TRANSCRIPT

ESG investing: Moving from limits to opportunities

David King: Good afternoon everyone, and thank you for joining us for today's webinar on ESG investing. As a brief introduction, my name is Dave King, Fidelity's head of ESG stewardship, and I will be moderating today's discussion. I lead a team that works with our Fidelity Investments professionals like Nicole to engage companies that we invest in, and develop insight regarding ESG teams, and identify potential risks and opportunities. Joining me today is Nicole Connolly, Fidelity's head of the ESG investing and portfolio manager of the Fidelity Women's Leadership Fund. To start, Nicole, tell us how you got into the ESG or sustainable investing, and why it's important to you?

Nicole Connolly: Yeah, hello everyone, this is Nicole Connolly. So I've been at Fidelity for 19 years, and half of that time has been spent analyzing companies across different sectors, different asset classes, different market caps. I've spent time on the debt side, and on the equity side, and half of my career here has been spent as a director of research, working in our equity group, where I manage different sector teams, I manage our technology team, our energy team, our emerging markets team. And on that management team, I was able to work on diversity initiatives, women's leadership initiatives, and I think that gives me a pretty unique perspective when talking to the companies we own in this Women's Leadership Fund about trying to implement those initiatives. And then, about 18 months ago, something very different happened. I was going about kind of my day to day work, and was invited to go to the digital summit, which was a conference organized by Fidelity for Fidelity employees to learn about digital transformation, and to learn about modernizing Fidelity in this kind of digital age. And I met with a group of women called the Women's Squad, that's in the personal investing division, run by Kathy Murphy. And these were women that had been researching the female investor market for the past two to three years. And hearing from women that, you know, yes I make the major purchasing decisions in the household, and yes, I pay the bills, but when it comes to investing, I often leave my money in cash, or I leave the investing to my spouse. And you know, these women at Fidelity, this Women's Squad, was trying to figure out how to get women more excited about investing, how to get women to come to the Fidelity platform, and I thought like what a, you know, an amazing part of, you know, work to be working on, and I said, what if I use my investment background, my investment skills, to design a product that would not only create wealth for the individual investor, but allow that investor to have impact. And the impact, in this case, is women's leadership. And so that was the genesis of the Women's Leadership Fund, and a little bit about how I got on my own path to purpose from an investing perspective.

KING: That's great. And through that, that's how we met up.

CONNOLLY: Yes! And Dave and I are kind of tied at the hip here in our work on ESG, and we've got a great team, so we're excited to tell you more about that.

KING: Right. So let's kind of talk about how Fidelity thinks about ESG investing.

CONNOLLY: Yeah, so I think that the tricky thing about ESG is there's a lot of kind of definitional ambiguity about what ESG is, and so, the way we think about it is at its simplest, it's aligning your capital with your values. And we think that can be done in a way where you generate superior and sustainable returns over time, and we'll show that, we'll prove that to you over the course of this presentation here. And so, the way we think about it is, investing in companies that are trying to limit their impact on the environment, investing in companies that are trying to do right by the employees, the customers, the suppliers they work with, the communities they operate in, that's the essence of the S, the social. And then companies that have good governance. What does that mean? It means companies that have independent and diverse boards of directors, companies that have management teams whose compensation incentives are aligned with the shareholder, and companies that exhibit good capital allocation, you know, they're making smart decisions with their capital in terms of mergers and acquisitions, in terms of a growth strategy. And so, you know, in many ways, you know, ESG is really just good business practice, and it's an extra layer of due diligence that we incorporate in the research process.

KING: I think we look at ESG as part of that research mosaic that our analysts are building about companies, right?

CONNOLLY: Yes. Yes, exactly. Exactly. And you know, I think what's interesting, you know, another thing that's interesting about ESG is, you know, it's a way for us to have more meaningful conversations with our own clients, with investors like you on the phone that want to figure out how to invest in a way that has meaning to you. And so, you know, we're pretty excited about the opportunity that represents for Fidelity, and the opportunity that represents for you as investors.

