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SRI Funds Post Losses, But Hold Their Own in Relative Performance

by Robert Kropp

While not immune from the battering endured by investors of all stripes, many SRI funds have outperformed mainstream funds on a relative basis this year.

SocialFunds.com -- In the waning days of 2008 investors can be forgiven for turning their eyes away from the market page of their newspapers as the carnage inflicted by the financial crisis, in which many funds have lost up to 50% of their value, seems to continue unabated. Financial analysts expect the crisis to continue to wreak havoc in the global economy for at least two more years.

In a bear market, SRI funds often outperform mainstream benchmarks, a tendency that appears to be relevant today. And funds that practice more conservative strategies such as value investing tend to do better than those looking for growth stocks, which tend to outperform in bubble markets.

Relative performance measurement indicates the performance of a fund against a benchmark index or peer funds. By considering relative performance, an investor can determine how a fund performs over a given time period, as opposed to absolute performance, which measures actual returns. Not surprisingly, in times of an economic downturn, such as this year, an investor can expect to find even top performing funds on a relative basis to have losses in absolute returns.

Over the last year, the Appleseed Fund, a midcap value fund that manages \$10 million in assets, has outperformed all other SRI funds in the domestic equity category.

But when SocialFunds.com spoke with Adam Strauss, Appleseed's fund manager, he was quick to point out that the fund's relatively strong showing extended beyond those that screen according to SRI principles.

"According to the Wall Street Journal fund performance ranking published on November 3, Appleseed ranks first among all midcap value funds, both those that screen for SRI and those that do not," Strauss continued.

While other SRI value funds exist—for example, Ariel Mutual Funds have performed well over the past year—none have performed as well as Appleseed.

Asked how Appleseed has outperformed other domestic equity funds in such a challenging year, Strauss answered, "As value investors, we keep a keen focus, and maintain a large margin of safety. That has allowed us to outperform growth investing. We look at how sustainable a company is before investing in it, and measure the downside risk."

As an example of Appleseed's SRI mandate, Strauss cited Female Health, a company that manufactures and sells the female condom in 108 countries. "By providing the female condom to developing countries, Female Health has helped to cut both the pregnancy and HIV rates. Its product has also allowed women in those countries to take charge of decisions affecting their lives."

Todd Ahlsten of Parnassus Investments takes a more expansive view of responsible investing. The fund manager for the Equity Income Fund, one of four Parnassus funds that have outperformed more than 90% of domestic equity funds in the last year, Ahlsten invests in growth stocks as well as value stocks.

"We invest in companies that provide services relevant to people's lives," said Ahlsten. For example, health care and information technology companies comprise nearly 40% of the Equity Income Fund's portfolio.

"We look for companies whose stocks produce higher margins," he continued. "And as important as anything is the emphasis we put on management. The companies we invest in must be run by good people."

Ahlsten believes that value stocks may be less prevalent than the current market might suggest. "We find value oases in the market today," he said. "But the stocks of many companies only seem cheap because of previous earnings that were unsustainable. We anticipate a de-leveraging of the market, after which the S&P Index will stabilize at a lower rate than before this year's crisis."

Similar to Appleseed, Parnassus maintains an SRI mandate in its investments. Andrea Reichert, Research Analyst for Parnassus, explained how the fund applies its mandate to the renewable energy sector.

"When solar energy was the poster child for the renewable energy industry, we questioned the sustainability of its earnings and found question marks on the demand side as well. But we are enthusiastic about the sector dynamics, as demonstrated by our decision to invest in Ormat Technologies, a geothermal company.

Reichert gave another example of the investment choices made by Parnassus. "When we looked at Waste Management, we saw a company with governance issues in its past. But we also saw a leader in the recycling movement and a company that recovers and processes methane gas from its landfills into an energy source for generating power."

Other high performers among the domestic equity funds are two of the CSIF Equity Portfolio Funds offered by Calvert Funds.

International and global funds have been especially hard-hit in the past year, as previously robust returns have been largely reversed. Nevertheless, MMA Praxis Mutual Funds' Praxis International funds and Portfolio 21 have managed to outperform roughly 75% of all peer mutual funds.

Balanced funds, designed for investors looking for a mixture of current income and modest capital appreciation, have performed relatively well in this bear market. Among balanced funds, Calvert's Conservative Allocation funds and Legg Mason's Social Awareness funds have performed best on a relative basis.

Even conservative fixed income funds have taken a beating in 2008, and only Community Capital Management's CRA Qualified Investment Fund managed to outperform more than 90% of its peer mutual funds. The CRA Fund and DWS Investments' DWS GNMA S Fund, also a fixed-income fund, have even managed to achieve positive absolute performances in the last year.

As a new year and a new President draws near, what do fund managers foresee? "Over the long term, the economy will be good," said Strauss of Appleseed, "Although I have to be pessimistic about the economy in the short term. Horrible mismanagement has been allowed for too long, irresponsible lending has gone unchecked, all kinds of negligence is evident everywhere. New regulations will help prevent such abuses from reoccurring, but the horse has already left the barn."

Strauss is more optimistic about the investment environment. "As the price of so many stocks go down, it becomes possible for investors to buy stocks at sale prices," he said.

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