BARRON'S COVER

BlackRock’s Larry Fink: The New Conscience of Wall Street?

By Leslie P. Norton • June 23, 2018

PHOTO: RICHARD PHIBBS
Most investors—and virtually all of the industry’s biggest names—emphasize the importance of long-term thinking, without doing much about it. Larry Fink, CEO of BlackRock, is different.

For years, he has been urging Wall Street to look toward the next decade instead of the next quarter. He has regularly and publicly attributed many of the economy’s ills—including poor adaptation to technological change and the pending retirement crisis—to an obsession with short-term returns. And he has been willing, in most cases, to put his company’s investment dollars—and his own reputation—where his mouth is.

Example A: The Letter.

Fink’s annual letter to the companies in which BlackRock (ticker: BLK) invests is widely read, but his January 2018 missive took on a life of its own. In tone and substance, it was similar to his previous annual letters. But he fired this salvo into a very different world. “To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society,” Fink wrote. “Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.”

Fink’s words amounted to a Rorschach test for a polarized nation. As debates rage over immigration, climate change, guns, income inequality, and other issues, even considering their economic impact on a company looks like a political statement. Yet Corporate America and Wall Street are increasingly doing so. An op-ed article in The Wall Street Journal—a rebuttal to the letter, really—dismissed Fink as “the latest to evangelize this fad.” Sam Zell, the billionaire real estate investor, called Fink “extraordinarily hypocritical.” Activist investor Nelson Peltz, meanwhile, provided a ringing endorsement: The attributes that Fink encourages, Peltz said, are necessary characteristics of quality companies.
Fink’s argument is rooted in the bottom line, and supported by a growing body of academic research. It also uses the language introduced by sustainable investors, many of whom take into account environmental, social, and governance, or ESG, factors, even though Fink would never describe BlackRock as an ESG investor. When investors consider ESG factors, studies indicate, they are identifying sound corporate behavior that will help keep capital safe. In the long term, stocks from companies that heed these issues are likely to outperform the broad market, research shows, and in the short term, this kind of investing can reduce risk: Analysts who rate companies on ESG factors warned investors about Equifax (EFX), Valeant Pharmaceuticals International (VRX), and Volkswagen (VOW.Germany) before those stocks blew up, because they fell short on multiple sustainability criteria.

Less than a month after The Letter was published, a gunman fired more than 100 bullets at Marjory Stoneman Douglas High School in Parkland, Fla., killing 17 people. BlackRock’s response was swift and unusually decisive: The $6.3 trillion money manager and parent of the $1.8 trillion iShares exchange-traded-fund lineup announced that it would create two new ETFs that didn't include gun makers. “We are not inserting our social values here,” Fink says. BlackRock didn’t divest itself of gun stocks; it simply offered an investment option for clients who wanted to avoid them.
It isn’t just about offering a choice to investors. More than any other big investor, Fink is following a path that clearly links sustainable investing to good long-term returns—and it’s one that other big investors are likely to follow. Says Ralph Schlosstein, CEO of Evercore, the investment bank, and a longtime friend of Fink: “Larry’s letter is at the head of the parade.”

Roger Ferguson, the chief executive of TIAA, the $1 trillion asset manager, says, “I applaud Larry’s move in broadening the conversation” to issues that are “increasingly resonating with investors.” TIAA has $633 billion tied to what it calls “responsible investment principles.” Companies must adopt a “broader focus on successfully executing a profitable long-term strategy,” Ferguson argues. “It’s those steady and consistent returns that are required to provide financial security in a world of expanding life expectancy.”

To hear Fink tell it, short-termism is a scourge of corporate thinking, and is encouraged by the financial media. “Short-termism has been captured by the tick-tock of reporting,” he says. “That’s why I’m trying to create a louder
dialogue about long-termism, or the idea that a long-term Warren Buffett-like process will lead to greater sustainable returns.” Buffett and JPMorgan Chase (JPM) CEO Jamie Dimon, who also advocate a long-term view, recently called for companies to drop quarterly profit forecasts.

Among the many ills attributable to short-term thinking, Fink argues, is an approaching retirement crisis. The focus on quarterly results by Corporate America and Wall Street can fuel volatility, striking fear in individuals and discouraging them from investing for the long haul. “Many people pulled out of the market in 2008 and 2009 and haven’t returned,” Fink says, and therefore missed out on the great bull market that followed—and an opportunity to bolster their retirement assets.

Ignoring ESG issues can take a toll in another way, too. “We have seen, time and time again, where a governance problem or environmental issue really has a big impact on a company and its stock price,” adds Fink. And now those issues are taking center stage because of cultural and political trends. “We’re seeing more and more of the social issues in the news, such as #MeToo and many other things, affecting investor returns.”