KING: I think the emergence of data, and data helping us to better identify these issues, has really helped. But can you give us some examples of what a good ESG company looks like?

CONNOLLY: Yeah. So if we go, so we have been thinking about how to bring this to life for investors, so a company I like to talk about is Etsy. Etsy is an online marketplace where they have 2 million female entrepreneurs on the platform selling their goods every day. And Etsy has a goal of becoming the first global ecommerce company to be carbon free. So what does that mean? It means that, you know, 98% of Etsy's carbon emissions are generated every time a product is shipped, and they try to offset the impact of that carbon through something called carbon offset. And carbon offsets are kind of mini investments in windfarms, solar projects, forest preservation programs. And this is a way that Etsy can invest in, you know, renewable energy projects, and invest in things that are reducing carbon globally, and offset the impact that their own business has on the environment. So that's an example of the E. An example of the S, you know, I talked about that digital summit, one of the companies that was at the digital summit was Salesforce, which is, you know, a large cap software company, a very successful company lead by Mark Benioff. And they told this story about how human resources, you know, went to Mark Benioff and said Mark, we have a problem, the men in this organization are paid more than the women at the same level, at the same role, for the same job, we need to fix that. And Mark Benioff said, "OK, well how much is it going to cost to fix?" And human resources said, "Well we want you to fix the problem regardless of how much it's going to cost," and Mark Benioff said, "OK." And so, here is a company that went on and, you know, paid $10 million to rectify that gender pay gap, and took the short-term hit on employee costs for the long-term good that comes from having a motivated, an employee base that feels like they've been treated fairly, and they're productive because of the way they feel about that. And so, that was kind of an aha moment for me at that digital summit where I said gee, that is a company I want to invest in. So that is an example of the S. And then, you've had some experience Dave, on the governance side.

KING: Yeah, as we've done our stewardship, performed our stewardship activities, we do a lot of conversations with companies about their governance. And how they're structured, and how they look at their executive pay plans, for example. Now, Southwestern is a good example of a G company that comes to mind after we engaged with them. They're an energy company, and if you're familiar with energy companies --

CONNOLLY: Right, right.

KING: -- they're kind of notorious for growing for growth's sake. Which may not deliver the best returns for investors. So we were looking at their incentive comp plans for their executive team, and we noticed there was no return metric that they were being evaluated or compensated on. We gave them that feedback last year, and as they were coming to proxy this year, we noticed that they modified or enhanced their compensation plan to include a return metric.

CONNOLLY: Yeah.

KING: So there's a great example of a company that's taking feedback, and managing and taking action, based on investor feedback, and actually moving forward, and doing something that's good for our investors, our underlying investors. So, we know their executives are not just being comped on growth, but also ensuring they're considering the returns on that growth for the investors. You know, I think that we always go over this hurdle, and try to define ESG for people --

CONNOLLY: Yeah. Yeah, yes.

KING: -- and I, when I think the audience hears this, hopefully I think that they think gee, these are just good business practices.

CONNOLLY: Right. Right, right. So often, people's minds, when they hear ESG, they jump to oh, that's something about excluding alcohol, and tobacco, and guns from my portfolio, which is certainly one way you could express your views, and your values. But what we're actually more excited about is investing in companies that have, you know, embraced these ESG principles, so that they can be built to last, and built to outperform over time. And it's really about kind of meeting the needs of the present while not sacrificing the needs of future generations. And so we really get excited about investing in companies more from a positive screening perspective than this negative screening, this exclusionary place. And we think that's a way to generate superior returns over time.

KING: Now Nicole, we talked about ESG is part of that overall fundamental analysis we perform bottoms up on companies. But overall, why is Fidelity excited about this?

