CM WEALTH ADVISORS

PERSPECTIVE

# Socially Responsible Investing

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First a word about nomenclature. What was initially called *Socially Responsible Investing* (SRI) is often referred to as *Responsible Investing* or *Sustainable Investing* today. Regardless of the title, the goal is to achieve a “double bottom line” – a competitive return while promoting positive societal and environmental outcomes.

## A Brief History of Socially Responsible Investing

The roots of SRI trace back to biblical times when Jewish law included directives on how to invest ethically. The next notable practitioners of SRI were the Methodists. Well over 200 years ago, they shunned investments that profited at the expense of their neighbors such as alcohol, tobacco, weapons and gambling.

The genesis of modern-day SRI began in the 1960s as concerns about civil rights and racial equality led to the creation of community development banks and protests against the Vietnam War resulted in the boycott of weapons-producing companies.

In the 1970s, the focus pivoted from civil rights to labor-management issues at corporations. Additionally, the environment became a focal point after the celebration of the first Earth Day in 1970. Later in the decade, the accident at Three Mile Island nuclear power plant intensified the focus on environmental issues.

An early triumph for SRI came in 1970 when Ralph Nader prevailed in having two socially based resolutions added to General Motors annual meeting proxy ballot. While the resolutions failed, it was the first time that the Securities Exchange Commission allowed socially responsible issues to appear on a proxy ballot.

As SRI grew in popularity, the first mutual funds to incorporate the concerns of socially responsible investors were launched in the early 1980s. Those funds excluded companies that profited from the original Methodist restricted activities – alcohol, tobacco, weapons and gambling – as well as companies that harmed the environment or instituted poor labor practices.

With the growth of socially responsible mutual funds, it became necessary to have a socially responsible index. In 1990, the Domini Social Index was established. It consisted of 400 primarily large-capitalization companies. The companies included in the index were selected based on a wide range of social and environmental issues.

With the development of an index to track SRI compliant companies, it became possible to track the performance of SRI versus traditional benchmarks such as the S&P 500.

Sustainable/Responsible Investing Today

As of year-end 2015, $22.9 billion of assets are professionally managed with a sustainable/responsible investment mandate – that equates to 26% of all professionally managed assets[1]. There are several different strategies for incorporating sustainable/responsible investing into portfolio management. The most common strategies are:

- Negative/exclusionary screening – the exclusion of companies that profit from forbidden activities. (The original methodology for implementing SRI).
- E (environment) S (social) G (governance) integration – incorporating ESG factors into the financial analysis of a company. Today, MSCI produces ESG ratings on 6,400 companies globally.
- Corporate engagement and shareholder action – the use of shareholder power to influence corporate behavior.
- Impact/community investing – targeted investments that attempt to solve social or environmental issues, typically implemented via the private markets.

The three factors that are of greatest importance to responsible investors are:

- The environment with a focus on items such as climate change, carbon emissions and clean technology.
- Social criteria with a focus on issues such as equal employment opportunity and diversity, labor and human rights, and doing business in regions with conflict risk.
- Governance including issues such as corporate spending and lobbying.

Unlike the past, product specific sustainable investing such as restricting investment in tobacco and alcohol producing companies, has become a much smaller focus. As of year-end 2015, it represents less than 10% of all professionally managed sustainable/responsible mandates.[1]

Many have assumed that SRI investing would result in sub-par investment performance. That, however, has proven not to be the case *over the long-term.* Return patterns between SRI benchmarks and the standard, broad market benchmark are very similar even though they may vary over the short-term. SRI investing has become mainstream and generates long-term competitive returns.[1]

CM Wealth Advisors and Sustainable/Responsible Investing

CM Wealth Advisors does not employ investment managers with a dedicated sustainable/responsible investment philosophy. However, the majority of our managers have a quality bias. Quality pertains to not only a company's financials (strong balance sheets, high quality earnings) but management and management practices as well. In other words, they invest with management teams that believe focusing on social, environmental and governance issues is best practice and a form of risk management.

[1] 2016 Global Sustainable Investment Review, Global Sustainable Investment Alliance

Their goal is to avoid reputational and financial risk. That does not mean that our managers won’t invest in companies that may be considered taboo, such as energy companies.

But it does mean that they seek out those energy companies that implement sound environmental practices.

None of our managers, however, are restricted from owning stocks in “sin” industries such as tobacco, gambling, or weaponry. If you are interested in implementing an investment strategy that excludes investments in these types of industries, please let us know.

Donovan, W. (2017, March 2). A Short History of Socially Responsible Investing . Retrieved from the balance : www.thebalance.com

History of Socially Responsible Investing. (n.d.). Retrieved from The Social Equity Group: www.socialequity.com