

## Institutional ESG All Cap Value Strategy

2Q10

### Market Review

We continue to believe the stock market is in the early stages of its 4- to 5-year cycle and that it makes sense to focus on companies that will be leveraged by an improvement in economic activity in the next few years. This approach may stand in contrast to the high and growing levels of pessimism on the part of many investors at this time.

### Portfolio Highlights

During the second quarter, stock selection and interaction in the health care sector contributed to relative performance, whereas stock selection and interaction in the energy and materials sectors were the largest detractors. Relative to the Russell 3000 Index, at the end of the second quarter, the Strategy's largest overweight positions were in the energy and industrials sectors. The Strategy's largest relative underweight positions at the end of the period were in the consumer staples and health care sectors.

During the quarter, we added a new position to the portfolio in Noble Energy (energy), while we sold out of existing Fund positions in Marriott International (consumer discretionary), Mitsubishi UFJ Financial Group Inc. (financials), Murphy Oil Corp. (energy) and Robert Half International Inc. (industrials). The top contributors to Strategy performance included Ericsson (ADR) in the information technology sector, Lawson Software Inc. in the information technology sector, Allied World Assurance Co. in the financials sector, Marriott International Inc. in the consumer discretionary sector and Noble Energy Inc. in the energy sector. Top detractors for the second quarter included Anadarko Petroleum Corp. in the energy sector, United States Steel Corp. in the materials sector, eBay Inc. in the information technology sector, Safeway Inc. in the consumer staples sector and Microsoft Corp. in the information technology sector.

### Outlook

The most important missing ingredient today is confidence. Confidence is easy to have in the best of times, but it is possible to foster it even when conditions are not great, as is the situation now. The bottom line is this: Pessimism is at very high levels in the stock market (positive). We also look for some good news in the next 30 to 60 days. We expect a stronger stock market between now and year-end. It is our opinion that the probability of a very strong advance is significantly greater than a material decline from here. We believe many economic and political concerns are factored into stock prices at this time. Even modest positive surprises could cause a significant advance for stocks.

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- MBA from Stanford's Graduate School of Business
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## Environmental, Social and Governance Investment Update

On the Environmental, Social and Governance (ESG) front, we'd like to discuss one of the most prevalent global issues today: the exploitation of labor rights. In particular, one of the fastest growing problems afflicting workers around the world, including the U.S., is human trafficking, forced labor and modern-day slavery.

According to a recently published report<sup>1</sup> by the non-governmental organization Verité, an estimated 12 to 27 million people are currently victims of modern-day slavery and other forms of forced labor around the world. In the U.S. alone, more than 10,000 people are forced to work at any given time. This report addresses current labor broker practices and the subsequent effects on the lives of the estimated 200 million international migrant workers involving 161 countries that serve as a source, a transit point or a destination for human trafficking.

**“In examining causes of the proliferation of labor exploitation overseas, poor governance and corruption are seen as key issues in trade and business operations.”**

In the Verité report, the key findings highlight the intersection of brokers, migrant workers and slavery. For example, in the Indian domestic garment manufacturing industry, juvenile girls may be forced to work 12-15 hour or 24-hour shifts under three-year contracts for a lump-sum payment of \$750, all the while being exposed to hazardous chemicals and other safety risks, isolated from their families and the outside world. Another example is in the U.S. agricultural sector, where Guatemalan, Mexican and Thai migrant workers, both documented and undocumented, are regularly trapped into forced labor through exorbitant broker fees, threats of violence and wages below the legal minimum.

In examining causes of the proliferation of labor exploitation overseas, poor governance and corruption are seen as key issues in trade and business operations.<sup>2</sup> In a World Bank study, six measures of country-level governance were analyzed with regard to the impact on the economy: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and the control of corruption.<sup>3</sup> Poor governance has been cited to have contributed to labor strikes or work stoppages, which, as noted in a World Bank study on Bangladesh, could cost the country \$60 million each day and cost the government 3-4% of GDP each year.<sup>4</sup>

Given the rise of globalization and international expansion, many of the companies in our portfolios will often outsource a portion of their labor needs and be indirectly involved with factory labor through their supply chain.

As investors, we can work directly with our companies to increase the transparency and reporting around labor practices and sourcing policies. We can ask companies about their recruitment and hiring practices and whether or not they conduct audits of their factories and monitor the enforcement of standards. Equally important in our view, we can ask companies about their remediation process in cases where violations are discovered.

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<sup>1</sup> “Help Wanted: Hiring, Human Trafficking and Modern-Day Slavery in the Global Economy,” [www.verite.org](http://www.verite.org).

<sup>2</sup> Citigroup Global Markets, Inc. Economic and Market Analysis: “Bangladesh 2007: Economy Holding Up Despite Politics”, 12 April 2007.

<sup>3</sup> “Measuring Governance Using Cross-Country Perceptions Data,” Kaufmann, Kraay and Mastruzzi, The World Bank, August 2005.

<sup>4</sup> See Citigroup.

# PORTFOLIO MANAGER COMMENTARY



For over a decade, in our ESG Investment Program, we have funded research on sweatshop and forced labor practices at the companies in our investment universe. [Please contact us for a copy of our current screening guidelines on Sweatshop and Child Labor Issues.] The results of the research have been both positive and challenging in that much progress has been made in the various sectors that source factory and low-wage workers with regard to human rights and labor standards. However, as the recent Verité report has shown, there is much more work to be done across the globe to improve fair labor conditions and end modern slavery.

As always, thank you for your support of our ESG Program.

**Past performance is no guarantee of future results.**

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