CONNOLLY: Yeah, so if we think about the macro factors driving ESG investing, there's a number of things that play here. There's the changing demographics of our own investor base here, where you know, we expect women to inherit dramatically from the wealth transfer that's going to happen over the next three decades. And you know, that wealth transfer is also going to impact the Millennials, and Gen Z, and we know from our own survey data that 80% of Millennials, or the next generation of investors, want to invest with purpose, and 70% of women want to invest with purpose. So we think those are some pretty powerful demographic trends. We're also seeing increased regulation, an increased regulatory development, specifically in Europe, where there's been a lot of discussion and implementation of initiatives around data privacy. Europe also mandates disclosure around gender pay gap, around the total cost of the employee base, and there's also a lot of environmental legislation happening in Europe. So we think that those things, and we're starting to see this now, are coming to the U.S. And then, you also have asset managers putting, you know, having more detailed, robust conversations with companies about these environmental and social issues, you know, support for shareholder proposals has, on the ENS front, has gone from 15% five years ago to 30% today. And so, you know, the companies themselves are hearing it from investors, they're hearing it from regulators, they're hearing it from their own customers. And they have been responding, I mean 85% of the S&P now puts out a corporate sustainability report. We had our own direct data team here look at how many companies talked about ESG in the last earnings call. That was about 440 companies of the S&P 500 talked about ESG in some capacity. So we're kind of seeing it from all angles here, and you know, we think this is a trend that's here to stay.

KING: Yeah, I think it's interesting, because you know, only a few years back, meeting with management, (overlapping dialogue; inaudible) they would stare at us blankly.

CONNOLLY: Yes. Right, right. Right.

KING: (laughter) Now it's part of the, integrated in our regular conversations.

CONNOLLY: Yes, that's great.

KING: As management comes through. So, how does this show up from an investment style? Some investors think ESG means just screening companies out, like I talked about.

CONNOLLY: Right, right.

KING: But can you explain how that's evolved?

CONNOLLY: Right. So we just talked about the negative and exclusionary piece. And ESG found its roots in something called socially responsible investing, which we think kind of began in the '60s and '70s, some say it began, you know, even further back than that.

KING: (overlapping dialogue; inaudible)

CONNOLLY: The Methodists. (laughter) But you know, we think it kind of began in earnest in the '60s and '70s against, you know, the backdrop of civil rights, and women's equality, and the Vietnam War. And we saw that the faith-based organizations really embraced this idea of avoiding companies that conflicted with their morals. And so that was the genesis of, you know, not investing in alcohol, and tobacco, and guns. And so that's again, certainly one way you could approach this, and --

KING: Yeah, and I think outside of our traditional funds, we're piloting something like this.

CONNOLLY: Yes, yes.

KING: We're piloting an ESG SMA that uses the ability to combine the potential for long-term growth with thematic ESG investing. Customers have the ability to exclude any combination of 10 or so themes about fossil fuels, nuclear, controversial weapons.

CONNOLLY: Yeah.

KING: It's being piloted actually in 20 branches right now, plus all of private wealth management.

CONNOLLY: Yes, yes.

KING: (overlapping dialogue; inaudible) something like that.

CONNOLLY: Yes. So, we're doing a fair amount in that space for those people that want to approach ESG with that negative exclusionary lens. And then ESG integration is something that, you know, Dave and I are working very closely on with the research team, and this is just making sure that all of our mutual funds, regardless of whether they're specifically focused on ESG or if they're just, you know, a traditional mutual fund, are making sure that they are incorporating the ESG risks and opportunities into the investment process, really understanding with their companies what are the material ESG risk factors. And you know, there's a number of different ways that we do that, which we can get into a little bit later, but that's the thought behind ESG integration, and there, we also really look for best in class companies from an ESG perspective. So this is more of a positive screening, you know, integrating ESG into everything we do with a lens of materiality. So what really matters from an ESG perspective to that company's financial results and valuation over time? And then thematic investing is typically, you know, funds that are focused on a specific part of the ESG umbrella. So that would be like the Women's Leadership Fund, which we'll talk about, that would be like, Fidelity's Select Environmental Fund, which is run by Kevin Walenta. And so, that's for people that have, you know, are passionate about a specific cause, and they want that to come through in their investment options.

