CREWCIAL PARTNERS

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BRACE FOR IMPACT

MANIFESTING RESILIENCE IN THE FACE OF RECURRENT THREATS

Brace for Impact

Aristotle wrote that 'self-preservation is the first law of nature.'

Through history, human progress and stagnation have been the twin results of our striving to simply survive in the face of both expected and unexpected perils. But beyond simply making it from one day to the next, what does it mean to persevere—more directly, what is the point?

The civilization of ancient Egypt relied heavily on the annual flooding of the Nile River, which brought fertile soil to the surrounding lands while also occasionally devastating settlements with uncontrolled torrents. Surmounting this natural force would take great effort, short-term sacrifice, and determination without a guarantee of success, whereas many must have assumed the tradeoff of so many adobe and reed dwellings each season was acceptable for the certainty offered by the existing state of affairs.

However, enough people of Egypt recognized the importance of utilizing and tempering this phenomenon to better ensure their forward-looking survival and prosperity, and they eventually harnessed the power of the flooding to develop an intricate irrigation system (later exported to surrounding civilizations). By mastering this technique, they were able to cultivate crops throughout the year and ensure a stable food supply, reducing the risk of longer-term famine and the rampant destruction of their homes, and enabling population growth beyond the status quo[1].

This ultimately allowed them to dedicate time and resources to other pursuits beyond mere survival, facilitating the development of a complex society with specialized roles, including artisans, architects, scribes, and scholars. The surplus food production resulting from their agricultural innovations supported the growth of urban centers and the construction of monumental structures such as the pyramids. All in all, it was the preeminent Mediterranean civilization for around 30 centuries[2].

Having a goal—a mission—helps to define the driving force that allows us to make that extra effort to see past immediate gratification towards a larger or more sustainable long-term objective. Because, on the other hand, an undue focus on immediate preservation can hinder the march forward and lead to the unfavorable persistence of present circumstances.

In medieval Europe, feudalism was a socio-economic system characterized by the exchange of land for military service and the hierarchical relationship between lords and vassals. It aimed to maintain stability and protection during a period of frequent invasions and political instability.

While feudalism provided a certain measure of security for those within the system and allowed baseline survival for many, it also led to centuries of social and economic stagnation[3]. This system discouraged innovation, entrepreneurial activities, and social mobility, as resources and power were

> **BE CAREFUL WHEN BUILDING WALLS TO PROTECT YOURSELF.
> THOSE SAME WALLS MAY CAGE YOU IN.**
>
> ANONYMOUS

concentrated in the hands of the feudal lords, whose sole focus was on maintaining the delicate balance of power among themselves, or tipping it in one or the other direction, all in the name of more or less static self-preservation of the status quo. The serfs and peasants, powerless and tied to the land, simply had no choice but to oblige this state of affairs to obtain the minimal requirements of shelter, food, and security to make it through to the next season themselves.

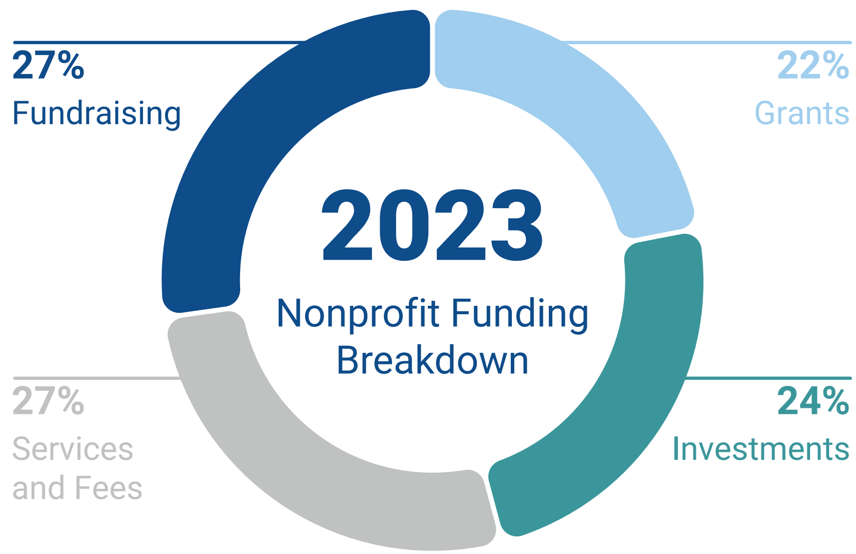
So how does one balance the occasionally paradoxical requirements of both shorter-term survival and longer-term progress and prosperity? While such objectives occasionally dovetail, the case is not aways so simple, leading to compromises that sometimes benefit today at the expense of tomorrow.

