Socially-Responsible Investing: *Is Virtue Its Own Reward?*

"If virtue promises happiness, prosperity and peace, then progress in virtue is progress in each of these."
-Epictetus

"Do well by doing good."
-Advice attributed to Benjamin Franklin

"How Will You Measure Your Life? "
-Title of a best-seller by Clayton Christensen, PhD[1]

In 2012, famed Harvard Professor Clayton Christensen published a book of reflections and advice for finding meaning and happiness in life. The question of life's meaning had become increasingly urgent to him after a bout of the same life-threatening illness from which his father had died.

Even without a life-changing experience as a catalyst, many thoughtful investors grapple with similar questions, such as:

- *What is the* purpose *of my wealth?*
- *What legacy do I wish to leave?*
- *Is successful management of my wealth solely a question of return maximization, or do I also want to pursue other, potentially competing goals?*
- *Is it possible to align my portfolio with my spiritual or social values, and if so, how?*

By the beginning of 2014, the owners of roughly $1 out of every $6 under professional management in the U.S.—about $6.6 Trillion in all -- had decided they wanted to put their money where their values are. More specifically, they had invested in Socially-Responsible Investment ("SRI") products.[2] The amount invested in SRI had grown by 76% for the prior three years, as investors—and especially women[3] and millennials—were increasingly attracted to financial products that they believed were aligned with their values.

In this article, we want to explore the background and purpose of Socially Responsible and other values-based investing. We will examine the trade-offs that may be required and the means available for implementing a values-based investment strategy, for those who may be considering this approach for their portfolios.

The key questions include:

- *What is Socially-Responsible Investing (SRI)?*
- *How is SRI implemented? What SRI products are available?*
- *What effect does value screening have on projected returns?*
- *Who should pursue SRI?*

A note on data quality: *When the BWA team began delving into the topic of SRI and other values-based investing, we learned quickly how soft the data surrounding these strategies are. Answers to even the most basic questions vary widely and/or are inconsistent.*

For example, the Forum for Sustainable and Responsible Investing published a figure of $6.6 Trillion for the amount of assets invested in SRI in the U.S. A UN-supported organization, the United Nations Environment Programme (UNEP) Finance Initiative, says that $60 Trillion is invested in such strategies globally. It seems unlikely that the U.S., with roughly half of the world's market capitalization, would account for only 11% of the global total of SRI.

While we will cite such numbers in this article, we take them with a large grain of salt, and suggest that readers do the same.

[1] Published by Harper Business, May 2012, 240 pp, co-authors Karen Dillon and James Allworth.

[2] The Forum for Sustainable and Responsible Investing.

[3] According to 2015 studies by both US Trust ("2015 US Trust Insights on Wealth and Worth") and Morgan Stanley ("Sustainable Signals: The Individual Perspective"), more than 70% of female investors agreed that environmental, social and corporate governance (ESG) criteria are important considerations when making an investment. Men were more evenly divided.

Background on Socially-Responsible Investing

It's important to start by noting that there is no single accepted definition of Socially-Responsible Investing, nor is that the only term by which such strategies are known. Other terms in circulation include values-based investing, ethical investing, sustainable investing, community investing, impact investing, green investing, and mission-related investing. The values being expressed by these names also vary widely, and may include religious, social-justice, ecological, political, community, or other categories of missions.

The Forum for Sustainable and Responsible Investing ("USSIF") defines SRI as "*an investment discipline that considers environmental, social and corporate governance (ESG) criteria to generate long-term competitive financial returns and positive societal impact*."

Economic tools that may be employed in pursuit of social goals include:

- ***Boycotts*** *(refusal to buy specific products or patronize specific businesses engaging in harmful practices);*
- ***Exclusionary screens*** *(screens to eliminate stocks of companies engaging in harmful practices);*
- ***Inclusionary screens*** *(screens to find stocks of companies engaging in beneficial practices);*
- ***Proxy actions, shareholder resolutions*** *and other forms of direct engagement with company managements intended to change management or corporate actions; and*
- ***Direct investing for social impact.***

While the term "Socially Responsible Investing" may only recently have come into vogue, the concepts underlying it date back, by some accounts, at least 250 years, to the 1758 prohibition of participation in the slave trade by Philadelphia Quakers. During the same era, John Wesley (1703 to 1791), founder of Methodism, often preached a sermon entitled, "The Use of Money," in which he commended the notion of "gain[ing] all that we can," but not "at the expense of life, nor at the expense of our health" and only to the extent we can do so "without hurting our neighbor."