KING: That's great. I think we have offerings across all of those different investment--

CONNOLLY: Yeah, yeah.

KING: -- capabilities. But let's talk about what Fidelity's been doing. How is the investment team involved?

CONNOLLY: Mm-hmm. So, you know, we formalized our ESG efforts in 2017, and Dave here was a big part of that, and a big reason we joined something called the PRI, which stands for the Principles of Responsible Investments, which is an organization that really is committed to making sure that all of the asset managers and asset owners that are part of that organization are approaching their investments through an ESG lens. So again, considering any of the ESG risks and opportunities in the investment process. And you know, in many ways, Fidelity has been doing this ESG work for years, but we're really just formalizing a lot of what we've been doing, and we've been doing the work on governance for a long time, and so it's just educating the research department even further about governance and environmental and social initiatives. And we've done, you know, had a number of different speakers come in to talk to us about climate change, and data privacy, but Dave, maybe you want to talk about the product offerings we have developed over the past few years.

KING: Yeah, I think we've launched some very interesting things. Along with that SMA pilot, and the Women's Leadership Fund that Nicole talked about, we have launched three sustainable index funds, looking at ESG leaders, it's a sector representative, diversified offering, it's U.S., there's a U.S. and international. And then a U.S. bond offering through the index fund. Then also, what we've noticed are those portfolio managers that actually do think about ESG --

CONNOLLY: Yeah. Right, right.

KING: -- are starting to bubble up in some of the ratings.

CONNOLLY: Right.

KING: So how sustainable is the fund?

CONNOLLY: Right.

KING: What we've found is hey, you Steve DuFour in the Focused Stock Fund… last year was named one of Barron's top sustainable funds.

CONNOLLY: Yeah, so I was talking to Steve, you know, last week about, you know, some of the ways he incorporates ESG into the fund, and he really thinks about ESG across all sectors, but he was talking about utilities as one sector, and he uses MSCI's MSG ratings to help direct him in the utility sector, so looking for high ESG scoring companies in the utilities sector, he owns a company called NextEra Energy, which is, you know, a large utility with the most renewable energy exposure of all the utilities. Our analyst Douglas Simmons, who's also a fund manager on utilities, calls it the green disruptor to the power sector. So, you know, they have wind and solar energy projects in 33 states, 30% of their earnings now come from renewable energy, and because they have spent, you know, so much time developing this infrastructure and the expertise, they have a big lead on all the other utilities that are trying to get into the renewable energy space. So, that's just an example of how Steve incorporates ESG into his process for the Focused Stock Fund.

KING: That's great. And I think it's been an education process, as we've been trying to bridge the two vocabularies, the ESG --

CONNOLLY: Yeah, right.

KING: -- and business issues. Now, how does this show up for the portfolio managers and analysts? How do they know what good ESG practices look like for a company?

CONNOLLY: Yeah. So, I think one of the more exciting things that we have done over the past nine months is in the middle box here of this portfolio analytics. Every fund manager at Fidelity gets an ESG report card. And so, this tells that fund manager how they look, how their carbon footprint looks versus the benchmark. Or what exposure they have to companies that don't have any women on the board. Or what exposure they have to ESG controversies generally. And so, this is a good starting point for Dave and I, and our team, to go to the fund manager and say listen, you've got these risks and opportunities in the fund from an ESG perspective, let's discuss.

KING: Lively conversation.

CONNOLLY: Yeah, right. Right! (laughter) We've had some lively ones, exactly. And so, we're, you know, we're rolling this out, and we have, you know, we have the expectation here is that our chief investment officers will review this on a quarterly basis with the fund managers. And then, we're also, our team's really, you know, working hard to put out different research about ESG, you know, we just did a piece of research looking at, you know, Lyft and Uber from an ESG perspective. And we're just trying to educate the team about things that we're seeing in the ESG space. And you know, more to come on that.