Fink usually begins work on his letter late in August, when he’s fly-fishing with his family. Ideas pop up “during casting,” he says. Back at the office, he shares about 10 themes with his writing staff. First among equals is the theme of “fiduciary responsibility,” he says; second is “profitability,” particularly “sustainable profitability.” He had already addressed climate
change in previous letters, but there was some urgency in 2017: In June, the Trump administration had withdrawn the U.S. from the Paris climate accord. Separately, BlackRock had just signed on to the Investment Stewardship Group of large U.S.-based institutional investors and global asset managers. BlackRock doesn’t always agree with groups that take on company management. In the year ended in June 2017, it voted in favor of management proposals in the U.S. 92% of the time, and for shareholder proposals, 12%, according to WorldQuant.

**ESG Chatter**
The bars show the average number of mentions of ESG-related terms in earnings calls.

In October, BlackRock hired Brian Deese, a 40-year-old who had advised the Obama administration on climate and energy policy, to run BlackRock’s overall sustainability efforts.
Deese says he pushed to sharpen the concept, introduced in The Letter, about the public’s loss of faith “in government’s ability to solve big problems and challenges that they see in front of them.” Then he advocated for a “very clear and crisp articulation, from an investment perspective, of how we see sustainability- and ESG-related issues, and why they’re actually integral to our fiduciary obligation.”

Not long after The Letter came the Parkland shooting. “They acted more decisively than any asset manager, to say we’re definitely going to be engaging with companies,” says Jon Hale, global head of Sustainable Investing Research at Morningstar. BlackRock gave institutional clients the option to exclude gun manufacturers and retailers. It launched a new ESG exchange-traded fund and a small-cap ETF that excluded gun-related shares.

This is relatively new ground for BlackRock, which has a long and successful investment record. Since its 1999 initial public offering, its stock has returned almost 24% a year, versus 6% for the S&P 500.

**No sacrifice required?**

Comparison of traditional and ESG-focused equity benchmarks by region, 2012–2018*

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*From 5/31/12 through 2/28/18  
Source: BlackRock Investment Institute, with data from MSCI, April 2018

At the end of 2017, BlackRock had $500 billion in assets that used exclusionary screens (like eliminating gun makers) or other environmental, social, and governance tools, but just $50 billion in accounts run explicitly according to ESG-related principles. Deese aims to increase that. BlackRock is developing ESG target-date funds for retirement plans, and has developed
three new emerging market fixed-income indexes with JPMorgan, all with ESG principles.

“There is an enormous increase in client desire to have conversations about ESG issues,” Deese says. “Over the past year, it has really reached a crescendo in the U.S.” Among other things, BlackRock can take what it learns from engaging with companies on sustainable topics to help create scores and other metrics it can then use in risk management and investing. The company is already a leader in risk management, thanks to its Aladdin software, which crawls through a client’s portfolio and identifies every source of risk.

BlackRock, for instance, is mapping near-term climate risks that could affect municipal bonds and real estate. The project has obvious implications for all sorts of physical assets owned by publicly traded companies. “We are going to figure out how to scale it across the investment platform as quickly as we can,” says Deese. Fink, using the language of ESG investing, say investors should focus on climate change not because of personal political views but because they would be failing in their fiduciary duty if they don’t consider it when analyzing investments.

Fink is a board member of the Nature Conservancy and a major donor to the Democratic Party; he was reportedly on Hillary Clinton’s short list for Treasury secretary. He is also an avid collector of American folk art, notably weather vanes.

Few question his skill at seeing where the wind is blowing. He founded BlackRock as an institutional bond shop just a few years into the 35-year-long bond bull market. He bought Merrill Lynch Investment Managers when he needed global distribution and a retail clientele. He purchased iShares just as exchange-traded funds came into vogue. A tireless globe-trotter, he gathers information from meetings with world leaders and other people of influence. Recently, he and other CEOs met with the pope to discuss climate change.

Before The Letter, critics were pointing out what they saw as inconsistencies in BlackRock’s behavior.
“‘I’m 65 years old,’” Fink says. “‘We are spending a great deal of time at BlackRock getting the firm ready for when the founders are retiring. My legacy is going to be about how the firm does after I leave.’”

Consider the matter of J.B. Hunt Transport Services (JBHT). In 2016, $2.5 billion Trillium Asset Management, a vocal sustainable investor, filed a proposal urging the logistics company to adopt a policy explicitly prohibiting discrimination based on sexual orientation, gender identity, or gender expression. Hunt, which operates in 48 states, had denied this was needed, but had complained about difficulty in recruiting. “Gee, they could do better” with a new policy, recalls Matt Patsky, Trillium’s CEO. The shareholder proposal passed and J.B. Hunt expanded its protections for employees.

BlackRock, despite having its own policy prohibiting discrimination, voted against the demand, without giving an explanation.

Not long afterward, BlackRock signed on with a coalition led by Trillium and the New York City comptroller to oppose a Texas bill regulating transgender access to public bathrooms, part of a series of anti-LGBT measures by that state’s legislature. When BlackRock signed, “it suddenly became acceptable,” says Patsky. State Street (STT) and T. Rowe Price Group (TROW) followed. Trillium kept the pressure on BlackRock. A year later, BlackRock released engagement principles that included human capital, prioritizing diversity as well as other matters important to stewardship.

