Role of Socially Responsible Investment in Uncertain Environment

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1. Introduction

Socially responsible investment (SRI), also known as sustainable, socially conscious, "green" or ethical investing, is any investment strategy which seeks to consider both financial return and good. In general, socially responsible investors encourage corporate practices that promote environmental stewardship, consumer protection, human rights, and diversity. Socially responsible investment is because of the nature of the business the company conduct. Such investments include avoiding investment in companies that produce or sell addictive substances (like alcohol, gambling and tobacco) and seeking out companies engaged in environmental sustainability and alternative energy/clean technology efforts, Particularly "green" companies have made social responsibility an integral part of their business models. Socially responsible investments can be made in individual companies or through a socially conscious mutual fund or exchange-trade “Socially conscious" investing is growing into a widely-followed practice, as there are dozens of new funds and pooled investment vehicles available for retail investors. Mutual funds and ETFs provide an added advantage in that investors can gain exposure to multiple companies across many sectors with a single investment. Just because an investment touts it as socially responsible doesn't mean that it will provide investors with a good return.

1. Sustainable, Responsible and impact Investors

SRI investors comprise individuals and family offices, as well as institutions, such as universities, foundations, pension funds, nonprofit organizations and religious institutions. There are hundreds of investment management firms that offer SRI investing funds and vehicles for these investors. Practitioners of sustainable SRI investors comprise individuals, including average retail investors to very high net worth, responsible and impact investing can be found throughout the United States. Examples include:

- Individuals who invest as part of their savings or retirement plans—in mutual funds that specialize in seeking companies with good labor and environmental practices.
- Credit unions and community development banks that have a specific mission of serving low- and middle-income communities.
- Hospitals and medical schools that refuse to invest in tobacco companies.
- Foundations that support community development loan funds and other high social impact investments in line with their missions. Religious institutions that file shareholder resolutions to urge companies in their portfolios to meet strong ethical and governance standards.

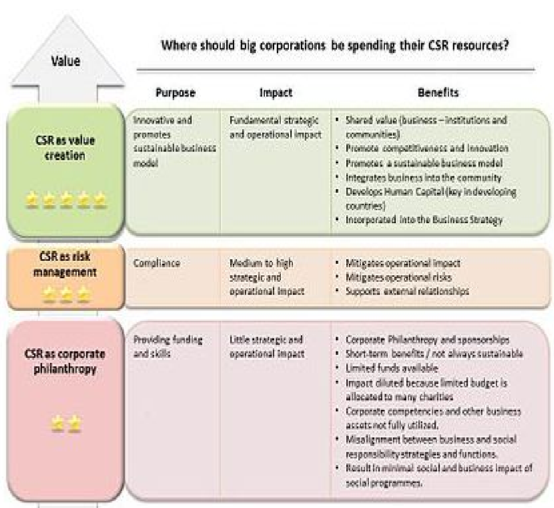


Figure 1

2. The Two Sides of the SRI Coin

2.1 Exclusionary

This side of the coin specifies not to invest in companies which engage in undesirable political or ethical practices like investing in alcohol, pornography or tobacco, companies that manufacture weapons or those that have poor labor practices such as using child labor in developing countries. To avoid such investment identification and compilation of firms it becomes time consuming and expensive.

2.1.1 The Merits of Exclusionary SRI.

1. It is based on a concept that by refusing to invest in unethical firm its stock price may suffer.
2. The shareholders wealth is directly related to appreciation in price; there are chances of them to stop this appreciation and force companies to mend their ways in order to attract more investors.
3. Price fall may happen by engaging in short sales.
4. The investments will be aligned with your personal beliefs, which can let you sleep a little better at night.
5. Emotion and ethics can supplant traditional investment logic and reasoning, as SRI investing can involve sacrificing investment opportunities in exchange for the satisfaction of doing the right thing.

2.1.2 Demerits

1. In reality SRI cannot accomplish much in terms of pushing prices lower unless a huge portion of all market participants avoid a company.
2. Non-SRI Investors will see the company trading at a discounted value, and they'll search some other investment opportunity.
3. There are chances of private equity fund taking the company over to unlock its value in the private market.
4. Exclusionary SRI can also become a slippery slope, where you end up excluding an ever-growing number of companies from your portfolio.
5. SRI when expanded too far ends up excluding an entire segment from an economy.

