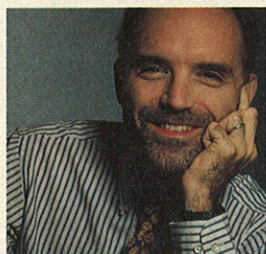


THE FUNDAMENTALIST



BY JASON ZWEIG

ASK JUST ABOUT ANY BROKER OR FINANCIAL PLANNER, AND you'll be told that doctors are not always the savviest investors. Even so, the American Medical Association has some investing advice for you. In April, the AMA released a list of 13 tobacco-related companies and 1,474 mutual funds that it says invest in them. Calling tobacco "a ruinous and enslaving product that has brought misery, disease, anguish and death," the AMA recommended that investors sell any holdings in the stocks and funds on its tobacco tally.

The AMA is only the latest group to climb onto the bandwagon of socially responsible investing. Mutual funds have been on board for years. Socially responsible funds "screen" their portfolios, buying only companies whose conduct their managers consider ethical. Let's call them the angel funds; there are at least 42 floating around, including \$487 million Pax World and \$35 million New Alternatives.

If you think smoking, sexism and racism are evil, why not put your money where your mouth is? A heavenly idea, to be sure. But hellishly hard to execute.

First off, you'll have a devil of a time finding an angel fund you fully agree with. Most are designed for an unrealistically homogeneous group of liberal Democrats. If you're an otherwise left-leaning Democrat who's got no beef with tobacco, you don't fit most of these funds' definitions of socially responsible. If you're a pro-choice Republican, you're just as much of a misfit.

And while socially responsible investing sounds as if it will help you take a principled stand, it won't carry you all the way to the moral high ground. If you're still eating Philadelphia cream cheese, Claussen pickles or Jell-O—all made by tobacco titan Philip Morris—you can't really cleanse yourself of any tobacco taint just by picking a fund manager who won't buy Philip Morris stock.

What's more, the ethical standards of these socially responsible funds can get pretty puzzling. Some angel funds refuse to buy U.S. Treasury securities; they don't want to support the military budget. But the same Treasury borrowings also fund AIDS research and earthquake relief. Is buying a Treasury bill immoral because a portion of it goes to build bombs—or is it moral because another portion goes to help people in need? How many angel funds can dance on the head of a pin?

Why "socially responsible" investing isn't quite as heavenly as it might sound

Now we get to my other problem with this stuff: Once you start, it's hard to know where to stop. Look at Sara Lee Corp., which makes lots of things besides those yummy cakes, including Ball Park franks, Playtex bras and Kiwi shoe polish. So how come the AMA named Sara Lee one of its 13 toxic tobacco stocks? A small unit of Sara Lee, Douwe Egberts, sells loose tobacco for pipes and snuff, mainly in Europe. That business makes up less than 2% of Sara Lee's \$17.7 billion revenues.

Taking its diagnosis one step further, the AMA says that if you own IAI Regional Fund, you should flush it out of your portfolio with a high colonic. This Minneapolis-based stock fund has delivered superb long-term returns at low risk. But last December, it had a grand total of 1.35% of its net assets, or \$7.8 million, in Sara Lee stock. With under 2% of Sara Lee's sales coming from tobacco, less than 27¢ out of every \$1,000 in the IAI fund is contaminated by nicotine.

Don't get me wrong. I despise cigarettes at least as much as the AMA does; my father, a heavy smoker, died of lung cancer, and I've been known to cross a street to avoid walking behind a smoker. But if investors must sell a top mutual fund because it has $\frac{27}{1,000}$ of 1% of its assets in tobacco, what's next? Should you sell a fund if it owns International Flavors & Fragrances, the big company that makes (among many other things) menthol flavoring for cigarettes sold overseas? Or Ackerley Communications, which owns billboards that sometimes carry cigarette ads?

Listen to Robert Sanborn, who has taken heat for putting more than 6% of his Oakmark Fund in Philip Morris. "I have a legal, fiduciary and even a moral obligation to invest in the stocks that offer the best combination of risk and reward," he says. "By that standard, I know of no more attractive stock on the New York Stock Exchange than Philip Morris, and that's why it's our largest holding."

I'm with Sanborn: A fund manager's job is to get the best return at the lowest risk—nothing more, nothing less. Of the 11 angel funds with five-year records, all but one (Parnassus, whose returns slipped in '95) have lagged the market by four to eight percentage points a year. My advice: Skip the angel funds and buy diversified funds with low expenses and solid long-term returns. Let the manager buy the best stocks he can find. Then, down the road, donate the proceeds to your favorite charity. You'll help a good cause and get a tax break to boot. **ES**



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