Truth creates light

US capital: Diversifying abroad, imperfect access

Edison themes

10 May 2022

The US equities market is the largest in the world, accounting for c 40% of total world market capitalisation. There is a culture of share ownership; over 50% of US households own equities and there is a rich ecosystem servicing this market. US investors are increasingly looking to diversify away from the home market: c$11.9tn of their holdings are in non-US equities, up 67% from $7.1tn in 2016, and we expect this trend to continue. ESG capital pools are growing, yet US equities are current laggards in ESG terms. Meanwhile, the growth companies that have largely driven US equity market performance now face headwinds in an environment of rising inflation and interest rates, making investors look again at diversifying their portfolios both in terms of sector and geography.

For non-US issuers the growing demand for non-domestic securities presents an opportunity to add US investors to their share registers. However, comprehensive access to qualified investment pools in the United States is far from straightforward, with changing market structures making it more challenging for issuers to access the market.

We describe this gap between the *total* pool of and *readily* available capital for issuers as 'dark capital'. Appropriate access to these pools of dark capital requires an appreciation of current market dynamics and sophisticated marketing approaches to raise their profile. As a capital markets analogy to the Washington Post's slogan 'Democracy dies in darkness', we are of the view that in a world of dark capital, 'Truth creates light'.

Advice from Rachel Carroll, head of our US office

We interview Rachel Carroll (see pages 14 and 15 of this report). She highlights that in the US over the last 20 years, there have been significant changes in the financial services industry and the impact on the field of investor relations has been pronounced. Her advice for issuers would be to take ownership of their capital markets strategy and the challenges of navigating an increasingly fragmented ecosystem where much of the capital sits outside the reach of traditional sell-side channels.

Flow data show a move out of growth

Morningstar data show that to the end of Q122 there has been a consistent rotation out of US growth since 2019, as investors have locked in gains and diversified into blended and value strategies. Q122 data suggest bond market funds were in aggregate seeing outflows, as did money market funds. By contrast, flows to equity seem relatively well supported, perhaps buoyed by the lack of inflation compensation from other asset classes and a corresponding focus on 'real' assets. Through 2021 value strategies started to see a comeback, as did flows into international equities, which continued into Q122. Many were starting to rotate portfolios for the post pandemic reopening and positioning into cyclical names. The flows into European names reversed in late February 2022 according to Lipper and iShares data, responding to the invasion with flows coming back to US equities, which were seen as more insulated from the geopolitical shock compared to Europe.

From the street

'It is a reasonable bet that American investors will gain more from international diversification over the next five decades than they did over the last five. Given the greater correlation between global markets, international diversification may no longer be a free lunch but it still seems like a sensible piece of insurance.'

Philip Coggan, *Financial Times* 5 March 2022

Edison themes

As one of the largest issuer-sponsored research firms, we are known for our bottom-up work on individual stocks. However, our thinking does not stop at the company level. Through our regular dialogue with management teams and investors, we consider the broad themes related to the companies we follow. Edison themes aims to identify the big issues likely to shape company strategy and portfolios in the years ahead.

Edison illuminates

Dark capital: this phenomenon now operates across multiple dimensions in US equity markets**.** Retail investor price-sensitivity has driven the primacy of passive investment, while wealth creation has triggered an explosion in relatively opaque small-scale wealth management operations, such as single-family offices.

In parallel, the US equity trading environment has also become increasingly fragmented with the trading activities and motivations of participants often unclear. For the dwindling proportion of visible active investors, access to a broad range of fundamental research is now constrained, exacerbating broadening information asymmetries.

This combination of factors has created 'dark capital' – an increasing disconnect between the available capital stock and available investment opportunities.

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The US equities market: Key points at a glance

- The US equity market is the world's largest, with a capitalisation of $52.2tn at the end of 2021 (Exhibit 8). This represents c 40% of global equity capitalisation and c 60% of institutional global equity indices.
- The US equity market has a strong growth company bias, with c 63% of US investible capitalisation in the information technology, healthcare, consumer services and communications services sectors, versus just c 39% ex-US.
- The US hosts eight of the 10 largest asset managers in the world. Passive investment, driven by cost concerns, dominates net equity inflow, with over $1tn flowing from US active to US passive funds within the last five years.
- The US is the world's largest regulated funds market with a c 48% share of the $71tn assets under management (AUM) and at least c 60% ($20.5tn) invested in equities at the end of 2021.
- US retail AUM is significant. At the end of 2020, households held c 40% of domestic equities, nearly 48m US households had a retirement account and over 58m owned at least one mutual fund.
- Single family offices appear to be growing rapidly driven by an increasing number of ultra-high net worth (UHNW) individuals. The Credit Suisse 2021 Global Wealth Report identifies over 110,000 such people in the US each with a net worth of $50m+.
- At the end of 2021, US ownership of international equity stood at c $11.9tn, up 67% on 2016. Some 42% of this investment is based in Europe. Recent flow data suggest further appetite for international exposure.
- The average US stock fund fell 8.6% in April 2022 and is down 14.1% for the first four months of 2022 according to data published by Refinitiv Lipper. Large-cap growth funds fared worse, down 12.4% in April 2022 and down 22.1% for the first four months of 2022. International funds fared better in April, down 6.6%, but still have had a difficult start to the year, down 14.3% in 2022 to end April.
- The US market structure is changing, with the fragmentation of trading through deregulation and electronification; the growth in passive AUM; the greater share of algorithmically driven market making; and the significant information asymmetry in research provision. This has made access to the US market more challenging for issuers.

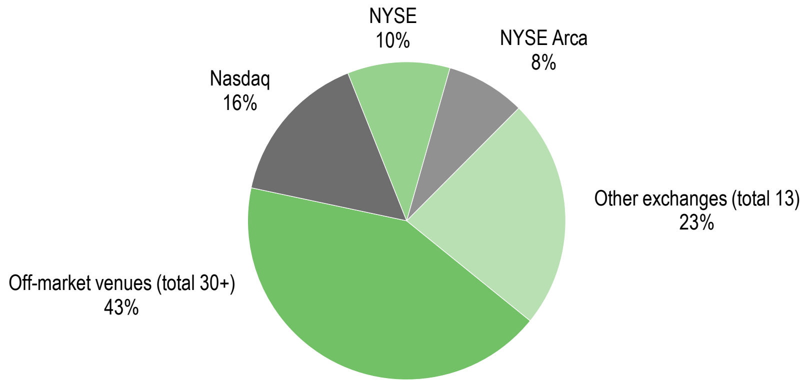
Dark capital: A new trend

The US equity market represents an unparalleled breadth and depth of overseas capital opportunity for UK and European companies and we explore aspects of this further in this note. However, this market opportunity is not easy to access effectively. The capital ecosystem operates across a large, ever-changing and highly fragmented landscape, which is complex to map and difficult to comprehensively leverage.

At Edison, we characterise the shortfall between the equity investment capital available in the US and that readily available to issuers as dark capital. Dark capital appears to be growing, and we believe has become an acute concern for many UK and European issuers.

