BARRON'S
THE DOW JONES BUSINESS AND FINANCIAL WEEKLY www.barrons.com JULY 10, 2017

FEATURE

Wonder Women: Capitalizing on Gender Equality

Companies that have women in leadership positions actually outperform those that don't.

By SARAH MAX

Three decades ago, veteran investor Jerome Dodson started asking the same question of many CEOs: "Have you thought about adding women to the board?" The founder and CEO of Parnassus Investments and manager of the top-performing Parnassus Endeavor fund says he was usually disappointed in the answer: "They said, 'What does that have to do with business?' "

Turns out, it has quite a lot to do with business. Consider Uber Technologies, where ongoing allegations about sexism contributed to co-founder Travis Kalanick's resignation and cast a pall over the privately held company. Lululemon Athletica (ticker: LULU) founder Chip Wilson's comment that his yoga pants don't work for larger women did investors no favors; the stock lost 36% of its value in six months after that remark and others—ultimately ending with his resignation.

But it's not just about headline risk: A steady stream of research over the past several years suggests that companies that score well on gender equality—based on factors such as the percentage of women on the board or in senior management, or progressive workplace policies—have a tangible edge over less-diverse peers. Greater equality has been linked to higher returns on equity, stronger dividend payouts, and lower stock volatility, to name a few key indicators.

"What the research points to is that it's not so much women versus men; it's that diverse groups perform better than non-diverse groups," says Joe Keefe, CEO of Pax World Management, which bases investment decisions in part on environmental, social, and governance, or ESG, factors, along with traditional metrics. Keefe's firm has petitioned the Securities and Exchange Commission to require that companies disclose diversity-related statistics. "Where women are better represented in corporate management, companies simply perform better," he says.

In an analysis of 3,000 global companies, for instance, Credit Suisse found that shares of companies with at least one female director outperformed those with no female directors by at least 3.5% a year from 2005 to 2016.

Because companies aren't required to disclose gender-related employee data, studies on gender equality typically focus on corporate boards. Women held roughly one in five Fortune 500 board seats in 2016, according to the latest tally from Deloitte and the Alliance for Board Diversity, a collaboration of leadership organizations aimed at promoting inclusion of women and minorities on corporate boards. That's an improvement since 2010, when it was fewer than one in six, but that distribution is "slanted toward certain sectors," says Lynn Blake, chief investment officer of Global Equity Beta Solutions at State Street Global Advisors. Health care and consumer staples, for instance, tend to score better on gender diversity, while energy and technology tend to lag behind.

Joseph Keefe, president & CEO of Pax World Funds and Pax World Management. *Photo supplied by Pax World Management*

Morgan Stanley's Sustainable and Responsible Investment and Global Quantitative Research teams recently took a broader look at gender diversity, factoring for the percentage of female employees, managers, and directors, as well as company policies or programs that promote equality. The team found that the most gender-diverse companies had a higher return on equity—0.7 of a percentage point a year, on average—than their regional sector peers, and a 1.1-percentage-point better annual return on equity than companies that ranked poorly.

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WHETHER CAUSE OR EFFECT, or both, it stands to reason. The researchers concluded that gender diversity is not only associated with higher levels of employee satisfaction— which translates to better returns, according to researchers at the London Business School—but also leads to better decision making, more innovation, and stronger connections with customers, who for many industries are predominantly female.

The economic benefits of more equality go beyond a single company's performance. "There is a strong business case for answering the global needs of women," says Jyoti Chopra, BNY Mellon's head of global citizenship and sustainability. The BNY Mellon and United Nations Foundation estimate that offering women better access to products and services in five areas—child care, contraception, water, energy, and telecommunications—could boost incremental annual spending by $300 billion by 2025. All told, narrowing the gender gap could raise global gross domestic product by $12 trillion a year, according to the McKinsey Global Institute.