In the 1950s and 1960s, the Reverend Dr. Martin Luther King encouraged the use of boycotts as an economic tool against practitioners of racial injustice. Divestment of South Africa-based assets was part of the campaign against apartheid in that country from the 1970s through the end of apartheid in 1994.

More recently, the United Nations has supported the development of six *Principles for Responsible Investing*, aimed at institutional investors around the world. Among other things, the Principles commit signatories to incorporating ESG criteria into their investment processes.[4] The number of signatories has grown from roughly 100 at launch in 2006 to about 1400 today, representing assets of about $60 Trillion[5] (chart, top right).

Over roughly the same time period, the market for "Green Bonds" has skyrocketed, from about $800 million issued in 2007 to almost $42 Billion in 2015.[6] Green Bonds are fixed income instruments, issued by corporations or government entities (federal, state, or municipal), the proceeds of which will be used for an environmental purpose. As an example, Apple issued $1.5 Billion of Green Bonds in February 2016, with proceeds to be used to finance projects for energy storage, energy efficiency, renewables, green buildings, and other aspects of energy management across Apple's operations.

For retail investors, choices of SRI financial products have multiplied. There are now over 150 public mutual funds incorporating some form of values-based screening in the investment process.[7] For an initial investment as low as a few thousand dollars, investors can find many possibilities, among both stock and bond funds, investing in the U.S. and around the world (chart, bottom right).

[4] Exactly what those criteria are is undefined. Most observers would include factors such as fair labor practices and avoidance of pollution, but, again, there may be conflicting opinions on what constitutes "fairness"— or pollution, for that matter.

[5] UNEP Finance Initiative.

[6] Climate Bonds Initiative.

[7] Morningstar.

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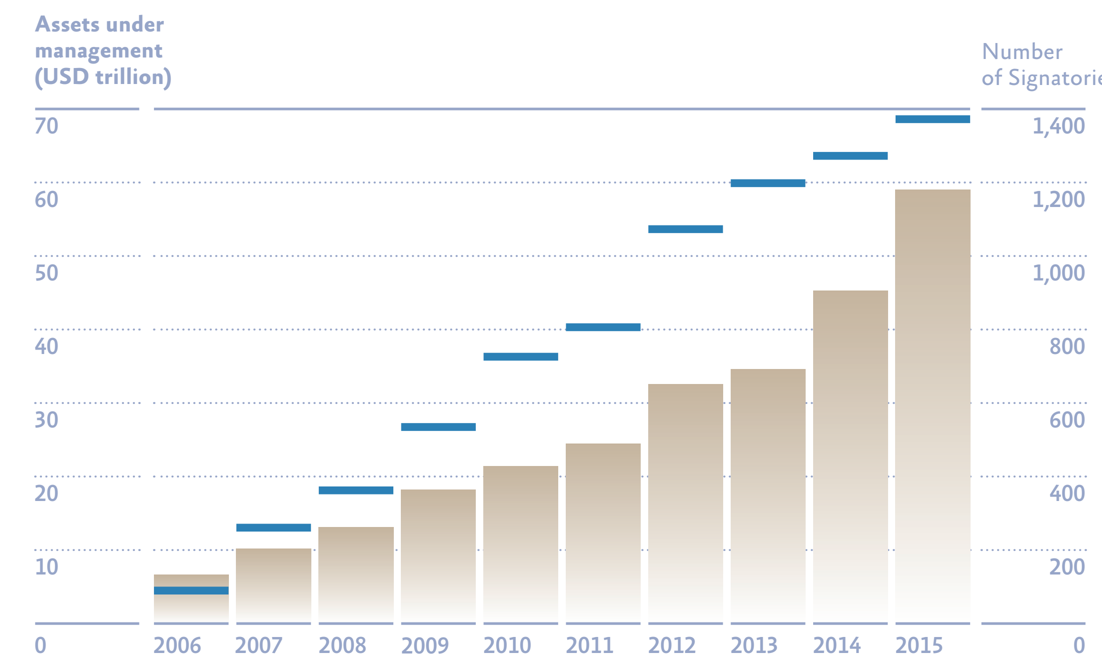
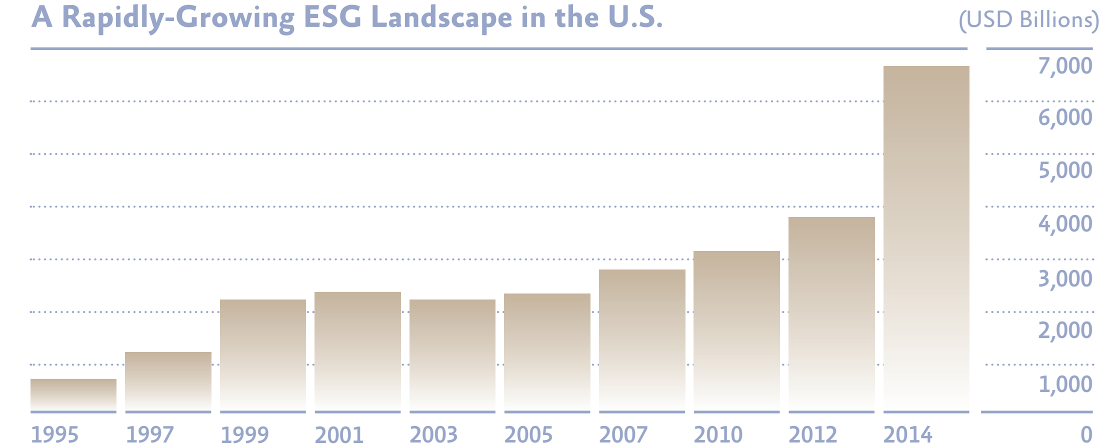
United Nations' Principles for Responsible Investing: Assets & Signatories



