# Q3 2018 Newsletter

*Matarin Capital Management, LLC aspires to be a symbol of stewardship within the investment management industry. We are dedicated to delivering above benchmark risk adjusted investment returns through insight, passion, and diligence. We aim to build strategic alliances with our clients based on the highest ethical standards.*

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MATARIN CAPITAL

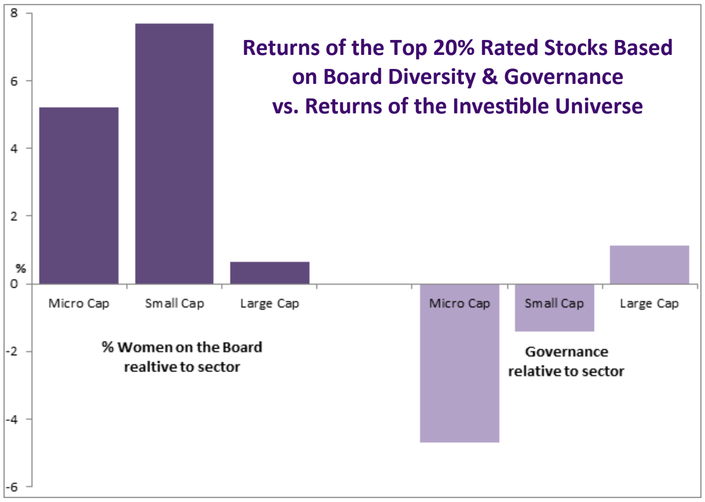
Investing with Insight and Integrity

## No Woman, Do Cry

Many large asset owners have been calling for board diversity within the companies whose stocks they own. CalPERS, NY Common and many others strategically use proxies to influence these outcomes. One could argue that this call arises from a sense of social justice. After all, among companies in the S&P 500, women make up only 21% of board members and 5% of CEOs, according to Catalyst.[1] In fact, you may be shocked to learn that within the S&P 1500 Index less than 1% of companies have over 50% women on the board of directors, and almost 10% of companies have NO female representation on their board at all. But the call for board diversity is about much more than fairness. It comes down to the bottom line.

At Matarin, we have researched a number of governance factors as part of our ongoing research on environmental, social, and governance (ESG) indicators. Gender diversity of the board of directors is one of the indicators which we've singled out for its ability to help predict stock price performance. We include this measure within the proprietary Governance factor that is one of the components of the People Concept in Matarin's stock selection process.

Over the years, we have worked with three different ESG data providers to identify data items which we believe would help to increase returns or reduce risk, if integrated into our investment process. Governance has been a modest predictor of stock price performance over time, with the best governed companies outperforming the worst by around 2% per year. However, during 2018 the *worst* governed companies have *out*performed their peers, as you can see in the graph on the right. Perhaps this is unsurprising in a year when investors are in a more speculative mood, and willing to take chances on riskier, expensively valued, fundamentally weaker companies. Year-to-date within small-cap stocks, our People concept has struggled. Within our Governance indicator, though, board diversity has been a bright spot, as companies that have the highest percentage of women on the board have outperformed companies that have the lowest.




At Matarin, we see a number of reasons to believe that company board gender diversity should be predictive of its future stock performance. In essence, the rationale comes down to cognitive diversity. And one reason that we believe so strongly in cognitive diversity is because we experience its effectiveness within our own team. We find that differences in perspectives within our team encourages debate and moves us away from harmful groupthink. In fact, University of Michigan Professor Scott Page's research demonstrates that often it's the most differentiating ideas that will have the potential to add the most value – because the team will have already digested the undifferentiated ideas. Therefore any member's value to a group derives not solely from their individual skill level, but also from how their skills interact with *others'*. (This is the same insight that is used in investing in diverse portfolios of stocks. The best portfolio will not be the one that contains all the highest forecasted return stocks, if all of those holdings have essentially the same characteristics. Instead, portfolio diversification helps to achieve a higher return-to-risk ratio over time.)

But when it comes to women on corporate boards, where is the boundary between general *cognitive* diversity on the one hand and *gender* diversity on the other? Columbia Business School Professor Katherine Phillips' research shows that our perceptions of gender and ethnic diversity in our group changes the way we prepare and present our ideas. The mere expectation that different teammates will have diverse reactions forces us to prepare our ideas to be resilient to critique from a number of different angles. Dr. Phillips has also demonstrated that when we hear dissenting ideas from people whom we perceive to be different from ourselves, we are more naturally curious to understand how it is possible that they are seeing the situation differently than we are.

At Matarin, we think a lot about behavioral science – how does the human element reflect on the fundamental and quantitative aspects of our financial analysis? In the case of Governance, the insights about group dynamics that are revealed by the structure of the board can be valuable and differentiating in addition to the financial data that we consider. Indeed, governance indicators have extra value to add, partly because they are diversifying. Diversifying, just like women on corporate boards.

[1] Catalyst, *Pyramid: Women in S&P 500 Companies* (June 1, 2018).

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