Life, Liberty, and Investing Returns with Perth Tolle

Caleb Silver

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By the time you're listening to this, both the U.K. and the U.S. may very well have declared climate emergencies, as heat waves and wildfires are wreaking deadly havoc on lives and property across both continents. Analysts estimate the economic damage to Europe alone will be at least half a point of gross domestic product (GDP), as everything from energy and food production to tourism and everyday life has been greatly disrupted. Great Britain recorded its hottest day ever on July 19, with temperatures hitting a record high of 40.3 degrees Celsius—that's 104.5 degrees Fahrenheit—in the east of England, according to the country's Met Office. London's fire brigade declared a major incident after a huge surge in fires across the capital on Tuesday. Record high temperatures across China have turned deadly, with reports of dozens of fatalities due to heatstroke, and Chinese officials have begun restricting power to factories to ensure sufficient supply for air conditioners. Seventy-six weather stations in China reported record high temperatures last week that exceeded 42 degrees Celsius—that's 108 Fahrenheit in some places. Here in the US, a heatwave moving its way across the country has already produced Salt Lake City's highest temperatures this past Sunday and could bring readings as high as 115 degrees in Texas and Oklahoma this week. About 40 million people are under heat alerts in the lower 48 states, according to the National Weather Service (NWS).

So, what can political leaders do beyond declaring climate emergencies and what does it mean if they do make those declarations? It's a complicated question, as you can imagine, particularly now, given the rampant inflation in the energy market. While oil prices have come down in recent weeks as global economies brace for a recession, energy demand will remain strong as air conditioners in cities around the world will be on full blast. In the U.S., the Biden administration, under an emergency declaration, could redirect federal funding to clean energy construction. It could also steer aid to communities on the frontlines of climate change and even curb the export of fossil fuels behind global warming. The president, by executive order, can tap more than 100 special powers normally intended to address hurricanes, terrorist attacks and other unforeseen events. For example, under the Stafford Disaster Relief and Emergency Assistance Act, the president could direct the Federal Emergency Management Agency to construct renewable energy products using federal money. He could also enact a national security exemption in a 2015 law that lifted a decades-long ban on most crude exports, re-imposing licensing requirements and other restrictions to curtail overseas oil sales. The problem, of course, is that high oil and gas prices are putting pressure on the administration to permit more production, not less. Not to mention the fact that President Biden has been trying to push his Build Back Better plan through Congress, which calls for more spending and investment in renewable energy, and it has faced staunch opposition from Senator Joe Manchin of West Virginia, among others. And, many of the executive powers he might try to push through would also face challenges in the Supreme Court.

In the UK, all three of the remaining candidates for Prime Minister and the leader of the ruling Tory Party are backing away from the government's climate strategy in the face of higher costs. That said, the Declaration of Emergencies will force climate action back to the top of the minds of voters, with mid-term elections fast approaching here in the U.S. In short, executive orders from presidents and prime ministers make for good political theater, but producing real change takes the will of unified voters who are pushing for lasting change. And change is hard when all most people want is a powerful air conditioner to beat the heat.

Perth Tolle is the founder of Life + Liberty Indexes and creator of the Freedom 100 Emerging Markets (EM) Index. Prior to forming Life + Liberty Indexes, Perth was a private wealth advisor at Fidelity Investments in Los Angeles and Houston. Prior to Fidelity, Perth lived and worked in Beijing and Hong Kong, where her observations led her to explore the relationship between freedom and markets.

Perth is a frequent speaker at investment industry events and provides commentary for various financial media including Barron’s, Bloomberg, Cheddar, CNBC, CNN, Fox Business, Institutional Investor, MarketWatch, Morningstar, and the Wall Street Journal.

Perth was named one of the Ten to Watch in 2020 by Wealth Management Magazine and one of the 100 People Transforming Business by Business Insider in 2021.

What's in this Episode?

