

The Good and Bad of Ethical Investing

Socially responsible funds deliver decent returns. But finding one that reflects your values isn't so easy.



Should you put your money where your heart is? Let's say you agree with Al Gore about global warming—or, on the other hand, you feel that the biggest threat to our society is the corrosion of traditional values. In either case, there are “socially responsible” (SRI) mutual funds that should steer clear of companies with businesses or policies that you would find objectionable. If these funds do their job, you never need suffer a guilty conscience about supporting activities you consider immoral, and the funds' returns will let you do well by doing good.

So what's not to like? Just about everything, according to the conventional wisdom, which claims that SRI funds have lousy performance, outrageous fees and even a narrow perspective on ethics. But I've taken a hard look at these funds recently, and I think much of what you've probably heard about SRI funds is misleading—including most of what I've written about them (I've parroted the conventional wisdom) and some of what the funds say about themselves.

VALUE VS. VALUES

Let's take performance first. Data from fund watcher Morningstar and research by finance professor Meir Statman of Santa Clara University show that over the long run the difference in returns between SRI funds and regular funds isn't all that big.

During the past five years, socially responsible funds have lagged conventionally-run funds by an average of 0.7 percentage points annually. That's not insignificant, but it's mostly due to the underperformance of technology stocks. (SRI funds at the liberal end of the spectrum tend to like tech firms for

their progressive labor policies and their lack of smokestacks.) Moreover, in the past decade, which includes tech's ups and downs, righteous funds are separated from other actively managed funds by less than a tenth of a percentage point a year. In other words, investing by principle hasn't cost you much principal.

Can that continue? Maybe, but the fact is, it's expensive to research how much pollution a company produces or whether some of its goods are produced by slave labor in China. And it's even more expensive to wage a campaign to get a company to change objectionable

SMALL SACRIFICE

Socially responsible funds have delivered returns that **underperformed conventional funds only slightly.**

< **0.1%**

AVERAGE ANNUAL DIFFERENCE IN RETURN, 1997-2007

NOTE: As of Sept. 30. SOURCE: Morningstar.

policies. The result: Even when SRI funds invest using indexes of companies (rather than actively buying and selling stocks), creating and maintaining those indexes isn't cheap. You'll pay fees roughly 0.7 percentage points higher than those you'd pay for the average S&P 500 index fund, and over the long run

you can expect SRI funds to underperform by about that amount. Then again, Statman has found that investors who buy SRI funds don't really care whether they cost more. They would rather compromise on fees than on beliefs.

Moreover, if investing by your moral compass makes you more likely to stick with a fund even when it's down, you'll do better than folks who chase whatever is hot at the moment.

COOKIE-CUTTER ETHICS

There's still one area, however, where I believe SRI funds come up short. The funds don't advertise the fact, but the truth is that they take a one-size-fits-all investing approach that's straight out of the 1960s, when ideologies were rigid and technology was primitive. If you're a Prius-driving, pro-choice Obama supporter, it's not hard to find an SRI fund: **TIAA-CREF Social Choice Equity** (ticker symbol: TICRX) or **Vanguard FTSE Social Index** (VFTSX) should work for you. Conversely, if you're an Evangelical Christian, one of the Timothy funds (timothyplan.com) could make sense. But if you're a devout Catholic environmentalist, a hard-core leftist who smokes and plays poker, or a gay Republican, you're most likely out of luck. You won't easily find an SRI fund that favors “green” companies but opposes abortion, or one that fights global warming but sees nothing wrong with “sin stocks.”

“There's not enough dialogue going back and forth between SRI firms and their investors,” says David Wieder, the former CEO of Domini Social Investments

and now a private investor. “The investment options for SRI should offer more flexibility and control.” Wieder thinks the day will come when you'll be able to create a unique, roll-your-own SRI fund that would invest according to your personal set of beliefs.

Technologically, that's not such a great leap for SRI fund companies to make. But they haven't made it yet. That leaves three choices: giving up on SRI for now,

accepting some compromises in your funds or working with an adviser who specializes in ethical investing and can customize a portfolio. You can find advisers at socialinvest.org and then do background checks at adviserinfo.sec.gov and brokercheck.finra.org. Stick to fee-only advisers, ask questions about the adviser's beliefs, and get the details of how he or she screens companies and mutual funds. This service won't come cheap, likely

1% of your invested assets a year, and many advisers have high minimums. But you can probably arrange a short-term consultation for \$2,000 or so. That's a price you'll have to pay until the ethical fund industry finally recognizes just how complicated you really are. **\$**

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Jason Zweig is the author of *Your Money and Your Brain*. You can e-mail him at investor@money.com.

