Marketing material
for professional investors and advisers only

In focus

Should investors consider happiness rather than GDP?

August 2021

The shift to whether we should pursue wellbeing rather than GDP growth is underway. Figuring out what makes society happy helps us identify the risks to the global economy from the S in ESG.

Piya Sachdeva
Economist

It was the practice of gratitude that helped me through the lockdowns last year. Every day I would write down three things I appreciated in my life, which allowed me to reflect on what made me happy. I recently stumbled upon that gratitude journal and flicking through the pages, there were a few themes to re-emerge. While I had been exceptionally grateful for the security of my job through the pandemic, it is clear that what makes me happy tends to be things that money cannot not buy. This goes against what I have been taught in my career as an economist, where Gross Domestic Product (GDP) as a monetary value of an economy, is the main measure of societal performance. I should only be as happy as the material things I own.

Of course, I am not the first person to have thought about this. About a decade ago, Nobel Laureate Joseph Stiglitz commissioned a report called *Mismeasuring Our Lives: Why GDP Doesn't Add Up*[1]. The report presented the case for retiring GDP in favour of wellbeing and in recent years, this idea has gained traction under the *Beyond GDP* movement. Though GDP has also come under fire for its poor measurement of the modern economy[2], *Beyond GDP* ultimately stems from the need for sustainable and inclusive growth. Governments need to improve the wellbeing of generations today yet maintain the resources needed for the wellbeing of future generations. These resources are natural capital, human capital, economic capital and of course, social capital.

It is no co-incidence that the idea to consider wellbeing as a measure of societal performance has been accompanied by the rise of investors considering social factors in their decision making. This can either be thinking about the impact of their investments or the risk that social factors may have on their financial returns.

As economists, we have considered governance for some time through the lens of political risk, which has historically influenced sovereign credit ratings and demanded a risk premium in emerging markets. More recently we have considered how climate change could affect long run economic growth and investment returns. We now turn to social factors – the "S" in ESG.

In this note, we explore the importance of income and other social factors in happiness and use our findings to help identify the risks to the world economy that stem from social factors. In part 1, we consider why wellbeing is important to investors. In part 2, we answer the all important question of whether money makes society happy. Finally in part 3, we identify three risks to the economy that stem from "S" and discuss what investors should do to protect their portfolios.

Executive summary: G underpins S

We find that GDP and unemployment actually account for a large share of happiness. This means a policy shift towards targeting wellbeing does not mean throwing the current policy framework out of the window. Particularly for developing countries, income is a reasonable proxy for wellbeing as it captures a variety of social factors. However, we can do better to measure societal performance. In our work, we find that boosting health outcomes, minimizing corruption and raising wider social trust are all important in boosting happiness.

Our work highlights that social considerations stem from strong governance – G underpins the S in ESG. Governments that improve health outcomes, raise transparency, reduce misinformation and importantly cut out corruption are likely to be rewarded with higher chances of re-election and better social outcomes. This also stands for businesses and is consistent with our previous work noting greater public scrutiny on companies' treatment of their stakeholders. This new social contract is here to stay and active investment managers play an important role in holding executives to account.

Just as GDP growth rates do not explain market performance, social factors do not usually impact markets much either at a country level, in contrast to the company level, where they are important. Companies are punished for poor governance standards, but countries rarely are unless there is social unrest which fuels political change or countries are subject to international sanctions. From this perspective, rather than seeking return from "happy" markets, macro investors integrating ESG into their framework should instead consider the risks to their investments from unhappy markets.

1 Sen, Jean Paul, Stiglitz (2010).

2 Independent Review of UK Economic Statistics, Bean (2016).

Our work points to three major risks for the world economy that stem from "S":

First, the Federal Reserve's (Fed) change to a more inclusive measure of full employment means keeping interest rates lower for longer in an attempt to extend the economic cycle and therefore lower unemployment for low income communities. However, blunt policy tools risk overheating the economy and damaging social outcomes through a boom-bust cycle.

Second, the energy transition is set to improve the wellbeing of future generations but needs to be very carefully managed to prevent damaging wellbeing today. Though this has been recognised by policymakers under the Just Transition umbrella[3], it will likely prove difficult to manage.

Third, as we emerge from the pandemic there is risk of social unrest, especially for countries with pre-existing lack of trust in institutions, such as Europe and emerging markets.

Part 1: Why do investors need to think about wellbeing?

Sustainable growth matters

Just as we should take a wider approach when it comes to a company's financial performance, we should also take a wider approach when it comes to judging economic performance.

3 See the Just Transition Mechanism (JTM) from the European Commission.

Ultimately this is fundamental in identifying whether countries are experiencing sustainable and inclusive growth. Economic growth that does not improve wellbeing is unsustainable just like growth funded by debt or growth causes irreversible damage to natural resources.

In changing the concept of the maximum level of employment to a more inclusive measure, the Fed has recognised the social implications of monetary policy and in particular, its role in reducing inequality. The central bank has cited the benefits of a strong economy to low income communities and now looks at a broader range of employment indicators. These include unemployment in the lowest wage quartile, unemployment in ethnic minorities and the participation of women in the labour force[4].

