WITH THE SHAME OF AUSTERITY EXPOSED, WE CAN EMBRACE RESILIENCE

A pandemic reinforces role of ESG

Austerity policies have taken their toll on disadvantaged communities. These policies were promoted under the dual guise of promoting growth by stimulating investment through tax cuts and protecting the public from the destructive forces of rising federal debt. But we now have enough data and empirical evidence to debunk the trickle-down supply-side theories that successive rounds of spending cuts aimed at reducing government budget deficits shield us from economic peril and that repeated tax cuts will stimulate sufficient investment to spur growth. With this knowledge, we have seen a shift to inclusive politics, and are now witnessing the dawn of a new sustainability-focused era.

We have seen the catastrophic effects of Covid-19 variants in India and other countries where vaccine rollout has been limited or ineffective. But major progress with vaccine distribution has fueled a renewed sense of optimism in the U.S., leading to sharp upward revisions to growth expectations, pronounced market rotation between value and growth, cyclical and steady, and large and small stocks during the quarter.

Over the past four decades, public policies dedicated to austerity, combined with private corporate actions, eroded our national economic resilience, and also magnified the relative effect of economic downturns on lower-wage workers, women, and minorities. We now discern a sea change in policy goals: starting with the Federal Reserve's (the Fed's) August 2020 pivot to its flexible average inflation targeting framework, continuing through the November 2020 election, and further bolstered by

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the January 5 Senate elections in Georgia that flipped control of the Senate to Democrats. For these reasons, the scope for and perceived legitimacy of active fiscal and monetary policies has expanded.

Governments have for decades instituted austerity and social and economic policies based on the premise that only zero-sum outcomes are available. Tax cuts have been motivated by the argument that taxes, and only taxes, should be viewed as expropriations, ignoring the growing extractive relationship between business on one side and people and planet on the other. This view, ginned up by dog whistles to increase racial animus, and further promoted to increasingly economically pressured middle- and working-class white voters, was sustained by sophisticated gerrymandering of congressional districts, with the result that meant that election outcomes were increasingly decided in partisan primaries.

Austerity policies reached their limit in 2020. Longstanding discrimination in health care access was starkly manifest in the differences in Covid-related death and morbidity by race, ethnicity, and class. The devastating effect of the pandemic-related economic shutdown on the most marginalized members of society exposed the rigid structure and the dismal results of decades of economic policy: economic inequality rivaling pre-World War II levels; impoverished families; continuing gender and racial pay inequities and discrimination; and an ever-more-visible policing structure designed to keep racial minorities under control. During a spring and summer of widespread hardship, with up to 22.9% of the labor force either unemployed, underemployed, or marginally attached to the labor force, the ongoing series of murders of Black, Brown, and Asian people, by police and by self-appointed vigilantes, could no longer be ignored. The Black Lives Matter demonstrations brought together millions of people, recognizing brutal discrimination but also finding strength in joint action.

The Biden/Harris Administration enacted the American Rescue Plan in March, and thereafter proposed the American Jobs Plan. The Biden Administration plans start with these premises: Economic policy is not a zero-sum game; thoughtful policies should address multiple priorities; impending climate change poses critical economic threats and must be addressed; and the key to prosperity for everyone is to build economic strength across the population rather than concentrating wealth and income among the few. Cumulatively, already-enacted and proposed pandemic-related stimulus from the Trump Administration stimulus, the American Rescue Plan, and the American Jobs Plan and American Family Plan (which are both still subject to revision) totals about $5 trillion, compared with approximately $830 billion spent on the fiscal stimulus after the 2007-2009 financial crisis. Forecasted real economic growth for 2021 has been successively revised upward from 3.6% in September 2020, and 4.0% in December 2020, to 6.5% in May of 2021, while expectations for consumer price inflation have been revised up by 0.3%, from 1.8% in September 2020 to 3.0% in May 2021. The bond market's expectation of inflation over the next two years, as measured by the breakeven inflation rate, has risen by 0.95% since year-end, while the expected increase over 10 years is a more moderate increase of 0.52%. In our view, these increases in the breakeven inflation rates represent a reasonable response to a significantly improved economic outlook, particularly in the near term. The higher expectation of inflation over the next two-year period compared to the next 10-year period reflects the Fed's stated intention to let the rate of inflation rise slightly in the short term to reach an average inflation rate of 2%. This comes after several years of the economy running at a lower rate of inflation, and its affirmation that it does not intend to let the inflation rate run above 2% for an extended period of time.

In our view, these increases in the breakeven inflation rates represent a reasonable response to a significantly improved economic outlook, particularly in the near term.

Although variant strains of Covid-19 are spreading rapidly, evidence on the protection afforded by vaccines and the extent to which U.S. residents are already vaccinated is already allowing for some welcome expansion of economic activity. The modest increase in corporate tax rates envisioned by the American Jobs Plan is offset by corporate savings on debt from extremely low interest rates and the general expansion in economic activity from

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infrastructure spending. We expect robust corporate earnings growth to continue through 2023, which should lead to positive equity returns.

We remain committed to our long-term focus and investment in high-quality and sustainability-centered companies seeking to meet the needs of tomorrow. Our belief in the importance of ESG is only reinforced by the past year, as we are convinced more than ever of the importance of integrating these goals into our investment decisions. We hope the companies we invest in will be able to work in concert with a government that both acknowledges these daunting challenges and takes action to address them.

As a nation, we have the financial ability to do better. Interest rates are low, and inflation has been low for two decades. We have the ability to invest in our schools, our children, our elderly, roads, bridges, and dams. We have the ability to fund basic research into zero-carbon or carbon-neutral energy sources and production methods. The return on investment for all of these projects is well above the borrowing costs, so these would add to economic wellbeing in the future.

We can focus on rebuilding the resilience of our economy and the resilience of our society. We can invest to improve the ability of our cities to withstand climate risk. We can support employment and raise the minimum wage so that working parents have a living wage, so that hunger and homelessness are not lurking behind every corner. We as a society have the ability to do, but only if we have the will.

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