

PALOS

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Weekly Commentary

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ESG and Responsible Investing Part 3: Social issues - The “S” in ESG

As ESG investing gains momentum, investors are asking, “what responsibilities should a company bear with regards to the well-being of employees, the communities they operate in, and the societies they impact?” In 2020 alone, the outcry to address racial injustices and inequality are driving the demand for action. While governments and political agendas are at the forefront, corporations also face growing scrutiny and pressures to back social change. Those that choose affirmative action are certain to be viewed favorably versus those who do not. Mandating positive action and implementing deliberate initiatives into a corporation’s culture carries greater importance than ever.

Socially conscious investors are likely to favour investments in companies that are aligned with their own moral or ethical values. Companies that shirk social responsibility face reputational and operational risk. The good news is that many of the risks are controllable. Operationally, ensuring that workplace safety, training, and generous benefits packages are made available to employees contributes to a positive working environment. The results are strengthened productivity, greater loyalty, and better talent retention.

However, there remain challenges that go beyond corporate control. For example, the emergence of the Covid pandemic illustrated that not all risks can be foreseen and prepared for. While most companies prioritized employee wellbeing by implementing stringent safety protocols, some industries like meat packing faced serious outbreaks in their facilities. It was subsequently revealed that workers were either inadequately protected or appropriate protocols had not implemented. Such shortcomings open the door to reputational damage, labour discontent, and legal liability.

Social responsibility crosses borders. Criticism has been directed at businesses that operate in jurisdictions that pay little attention to child labour laws, poor working conditions, and unfair pay. Such practices are commonplace amongst many multi-nationals operating in the apparel, electronics, mining, and manufacturing industries. Less stringent labour laws and disregard for human rights violations make it difficult to encourage better behavior. Another problem is the fact that reliable data is either scant, unreliable, or unavailable. Monitoring a company’s commitment to racial diversity is challenged by the reality that most companies do not report. There’s room for improvement.

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Although non-standardization and lack of reliable data make monitoring difficult, progress is being made. Some boards have mandated that executive compensation be aligned with improvements in workforce diversity. Action is being taken to enshrine whistle-blower protection and toughen punishment for violation of anti-bribery laws.

Social Impact Bonds (SIB's) are a relatively new investment approach and rising in popularity. SIB's brings together governments, social services, and investors who have a desire to empower social change. The investment universe for SIB's is immense and addresses a variety of social issues that include affordable housing, youth unemployment, aboriginal issues, and poverty. While there is much work to be done the fact remains that investors are indicating that social aspects are growing in importance when assessing the merits of any investment thesis.

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| Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹ | FundServ | NAVPS | YTD Returns |
|--|----------|--------|--------------|
| Palos Income Fund L.P. | PAL100 | \$7.62 | 0.00% |
| Palos Equity Income Fund - RRSP | PAL101 | \$5.47 | 1.13% |
| Palos Merchant Fund L.P. (Dec 31, 2019) ² | PAL500 | \$1.71 | 20.15% |
| Palos WP Growth Fund - RRSP | PAL210 | \$8.85 | 29.92% |
| Palos-Mitchell Alpha Fund ³ | PAL300 | \$8.95 | -12.31% |
| S&P TSX Composite (Total Return with dividends reinvested) | | | -0.33% |
| S&P 500 (Total Return with dividends reinvested) | | | 9.22% |
| S&P TSX Venture (Total Return with dividends reinvested) | | | 27.06% |
| Chart 2: Market Data ¹ | | | Value |
| US Government 10-Year | | | 0.77% |
| Canadian Government 10-Year | | | 0.63% |
| Crude Oil Spot | | | US \$40.60 |
| Gold Spot | | | US \$1919.50 |
| US Gov't10-Year/Moody BAA Corp. Spread | | | 267 bps |
| USD/CAD Exchange Rate Spot | | | US \$0.7625 |

¹ Period ending October 9, 2020. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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