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Heard on the Street
More 401(k) Owners May Soon Vote on Issues Like Musk Pay

By Jon Sindreu
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Do you think Elon Musk should be paid $47 billion to keep his attention focused on Tesla? Or that Disney has gone "woke?" Or that Shell isn't moving away from oil fast enough?

If, like many people, you own these companies through mutual or exchange-traded funds -- say, as part of your 401(k) -- you don't get a say in these matters; only your fund manager does. But this could soon change as big investment firms embrace "pass-through voting." That is, giving clients a voice during proxy season -- the spring period when listed corporations hold annual general meetings.

Since 2022, BlackRock has rolled out pass-through voting for some institutional clients in its equity tracker funds. This season, the experiment was extended to the three million U.S. retail shareholders of the company's mammoth iShares Core S&P 500 ETF. So far, the owners of $600 billion worth of assets opted in. Vanguard and State Street Global Advisors have similar projects with an increasing number of funds.

Of course, big clients with separate accounts at asset-management firms already had the ability to vote. As did individual investors, even if they owned single stocks through trading platforms. Recently, eToro said votes were cast on an unprecedented 24% of the Tesla shares owned by its users, with 80% backing Musk's pay package.

Still, most people stash their savings in passive funds that track hundreds of companies. Wading through all the relevant 100-page proxy statements to vote on mostly mundane resolutions would be unbearable. This is why the pass-through voting systems unveiled by the big index-fund managers include a limited menu of options for individual investors, such as following recommendations from proxy-advisory firms ISS and Glass Lewis. Both recently urged shareholders to vote against Musk's pay.

Funds are getting serious about pass-through voting because of digital **technology**, which is fueling a trend toward customization and helping cut through a messy, old-school proxy system.

It isn't straightforward to ascertain who owns what to grant them the appropriate voting rights, especially when many investors own funds through brokerage or wealth platforms. Financial **technology** firms, most prominently Broadridge, can solve this problem by liaising with all involved parties.

Yet pass-through voting may be gaining favor because strategies focused on environmental, social and corporate-governance issues are losing it.

In 2021, when ESG was in its heyday, BlackRock CEO Larry Fink told his shareholders his firm's fund managers would influence company boards to promote racial and social justice. Three years later, Fink has come under fire in an anti-ESG backlash. Consumer products including beer, apparel and electric cars have become increasingly politicized.

BlackRock and most of its peers have maintained ESG is about extracting greater financial value, not politics. But drawing the line is hard. Take Shell: Ahead of its annual meeting last week, big investment managers such as Amundi filed a resolution pushing for greater alignment with Paris climate agreement targets, which ended up receiving 19% of the vote despite executives' opposition. Such a move may well have met ethical goals and reduced risks of regulatory backlash, but enough to justify pumping less crude at $80 a barrel? Perhaps not.

The underlying problem is that green-minded pension holders in Scandinavia and evangelical 401(k) savers in Alabama have very different values.

For top ETF providers that rely on mass appeal, such as BlackRock, Vanguard and State Street, it seems smart to pass these political footballs to clients. The Republican-backed Index Act of 2022 was a warning that lawmakers could force them to do so. This defuses some antitrust concerns about index funds owning most corporations in the developed world.

Today's pass-through voting stops short of granting a voice on specific agenda items such as the compensation of Tesla's boss. Introducing single-issue votes is technologically complex and could raise legal questions if investors knowingly vote against a company's interests.

But that could change thanks to startups such as Tumelo, originally founded by Cambridge University students to allow for greater control over the university's endowment fund.

London-based Legal & General Investment Management has started to use Tumelo's **technology** to offer its clients, the Camden Pension Fund and the Superannuation Arrangements of the University of London, the possibility of voting across all of its pooled investments based on the recommendations of PIRC, a voting-policy provider they have selected. Crucially, both can override PIRC and directly vote on key issues. LGIM's stewardship team makes the decision if neither PIRC nor the ultimate investors take a view -- or in the rare cases when it believes the choices go against its fiduciary duty.