Dark capital operates across multiple dimensions in the US. For example, as detailed further in this note, the trading environment for domestic equities has become highly fragmented through a process of electronification and deregulation. Much of the liquidity has been pushed off-exchange and onto 'unlit' venues (or 'dark pools') where the identities and motivations of the trading parties are often difficult to discern. We illustrate the scale of this phenomenon in Exhibit 1 below.

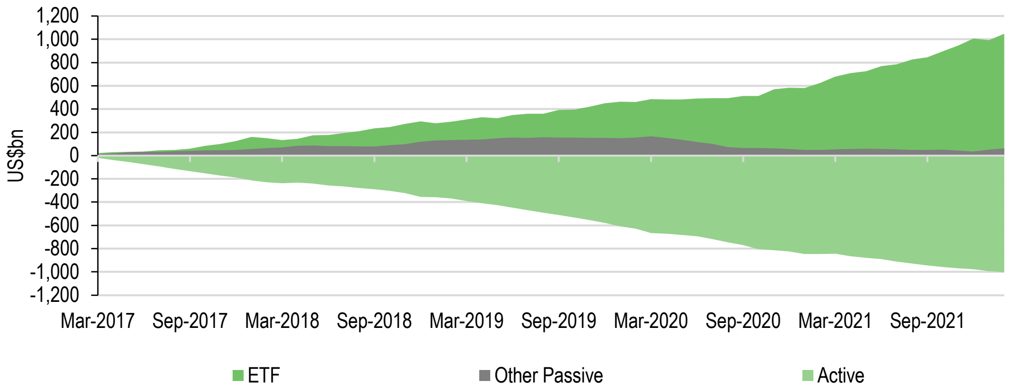
Exhibit 1: Fragmentation of US equity trading market share



Source: FINRA, SEC, Edison Investment Research

A better understood and documented dynamic is the increasing passivity of equity investment in the US. The creation of low-cost index-tracking and exchange traded funds (ETFs) has dominated net flows for many years and Morningstar has noted the persistent price-sensitivity of investors. In August 2019, passive equity investment funds finally overtook active AUM and since then the trend has accelerated. In less than five years over $1tn has flowed from active to passive equity funds.

Exhibit 2: Passive inflows and active outflows for US equity funds



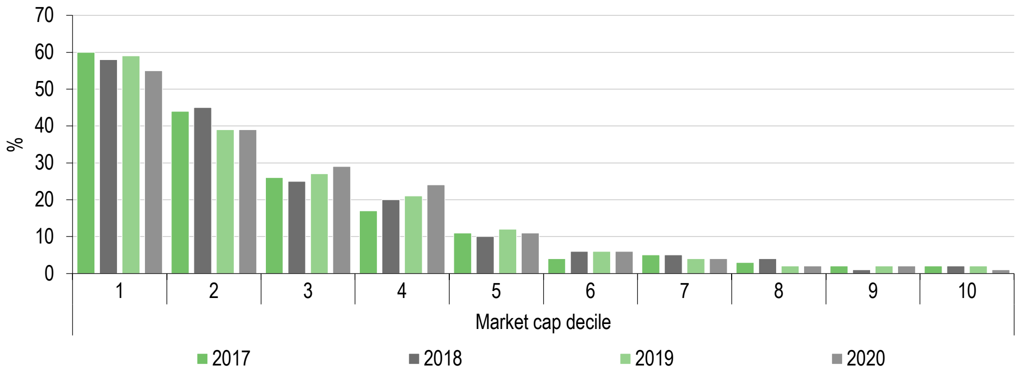
Source: Morningstar, Edison Investment Research

The combination of increased algorithmic trading and passive investment has led some commentators to suggest that markets are increasingly 'on autopilot'. If these trends persist, they may have long-term consequences for the efficiency of capital allocation to US public equity. A more proximate issue, however, is that sell-side equity sales teams and investment advisers are talking to a diminishing part of the overall capital pool. The remainder is largely inaccessible dark capital.

Compounding this dynamic is growing information asymmetry in the form of research provision. Europe's MiFID II regulation has deemed freely disseminated equity research an inducement for asset managers to trade with sell-side banks. Hence, in Europe and the UK, research requires a separate payment from the asset manager. Many US asset managers have now adopted the MiFID II provisions on a global basis, with the majority absorbing the cost of research on their own P&L. This shift has already led to a significant reduction in research consumption, with smaller issuers and asset managers being disproportionally affected.

A recent Staff Report from the US Securities and Exchange Commission (SEC) suggests that the baseline position for smaller US issuers is already far from ideal, with a c40% of issuers with market capitalisations of $250m or less attracting no research coverage. The gradual decline on overall research coverage is illustrated in exhibit 3 below.

Exhibit 3: A large percentage of small US issuers attract no research coverage

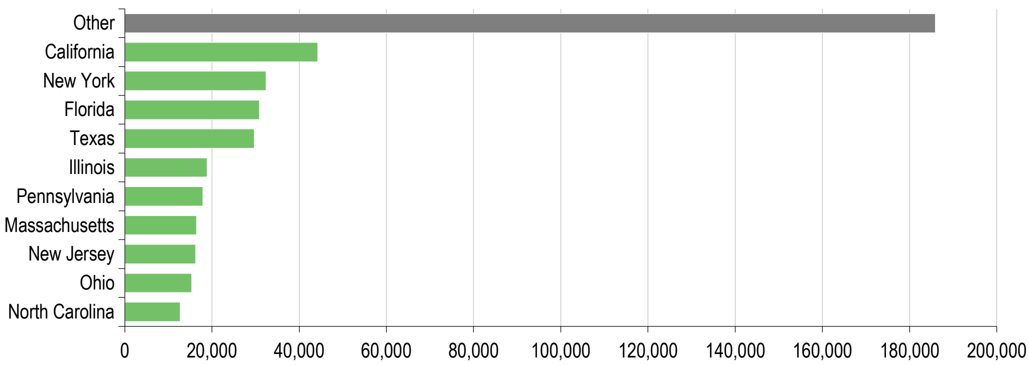


Source: SEC Staff Report February 2022, Edison Investment Research

As troubling as this may be, this study almost certainly understates research coverage shortfalls as under MiFID II only paying parties can legally receive research; investors will have access only to a subset of what is published. Access to analysts and issuers, which is generally priced at a premium and charged separately, is probably even more affected. If this is the position of domestically-listed stocks, it is not unreasonable to suggest that the visibility of many UK and European issuers to a large proportion of the US investor base is very low indeed. At Edison, we believe that this dynamic is escalating the breakdown in connectivity between research providers, issuers, advisers and asset managers and is significantly contributing to the growth of dark capital.

Finally, we would highlight that the sheer breadth and ongoing segmentation of the US investment market are also creating pools of dark capital. As an example of the former, a database search of the Financial Industry Regulatory Authority (FINRA) reveals over 420,000 active registered investment advisers servicing a range of investors from the mass affluent to UHNW individuals. These advisers are located in the US as shown in Exhibit 4.