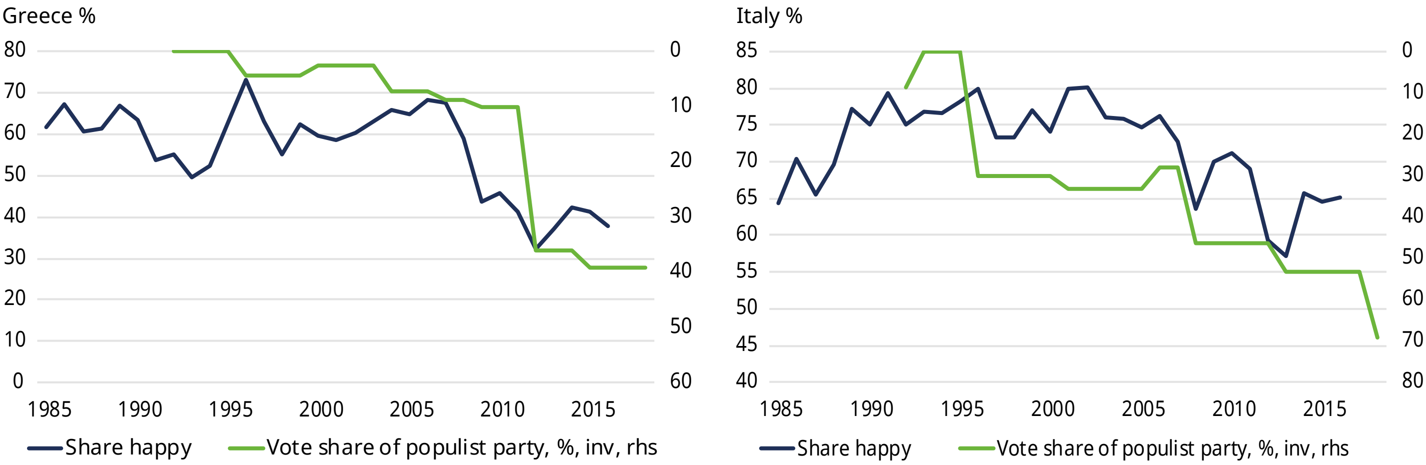
Unhappy people vote for political change

Studies show that satisfaction is linked to political choice. In particular, happier people are more likely to turn up to vote in elections and also more likely to vote for the incumbent political party[5]. Looking back, keeping an eye on subjective happiness measures would have hinted at the coming political change in Europe, particularly for Greece and Italy, where happiness fell markedly after the Global Financial Crisis (chart 1).

4 How Should We Think about Full Employment in the Federal Reserve's Dual Mandate? Governor Lael Brainard, February 24, 2021.

5 World Happiness Report 2019, Happiness and Voting Behaviour.

Chart 1: Happiness vs. Populist party share



Source: Eurobarometer, The Guardian, Schroders Economics Group. Data interpolated where necessary. June 2021.

Box 1: How do we measure happiness?

Albert Einstein said that not everything that counts can be counted. But if we are to look to happiness as a measure of societal performance, we must first understand how happiness is measured. Measures of happiness can be separated into two subjective and objective.

Subjective
Psychologists actually have two concepts of happiness: hedonic and eudaimonic. Subjective happiness measures tend to be based on hedonic happiness, the feeling of pleasure or enjoyment. Eudaimonic happiness on the other hand is the feeling of meaning or purpose.

Within happiness surveys, there are usually two types of questions.

The first asks how satisfied are you with your life? This can be done on a continuous scale (known as the Cantril scale) or discrete intervals.

The second approach asks about the emotional state; whether you have experienced positive or negative emotions. But as emotions are naturally short term, these have little relationship with life satisfaction measures. You can be happy with your overall life but be angry or stressed.

Many governments are now collecting their own data on subjective happiness, including New Zealand and the UK, though the most prominent international data on subjective happiness is from the World Values Survey, the *World Happiness Report as surveyed by Gallup and the Eurobarometer survey.*

Objective
There is a vast amount of data on the quality of life, which many organisations view as happiness measures. One of the main objective happiness data sets is the Better Life Index, where the OECD monitors 11 areas of life, both monetary and non-monetary. These are not presented in any order unlike another prominent dataset; the Social Progress Index, which splits aspects of life into three progressive categories; basic human needs, foundations of wellbeing and opportunity.

Signal of future policy direction
For developed markets, where wellbeing is being more seriously considered by governments, understanding happiness could signal future policy direction. Leading the way on this, New Zealand has introduced their wellbeing budget in 2019 and since then, financial decisions have been informed by wellbeing. In the next section, we explore the relationship between subjective happiness (life satisfaction) and objective happiness.

Part 2: What makes a country happy?

Money can buy happiness, but only to a point
As Gross Domestic Product (GDP) is the conventional measure for economic performance, it is a natural starting point to understand the relationship between GDP growth and happiness. Does more money make us happier?

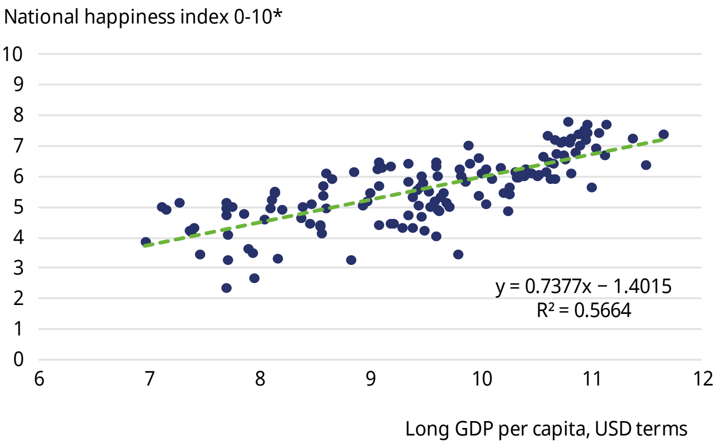
If GDP were to have little relationship with happiness, an explicit pursuit of higher wellbeing could have major implications for economic policy, growth and financial markets. Pivoting societal goals, governments would likely change economic incentives via policy levers to shift resources towards certain areas of the economy. This could also have a detrimental impact to government deficits as spending generates less income than before, though in the long run happier workers should be more productive[6].

In fact, GDP per person has a strong relationship with national happiness – explaining 56% of the differences across countries (chart 2). This also holds for a smaller dataset of more advanced economies through the lens of personal earnings. Though the amount of happiness explained by income is lower in advanced economies, it still remains relatively high, with income explaining half of the variation of happiness across countries. The lower explanatory power in richer countries partly reflects the non-linear relationship between GDP per person and happiness. The richer someone is, the smaller the boost in happiness from becoming richer. Happiness plateaus as the average income in society reaches $70,000 (chart 3).

