

#postCOVID19 Part One

Featuring: **Linda-Eling Lee**, Global Head of ESG Research at MSCI

Adam Bass: This is MSCI Perspectives. Your source for weekly research insights as investors respond to the COVID-19 pandemic. I'm your host Adam Bass, and today is May 21st, 2020. A bit of housekeeping. Those who prefer to listen to podcasts on Google podcasts can now find MSCI Perspectives there. That's in addition of course, to Apple podcast, Stitcher, and Spotify. This week, the first of a two part series, we look at environmental, social, and governance or ESG investing. ESG has been resilient through the crisis, but it may also play an important role in the recovery. To learn more, we turn to Linda-Eling Lee, global head of ESG research at MSCI. Linda, welcome. How have you been doing these past few months?

Linda-Eling Lee: I'm doing really pretty well. I am here in New York, and it's been great, actually, to be a bit hunkered down and really kind of focus. But I actually haven't heard on these podcasts how you're doing, Adam. How are you?

Adam Bass: Well, you're right. No one has asked me that. So, thank you. All things considered, I'm doing all right. I'm hunkered down with my family as well. And I've noticed all this togetherness has actually sparked an evolution of our family dynamic in an interesting but positive way that I truly hope will carry on.

Linda-Eling Lee: Well, I think that's great to hear.

Adam Bass: Okay. Now that you've sufficiently embarrassed me, let's get to the topic at hand. It really seems like ESG is having a moment right now. Many of our guests have commented on that, but now that we have you here, what themes have you seen emerge? What are investors focused on?

Linda-Eling Lee: In the early phases, they were very initially focused on the supply chain impacts from the lockdowns in China and Asia, but what has really emerged, I think, as the real story here, in terms of what investors have been really focused on during this pandemic when it comes to ESG, is on the S in the ESG. They're really converged on this issue related to people. So this is really actually kind of a new phenomenon. I've been in the ESG research field for well over a decade, and I have never seen S be the number one issue that investors are talking about and caring about and asking about. It's

always been much more around governance, and then more recently around environmental and climate issues.

Adam Bass: That's a bit surprising, given that so many companies are under financial stress.

Linda-Eling Lee: I think investors are asking these questions, not really because they have such strong opinions about the very specific policies or procedures that companies have in place, but because, I think, how well companies are managing their people issues, it's a good indication, it's a proxy measure for the quality of management and the company's ability to be really agile and resilient and innovative, especially in the face of this crisis and beyond.

Adam Bass: Can you give us an example?

Linda-Eling Lee: In the US electricity market, the infrastructure is really aging, and that is going to mean more and longer power outages. And at the same time, this virus is estimated to affect up to 40% of US utilities workers, due to sickness or quarantine measures. So investors could look to differentiate utilities that can be better positioned to manage service disruptions because maybe their human capital programs could help minimize some of the disease that's spreading among their workforce.

Linda-Eling Lee: A second example would be around layoffs and executive compensation, that [inaudible 00:03:40] kind of grabs the headlines. We've all seen a lot of headlines that some CEOs, they've taken pay cuts, while they are affecting layoffs. Some that the other ones have, for example, given employees raises across the board. And when we've seen these announcements, sometimes they generate good publicity, but what's really important, I think, to investors is to know how well an executive pay has been aligned with performance, and really how far apart they see his pay is from the average worker.

Adam Bass: Pay disparity has been a focus for some time, even before the crisis. It's just one of the many trends, it seems, to have brought into sharper focus. But one day, hopefully soon, we will start transitioning to a post-COVID world. What have you and your team seen emerging in terms of themes?

Linda-Eling Lee: So over the last couple of weeks, what we've started to do was a little project to put together a series of charts that help illuminate where the post-COVID world might be headed. We're not really prognosticating or predicting, but we wanted to bring some interesting data to help investors think about the way the world might be changing in a more fundamental way post-COVID. And I would

probably group those 10 charts and analysis under three headings. And the first one is really around macro level systemic risks. So the pandemic has really crystallized for investors the fact that we face some of these interconnected systemic challenges that can actually really bring down our society and economy pretty quickly. And they are not really risks that you can actually easily diversify away.

Adam Bass: Let's dive right in. What are some of those risks?

Linda-Eling Lee: Really, the top of that list is inequality. There is a great deal of inequality in our economy, which is now just being exacerbated by the pandemic. And our policy response to it, we had headlined, actually, one of our pieces around that from occupy Wall Street to potentially occupy Zoom conference because at this last crisis, of course, the financial crisis has sparked this backlash against Wall Street. But this one could actually spark a backlash against the more digitally privileged people who can all work safely from home. And they are really very clustered around the tech sector.

Adam Bass: Sounds like another brick in the digital divide wall. What's behind that?

Linda-Eling Lee: On the one hand, you have workers who are primarily working in technology fields or technology enabled fields. They're highly educated. They are more highly compensated. And their ability to work from home keeps them much safer than the workers that are clustered in the part of the chart that is less educated, less well-paid, much more exposed to contagion from social proximity, because there are in industries like restaurants and retail and ports and airports and so forth.

Adam Bass: And it certainly exposes some of the vulnerabilities that were already present within the social and healthcare infrastructures.

Linda-Eling Lee: Yeah, definitely. I think that's what it is. So for one example, we know that the incentives in our drug development process is towards more lifestyle drugs like Viagra, and much less towards drugs that have a public health benefit like vaccines. Right now, we already know that there are huge risks with anti microbial resistance, for example, but only 9% of healthcare companies even acknowledge that as a potential risk, let alone actually have R&D programs to address that.

Adam Bass: We've also heard a lot about people looking to move out of cities. I read the other day that about 5% of New Yorkers left town to shelter in place elsewhere. You have to wonder whether this is temporary, or if people start to think, "Hey, maybe the suburbs aren't so bad."

Linda-Eling Lee: I'm actually really fascinated to see what happens over the next couple of years. Of course, at migration towards the suburbs or exurbs, it could actually mean, ironically, more risks because outward migration means that you're going to have more human encroachment into wild areas. Spreading out from urban centers actually means that you're losing a buffer zone between inhabited and uninhabited land. And this loss of buffer zone can kind of accelerate things like the emergence of the next pandemic. In fact, 70% of new infectious diseases in humans actually originate from another species. And at the same time, if you are losing a wild lands and decreasing biodiversity, it can actually shrink the pool of novel drug compounds. We've already been projected to lose one important drug every other year, just from this current loss rate of biodiversity. So this is the kind of interconnected, systemic risks that I think that we'll really have to think a lot harder about in a post-COVID world.

Adam Bass: That's all for this week. Thanks to Linda and to all of you for joining us, be sure to tune in next week for the rest of our conversation with Linda-Eling Lee, when we discuss micro trends emerging from the crisis, creating new risks and potential opportunities. We also asked the question, how green will the eventual recovery be?

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