Footnotes For Fiduciaries

Stockpicking is Still Legal

Sloane Ortel, CIO at Ethical Capital

2025-09-26

Does Divestment Destroy Portfolios?

Will BDS-related divestment materially harm endowment returns?

- Recent JLens/ADL study claims **$33.2 billion** in foregone returns
- Huge, if true…

Today's Goal: Separate fiduciary fact from advocacy fiction

What This Presentation Covers

1. **The JLens Claims** - What they found, why it's methodologically invalid
2. **The Croquet Problem** - Why their methodology is like letting kids move the ball
3. **Point-in-Time Reality** - Using future information to judge past decisions
4. **The Spectrum Truth** - Why heterogeneity is freedom, not a bug
5. **Performance Reality** - What actually happens (it's not just Norway)
6. **Signal Analysis** - What operating in Gaza tells us about business value
7. **The Hidden Costs** - What NOT divesting actually costs institutions
8. **Implementation Guide** - Concrete steps using the Norway Model

---

Part 1: The JLens Study Problems

Note: These aren't minor methodological quibbles - they're the difference between croquet and golf

Problem 0: Selection Bias

- **Method:** "Focused and conservative" approach excluded 38 companies
- **Finding:** 1.8% annual underperformance (11.1% vs 12.9% returns)
- **Projection:** $33.2 billion foregone over 10 years

The Selection Issue: 38 company sample represented 32% of the S&P 500

[Research note: Total companies on underlying lists » 38, many small/private excluded from sample]

The Croquet Problem

My parents used to play a special version of croquet when I was a kid where **I got to pick up the ball and put it wherever I wanted**.

That kind of BDS is what JLens is testing.

- Pick your 38 favorite companies from hundreds of possibilities
- Apply 2024 knowledge to 2014 decisions
- Make "no other adjustments" to simulate incompetence
- Claim this proves something about professional divestment

Problem 1: Point-in-Time Data Failure

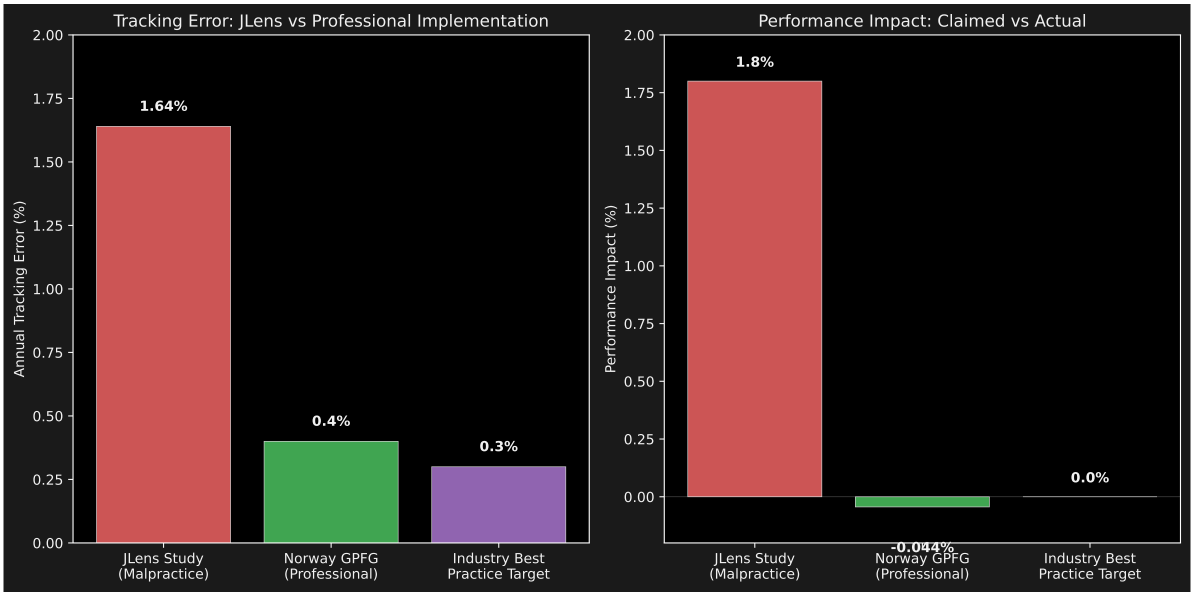
Applied 2024 exclusion list to entire 2014-2024 period

The Organizations Cited Didn't Exist: - Don't Buy into Occupation Coalition: Formed January 2021 - OHCHR Database: First published February 2020 - AFSC Investigate: Launched 2019

The Point-in-Time Problem: Real investors make decisions with information available **at the time**, not with perfect hindsight. This isn't a small detail - it's the difference between research and fantasy.

