Finance

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Socially Responsible Investing

Socially responsible investing, or SRI, is the use of noneconomic factors to develop an investment strategy. This is usually done in the hopes of promoting a societal good. It is often described as appealing to millennials, but I have had numerous older clients express interest as well. Thus, I think it is an important topic to review.

While SRI sounds like a great goal, SRI has been fraught with two issues, the difficulty in defining social responsibility and the belief that SRI requires lower returns for higher costs. Let us examine them both.

First, socially responsible investing is a large umbrella. Investments that are considered to fall under SRI can focus on a wide range of issues from diversity, corporate governance, the environment, or other social and political factors. For example, an SRI fund may exclude companies with poor labor practices, those that are involved in fossil fuels, producers or sellers of alcohol, or ones with a poor carbon footprint. Figuring out which fund is in line with your own values is terribly important, and no one fund will be a perfect match. So, an investor concerned with the environment may choose a mutual fund or ETF that focuses on companies that are leaders in alternative energy production. Alternatively, if gender diversity is key, a mutual fund or ETF that screens for companies with females in key leadership roles would be more appropriate. Usually a blend of funds is the best way to address your likely diverse social concerns.

Next, it has long been held that to participate in SRI means to sacrifice returns. Is this the case?

A 2016 article in the Wall Street Journal[1] notes that your return on SRI is somewhat intangible. We can look at the returns, but the impact on society cannot be measured for any given investment. And, companies that focus on good governance, eco-efficiency, employee satisfaction often over perform because it indicates good business sense.

Another recent article by Investopedia[2] found that a review of more than 50 studies published in peer-reviewed journals found that SRI strategies performed just as well as non-SRI approaches. In addition, Indexes made up of companies screened by SRI criteria compared with those that did not. In this same article, it was reported that the MSCI KLD 400 Social Index saw returns of 13.05 percent over 10 years while the S&P 500 saw returns of 11.27 percent.

Returns may be improved if an SRI fund builds a diverse portfolio and focuses on positive screening for companies who are leaders in their sector. And, ETFs that passively track an SRI index can keep costs down, which helps overall returns.

In conclusion, there are numerous ways to create a portfolio that is in line with your own values and investment goals. Individual stock selection, mutual funds, and ETFs can all play a role but carry the usual risks associated with each. Careful discussion with your investment professional is important.

[1] Edmans, A; Vogel, D. Does "Socially Responsible Investing Make Financial Sense?" Wall Street Journal. Feb 27, 2016. Web. May 18, 2017

[2] Macdonald, L. "Socially Responsible Stocks: do Good Deeds Punish Profits?" Investopedia. May 1, 2017. Web. May 18, 2017.

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