For institutional investors facing such things as unforeseen economic downturns, markets crashes, sudden changes in leadership, or unforeseen external complications (such as COVID-19), self-preservation can lead to risk aversion and an undue focus on short-term risks without an appropriate consideration of longer-term opportunities and more subtle, albeit more nefarious long-term challenges. When a near-term focus becomes magnified during difficult periods, long-term financial sustainability, social responsibility, and/or ethical considerations often take a back seat to immediate concerns and are left unaccounted for, ultimately leading to grave consequences.

Returning to the Middle Ages for a second time with a more sympathetic lens: Despite the period's reputation for stagnation, one innovation stands out precisely for the balancing act that allowed it to grow, eventually prosper, and ultimately supplant more archaic systems—the rise of the independent town.

While feudalism lasted for hundreds of years, underlying social and economic currents constantly fissured and cracked the overarching political structure despite all attempts at suppression. Perhaps most consequentially, during the late medieval and early modern periods, European trade expanded significantly. The discovery of new lands and overseas routes, such as those to Asia and the Americas, opened up more-expansive opportunities for long-distance trade throughout the general population. This led to the rise of an enterprising new social class known as the bourgeoisie, composed of merchants and traders, who eventually began to demand self-determination in government and broader sovereignty. This in turn led to the development of independent towns, marking a pivotal shift towards modernity, as communities sought to assert their autonomy and break free from the constraints of feudalism. These towns, often situated just outside or on the fringes of the domains of feudal lords, emerged as centers of economic and political power. Of course, many of the older order saw this as a threat to their dominance and sought to suppress the upstarts, but fortified with the same walls and beholden to the same defensive techniques as their lordly neighbors, the new merchant- and artisan-led settlements adapted existing technologies to assert independence while integrating into a market edging closer and closer to that of today.

But how, specifically, does this niche historical example relate to a modern endowment struggling to determine its next move amid recent challenges?



Source: https://www.mip.com/wp-content/uploads/2023/03/2023-Trends-and-Insights_Research-Study_v4.pdf?submissionGuid=f49e2273-5f47-4733-bdb7-644490c3de08

The Balancing Act: Immediate Concerns and Ultimate Goals

First, the importance of a long-term mindset over short-term considerations lies in the sustainability and impact of an organization's mission, its reason for being.

Just as these towns and their collective resources existed to cater to the needs of their people while providing an environment conducive to security and prosperity, non-profit organizations contribute to positive change and address social, economic, and/or environmental challenges when they possess sufficient capital to realize their objectives. Cultivating a long-term mindset and approach allows one to focus on achieving one's mission over an extended period, making strategic decisions that at times look past short-term costs and risks for long-term sustainability and growth. These intangibles are not the metaphorical strong walls protecting the village per se, but the more fundamental choice of a favorable, defensible physical location (e.g., high ground, water source) preceding the construction of the town.

It is this well-situated position that fundamentally ensures your ability to provide sufficiently to weather current or less expected misfortunes, while also increasing the likelihood that once such situations pass, you're already favorably oriented to quickly scale and recover to previous levels of impact (and beyond).

Now, this is easy to expound upon during periods of relative calm or market upswings, but the very real distress evoked from circumstances beyond one's control is quite natural, reasonable at the time, and impossible to ignore. However, the secret is relatively straightforward: While difficult to appreciate as they're happening, bad years and shorter-term periods of poor performance will be transitory so long as one maintains an intelligent, diversified, and well-balanced portfolio steadfastly aligned with a strong, mission-oriented Investment Policy Statement (IPS). While it may seem simple, these are the stone foundation of your walls.

