Adam Smith Advisors

A Cherry Tree Affiliate

October 2016

ADAM SMITH INSIGHTS: *Published by Keith Tufte, President of Adam Smith Advisors, LLC, with insights on investing and wealth management.*

INVESTING QUOTE OF THE MONTH:

"The problem is not that people don't want to help others; the problem is they don't know who to trust and whether their money will actually make a difference in someone's life." – Brett Hagler

SOCIALLY RESPONSIBLE INVESTING-INVESTING WITH YOUR HEART AND YOUR HEAD

The socially responsible investing (SRI) trend has been growing rapidly over the past 10 years. According to Kiplinger Magazine, there are now 493 socially responsible funds with assets of $569 billion. It has come a long way from the days when it primarily meant avoiding investing in controversial industries such as firearms, tobacco, alcohol, and gambling. Most of us want to be socially responsible, and not trash the planet for our children and grandchildren. Most agree that corporations should not exploit their workers or communities to make a profit. These days there is a wide variety of SRI funds available with many different objectives. Today more investors want to invest with their values, and expect to get a competitive investment return as well. In several of the best funds you can invest in a socially responsible manner, feel good about doing so, and not sacrifice returns in the process. Younger investors and millennials seem to be particularly interested in SRI investing.

HOW DOES THE INDUSTRY DEFINE "SOCIALLY RESPONSIBLE" COMPANIES?

That is a problem. There is no consensus on how to define social responsibility, or how to construct a portfolio based on this concept. The other problem is that each investor likely has his or her own set of values and definition for what he or she considers socially responsible. Those unique personal criteria may not match up exactly with many socially responsible funds' definitions. Most socially responsible funds look for companies that do a good job relative to environmental, social, employee rights, consumer protection, human rights, climate change, sustainability, and corporate governance factors. Are you looking for companies that get high marks for diversity, or that avoid military weapons, or that are doing good (and not bad) things for the environment? Labelling large complicated companies as either "good" or "bad" is often an exercise in ambiguity, and good or bad is defined in an investment fund subjectively by someone other than yourself.

WHAT ARE A FEW OF OUR FAVORITE SOCIALLY RESPONSIBLE FUNDS?

We look for the same things here that we do with all of our funds: diversification, low cost, liquidity, tax efficiency, low turnover, a long track record, and sponsorship by a large firm with a good reputation. We do not have a specific social cause in mind when choosing these funds. We believe with these funds you can have your cake and eat it too by investing with a socially responsible mission, and still keeping your costs, returns, and risk competitive over time.

Vanguard FTSE Social Index Fund (VFTSX). The fund includes about 400 large and mid-cap stocks that have been screened for positive socially responsible criteria (such as workplace diversity), and excludes companies in tobacco, weapons, nuclear power, human rights or environmental violations, and components of biological and nuclear weapons. This is a large company U.S. stock fund with a low expense ratio of only 0.25%.

iShares MSCI KLD 400 Social ETF (DSI). This is the largest ETF fund in the SRI category. This fund excludes companies involved in alcohol, gambling, adult entertainment, weapons, nuclear power, and GMOs. This is a socially responsible large company U.S. stock fund with an expense ratio of 0.50%. It holds approximately 400 stocks.

DFA International Social Core Equity (DSCLX). The fund avoids companies involved in weapons, tobacco, alcohol, gambling, contraceptives, adult entertainment, recent child labor controversies, and stem cell research. It owns approximately 3,500 international stocks, has an expense ratio of 0.46% per year.

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OTHER CONSIDERATIONS ON SOCIALLY RESPONSIBLE INVESTING (SRI)

1. It is difficult to build a completely diversified portfolio using socially responsible funds. For most of our clients who are interested in SRI, we commit about 5%-20% of their portfolio to these type of funds.

2. Investing part of your portfolio in SRI funds is unlikely to have the real world impact you may envision. It may make you feel better about how you are investing, but there may be other ways to support your social mission with more direct and significant impact. Some people feel like they can have a bigger impact to their favorite causes by spending their money as consumers on products and services from companies that match their social goals and values, or volunteering in areas they support. Others feel they can have a bigger and more targeted impact by donating money specifically to charities that support their favorite causes and missions, and a donor-advised charitable fund can be an excellent tool for that.

3. The expense ratios of the socially responsible funds are generally slightly (or much) higher than non-SRI funds in the same asset class.

4. In some years SRI funds will outperform the market, and in other years they will lag. According to Morningstar, the history of the long-term performance of SRI funds relative to regular funds is not strongly in favor or against them. In general, these SRI funds are overweight in technology, healthcare, and financial services relative to broad indices, and an underweight in energy and utility stocks. The top two SRI funds listed above have returns that are about 95%-98% correlated to the S&P 500 U.S. stock index, and many of the top names in these SRI funds are similar to the overall U.S. index (Apple, Microsoft, Alphabet, Wells Fargo, Johnson & Johnson, JP Morgan, Procter & Gamble, etc.).

5. Some SRI funds are focused on specific "green" areas such as wind and solar power companies or water companies. We are less interested in these type of funds because they tend to be more costly, less diversified, smaller, and less liquid. They often invest in small risky companies, many of which are not making a profit. Many of the alternative energy funds have had poor recent performance due to the big drop in oil and gas prices.

> **"Goodness is the only investment that never fails."**
> **– Henry David Thoreau**

If you would like to discuss possibly adding some socially responsible funds to your investment portfolio, please contact us anytime.

Adam Smith Advisors, LLC (ASA) provides unique wealth management services for a select group of client families to help give them peace of mind. Author Keith Tufte, (CIO of ASA) has over 25 years of successful investment management experience as a Wall Street Analyst, Mutual Fund Portfolio Manager, Director of Equity Research for a major mutual fund firm, Hedge Fund Portfolio Manager, and Wealth Management Advisor. Please FORWARD this e-mail to friends/relatives/business associates that you think may have an interest. Please see our website at http://www.cherrytree.com.

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