Exhibit 4: Distribution of active FINRA-registered investment advisers by state

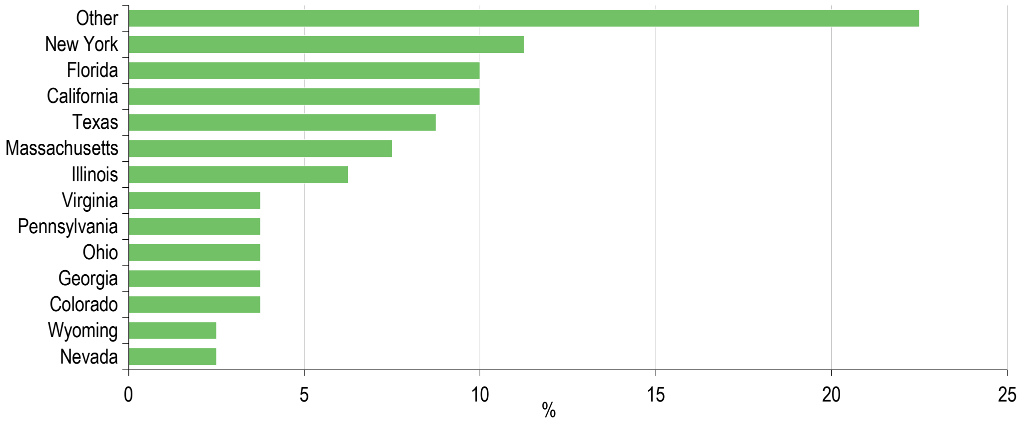


Source: FINRA Brokercheck April 2022, Edison Investment Research

It is unsurprising that the financial hubs situated in both California and New York feature prominently in this analysis. However, areas such as Texas are often overlooked by the financial community. Moreover, over 44% (c 186,000) of these advisers are based in states outside the top 10, suggesting significant pools of capital under advisement and management that may not be adequately serviced by conventional marketing practices. Given US investors' appetite for international equity investments noted further herein, it seems highly likely that this network offers significant untapped potential for both investors and overseas issuers alike.

Fragmentation of the UHNW market is also contributing to dark capital formation through the growth of family offices. Segment data is imprecise, however Campden Wealth reported a 41% increase in offices between 2017 and 2019, with 3,100 offices managing an average of $852m, implying $2.6tn total AUM. Moreover, the Credit Suisse 2021 Global wealth report identifies over 110,000 UHNWs individuals in the US with a net worth of $50m+, suggesting a large addressable market. The most recent Campden/RBC survey suggests a broad distribution of family office activity in the US.

Exhibit 5: Locations of family office survey US respondents by state



Source: Campden/RBC North America Family Office Report 2021, Edison Investment Research

Moreover, the same survey suggests that 46% of North American family offices are seeking new investment opportunities and that they are 34% invested in public equities.

To conclude, our analysis suggests that a large proportion of US capital does not have effective visibility of a large proportion of UK and European stocks. Equally, listed businesses are not aware of the existence and/or investment strategies of a large pool of potential shareholders. Appropriate access to these pools of dark capital requires an appreciation of current market dynamics and a sophisticated marketing approach.

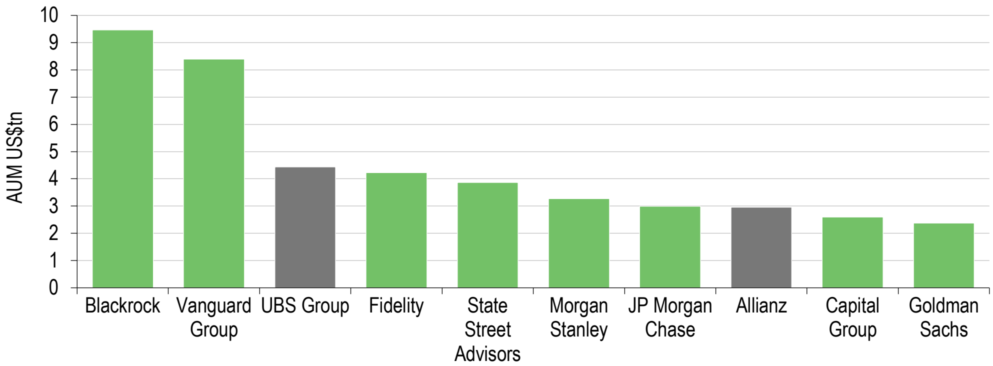
The US has a thriving equity culture

The US's affinity for equity investment has deep and complex roots. Historically, the US had a relatively weak and fragmented banking system. Arguably this created the conditions for the early development of market-based finance, with equity playing a major role. It is also likely that this dynamic encouraged greater risk-taking and entrepreneurship and has been a driver for the relative success of US listed companies. Taken together, these factors are clearly self-reinforcing.

What is less contentious is that the legal and regulatory environment in the US has been highly supportive of equity investment for decades. Mutual funds have been available since the 1920s and the regulatory framework in place since 1933. Legislation has encouraged a mass market for funded pensions since the 1970s.

Whether by nature or nurture, what is certain is that the US is now home to the world's largest and deepest capital markets, with domestic asset managers dominating global rankings of AUM.

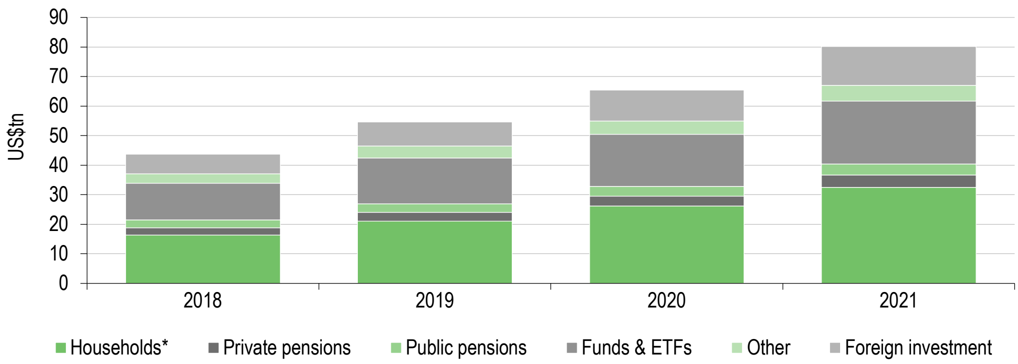
Exhibit 6: Top 10 global asset managers by assets under management



Source: thebalance.com. Note: Non-US (EU) groups in grey.

Not only is US investment in US equities deep, it is also broad. In 2021, the Investment Company Institute (ICI) estimated that in 2020 58.7m US households (45.7%) owned at least one mutual fund and 47.9m (37.3%) held one or more retirement accounts. The US is also the world's largest funds market. Data compiled by the International Investment Funds Association (IIFA) suggest that by the end of 2021, the US was home to over 10,000 funds, of which over 6,300 were dedicated to equity, and nearly 2,600 ETFs. The most recently available data suggest that US households directly own c US$32.5tn of domestic equity, over 40% of the available stock.