This facet of ESG investing is still in its early days, but the fund industry has stepped up its interest in gender equality of late. Some of this is probably driven by research linking equality and performance. The industry's efforts to cater to women, who are primary breadwinners in 40% of U.S. households and control more than half of the personal wealth, according to the BMO Wealth Institute, is also a motivating factor. "Women as investors are becoming a bigger force, and they are consistently showing more interest in ESG in general," says Jon Hale, who heads up sustainability research at Morningstar.

Earlier this year, State Street Global Advisors installed its Fearless Girl bronze statue in front of the iconic Wall Street bull in the same week it said that it would look at board diversity when voting on directors; it also wrote letters to 3,500 companies urging them to take action. "Almost 25% of the largest U.S. public companies still have no women on their boards," says Blake, noting that this is a firmwide initiative for State Street Corp. (STT), which has over $2.5 trillion in assets under management. (Women represent 47% of State Street's global employees, 22% of its executive vice presidents, and 28% of its senior vice presidents.)

Neuberger Berman recently evaluated the gender diversity of companies in its NB SRI strategy, which includes the $2.4 billion Neuberger Berman Socially Responsive fund (NBSRX), launched in 1994. It found that 99% of its holdings had at least one woman on the board, and 82% had established diversity programs and initiatives. While the fund doesn't explicitly screen for gender diversity, it is one quality indicator, particularly for growth companies. "If you're trying to grow, and attract and hire people in an environment where we have low unemployment, thinking about how to position yourself as an employer of choice is important," says Ingrid Dyott, a co-manager of the fund, whose retail shares are up an average of 8.9% a year over the past 15 years, slightly better than the S&P 500 and its large-growth category peers.

FOR INVESTORS looking to allocate funds explicitly to companies that rank relatively high on gender diversity, there are two funds.

Launched in 1993, the $146 million Pax Ellevate Global Women's Index (PXWEX) has gone through a few iterations. In 2007, Pax World Management took over the fund, and in 2014 converted it to an index fund managed in conjunction with Ellevate Asset Management, founded by former Merrill Lynch Wealth Management CEO Sallie Krawcheck. Over the past three years, just after converting to an index fund, it has averaged annual returns of 5.6%, versus 1.2% for its world stock fund peers.

The index starts with the MSCI World Index, then zeroes in on the top quartile based on gender equality, as measured primarily by the percentage of women on the board and in senior management, in addition to other ESG factors.

At top holding Microsoft (MSFT), for example, women represent 25% of the board of directors and 20% of executive officers, including Chief Financial Officer Amy Hood. Part of senior leaders' compensation is tied to diversity gains in their respective organizations; women represented 27.7% of all new-employee hires in 2016 and earned $0.998 for every $1 earned by men. Another top holding, regional bank KeyCorp (KEY), has more than 30% female representation on its board and nearly as much among executive officers; in 2016, 62% of all new hires were women.

Although the fund is passive, Pax Ellevate generally opposes director slates for boards with fewer than two women, and it has petitioned the SEC to require companies to disclose the percentage pay gap between male and female employees. It has also filed or co-filed shareholder resolutions with companies to disclose differences in pay according to gender, and take steps to address them. Apple (AAPL), Amazon.com (AMZN), and eBay (EBAY), to name a few, have since publicly disclosed the results of their gender pay assessments, says Keefe.

The $324 million SPDR SSGA Gender Diversity Index exchange-traded fund (SHE) launched in March 2016 with seed money from the California State Teachers' Retirement System. The idea, says SSGA's Blake, was spurred by CalSTRS' interest in helping move the needle on gender diversity.

The ETF focuses on U.S. companies that rank high for diversity within their respective sectors, based on board composition and senior-level management. It tracks 185 stocks, but its top 10 holdings represent 36% of assets, led by Pfizer (PFE), PepsiCo (PEP), and Amgen (AMGN).

