Can you be a socially responsible investor and still make money?

BY SANDI WEAVER
Financial Planning Association of Greater Kansas City

Many of us are card-carrying Sierra Club members and concerned about climate change. But when it comes to our money, few of us invest our values, although we'd like to.

We work with many clients at my firm, a few of whom have had us invest their hard-earned savings in a socially-responsible manner. They're willing to earn a lower rate of return if need be. They're willing to incur a higher risk level if need be. They're willing to save more, work longer, spend less, and more, if need be.

What's the sacrifice, if any? I'll focus on three of our clients to unearth their motives, how we invested their money and their results.

"Socially responsible investing (SRI) — also known as sustainable, socially conscious, "green" or ethical investing — is any investment strategy which seeks to consider both financial return and social good to bring about a social change", according to Wikipedia.

John and Jill

John and Jill (names changed for confidentiality) used socially responsible investing (SRI) for Jill's portion of their investment portfolio from the first day they hired us in 2003. John, a lawyer with his own practice, is about 10 years older than Jill, is recently retired and for many years funded his own SEP retirement plan.

Jill is a nurse practitioner and has insisted that her investments be socially responsible whenever possible. She has adamantly told us "Why would I want to support corporations that kill people when I'm spending my life trying to save them?"

Jill's definition of SRI is very restrictive, compared to others.

Their portfolio is 50 percent SRI mutual funds and ETFs. When few SRI choices are available, John allows us to use his accounts to balance the portfolio with non-SRI investments to get the diversification we need.

We have far more SRI choices now than we did 14 years ago when we first configured their portfolio. We use funds and ETFs from the Amana, Calvert, Neuberger Berman, Parnassus, Pax and PIMCO mutual fund families now, but have used funds from Ariel and Aquinas fund families in the past.

Do you lose money?

What's the result? Back in 2005, we measured the rate of return on the non-SRI investments, 8.3 percent, against that of the SRI funds, 5.5 percent. That relationship has probably narrowed significantly since.

When we compare John and Jill's portfolio, with its 50 percent SRI funds, to that of Dana's (name changed) portfolio with all non-SRI funds, the 10-year average annual performance comes within .3 of 1 percent so there's little sacrifice of long-term return. However, let me footnote that asset allocation matters.

Both John and Jill maintained a moderate asset allocation throughout most of the last 10 years with about 60 percent invested in higher-risk investments such as stocks and non-traditional investments. Dana's portfolio was also configured similarly, but in recent years her portfolio has remained moderate while John and Jill have downshifted to a less aggressive 50 percent high-risk allocation.

That downshifting sacrifices some return for lower risk, except in bear markets.

Is it riskier?

If you compare the pattern of annual returns between the two portfolios during this decade, it differs only during volatile, outlier years such as the Great Recession year of 2008 and the bounce-back years of 2009 and 2010. Hard-running bull markets in 2012 and 2013 also revealed variations, but most years had comparable returns.

Differences manifested during 2008, the Great Recession. Both portfolios swooned of course, but the SRI portfolio held ground better, dipping 17 percent less. Back in 2005, when we measured the rate of return on the non-SRI investments against that of the SRI funds, we also calculated the weighted risk, an inexact measure.

For that single bull market year, weighted risk was 9.5 percent on the non-SRI investments and a safer 8.1 percent on the SRI funds, showing the same trend.

Sally

A second client, Sally, (name changed) now lives in the middle of Missouri, has a history in social work and currently works in the university system assisting minorities. She's married but we only work on her finances, not her husband's. Sally doesn't want (1) large-scale agriculture, (2) companies with human rights violations, or (3) any major environmental polluters. Sally will approve the use of companies in the military, nuclear, tobacco, and alcohol arenas.

We use Morningstar's professional advisor research for investments, and this information is available. Most of this data is also accessible elsewhere by the do-it-yourself investor.

We use funds and ETFs from Calvert and Vanguard in her portfolio and pair those with other funds in other asset classes where good SRI alternatives are not easily available. Her portfolio is 34 percent SRI.

Some mutual fund families, such as Amana or Calvert, have a full array of mutual funds which are SRI. Some fund families, such as American Funds or PIMCO, will extend a popular mutual fund. For example, PIMCO has modified their core bond fund, adding a special class holding only bonds from companies meeting the SRI definition.

Index SRI funds employing passive management are now available and we're using them in some asset classes; they typically have lower internal expenses. One of Vanguard's social-responsible indexes of U.S. stocks charges us .22 of 1 percent for operating expenses--that's cheap for retail shares. In our regular portfolios, without SRI funds, we use a U.S. stock index where we pay .13 of 1 percent; we of course use the institutional classes of various funds and get a discount.

Lisa and Miles

A third client, Lisa and Miles, (names changed) spent their successful careers in journalism and non-profit work. They visited Cuba when no one else did and protested crowded urban development before it was cool to do so. When they first hired us a few years ago, they asked us to see if we could invest in an alternative-energy fund rather than the commodity fund with oil and gas stocks which we used at the time.

When we hit the research data, the annualized returns on two alternative funds from Calvert and PowerShares fared worse than the commodity fund over the last 5 years, but that trend reversed over the last 3 years. The alternative funds were recent startups and unfortunately did not have a 10-year record.

Our recommendation to stick with the broad-scoped commodity fund was predicated on the risk level. Commodity and energy funds are volatile creatures and best suited for only small amounts of money. Over the last 5 years, the downside capture ratios in those two alternative-energy funds made the commodity fund look like your grandmother's CDs! This statistic indicated that the alternative-energy funds were shooting 47 percent more to the downside than the commodity fund in a bear market. We advised Lisa and Miles to pass on alternative-energy at the time.

Is it possible to "do good" and make money?

Yes. Over a long-term horizon, with some work, the rate of return on your SRI portfolio can be quite respectable. However, it's essential to invest smart. Use research data to ferret out high-quality investments and avoid dangerous risk levels. Be willing to be out-of-step with your neighbors. You may not have a winning, outstanding year in the market when they do. Monitor those investments to ensure they remain solid fundamentally and be willing to nimbly shift into a better SRI fund when needed.

Sandi Weaver, CPA, CFP, CFA is a financial adviser at Petrovic Weaver Financial Services on Corinth Square in Prairie Village.