We spend a lot of time on this podcast talking about the "E" of ESG, the environmental aspect of the ESG investing theme. Well, because we are green investors. But there's another "E" word that we need to consider as responsible and sustainable investors, and that's ethics. Ethical investing has been around for decades, but no one has brought it front-and-center, focusing on the issues that really matter in the 21st century, like Perth Toll. Perth is the founder of Life + Liberty Indexes and the creator of the Freedom 100 EM Index, the world's first freedom-weighted emerging markets equity index strategy. She's all over financial media and the conference circuit where I've had the pleasure of listening to her speak and to get to know her. And she is our special guest this week on The Green Investor. Welcome Perth.

Perth: Thanks for having me, Caleb.

Caleb: I'm so glad you joined us. You're so passionate about the relationship between freedom and capital markets, something a lot of investors may take for granted. What brought you to this place and what have you discovered on your journey?

Perth: Yeah. So I grew up in both China and the U.S. and moved back and forth between the countries throughout my childhood. After college, I went and lived in Hong Kong, and, while I was there, I traveled to the mainland and to, you know, cities like Beijing and Shanghai. And that's where I realized that my life would have been very different had I stayed in China as a child. And freedom is what made that difference. And so I started exploring the relationship between freedom and markets as well.

Caleb: And you were an adviser with Fidelity at a earlier point in your career. What made you want to transition to create your own shop? Were you just not able to exercise that belief in that type of an environment?

Perth: So, at Fidelity, I was a financial advisor in the L.A. and Houston markets, and this was after I came back from Hong Kong. And I did have clients, for example, a Russian client that said, "I don't want to invest in Russia because it would be like funding terrorism." I had clients from other countries, like in the Middle East, say the same thing to me, and I felt the same way about China. And many emerging market funds and indexes at the time were very, and still are very autocracy-heavy and had a lot of these autocratic countries and it's just because of the nature of the emerging markets universe. So I realized that a product like this should exist and needed to exist. And no, I would not have been able to do this at Fidelity because it would have been like an outside business activity that probably wouldn't have been approved. I left Fidelity though, because I wanted to stay at home with my young child at the time. A few years after I left Fidelity, I worked for another ETF firm, and then I decided to go out on my own and start this because it was still an idea that I just felt like the market was ready for.

Caleb: You created your own indexes and ETFs, and folks, you have no idea how hard this is, even for large institutions with billions of dollars in assets and huge legal teams. But you did it with your small firm. Why did you choose to create your own? And then I wanted to get into the process a little bit of how you did it and how you maintain it, but this is no small deal!

Perth: Thanks, Caleb. Yeah, and actually the index is the easier of the two paths that index an ETF. So we did both. And the index, you know, it's fairly easy—you just have somebody calculate it. I mean, I created the rulebook, the methodology, that basically turns the freedom scores into weights. So we use freedom scores from third party think tanks that are independent, like the Cato Institute and the Fraser Institute. And we turn those scores into freedom weights and the countries are 100% freedom weighted, instead of market cap weighted, which takes care of that autocracy concentration problem. The higher freedom countries get a higher weight, the lower freedom countries get a lower weight, and the worst offenders are excluded altogether from the index. And my initial plan was to license this index to issuers, like iShares or Vanguard, but nobody wanted it when I shopped it around. And so that's why we had to basically sponsor our own ETF. And that was actually the much harder part.

Caleb: Sponsoring your own ETF, marketing it, raising the money, going through all the Securities and Exchange Commission (SEC) rigamarole, that's a very big deal. And I know a lot of folks out there that do this for firms like yours, but how long did it take, and how much did it cost to really get it off the ground and get it out to the public?

Perth: So the index, in its current iteration, was incepted in 2017, and the ETF in 2019. So it took about two years between the index inception to the time that we had an ETF. And during those two years, the first year I shopped around and talked to basically every ETF issuer in the United States and then decided, okay, we obviously have to do this on our own because nobody wants to license the index. And that's when I started to raise money for our firm, for the operation cost of an ETF. It does cost about $250,000 a year. Emerging markets products are a little more expensive because there's the custody costs of giving our investors access to local shares in each of these markets. And we're very proud to pay that on behalf of our investors. So emerging markets products do cost a little more as a result, but I don't know of any other structure that is as beneficial for clients as an ETF, tax-wise. So that was something that I was very willing to do, is continue to go down the road of making an ETF.