KING: Yeah, I think it's really important to just start the conversation with our investors. They're worrying about some of these issues. They're prevalent, you read them in the press every day.

CONNOLLY: Right.

KING: And some of them are real business risks and issues that they have to deal with.

CONNOLLY: Yeah.

KING: And it's making sure that we're having those conversations with companies, and so these are the ways that we're using to one, surface these issues, and start that dialogue. But I think we also have one about (overlapping dialogue; inaudible) --

CONNOLLY: Right, right.

KING: -- our trip.

CONNOLLY: So, back to the point of, you know, yes Dave and I, with our team, we're doing work on ESG, but the goal here is really integration between the fundamental research team, and the ESG team. And so this is a trip that the ESG team, and our fundamental analysts on the cyclicals team just did to a recycling facility here in Boston, and this is a recycling facility of a public company that you know, we're looking at as a potential investment. And recycling is very topical right now, because recycling prices have really, you know, fallen dramatically as a result of China saying we don't want any more recycled product coming to us from the U.S. And that has sent recycling prices in a freefall, which has implications for waste companies who, on average, might see about 10 to 15% of their earnings coming from recycling. It has an impact for packaging companies. So we've seen, in the packaging space, companies like Ball Corp that are more focused on aluminum cans, which are more environmentally friendly, than plastic players. We've seen dramatic dispersion in the stock prices, in the packaging companies, depending on what type of packaging you produce. And so, we think there's a lot of stock implications here, and wanted to go to some experts, people that are actually living, breathing, sleeping recycling every day, to learn about what direction recycling prices might be headed in the future. So this was a really fun trip, and I mean --

KING: Eye opening.

CONNOLLY: Eye opening, like we were saying every American should have to tour a recycling facility, because the amount of waste, and you know, product that is trying to be recycled, but that's for some reason not being recycled, is just eye opening, and has me thinking differently about my own usage of plastic, all of that.

KING: Right. And you forget that there's -- once we put it in the recycling bin --

CONNOLLY: Yes!

KING: -- you forget there's a whole business behind there, there's a commodity business, creating and taking those products. This has upstream and downstream implications --

CONNOLLY: Right.

KING: -- as you're talking to, you know, the petrochemical companies, the paper board companies versus the packaging manufacturers, versus our consumer product goods.

CONNOLLY: Right.

KING: Who are filling those bottles, or those cups, with their product, and then the retailers --

CONNOLLY: Right.

KING: -- who are seeing this. So you're seeing it, this has broad implications, it's a very interesting topic.

CONNOLLY: Yeah. And it's, I think the trip, I mean we do these types of trips, whether it has an ESG lens or not, you know, every week, and that is the power of active management, and the power of investing with Fidelity is you have research analysts and fund managers on the ground, in the field, that are really kicking the tires, that you can't really get access to when investing in more of a passive product, so.

KING: Right. Right. Or even glean from reading a PowerPoint presentation, or talking (overlapping dialogue; inaudible).

CONNOLLY: Yes, yes.

KING: Visiting is a very effective tool. You know, a lot of people talk about ESG, and there's the return question.

CONNOLLY: Right.

KING: You know, can this be done while still achieving returns?