Source: U.N. Principles for Responsible Investment.

A Rapidly-Growing ESG Landscape in the U.S.



Source: US SIF, The Forum for Sustainable and Responsible Investing.

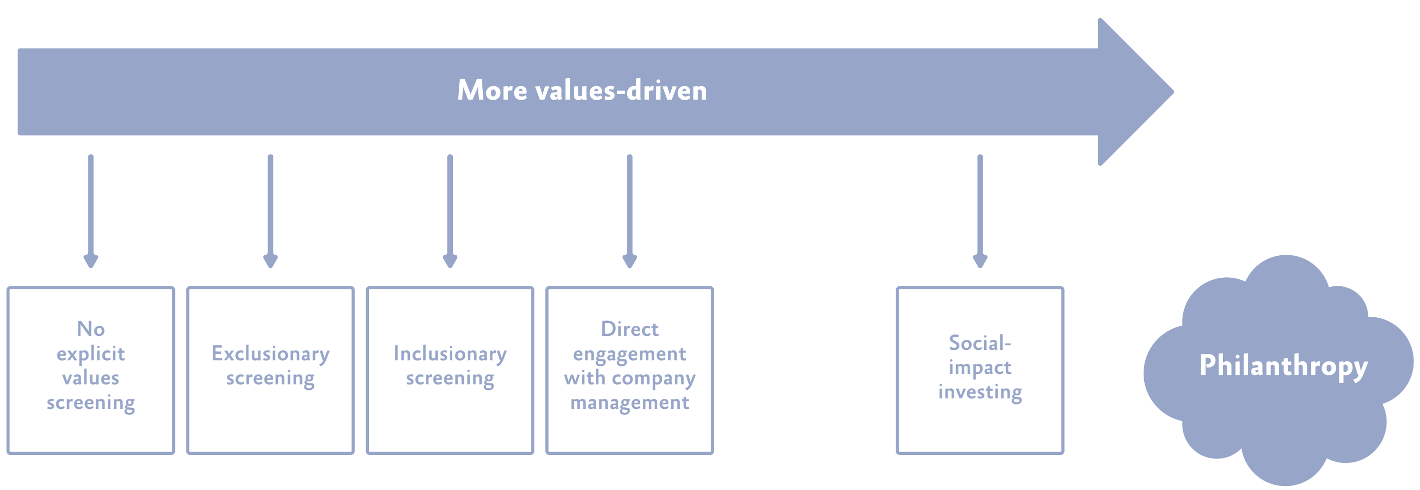
Data on a small, but reasonably representative, sample of these investments can be found in the Appendix.