The shape of the relationship between happiness and income is significant for two reasons. Firstly, in the broader context of inequality this supports the case for distributive policies.

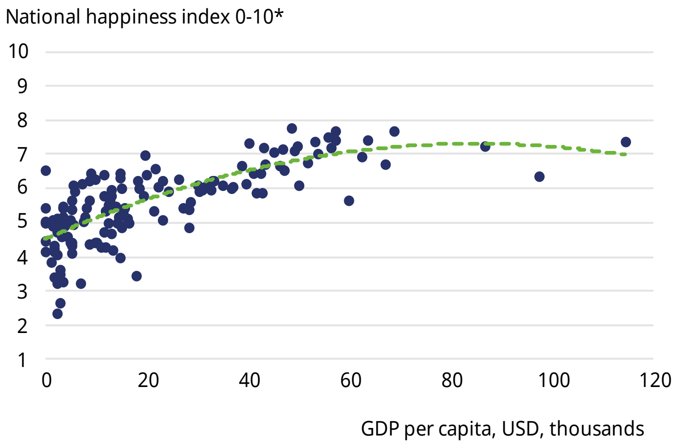
6 Does Employee Happiness have an Impact on Productivity? Bellet, De Neve, Ward (2019).

Chart 2: Log GDP per capita vs. Happiness



*Life evaluation using Cantril Ladder.
Source: World Happiness Report data/Gallup, 2021.

Chart 3: GDP per capita vs. Happiness



Source: World Happiness Report data/Gallup, 2021.

An additional dollar of income taken from the rich and given to the poor, is likely to make society happier as a whole. Secondly, for rich countries, it may be that there are more effective ways for society to boost happiness than by solely pursuing more economic growth.

What else matters?

The *Beyond GDP* movement has accelerated the data collection of the various aspects of society from various international bodies. The OECD was one of the first to bring together internationally comparable measures of wellbeing under its Better Life Index.

But some things matter more than others when it comes to driving wellbeing. This is important for investors trying to understand what has the largest social impact and understanding where social risks are most likely to come from. To explore this, we use regression analysis to explore what *objective* social factors best explain *subjective* happiness, measured by life satisfaction.

We consider the eleven areas of life identified by the OECD (see table 1). For completeness, we add in inequality, social trust and a measure of perceived corruption given their importance in wellbeing literature and understanding of social capital.

Table 1: Objective measures of wellbeing considered in our work

Area of life	Data series
Housing	Dwellings without basic facilities Housing expenditure Rooms per person
Income	Household net adjusted disposable income Household net wealth Personal Earnings
Jobs	Labour market insecurity Employment rate Long term unemployment rate
Community	Quality of support network Inequality (Gini coefficient, UN) Social trust (World Values Survey) Perceived business and government corruption (Gallup survey)
Education	Educational Attainment Student skills Years in education
Environment	Air pollution Water quality
Civic engagement	Stakeholder engagement for developing regulations Voter turnout
Health	Life expectancy Self reported health
Safety	Feeling safe walking alone at night Homocide rate
Work-Life Balance	Employees working very long hours Time devoted to leisure and personal care

Source: OECD Better Life Index, Gallup, World Values Survey, UN WIID, Schroders Economics Group, June 2021.

Out of all these factors we find that four stand out as having the strongest relationship with happiness.

These are:

- Personal income
- Long-term unemployment
- Self-perceived health
- Perceived corruption

There is already a significant amount of attention given to income and unemployment by policymakers and investors. Income can be seen as a proxy for GDP per capita and unemployment is a focus of central banks around the world. Low unemployment is one part of the dual mandate of the Fed along with the stability of prices.

When considered alone, income explains 50% of the variation in happiness experienced across countries. Income and unemployment together explain 60%. However, health and corruption are also clearly important when it comes to wellbeing. For both, there a less than 1 in 100 chance that differences in the data are explained by chance alone. Not only this, considering health and corruption as well as income and unemployment raises the share of happiness explained across countries to 90% and also reduces the error of predictions from the model (chart 4).

Chart 4: Fit of happiness models

Source: Schroders Economics Group, May 2021. Variables are transformed into logs in the regression.

Ultimately, our work shows that the existing economic framework of targeting higher GDP growth and low unemployment does a relatively good job, but targeting perceived corruption and health outcomes would help complete the picture. It is worth looking into corruption and health in a little more detail given their importance in society.

Is society trustworthy?

Investors have long considered corruption and wider governance measures as important at both an economy and firm level. From a macro perspective, this is mainly through the lens of political risk, which has historically influenced sovereign credit ratings and demanded a risk premium in emerging markets.

The perception of corruption data that we use in our work is in fact a measure of institutional trust, which captures both government and business corruption. More specifically, survey respondents are asked whether *corruption is widespread in government and business?*[7] This also has a good relationship with broader trust in society, where people are asked whether they can trust others (chart 5). Of course, social trust goes hand in hand with how we think about social capital itself, where social capital is defined as *"the links, shared values and understandings in society that enable individuals and groups to trust each other and work together"*[8].

7 Survey done by Gallup.

8 OECD insights: Human Capital.

Inequality also has a role to play here. Various studies have found that income inequality helps determine social trust (chart 6). A working paper by the International Monetary Fund (IMF) found that in both the United States and Europe, inequality, particularly at the bottom of the distribution, lowers trust in others[9]. The thesis is that unequal societies strengthen social hierarchy, which undermines social trust and raises the perception of corruption. But political scientists warn of a destructive loop as the causality can also be reversed. Corruption can lower institutional and wider social trust whilst exacerbating inequality by transferring resources to the rich[10].

Stepping back, we find that corruption is more highly correlated to happiness than social trust or inequality itself. This suggests that it may be the equality of opportunity and fairness of institutions in society is more important for wellbeing than equal outcome. This also corroborated by a study by Harvard university that finds that social trust is a stronger reflection of the fairness of institutions than a pure aversion to differences in society[11].