CONNOLLY: Yes! So, whether we're talking to retail investors, or institutional investors, or people that are managing a company 401(k), we always get asked about performance. And there's still a lot of skepticism about, you know, whether you can achieve competitive performance with an ESG lens. And so this is a piece of research done by Mike Robertson on our quantitative team here at Fidelity. And we looked at the Russell 1000, so these are the top 1,000 companies in the U.S. by market cap, and we did this with the help of MSCI data. And we took those 1,000 companies and we broke them into quintiles where the top quintile was the highest ESG scoring companies, and the bottom quintile was your real poor ESG performers. And we did this across every sector, and we found that not only did the top quintiles, these are again the strong ESG performers, outperform the bottom ESG performers by I think about 3%, but they also outperformed the market by 1.5% a year over the past five years. So 1.5% of excess performance annually over the past five years. And so, you know, the pushback might be well, this is only five years of data, and that's really because ESG has really, within the past few years, we've really only just had the data, and so we think as we continue to see better disclosure from companies, that we'll be able to build on this time series and what we've seen actually is that since we've started tracking this about two years ago, the performance just keeps getting better, of these ESG companies. So, what this says to me is, you know, at the very least, you don't have to sacrifice performance to invest with impact. And so I think as people start to appreciate this, the conversation goes from like, why would I be interested in an ESG fund, to why wouldn't I be interested in an ESG fund? I mean, why wouldn't people be interested in achieving competitive returns, while also having a positive impact on society and the planet. You know, I can't think of many people that wouldn't, you know, want that.

KING: Right. And we're seeing more and more academic research on (overlapping dialogue; inaudible).

CONNOLLY: Yes, yes. Yes, so another study we would refer people to here on the call, if you're interested, is work done by George Serafeim out of Harvard Business School. He looked at about 20 years of data, utilizing something called the SASB framework, so this is Sustainability Accounting Standards Board, has done a lot of work trying to figure out what are material ESG factors. And he used that materiality lens to look at ESG scores across about 2,000 companies. And he did that over the past 20 years, and he found that the highest scoring ESG companies outperformed the low scoring ESG companies. So that's a study you can find online, happy to answer any questions about that in the Q&A.

KING: Yeah. I think that's a really important point about materiality too. Because not every ESG issue is important to every single company.

CONNOLLY: Yeah. Right. Right.

KING: It depends on what industry the company is in, what sector they are in, or things like that. But I want to turn it over, because Nicole, you're also a portfolio manager for the newly launched Women's Leadership Fund. Can we talk about this fund, and how it came to be?

CONNOLLY: Yeah. So, this is a fund that fits, you know, squarely in the S, the social part of the ESG pillar, and the goal here is to deliver return with a purpose. And the purpose in this case is paving the way for future female leaders, while also helping women across all industries, all sectors, all levels, thrive in their career. And the goal here is also, you know, we aim to deliver best in class performance to the shareholders of this fund. And so, maybe if we go to the next. So, the genesis of this fund, you know, I talked a little bit about the work that our Women's Squad had done here, and this was a truly collaborative effort between our asset management group, our personal investing division, our product group, and really coming together to say how can we meet our clients' needs? And we really have the demographics at our back here, you know, women are expected to control close to 30 trillion in wealth by 2025. That's happening because of the massive wealth transfer over the next three decades. It's happening as companies like Salesforce, that I mentioned, are trying to narrow the gender pay gap, that's happening across companies across America. And it's happening also as companies offer more return to work programs. So this is for, you know, women that have been out of the workforce, maybe to raise a family. Offering them a way back into the workforce, so that's a catalyst for increased female labor participation. So all of these things are working together to create a really favorable backdrop for an increase in women's wealth, and we're exciting to have a product to meet that demand.

KING: So as you've thought about building the fund, and building the parameters around this fund, did you look at how the companies performed in that universe?

CONNOLLY: Yeah. So clearly, we had a good business case for a women's leadership fund, but did we have an investment case? And so, we looked at some seminal work done in the space, Credit Suisse had done a piece of research looking at 3,400 companies across different sectors, different geographies, and looking at gender diversity in the C suite. So what is the female representation in the C suite, looking at CEO, CFO, chief technology officer roles, and found that, you can see in the turquoise line here, companies that had 50% female representation, you know, outperformed every other company in this analysis. Now we looked at this analysis and said well gee, that's pretty compelling, but it's only over a three-year time period. So we wanted to do something even more robust, and if we go to the next slide, we looked at 10 years of data with the help of Thomson Reuters, which is an external, a third party vendor that we use. And we looked at the top 1,000 companies in the U.S., and we looked for companies that had above average gender diversity, and had two or more diversity policies in place. Because we don't think it's enough to merely have female representation in the C suite, we really think you need a culture of inclusion with initiatives and a philosophy in place to really create, you know, a foundation for women to accelerate and advance in the organization. So we looked at these companies, these companies to have again, above average diversity in the C suite, and diversity initiatives in place. And those, let's call them gender diverse female-forward companies, outperformed the benchmark by close to 1% a year over the past 10 years. And so, to put some numbers around that, if you had started with $10,000 in 2008, and had invested it in this female-forward gender diverse universe, that would be about $35,000 today, which is $4,000 more than it would have been if you had invested it in the market. And what we think about women is that a lot of women are invested in cash, so $10,000 in '08 is $10,000 10 years later. So the potential is dramatic for this universe, and the impact it can have on women's finances. So, we found that this was a pretty compelling piece of work.