Wealthier private investors who want to use their money to further their values may go a step beyond SRI portfolio investing, by funding direct social-impact investments. These are direct investments in projects that are driven primarily toward a public good, but with the intention also of earning a reasonable financial return.

As an example, Shift Capital[8] is a Philadelphia-based, socially-focused real estate firm. Its mission is to revitalize struggling neighborhoods by purchasing and rehabilitating abandoned, vacant, or otherwise underutilized industrial, commercial, and residential properties in areas which have fundamental underlying strengths (such as easy access to public transportation or to job sources). Shift taps both public and private funding sources to purchase and renovate properties, with the intention that Shift's work will catalyze ongoing improvements in public safety, employment, and habitability in the areas surrounding its projects.

While social benefits are the key driver, Shift, like other social-impact investors, is a profit-seeking firm. It intends its funders to be patient investors, rather than philanthropists, and expects to provide a financial return in line with the market by buying disused properties cheaply, returning them to productive use, and selling them at higher prices.

Investors might therefore visualize the range of possibilities for SRI as a continuum, ranging from no values screening, on one extreme, to direct social-impact investing, on the other (see diagram below). Philanthropy discards the profit motive, and therefore lies outside of this continuum.



[8] Which was co- founded in 2013 by a member of a BWA client family. Cited with permission.

Complications: Whose Values? What Criteria?

Just as there is no single definition of Socially-Responsible Investing, there are no widely-accepted criteria for determining socially-responsible corporate behavior. Instead, each SRI fund employs its own criteria to decide which companies pass its values screens. What constitutes socially-responsible behavior is at least partly in the eye of the beholder.

Consider, for example, a potential portfolio company with a business mix that included tobacco sales comprising 10% of overall revenues. Some funds might choose to include this company as eligible for purchase on the grounds that tobacco is a small part of the business. Others would eliminate it from consideration, as tobacco sales of <u>any</u> level would be automatically disqualifying.

Moreover, just like people, few companies are all-good or all-bad. A company that scores well on some SRI dimensions (say, environmental standards) but poorly on others (say, gender diversity initiatives) might be deemed socially responsible by some screening organizations, while failing the screens of others.

The same problem affects Green Bonds. Multiple standards of "green-ness" have been developed, including the Green Bond Principles, created by a group of over 50 large financial institutions, and the Climate Bonds Standard, created by The Climate Bonds Initiative, a global not-for-profit. Competing indices of Green Bonds have been developed by, among others, Barclays/MSCI, Standard & Poors, and Bank of America Merrill Lynch.

Adherence to these standards is voluntary. Enforcement to ensure that issuers use the proceeds of Green Bonds for the indicated environmental purposes may be sparse or nonexistent.

Investors should also be aware that not all sponsoring organizations have a deep cultural affinity with social responsibility or other values standards. Some SRI funds are probably created primarily as a marketing strategy to draw in assets—much like 130/30 funds and "liquid alts".

A final complication is that it may be difficult or impossible to measure the actual social effects of choosing Socially-Responsible investments instead of non-screened counterparts. Tools measuring social outcomes (such as reduced levels of pollution, more-equal employment opportunities, enhanced workplace safety, and other markers of social good) are only now being developed. Most of them focus on measuring the effects of direct social-impact investment projects, rather than portfolio investments. Even then, data are scarce and may be non-comparable and/or of poor quality. For now, investors in most SRI products may simply have to take on faith that their investments are making a positive difference.

Financial Returns and Social Responsibility

One of the key questions for prospective investors in SRI is whether and to what extent there is a trade-off between social responsibility and profit maximization. Put simply, if you buy an SRI product, will you make a lower return than in a similar product that doesn't impose value screens?

Given the lack of agreement around other basic aspects of SRI (including how it is defined and how much investment it has attracted), it's not surprising that there is no consensus on this question, either.

Empirical data on this question have historically been sparse and inconclusive. The two sides of the question have therefore tended to be argued with reasoning more than with data.

Those arguing that SRI reduces expected return have cited portfolio theory that suggests that any narrowing of the investment opportunity set—the assets from which a portfolio can be chosen—will always reduce expected return. In theory, having more assets to choose from is always economically preferable to having fewer.