Caleb: So you're saying a lot of the issuers didn't want it, necessarily. And on the index side, a lot of the institutions didn't want it. But you knew that individual investors wanted this type of thing. You were passionate about it, but you knew there are folks out there who wanted it, so you had to do it your way. Looks like you were proven right. You got over $200 million in assets under management (AUM) in the ETF right now, I believe, and it seems to be growing every year. So congratulations on that again, folks. Not easy at all to do this. Let's get into some of the methodology. You say you provide a differentiated emerging markets equity exposure by using quantitative, personal, and economic freedom metrics. You talked about those. You get some of those from the Cato Institute. But a lot of people may wonder, how do you quantify something like freedom? You actually have metrics to do this. So let's dig in to a few of those metrics.

Perth: Yeah. So these guys actually use 79 different metrics for personal and economic freedoms. They're the only ones that I know of that encompass both personal and economic freedoms. And I think that's important to have. So I categorize personal freedoms into civil and political freedoms. Civil freedoms are things like terrorism, torture, trafficking, internal organized conflict or causing wars in other places. Women's freedoms are part of this as well. There are five proxies for women's freedoms and things like women's rights to inheritance, women's rights to a movement, women's rights to children after divorce, and things like that. And then political freedoms are things like freedom of speech, mediam expression, assembly, and so forth. And then the economic freedoms are things we're all familiar with, like business regulations, rule of law, taxation, private property rights, soundness of monetary policy, freedom to trade internationally, and so forth. So all of these things added together gives me a composite score from these think tanks, and I use that composite score that encompasses all 79 variables. I use those as inputs into the algorithm that gives us the country weights.

Caleb: So then you get your country weights. I see some of the countries at the top of the list: Chile, Taiwan, South Korea, Poland, all of these countries, I assume, score relatively well, right? You're comparing one country to the other against the rest of the world. You don't see a lot of other Asian countries in there, particularly China. So when you're looking at these things, you want the countries that score best and then you're finding the companies within these countries that are outperformers. Do the companies also go through a similar type of screening, or is it once your country is in, then you can find the companies you want to invest in?

Perth: Yeah. So it is a top-down approach in the freedom screening, and the freedom waiting is done on the country level, it is 100% freedom weighted, not a tilt or an overlay, so that's important. And then on the security level, what we do is we just want to get a good representation of these markets in a very tradable way. So we just take the ten largest, most liquid securities in each of those markets that are not state-owned enterprises (SOEs), with state-owned being defined as 20% or more government ownership. So that's really just to bring the economic freedom theme all the way through. So in each of the markets, we'll have ten securities, and right now there's 11 countries, so there's 110 securities in the fund at the moment.

Caleb: Let's talk a little bit about state-owned enterprises because, you know, you say in your investing material, they just don't run that efficiently like private companies do. What have you noticed in your research and as you've been putting together these indexes in ETFs, that that strikes you as so interesting about this?

Perth: Yeah. So you mentioned we don't have any China in the index. We also don't have Russia, Saudi Arabia, Turkey, Egypt and so forth. So the freedom-weighting methodology naturally excludes the worst autocracies. And one of the things about these types of countries and why we don't want any exposure to them is that in these countries, companies have to put state interests above their own, above shareholders and above even their customers' interest. For example, Tencent operates an app called WeChat. And there was a time when the Chinese government used WeChat to, you know, find Uighurs and other dissidents. So when the state asks for that data from Tencent, you know, they're going to have to hand it over. So this is just one example. And then, you know, there was a recent example in Egypt of expropriation where the biggest dairy company in Egypt, the government wanted to take it over. The founder said no and got thrown in prison. His son said no, also got thrown in prison. So these are things that happen in the less-free markets where the government has an outsized role in private market activity and there's a cost of doing business that way. And when we invest in these companies, in these countries, we are subsidizing their cost of doing business that way of putting the state interest before all of their stakeholders. So that's another reason why we exclude state-owned enterprises, is that those are the companies where the state has even more control. Even in the freer countries, we don't want that state influence on business activity in private businesses, so we find that they're less efficient when they're run that way. And also, we don't want to subsidize the cost of doing business in that manner.

