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FAITH & BUSINESS

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Photo: Aldi SugandaRizal (2 years old) smoking a cigarette while playing at the family home on May 23, 2010 in Sekayu district, South Sumatera, Indonesia. (Ardiles Rante / Barcroft Media / Getty Images)

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The Smoking Gun of Mutual Funds

Fame, of sorts, came early to Hadi Ilam. In 2012 the Australian Broadcasting Corporation made Hadi the focal point of one of their television news pieces. Hadi was just eight years old and lived in a small village in Indonesia. He had already been smoking regularly for four years. Asked about why he smoked, Hadi said, "I'm just wanting cigarettes. Just wanting them."

At first, his parents tried to stop Hadi's smoking by cutting off his pocket money … so he began stealing to fund his habit, including food from his own family. According to his father, "When we didn't give him money and he found rice at home, he'd go selling the rice. Anything he could steal in the house, he would sell."

Hadi's parents' efforts to discipline their son away from smoking were equally unsuccessful — they were simply no match for his craving for nicotine. Eventually an Indonesian children's charity learned about Hadi and his addiction. They arranged for him to join a treatment program in Jakarta. After a month in rehab, Hadi was released. But the pull of addiction was too strong. Before long, Hadi ran away from home, leaving his parents devastated. It was three weeks before he was found, trying to steal from a mosque donation box 300 kilometres away.

His father says, "I feel disappointed that I couldn't take care of my own child perfectly. Now he even has a new weapon. He says, 'If you don't give me cigarettes, I will run away again.' As a parent I now fear losing him once more."

As unsettling as Hadi's story may be, it is simply the visible evidence of a more troubling reality. A 2010 report by distinguished scientists concluded that tobacco is substantially more addictive than either heroin or cocaine. This is especially problematic for children. According to the U.S. Surgeon General "nicotine is a highly addictive drug; and adolescents, who are still going through critical periods of growth and development, are particularly vulnerable to its effects." In fact, research on nicotine dependence shows that key symptoms of addiction — strong urges to smoke, anxiety, irritability and unsuccessful quit attempts — can appear in young kids "after occasional smoking first begins and well before daily smoking has even started. Some youths experience tobacco dependence within a day of first inhaling."

It would be comforting, therefore, if Hadi's celebrity came about because his story was so unusual. Unfortunately, it's just the opposite. The rate of children smoking in Indonesia has tripled in just the past 10 years, and now totals more than 21 million. In fact, more than 40 percent of 13 to 15 year-old Indonesian boys smoke — and the average starting age for smoking has dropped from 19 to 7 over the past decade.

Hadi isn't even especially notable for having started smoking at age four. Nearly 2 percent of Indonesian children begin smoking at that age. Instead the really early starters are children like Aldi Rizal who became an internet phenomenon back in

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2010 as "the smoking toddler." Aldi started smoking when he was 11 months old. Before he was a year and a half, he was up to four packs a day. When his mother tried to keep cigarettes from him, he would bang his head on a wall — so violently that "he's got scars on his forehead," she said. Sadly, a quick search of Google or YouTube reveals that Aldi is hardly the only Indonesian youngster who started smoking as a toddler.

So what's going on here? In particular, with smoking rates in the developed world continuing to drop, especially among children (U.S. childhood smoking is half what it was 20 years ago), why is the situation so very different in Indonesia and elsewhere in the developing world? It turns out these two phenomenon are deeply connected.

Facing greater restrictions in the U.S. and other industrialized nations, tobacco companies dramatically stepped up their marketing efforts in developing countries, particularly targeting women and adolescents. Indonesia, now the world's fastest growing cigarette market, represents something of a poster child. Cigarette advertising is absolutely everywhere in Indonesia — television, newspapers, magazines, and plastered on trees lining the roads. Indonesian cities are choked with cigarette billboards promising, among other things, "pleasure, style and confidence." In fact, "you can't walk more than a few feet in the Republic of Indonesia without seeing a tobacco advertisement." Moreover, tobacco companies sponsor almost all of the country's concerts and sports events — at which cigarettes are routinely given away for free, including to children.

Indonesia has been referred to as 'the Wild West' of tobacco advertising and regulation, but the situation is not markedly better in many other Asian countries …and in some cases it's even worse. In fact, as astounding as it may seem, the childhood smoking crisis in Indonesia is outpaced by some other Asian nations. In Papua New Guinea, for instance, the most recent World Health Organization (WHO) data reveal that an astonishing 55 percent of boys age 13-15 smoke, as do 40 percent of the girls in that age bracket.