Money70 OUR LIST OF RECOMMENDED MUTUAL FUNDS AND ETFs

MONEY 70 stock funds were beaten down in the month ended Nov. 15 by continuing concerns over the slumping housing market and the credit crisis. The hardest-hit funds: **Bridgeway Small Cap Value** dropped 10.7%, while **Muhlenkamp** and **Primecap Odyssey Aggressive Growth** both fell more than 9%. Most bond funds registered healthy gains, with **T. Rowe Price International Bond** and **Vanguard Inflation-Protected Securities** returning 3.2%.

FUND (TICKER)	TOTAL RETURN			EXPENSES (AS % OF ASSETS) ²	PHONE NUMBER (800)
	1 MO.	1 YR.	3 YRS. ¹		
Large-Cap					
American Funds Amcap (AMCPX) ³	-5.0%	6.1%	8.4%	0.64	421-0180
Am. Funds Am. Mutual (AMRMX) ³	-4.9	4.2	8.8	0.55	421-0180
Fidelity Dividend Growth (FDGFX)	-6.1	3.3	7.2	0.60	343-3548
Fidelity Spartan 500 Index (FSMKX)	-5.6	5.6	9.0	0.10	343-3548
Fidelity Spartan Total Market (FSTMX)	-5.6	5.8	9.9	0.10	343-3548
iShares S&P 500 Index (IVV)	-5.6	5.6	9.0	0.09	474-2737
Jensen (JENSX)	-1.1	7.7	7.2	0.85	992-4144
Madison Mosaic Investors (MINVX)	-2.9	-0.2	4.7	0.95	368-3195
Matrix Advisors Value (MAVFX)	-7.0	2.5	6.8	0.99	366-6223
Selected American (SLASX)	-5.0	5.5	10.4	0.90	243-1575
Sound Shore (SSHFX)	-5.5	4.5	10.2	0.92	551-1980
T. Rowe Price B/C Growth (TRBCX)	-6.0	11.6	9.7	0.82	638-5660
T. Rowe Price Equity Income (PRFDX)	-4.7	4.5	9.8	0.69	638-5660
Vanguard 500 Index (VFINX)	-5.6	5.5	8.9	0.18	851-4999
Vanguard Total Stock Market (VTSMX)	-5.7	5.6	9.7	0.18	851-4999
Vanguard Total Stock Market ETF (VTI)	-5.6	5.7	9.8	0.07	851-4999
Vanguard Windsor II (VWNFX)	-5.8	6.4	10.5	0.34	851-4999
Midcap					
Fairholme (FAIRX)	-4.9	16.2	16.4	1.00	202-2263 ⁴
FAM Value (FAMVX)	-2.8	0.3	6.3	1.18	932-3271
Fidelity Value (FDVLX)	-7.1	4.7	12.1	0.67	343-3548
FPA Perennial (FPPFX) ⁵	-0.4	7.8	9.2	0.92	982-4372
Janus Mid Cap Value (JMCVX)	-3.9	7.6	12.2	0.93	525-3713
Meridian Growth (MERDX)	-4.5	4.7	8.7	0.84	446-6662
Primecap Odyssey Agg. Gro. (POAGX)	-9.0	2.1	12.2	0.99	729-2307
Vanguard Mid-Cap ETF (VO)	-5.9	5.9	12.7	0.12	851-4999
Vanguard Mid-Cap Index (VIMSX)	-5.9	5.8	12.6	0.22	851-4999
Multicap					
Bridgeway Agg. Inv. 2 (BRAIX)	-7.5	21.5	17.7	1.21	661-3550
Muhlenkamp (MUHLX)	-9.1	-7.8	2.5	1.04	860-3863
Weitz Hickory (WEHIX)	-5.6	-10.2	4.3	1.20	304-9745
Small-Cap					
Bridgeway Small Cap Value (BRSVX)	-10.7	1.7	14.4	0.83	661-3550
Royce Pennsylvania Mutual (PENNX)	-5.0	4.2	11.6	0.87	221-4268
Royce Value Plus Service (RYVPX)	-6.2	8.1	14.6	1.26	221-4268
T. Rowe Price New Horizons (PRNHX)	-7.2	5.5	10.0	0.83	638-5660
Vanguard Small-Cap ETF (VB)	-6.3	2.2	10.1	0.09	851-4999
Vanguard Small-Cap Index (NAESX)	-6.3	2.1	9.9	0.23	851-4999
Specialty					
Cohen & Steers Realty (CSRSX)	-7.6	-7.8	14.3	0.96	330-7348

NOTES: As of Nov. 15. N.A.: Not available. Load funds are included for those who prefer to use a broker. ¹Annualized. ²Audited and annualized figures except on Fidelity. ³5.75% sales load. ⁴Area code is 866. ⁵25% sales load. ⁶Area code is 877. ⁷Includes a waiver. ⁸3.75% sales load. ⁹3.50% sales load. SOURCES: Lipper, New York, 877-955-4773; the fund companies.

