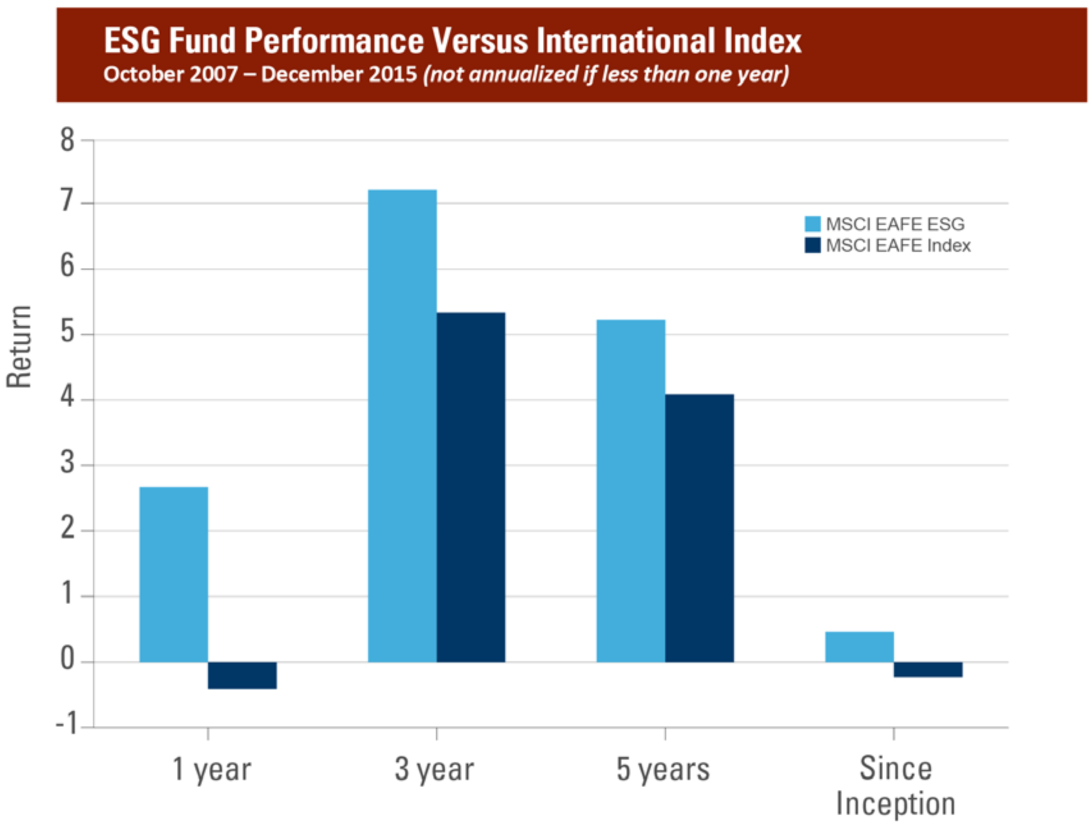
# Socially Responsible Investments May Yield Sustainable Returns

*by John P. Langan and Mark A. Griffin*

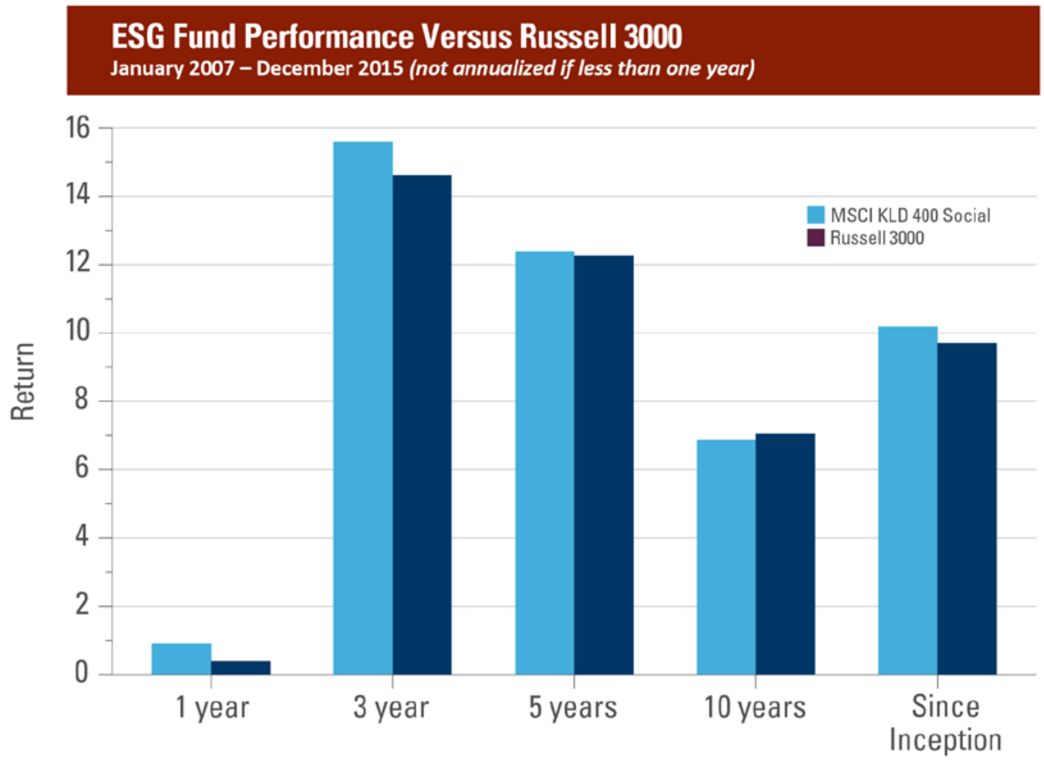
**Summary** — The gap between acceptable returns and social consciousness may finally have narrowed enough for institutional investors to enter the socially responsible market.