Although not yet used by individual investors, the **technology** is ready for it, Tumelo CEO and co-founder Georgia Stewart said.

This could be a glimpse into the future. ETF holders may soon be able to choose from an extensive menu of proxy-voting policies tailored to their political preferences, and then cast specific votes on the issues they strongly care about. Generative artificial intelligence could dramatically lower the cost of designing policies that appeal to different groups.

The big question is how this would change corporate governance. So far, Broadridge data suggests individual investors are less favorable to environmental and social proposals than fund managers. The latter also tend to side with executives, who currently get their way in roughly 90% of resolutions. Indeed, "always agree with management" is among the few pass-through options allowed by today's index providers.

As with real democracy, shareholder democracy may bring with it more flashy campaigns -- and the odd big upset.

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Bullish Investors Flood Into Stock, Bond Funds

By Jack Pitcher
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Investors are finally putting their money where their mouths are.

U.S.-based mutual and exchange-traded funds have drawn a net $172 billion of inflows so far this year, a marked turnaround after they collectively bled assets in each of the past two years.

The flows mark a break from the risk aversion that investors had shown for much of the past two years and an embrace of the narrative that a strong U.S. economy will support financial markets. Assets in money-market funds and other cashlike products that investors favored last year have plateaued. Investors are putting their money to work in stocks and bonds instead.

"The economy is in good shape, labor markets are in good shape and central banks globally look ready to provide support," said Michael Arone, chief investment strategist at State Street Global Advisors. "That's an attractive backdrop for investing, and it's the primary reason you're seeing an increased appetite for everything."

Flows to U.S. stock and bond funds this year are the strongest since 2021, when interest rates were near zero. Globally, the net $468 billion invested in ETFs through April is the highest on record, according to ETFGI data.

The soft-landing trade appears fully back in vogue after several months of hot inflation data rattled investor confidence. The most recent consumer-price data was lower than forecast, and first-quarter earnings results showed booming corporate profits. The S&P 500 is up 11% in 2024, trading just below its record.

Skeptics argue that equity valuations look expensive and the extra yield offered by risky corporate debt is historically low. The S&P 500's price compared with expected earnings over the next 12 months is currently in the top decile of its historical range, according to Morgan Stanley.

This week, traders will closely watch Friday's release of the personal-consumption expenditures index, the Federal Reserve's preferred inflation gauge. Markets appear sanguine about the economic outlook currently, but a hot inflation number could cast doubt on their hopes for interest-rate cuts.

Wall Street is currently pricing in at least one cut later this year, though minutes from the Fed's most recent meeting showed central-bank officials are still concerned about persisting inflation. If the easier monetary policy that investors are anticipating doesn't materialize, the stock-market rally is likely to sputter, analysts warn.

Investors look anything but defensive. Of the 10 ETFs that have taken in the most money this year, just one is a bond fund. Two track the price of bitcoin.

The leader, the Vanguard S&P 500 ETF, is on pace for a banner year. Investors have added a net $37 billion in less than five months; the annual record for any ETF inflow is $50 billion.

The risk-taking extends into fixed-income markets, where some of the most popular funds over the past month hold riskier corporate bonds and loans that pay higher yields.

"In the last few weeks, we've seen significant inflows to loans," Arone added. "That tells me that investors' risk appetite is elevated, their confidence is higher and they're willing to take credit risk."

Shane Archuleta, a 29-year-old IT professional in Fort Myers, Fla., is one of the investors rushing into the market. Archuleta said he now tries to invest almost 50% of his after-tax income in retirement and taxable accounts that he manages on Robinhood and E*Trade.

Archuleta has mostly been buying ETFs, including Vanguard's S&P 500 fund, a Vanguard growth fund and Invesco's QQQ, which tracks the Nasdaq-100 index. With a multidecade investment horizon, he says he prefers higher-risk, growth-oriented funds for now.