Problem 2: Statistical Malpractice

- "38 companies excluded and **no other adjustments made**"
- Tracking error of 1.64% - essentially equals claimed underperformance
- No rebalancing, optimization, or professional management



Key Insight: JLens's tracking error (1.64%) explains 91% of their claimed underperformance - proving they modeled incompetent execution, not divestment impact.

The Study Cannot Be Replicated

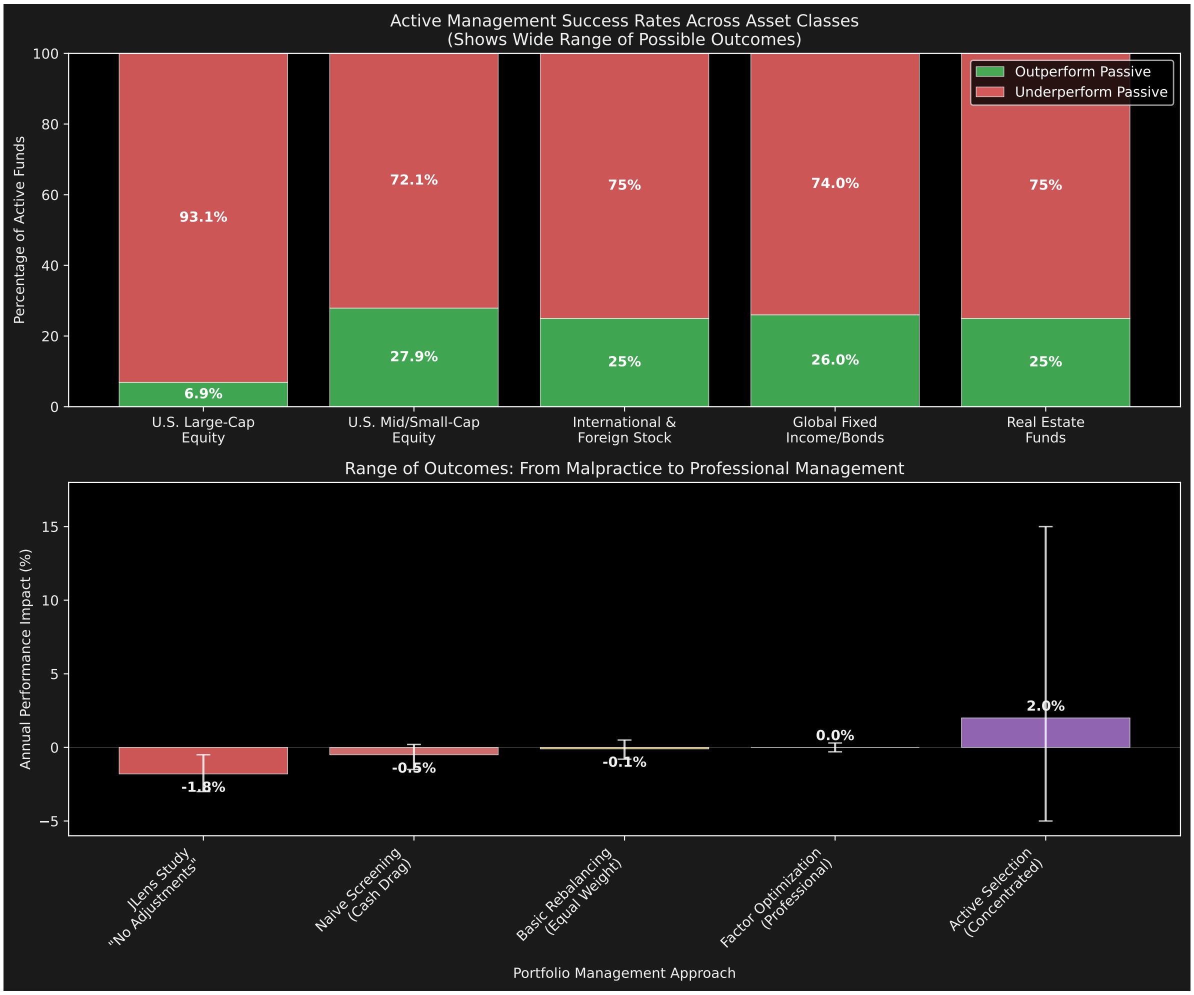
JLens won't disclose: - Data sources - Rebalancing methodology - What "no other adjustments" means - How they weighted remaining holdings

Non-replicable results are invalid in both academic and investment contexts.

