Portfolios With Purpose

Affluent investors are embracing socially responsible investing as opportunities and potential returns grow.

BY CATHERINE CURAN | PHOTO-ILLUSTRATION BY JOHN WEBBER

KATHY JUBITZ has no tolerance for polluters in her portfolio. A former environmental educator, she used to wake up two hours early every morning to commute on public transportation rather than foul the air with her car's exhaust. In 2000, after her father, Al, reaped a windfall from the sale of a division of his Portland, Ore.–based shipping company, Jubitz Corp., she suddenly found herself grappling with a thornier personal choice: translating her passionate environmentalism to the management of substantial wealth.

In addition to overseeing their family trust, Jubitz, her father and her two sisters were collaborating on investment decisions for the nearly $15 million Jubitz family foundation that they set up after the sale.

Their broker chased high returns by investing in companies such as Exxon without first considering their environmental records, making Jubitz and her husband apoplectic when they reviewed her monthly portfolio statements. Jubitz's work with her family's foundation heightened her sense of responsibility about the ramifications of her investments.

"Our goals for the foundation are to support environmental causes, peace and children," Jubitz says. "It seemed contradictory to give money to big companies that are harming the environment, and then we turn around and just put a Band-Aid on it. Why not speak with our money?"

TOP VIEW | ONCE A CONCERN only for religious or politically active investors, socially responsible investing (SRI) is now part of mainstream thinking. As a result, the approach has gone way beyond just equities to include all kinds of investment vehicles; and, thanks to new research, it can be structured to yield market-rate returns against respected sector benchmarks. SRI does mean taking time to find the right choices, and can still require pressuring your advisor to take a different approach—but as returns improve, many more wealthy investors are willing to do just that.

Jubitz knew her father felt the same way, so she encouraged him to make a change. In 2006 he moved the family's assets to CTC Consulting, an arm of U.S. Trust, which is a subsidiary of Bank of America's private wealth division. Dan Gimble, an investment manager at CTC, introduced the Jubitz family to a set of screening and scoring tools that would help them identify and invest in an equity index fund customized to their values. Better still, the fund, created by the Aperio Group—a Sausalito, Calif.–based custom indexer for affluent individuals—would track the Russell 3000 Index with a minimal margin for error. Best of all, the fund was designed to give market-rate returns with low fees, thus undermining the bias widely held on Wall Street that socially responsible investing means lower returns. "It's very thorough and scientific," Al says of the fund. "You get your cake and eat it, too."

The Aperio Group's indexing fund is just one in a vast array of new financial options specifically designed for high-net-worth individuals who, like the Jubitzes, want to invest their wealth in ways that are consistent with their values. Once perceived as a fringe, alternative strategy for devoted acolytes willing to give up profits, social responsibility is fast becoming a powerful financial-analysis tool for growing wealth in the long term.

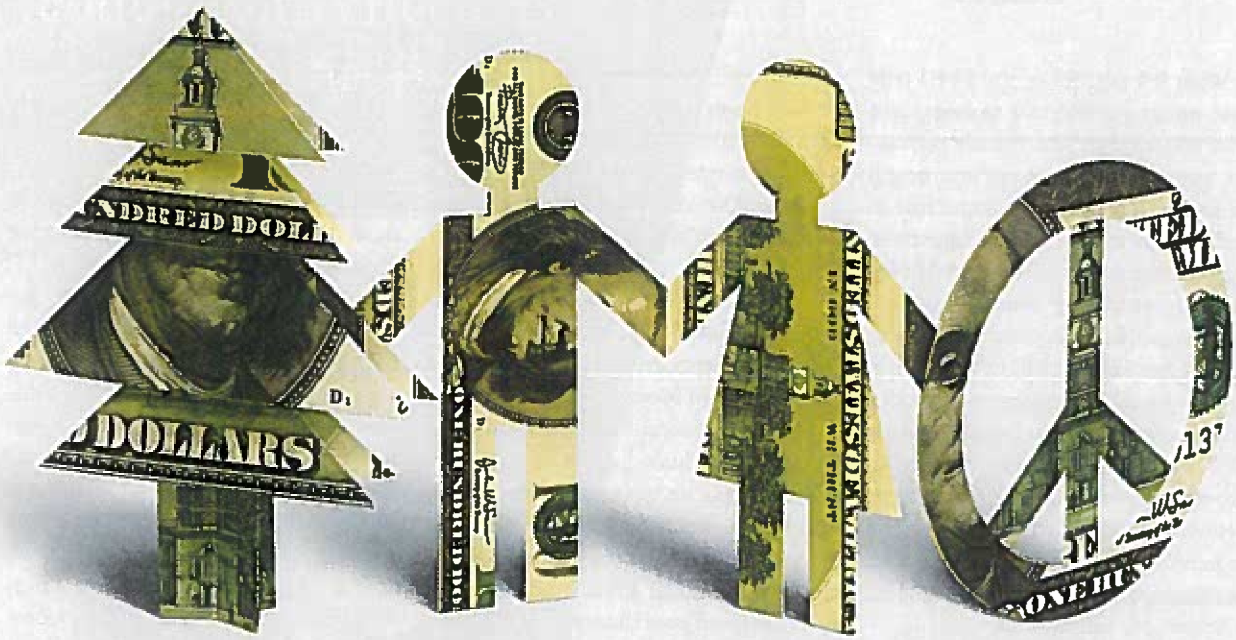
Traditionally, equities have been the main arena for socially responsible investing (SRI). However, today there are opportunities for affluent investors in microfinance, private equity, real estate and more. Individuals can incorporate analysis of environmental, social and governance (ESG) factors into investments in each of these areas, from the new exchange traded social index fund from Barclays Global Investors to a private equity fund focused on the environment. What's more, as Aperio has done using the Russell 3000, investments in other asset classes can be structured to yield market-rate returns against respected sector benchmarks.

