

SOCIALLY RESPONSIBLE INVESTING

Goal is ethical earnings

By Anne Pappmehl



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Socially responsible investing in Canada has become a little more passive. In October 2004, Ethical Funds added an index fund to its family called the **Ethical Canadian Index Fund**. The fund, whose aim is long-term growth through capital appreciation, tracks the Ethical Canadian Index.

This was not the first SRI index fund available to Canadians. Meritas Mutual Funds in Cambridge, Ont., has been offering the Meritas Jantzi Social Index Fund since 2001.

The Ethical Canadian Index matches, as closely as possible, the weightings and performance of individual investments within the S&P Total Return Composite Index. However, the Ethical Canadian Index Fund excludes companies that don't meet the fund company's core sustainable investing criteria, using its Corporate Sustainability Scorecard.

This scorecard approach is fairly new, so let me explain. As a whole, socially responsible investing has been under fire for taking a subjective approach to investing, which has a tendency to result in compromised returns. This perception is not entirely accurate.

SRI is a broad, umbrella term referring to a range of investment styles that may indeed be along ethical (and hence subjective) lines, but may also be more along performance-driven (and more objective) lines.

Indeed, when a fund screens out certain sectors or industries that don't correspond with the fund's ethical beliefs or values, it also restricts the availability of stocks in a

portfolio. That may result in compromised returns.

However, as long as investors are aware of the risk, and that risk is clearly stated in the fund's statement of investment policies and guidelines, this is acceptable. This doesn't mean that a fund that in-

vests according to ethics or values is guaranteed to be an underperformer, either. Depending on market conditions and the portfolio's contents, an ethical fund can outperform market benchmarks.

However, most investors are unwilling to risk their entire retirement savings on values alone. That's why sustainability criteria are viewed by the markets as more quantitative and rigorous. Evaluating according to environmental and social indicators is a way of extending the criteria to identify additional risks as well as benefits and opportunities associated with a company. This is where the scorecard approach comes in.

In Ethical Funds' case, the scorecard is built along key environmental, social and corporate governance performance indicators — for example, how well a company manages its toxic waste, reduces greenhouse-gas emissions, saves energy and hires locally.

Companies that display progressive thinking in these key sustainability areas also tend to be well managed and innovative.

Objective criteria

It appears that the fund company's new president and CEO, Don Rolfe, is aiming to take the subjectivity element away from Ethical Funds and replace it with the more objective criteria.

That is to the fund company's credit. That does not mean that

Ethical Funds has abandoned the values side of its investing philosophy. All funds within the family still exclude tobacco and alcohol, and have minimal exposure to the military.

Another new offering from Ethical Funds is the **Ethical Monthly Income Fund**. This is essentially a balanced fund that aims to provide investors with a steady flow of income, paid out monthly. It is suitable for investors who want to generate regular income without eroding their capital.

Like its index counterpart, this income fund aims to find benefits and opportunities associated with sustainability while excluding companies that pose a risk or fail to take advantage of sustainability opportunities.

More and more companies recognize environmental sustainability and corporate social responsibility as a bottom-line enhancer, so it should come as no surprise that the fund's top holdings include mainstream players like Royal Bank, Suncor Energy, EnCana Corp., BCE Inc. and Manulife Financial.

It's too early to talk about performance of these two new funds, other than to say that they seem to be meeting the funds' objectives so far. But I can tell you about distributions, management fees and load charges.

The Ethical Canadian Index Fund comes with no upfront management fee and a low management expense ratio of 1.07 per cent. This is typical of index funds because the passive style of investing is less costly to research and administration. You do have to pay some type of sales charge if you want to purchase it, either through a front-end load or low load. Investors should also bear in

mind, that, with this being an equity index fund, the risk level runs in the medium to high range.

The Ethical Monthly Income Fund comes with a management fee of 1.5 per cent and 2.07 MER and may be purchased at either a low-load, front-end or deferred sales charge. There's no escaping those pesky sales charges, unfortunately, but the management fees and MERs are at the lower-than-average range for SRI funds, which tend to run higher than those of mainstream funds.

With the sustainability, rather than pure ethics focus, these funds would benefit a mainstream investor as much as they would an investor who seeks to align values with value — that is, provided they fit with one's overall portfolio needs.

And finally, to the SRI skeptics: the Jantzi Social Index hasn't been doing too badly. Since its inception in 2000 to February 2005, the Jantzi Social Index has achieved an annualized return of 4.3 per cent and cumulative return of 24.28 per cent. The S&P/TSX 60 and S&P/TSX Composite indexes achieved annualized returns of three per cent and 4.9 per cent, respectively, and cumulative returns of 16.48 per cent and 24.26 per cent.

The JSI consists of 60 Canadian companies that, like the Ethical Canadian Index, pass a set of broadly-based social and environmental screens. This includes mainstream players like Royal Bank, Shoppers Drug Mart and CIBC, as well as companies that are known for their sustainability branding like Husky Injection Moldings and Zenon Environmental.

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