Adaptation and Evolution

The best companies adapt. They build on a durable existing business by investing in options that pave a path for continued profitable growth. This is true not only for companies but for investment firms as well. Because markets evolve, we know that we have to be adaptive in how and where we seek opportunities. It is always “different this time”—it’s just a matter of degree.

At Berkshire Hathaway’s annual meeting in 2017, Warren Buffett noted a sea change in the investment landscape: today’s largest and highest-quality businesses flourish with little tangible capital. The following day, he again mentioned the idea and added that “I don’t think people appreciated it—at all.” Investors who fail to recognize the circumstances that create opportunity will find it harder to adopt strategies that succeed than investors whose beliefs match reality.

Accumulated intellectual property, including brands and patents, now creates more value for shareholders than manufacturing plants and storefronts. Communication channels that used to be closed to all but the richest advertisers are now open, supported by large follower counts, and reflective of a collective social consciousness. Today’s leading companies employ talented knowledge workers who create products with purpose. It is this sense of purpose that creates demand. Success requires cultural alignment between employees and customers. Done right, this alignment adds value to both constituencies and distinguishes a company from its competitors.
Integration With Our Culture and Framework

We at Counterpoint Global make long-term investments in companies that we believe can realize a significant increase in market value over time as a result of enduring competitive advantages stewarded by capable management teams. Our culture combines a partnership mindset with a commitment to continuous learning, intellectual flexibility and self-awareness. We are willing to be different when necessary in order to strengthen our advantage. We seek these traits in company management. In our view, the most lasting value is created by executives who make thoughtful decisions that incorporate the needs of all stakeholders. Whether in capital allocation, corporate governance, operational excellence or regulatory compliance, our focus on sound practices is resolute.

Our study of unique businesses reveals that the ways management teams create value is changing. A railroad is much different than social media, and physical barriers to entry are much different than network effects. With the shift from tangible to intangible investments comes an expansion in the stakeholder base and change in the creation of competitive advantage. Smart management teams recognize these shifts, and appreciate what is required of them as they pursue profitable growth. Similarly, we have worked hard to understand these factors. As a result, a formalized Sustainability Research framework is now integrated into our investing process.

Existing Limitations Provide Opportunity

Sustainability Research is not a separate methodology or exclusive from our core activities at Counterpoint Global. Our approach is additive to our existing investment process and to our anticipated investment returns. Human behavior is anchored on existing processes and relationships and is among the hardest things to change. We think the same holds true for investors. The implementation of an ESG methodology is failing at many investment firms because of a combination of inertia and a lack of understanding. This failure includes:

1. The inability to recognize a material regime shift in the investment landscape towards sustainability, providing a large opportunity with less competition;
2. Applying a revolutionary approach instead of an evolutionary one and disturbing what is “already working” in an investment process;
3. A reliance on underdeveloped, third-party metrics for implementation, pointing investors in the wrong direction; and
4. Assuming that sustainable investing results only in excluding companies from an investment universe rather than identifying companies with stocks that are expected to generate attractive returns.

The biases that these limitations create in the market are what we seek to exploit. However well intentioned, a sustainability index fund may include a natural resources company engaged in strip mining and exclude a company that has an unusual share class structure even if it has a management team with proper alignment and incentives. We prefer to exercise our own judgment rather than abide by the restrictions that others impose.

Socially Responsible Investing: Historically a reductive process

Original Investment Universe

Environmental Screen

Social Screen

Governance Screen

Reduced Universe

E&S (Environmental & Social)

Counterpoint Global: Sustainability Research as an additive lens

VALUE DRIVERS

Moat

Growth

Efficiency

Optionality

E&S Research
Leadership
Our Sustainability Research emerged from the creativity, passion and entrepreneurial spirit of one of our team members just as our Disruptive Change Research did fifteen years ago. Thomas Kamei leads our effort in New York by promoting awareness of sustainability trends across our organization. A student of architecture and design, Thomas pairs his understanding and vision of structural systems with a decade of experience investing in leading internet companies. His leadership has enabled us to collaborate with nonprofit and public sector stakeholders as well as to engage with the management teams of our current and prospective company investments.

Sustainability Research in Practice
Our Sustainability Research has identified risks that other investors have underappreciated and investment opportunities they have overlooked.

For example, let’s start with environmental issues:

**RISK**
Companies that produce goods that are difficult to recycle are struggling from increasing consumer and regulatory scrutiny.

**OPPORTUNITY**
Companies that provide water and energy conservation services to customers, such as cloud computing datacenters, are flourishing as they help reduce operating costs for their customers.

The same point applies to social issues:

**RISK**
Concerns about data privacy are emerging as expensive threats for many established financial services businesses.

**OPPORTUNITY**
Decentralized financial innovations such as blockchain provide the potential for increased financial inclusion for low-income citizens in emerging markets.

Our Sustainability Research has helped us with governance as well. Our proprietary method for measuring and evaluating sustainability has led to valuable and expanding conversations with management teams. Most managements appreciate us sharing the insights we have gleaned from studying how companies have successfully aligned profits and impact. The result is a valuable two-way dialogue. A deepening of our partnership with the management teams in our investment portfolio naturally leads to a better understanding of their decision-making process. This gives us a deeper appreciation for the risks and opportunities they face. By engaging management teams on sustainability, we signal that we value these efforts for both their long-term value creation potential and positive impact on society.

Different, But Same
We are investors first and foremost. Our paramount responsibility is to protect and grow the wealth of our clients. Because the stock market is a complex adaptive system, an investment team must evolve in order to understand opportunities and translate them into excess returns. Our Sustainable Research is allowing us to gather data that is more useful than traditional ESG screens. This enables us to capture insights from company management and to observe trends that were previously hidden.

Sustainability initiatives are often criticized outside of investing because the costs and outcomes are unknown. While the impact of sustainability on investing is difficult to measure precisely, we believe the convergence of profits and purpose will lead to improved long-term business performance and investment returns.

**Sustain** /saɪˈstæn/ to strengthen or support physically or mentally
Counterpoint Global

**Counterpoint Global Team**

DENNIS LYNCH, Head of Counterpoint Global

New York

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<td>SAM CHAINANI</td>
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<td>JASON YEUNG</td>
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<td>DAVID COHEN</td>
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<td>THOMAS KAMEI</td>
<td>Internet, Sustainability</td>
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<td>MANAS GAUTAM</td>
<td>Generalist</td>
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<td>ANNE EDELSTEIN</td>
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<td>ABDH KUMAR</td>
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**Disruptive Change Research**

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**Consilient Research**

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**Client Relationship and Business Management**

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<td>MARK TODTFELD</td>
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<td>MARY SUE MARSHALL</td>
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<td>PRAJAKTA NADKARNI</td>
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<td>RUOBING CHANG</td>
<td>Business Management</td>
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**Global Opportunity Team**

KRIStIAN HEUGH, Lead Investor Global, International, Asia

Hong Kong

- 6 Investors
- 3 Portfolio Specialists

“Investor” refers to an analyst or portfolio manager of Counterpoint Global.
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