The opposite case is that bad corporate behavior ultimately has a financial cost. Companies that pollute the environment, sell dangerous products, fail to provide safe working conditions, discriminate against certain classes of employees, or otherwise engage in irresponsible acts will at some point be held accountable, by customers, regulators, the legal system, or otherwise.

Recent research has tended to provide encouragement to those who wish to invest in socially-conscious companies. For example, in 2014 (updated 2015) a team based at the University of Oxford published a meta-study (that is, a study of other studies and research) of over 200 individual studies addressing various aspects of SRI investing. The report on this work, entitled *From the Stockholder to the Stakeholder*, is available at arabesque.com/oxford-study-pdf.

Among the meta-findings are:

- 90% of the studies on the cost of capital (how much it costs a company to finance its operations) show that adhering to sustainability standards lowers the cost of capital.
- 88% of the studies show that sound environmental, social, and governance standards result in better operational performance of firms.
- 80% of the studies show that stock price performance of companies is positively influenced by good sustainability practices.
- Medium to longer-term competitive advantages can be achieved through a broader corporate orientation toward stakeholders (communities, suppliers, customers, and employees), rather than a focus exclusively on shareholders.

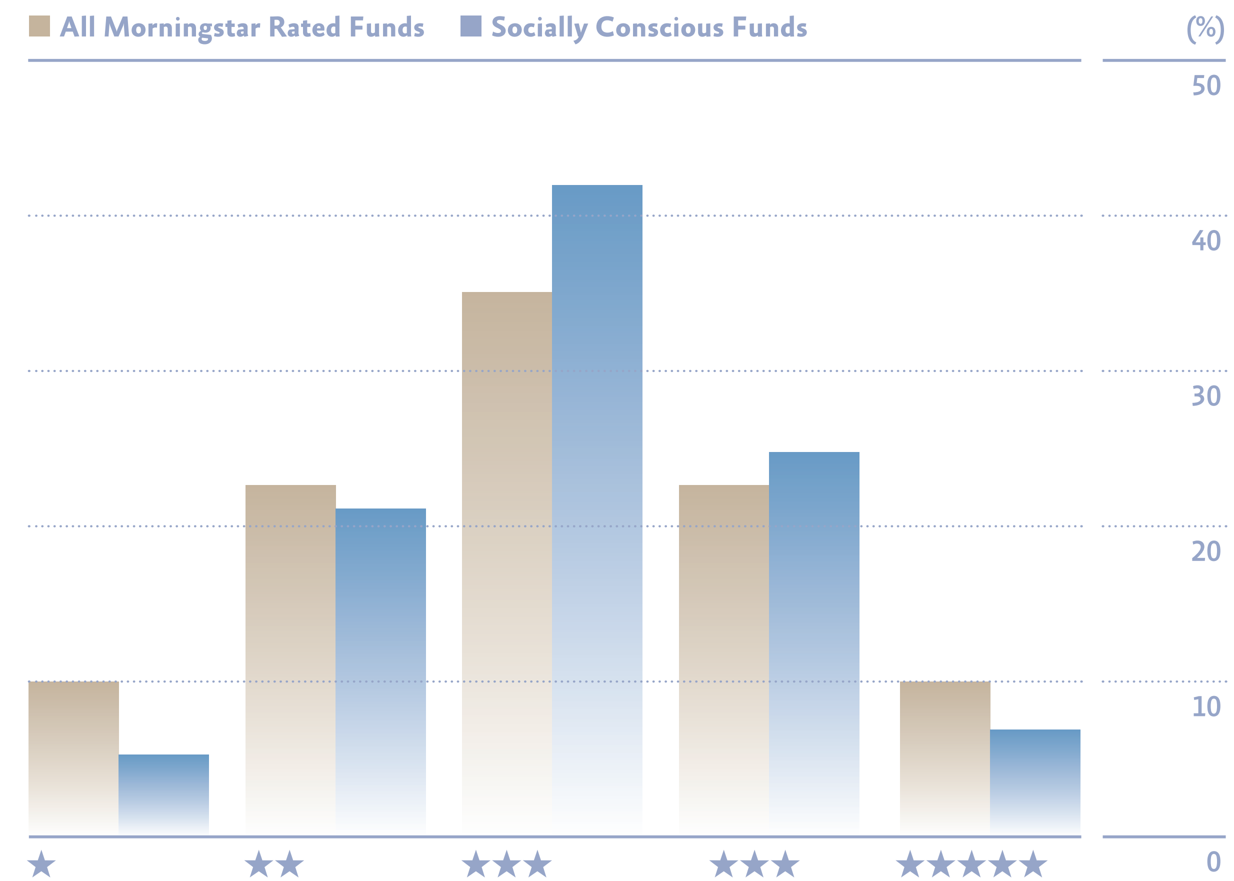
Research from Morningstar is also broadly supportive of the performance potential of SRI investment products. Morningstar compared the risk and return histories of the approximately 1,800 funds tagged as "socially conscious" to the broad universe of funds, grouping them by investment categories. The graphic on the next page shows the results of this research, indicating that the average risk-adjusted performance of socially conscious investment products skews somewhat higher than the average otherwise-similar non-screened product.

