Footnotes For Fiduciaries: A Complete Analysis

Stockpicking is Still Legal

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Executive Summary

Will BDS-related divestment materially harm endowment returns? A recent JLens/ADL study claims **$33.2 billion** in foregone returns over 10 years. This analysis examines that claim and finds it methodologically invalid due to fundamental flaws in implementation, temporal consistency, and replicability.

The evidence from actual institutional implementations tells a different story: professionally managed exclusions track benchmarks within basis points, not percentage points. Norway's $1.4 trillion sovereign wealth fund has achieved +0.44% cumulative returns from exclusions while maintaining tracking error of only 0.3-0.5%.

This report provides fiduciaries with the evidence and framework needed to implement exclusions professionally, using the "Norway Model" approach that turns divestment from an activist demand into a governance motion with proper risk controls.

The JLens Study: Critical Methodological Flaws

Problem 0: Selection Bias

The JLens study employed what they called a "focused and conservative" approach, excluding 38 companies from a much larger universe of potential targets. This 38-company sample represented 32% of the S&P 500's market capitalization, creating massive concentration risk.

Key Issues: - Cherry-picked sample from hundreds of potential exclusions - Concentrated in technology sector leaders that drove 2014-2024 performance - No disclosure of selection criteria or methodology

[Research note: Total companies on underlying exclusion lists significantly exceed 38, with many small/private companies excluded from the sample]

The Croquet Problem

As I often explain to clients, the JLens methodology reminds me of a special version of croquet my parents used to play when I was a kid: **I got to pick up the ball and put it wherever I wanted.**

That kind of BDS is what JLens is testing.

Their approach: - Pick 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

The study applied a static 2024 exclusion list retroactively across the entire 2014-2024 period. This creates a fundamental temporal inconsistency problem.

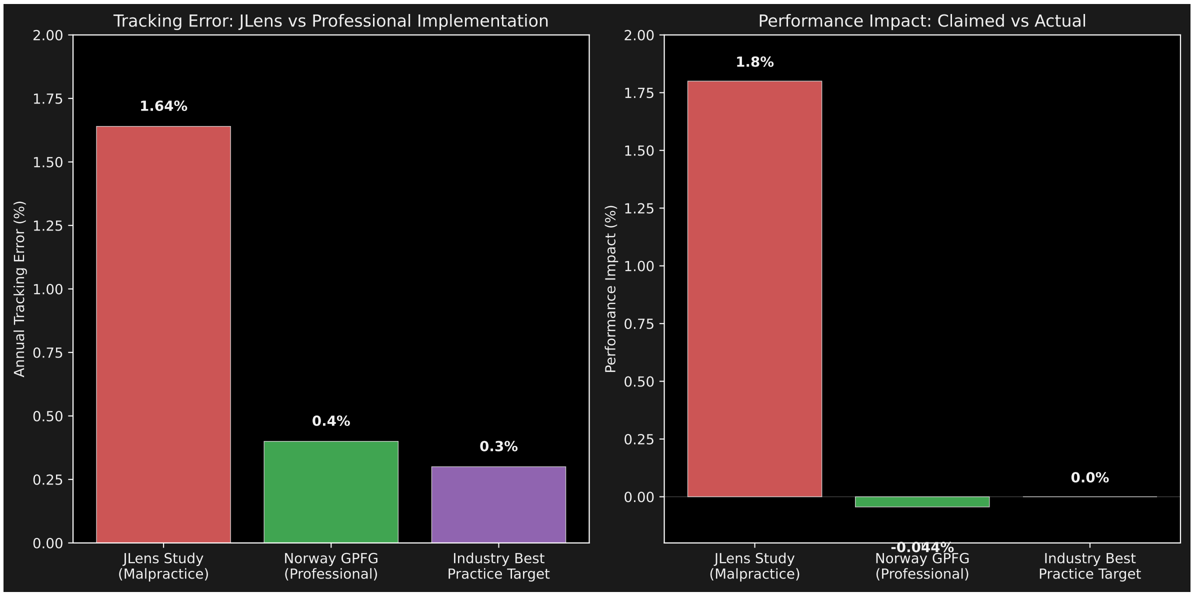
Organizations cited as sources weren't operational during early study years: - Don't Buy into Occupation Coalition: Formed January 2021 - OHCHR Database: First published February 2020 - AFSC Investigate: Launched 2019