Exhibit 7: US households own more than 40% of domestic equity

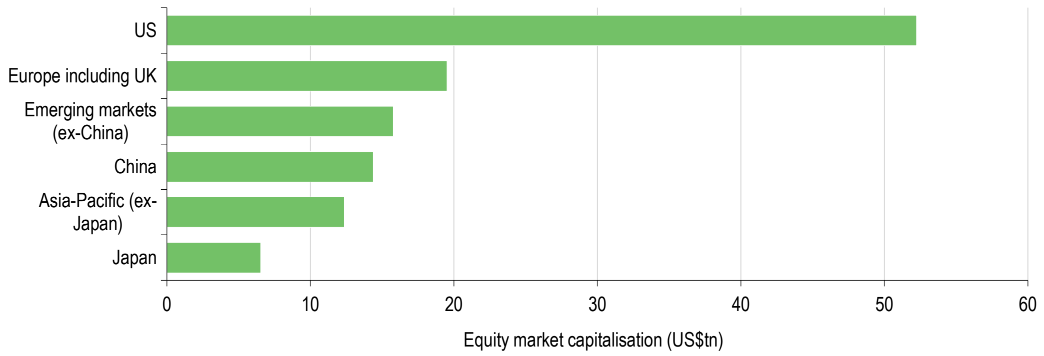


Source: US Federal Reserve, Edison Investment Research. Note: *Includes non-profits.

US equity: The global growth market

The US hosts the world's largest equity markets by a very substantial margin. Data from the World Federation of Exchanges estimates that by the end of 2021, total US equity market capitalisation had reached over $52.2tn, larger than the combined stock markets of Europe and global emerging markets. On this basis, US equity constitutes c 42% of global equity market value. However, this metric probably still understates the US presence in global equity. If one considers the benchmark indices commonly used by institutions, which adjust for factors such as investability, the US share of global market capitalisation reaches closer to 60%. The US equity market is far too big to ignore for investors and issuers alike.

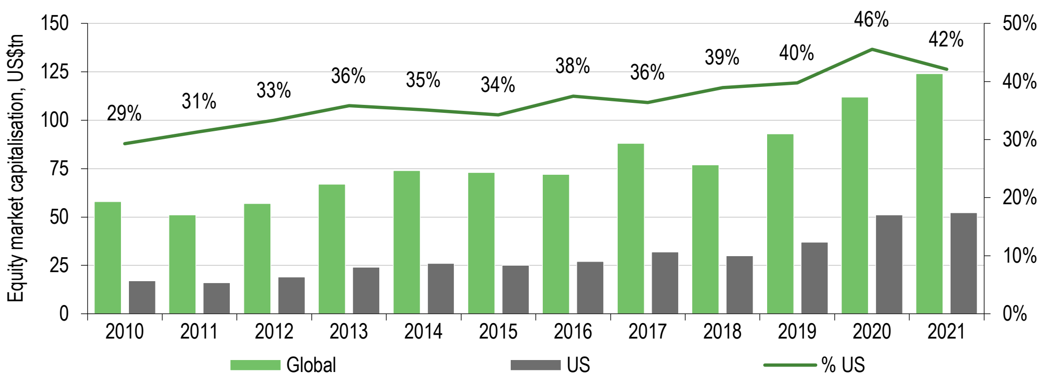
Exhibit 8: US equity market size versus regional and national peers



Source: World Federation of Exchanges, Edison Investment Research

The historical development of US markets versus its global peers is also striking. Despite the US's falling share of global GDP and the rise of Asian 'Tiger' economies, US equity markets have extended their lead in recent years. This relative success has supported foreign portfolio investment and diversification and growing levels of strategic foreign direct investment, as we discuss later in this report.

Exhibit 9: US equity has extended its lead



Source: World Federation of Exchanges, FINRA, Edison Investment Research

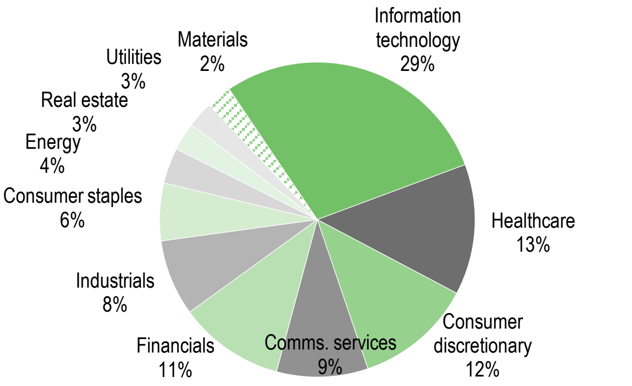
While US equities may appear expensive on traditional valuation metrics, this is not the whole story behind the continued dominance of US markets. The US corporate ethos, which combines an exclusive focus on shareholder value with an aggressive business philosophy, has created world leaders in many industries. US corporate success is much broader than just the technology sector or Nasdaq.

Furthermore, the US corporate sector has systematically generated higher returns on equity and higher profits growth than developed market peers, both prior to and following the financial crisis of 2008. In short, there is no group of companies that has benefited more from the period of globalisation that started in the 1990s.

However, the role that US 'growth' companies have played in supporting market development should also not be overlooked. A current global ranking of the largest listed companies is almost unrecognisable from one 20 years ago and US growth companies now feature prominently (eg the FANG group of Meta (Facebook), Amazon, Netflix and Alphabet (Google).

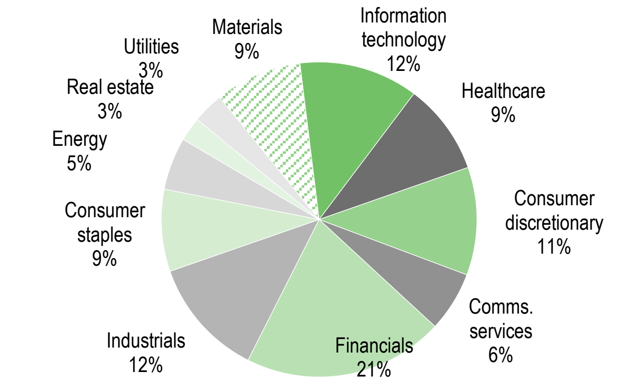
Consequently, the composition of the US equity market is radically different compared to the rest of the global equity universe, as illustrated below. If one considers the information technology, healthcare, consumer discretionary and communications services to represent 'growth' equities, then this represents c 63% of US equity capitalisation versus just 39% in the rest of the world.