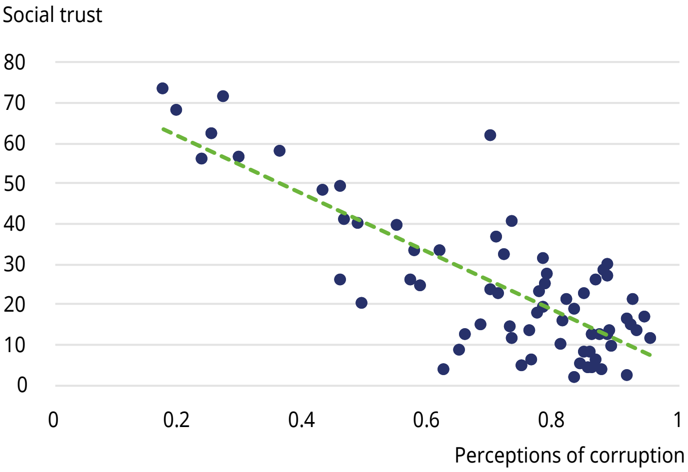
So how do countries rank on corruption? It is no surprise that emerging markets have higher perceptions of corruption than developed markets (chart 7). Within developed markets, the

9 Growing Apart, Losing Trust? The Impact of Inequality on Social Capital, Gould and Hijzen (2016).

10 All for All: Equality, Corruption and Social Trust, Rothstein (2005).

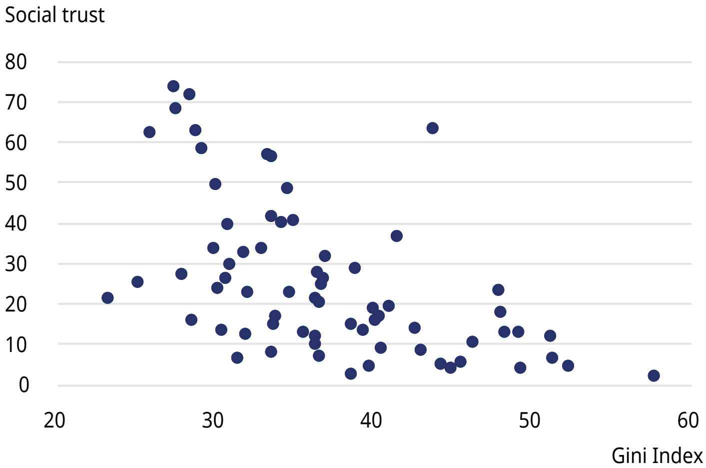
11 Corruption and Inequality as Correlates of Social Trust: Fairness Matters More Than

Chart 5: Social trust vs. Corruption



Source: World Happiness Report, World Values Survey, 2021.

Chart 6: Social trust vs. Inequality



Source: World Values Survey, UN WIID.

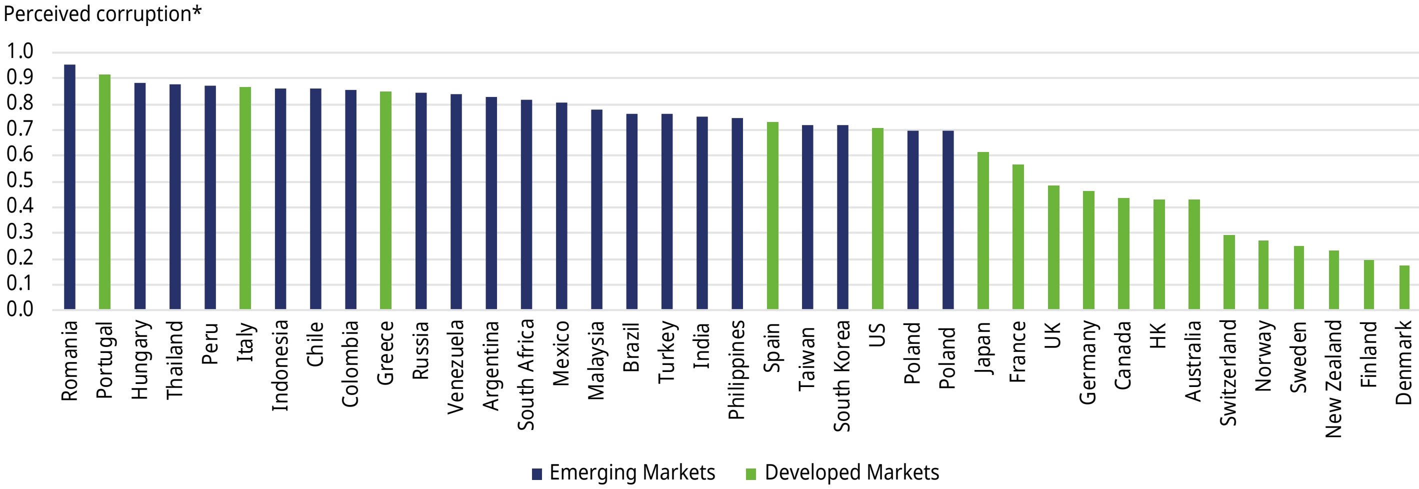
Nordic countries have the lowest perception of corruption and highest social trust levels. This helps to explain why these countries consistently rank as some of the happiest countries in the world.

Eastern Europe in particular stands out as having especially high perceptions of corruption with Romania, Portugal and Hungary topping the list across both major developed and emerging markets. Italy and Greece also score relatively low. It is worth highlighting that these rankings are fairly consistent with other surveys such as the Corruption Perceptions Index[12]. In more detailed surveys of people's views and across the bloc, the high perceptions of corruption reflect various factors. These include the prevalence of bribes, perceptions that governments are ruled by private interests, tax avoidance, challenges to the Rule of Law and regional inequality[13].