KING: Yes, it's definitely a compelling business case.

CONNOLLY: And this is before you even put the active management --

KING: Overlay.

CONNOLLY: -- overlay onto the numbers. Yeah.

KING: Right. So let's talk about that, and the criteria you used to evaluate diversity.

CONNOLLY: Yeah. So we had answered the -- we have the business case, we have the answer on the investment case, but do we have a universe that's big enough to choose from?

KING: Right.

CONNOLLY: And so, we looked at the Russell 3000, so this was the top 3000 companies in the U.S., and we said how many meet at least one of these criteria? So how many have an influential woman in the C suite? This would be like Mary Dillon leading Ulta Beauty. You know, some people might roll their eyes about cosmetics, but cosmetics, interestingly, is a very resilient industry, and Ulta Beauty has put up 37 quarters of positive, organic sales growth, which very few retailers have done. It would also be women like Amy Hood, who's the CFO of Microsoft. She's been influential in changing that company's culture, and their appetite for innovation. So that's criteria number one. Criteria number two is the governance piece. So this is what does the diversity on the board look like? So here, we're looking for 33% or more female representation, which would be a company like Disney, where almost half of the board is female. And then the last piece, which we think is the real special sauce here, it's what's differentiating us from other products in the market, is this deep dive we do into a company's culture, into a company's diversity initiatives, 20 different criteria that we look at from flexible work environments, parental leave policies, gender pay gap philosophy, monitoring the year over year progress in the hiring, development, promotion of women, and we look at a company across all these different criteria, and actually, it's a very labor intensive process that again, you can't recreate in an index product. And so, we looked at these three criteria, and we came up with 700 companies across all different sectors. And these companies exist in technology, in healthcare, in consumer, in real estate, in utilities. And that's one of the reasons we think this fund, because it's so diversified, can play a central role in somebody's equity exposure.

KING: Right. So you talk about this criteria that you use, and it's interesting, because there has been a lot of talk about women in the leadership, or lack thereof.

CONNOLLY: Yeah. Yeah.

KING: So really, can we talk about how big your universe is? Can you build a portfolio this size?

CONNOLLY: Yeah. So we take the 700, which by the way, has only been growing. I mean, when I first did this analysis last May, the universe was about 500 large, and we've just seen companies really embrace diversity because of the innovation it can bring to your company, because the fact that you, you know, better reflect the needs of your customers, you know, Amazon added Indra Nooyi who's the former CEO of Pepsi, to their board, a few months ago. You know, Best Buy just promoted Corie Barry from CFO to CEO. So these are some of the changes you're seeing in corporate America. And so, we take the 700 companies, and we overlay, you know, the power of the Fidelity fundamental research engine with 120 analysts covering all told, I think north of 2,000 companies across the globe, they're looking for long-term winners in their sector, they're the experts on their sector. And so I, you know, get to leverage all of the great work that these analysts are doing on their companies, and then overlay my own investment philosophy, which is around looking for open ended growth opportunities. So companies that can grow earnings faster than the market, companies that are benefiting from operating in a large, addressable market. With strong, you know, moats around their business. And then, that's one part of the approach. And then the second part of the approach is looking for resilient, stable, more defensive businesses, companies that generate a lot of cash, companies that don't have a lot of debt on the balance sheet, companies that have high returns on capital, and so it's a mix of that quality and growth approach that gets me to about 100 names in total for the fund.