Part 2: The Spectrum Truth

Institutional heterogeneity isn't a problem - it's free will. They fought a whole war in heaven over it.

The Wide World of Active Management



Why Institutional Heterogeneity is a Feature

- **Active stock-picking:** Concentrated portfolios, embrace tracking error, skill-based returns
- **Optimized indexing:** Factor-neutral rebalancing, minimal tracking error
- **Screened benchmarks:** Purpose-built indexes with exclusions built-in
- **Overlay strategies:** Third-party optimization on top of existing managers

The beauty: Institutions can choose approaches that match their mission, risk tolerance, and stakeholder expectations. This isn't a bug - it's freedom.

The Active Management Reality

Fiduciaries are clutching their pearls about tracking error with divestment...

...while happily signing up for much worse outcomes with traditional active management

- 70-93% of active equity managers underperform their benchmarks
- Yet boards routinely approve active management with higher fees and worse outcomes
- Active management = making conscious choices about what to own AND what not to own
- **I'm an active manager when I pick good stocks AND when I pick not to own bad ones**

"Wait, divestment is just active management?" "Always has been."

The Control Difference

With divestment, you can actually exercise control over externalities:

- Geopolitical risk management through exclusions
- Stakeholder alignment through values-based screening
- Long-term risk mitigation through conduct criteria

By contrast, commodity trend analysis is astrology for men

The Point: Both divestment and traditional active management are forms of active portfolio management. The difference? Divestment lets you manage risks you can actually identify and control.

As I often tell prospects: The choice really is whether they want to keep their brains smooth or engage with the things that are troubling them.

Part 3: Performance Reality Check

It's Not Just Norway

A significant percentage of NACUBO institutions already use ethical screening

Professionally managed exclusions track benchmarks within **basis points**, not percentage points.

Institutional Scorecard

Institution	Assets	Scope	Return Impact	Risk Controls
NBIM (Norway)	$1.4T	180+ exclusions	+0.44% cumulative	Tracking error 0.3–0.5%
UC Regents	$126B	Fossil fuel divestment	"Financial risk management"	Consultant oversight + phased exit
PFZW / KLP	$200B+	Settlement exclusions	Neutral-to-positive	Vendor optimization + quarterly reviews
Many NACUBO Members	$XXX	Various screens	Ongoing success	Professional implementation

Academic Evidence

- **Trinks & Scholtens (2018):** 90 years of data - divestment "does not significantly impair financial performance"
- **EDHEC (2023):** Professional optimization reduces tracking error by 80-90%
- **Plantinga & Scholtens (2021):** 40-year study finds differences of "a few basis points"

Why Naïve Studies Fail

- **Static lists applied retroactively** ignore point-in-time information sets
- **"No other adjustments"** = fiduciary malpractice (cash drag, sector concentration)
- **Tracking error parity** with claimed losses proves the model was incompetent

---

Part 4: Signal Analysis

Specialist vs Commercial Sources

Two Types of Information Sources:

- **Commercial/Academic:** Broad market analysis, backward-looking, profit-motivated
- **Specialist/Activist:** Deep sector expertise, forward-looking, mission-driven

The Question: Which source better identifies emerging risks and opportunities in complex geopolitical situations?

The Gaza Signal

The Business Value Question: If operating in Gaza is worth it to a company despite:

- Massive reputational risks
- Stakeholder backlash
- Operational complexity
- Regulatory scrutiny

Then how much is their business really worth?

The Signal: Companies that continue high-risk operations may be signaling that their business model depends on activities that create long-term stakeholder conflict.

Part 5: The Hidden Costs

What NOT Divesting Actually Costs

The JLens study ignores the costs of maintaining controversial holdings:

- **Eroded stakeholder relationships** - students, faculty, donors, alumni
- **Reduced ability to act truly long-term** - constant crisis management
- **Ignoring institutional intuition** - what happens when leadership knows something is wrong but can't act?
- **Opportunity costs** - resources spent on controversy instead of mission

The Stakeholder Reality

For many institutions, the real question isn't: "Will divestment hurt returns by X basis points?"

It's: "Can we maintain our mission and stakeholder relationships while holding these positions?"

The Fiduciary Reality: Sometimes the biggest risk is not acting when your stakeholders are telling you to act.

