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## **ETHICAL EATING AS A GUIDE TO ETHICAL INVESTING**

**Consumption that also promotes a social good has risen in popularity in recent years. In some industries, a clear conception of ethical business behavior has developed. For example, a pretty firm consensus has arisen of what ethical eating looks like. Utilization of free-range animals along with GMO and chemical free crops, often locally sourced, would be among the expectations for an ethical restaurant or grocery. While many food industry participants have adopted these ethical concepts, the investment management industry has so far resisted consistent ethical delimiters. To bring better definition to ethical investing, what if we defined ethical investing using the established standards of ethical eating? Should investors expect ethical sourcing, presentation, "nutrition," and citizenship from corporations to which they have contributed capital? JAG Capital Management thinks these are achievable goals for an ethical investor.**

### **Inspiration**

Binge television watchers may be familiar with the episode of *Chefs Table* highlighting Blue Hill Restaurant in New York. Their efforts in farm-to-table ethical eating have earned a national following. St. Louis (my hometown) has its own farm-to-table movement, and I was lucky enough to eat at Winslow's Home recently. Winslow's Home has creative and tasty food (I had beet salad and brisket) which points directly to Winslow's Farm (35 miles away) and a few other farm locations. Along with being nourished, you get a message eating there. The restaurant devotes an entire wall (floor to ceiling) to books and supplies for essential living. We'd like to borrow from the farm-to-table movement to illustrate JAG's concept for ethical investing.

## Sourcing

Farm-to-table restaurants, at least committed ones, rely on relationships with local farmers to provide the foods. Transportation, and its environmental impacts are minimized, and the restaurateur has access to the farm to inspect for quality. A successful ethical sourcing strategy yields foods that are fresh. Along with proximity, ethical eating requires food components that are as chemical-free as possible, with minimal herbicides, pesticides, and hormones. Purity of supplied ingredients is critical as the end product can only be as ethical as its components. Sourcing of ethical investments probably begins with company behavior, as an ethical investment portfolio cannot likely be created using companies that are not performing ethically themselves. Portfolios require “clean” source material to ultimately produce an ethical product. Companies sourcing production components ethically would likely be using local labor, and not relying on long, overseas supply chains. Ethical companies are ones that strive to reduce waste and minimize environmental damage from their production processes. Sourcing investment choices from companies showing environmental and social progress is a good start for an ethical investment portfolio. These are good ingredients.

## Presentation

Once an eatery acquires food ingredients ethically, it then needs to prepare them ethically. So that customers can appreciate the purity of the ingredients, ethical foods are often prepared simply, expressing the pure, clean, fresh flavors of the foods. Just as important as preparation, is translating what is happening on the plate to the customer. Meal descriptions are straight-forward, highlight the value of the ingredients, and draw a bright line to the sourcing decisions. Even an ethical company may have difficulty identifying their sources and describing their processes for competitive reasons. However, translating what is happening in the business in communication to their stakeholders can be evaluated ethically. Companies have been known to hide bad news deep in their SEC filing footnotes. Other less-than-ethical firms limit disclosure by pre-selecting investor questions in quarterly conference calls. A standard exists for truth-in-labelling for a corporation. Generally Accepted Accounting Principles (GAAP) have been adopted to promote understandable and relatable financial statements. You may be surprised to learn that over 2,600 US companies report non-GAAP financials, or financial reports that differ from accepted accounting standards. If ethical presentation is straight-forward and standards-based, it seems to us that ethical financial presentation requires GAAP. Despite the high number of non-GAAP reports, an ethical investment portfolio can be assembled emphasizing companies that report GAAP numbers to their shareholders.

## Nutrition

It is not enough for a meal to be ethically sourced and ethically presented, that food also succeeds most when it has a benefit to the consumer in terms of their own eating enjoyment (taste) and health. Local, chemical-free foods, simply prepared are believed to provide superior nutrition for the diner, providing them a personal benefit.

An ethical company flourishes when providing personal benefit both to its consumers and its investors. On the consumer side, companies can provide products that have health and quality-of-life benefits. Common examples of such companies are solar energy users, electric car adopters, and organic food fulfillment firms. On the investor side, the benefit is even more pronounced. An ethical company gives its shareholders voting rights to influence, accept, or reject governance, financing (dilution), and executive compensation decisions. Nearly 400 US companies deny their shareholders these rights by having several classes of stock. A nutritious investment would preserve all of the benefits of shareholder rights, in our opinion. From these companies, an ethical investment portfolio can be created which contains companies preserving voting rights for common shareholders.

## Citizenship

In sourcing locally, presenting fairly, and delivering health benefits, those practicing ethical eating support their communities. Practitioners of these methods often alert consumers and competitors to best practices and help to broaden the education and experience bases of their cities.

For a corporation, ethical behavior requires producing a good or a service that improves people's lives, while earning a return on the capital necessary to compensate for the risk of providing that good or service. This is corporate citizenship in its simplest form. Several aspects of modern finance have blurred that relationship. Between 15% and 20% of the largest 3,000 US public companies do not earn a profit. This is not delivering on the basic mission. About the same percentage of public companies have dangerous levels of leverage, over 55% of assets. Moreover, more than fifty US companies have materially underfunded pension plans. By failing to compensate providers of capital, putting investors at risk, and failing to preserve workers' futures, corporations are not acting as good citizens, in our opinion. Particular to our own investment management industry, financialization (layer upon layer of financial structures and fees), development of market threatening derivatives, proliferation of market blurring ETFs, and a preoccupation with benchmarking have all served to add layers of risk and levels of obfuscation to investors. Ethical companies, earning a return, controlling leverage, protecting employees' futures, and limiting complexity are available to investors. An ethical investment portfolio houses stocks of these firms.

## Conclusion

Taking our cue from well-established views of ethical eating, the JAG Impact Growth portfolio is assembled from companies providing evidence of ethical sourcing, presentation, nutrition, and citizenship. We serve an appetizer of companies with high Environmental, Social, and Governance (ESG) scores, and for the first course, a healthy portion of GAAP. The second course contains voting rights, and for dessert, corporations with fully funded pensions. With these ethical investments, we intend to outperform the inflation rate. Bon appetit!

## About JAG

JAG Capital Management is an independent, 100% employee-owned registered investment advisor headquartered in St. Louis, Missouri. The firm provides portfolio management services for institutions, individuals, investment advisory firms and corporations. In addition to managing the JAG Large Cap Growth mutual fund, equity and fixed income separate accounts are also offered.

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