12 From Transparency International: The global coalition against corruption.

13 Global Corruption Barometer – EU 2021.

Chart 7: Perceived corruption across emerging and developed markets



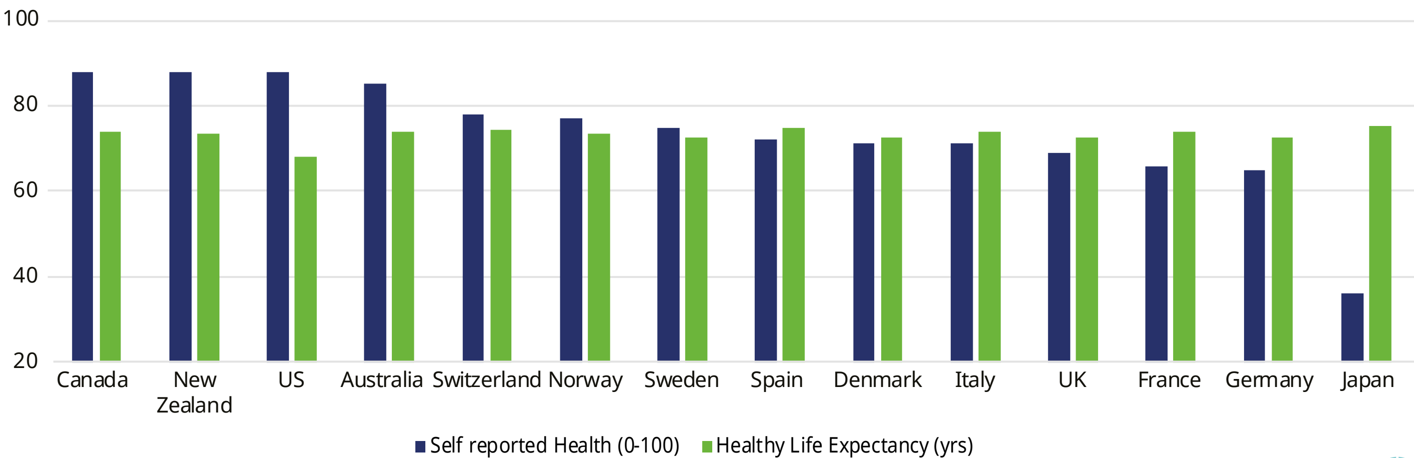
Survey asks whether corruption is widespread in government and business? Score 0-1.
Source: Schroders Economics, World Happiness Report, June 2021.

Mental health matters

Popping up in my journal several times, it is unsurprising that we find health has a strong relationship with happiness. The measure we use is self-reported health – the share of those reporting "at least good" health. This actually has a stronger relationship with happiness than physical health alone, proxied by life expectancy. Importantly, this reflects that self assessed health combines both mental and physical health. Interestingly, the inclusion of mental health can also be seen from a relationship between self-reported health and strong ties with family and friends.

Mental health is especially important to consider in advanced economies, where life expectancy and other measures of physical health are already very high (chart 8). New Zealand's wellbeing budget is consistent with our finding that health matters. Though already experiencing relatively good health compared to others, health is one of the five wellbeing objectives that underpin its fiscal policy decisions. Elsewhere in developed markets, Japan stands out as having very poor self reported health, despite its high life expectancy. Factors often cited for this are pressure at school, long working hours, social isolation (particularly in the elderly) and a cultural stigma around mental health issues that prevents people from seeking help.

Chart 8: Health in developed markets



Source: Schroders Economics Group, Gallup, World Happiness Report, June 2021.

Part 3: What does this mean for investors?

Our work creates a framework to think about social factors from a top-down perspective. Countries that raise incomes and health outcomes whilst reducing corruption and unemployment are likely to be happier and improve "S".

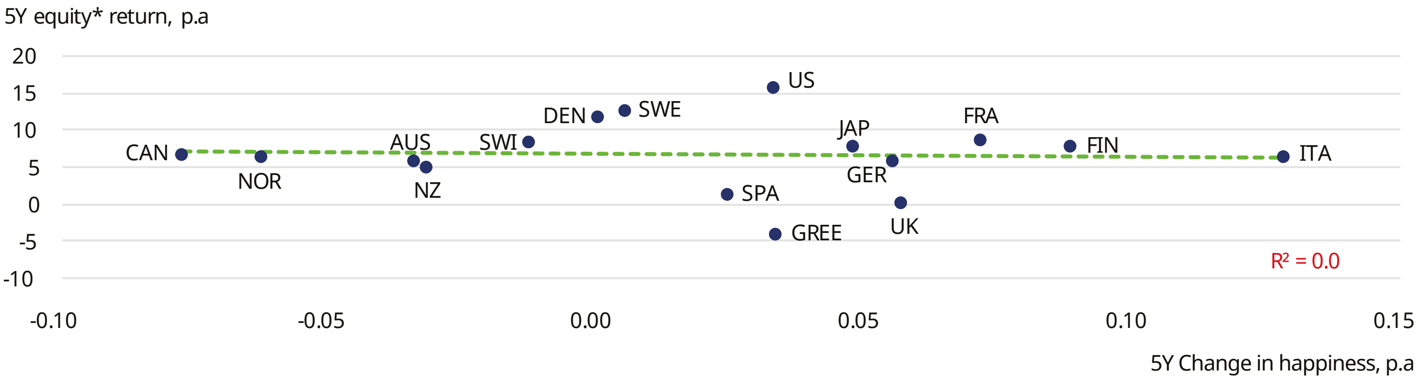
For impact investors, our work highlights the positive social impact from investing in healthcare and funding governments who are actively increasing transparency. Our finding that reducing corruption and raising social trust improves wellbeing highlights that social considerations cannot be seen as distinct from governance. In "ESG", "G" ultimately underpins "S". Our previous work shows that governments are seen as the least competent and most unethical of all institutions. Those that improve transparency, reduce misinformation and importantly cut out corruption are likely to be rewarded with better social outcomes and higher chances of re-election. This presents an opportunity for emerging markets but also Europe, where many countries still suffer from a high perception of corruption.