Exhibit 10: Sectoral composition of US equities



Source: Bloomberg, Edison Investment Research

Exhibit 11: Sectoral composition of global equities ex-US

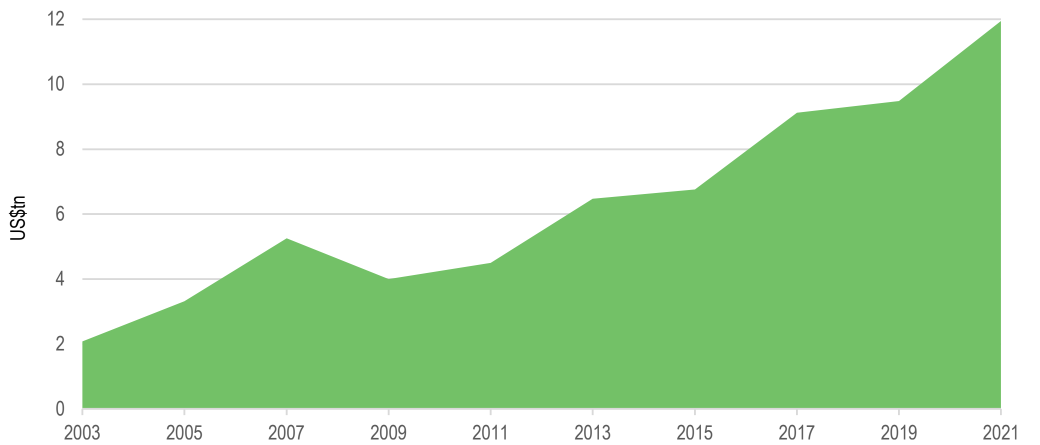


Source: Bloomberg, Edison Investment Research

Growing US investment in international equity

The most recent data release from the US Treasury suggests that US portfolio investment in international equities had reached over $11.9tn by the end of 2021, marking a 12.5% rise from the end of 2020, and a c 67% increase since 2016. While much of this growth is attributable to portfolio performance, it also reflects growing investible wealth within the US, the liberalisation of capital flows and US portfolio rebalancing. That this growth should have occurred in a period of virtual US equity hegemony is indicative of resilient US demand for international equities.

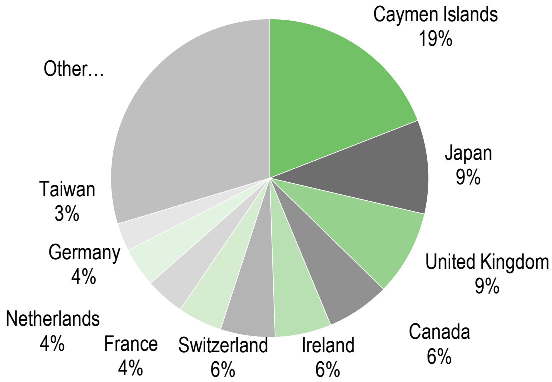
Exhibit 12: Significant growth in US international equity portfolio holdings



Source: US Treasury 2021, Edison Investment Research

A breakdown of these international equity holdings by country of issuer in 2020 is shown below. While this does suggest that US investment is widespread, the precise picture is somewhat distorted by the limitations of the reporting regime. For instance, the outsize holdings in the Cayman Islands are overwhelmingly due to tax optimisation strategies and misattribute the underlying nationality of the issuer and corresponding destination of US investment. The US Treasury notes that such considerations may have caused US investment equity investment in emerging markets, and particularly in China, to be understated.

Exhibit 13: US holdings of international equities by country of issuer

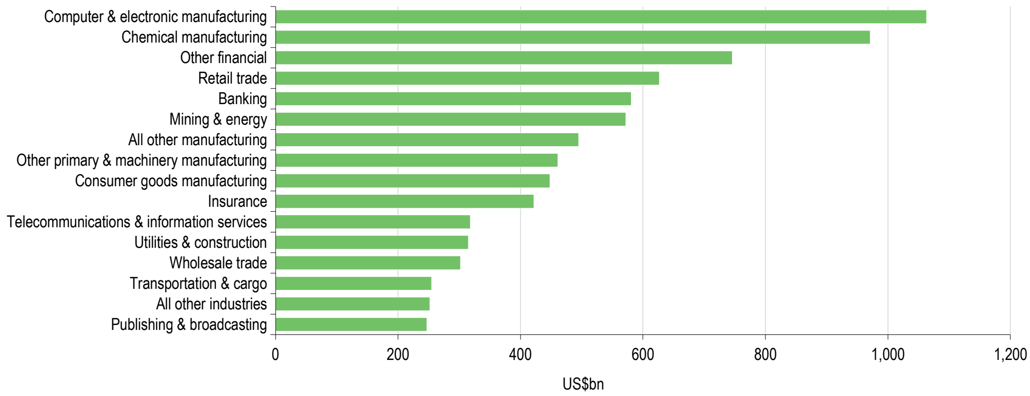


Source: US Treasury 2020, Edison Investment Research

Such caveats aside, additional analysis of this US Treasury data suggests that Europe and Asia were the leading regions for US international equity portfolio investment in 2020, accounting for $4.5tn (42.5%) and $2.5tn (23.4%) of total holdings of $10.6tn. Investment in both Latin America $0.2tn (2.3%) and Africa $0.1tn (1.0%) appears marginal.

A further indicator of the breadth of US international portfolio investment is by analysis of invested industry. Excluding collective holdings such as trust and funds, the position at the end of 2020 is illustrated in Exhibit 14.

Exhibit 14: US holdings of international equities by industry group



Source: US Treasury 2020, Edison Investment Research

Such a broad sectoral spread of exposure suggests that US portfolio investors remain open minded to opportunities offered to them through international equites and for diversification outside of the dominant sectors in their domestic market.

Trading US equity: It's (very) complicated

US equity markets such as the New York Stock Exchange (NYSE) and Nasdaq have long been household names and feature prominently in media coverage of global business. Indeed, prior to the 21st century, they did dominate US equity market trading, particularly in respect of their own listed stocks. NYSE held a c 90% share of trading in its listings and Nasdaq c 100%.

Today however, the trading environment for US equities is considerably more fragmented and complex, with the US currently hosting 16 stock exchanges, differing mainly in their pricing and trading models. Most exchange-traded liquidity falls within three parent groups, namely:

- International Exchange (ICE), controlling NYSE, NYSE Arca, NYSE American, NYSE National and NYSE Chicago.
- NASDAQ, controlling Nasdaq, Nasdaq PHLX (Philadelphia) and Nasdaq BX (Boston).
- The Chicago Board of Exchange (CBOE), controlling EDGX, BZX, EDGA and BYX.

As recently as 2020, there was just one exchange falling outside of the above three groups: the Investors Exchange (IEX). This was launched in 2012 and was intended to mitigate the perceived negative effects of growing levels of ultra-fast and often short-term algorithmic trading, collectively referred to as high-frequency trading (HFT). Such impacts are thought to include market volatility (so-called 'flash crashes'), excessive speculation, false liquidity and information asymmetry that disadvantages retail investors. HFT is currently thought to constitute c 50% of US equity turnover.

Since 2020, the US has seen the launch of three more stock exchanges: The Long-Term Stock Exchange, Miax Pearl Equities and the Members Exchange. Each also seeks to improve on current exchange practices in areas such as corporate governance; lower exchange and data fees; more transparent trading and better user representation on exchange regulation.