KING: That's great. Now, let's talk about what happens when a female executive or board member leaves.

CONNOLLY: Yeah. So, we're talking a little bit here about the buy discipline, and the sell discipline. You know, the buy discipline is pretty straightforward, it's got to meet the women's criteria, and it's got to have a strong fundamental story. On the sell discipline, you know, I think, I never want to be in a position where I'm a forced seller because a female executive leaves. So that's kind of the power of that third pillar, with the diversity policies in place. Like I'm trying to make sure that when there's, you know, female executives in the C suite, there is also a culture committed to diversity that's behind that. And so that's how, you know, generally I think about, so if I ever have a female executive leave, I have this, you know, robust diversity framework that I can go to, to say well where is this company on their women's leadership journey? And you know, haven't really had a situation happen over the course of the past 12 months, either as the fund has been live, or as we've been piloting it, where I've had to sell a stock because of changes in the women's leadership thesis.

KING: That's great.

CONNOLLY: Yeah.

KING: Now, you can measure this fund on two ways, return --

CONNOLLY: Yeah. Yeah.

KING: -- but that also impacts it.

CONNOLLY: Yes.

KING: And let's just quickly talk about that.

CONNOLLY: Yeah. So, you know, I -- my belief is that when people invest for impact, they want to see the impact that they're having. And the beauty of this fund is that we can share with our investors the type of impact we're having. You know, we're investing in close to 40, you know, women-led businesses, 7 companies that actually have both a female CEO and CFO, there's actually very few of those in the market. Sixty boards with greater than 30% female representation, we're investing in 20 return to work programs, and what we hope to be sharing over the course of the next six months, using our own machine learning AI capabilities, is like how many weeks of maternity leave are we investing in? You know, that's actually something that's pretty hard to find, from a disclosure perspective. So, you know, I think this is pretty exciting, what we're doing, and you couple this with then, the conversations we're having with the companies about things like gender pay gaps, about the diversity of their board, and it's a pretty impactful story. And the whole premise to all of this if you're investing in companies that have a diverse organization, that organization better reflect the composition of the customer base, the customers they're serving, which allows them to better innovate for those customers, and meet the needs of those customers. And the second piece is, with more diversity, you're going to have better decision making, you're going to have more voices and opinions at the decision making table, better decisions regarding growth strategies, capital allocation strategies, balance sheets, and those are the reasons, some of the reasons why I think the companies that are more diverse in this fund are set to outperform over the long-term.

KING: Excellent.

CONNOLLY: Yeah.

KING: And how about you share one example of one of the companies?

CONNOLLY: Yeah. Oh, yeah. So if we go to American Waterworks, OK. So American Waterworks is a regulated utility providing, you know, water services across the country to about 14 million different customers. And it's, its really, it meets all three criteria of the women's leadership. It's lead by Susan Story, it has a female CFO, Linda Sullivan, 50% of the board is female, and it really, you know, I love the power of the women's leadership story here, of the diversity that this company has. And it fundamentally is also super well positioned with the fact that it's a play on the aging water infrastructure in the United States. A water pipe breaks every two minutes. And the EPA, you know, estimates that there's about a trillion in investment needed for water infrastructure. And so, American Waterworks invests in the maintenance, repair, the building of this water infrastructure, and is basically guaranteed a return on that investment by the state that it operates in. So that's the regulated piece. So I like the visibility that you get from that return, that regulated return. It also operates in a really fragmented industry, so you have this M&A opportunity where they can roll up other water utilities, and so I think all of that gets you to about 7 to 10% earnings growth, very high visible earnings growth over the next five years, and what I love about this story is you've got the women's story, you've got the environment story, and you've got kind of a stable, defensive quality piece of the investment process that I like.

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