FUND (TICKER)	TOTAL RETURN			EXPENSES (AS % OF ASSETS) ²	PHONE NUMBER (800)
	1 MO.	1 YR.	3 YRS. ¹		
Specialty continued					
iPath Dow Jones Select Div. (DVY)	-3.9	-2.8	6.1%	0.40	474-2737
iShares S&P GSSI Nat. Res. Index (IGE)	-7.9	28.2	25.4	0.48	474-2737
Third Ave. Real Estate Value (TAREX)	-4.8	-2.3	13.7	1.11	443-1021
T. Rowe Price New Era (PRNEX)	-6.8	34.2	26.8	0.67	638-5660
Vanguard REIT ETF (VNQ)	-6.7	-6.5	13.3	0.11	851-4999
Vanguard REIT Index (VGSIX)	-6.7	-6.6	13.2	0.21	851-4999
Foreign					
Am. Funds EuroPacific Gro. (AEPGX) ³	-1.5	23.9	22.5	0.75	421-0180
American New World (NEWFX)	-0.1	36.8	30.9	0.99	421-0180
Artisan International (ARTIX)	-1.2	25.5	22.2	1.20	344-1770
Dodge & Cox Intl. Stock (DODFX)	-3.3	16.8	20.7	0.66	621-3970
Fidelity Spartan Intl. (FSIIX)	-3.2	16.9	19.0	0.09 ⁷	343-3548
iShares MSCI EAFE Index (EFA)	-2.6	17.2	19.0	0.35	474-2737
Oakmark International (OAKIX)	-5.7	4.2	15.8	1.09	625-6275
T. Rowe Price Emer. Markets (PRMSX)	-2.6	52.0	40.7	1.25	638-5660
T. Rowe Price Intl. Discovery (PRIDX)	-3.2	26.2	27.1	1.24	638-5660
Vanguard Emer. Markets ETF (VWO)	-2.7	50.2	N.A.	0.29	851-4999
Vanguard Emer. Markets Stock (VEIEIX)	-2.7	50.1	37.2	0.41	851-4999
Vanguard Intl. Growth (VWIGX)	-2.9	21.0	20.9	0.54	851-4999
Vanguard Total Intl. Stock (VGTIX)	-3.3	21.8	21.6	0.32	851-4999
Bond					
American Funds Amer. H/I (AHITX) ⁸	-2.0	3.5	6.3	0.65	421-0180
Dodge & Cox Income (DODIX)	0.2	4.9	4.0	0.44	621-3979
FPA New Income (FPNIX) ⁹	0.9	6.1	4.0	0.62	982-4372
Harbor Bond (HABDX)	1.6	7.5	4.7	0.58	422-1050
iShares Lehman 1-3 Yr. Treas. (SHY)	1.3	7.0	3.9	0.15	474-2737
iShares Lehman TIPS Bond (TIP)	3.1	9.2	4.6	0.20	474-2737
iShares Lehman U.S. Agg. Bd. (AGG)	1.1	6.0	4.0	0.20	474-2737
T. Rowe Price International Bond (RPIBX)	3.2	13.0	4.6	0.84	638-5660
Vanguard Infl.-Pro. Sec. (VIPSX)	3.2	9.2	4.7	0.20	851-4999
Vanguard Intern.-Term T/E (VWITX)	-0.2	2.6	3.1	0.16	851-4999
Vanguard Short-Term Bond (VBISX)	1.2	6.9	3.9	0.18	851-4999
Vanguard Total Bond Market (VBMFX)	1.2	6.4	4.2	0.20	851-4999
Target-Retirement					
T. Rowe Price Retirement (STOCK/BOND ALLOCATION)					638-5660
2005 Fund (55%/45%) (TRRFK)	-2.4	7.1	8.4	0.61	
2020 Fund (80%/20%) (TRRBK)	-3.9	7.9	10.4	0.72	
Vanguard Target Retirement					851-4999
2025 Fund (81%/19%) (VTTVX)	-3.8	8.5	9.2	0.21	
2035 Fund (90%/10%) (VTTHX)	-4.6	8.6	10.3	0.21	