"Responsible investing is a discipline that gives people tools to make a profit," explains David Wood, the director of Boston College's Institute for Responsible Investment. Wood is a coauthor of a new guide for wealthy investors and their managers, the *Handbook on Responsible Investment Across Asset Classes*, which details the range of sophisticated SRI choices and the potential benchmarks they can be measured against. (See "SRI Performance Benchmarks," page 52.)

FRINGE NO MORE

SRI has deep roots in traditional religious tenets linking money and ethics. Since the 1970s, this strategy has been known primarily for its exclusion of "sin stocks," such as tobacco companies or firms that do business with oppressive regimes.

In the Internet era, however, technologically advanced screening and scoring techniques allow investors to



select companies with relatively positive track records on favored issues, from good governance to gay-friendly benefits. Investors have three options: screening out, screening in or choosing "best in class" to keep, for instance, oil stocks in a portfolio but select—and try to reward—the company that pollutes least. The ESG factors, therefore, become one more step in analyzing the risks of owning stock in a given company, rather than the use of a broad investment style.

Growing interest from investors is prompting deeper and more sophisticated analyses of SRI's effect on the bottom line. This, in turn, has undermined the conventional wisdom that SRI equals poor returns. Late last fall, the United Nations Environment Program and Mercer Consulting released a report of 20 academic studies overturning that old notion, with half of the studies correlating SRI with positive performance. Of the remaining 10 studies, seven reported that the effect was neutral, and the other three showed it as negative.

Among mutual funds, the academic research reveals that SRI funds slightly outperformed conventional funds on average returns, with a difference that was so small as to be statistically insignificant, according to Meir Statman, a finance professor at Santa Clara University in California. The key factor denting returns was the cost of the funds—not the incorporation of ESG concerns—which lends credence to the indexing approach that the Jubitz family favors. Meanwhile, the Domini 400 Social Index slightly outpaced the S&P 500 in the overall span from its debut in May 1990 to June 2006. "The fair statement is that those two indexes and the funds perform about the same," Statman says.

"It's an evolving capital market, and what's really interesting to me are the new vehicles being created, moving well beyond the negative screens," says Stuart Davidson, a board member for the philanthropic social venture fund Acumen who allocates a portion of his personal wealth to SRI. "It's much more toward defining particular sets of transactions, like microfinance."

The recent proliferation of investment vehicles with socially responsible elements reflects a huge new wave of demand. Affluent individuals poured $17.3 billion into separately managed accounts with social screens in 2005, contributing to a tenfold leap in assets in these accounts since 1995, according to the Social Investment Forum. In North America, 6 percent of wealthy individuals requested social screens in 2006, allocating 8 percent of their portfolios to this strategy, according to Merrill Lynch/Capgemini's *2007 World Wealth Report*.

> **Once perceived as a fringe, alternative strategy . . .** social responsibility is fast becoming a powerful financial-analysis tool.

With 9.4 percent of the $24.4 trillion under professional management now allocated to SRI, money managers expect social and environmental concerns to play an ever-larger role in mainstream investment management, suggests research by Mercer cited in the Social Investment Forum's report.

"Certainly this is going to increase," says Ileana van der Linde, a principal in the wealth management practice of Capgemini, which began tracking SRI in last year's report because of growing investor interest. "The high-net-worth individual will have access to private areas they want to invest in, pet projects where they can say, 'This is where my interests lie.'"