As if this alphabet soup of official exchanges was not complex enough, the last 20 years have also seen a proliferation of off-exchange alternative trading systems (ATSs). The most recent filings with the SEC and FINRA identify over 30 ATSs that operate in the equity market in some capacity. In addition, the US hosts three systems to trade equities over the counter (OTC) and is seeing the addition of an increasing number of single dealer platforms (SDPs) on which order flow can be traded against the platform's own equity inventory and capital.

Trading market share data provided by the CBOE suggests that as of end-March 2022, these off-exchange venues collectively commanded a c 40% market share of equity turnover. While the recent addition of three new exchanges has caused a small reversal of off-exchange market share, the multi-year trend has been towards increasing off-exchange activity.

Whether the current US equity trading environment strikes the right balance between market concentration and fragmentation is hotly debated. Concentrated markets can offer greater depth and higher probability of order execution as specified by the client. Yet it can also lead to monopolistic behaviour on pricing and limit innovation. Conversely, fragmented markets can be more competitive and geared toward innovation to win business. However, this can lead to lower probability of order execution and increased total trade costs, as brokers are obliged to search multiple trading venues to fulfil their best execution obligations.

Wherever the optimal mix may lie, there is at least the perception that the current regime creates a two-tier system in which retail investors are often disadvantaged. At the very least there is diminished visibility on total traded volume, something that we believe is a contributor to the formation of dark capital.

US investment: Selling US growth, buying overseas

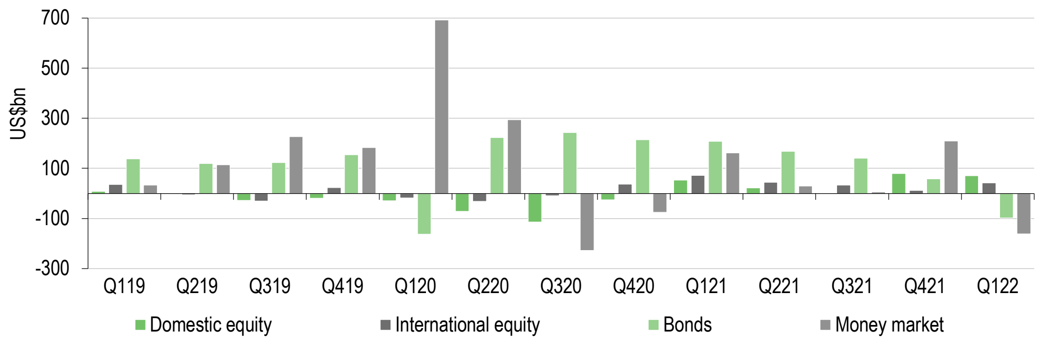
Taking US fund flows as a proxy for domestic investment, we illustrate the shifting behaviour of US investors below. Investors continued to position themselves defensively through 2019 with small outflows of both domestic and international equity more than offset by inflows to both bond and money market funds.

The subsequent COVID-19 led market shock in the first half of 2020 amplified these trends with a Q120 'dash for cash' driven inflow to money market funds being most notable. However, the outflows from equity funds remained relatively modest and bond fund flows were strong throughout the year as the dominant market narrative was one of a 'Goldilocks recovery' of strong growth and pervasively low interest rates and inflation.

By the start of 2021, the appearance of COVID-19 vaccines and stronger than expected corporate earnings led investors to be more constructive on equities, with some evidence of international diversification. However, as 2021 progressed the 'Goldilocks recovery' was increasingly undermined by accelerating inflation, steadily eroding bond market fund inflows.

By Q122, data suggests bond market funds were in aggregate seeing outflows, as did money market funds. By contrast, flows to equity seem relatively well supported, perhaps buoyed by the lack of inflation compensation from other asset classes and a corresponding focus on 'real' assets.

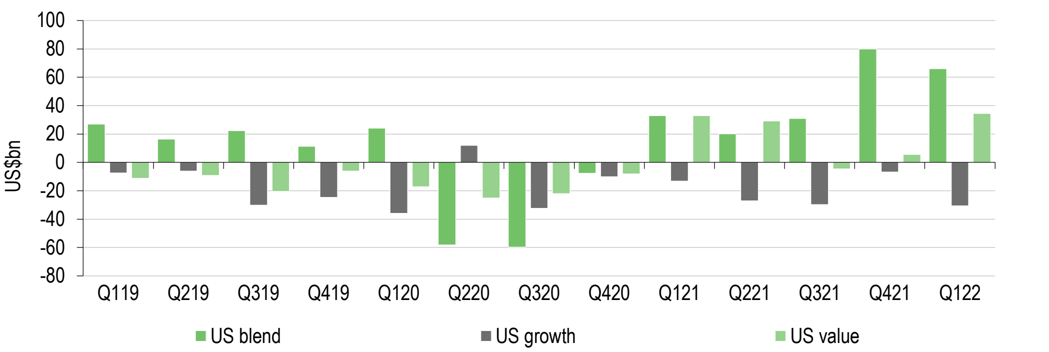
Exhibit 15: US fund flows by asset class



Source: Morningstar, Edison Investment Research

A further drill-down into US equity fund flows reveals that US investors have been quite consistent net sellers of US growth stocks through the 2019–Q122 period. However, this has supported a shift to blend strategies. Value did not see inflows until 2021 as stagflation fears gathered.

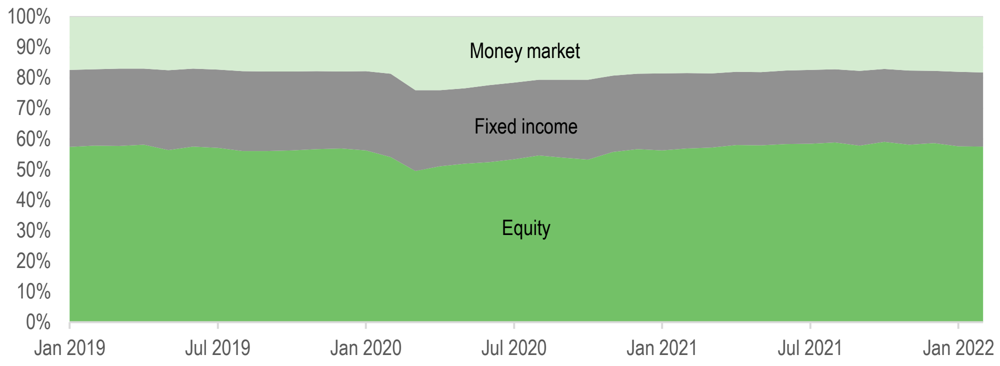
Exhibit 16: US equity fund flows by strategy



Source: Morningstar, Edison Investment Research

However, an analysis of AUM of mutual funds sold in the US funds presents a more nuanced interpretation of US investor behaviour. This suggests that, with the exception of the Q120 COVID-19 shock, asset composition has remained remarkably stable and the level of portfolio de-risking over the 2019 to February 2022 period (the most recent available at the time of writing) appears quite modest. Thus, a reasonable interpretation of asset flows is that they largely represent passive, performance-driven rebalancing of portfolios. Growth equities were sold because they had largely outperformed the rest of the portfolio and investors progressively 'locked in' this outperformance.