2.2 Inclusionary

The second side of the coin is called "activist" investing or inclusionary selection. This approach involves investing in companies that either:

2.2.1 Already Support a Desired Social Goal

The ultimate goal of an investor in first case is to invest in firms which meet their desired ethical values so that the investor extends support to the company by buying their stock and increasing the stock price or

2.2.2 Are Violating a Social Goal

In this case the investor invests in companies engaging in undesirable practices, wherein he establishes himself as a shareholder to which company management must answer. Therefore we can say that through activist investing a shareholder uses his rights to vote proxies in line with his goals and attend meetings to propose appropriate changes.

2.2.3 The Merits of Inclusive SRI

1. It can be a tool to effect social change as you can invest in companies which are in accordance with your social goals. (example green tech companies, working to provide alternative energy sources).
2. Being an active share holder you can directly effect change if you have a good number of shareholders agreeing with you.
3. It doesn’t have any inherent flaws; it can entail a lot of work to get things accomplished.
4. There are number of mutual fund companies which possibly help you in this regard.
5. A shareholder with modest sum of money can participate in these activities.

2.2.4 Demerits

1. Conventional wisdom, which says that if you’re limited in what securities you own you’re subjecting yourself to either lower returns or higher risks, or both.
2. They generate average returns which are unsatisfactory.
3. It’s not possible for the companies to always stand up to shareholders ethical desires.
4. It becomes highly impossible for an investor to know where to draw a line and till what extent he should compromise.
5. Choosing a company with lesser evil is not practically possible.

Figure 2

3. SRI Trends in US

The US SIF Foundation's ***Report on Sustainable and Responsible Investing Trends in the US*** identified $3.74 trillion in total assets under management at the end of 2011 using one or more sustainable, responsible and impact investing strategies.

Sustainable and Responsible Investing in the United States in 2012: $3.74 trillion

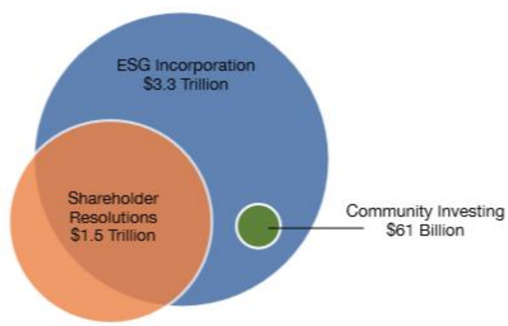


Figure 3
(**Source**: *Report on Sustainable and Responsible Investing Trends in the US*)

From 2010 to 2012, sustainable, responsible and impact investing enjoyed a growth rate of more than 22 percent, increasing from $3.07 trillion in 2010. More than one out of every nine dollars under professional management in the United States today—**11% of the $ 33. 3 trillion in total assets** under management tracked by Thomson Reuters Nelson—is involved in SRI

4. Mission Related Investment (MRI)

It has some common resemblances with SRI, which also considers social and environmental returns in addition to financial ones; However, MRI is individually targeted to each organization's Specific mission. MRI requires that a non-profit institution articulate its core values, and seek ways of investing That is consistent with these values.

4.1 MRI Has Two Specific Goals

1. To align the organization's actions with its objectives, by avoiding investments that would compromise principles.
2. The desire to actively use investing as a means to further the organization's mission.

4.2 The Different forms of MRI

4.2.1 Investment Screening

Portfolio screening requires that a money manager is willing and able to do the additional Work required to ensure these core values are not abandoned in the process of meeting the philanthropic organization's financial objectives. Sometimes this means investment screening. For example, if protecting the environment is a core objective of the organization, investing in companies that cause environmental damage would create a conflict. Or, if protecting human rights were central to the mission of the organization, investing in a company that profits from business relationships with oppressive regimes would create a conflict.

4.2.2 MRI Investment Program

To avoid the conflict in screening, MRI investment program works to achieve the financial objectives of the institution—and is assessed using the same established performance measurements. The difference is that MRI techniques seek to directly connect an institution's core values with its financial activities.

.4.2.3 Ethical Issues

1. MRI emanates from the very nature of the philanthropic trust. Non-profit endowments are Monies held in trust. Once a donation has been made, the assets no longer belong to the donor, and instead are held in trust for the public good. Society, in the largest sense of the word, is the Beneficiary of this trust.
2. In exchange for providing this benefit to society the donor receives a tax advantage. As all assets donated are generally tax-deductible, along with most of the earnings on those assets, there is a duty to manage all the funds in such a way as to provide the greatest benefit to society—the ultimate beneficiary of the trust. MRI provides the means to do this.
3. Reason that non-profit organizations use MRI is that philanthropy is an outgrowth of the bountiful wealth of capitalism, and has a responsibility to ameliorate the problems not solved by the market system itself. Indeed, some of the vexing issues addressed by philanthropy are an outgrowth of capitalistic development, disruption and change.