> **"WHEN A NEAR-TERM FOCUS BECOMES MAGNIFIED DURING DIFFICULT PERIODS, LONG-TERM FINANCIAL SUSTAINABILITY, SOCIAL RESPONSIBILITY, AND/OR ETHICAL CONSIDERATIONS OFTEN TAKE A BACK SEAT..."**

As in a siege, when one is well-positioned with access to water (i.e., cash/ liquidity), ample sustenance reaped during more fertile periods (a well-designed spending policy), and strong defenses (diversification, contrarian thinking, and avoidance of the madness of crowds), the concerns surrounding future impact due to broader market issues such as inflation or a general downturn are primarily psychological in nature. The besieging army in the field, be it a literal army or the metaphorical fallout from, say, a new conflict affecting the global supply chain, does not have time on its side (although it can feel that way). It is subject to the general entropy of all such enterprises; desertions, exhaustion, and an inability to support such a force beyond the reserves initially stockpiled will typically deplete such opposition longer term, all things being equal[4].

Markets often experience cyclicality by their very nature, with downturns followed by recovery and growth. The fear of what's happening now is generally an extrapolation of anxiety around present circumstances continuing unremittent; however, as stated, all such periods are transient, and even beneficial once markets correct, and maintaining investment discipline is a decisive factor in determining which organizations will survive, or even thrive, and which may be unable to continue.

But what exactly comprises the archetypical "well-constructed portfolio," the modern fortifications able to weather the storm?

1. **Balance:** The first component is an investment strategy that balances short- to intermediate-term impact and liquidity needs with long-term financial goals. Non-profits and all long-term investors should establish an investment approach that outlines an appropriate asset allocation, risk tolerances, and ample diversification to generate appropriate returns that preserve capital for the long term.

2. **Transparency:** Articulating such a strategy in a comprehensive IPS allows for transparency during downturns so that investment committees, particularly those subject to or undergoing membership changes, can collectively understand the strategy in context and expectations for future performance and mission achievement. Such transparency is essential, and investment committees should maintain open communication with stakeholders, including donors, board members, and the organization's leadership, providing regular updates on investment performance, market conditions, and the rationale behind their investment decisions. Effective communication helps build trust, ensures alignment, and reinforces a committee's commitment to responsible stewardship of an organization's assets.

3. **Mindfulness:** An awareness of the various risk factors that impact the staying power of any portfolio is also essential; this involves a robust framework of risk assessment, so one knows exactly what they are holding and can make clear decisions based on the long-term principles that underlie and support strong investment outcomes. At its core, an effective risk-assessment framework assesses prospective returns in light of expected market volatility, credit risk, liquidity risk, currency fluctuations, etc., and by analyzing these risks, organizations can develop strategies to optimize their own performance.

These are relatively fundamental tools. However, truly effective portfolio construction should also be oriented to consider certain key factors underlying the above; effectively, it should assess the potential of its active managers and their holdings to continue operating successfully into the future based on the demands required of the future across each industry, and it should take pains to capitalize on the full range of available talent. Such an approach can also secondarily support certain institutions' missions by investing in alignment with the future sought by that organization.

In this respect, two regularly underexplored, yet often crucial risk factors are frequently excluded from the broader framework: sustainability and inclusion. These are the watchmen on your walls providing a 360-degree view from atop your existing fortifications, adding an extra layer of intelligent protection.

The Vigilant Sentinels

Investing for sustainability comes in many forms, all fundamentally concerned with a company's ability to continue operating successfully. Conceptually, it has existed as long as investing, although its most recent historical iteration is commonly referred to as Environmental, Social, and Governance (ESG) principles, which can be many things highly dependent on context; when applied meaningfully and transparently, they provide important risk insights that should be assessed by all investors:

> **Incorporating ESG, SRI, or impact in investments requires a process of factorizing the issues/topics the investor deems relevant — for example, using a workforce diversity metric to determine the level of commitment to inclusivity, or measuring an organization's carbon emissions as a tool to assess its commitment to environmental sustainability. This factorization process depends on subjective definitions of the issues. To add further complexity, ESG and SRI are not asset classes themselves, but rather a way of investing within each class, subject to the idiosyncrasies and particularities of the services and products represented by the relevant sectors... for example, in the case of tobacco or alcohol, a reduction in water use and waste, a responsible use of limited, sustainable farmland, and fair trade agreements to ensure labor practices protect those workers harvesting and preparing the raw materials...Importantly, success is how each organization defines it, based on its own values and financial expectations[5].**

Such criteria simply expands and enhances the risk framework by which one builds a portfolio, allowing for greater knowledge to make better-informed decisions. They act as additional sentinels—ever-vigilant eyes and ears assessing the town from all sides, ready to raise the alarm as needed.

In the first instance, this can lead towards a more proactive resilience. By incorporating sustainability considerations into investment decisions, institutional investors can better identify and mitigate potential risks that may have a short-term impact on financial performance. For example, evaluating a company's environmental practices can help anticipate regulatory risks, resource scarcity, or reputational issues that may lead to financial setbacks.

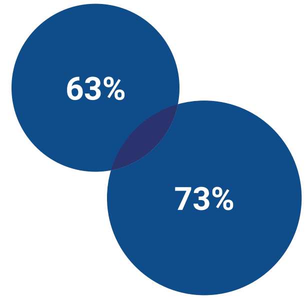
Similarly, assessing social factors such as labor practices, community relations, or product safety can uncover risks related to legal liabilities, consumer boycotts, or operational disruptions. By incorporating an awareness of these risks and accounting for them in valuation and company engagement, investors can avoid unpleasant surprises which more often than not rob them of the ability to act in a rational, balanced, long-term manner.

More fundamentally, in terms of constructing a portfolio built to last in perpetuity, ESG integration in a traditional investing process (not to be mistaken with investing in ESG strategies) goes beyond simply assessing risk; it can also help one identify companies well-positioned for long-term value creation. A Harvard Business Review article from 2016, "The Comprehensive Business Case for Sustainability,[6]" reports a positive correlation between strong ESG integration and financial performance across numerous studies, noting that companies with robust sustainability practices tend to be more innovative, have a better ability to identify emerging market opportunities, and demonstrate a stronger long-term orientation. By investing in sustainability-oriented companies, institutional investors can align their portfolios with business models with the potential to generate strong financial returns over time. Such companies often exhibit qualities like efficient resource utilization, strong corporate governance, inclusion, employee satisfaction, and positive community impact. These factors contribute to their ability to weather short-term financial fluctuations and maintain their competitive advantage, leading to longer-term value appreciation.

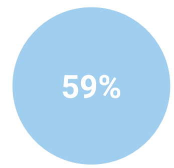
Like the then-newly-developing conceptions of political and economic power in medieval towns, integration of ESG principles represents both an expansion of one's scope of experience and the removal of antiquated thinking. It can take many forms, ranging from assessments intended to lead to the full exclusion of companies or industries, towards approaches that see engagement as more impactful, which aim to capture significant excess returns by accounting for the benefits and risks of various corporate behaviors in a far more robust way than that of other market participants.

In this sense, much of what we believe we know regarding ESG principles and their application will at times require modification or even, in some cases, a complete rethinking. Maintaining a mindset that remains open to reiteration is pivotal to success. In that sense, we seek to both fortify the defenses and paradigms of thought that serve a productive purpose while tearing down those that do not.

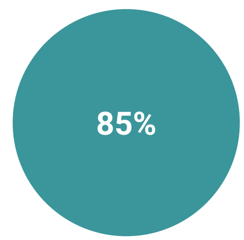
ESG integration signals a commitment to a broader ecosystem that includes stakeholders such as clients, employees, regulators, and the public. A strong reputation and stakeholder trust are invaluable assets, particularly during challenging times. Integrating credible sustainability principles helps institutional investors build and maintain their reputations as responsible, ethical, and forward-looking stewards of capital. By prioritizing factors that support responsibility and transparency, organizations can demonstrate their commitment to environmental sustainability, social well-being, and sound governance practices.