One aspect of this question that is not in doubt is that social or values screening imposes an incremental cost on the analytical process. This cost may be *de minimis* in the case of relatively passive negative screening (e.g., eliminate tobacco, alcohol, and munitions makers). In-depth analysis of corporate environmental, labor, and other social practices will obviously cost more.

The evidence that BWA has examined, which includes return histories from approximately two dozen SRI investment products from various providers and with various strategies,[9] suggest to us that SRI can generate solid returns that may be competitive with non-screened products. However, we believe that, for the sake of conservatism, SRI investors should be prepared to accept some modest potential give-up in return in order to further their values.[10]

[9] We would be happy to share our data.

[10] Anyone who wishes to try to maximize returns by going in the opposite direction may want to review the USA Mutuals Barrier Fund, formerly known as The Vice Fund and carrying the ticker VICEX. It is loaded with tobacco, alcohol, and munitions makers. It beat the S&P 500 for the one year, five years, and ten years ending 12/31/15.



Source: Morningstar. Data as of 09/30/2015.

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Is SRI Appropriate for You?

The decision to express one's values by participating in SRI is a very personal one. There is no one-size-fits-all solution to this investment question.

We do think there is a hierarchy of questions for investors to ponder. We've depicted them below as a decision tree. A fuller explanation follows.

1. Do you care?
Many investors will prefer simply to try to make as much money as they can in their portfolios, perhaps donating some portion of their profits to charity.

2. Do you care enough to forego some potential return?
Potential SRI investors should be comfortable with the possibility that their financial returns may be modestly lower than if they did not impose values criteria.

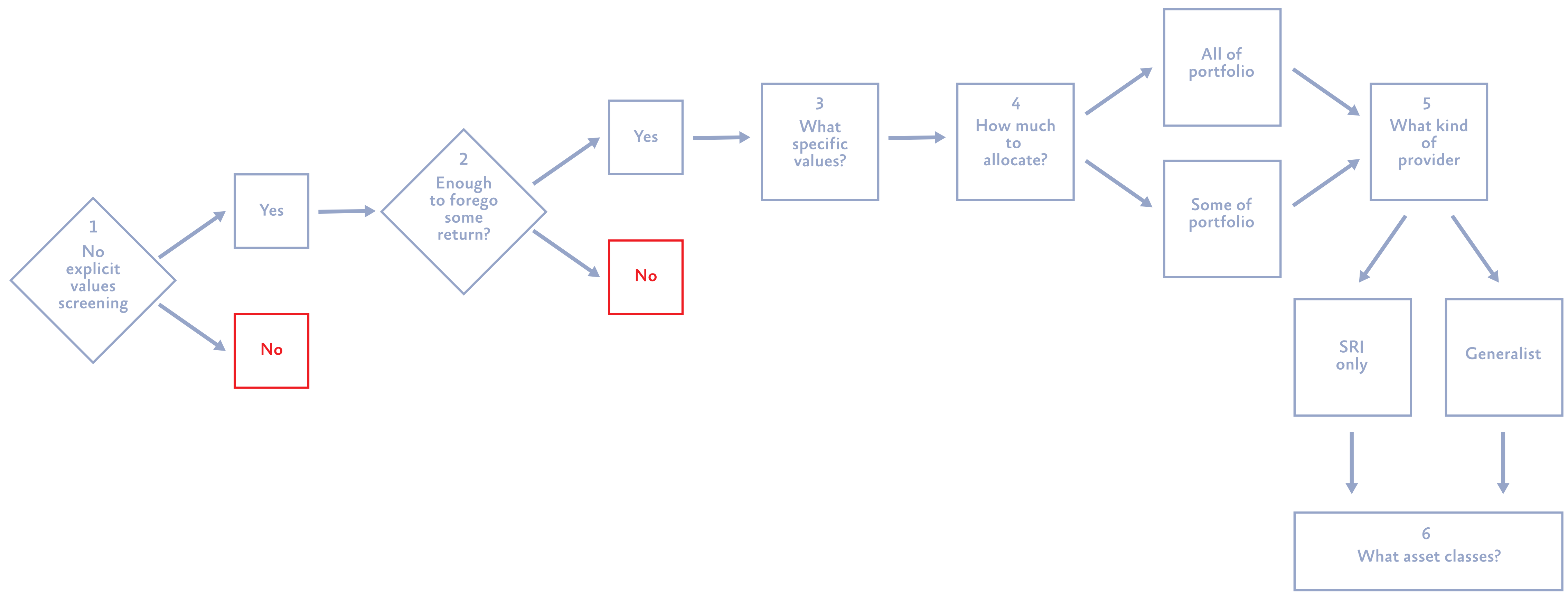
3. What, specifically, do you care about?
Given the multiplicity of SRI investment products available, prospective investors should be clear about the specific values (e.g., religious, environmental, social) they wish to express through their portfolios.