5. Background on Companies Using MRI

5.1 Caterpillar has profited from sales of its products to Israeli military and civilian authorities, including its D-9 bulldozers which are used to demolish Palestinian homes and construct settlements and Israeli-only roads on Palestinian land, acts deemed illegal under international law. The company has never accepted responsibility for how its products are used and has not responded to requests for dialogue since 2009 from MRTI or other religious groups.

5.2 Hewlett-Packard has profited from sales of specialized technology used in invasive and unjust biometric scanning processes at checkpoints in the separation wall constructed on Palestinian territory. It has also provided hardware used by the Israeli Navy in its internationally condemned blockade of the Gaza Strip and in the municipal governments of Israeli settlements on Palestinian land, deemed illegal under international law. Discussions with the company have been unproductive, and the company has been unwilling to address serious issues of concern.

5.3 Motorola Solutions, one of two companies to emerge from a corporate reorganization of Motorola at the start of 2011, has profited from providing communications technology to the Israeli military used in operations in the West Bank and the blockade of Gaza, and has built and supported high-tech surveillance systems in the separation barrier and Israeli settlements built illegally on Palestinian land. The company has consistently declined to have dialogue with religious investors.

6. Strategies for Social Investor

Social investors use five basic strategies to maximize financial return and attempt to maximize social good:

6.1 Screening

This is the filtering process used to either identify certain securities to exclude or to find those that should be included in investors' portfolios based on social and /or environmental criteria since inception.

6.2 Negative Screening

The original focus of SRIs was to avoid investments in companies engaged in undesirable activities, whether it was a beer brewer or tobacco manufacturer. These negative screens exclude certain securities from investment consideration based on social or environmental criteria and can preclude investing in tobacco, gambling, alcohol or weapons manufacturing.

6.3 Inclusionary/Positive Screening

Inclusionary or positive screening favors investments in companies that have strong records in a particular area such as in the environment, employee relations or diversity. Screening individual companies in an industry on social and environmental grounds highlights the records of individual firms relative to their peers. This screening technique grew out of the negative screening process. As avoidance screens became more sophisticated, some investors began to realize they could actively seek out and include companies with desirable characteristics in their portfolios, rather than simply avoiding companies. Extensive evaluations of corporations business practices are now commonly performed so that companies are often assessed to determine how sustainable they are as businesses and whether or not they are having a high and positive social and environmental impact. Positive screening is often used to support underserved communities in areas such as mortgages or small business credit.

6.4 Divestiture

Divesting securities means to remove selected investments from a portfolio based on certain social or environmental criteria. On Wall Street, there has always been the belief that if you don\'t like how a company is run you can simply sell your stake and move on - the so-called "Wall Street Walk". Although this may sound simple and elegant in theory, the reality is that there are always transaction costs related to moving into or out of security. Furthermore, many institutional investors hold such large positions that it can be extremely difficult and expensive to simply sell out of them.

6.5 Shareholder Activism

Shareholder activism attempts to positively influence corporate behavior in the belief that the cooperative efforts of social investors can prod management to steer a more responsible social and/or environmental course. These efforts can include initiating conversations with corporate management on issues of concern, along with submitting and voting proxy resolutions. Issues such as overseas labor, discrimination, marketing practices and CEO compensation are often questioned in the belief that changes will improve financial performance over time and enhance the well being of the stockholders customers, employees, vendors and communities.

7. The Downsides of SRI

Some people might think an SRI should underperform because it places additional constraints on portfolio managers. It rules out companies that sell addictive or harmful products such as tobacco, alcohol, pornography, gambling games or weaponry. And it directs investors to buy stakes in companies that: i) preserve the environment, ii) practice good employee relations, iii) do not violate human rights, iv) adhere to good governance, v) are sensitive to indigenous peoples and/or vi) enjoy good relations with their communities. These extra ESG requirements leave a smaller population from which to choose and earn good investment returns. In particular, the absence of stocks from the noncyclical sectors of tobacco, alcohol and gambling can punish relative performance during bear markets. Moreover, ESG-compliant companies may forgo profit opportunities (e.g. not mining in an area where environmental concerns exist) or incur extra costs (e.g. operating advanced pollution-remediation technologies), whereas non-ESG companies might create more profit by doing the opposite.