Professor Michael Daube, a WHO tobacco advisor, and president of the Australian Council on Smoking and Health, says that large markets, including a large proportion of young people, coupled with low taxes, corruption, and lax advertising rules make the Asia-Pacific region especially attractive to tobacco companies. The result, according to Daube, is a "tobacco holocaust" in poor nations, especially in Asia. In fact, roughly half of the 80,000 to 100,000 children worldwide who take up smoking every day live in Asia. The region is now the world's largest tobacco market.

"This is an industry absolutely without a moral radar. They are just willfully imposing a pandemic on developing countries …This is going to cause far more deaths than any wars we've ever seen," says Daube. In fact, cigarettes now kill more people than alcohol, AIDS, car accidents, illegal drugs, murders, and suicide combined. As a result, global smoking deaths are expected to total 1 billion over the course of this century, up from 100 million during the 20th century. The very large majority of these deaths will be in developing countries.* All of which led Britain's Independent newspaper to write of the big tobacco companies, "The price of their profits will be measured in human lives."

But you already knew that cigarettes are deadly, and the tobacco business unseemly. And if you're a parent, then like most American parents, you very

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probably do (or did) everything possible to keep your own children from smoking. In addition, you're likely thankful that in this country children aren't allowed to purchase cigarettes, and thankful, as well, that for many of our young people taxes (intentionally) make cigarettes prohibitively expensive.

All of which makes especially shocking that many of the American parents who so determinedly shield their own children from smoking are helping tobacco companies foist their products on millions of children across the developing world. In fact, it's precisely American parents' efforts to bring about a good life for their own children that help put children like Hadi and Aldi at risk.

One of the most popular mechanisms by which American parents fund their children's college education is through what are referred to as 529 savings plans. These plans allow parents to make contributions into designated mutual funds, the tax-advantaged proceeds of which will eventually by tapped for their children's college costs. But here's what few parents bother to learn — the biggest owners of tobacco company equities are, you guessed it, 529 plan mutual funds.

Take, for instance, the world's biggest tobacco company, Philip Morris International (PMI). The top mutual fund owner of PMI is a fund within the Virginia 529 savings plan. In fact, of the top six mutual fund owners of Philip Morris stock, all but one are funds within 529 college savings plans (source: Morningstar). British American Tobacco is the second-largest tobacco company. The top mutual fund owner of its stock is another 529 savings plan. The same is true for Altria, owners of the Marlboro brand in the U.S.

You may be wondering why tobacco companies are such a popular investment for 529 mutual funds. The answer is simple. On average, tobacco companies pay out as dividends to shareholders an extraordinary 70+ percent of profits. They can afford to do so because their customers are, in the aggregate, extraordinary dependable …and pretty much willing to pay whatever the tobacco companies choose to charge. That's one of the advantages of hooking your customers on an extraordinarily addictive product.

All of which means that tobacco companies are essentially giant plunder machines, extracting monies** (as well as health and life) from individuals and families in developing countries and depositing the proceeds in the mutual fund accounts of western investors. Which means, in turn, that many American parents are, in no small part, funding their children's college education at direct cost to the health and mortality of children throughout the developing world. Recognizing this fact would, no doubt, leave many of these parents (and their children) absolutely aghast.

Of course the problem is hardly limited to parents saving for college. The 20 largest institutional owners of Philip Morris include mutual funds from Vanguard, State Street, BlackRock, Fidelity, Mellon Capital, TIAA-CREF, Wellington, Franklin and Merrill Lynch — more or less the 'who's who' of American mutual fund companies. And it's no different with the ownership of the other major tobacco companies. Which means that a considerable portion of mutual fund investors are padding their investment accounts at the expense of the most vulnerable members of the global community.

To make matters worse, tobacco is just one of the several investment categories, colloquially referred to as 'sin stocks,' that show up frequently in the holdings of

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prominent mutual funds. As a reminder of what that label signifies, here's the description provided by the investor-education website Investopedia:

> ***Definition of 'Sin Stock:'*** *A stock of a company either directly involved in or associated with activities widely considered to be* unethical or immoral. *Sin stocks are found in sectors whose activities are frowned upon by some or most of society, because they are perceived as* making money from exploiting human weaknesses and frailties. *Sin stock sectors therefore include alcohol, tobacco, gambling, sex-related industries, weapons manufacturers and the military. Also known as "sinful stocks", they are the polar opposite of ethical investing and socially responsible investing, whose proponents emphasize investments that benefit society (emphasis added).*

For much of the last century, most Christians, along with most other ethical investors, studiously avoided 'sin stocks.' They knew they didn't want to be shareholders — i.e., complicit beneficiaries — of tobacco companies, gambling companies, pornography-related companies, etc. In fact, the choice against such stocks was easy and clear cut. For Christians, and other ethical investors, these companies' products ran entirely counter to their deeply-held spiritual and moral beliefs. They knew it would be wrong, therefore, to profit from companies whose products so egregiously violated their convictions.