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

Problem 2: Statistical Malpractice

The study states: "38 companies excluded and **no other adjustments made**." This approach would constitute fiduciary malpractice:

- Tracking error of 1.64% annually - essentially equal to claimed underperformance
- No rebalancing after removing major index constituents
- No sector adjustment after removing concentrated technology positions
- Potential cash drag from uninvested proceeds (up to 32% of market cap)



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

Non-Replicable Methodology

The study cannot be independently verified because JLens won't disclose: - Data sources - Rebalancing methodology - What "no other adjustments" means in practice - How they weighted remaining holdings after exclusions

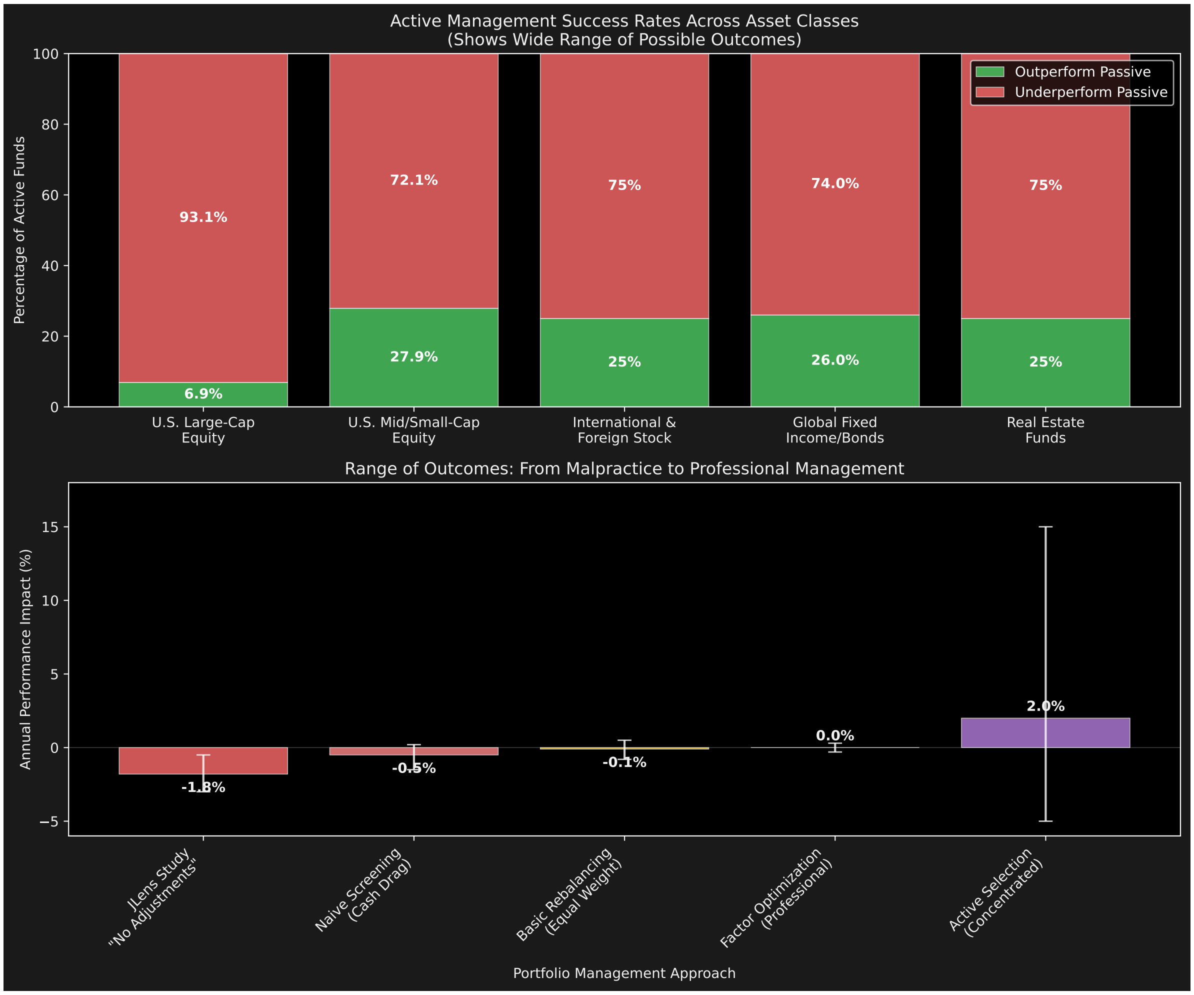
Non-replicable results are invalid in both academic and investment contexts.