Part 6: The Norway Model Framework

How boards can implement exclusions without breaching fiduciary duty

Why Boards Need This Framework

- Turns "divest" into a governance motion with tracking-error discipline
- Shows trustees how to deliver exclusions without breaching prudence
- Mirrors how NBIM, PFZW, and UC Regents structure conduct screens

Core Decision Framework

1. Mandate & Guardrails

- Adopt written conduct criteria referencing international law + credible evidence sources
- Set **tracking-error budget (30 bps)** and require factor/sector neutrality
- Delegate execution to CIO/consultants while retaining policy oversight

2. Phased Implementation

- **Immediate:** Stop new purchases, log current exposure
- **30-60 days:** Exit via orderly trading schedule (avoid divestment shock)
- **Quarterly:** Certify reinvestment into benchmark-aligned replacements

3. Reporting & Transparency

- Publish exclusion rationale, evidence citations, and guardrails
- Require quarterly one-page dashboards (tracking error, factor exposure, progress)
- Create appeals/exception process with time limits and public log

Implementation Practices that Preserve Returns

- Set explicit tracking-error guardrail (30 bps) and require factor/sector neutrality
- Reinvest promptly to avoid cash drag; use screened indexes or optimization overlays
- Phase trades (30–60 days) with compliance sign-off to avoid market impact
- Monitor via quarterly analytics (tracking error, factor deltas, contribution to return)

Part 7: Implementation Checklist

For Board Members & Trustees

Evidence You Can Cite

- **NBIM (Norway) 2024 Report** – 0.3–0.5% tracking error; exclusions added +0.44% cumulative return
- **UC Regents 2020 Fossil Fuel Divestment** – expressly labeled "financial risk management"
- **EDHEC 2023 Optimization Study** – professional rebalancing cuts tracking error by 80–90%
- **NACUBO Experience** – significant percentage already using ethical screens successfully

Fiduciary Considerations

1. **Risk Management:** Can exclusions be implemented within acceptable tracking error limits?
2. **Professional Implementation:** Will portfolio management employ optimization techniques?
3. **Stakeholder Alignment:** How do exclusions align with institutional mission?
4. **Performance Monitoring:** What governance ensures ongoing assessment of impact?
5. **Hidden Cost Assessment:** What are the costs of NOT acting?

For Staff Implementation

- Update IPS / investment policy statement with conduct language + tracking error budget
- Instruct index/active managers to load exclusion list + optimization constraints
- Coordinate consultant to run pre/post analytics (tracking error, factor tilts, liquidity)
- Document phased trade plan and compliance attestations
- Schedule annual policy review plus event-driven updates

Minimum Standards for Future Studies

Any credible analysis of divestment impacts should include:

- **Point-in-time exclusion lists** reflecting realistic investor experience
- **Full methodological transparency** enabling independent replication
- **Multiple implementation scenarios** from naive to professionally optimized
- **Multi-period analysis** avoiding cherry-picked market regimes
- **Total cost analysis** including stakeholder relationship impacts

---

Conclusion

The JLens Study is Invalid Because

1. **The Croquet Problem** - they got to move the ball wherever they wanted
2. **Point-in-time failure** - used future information to judge past decisions
3. **Implementation malpractice** - approach would expose fiduciaries to legal liability
4. **Non-replicable methodology** - cannot be verified by third parties
5. **Ignores hidden costs** - doesn't account for stakeholder relationship damage

What We Know from Real Evidence

- **Norway ($1.4T):** +0.44% from exclusions with 0.3-0.5% tracking error
- **UC System ($126B):** Successful divestment as "risk management"
- **NACUBO Members:** Many already using screens successfully
- **Academic consensus:** Impact measured in basis points, not percentage points
- **Professional management:** Wide spectrum of approaches, most successful

For Fiduciaries: The Path Forward

Use the Norway Model framework to implement exclusions professionally:

- Set tracking error guardrails (30 bps)
- Require factor-neutral optimization
- Phase implementation over 30-60 days
- Publish transparent reporting
- Monitor quarterly with professional analytics
- **Consider total costs** - not just hypothetical performance impacts

Bottom Line: Any trustee considering the JLens study should demand complete methodology disclosure and comparison with actual institutional implementations.

About This Analysis

About Ethical Capital

- Utah registered investment adviser
- Specializes in concentrated ethical portfolios (we embrace tracking error)
- Contact: hello@ethicic.com • +1 (347) 625 9000
- Screening policy: https://ethicic.com/content/process/screening-policy

About Dryvestment

- Ethical Capital's Labs experiment
- "Google translate" for activists and fiduciaries
- Produces educational briefs only—no individual investment advice
- All outputs versioned and updated as research evolves

This analysis is provided to support evidence-based policy discussion. We welcome transparency from any party to enable replication and verification.

Thank You

Questions?

For more resources: - Full technical analysis available - Implementation templates for boards - Contact: hello@ethicic.com