4. How much of your portfolio should conform to your values?
If SRI is important, should all of your portfolio be managed in this way? If not, which portion(s) of your portfolio will be invested via values criteria and which will not be screened?

5. What kind of provider do you want?
SRI products are marketed both by generalist investment managers and by firms that have social responsibility as their core foundational value and that provide *only* values-based investments.

6. In which asset class(es) do you wish to include SRI?
Should screening be used for stocks, bonds, both? Can you pursue direct social-impact investing, and do you wish to do so?

Thinking through these questions -- and their trade-off implications -- should help point investors in the right direction. Once an investor has decided, for example, that protecting the environment and supporting renewable energy is paramount; that giving up some potential return is an acceptable price to pay in order to do this; that only firms that have social values "in their DNA" are acceptable providers; and that the best place to incorporate SRI is in equities, the universe of possible choices becomes quite manageable.



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Appendix: Sample* Socially-screened Funds

*No-Load funds only. These funds have been selected primarily to illustrate the diversity of values and approaches to SRI, among the 150+ funds available.
No endorsement is implied or should be inferred.

	Ave Maria Growth AVEGX	New Covenant Growth NCGFX	Amana Growth AMIGX	Green Century Balanced GCBLX	Appleseed APPIX	Parnassus Core Equity Inst'l PRILX	Vanguard S&P 500 Index VFINX
Investment Style	Mid-Cap Growth	Large Growth	Large Growth	Aggressive Allocation	World Allocation	Large Blend	Large Blend
Morningstar rating	5	2	4	4	2	5	4
Values Mandate	Faith-based: Catholic	Faith-based: Protestant	Faith-based: Islamic	Environmentally responsible	Broad based ESG	Broad based ESG	None
Negative Screens	4 areas of "moral screens": Abortion; embryonic stem cell research; Planned Parenthood; pornography.	No companies from tobacco or military industries prohibited by Gen'l Assembly of Presbyterian Church. No companies with more than 25% revenues from alcohol, tobacco, or gambling.	5% max in revenues from gambling, tobacco, pork, alcohol, pornography. No financial stocks. No companies with 30% or more financial leverage	Avoids fossil fuels, nuclear power, military weapons, factory farming, GMOs, tobacco	Seeks to balance profits with social responsibility. No too-big-to-fail banks. No companies with "significant" revenues from alcohol, gambling, tobacco, weapons, or pornography.	No companies with more than 10% revenues from alcohol, tobacco, gambling, weapons, nuclear power. None with financial ties to Sudan.	
Positive Screens	As established by fund's Catholic Advisory Board	Social witness principles adopted by the Presbyterian church	Follows guidelines established by the Fiqh Council of North America (FCNA)	Positive screens for energy efficiency, water conservation, air pollution. Seeks to invest in renewables.	Good labor, environmental, and human rights standards	Positive corporate governance, business ethics, employee benefits, corporate culture, stakeholder relations, environmental impact.	