ENERGIZED INVESTORS DELVE DEEPER

Increasing concern about global warming underpins many investors' interest in SRI. This new urgency has encouraged a broad examination of environmental practices, regardless of industry sector, with a view toward the risks pollution poses to profits and to people. It has also hiked demand for alternative-energy investments, which leapt 43 percent in 2006 to $70 billion worldwide, according to the *World Wealth Report*. New vehicles are still popping up, including Calvert's clean-energy fund, which enjoyed a 16.8 percent return from its inception in June 2007 through the middle of November.

Following recent corporate scandals, some individuals have also come to view corporate governance issues as a central element of smart investing, and one that falls under the rubric of social responsibility. Al Jubitz, for example, deems good governance so important that he ranks it on par with environmental issues and production of firearms. The Social Investment Forum says that from 2003 to 2005, the attention inspired by SRI combined with existing activism around corporate governance to produce a 22 percent uptick in social-issue shareholder resolutions that came to a proxy vote. While institutions are generating much of the increased shareholder advocacy, wealthy individuals and foundations are increasingly interested in committing their assets to activism.

> Advisors say the trend is particularly strong among the newly wealthy and trust beneficiaries interested in defining what being worth millions means in terms of their moral values.

"It's a different type of SRI than, 'Oh, just buy me some SRI mutual funds,'" says Bruce Kahn, second vice president of wealth management at Smith Barney and a specialist in socially responsible investing. "The active shareholder is critical, and that's a growing trend with SRI."

Still, attempting to reconcile cherished personal beliefs with money management principles adds one more layer of intricacy to today's highly complex investment universe. Those seeking a truly customized SRI product must spend time articulating their values and then matching those values to assets to be invested. And even though recent research is shoring up SRI's credentials, some on Wall Street still dismiss the movement. Actively incorporating environmental, governmental and social factors into a portfolio may mean educating your advisor, or, as the Jubitz family did, transferring funds to a more receptive firm.

Investors must also confront the compromises that are inevitable with SRI. No business is completely socially responsible or irresponsible. In a summer 2007 article in the *Journal of Investment Consulting*, Statman analyzed firms in the Domini 400 Social Index and illuminated the nuances of their scores. Hewlett Packard and Green Mountain Coffee Roasters had roughly equivalent total social responsibility scores. HP racked up stronger results in corporate governance and human rights, while Green Mountain Coffee scored higher on community and diversity.

Individuals who are engaged in SRI are willing to invest their time because they see it as an important mechanism for both influencing society and articulating their personal philosophies. Advisors say the trend is particularly strong among the newly wealthy and second- and third-generation trust beneficiaries interested in defining what being worth millions means in terms of their moral values.

Others who have been successful in business view SRI as a market force to achieve personal goals. "Pretty much all of the endeavors and choices one makes in life are a vote that pushes a market, even in some tiny way, in one direction or another, and that has a social impact," Davidson says. "The more I am able to use the capital allocation process to tilt the playing field in favor of positive societal outcomes, the better. If this can be done without any hit to returns, even better."

EVALUATING ETHICS AND OPTIONS

Until recently, it was tough for investors to tailor their equity portfolios to further such personal goals. That has changed, thanks to advanced research from SRI-rating services such as IW Financial in Portland, Maine, which provides the information used by the Aperio Group, and sophisticated equity models from firms such as Barra, based in Berkeley, Calif.

By combining detailed evaluations of companies' social responsibility with cutting-edge financial models, Aperio offered the Jubitz family a truly customized portfolio reflecting their specific concerns. After selecting stocks based on the family's preferences, Aperio modeled the stocks using standard fundamental factors to predict performance. That allowed the Jubitzes to reduce the projected tracking error on their portfolio to 0.6 percent—essentially creating a custom version of the Russell 3000.

To decide on the stocks, the family began by meeting with Mark Bateman, the director of research at IW Financial, and filling out detailed questionnaires. Topics ranged from whether a company made firearms to the diversity of its board and workforce to its environmental track record. The Jubitzes rated their feelings about each issue. Bateman guided them to put their responses in context. Because they all strongly disliked firearms, he asked whether they rated other negatives similarly. Corporate governance was one of the few equally important areas.

The four family members had to negotiate differences. Jubitz recalls that her father was extremely opposed to so-called sin stocks: gambling, alcohol, tobacco and pornography. She and her sisters felt less concerned about owning stock in such companies, viewing the products more as matters of consumer choice. In this case, the sisters prevailed. "It was three against one," Jubitz recalls.

Jubitz found that she also had to compromise. She disagreed with her

Taking the Reins

SOME INVESTORS in social responsibility choose equities, others microcredit. Stephanie Odegard takes a more active approach, having started a New York business that employs more than 10,000 people in Nepal.

