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Do Nice Investors Finish Last?

With the wide variety of SRI choices today, they don't have to.

By William Noonan

While its roots date back to biblical times, socially responsible investing (SRI) has gained significant visibility within the stock market over the past three decades—an investment trend that began following the Vietnam War by those who did not want their money supporting companies or products that did not align with their core beliefs.

What may have been considered a passing "feel good" fad in the past, SRI today has evolved into a fairly commonplace moral investment compass—one that can take diverse directions.

In brief, socially responsible investing is a broad-based approach to investing that may encompass the consideration of environmental, social and corporate governance criteria in addition to standard financial analysis. From a portfolio manager's point of view, generally there are two approaches to socially responsible investing, both having merit.

Activists invest in what they deem morally objectionable companies and then attend shareholder meetings as an activist for change. Boycotters invest in only those companies that uphold the morally appropriate values of the SRI investor.

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Far too often SRI investors choose funds that deliver subpar performance, and they tolerate underperformance in exchange for not compromising their values. But investors don't have to substitute poor performance for clear conscience. Professional money managers do exist and can help SRI investors to "have their cake and eat it, too."

In order to achieve the best returns while still practicing what you preach, it is imperative that socially responsible investors know whether their investment manager or team is an investment professional or a crusader first. The crusader is often times primarily obsessed with the cause and the investment second, resulting in less than stellar performance. But a professional manager can overlay the "cause" and generate above average results.

Let's face it; with the number of publicly traded companies available to invest in today, a professional manager should have no problem identifying sound investments that also hold up to individuals' core beliefs. Socially responsible investing is now part of the mainstream, making it less difficult today to invest in money-making companies while following a moral compass.
Community investing, for example, is an increasingly popular practice that provides decent returns while assisting communities in need. Socially responsible investors can help stimulate jobs and housing in distressed communities by investing in community development institutions or venture capital funds.

The expanding variety of "green" investments provides a large outlet for socially minded investors—manufacturers of hybrid vehicles, energy-efficient appliances, "green" building materials and technologies such as solar and wind power development have gained great momentum in the stock market in recent years, an ascent that appears likely to continue.

Investing responsibly from a religious beliefs perspective is also on the rise, with an expanding number of faith-based funds that avoid companies involved with alcohol, gambling, tobacco, and/or pornography. Companies that manufacture products or encourage behavior deemed objectionable can also be boycotted; this is an area where a seasoned team of professionals can assist investors who may not have time or access to research those companies associated with religiously offensive product lines.

The SRI trend has also paved the way for an estimated 200 mutual funds that offer investors a social investment strategy—some broad in nature and others focused on specific causes.

While there is an increasingly wide selection of SRIs, the socially conscious approach to investment is not "one size fits all." Investors should define their goals and objectives. To some, socially responsible investment is defined by the promotion of environmentally sustainable commerce; for others it translates into boycotting those companies that produce weapons or sell tobacco and alcohol or promote gambling. It comes down to personal values and objectives.

A socially responsible portfolio is built on one or a combination of investment approaches. Earlier in this article, the terms "activists" and "boycotters" were used to define SRI approaches taken by portfolio managers. For the fledgling investor who may not yet be working with a portfolio manager, let's briefly examine the three general SRI categories: portfolio screening, best practices classification and shareholder status.

Portfolio screening, a popular approach among both investors and mutual funds, can take the form of negative and positive screening. Negative screening excludes companies based on actions, policies, products or services, while positive screening includes companies that meet certain standards.

Best practices classification selects companies with high rankings based on one or

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more environmental, ethical, social, governance or financial criteria.

The third approach, using shareholder status as an owner in the company, enables the investor to not only monitor a company's management and practices but to have a direct say in these matters via proxy voting or by attending shareholder's meetings.

Regardless of the approach taken, it is advisable to choose a benchmark against which to evaluate the performance of selected investments. A benchmark is an index that defines how a portfolio of similar investments might perform. In terms of SRI, suitable benchmark portfolios would include companies that hold the same principles as the investor.

Ultimately SRI still spells investing. SRIs can fulfill an ethical desire, but investors should not lose sight of the bottom line of a portfolio—high returns. By focusing exclusively on investments that meet specific, not broad, ethical criteria, an under diversified portfolio can be the end result … never a good thing.

The SRI investor must keep in mind that public companies, no matter how socially responsible, are in business to make profits. Standards and expectations should be realistic—there are degrees of social responsibility within many securities, and as such those investments may yield higher gains. Conversely, the most vigilant socially responsible companies may not perform as well due to their stringent practices.

That said, SRI can provide high returns; clean energy, product safety and community sectors are proven examples of investments that can pay off in terms of conscience and capital. But the ins and outs of SRI are many; the guidance of a professional and trusted investment advisor can help turn your moral compass toward a rewarding direction.

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