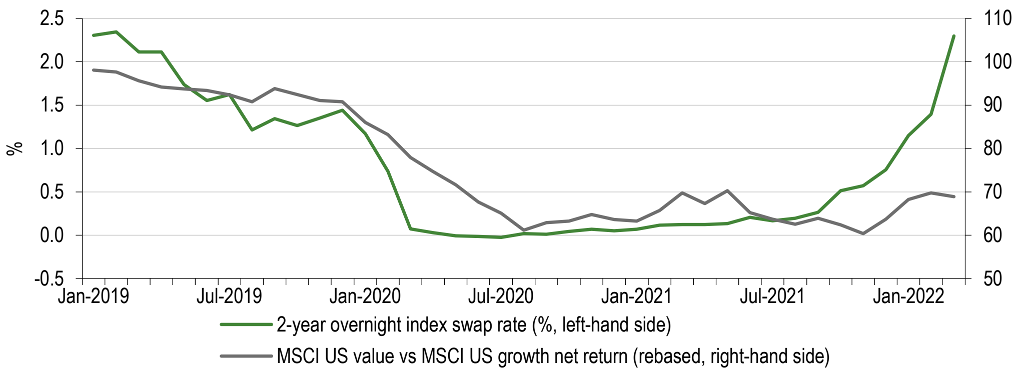
Exhibit 17: US equity fund AUM by asset class



Source: Morningstar, Edison Investment Research

Whether growth equities remain resilient in the face of the prospect of higher US interest rates remains to be seen, however. Growth equities may be considered more rate sensitive because a greater proportion of their discounted cash flows and net present value lie in the future relative to their 'value' peers. This is analogous to the concept of duration in fixed income markets.

Exhibit 18: MSCI US value versus growth net return



Source: Bloomberg, Edison Investment Research

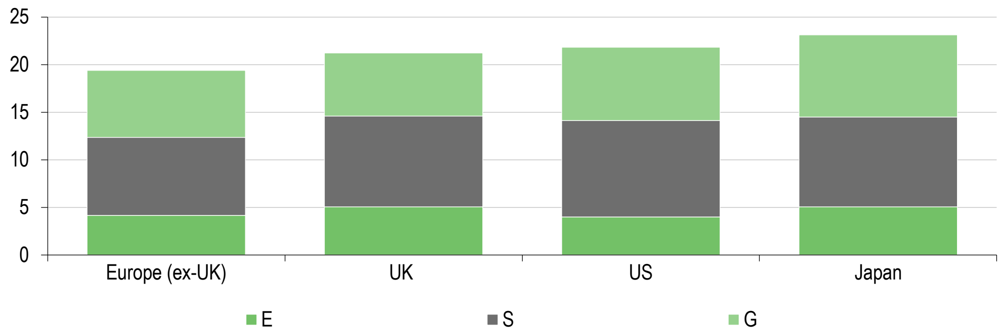
Given the greater exposure of the broad US equity market to such growth sectors, one might anticipate further portfolio diversification by US equity investors into international stocks going forward. Additionally, given the large premium to US growth, alternative growth opportunities in overseas markets are likely to be sought as multiples come under pressure.

ESG may prove a challenge to US equities

While there has been no shortage of superlatives applied to US equities, one area in which the US is not leading is in the ratings for environmental, social and governance (ESG) criteria. The most recent available data from Morningstar Sustainalytics (February 2022) suggests that US equity currently carries more ESG risk than either Europe or UK equity. A compositional breakdown reveals that, while the US scores well on environmental criteria, it loses ground on both social and governance issues. Despite the very public focus on 'G', it is the risk attached to 'S' and 'G' that currently make the biggest contributions to overall ESG risk within this framework.

Part of this market disparity may be considered compositional. For example, UK equities carry a higher environmental risk weighting due to their outsize exposure to the materials and energy sectors; the US's exposure to these sectors is relatively small. Conversely, the US has greater exposure to social factors due to the high weightings of the information technology and consumer discretionary sectors on factors such as data security.

Exhibit 19: Selected equity market ESG risk scores (low = less risky)

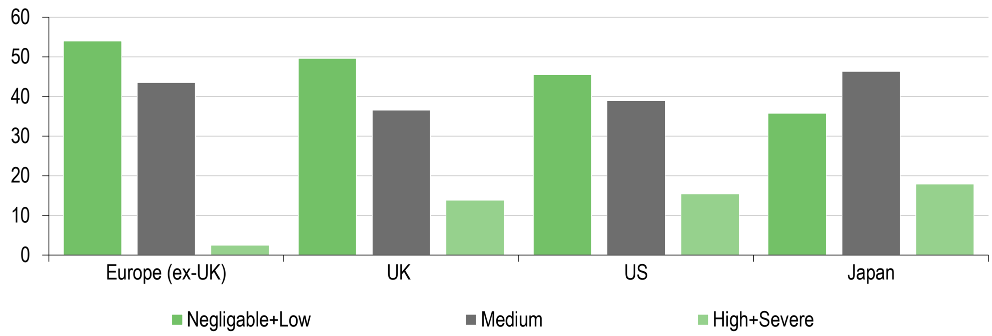


Source: Morningstar Sustainalytics, Edison Investment Research

However, it is unclear how these factors might support or undermine the US's absolute and relative performance in the future; ESG is an evolving discipline. It may well be that many of the US service companies that currently score well on the environmental pillar might not fare so well once Scope 3 (through the value chain) emissions are considered. Even more uncertainty surrounds the social pillar. The societal impact of a number of the largest US companies is now being questioned and attracting the attention of politicians and regulators alike.

It is not just the large, high-profile US companies that might prove challenged. An analysis of US companies by risk bucket (ie, equal-weight) suggests widespread shortfalls in ESG performance.

Exhibit 20: Percentage of market companies in ESG risk buckets



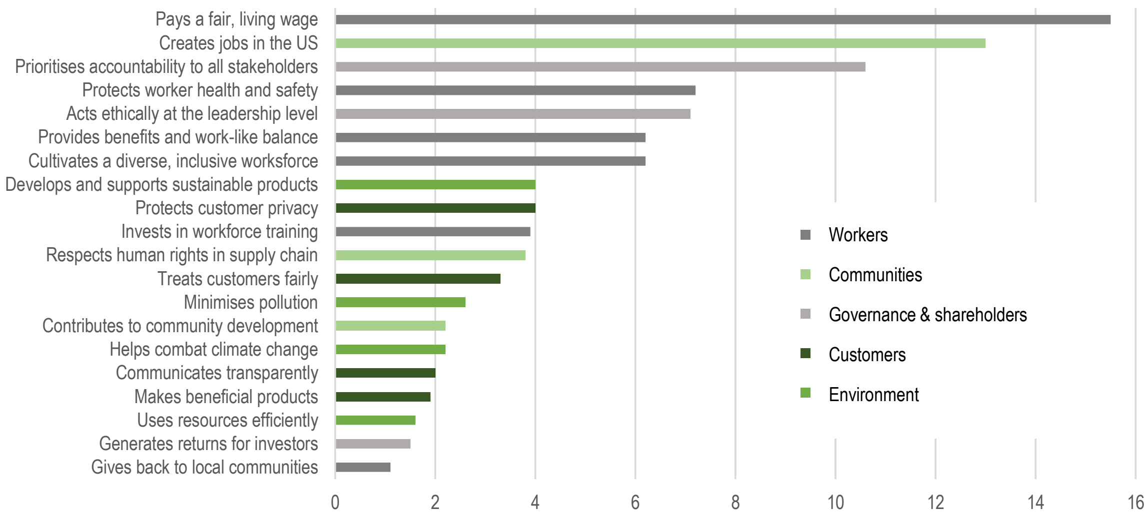
Source: Morningstar Sustainalytics, Edison Investment Research