The Active Management Reality

The Spectrum of Professional Management

Fiduciaries routinely worry about tracking error with divestment while happily approving traditional active management with significantly worse outcomes:

- 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**



Institutional Heterogeneity as Freedom

The professional management spectrum includes: - **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

Institutional heterogeneity isn't a problem - it's free will. They fought a whole war in heaven over it. Institutions can choose approaches that match their mission, risk tolerance, and stakeholder expectations.

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.

Performance Reality: What Actually Happens

It's Not Just Norway

A significant percentage of NACUBO institutions already use ethical screening successfully. 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 contribution	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 impact	Vendor optimization + quarterly reviews
Many NACUBO Members	Various	Multiple screens	Ongoing success	Professional implementation

Academic Evidence

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

Why Naïve Studies Fail

- **Static lists applied retroactively** ignore point-in-time information sets available to real investors
- **"No other adjustments"** constitutes fiduciary malpractice through cash drag and sector concentration
- **Tracking error parity** with claimed losses proves the model tested incompetent execution

Signal Analysis: Information Sources and Business Value

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.

The Hidden Costs of Inaction

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 mode
- **Ignoring institutional intuition** - what happens when leadership knows something is wrong but can't act?
- **Opportunity costs** - resources spent on controversy management instead of core 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 to long-term institutional success is not acting when your stakeholders are telling you to act.

The Norway Model: Implementation Framework

Why Boards Need This Framework

The Norway Model 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 - Provides measurable guardrails and professional oversight

Core Decision Framework

1. Mandate & Guardrails

- Adopt written conduct criteria referencing international law and 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 to avoid divestment shock
- **Quarterly:** Certify reinvestment into benchmark-aligned replacements

3. Reporting & Transparency

- Publish exclusion rationale, evidence citations, and risk 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)

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 and stakeholder expectations?
4. **Performance Monitoring:** What governance ensures ongoing assessment of impact?
5. **Hidden Cost Assessment:** What are the costs of NOT acting on stakeholder concerns?

For Staff Implementation

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

Minimum Standards for Future Studies

Any credible analysis of divestment impacts should include:

- **Point-in-time exclusion lists** reflecting realistic investor experience and available information
- **Full methodological transparency** enabling independent replication by third parties
- **Multiple implementation scenarios** from naive exclusion to professionally optimized approaches
- **Multi-period analysis** avoiding cherry-picked market regimes and time periods
- **Total cost analysis** including stakeholder relationship impacts and opportunity costs

Conclusions

The JLens Study is Invalid

1. **The Croquet Problem** - They got to move the ball wherever they wanted through selective methodology
2. **Point-in-time failure** - Applied future information to judge past investment decisions

3. **Implementation malpractice** - Tested approach would expose any fiduciary to legal liability
4. **Non-replicable methodology** - Results cannot be verified by independent third parties
5. **Ignores hidden costs** - Fails to account for stakeholder relationship damage and opportunity costs

What We Know from Real Evidence

- **Norway ($1.4T):** +0.44% cumulative contribution from exclusions with 0.3-0.5% tracking error
- **UC System ($126B):** Successfully completed fossil fuel divestment framed as "risk management"
- **NACUBO Members:** Many institutions already implementing ethical screens successfully
- **Academic consensus:** Performance impact measured in basis points, not percentage points
- **Professional management:** Wide spectrum of approaches available, most demonstrably successful

For Fiduciaries: The Path Forward

Use the Norway Model framework to implement exclusions professionally:

- Set tracking error guardrails (30 bps) with professional monitoring
- Require factor-neutral optimization to minimize unintended exposures
- Phase implementation over 30-60 days to avoid market impact
- Publish transparent reporting on process and outcomes
- Monitor quarterly with professional analytics and risk assessment
- **Consider total costs** - not just hypothetical performance impacts from flawed studies

Bottom Line: Any trustee considering the JLens study should demand complete methodology disclosure enabling replication and comparison with actual institutional implementations that demonstrate professional standards.

About This Analysis

About Ethical Capital

- Utah registered investment adviser specializing in concentrated ethical portfolios

- We embrace tracking error as a conscious choice for values alignment
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- Screening policy: https://ethicic.com/content/process/screening-policy

About Dryvestment

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