63% of buyers and **73%** of suppliers reported that sustainable procurement practices helped them endure the pandemic.



59% of leaders reported increased sales revenue based on improved reputations around sustainability.



85% of business leaders reported sustainability practices helped them mitigate risk.

While ethical behavior is often enforced by the threat of fines or other legal penalties, official sanctions can only go so far. The stick must be balanced with a carrot—e.g., bigger orders, better prices, or longer-term contracts. Examples include Starbucks, which offered to pay above-market prices to coffee farms to show they were making improvements to environmental and social responsibility, and Nike, which worked with its suppliers to improve productivity at their factories by improving the lives of workers. When productivity went up, compliance with Nike's sustainability goals increased as well because the factory owners had no incentive to violate the rules.

Source: https://www.gsb.stanford.edu/insights/sustainable-supply-chains-helped-companies-endure-pandemic

The Denouement

Perhaps the most fundamental point to keep in mind when balancing immediate versus ultimate goals, particularly in terms of sustainable investing, is that the march of progress is, at least historically, inevitable, and embracing change and recognizing the relatively deterministic nature of cycles are key to long-term survival.

The growing influence of the bourgeoisie eroded the power of the feudal nobility, as wealth and business acumen became alternative sources of influence and status, leading to alternative forms of governance and social organization. Those among the aristocratic class who resisted the changing landscape to shore up existing power for themselves ultimately left their successors with dwindling influence, and finally, in many cases, obsolescence. New urban centers broke free from feudal constraints and asserted their autonomy by adapting the resources at their disposal to their needs, coupling such use with forward-thinking innovation. Through the adaptation of existing technologies for defense, economic prosperity, and the acquisition of political influence and respect through proven staying power, these towns reshaped the social fabric of medieval society and brought it into the early modern period.

While short-term volatility is inevitable, difficult, and anxiety-inducing, it is also an unavoidable part of investing for a greater good and financial goal, and should not prompt a deviation from a well-defined strategy that relies on such cycles and a forward-looking orientation to generate future wealth. By anticipating one's ultimate needs and investing according to established long-term principles, an organization can serve as an inspiration to its community, signaling that times of abundance will indeed return.

Many of the walled cities and massive foundations of feudal castles still exist, albeit in different form—as modern regional or national hubs of commerce and culture for the former, and as awe-inspiring ruins dutifully managed by historical societies for the latter.

Bracing for impact means embracing impact, absorbing the lessons of the past and adjusting today to be better prepared for the shifting landscapes of tomorrow. This is a weighty task and responsibility, but it is also very achievable through discipline and a willingness to embrace all of the tools at your disposal, leaving you standing tall among yesterday's rubble.

The US Environmental Protection Agency on Friday recently launched two competitive grant programs with $20 billion in funding to spark clean energy investments across the country. The programs, part of the overall $27 billion Greenhouse Gas Reduction Fund established by the Inflation Reduction Act (IRA) last year, are the latest move supporting projects that reduce planet-warming emissions. The non-profit green banks help reduce risk of projects in lower-income communities by providing a financial backstop and help attract private sector investment. Michael Regan, the EPA administrator, said the fund will spur private investment into clean technology and "expand economic opportunity for communities that have been left behind."

Source: https://www.reuters.com/sustainability/us-launches-20-bln-green-bank-programs-curb-climate-change-2023-07-14/

Endnotes

[1] Shaw, I. (2019). The Oxford Handbook of Ancient Egypt. Oxford University Press.

[2] https://www.history.com/topics/ancient-egypt/ancient-egypt

[3] Wickham, C. (2009). The Inheritance of Rome: A History of Europe from 400 to 1000. Penguin Books.

[4] History is rife with examples, with an arbitrary sampling across time including the Siege of Constantinople (674-678), Siege of Malta (1565), and Siege of Vicksburg (1863).

[5] Ligonde, S., De Temple, G., & Ajuyah, T. (2022). Defining Your Double Bottom Line: Philanthropy and the Investment Landscape. The Foundation Review, 14(4). https://doi.org/10.9707/1944-5660.1635

[6] https://hbr.org/2016/10/the-comprehensive-business-case-for-sustainability