Fund Inception	2003	1999	1994	1992	2011	1992	1976
Medal (if applicable)			Silver			Silver	Gold
Manager tenure	2.5 yrs	4 yrs	22 yrs	10 yrs	9 yrs	15 yrs	15 yrs
Assets under mgmt	$315.5 mm	$386.3 mm	$1.7 B	$176.1 mm	$197 mm	$12.5 B	$204 B
Expense ratio	1.17%	1.02%	0.83%	1.48%	0.95%	0.67%	0.15%
Turnover	32%	107%	<10%	30%	52%	27%	3%
Yield (12-month)	0.25%	0.70%	0.70%	0.00%	0.15%	2.30%	2.10%
Number of stock holdings	37	242	44	90	25	41	500
Average mkt. cap.	$16.7 B	$54.2 B	$40.4 B	$21.5 B	$4.9 B	$31.0 B	$69.3 B
% of portfolio in top 10	36%	15.4%	39%	14%	55%	35%	18%
% in cash	6.5%	4.8%	1.8%	7.7%	17.7%	2.5%	0.4%
% in Tech	13.1%	16.2%	41.7%	22.2%	17.3%	18.8%	18.4%
% in energy	5.3%	7.3%	0.0%	0.0%	6.9%	2.6%	6.6%
% in financials	2.8%	15.5%	0.0%	17.5%	12.5%	7.8%	14.1%
% in healthcare	16.5%	20.7%	27.1%	16.6%	2.4%	14.4%	15.3%
% in non-US	0.0%	8.7%	13.5%	6.6%	22.1%	4.6%	0.6%
Minimum Investment	$2,500	$500	$100,000	$2,500	$100,000	$100,000	$3,000
5 yrs annualized (as of 3/30/16)	9.3%	8.4%	8.5%	7.2%	4.1%	12.5%	11.4%
Fund Advisor/Subadvisor	Schwartz Investment Counsel	SEI Investments	Saturna Capital Corp	Trillium	Pekin Singer Strauss		
Top 10 holdings	Schlumberger	Alphabet Inc	Adobe Systems	Alphabet Inc	Sprott Physical Gold	Danaher Corp	Apple
	Cognizant	Citigroup	Amgen	Cigna	United Natural Foods	Motorola Solutions	Microsoft
	Ansys	JPM Chase	Intuit	Apple	Oaktree Capital Group	Mondelez International	ExxonMobil
	MSC Industrial Direct	UnitedHealth Group	Church & Dwight Co	Gilead Sciences	Mosaic Co	VF Corp	J&J
	Omnicom	Facebook	Apple	United Natural Foods	Verizon Communications	Xylem Inc	GE
	Laboratory Corp of America	Amazon	TJX Companies	Shire PLC	Samsung Electronics	Intel Corp	Wells Fargo
	Amgen	J&J	Estee Lauder	F5 Networks	DSW Inc	UPS Class B	JPM Chase
	Graco	WW Grainger	Novo Nordisk	Aflac	Hyundai Home	Gilead Sciences	Berkshire Hathaway
	Toro	Visa	Lowe's	European Invt Bk	Equity Commonwealth	P&G	P&G
	Ross Stores	Toyota	Cisco	Regency Centers	Titan International	Charles Schwab	Pfizer

Most data as of 2/29/16
Source: Morningstar Office and fund-specifc prospectus materials

Summing up

At Beekman Wealth Advisory, we do not advocate for nor against values-based investing. We understand this is a very personal choice. We are an active and engaged partner for those investors who wish to explore SRI further and to incorporate it into their portfolios.

Elizabeth P. Anderson, CFA, is the founder of Beekman Wealth Advisory LLC, a boutique financial consultancy providing highly customized services to families and individuals. Founded in 2003, Beekman Wealth Advisory's business model reflects its unwavering commitment to the best interests of its clients.

Lauren Archer, Vice President, is responsible for initial screening of money managers and investment theses, and works closely with BWA clients.

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