It's too early to say whether all of this will pay off over the long term, but so far the strategy has trailed the broader index. It's up 15.3% over the past 12 months, versus the S&P 500's 18.9%. This stems in part from the fund's overweighting in health care and underweighting in technology. Moreover, the fund has no exposure to highflying FANG stocks, which don't rank as high as other tech names on gender diversity.

Of course, the fund industry has its own issues with gender, much to the frustration of investors who are scrutinizing diversity. "It is embarrassing that my industry has so few women," says Parnassus' Dodson, who counts diversity and workplace quality as key considerations in his stock-picking. "Even in our firm [where four of the 15 people on the investment team are women], we've had to really make it a priority."

Women are the sole portfolio managers on just 3% of U.S. mutual funds, overseeing less than 2% of the $12.6 trillion in U.S. fund assets, according to Morningstar. "We're still woefully underrepresented, but I'm confident that it's changing," says Dyott, who points to the growing number of female candidates interviewing for investment positions. It's a sea change from when she started at Neuberger 20 years ago.

The annualized returns for the Pax Ellevate Global Women's Index Fund – Individual Investor class as of 06/30/2017 were, 1 year: 16.46%, 3 year: 5.66%, 5 year: 11.02%, 10 year: 3.42%. The annualized returns for the Pax Ellevate Global Women's Index Fund – Institutional class as of 06/30/2017 were, 1 year: 16.83%, 3 year: 5.93%, 5: year 11.31%, 10 year: 3.68%. The returns for the MSCI World Index as of 06/30/2017 were, 1 year: 18.20%, 3 year: 5.24%, 5 year: 11.38%, 10 year: 3.97%. The returns for the Pax Global Women's Leadership Index as of 6/30/2017 were, 1 year: 17.42% and 3 year: 6.50%.

Performance data quoted represent past performance, which does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For most recent month-end performance information, visit www.paxworld.com.

Total annual Pax Ellevate Global Women's Index Fund operating expenses, gross of any fee waivers or reimbursements, for Institutional Class and Individual Investor Class shares are 0.65% and 0.90%, respectively, as of 5/1/2017 prospectus.

Top Ten holdings as of 6/30/2017: Microsoft Corp. 2.7%, Principal Financial Group, Inc. 2.0%, Johnson & Johnson 1.9%, Texas Instruments, Inc. 1.9%, Facebook, Inc., Class A 1.9%, KeyCorp. 1.9%, salesforce.com, inc. 1.8%, NIKE, Inc., Class B 1.7%, Abbott Laboratories 1.5%, Alphabet, Inc., Class C 1.5%. Holdings are subject to change.

The Pax Ellevate Global Women's Index Fund seeks investment returns that closely correspond to or exceed the price and yield performance, before fees and expenses, of the Pax Global Women's Leadership Index, the first broad-market index of the highest-rated companies in the world in advancing women's leadership, as rated by Pax World Gender Analytics.

Definitions:

ESG – Environmental, social and governance.

Return on Equity (ROE) – Return on equity is the amount of net income returned as a percentage of shareholders equity.

S&P 500 Index – The S&P 500 Index is an unmanaged index of large capitalization common stocks.

MSCI World Index – The MSCI World (Net) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. The MSCI World (Net) Index consists of the following 23 developed market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States. One cannot invest directly in an index

RISKS: Equity investments are subject to market fluctuations, the Fund's share price can fall because of weakness in the broad market, a particular industry, or specific holdings. The Fund does not take defensive positions in declining markets. The Fund's performance would likely be adversely affected by a decline in the Index. Investments in emerging markets and non-U.S. securities are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation, intervention and political developments. There is no guarantee that the objective will be met and diversification does not eliminate risk.

You should consider a fund's investment objectives, risks, and charges and expenses carefully before investing. For this and other information, call 800.767.1729 or visit www.paxworld.com for a fund prospectus and read it carefully before investing.

Holdings listed in this article are subject to change. This information is not a recommendation to buy to sell any security.

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