7.1 The Upsides of SRI

Cyclical stocks tend to boost returns during bull markets and allow SRIs to catch up from any underperformance caused by not buying into tobacco, alcohol and gambling industries during bear markets.

8. Socially Responsible Investment Indexes

Through indices such as those listed below, investors are able to benchmark the performance of their portfolios against a set of sustainability leaders. They can see where they may be falling behind or where they are outperforming. Sustainability indices also allow investors that integrate environmental, social and governance (ESG) factors into their decision process to easily identify companies for investment. Sustainalytics works with its index partners to create and maintain sustainability indices by developing index methodologies, providing data and research and helping connect clients with index providers.

Figure 4

8.1 Among the Most Commonly Used Socially Responsible Investment Indexes are

8.1.1 'Domini 400 Social Index'

The Domini Social Index 400 is a marketcapitalization weighted index that tracks the performance of companies that meet aw ide range of social and environmental standards.The index is considered a benchmark for measuring the effect that selecting socially responsible stock has on a financial portfolio's performance. This practice is also called social screening. The graph below shows a comparison between DS400 and S&P 500 for social stocks from year 1990 to 2007 which shows an up trend in social investment from 1995 to 2000. From 2006 onwards there is an uptrend in social investment.

Figure 5

(Source; https://www.domini.com/)

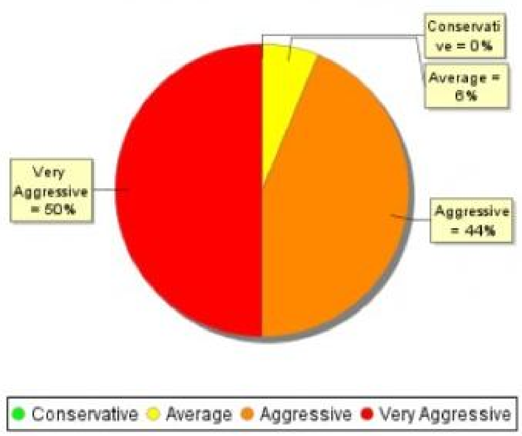
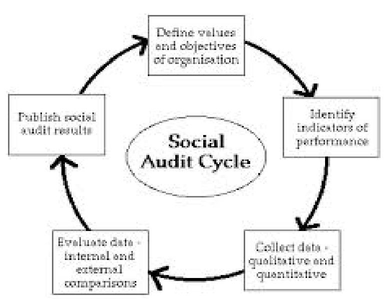


Figure 6

The above figure revels that the investment in social stock has been grown from aggressive to very aggressive

8.1.2 The FTSE Index Series

Some individuals choose investments based on social and personal beliefs. For this type of investor, Vanguard FTSE Social Index Fund was introduced since 2000. This low-cost fund seeks to track a benchmark of large- and mid-capitalization stocks that have been screened for certain social, human rights, and environmental criteria. In addition to stock market volatility, one of the fund's other key risks is that this socially conscious approach may produce returns that diverge from those of the broad market.



The Social Audit Cycle

Figure 7

8.1.3 Calvert Social Index®

Calvert, a leader in sustainable and responsible investing, has created the Calvert Social Index® as a broad-based, rigorously constructed benchmark for measuring the performance of US-based sustainable and responsible companies. Calvert starts by taking the 1,000 largest companies in the U.S., based on total market capitalization, included in the Dow Jones Total Market Index (the Dow Jones TMI). Then Calvert's Sustainability Research Department determines which companies meet each one of Calvert's Signature Strategies® environmental, social and governance (ESG) criteria. The Index encompasses only those companies that satisfy all of the ESG criteria.

Table 1

As of 30/09/2014	
ECONOMIC SECTOR	**PERCENTAGE**
Information Tech	27.75%
Financials	17.71%
Health care	16.83%
Consumer Disc	15.16%
Consumer Staples	8.31%
Industrials	7056%
Energy	2.38%
Telecom services	1.88%
Materials	1.52%
Utilities	0.89%

From the graph below we can analyze the growth in social index due to aggressive investment in social stock

Figure 8
(Source:www.yahoofinance.com)

8.1.4 Jantzi Social Index

Sustainalytics owns and maintains the JSI, a socially screened, free-float market capitalization-weighted stock index launched in 2000 consisting of 60 Canadian companies that pass a broad set of environmental, social, and governance rating criteria. The JSI also incorporates several exclusionary indicators, which eliminate firms from contention regardless of what their record of performance may be in other areas. The JSI does not include companies that have significant involvement in:

- the production of nuclear power;
- the manufacture of tobacco products;
- Weapons-related contracting.
- It manages the Meritas Mutual Funds family of socially responsible investments which includes the Meritas Jantzi Social Index Fund.