These deficits may well be of a more structural nature and bring the governance pillar into focus. Until recently the legal and regulatory framework guiding ESG activity in the US was neutral at best if not actively hostile. The fiduciary duties of company directors and some investors were often narrowly framed. More recently, bodies such as the SEC have taken a more constructive position on ESG. However, US boards are coming from a position where they typically have far more power over how they run companies than their counterparts in Europe or the UK, and have a more aggressive approach on remuneration and incentive structures compared to their European peers. Overall, US companies currently attract lower ESG ratings for governance. It is unclear as to whether we will see a real change.

In August 2019, the US Business Roundtable saw 181 CEOs redefine the purpose of a company. Focused on shareholder primacy since 1997, the new statement pledged to take a more stakeholder approach and to promote 'an economy that serves all Americans'. More than two years on, the jury is still out as to whether US corporations have significantly changed their behaviour, with various parties claiming both rampant 'greenwashing' and significant progress.

Such disagreement should surprise no-one. It is notable that the expectations of the American public seem to be very heavily tilted in favour of labour reclaiming a larger share of wealth creation. The environmental policies that many companies are keen to promote appear to have a relatively low public priority. Generating returns for shareholders comes lower still.

Exhibit 21: American's top priorities for companies, % response



Source: JUST capital – The People's Priorities, 2021

While ESG should not be considered a zero-sum game, it is often presented as a framework in which pretty much everyone wins. Potential tension between shareholders and other stakeholders is defused if shareholders also benefit from better ESG. For European and UK equities, there is a reasonable body of research to suggest that ESG has delivered; suitably adjusted, better ESG seems to have delivered better investment performance.

In the US however, the investment case is very far from clear. Investment Metrics published research in October 2021 suggesting that the sector-adjusted performance of highly rated ESG stocks in the US marginally lagged the rest of the market, supporting research conducted by Refinitiv in 2020. More recently, relatively low ESG ratings have not prevented investors flocking to energy and materials stocks. While this is an area that merits further investigation and ESG frameworks are still developing, the potential conflicts of interests between shareholders, management and other stakeholders have yet to be truly tested.

Q&A with Rachel Carroll: An on-the-ground view

Rachel Carroll, the president and managing partner of Edison Atlantic, shares her experience of how the US market has evolved and how issuers should be thinking about accessing this market.

What changes have you seen in terms of how investors find investible opportunities?

The sell-side still occupies an incredibly important part of the capital markets ecosystem but its role as the principal intermediary that educates the market and connects companies to capital has diminished. Professional investors now amass intelligence from a variety of sources including proprietary data systems and channel checks, industry and expert networks, key opinion leaders, independent intelligence firms and each other. As a result, the market has become increasingly fragmented with sell-side firms often chasing the same small pool of active funds or becoming increasingly disintermediated from the process. This report reaffirms the importance of targeting private wealth, including single family offices, but this is a notoriously difficult group to access for most issuers. The US may have a high proportion of retail ownership, but it is hard to forget the seismic volatility caused by retail investing in certain stocks during the pandemic. While a lot of the exuberance has evaporated, the cultural phenomenon of making your fortune in the market is deeply embedded and US retail has formed its own community online that often congregates in network bubbles. This presents a far more complex environment for issuers to navigate, but it also represents a significant opportunity to attract a much broader and deeper pool of capital than ever before.

How do firms use data analytics to target investors and validate interest?

When issuers and their advisers consider how to target new investors, they will often employ peer group analysis using systems that pull data from 13F filings. These filings require institutions that manage in excess of $100m AUM to disclose any holdings above 5%. The challenge with these data systems is that institutions will seek to avoid triggering the disclosure requirement and the long ‘tail’ of smaller institutions, family offices and retail holdings are often invisible. A more interesting approach in my view are platforms that look at predictive targeting analytics that analyse patterns in investment behaviour to predict propensity to invest in a certain theme or financial profile. These platforms often work within the confines of an existing community that has signed up to a platform, or in some instances, may be able to search across global pools of data. Edison is a good example of this; we are able to predict investor engagement in a particular theme or investment trend by analysing how our content across 1.5 million engaged users is consumed online. As a Google partner, we also have access to a much bigger lake of data that is used to design our digital marketing campaigns.

Given the scale and diversity of the US market, what approach should an issuer take to maximise influence with these groups?

Assess the quality of your information systems and the expertise of your advisers. Your broker will often have a restricted list specialising in a certain geography or type of investor. With the pool of active money proportionally shrinking, the competition for ‘blue-chip’ capital is increasing and a lot of sell-side firms are chasing the same dollar. With increased disintermediation between the sell-side and buy-side, consider how disclosures trigger investment from groups including passive vehicles and ESG funds. Develop a content strategy that can successfully engage investors at differing levels of sophistication supported by a channel planning strategy to effectively communicate with target groups. Recognise that with the slew of new issuance in recent years and a tendency for all investors to actively trade around positions, a highly proactive strategy that provides continual touchpoints with the market will help reduce volatility and drive share price appreciation over time. In a post pandemic environment, the means to connect with the capital markets are still evolving; I would encourage issuers to be creative and open to adopting innovative solutions.

What advice would you give to US and non-US issuers seeking to optimise their US capital markets strategy?

In the last 20 years, there have been significant changes in the financial services industry and the impact on the field of investor relations has been pronounced. It is important for issuers to be cognisant of how recent trends affect their ability to connect with the optimal blend of investment capital. For US issuers, my advice would be to take ownership of your capital markets strategy and the challenges of navigating an increasingly fragmented ecosystem where much of the capital sits outside the reach of traditional sell-side channels. As a global IR firm with the bulk of our operations in Europe and the United States, we are often working with international companies who operate across borders and are seeking to attract US investment to a foreign listing or are considering a US IPO. This often requires more planning and preparation than is typically anticipated and a highly proactive campaign strategy including content, digital marketing, IR and PR tactics to develop and sustain mindshare. The good news is with nearly half the world's equity capital within its shores and around $11.9tn dedicated to non-US equities, the US can deliver exceptional results.

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