Caleb: There's the ethical reason, and then there's the investment reason. In terms of performance, though, as you've been investing and tracking countries and companies that make it into your criteria, how is performance when you look at it compared to something like the global MSCI or the S&P 500 over the past three or four years?

Perth: Yeah, we are strongly outperforming those benchmarks over the life of the fund. And I think one reason for that, I actually didn't expect the thesis to play out this well this soon. And I think one reason for that is because we've had some extreme events. We've had COVID, we've had the China crash, we've had Russia's invasion, and thereafter all their stocks going to zero. So we didn't have exposure to any of that going through this period of time, and that has helped us extremely. Now, I don't think that that is something that we can expect every year, but I do expect that in the long run, freer countries will outperform because they do have more sustainable growth, they recover faster from drawdowns—and we saw that in the recovery from COVID—and they use their capital more efficiently, both economic and human capital. So capital, as Walter Wriston said, is not just money, it's also people and ideas. And capital goes where it's most welcome and well-treated. So we think that the freer markets have an easier time attracting and retaining capital and experience less capital flight and capital destruction. So we do expect the outperformance to continue in the long run, though in the short term no one knows what will happen.

Caleb: No one knows what's going to happen tomorrow in the stock market anyway, and we're in a particularly volatile time now. You also say that freedoms are interconnected. You're talking about civil freedoms, political freedoms and economic freedoms. They work together and they should be measured as a composite. You're able to actually put all these together and look at them through that prism. A lot of folks may think that you need to separate them, but why do you think they need to be looked at together?

Perth: Yeah. So the reason why we look at all the freedoms together is that our data providers believe, and I agree, that freedoms are like the parts of an automobile—that you can't have a steering wheel without a transmission—the car still won't run. So, you know, we've heard it said that economic freedom precedes, it is necessary but not a precondition for human freedom, for personal freedom. And we've seen that to be the case in a lot of these countries that, you know, they'll open up economically but that increase in economic freedom won't be followed up by an increase in human freedom, so they reach a plateau. And now we're seeing that in some of the biggest emerging markets like China. So, it becomes a growth story of the past. So really, both freedoms need to work together. If you if you don't have economic freedom, if the government is doling out all the jobs and we have a situation like the Arab Spring where people aren't free to provide for their families and work and, you know, make money, then you don't really have freedom, even if you have some degree of personal freedom. On the other hand, if you don't have personal freedom but you have some degree of economic freedom, then you end up with something like China had over the past few decades. And, if you look at China as Exhibit A here, the NCHI index, which is the China onshore and offshore shares, has had a total return below that of Chinese treasuries, since the inception of the index in 1990. So this was at a time when China experienced extreme growth—and that was very real growth—where they went from abysmal economic policies under Mao to not-so-bad policies, and incremental improvement and rising economic freedom helped China tremendously and lifted people out of poverty. And it was a very exciting time. But during that time of growth, investors were only able to capture less than Treasury-like returns. So that's pretty abysmal. And that comes from an unfree market, a lot of dilution, a lot of expropriation. And in China, you know, the ownership structures are opaque. Accounting structures are very opaque as well. So without that transparency, without that rule of law and private property rights, including shareholder rights, it's very difficult for investors to capture growth. So that's why we try to stay away from these markets where investors, even if there is growth, have difficulty capturing it.

Caleb: Perth, you know this well, but we're entering a time where we're in a era of intense polarization, polarization of political ideals across the world, the rise of the ultra right, the rise of the ultra left, individual freedoms are going to get squeezed in the middle of this polarization that's already happening. How is that going to impact the investing landscape for you and the people who want to follow you into this theme?