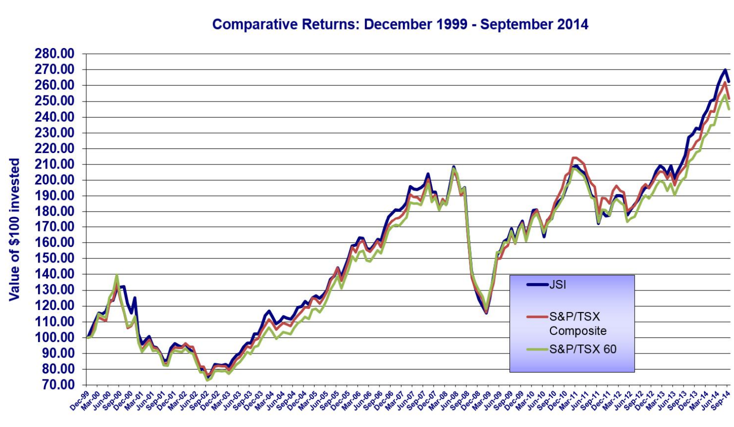


Figure 9
(Source http://www.sustainalytics.com)

9. Comparision of Sin Stocks to Social Stocks

SRI fans argue that it's possible to do some good while making money. Their argument rests on the idea that socially responsible companies are likely to be well managed because their underpinnings are based on solid values. Sin stock fans argue that SRI mandates pass up good opportunities in companies that have strong fundamentals, trading profits for a feel-good factor. The sin stock crowd feels good when their investments deliver solid returns. They would rather put money in the bank by backing industries that meet consumer demand than starve for their convictions.

The Pax World Balanced fund, launched on August 10, 1971, is the oldest operating SRI fund in the business. The Vice Fund, launched on August 30, 2002, is the industry's oldest sin fund. A look at their annualized returns (as of July 31, 2008) tells an interesting story. Both lost money during the past year, although Pax lost a lot less. During the last three years, Vice gets the edge, but just barely. For five years, the sinners get the nod.

Table 2

Fund Name	1 Year	3 Year	5 Year	10 Year	Since Inception
Pax World Balanced	-4.89%	3.74%	7.32%	5.96%	9.03%
Vice Fund	-13.46%	4.12%	12.75%	N/A	11.45%

Comparing the funds to their respective indexes provides another perspective. Pax delivered index-like performance across the board, while Vice bested its benchmark in all but the one-year period.

Table 3

Fund Name	1 Year	3 Year	5 Year	10 Year	Since Inception
Pax World Balanced	-4.89%	3.74%	7.32%	5.96%	9.03%
Dow Jones U.S. Moderate	-4.31%	3.43%	7.29%	6.00%	N/A

Fund Name	1 Year	3 Year	5 Year	10 Year	Since Inception
Vice Fund	-13.46%	4.12%	12.75%	N/A	11.45%
Russell 1000	-10.62%	3.08%	7.55%	3.38%	N/A

9.1 Complications

SRI once avoided gambling and alcohol, the Pax fund and a few others have relaxed that mandate, arguing that there are greater social ills and corporate governance issues to be concerned about and that gambling and alcohol are no longer viewed in the same light as they once were. Interestingly, the funds tend to invest heavily in technology, healthcare and financial services. With scandal-plagued Enron and American International both making headlines for all the wrong reasons, and gambling and alcohol stocks now in their portfolios, the value of SRI screens seems to have at least a small question mark beside it in the minds of neutral investors who favor neither the sinners nor the saints. Screens aside, it is also important to consider the cyclical nature of the markets. When sectors, such as technology and healthcare, are topping the charts, sin stocks may be out of favor or at least underperforming the market leaders. Similarly, when stocks that SRI funds won't buy are leading the pack, sin stocks will outperform.

10. Conclusion

Socially responsible investing does not result in lower investment returns. This is an important finding because it provides support to individual investors and trustees of institutional funds that they can pursue a program of socially responsible investing with the expectation that investment returns will be similar to traditional investment options. Finally, it is important to note that the question of whether or not SRI reduces investment returns will never be laid completely to rest. Some proponents of SRI are so steeped in their own moral superiority that they cannot fathom the possibility that the integration of ESG factors does not have a beneficial effect on investment returns. The challenge for the rest of us is to ignore the rhetorical noise emanating from these extreme views and focus on facts.

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