For companies, who as a whole are seen as being more trustworthy than governments, this also provides an opportunity to contribute to societal trust, especially in countries with weak governments. This can be through corporate social responsibility programmes and addressing contemporary issues that are important to stakeholders. For equity investors, this highlights the importance of "corporate karma"; the growing recognition that taking care of stakeholders has positive business benefits. The broader link between institutional trust is consistent with our previous work noting greater public scrutiny on companies' treatment of their stakeholders. This new social contract between businesses and society is likely to stay. And as stewards of client capital, this underscores the importance of active investment management in encouraging transparency and holding executives to account.

From a top-down perspective, there is no relationship between happiness and equity returns using historical data in developed markets (chart 9). This is perhaps not too surprising given the very low relationship between GDP growth and equity market returns that researchers have found in the past[14]. Just as GDP growth rates do not explain market performance, social factors do not usually much impact either at a country level, in contrast to the company level, where they are important. Companies are punished for poor governance standards, but countries rarely are unless there is social unrest which fuels political change or countries are subject

14 What's growth got to do with it? Equity Returns and Economic Growth, CFA Institute Journal Review, 2015.

Chart 9: Equity returns vs. Happiness



*Using MSCI indices. Source: Schroders Economics Group, Gallup, Refinitiv, 26 July 2021.

to international sanctions. However, there are many examples of where "S" has weighed on financial markets, particularly in the Emerging and Frontier world. In most cases disillusionment caused by low standards of wellbeing has led to populist governments. In 2010, the Arab Spring uprising swept the Middle East and North Africa as protesters challenged authoritarian regimes, corruption and low living standards. This ultimately led to regime changes in Tunisia, Egypt and Libya and pushed up global oil prices to a peak of $120 per barrel in 2011. In 2015, following a backlash against austerity, Greece elected hard-left radicals who pledged to renegotiate terms of its financial bailout. Greece later then suffered a liquidity and sovereign debt crisis. Not only this, wider fears around the stability of the euro in the case of "Grexit" weighed on the bloc's currency. More recently in 2019, Latin America experienced mass protests against corruption, inequality and poor living standards leaving the region vulnerable to capital outflows and for many countries led to drastic political change.

Investors integrating ESG into their framework from a top-down perspective, should therefore consider the risks to their investments from "S", rather than "happy" markets as a return generator. Our work points to three risks to the world economy from "S" today:

The broader mandate of the Fed:
Reacting to slowly to inflation risks damaging "S"
Changing the concept of the maximum level of employment to a more inclusive measure, the Fed is recognising the social implications of monetary policy and within this, its role in reducing inequality. This is clear from the central bank's citing of the benefits of a strong economy to low income communities. In reality, this means targeting a lower level of unemployment and along with its shift to *Average Inflation Targeting* (AIT) points to keeping interest rates lower for longer in the hope of extending the economic cycle. If done successfully, our work shows that lower unemployment and inequality should raise overall wellbeing.

This social agenda broadens the mandate of monetary policy which has historically been focussed on inflation and financial stability. As we have highlighted before, monetary policy is becoming increasingly subservient to fiscal policy as many central banks are under pressure to keep interest rates low helping to ensure government debt remains on a sustainable track. This is especially the case after the pandemic, which has caused public debt to rocket. Numerous central banks in emerging markets have now started quantitative easing to ease financial conditions and absorb government bond issuance. As a result, the role monetary policy in keeping borrowing costs down is no longer only a developed market phenomenon. Of course the pandemic has been an extraordinary health crisis and therefore a "one-off" hit to public spending, but in the next decade, social spending including on pensions and healthcare is expected to rise across both developed and emerging markets. The bottom line is that the pressure on central banks to keep interest rates low is here to stay.

Pursuing these political agendas threatens central bank independence, particularly for emerging markets where central banks are still building credibility. Ultimately, asking the central bank to do more comes with risks. The Fed has blunt policy tools that target broad measures. This will make it difficult to target unemployment in certain communities and given the long lags between policy decisions and economic outcomes, the Fed risks reacting too slowly to higher inflation. The wider need for central banks to support government borrowing also limits the ability to respond to rising inflation. This risks letting the economy overheat, potentially unhinging inflation expectations and causing higher inflation. This can spiral out of control as people negotiate higher wages to preserve their purchasing power.

Any reactive aggressive rise in interest rates risks tipping the economy into recession, creating a self-defeating boom-bust cycle. Investors may remember the US in the late 1970s when the Fed was forced to hike rates to 20% to bring inflation down. This caused activity to fall and unemployment to rise. It is worth also highlighting that high inflation itself is socially damaging as higher prices erode purchasing power undermining savings and the currency.

For investors, the risk of higher inflation supports owning assets that protect the portfolio from inflation including inflation linked government bonds, commodities or gold as consider increasing exposure to real assets from financial assets. Meanwhile, stock pickers should seek out companies with lower exposure to raw materials and strong pricing power.

The management of energy transition:
"E" at the expense of "S"?

Managing climate change is crucial for the sustainable growth and the wellbeing of future generations. In the long term, the energy transition is an opportunity to create new relatively high paying jobs in clean energy. However this will have to be managed very carefully as the transition will likely have social implications for the today's generation.

As we highlighted in our inescapable truths faced by investors, switching away from burning low cost carbon will have a cost on the economy. Phasing it out will hurt many businesses and economies, particularly in the emerging markets. Output and jobs will be lost in those industries and significant government spending will be needed to support and re-direct workers to the new opportunities in the sustainable economy. This will weigh on public finances and in turn, put pressure on government yields if this is funded by issuing debt rather than raising taxes. Though some heavily polluted countries could experience better physical health, the shorter-term detrimental impact to income and jobs will reduce wellbeing for generations today. This is being recognised by policymakers today under the *Just Transition*. For example, in the EU, the *Just Transition Mechanism (JTM) provides financial support through loans and grants to alleviate* the socio-economic impact of the energy transition.