Perth: Yeah. So I think the more polarized the world gets, the more alpha there is to be had in a freedom way. There is going to be a lot of bifurcation between the free world and the less free world. And you see that happening now even in developed markets. You know, we started this in the emerging markets space because of that divergence in freedom levels that exist in emerging markets. Developed markets, historically, have been quite homogenous as far as freedom levels. They're all pretty free, relatively speaking. There is no 100% free market, just as there's no 100% unfree market. So even in the U.S. here, we're not 100% free and we're just one of the least worst, right? So we started this in emerging markets because we found the most value there in doing a freedom-weighted strategy. Now, as the world bifurcates, we expect that maybe even in developed markets, there would be value to be had in a strategy like this.

Caleb: What hotspots are you and your team watching now that could become a much bigger deal later this year or even into 2023?

Perth: So we're watching the countries that are benefiting from a lot of human migration due to these kinds of current events. So, for example, Poland is benefiting from the human migration from Ukraine. Colombia has been benefiting from migration from Venezuela in recent years, although Colombia is running into some some major issues now. So these are the countries that we would expect to see increases in their scores. Now, there are also countries that we're watching that are currently very high on our index, like Chile. Now, Chile is is top holding right now because of its market movement, not because of its freedom score. So, because it's the one of the few well-performing emerging markets this year because of the exposure to commodities that they have in all of their industries. So we're watching Chile closely because of the political movements happening there. And I actually do, unfortunately, expect a drop in their score in coming years. So that's something that that we're watching as well. So the economic freedom in Chile, the human migration in some of these other markets, we also like markets such as Taiwan that are the beacon of freedom in their regions. You can say the same about Colombia and Poland right now as well, but Taiwan especially is under fire, as always. You know, that's just the way of life in Taiwan, and could be the epicenter of this bifurcation going forward. So one thing I would tell you, investors as well when I talk about Taiwan is that people ask, well, what if Taiwan gets invaded by China? Are you concerned about that? And I would say that if you're an investor and you're concerned about something like that happening, I would be a little more concerned about having 30% China exposure in your market cap-weighted emerging market funds, because as we saw from Russia and Ukraine, Russia is the market that got hit with sanctions instantly, worldwide sanctions as soon as they invaded Ukraine. And everybody is watching China and Taiwan next and seeing what's going to happen. I do believe that China was deterred by the internatinal actions taken against Russia, and I think that they will continue to be a little bit deterred. But if we're concerned about that, I would be more concerned about the exposure to China.

Caleb: What are your influences, Perth? Who helped guide the way or who do you look out to in the industry, who you've tried to model some of your career and industry practices after?

Perth: So one of my biggest influences is Rob Arnott of Research Affiliates, who is actually an LP in our firm and the first investor in our funds as well, and I tell that story often. He basically pioneered non-cap-weighted indexing. So, really, he is one of the reasons why we're all here in the ETF space is that we're all variations on cap weight. And so he kind of pioneered that—he didn't invent it—but he popularized it. So I think that was one of my early inspirations. As far as freedom weight, one of my inspirations is just the freedom fighters around the world, I mean, especially in Hong Kong, because I spent time there, and it's a place that's dear to my heart. Those guys gave their lives and futures to take a stand for freedom. Right now, there's Russian activists that have given their freedom to stand up for the freedom of their brethren in Russia and in Ukraine. And so, I think these guys are my true inspirations. And, you know, we're doing what we can in the indexing world to help investors have a way of expressing their preferences for freedom, you know, in these markets that didn't exist before. So that's why we're here. But, you know, freedom has a lot of benefits that are very nebulous. Freer countries have higher life expectancy, lower infant mortality, higher gender equality, lower poverty rates, higher per capita GDP, higher income. And even countires in the lowest income levels that are in the free world are much better off than the less-free countries in the lowest income levels. So all of these things are the benefits of freedom that are very difficult to visualize. And we're here to try to be a running scorecard for freedom in the emerging market space.

Caleb: Well, you're definitely a trailblazer in your own right. And a lot of people will probably say, in the short order, that you were their inspiration. Perth Tolle, the founder of the Life + Liberty Indexes and the creator of the Freedom 100 GM Index. So good to have you on the Green Investor. Thanks for joining us.

Perth: Thank you.