Surreptitiously, mutual funds changed all that. Most individual investors bought, hook, line and sinker, the funds' implicit pitch: 'Investing is challenging. Let the professionals do it for you.' Today, few individuals invest directly. Instead, the vast majority do their investing through mutual funds. Not surprising, really, since the funds are right — investing is challenging.

Unfortunately, there has been a very large, and largely hidden, consequence to all of this. Most Christians, and many others as well, continue to believe that their investments should not violate their spiritual and ethical principles. But because they pay little, if any, attention to the actual holdings of their mutual funds, these investors routinely profit from companies whose products and practices contradict their deepest beliefs. For Christians, this is especially consequential.

But before turning to that topic, let's take a moment to consider what a few readers might be thinking: 'If I leave my investing decisions to a third party, doesn't that absolve me of moral responsibility for those investments?' The simple answer: No, not at all.*** Consider two related realms of human responsibility.

Like with investing, parenting is challenging. Like with investing, certain individuals with special aptitude and training may be especially skilled at child-rearing. Good nannies, for instance. As a result, some (affluent) parents seek the assistance of a professional. Yet no parent imagines that employing a nanny means they no longer bear responsibility for their children's well-being. Just the opposite. Parents considering a nanny characteristically do a high degree of due diligence to ensure that a prospective nanny's efforts will meet their own high standards. And then most such parents attentively monitor their nanny over time to ensure that actual performance measures up appropriately.

Why? Because parental responsibility can't be off-loaded. It stays with parents, whether or not they get help from a skilled professional. Similarly, moral responsibility remains with investors, regardless of whether they invest directly or with the assistance of mutual fund experts.

Given how frequently we read about corporate malfeasance, not knowing what one's mutual funds are invested in is an exercise in moral recklessness.

For much the same reason, there is a widely-recognized legal principle that 'ignorance of the law is no excuse.' The underlying rationale is that citizenship includes an obligation to be aware of the governing laws. Pleading ignorance is, therefore, typically viewed as a case of willful blindness — a patent attempt to evade responsibility. So, for example, many times people caught transporting packages containing illegal drugs have asserted that they never asked about the contents of the package and consequently are innocent of criminal wrongdoing. Such defenses have not succeeded. Courts have consistently ruled that defendants have a responsibility to know what is in the packages they carry — and, as a result, that failing to learn the contents represents criminal recklessness.

Investing is, in this sense, much like citizenship — an activity which bears a responsibility to be appropriately informed. Given how frequently we read about corporate malfeasance, not knowing what one's mutual fund(s) are invested in is akin to not knowing what's in the package you are carrying across the border — in other words, not knowing is an exercise in moral recklessness.

All of which means that investing in (most) mutual funds is especially problematic for Christians. Jesus' parables about the talents and the minas make clear that we will all eventually face a day of divine reckoning, a day in which we will be assessed on how well or poorly we deployed the resources entrusted to us. Evaluated against what standard? Love — the 'royal law' o Scripture. Stating the truly obvious, investments that "make money from exploiting human weaknesses and frailties" will entirely fail that test. More pointedly, investments that profit from addicting poor children to products that kill them will egregiously fail that test.

But it's important to see the larger principle here — to see the forest, not just a few of the trees. Love is the foundation of God's kingdom. Exploitation (plunder) is its polar opposite. Business products and practices which add value to people's lives, which make individuals better off and the world a better place, fulfill God's love principle. But all the products and practices that exploit and harm people violate that principle. All the products and practices that plunder profoundly contradict God's intent. In fact, they directly foster his enemy's kingdom. Take heed, therefore. When it comes time for the final tally on our lives, including on our investments, profits from plunder won't be magically transformed simply because a mutual fund acted as intermediary.

** To be clear, tobacco companies have hardly given up on hooking new young smokers in the U.S. Hispanic youth are a primary target. According to data from the US Department of Commerce, the number of Latino youth smokers in the U.S. is expected to triple by 2020, increasing from 9 to 19 percent of the country's youth population.*

*** The direct economic burden is substantial. In Indonesia, families spend nearly as much on cigarettes as on food. In Bangladesh, the poorest households spend almost 10 times as much on tobacco as on education. In the Philippines, smokers' families spend almost 20 percent of household income on cigarettes.*

**** For a more thorough treatment of the moral issues, see our "Blind Spot" column at http://eventidefunds.com/faith-and-business/blind-spot/.*

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