However, even with policy support, there is still likely to be severe disruption in countries and regions where there are a high share of jobs are in fuel extraction, including coal, gas and petroleum. If the energy transition is not managed well enough, governments could ultimately pay the cost through political change.

Social unrest after the pandemic:
Could the pandemic expose weak "G"?

Governments have clearly had a difficult balancing act to navigate during the pandemic where lockdowns enacted to protect physical health have damaged mental health, hurt incomes and lost jobs. However, the pandemic has shown the importance of building social capital in better equipping economies for sustainable growth. Various social factors have been found to have been good predictors of countries that handled the pandemic well. These include, confidence and trust in public institutions, income inequality and even whether the leader of a country was a woman[15].

Helped by an unprecedented amount of government support, surveys so far have shown surprising resilience in subjective happiness last year when it comes to evaluating life (chart 10), though there was a 10% spike in the number of people who said they were feeling sad or worried[16].

The limited impact on happiness so far is consistent with history. Work by the International Monetary Fund (IMF) shows that social scarring does not show up quickly and unrests tend to emerge as the pandemic eases[17]. Our finding that lowering corruption is important for wellbeing is consistent with IMF's view that threats are larger for countries with pre-existing lack of trust in institutions, poor governance, poverty and inequality. This ultimately justifies a risk premium in markets with high levels of corruption and poor governance.

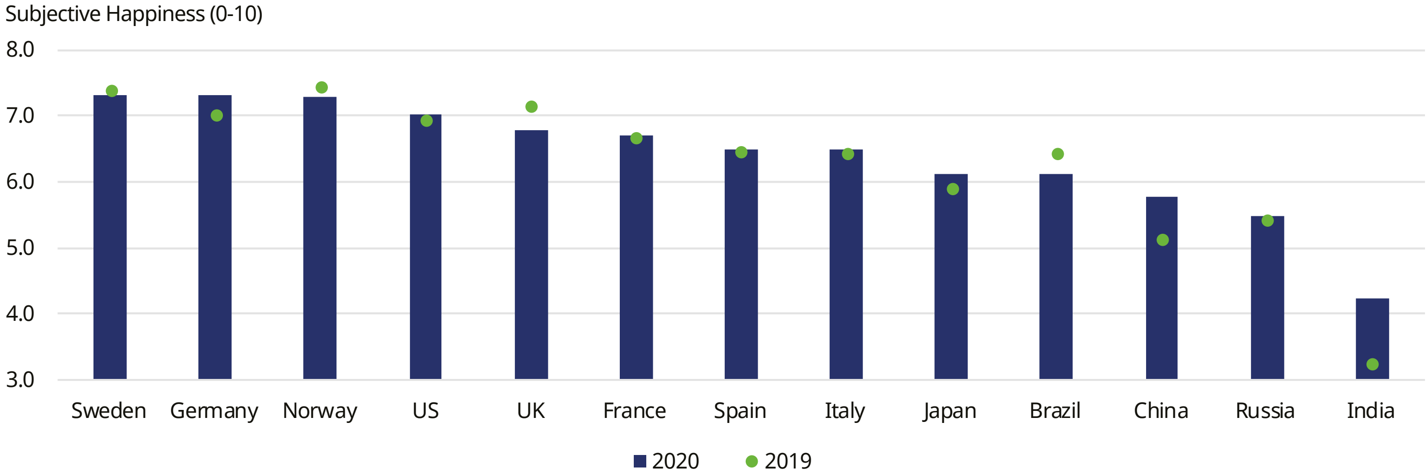
More widely, the social and political risks stemming from the mitigation of climate change and the pandemic call for investors to diversify their portfolios. Our previous work on geopolitical risk supports taking a dynamic approach; switching into safe haven assets when risks are elevated.

15 World Happiness Report, 2021, Life under COVID-19.

16 World Happiness Report 2021. Life Under COVID-19 .

17 IMF blog: COVID's Long Shadow: Social Repercussions of Pandemics, 2021.

Chart 10: Happiness in selected economies



Source: Schroders Economics Group, Gallup/ World Happiness Report, June 2021.

Conclusion

Social considerations stem from strong governance

The shift to whether we should pursue wellbeing rather than GDP growth is underway. We find that GDP and unemployment actually account for a large share of happiness, so any policy shift towards targeting wellbeing does not mean throwing the current policy framework out of the window. Particularly for developing countries, income is a reasonable proxy for wellbeing capturing a variety of social factors. However, our work shows that the measurement of success for a society can be improved and should be broader than GDP and unemployment. Ultimately, a focus on improving health, minimising corruption and raising wider social trust would make society happier. Given that more money boosts happiness less for the rich than for the poor, any change to targeting societal wellbeing is likely to be accompanied by policies to reduce inequality.

Our finding that countries with low corruption are happier highlights that social considerations stem from strong governance: In "ESG", "S" is underpinned by G and alongside this, democracy allows an unhappy society to pursue political change.

Protecting portfolios from social risks

Just as GDP growth rates do not explain market performance, social factors do not usually impact markets much either at a country level, in contrast to the company level, where they are important. Companies are punished for poor governance standards, but countries rarely are unless there is social unrest which fuels political change or countries are subject to international sanctions. From this perspective, rather than seeking return from "happy" markets, macro investors integrating ESG into their framework should instead consider the risks to their investments from social factors.

The risk that monetary policy runs the economy hot argues for inflation hedges in the portfolio. More widely, this also presents an opportunity for real assets to perform relative to financial assets. Meanwhile, stock pickers should seek out companies with lower exposure to raw materials and strong pricing power.