Her eponymous $15 million company produces and imports handmade rugs that combine her modern designs with traditional Tibetan techniques. The sumptuous solid blocks of color in her Nima collection recall the hallucinatory depth of a Rothko painting, in organic wool soft enough to invite bare feet. Best of all, the carpets are produced under socially responsible conditions from start to finish. That means washing the rugs in chemical-free recycled water, dyeing them in plants with smoke-free boilers, and ensuring that they earn a certification from the carpet-industry organization Rugmark, which indicates that children did not manufacture the rugs. Thanks to Rugmark, 7,000 children have been educated in Nepal.

"I started this business to prove you could do a socially responsible business that would impact a huge number of people in a country much less developed, making a traditional artisanal product that would mean something to the people who made it and also appeal to a high-net-worth, sophisticated market that could understand this nature of the project," Odegard says. "The business has to be profitable on this side of the ocean; the Nepalese need ongoing business and an ongoing source of income."

Founded in 1987 with $20,000 in start-up capital, Odegard Inc. logged 20 percent revenue growth in 2007 over 2006. The rugs grace trendy restaurants, hotels and top museums, including Restaurant Daniel in New York, Robert De Niro's hotel in Manhattan's TriBeCa neighborhood and the Getty Museum in Los Angeles.

Odegard, who also invests her company's 401(k) money in socially responsible funds, says her business allows her to help others while having an outlet for her creative side. "This fits all of my desires and passions," she says. —*CC* father and sisters, who were willing to invest in the nuclear energy sector, so she was overruled.

The family spent about six hours on conference calls over several months working through their stock choices. Though they started with relatively similar beliefs, Al enjoyed the chance to hear and discuss the nuances in his daughters' philosophies. Late last fall, he scanned through old and new lists of large-cap domestic holdings, happily ticking off Halliburton and Sunoco as companies that the family had left off their personalized index. So far, 25 percent of their portfolio is SRI, and he plans to make further changes. It's too soon to tell how well the investments will perform, but the family expects healthy returns.

SRI Performance Benchmarks

UNTIL RECENTLY, SOCIALLY RESPONSIBLE INVESTORS have focused primarily on equities. Now a publication, *Handbook on Responsible Investment Across Asset Classes*, published in late 2007 by Boston College's Institute for Responsible Investment, details opportunities for incorporating social responsibility across a broad portfolio. The following is a guide for benchmarking SRI holdings to conventional market performance.

CASH AND CASH EQUIVALENTS. SRI products from community development banks, credit unions and loan funds. **Benchmark:** Merrill Lynch 91-day Treasury Index.

FIXED INCOME. Targeted community development bond funds; screened portfolios of government or corporate bonds. **Benchmark:** Lehman Brothers' U.S. Aggregate Index.

PRIVATE EQUITY. Social or clean-tech venture capital funds; private equity funds with environmental, social and governance (ESG) programs. **Benchmark:** Venture Economics' U.S. Private Equity Performance Index.

REAL ESTATE. Pooled debt made with ESG criteria; developers or REITs with outstanding ESG records. **Benchmarks:** NCREIF Property Index; S&P/GRA Commercial Real Estate Index.

HEDGE FUNDS. ESG analysis can be applied to assets and used to identify arbitrage opportunities. **Benchmark:** MSCI Hedge Fund indexes.

COMMODITIES. Structure contracts to support sustainable production; require detailed ESG reporting. **Benchmark:** S&P GSCI Commodity Index. —CC

"What's cool about that is that you cannot say it's going to do worse—it's going to do what the market does anyway," he says. "If your stock picker is doing better, great; I'll take the index for now."

Davidson, on the other hand, has focused his SRI on small private companies. As a managing partner in an early-stage technology venture capital fund, he is well versed in venture deals and enjoys investing in small socially responsible firms. Davidson has identified some of his investments through Investors' Circle, a network of angel investors and other wealthy funders that backs socially responsible entrepreneurs. His areas of interest include healthcare and food. Through the network, he invested in the hearing-aid firm Sonic Innovations, yielding a 50 percent internal rate of return and earning back 3.5 times his investment. Yogurt maker Stonyfield Farm also generated a return of several times Davidson's investment.

Microfinance is another hot area for affluent investors, who now have 70 funds to choose from. Davidson and his family have logged healthy returns on money invested in BlueOrchard, a fund of funds.

Ultimately, SRI across various asset classes will keep winning investors' dollars by generating strong returns. Davidson says his portfolio has been net positive thanks to some outsize winners. He is now exploring a fund, structured like a private equity investment, to provide responsible stewardship of Western ranch lands.

Al Jubitz is also looking for more socially responsible investments, including bonds and hedge funds. "No question that once I start marching down this path," he says, "I would desire the whole portfolio to be SRI." ◻

Catherine Curan is a senior correspondent for WORTH.