Socially Responsible Investing Comes of Age

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There is an evolution under way in socially responsible investing. It no longer means just screening out certain securities from portfolios according to ethical considerations (no sin stocks!), but investing with an eye toward hastening the greater good. Social considerations like gender equality, the environment and good corporate governance become yardsticks to measure a company alongside P/E ratios and sales growth.

The belief among many managers is that investing in these kinds of companies will outperform in the long run. Consider Parnassus Investments' Endeavor Fund, launched 10 years ago with a realization that companies on *Fortune* magazine's "Best Places to Work" list outperform the broader market. The fund's methodology is more complex, and also screens out fossil fuel stocks, but its 10-year annualized total return (through Sept. 30) was 11.5 percent, compared to 6.8 percent for the S&P 500. It's Morningstar's top-ranked fund in the category for that time frame. Happy workers, it turns out, make for more successful companies.

Not all socially responsible funds have that track record, of course. For most, in the short term, they provide a feel-good story for investors. Asset managers suggest advisors use the funds to woo the children of current clients who, presumably, have more of a desire to "invest with meaning."

It's also an area where asset managers can perhaps justify higher active management fees. Tom Roseen, head of research services at Lipper Thomson Reuters, said total net assets in SRI funds are at $88.5 billion, up from $59.1 billion in 2011, and have an average expense ratio of 1.2 percent.

Lipper found the fees are one reason so few of these funds beat a manager's benchmark, a performance only slightly lower than the broader open-fund universe.

At the one-year mark, 30 percent of SRI funds outpaced their manager's benchmark; at the three-year mark, 28 percent; at five years, 23 percent and at 10 years, 25 percent.

SRI Fund Performance as of 11/30/15

Name	Ticker	Firm Name	Fund Size	Total Ret Annlzd 5 Yr (Mo-End)
TOP FIVE				
Eventide Gilead N	ETGLX	Eventide Funds	$1,920,603,348	18.7%
Parnassus	PARNX	Parnassus	784,411,708	15.7
Parnassus Endeavor Fund	PARWX	Parnassus	1,411,726,620	15.5
Vanguard FTSE Social Index Inv	VFTSX	Vanguard	2,024,857,560	15.3
VALIC Company II Socially Responsible	VCSRX	VALIC	764,167,666	14.8
BOTTOM FIVE				
American Century NT Emerging Mkts Instl	ACLKX	American Century Investments	$400,702,622	-0.7%
Calvert Global Energy Solutions A	CGAEX	Calvert Investments	886,181,32	-3.2
DFA Emerging Markets Social Core Eq	DFESX	Dimensional Fund Advisors	943,139,190	-3.4
Firsthand Alternative Energy	ALTEX	Firsthand Funds	6,884,625	-3.6
Guinness Atkinson Alternative Energy	GAAEX	Guinness Atkinson	13,151,474	-9.7

Source: Morningstar Inc.

"SRI funds can over- and underperform in the short term, but over the long term, performance balances out," according to an analysis by Chicago-based Morningstar. "In practice, though, it has been surprisingly difficult to prove that social screens make any significant long-term difference to investment returns."

Like every other style of investing, there are good managers and bad managers. Parnassus Investments and Calvert Investments are two fund shops that focus exclusively on socially responsible investing and have strong track records.

But larger fund shops not exclusively devoted to socially sustainable investing have more recently launched their own funds in the space. And investments in SRI strategies are poised to increase even further now that the Labor Department rescinded a 2008 bulletin discouraging investors from considering the factors in pension plans, said Meg Voorhes, director of research at US SIF, the U.S. membership association for the socially responsible financial sector.

With all the money flowing to these funds, it's worth asking if there is enough "good" to go around. A recent study by US SIF noted that half of the 16 leading money managers integrating SRI or ESG (Environmental, Social and Governance) factors do not fully disclose the specific criteria they use. As more fund managers enter the space and claim the mantle of socially responsible investing, that becomes critical.

"ESG integration is a technical term; it's harder to explain than a negative screening," Voorhes said. "We define it as systematic and explicit inclusion by investment managers of environmental, social and government factors into financial analysis. So people go, 'OK, what does that mean?' That is going to vary somewhat by investment manager. It's going to vary by asset class."

Some managers may say the criteria they use to pick stocks is part of their "special sauce" and can't be disclosed.

Voorhes doesn't buy that. "What is probably propriety is how you weight those criteria." But managers should be upfront with their intentions. Transparency, too, is a social good.