In May 2017, came a momentous Exxon Mobil (XOM) vote. Big pension
plans wanted Exxon to report how its business would be affected if measures
to curb global warming reduced demand for oil. BlackRock, which owns 6% of
Exxon’s stock, was among the 62% of voters that supported the proposal,
which the energy giant opposed. The investment firm aims to minimize the
environmental impact of its own energy usage. By the end of this year, 100%
of its U.S. facilities will be powered by renewable power.

For its part, Exxon responded to The Letter with a letter of its own to Fink,
outlining the company’s contributions to society. “We mutually benefit from
ongoing engagement which has demonstrated our aligned values, including
the importance of a long-term perspective,” wrote CEO Darren Woods.
Fink had been increasing the pressure on corporate leaders in his letters. In
2015, as interest rates perched just above zero, he wrote that returning
excess capital to investors sends a “discouraging message” about a
company’s resource management. He asked companies to articulate a long-
term strategy that would help shareholders understand their short-term
decisions.

In his 2016 letter, Fink thrust sustainability into the spotlight. “Generating
sustainable returns over time requires a sharper focus, not only on
governance, but also on environmental and social factors facing companies
today,” he wrote. Companies that handled ESG well usually had “excellent”
management, he contended. In 2017, with inflation rising and globalization
under threat, Fink wrote that BlackRock was focused on ensuring “board
accountability for creating long-term value.” He added that addressing
environmental, social, and governance factors could help.

Long before Larry Fink had the leverage to change Wall Street, investors and
activists were linking their causes to capital. In the 1960s, the Vietnam War
prompted some to drop arms-related investments. Then came divestment
from South Africa to protest apartheid. Some funds began eliminating “sin
stocks” issued by tobacco merchants, fossil-fuel producers, and the like.
As climate change became an issue, European political figures, nonprofit policy organizations, and big pension funds took an active interest. Having moved into Europe through the Merrill Lynch acquisition, BlackRock was aware that ESG was rapidly becoming the norm. “In Europe, you cannot be an asset manager and not embrace ESG,” says Roelfien Kuijpers of DWS Group.

BlackRock’s call for sustainability and social purpose could be seen by some as problematic. Its index funds include Nike (NKE, subject of some sexual-misconduct accusations); Philip Morris (PM, manufacturer of cigarettes); and Coca-Cola and PepsiCo (KO and PEP, both heavy users of sugar, which many regard as detrimental to health). Last month, a group of antigun protesters rallied outside BlackRock’s annual meeting to protest its continued holding of Sturm Ruger (RGR), maker of the assault rifle that the Parkland shooter used on former classmates. BlackRock is Sturm Ruger’s largest investor because the gun manufacturer is in indexes on which some of the firm’s ETFs are based.

And BlackRock itself is a work in progress. This year, it reported that women in its United Kingdom business earn 28% less per hour than their male colleagues, and that their median bonus was 45% lower. Women also made up just 28% of BlackRock’s board. BlackRock says it’s working on the issues: 53% of the 390 analyst trainees it hired in 2017 were women, and the group was ethnically diverse.

BlackRock’s competitors, however small, view it as insincere to point out the insincerity of promoting the language of sustainability as best practice while using an ESG lens on only a small part of the business.
“If BlackRock is doing it, they’re doing it because it is a good business decision,” says Trillium’s Patsky. “If it correlates with best practices, shouldn’t you encourage it to happen with the entire $6 trillion in assets?”

BlackRock’s full-throated support is taking the ESG industry from the minors to the big leagues. BlackRock’s involvement, says John Streur, CEO of Calvert Research & Management, a responsible-investment firm, suggests the industry will become more standardized around how companies measure, report, and define ESG data. (For an ESG glossary, see page S13.) In addition to a fat wallet, BlackRock has enormous analytical abilities.

Says Fink: “ESG risks are going to be a formidable component of investing over a sustained period of time. We want ESG risk management to be a tool that every manager is looking at as a reference point. We have to create the metrics for every company. I hope we are part of creating them; that’s one of our ambitions.”

Scarcely a day goes by without someone quoting Fink’s letter, particularly the part about “social purpose.” Fink elaborated for Barron’s: “A sense of purpose is an understanding at every level of the company about its role in the world and in the community. Purpose unifies employees, helps companies see their customers’ needs more clearly, and drives better long-term decision-making. This is true whether you’re producing oil, making movies, or helping people plan for retirement.”

Fink sees environmental, social, and governance standards and similar criteria as tools that will eventually be incorporated by all investors. In any case, he’ll be remembered for forcing some companies to discuss the issues.

“I’m 65 years old,” he says. “I would like to do this for five-plus years more. We are spending a great deal of time at BlackRock getting the firm ready for when the founders are retiring. My legacy is going to be about how the firm does after I leave.”

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