Institutions, foundations, and other organizations looking to invest reserves and endowment funds in socially responsible investment (SRI) vehicles have historically been faced with a trade-off between conscience and return. However, there is fresh and growing evidence that organizations looking to consider environmental, social, and governance (ESG) factors in the construction of their investment portfolios may no longer need to resign themselves to a performance trade-off. Of course, there is no certainty that ESG mandates will perform as well as portfolios constructed without constraints, but recent data has been encouraging.

As illustrated below, ESG funds have been closely competitive with a broad index of domestic securities for nearly a decade, and for five years have outpaced securities in developed countries except the United State and Canada. We must point out that this is not an exhaustive, long-term study, but it suggests that these funds may be throwing off their reputation for lackluster performance. In addition, the number of options available to investors is growing. As awareness of SRI increases, we expect more institutional investors are likely to adopt policies to take advantage of this option. However, that does not mean it will be easy to implement.




Source: Zephyr StyleADVISOR



Source: Zephyr StyleADVISOR

## The dynamic, expanding SRI market

Socially conscious investing is not a new idea, but it received several affirmative boosts in 2015. The world's largest asset manager, BlackRock, formed a new unit to focus on the SRI market. Meanwhile, Goldman Sachs, the investment banking and asset management behemoth, bought Imprint Capital Advisors, an asset management firm that designs ESG portfolios. These firms join long-time player Calvert Investments with more than $13 billion in SRI assets under management, and Principles of Responsible Investment (PRI), a United Nations-sponsored initiative in sustainable investing that manages $59 trillion in institutional funds worldwide.

Also in 2015, Sustainanalytics, a sustainability research fund, launched the Columbia U.S. Social Bond (CONAX) fund, which emphasizes the social benefits of municipal bond financing of hospitals, schools, public utilities, and the like.

## Defining and validating SRI

While the closing of the performance gap and increasing number of options for SRIs are good news for institutional investors, there are still questions relating to whether or not long-term performance will remain competitive. Perhaps more significantly, there is a long-term challenge in defining and validating (i.e., auditing) what is meant by "sustainable" and the underlying screens for environmental, social, and governance acceptability. The risk is that investors can still fall prey to unsubstantiated marketing ploys of funds with weak ESG screens.

It's similar to food labeling: Items claiming to be "all natural" or "organic" may contain unnatural or inorganic ingredients if the producers haven't been diligent in vetting their suppliers and handlers, or if they are being deliberately deceiving.

Likewise, it's easy to exclude a defense contractor that makes weapons, or a utility company that burns dirty coal to generate electricity, but what about a company like Apple? Should its high-flying stock be excluded because some product assembly occurs in regions of the world where human rights are not well protected? Given that a very high percentage of publicly traded companies do business with China, is this a reasonable restriction?

An increase in the quantity and availability of ESG data enhances the ability to judge individual companies rather than screen entire sectors (alcohol, tobacco, fire arms, defense), and may help provide the basis for developing uniform definitions and standards by which funds can be audited for the benefit of institutional investors.

## Challenges to SRI implementation

The desire to follow a socially responsible mandate poses significant challenges to institutional investors that have long desired to align their investment capital with organizations they view as good corporate citizens. The question is, what SRI restrictions are desired, and how strictly do you impose them? The tighter the restrictions, the narrower the investment universe and opportunity set, and the more likely an investor is to find that standards have been violated *after* the investment is already made.

Challenges also arise when institutional investors follow fairly strict investment policies. Most of these investors necessarily expect to generate returns competitive with their policy benchmark, without exhibiting greater volatility or risk. The overlay of a socially responsible mandate may cause meaningful dispersion in results (known as a tracking error) compared to their policy benchmark. These organizations need to understand the potential impact prior to implementation.

## How we can help

While a discussion of the modeling involved in SRI investing is beyond the scope of this article, CliftonLarsonAllen (CLA) can help your organization understand the potential impact of these investments on both portfolio returns and volatility. CLA can also assist in manager searches to help you express your specific social responsibility viewpoint.

In addition, CLA can assist organizations in drafting and updating their investment policies to properly capture their socially responsible viewpoint, tightening governance, and defining appropriate risk budgets and policies.

*John P. Langan, Chief Industry Officer, Nonprofit*
*john.langan@CLAconnect.com or 301-902-8532*

*Mark A. Griffin, CIMA®, Managing Principal, CLA Institutional Investment Services*
*CliftonLarsonAllen Wealth Advisors, LLC*
*mark.griffin@CLAconnect.com or 920-232-2238*