Invest With Your Morals With Faith-Based Funds

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People who use their religious values to guide their daily life can also put their morals where their money is with faith-based funds.

Faith-based investing is considered a niche of the overall socially responsible investing theme, but it's really the originator of the idea of using morals to guide monetary decisions. Some analysts who study the space tie this type of activity to Quakers who boycotted sugar products during the slave trade. Tom Roseen, head of research services at Lipper Thomson Reuters, says the first publicly available socially responsible fund was created in 1928 by a religious group, the Pioneer Fund, (now Pioneer Investments) to avoid investments in tobacco, alcohol and gambling.

Many of the religiously based mutual funds still screen out those big three "sin" industries. Aside from those categories, the investing philosophies of faith-based funds are much more diverse, following the tenets of their religion.

"It's hard to consider religious funds like an asset class or a specific group because they're so different in so many ways. They vary in what they look for and what they screen out. It's hard to make too many generalizations except broad ones," says David Kathman, socially responsible investment analyst for Chicago-based Morningstar, an independent research firm.

As Ron Dugan, chief strategic investment officer for Dallas-based GuideStone Funds, a Christian fund family, explains: "We don't want to have any of our investors in our funds be embarrassed by any of the holdings that might be in any respective funds that they choose to invest in."

GuideStone Financial Resources is the parent of GuideStone Funds, the financial services provider to the Southern Baptist Convention and the largest Christian-based fund.

Faith-based funds control billions. Pinning down how many faith-based funds are available is difficult because some straddle the line between the narrower faith-based term and the broader socially responsible term (also known as environmental, social and governance funds). Roseen counts 45 religious-focused funds, while Kathman counts 59 funds.

In 1994, Lipper counted only four uniquely religious funds, with total net assets of $89.6 million. As of Oct. 31, the 45 funds have total net assets of $23.1 billion.

Compared with the rest of the socially responsible investing space, in 1994, total socially responsible investments were $2.9 billion, and as of Oct. 31, that figure stood at $88.5 billion.

These funds mostly just invested in the domestic sector of large-capitalization stocks, but Roseen says now many fund families offer a broader portfolio that allows investors to diversify their holdings.

Most religious-based funds follow the tenets of Protestantism, Catholicism or Islam, Kathman says, and this helps guide advisors on how to select investments. Some have a proactive social stance, taking in some environmental or other social-service issues, while others aren't socially active. Some funds have liberal religious leanings, and others are conservative.

For instance, in addition to avoiding the big three "sin" industries, Dugan says the GuideStone funds also screen out pornography, companies involved with abortion or "any company whose products, services or activities are publicly recognized as being incomparable with the moral and ethical posture of GuideStone."

Islamic funds will often screen out pork-producing companies. Islam also forbids usury, which meant that for a long time interest-bearing investments such as bonds were forbidden. Some funds get around this income prohibition by investing in dividend-paying stocks. Recently, a new class of bond-like investments called "sukuk," which are Islamic investment certificates, became available, says Patrick Drum, portfolio manager of the Amana Participation Fund, who oversees the sukuk strategy at Bellingham, Washington-based Amana Funds. With $3.31 billion in assets under management, Amana Funds is the largest Islamic investment fund in the U.S. and is overseen by Saturna Capital.

"Sukuk is really is an asset. It's defined as an undivided beneficial ownership in an underlying asset. That's the key definition. These are used for lease-buy back investments, such as for project finance or real estate or equipment leases," Drum says.

The bond-like attributes of sukuk investments include having stated rates of income, maturity dates, and usually a credit rating.

"It's not a bond because the investors own the underlying asset. And they have recourse from a legal perspective. The terms aren't guaranteed. Although they have a coupon, it represents the economic profit or losses of that contract," Drum says.

Funds don't sacrifice performance. One of the perceived knocks on faith-based investing, or socially responsible investing as a whole, is the participants sacrifice performance to sleep well at night, but Roseen and Kathman both say that's not the case.

"I get this question all the time, literally every time I talk about [environmental, social and governance investing]. … In the short term it can, and some funds do well, but overall it seems to be neutral. In theory, it should hurt because according to modern portfolio theory, any time you restrict your investment universe, you're lowering your expected return for a given amount of risk, but in practice it doesn't really. There are so many other factors and moving parts that in practice, it's not worth worrying about," Kathman says.

Roseen says when people are concerned about the economy, faith-based funds can perform poorly because investors will favor defensive stocks that can include alcohol and firearms.

"That's where the faith-based funds get hurt a little bit. But there are many more times that faith-based funds are doing just as well or better," he says.

And some faith-based funds are top performers in their respective investment categories.

Roseen says several GuideStone stock and bond funds have beaten their class average for one, three, five and 10 years, such as the GuideStone Equity Index Fund (ticker: GEQYX) and the Steward Large Cap Enhanced Index Fund (SEECX).

He adds that Thrivent Asset Management won Lipper's Best Small Company Mixed Asset Funds group award for 2015. "That's a claim to fame, because we're pinning them against the Fidelitys and the Vanguards of the world," he says.

Kathman says if there is anything that investors should watch for with faith-based and ESG funds in general, it's cost, not necessarily performance. He says out of the 59 funds Morningstar recognizes as faith-based, 26 have expenses in the highest quintile compared with the rest of their peer group.

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