Social and political risks stemming from the mitigation of climate change and potential unrest after the pandemic calls for investors to diversify their portfolios and switch into safe haven assets when risks are elevated. Finally, companies with strong stakeholder relationships and ties to their local community should also have lower downside risk in a volatile environment and be more able to maintain their licence to operate.

For impact investors, our work highlights the positive social impact from investing in healthcare companies and funding governments who are actively cracking down on corruption and increasing transparency. This also stands for businesses and is consistent with the growing recognition that taking care of stakeholders has positive business benefits. This new social contract is here to stay and active investment managers play an important role in holding executives to account.

Important Information

The views and opinions contained herein are those of the authors as at the date of publication and are subject to change and may become outdated due to market or regulatory developments. Such views and opinions may not necessarily represent those expressed or reflected in other Schroders communications.

This document is intended to be for information purposes only. The material is not intended as an offer or solicitation for the purchase or sale of any financial instrument or security or to adopt any investment strategy. The information provided is not intended to constitute investment advice, an investment recommendation or investment research and does not take into account specific circumstances of any recipient. The material is not intended to provide, and should not be relied on for, accounting, legal or tax advice.

Information herein is believed to be reliable but Schroders

does not represent or warrant its completeness or accuracy.

No responsibility or liability is accepted by Schroders, its officers, employees or agents for errors of fact or opinion or for any loss arising from use of all or any part of the information in this document. No reliance should be placed on the views and information in the document when taking individual investment and/or strategic decisions. Schroders has no obligation to notify any recipient should any information contained herein change or subsequently become inaccurate. Unless otherwise authorised by Schroders, any reproduction of all or part of the information in this document is prohibited.

Any data contained in this document has been obtained from sources we consider to be reliable. Schroders has not independently verified or validated such data and it should be independently verified before further publication or use. Schroders does not represent or warrant the accuracy or completeness of any such data.

All investing involves risk including the possible loss of principal.

Third party data are owned or licensed by the data provider and may not be reproduced or extracted and used for any other purpose without the data provider's consent. Third party data are provided without any warranties of any kind. The data provider and issuer of the document shall have no liability in connection with the third party data. www.schroders.com contains additional disclaimers which apply to the third party data.

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Exchange rate changes may cause the value of any overseas investments to rise or fall. This document may contain 'forward-looking' information, such as forecasts or projections. Please note that any such information is not a guarantee of any future performance and there is no assurance that any forecast or projection will be realised.

European Union/European Economic Area: Issued by Schroder Investment Management Limited,1 London Wall Place, London, EC2Y 5AU. Registered Number 1893220 England. Authorised and regulated by the Financial Conduct Authority.

Note to Readers in Australia: Issued by Schroder Investment Management Australia Limited, Level 20, Angel Place, 123 Pitt Street, Sydney NSW 2000 Australia. ABN 22 000 443 274, AFSL 226473.

Note to Readers in Canada: Schroder Investment Management North America Inc., 7 Bryant Park, New York, NY 10018-3706. NRD Number 12130. Registered as a Portfolio Manager with the Ontario Securities Commission, Alberta Securities Commission, the British Columbia Securities Commission, the Manitoba Securities Commission, the Nova Scotia Securities Commission, the Saskatchewan Securities Commission and the (Quebec) Autorite des Marches Financiers.

Note to Readers in Hong Kong: Schroder Investment Management (Hong Kong) Limited, Level 33, Two Pacific Place 88 Queensway, Hong Kong. Central Entity Number (CE No.) ACJ591. Regulated by the Securities and Futures Commission.

Note to Readers in Indonesia: PT Schroder Investment Management Indonesia, Indonesia Stock Exchange Building Tower 1, 30th Floor, Jalan Jend. Sudirman Kav 52-53 Jakarta 12190 Indonesia. Registered / Company Number by Bapepam Chairman's Decree No: KEP-04/PM/MI/1997 dated April 25, 1997 on the investment management activities and Regulated by Otoritas Jasa Keuangan ('OJK'), formerly the Capital Market and Financial Institution Supervisory Agency ('Bapepam dan LK').

Note to Readers in Japan: Schroder Investment Management (Japan) Limited, 21st Floor, Marunouchi Trust Tower Main, 1-8-3 Marunouchi, Chiyoda-Ku, Tokyo 100- 0005, Japan. Registered as a Financial Instruments Business Operator regulated by the Financial Services Agency of Japan. Kanto Local Finance Bureau (FIBO) No. 90.

Note to Readers in People's Republic of China: Schroder Investment Management (Shanghai) Co., Ltd., RM1101 11/F Shanghai IFC Phase (HSBC Building) 8 Century Avenue, Pudong, Shanghai, China, AMAC registration NO. P1066560. Regulated by Asset Management Association of China.

Note to Readers in Singapore: Schroder Investment Management (Singapore) Ltd, 138 Market Street #23-01, CapitaGreen, Singapore 048946. Company Registration No. 199201080H. Regulated by the Monetary Authority of Singapore.

Note to Readers in South Korea: Schroders Korea Limited, 26th Floor, 136, Sejong-daero, (Taepyeongno 1-ga, Seoul Finance Center), Jung-gu, Seoul 100-768, South Korea. Registered and regulated by Financial Supervisory Service of Korea.

Note to Readers in Switzerland: Schroder Investment Management (Switzerland) AG, Central 2, CH-8001 Zürich, Switzerland. Authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

Note to Readers in Taiwan: Schroder Investment Management (Taiwan) Limited, 9F, 108, Sec.5, Hsin-Yi Road, Hsin-YI District, Taipei 11047 Taiwan, R.O.C. Registered as a Securities Investment Trust Enterprise regulated by the Securities and Futures Bureau, Financial Supervisory Commission, R.O.C.

Note to Readers in the United Arab Emirates: Schroder Investment Management Limited, 1st Floor, Gate Village Six, Dubai International Financial Centre, PO Box 506612 Dubai, United Arab Emirates. Registered Number 1893220 England. Authorised and regulated by the Financial Conduct Authority.

601810