirement System) are the two largest pension funds in the United States. This is the fifth forum of this kind, featuring experts from McKinsey, Goldman Sachs, State Street, The Carlyle Group, Ernst & Young, CFA Institute and Lancaster University, to name a few. Over 400 people participated, mostly investment managers. We found the sessions very educational and would like to share some takeaways with you.

First of all, how do we define Diversity and Inclusion?

A very interesting quote we heard at the Forum was: "Diversity is being asked to the party. Inclusion is being asked to dance."

Diversity often refers to the variety of similarities and differences among people, and includes a wide range of factors, such as gender, race, ethnicity, religion, disability and work style.

Inclusion is a dynamic state of operating in which diversity is leveraged to create a fair, healthy and high-performing organization or community. An inclusive environment ensures equitable access to resources and opportunities for all.

What did the data tell us?

McKinsey issued a diversity report in 2018 based on a large data set of over 1,000 companies in 12 countries. The findings were:

- There is a statistically significant correlation between a more diverse leadership team and financial outperformance.
- Leadership roles matter. Companies in the top quartile for gender diversity on executive teams were 21% more likely to outperform in terms of profitability and 27% more likely to have superior value creation.
- It's not just about gender. Companies in the top quartile for ethnic/culture diversity on executive teams were 33% more likely to have industry-leading profitability.
- There is a penalty for opting out. Companies in the bottom quartile for both gender and ethnic/culture diversity were 29% less likely to achieve above-average profitability.

Why do Diversity and Inclusion matter for investment management firms now?

- **Structural changes:** As the investment management industry faces increasing challenges from margin pressures, technological disruption and fierce competition, successful firms must be able to attract and retain the best talent. To achieve this, an inclusive culture that effectively leverages diverse views is very important.
- **Millennial talent:** The 2018 Deloitte Millennial Survey found that most millennials (83%) and Gen Zers (80%) believe that business success should be measured by more than financial performance. Diversity/inclusion and flexibility are important keys to happiness.
- **Regulators and policymakers:** Diversity is part of the larger conduct and culture focus of regulators. The new UK gender pay disclosure requirement is a good example.
- **Client demand:** CFA Institute conducted a survey of more than 800 institutional investors. Eighty-three percent said gender diversity is important to them. Fifty-five percent believed that gender diversity on investment teams leads to better performance through diverse viewpoints.
- **Teams dominate:** There has been a shift from the “star portfolio manager” model to investment teams. According to Morningstar, seventy-five percent of actively managed US equity funds and fixed income funds are run by teams.
- **Awareness of biases:** Behavioural finance is playing a more important role in studying how we all behave. An inclusive culture helps to understand and mitigate our biases.

At Global Alpha, we strongly believe that team diversity is a key contributor to successful investing. It has been a deliberate practice at the firm to build a team of investment professionals with different genders, backgrounds and experiences. When hiring, we look for candidates who can work well within a team environment and who are able to demonstrate flexibility and resilience when faced with difficult portfolio management decisions.

One of our three founders is a female minority. Among the six members of our management team, two are female and three are minorities. Of the ten people that make up the entire Global Alpha team, three are female and five are minorities.

In conclusion, there is no doubt that the business case for diversity is compelling. Building a truly inclusive culture takes a long-term tremendous effort, but it’s well worth it.

Have a great weekend.

The Global Alpha team