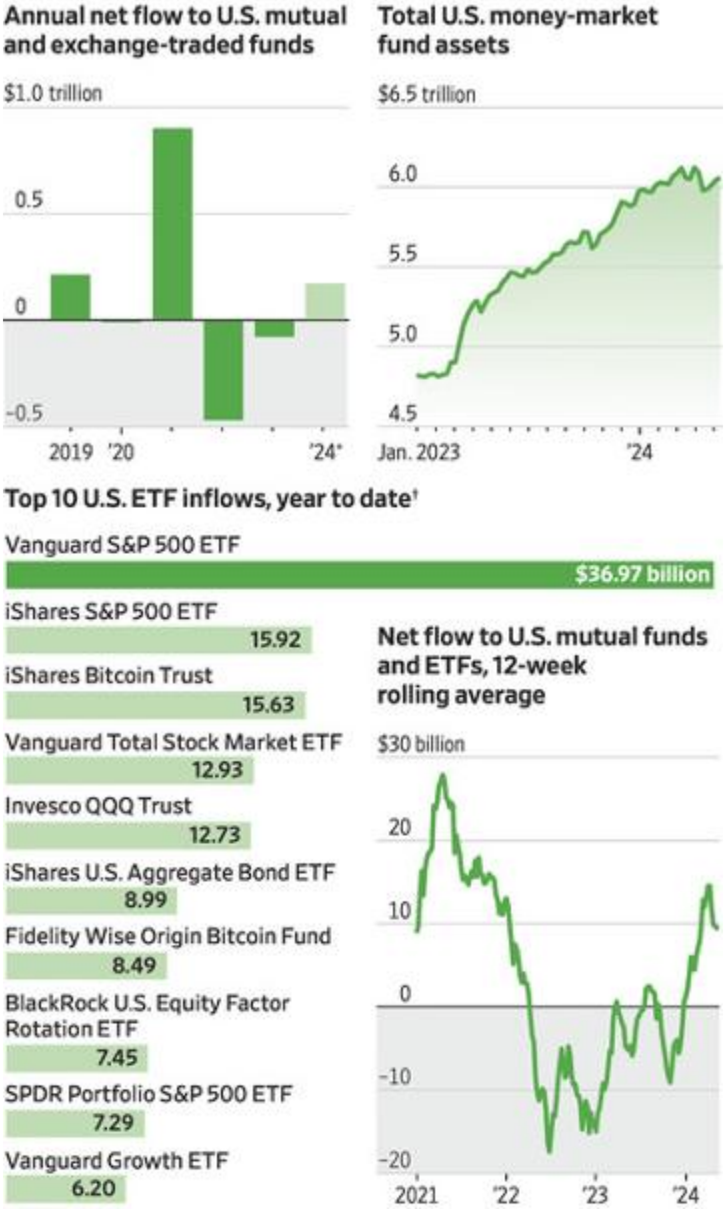
"My big thing is, 'Don't bet against the U.S. equity market.' I have no doubt in the very long run it's going to go up," Archuleta said.

Fund managers are optimistic, too. Bank of America's most recent survey of fund managers showed the most bullish sentiment since 2021. The survey found cash levels at multiyear lows and stock allocations at multiyear highs.

Flows tend to lag behind performance. Stocks and bonds got crushed by the Fed's rate-rising campaign in 2022, so a slower 2023 wasn't necessarily a surprise, said Aniket Ullal, head of ETF data and analytics at CFRA Research.

What stands out this year is the breadth of funds taking in money. Investors aren't just putting all their money into the booming **technology** sector.

"The flows are very broad-based across all categories," Ullal said. "It's not like a couple of funds or categories are carrying the space."



*2024 figure is through May 15. Money-market funds are excluded. †Through May 17
Sources: Investment Company Institute (net flows, total assets); FactSet (inflows)

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