Performance of Socially and Environmentally Screened Mutual Funds

Information about social mutual funds allows investors to evaluate the performance of actively managed portfolios that utilize social and environmental screening. Evaluations of these investments are sometimes utilized as a proxy for assessing sustainable and responsible investing as a whole.

Academic research generally has revealed no significant difference between the financial performance of socially and environmentally screened mutual funds and the performance of their unscreened peers. Several studies suggest, however, that there may be more risk associated with sustainable and responsible investing. SRI World Group's analysis of socially responsible mutual funds supports these findings.

In a year 2000 study, Meir Statman of Santa Clara University compared the performance of 31 social mutual funds to that of 62 unscreened conventional funds; each group had approximately the same asset size. Statman found that the mean performance of the social mutual funds beat that of the conventional funds. The difference in performance between the two fund groups, however, was not statistically significant. Also, the mean performance for both groups was negative. Statman concluded that the social mutual funds' performance was no worse than that of the conventional funds.[1]

The findings in Statman's 2000 study echoed those of a similar study he and his colleagues, Sally Hamilton and Jo Hoje, conducted in 1993. Upon comparing the returns of social mutual funds and conventional funds from 1981 to 1990, the three researchers found there was not a statistically significant difference between the risk-adjusted returns for the two fund groups.[2]

For the three-year period ending December 31, 2001, SRI World Group performed its own analysis of the risk vs. return trade-off for the largest broadly screened social mutual funds. This investigation demonstrates that sustainable and responsible investing portfolios generally produce returns competitive with conventional portfolios.

SRI World Group reviewed the three-year performance data for 19 broadly screened social mutual funds, each with assets totaling more than $75 million. The benchmarks of three years and $75 million in assets have been established by the Foundation for Fiduciary Studies as important requirements for meeting fiduciary standards.[3] Broadly screened funds are loosely defined as funds that consider more than a single parameter, such as tobacco, in their social and environmental screening.

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SRI World Group examined both the financial return and the relative risk associated with each mutual fund and compared these criteria to the fund's respective peer group as defined by Morningstar (a peer group includes all screened and unscreened funds in a fund category). It is important to evaluate a combination of risk and return measures because investors do not want to undertake undue risk to achieve high financial returns.

In the analysis, financial performance was measured using each fund's annualized three-year return. Relative risk was measured using a three-year standard deviation. Standard deviation measures the amount a fund deviates from expected returns. Funds that have a history of volatile financial performance will demonstrate higher standard deviations and thus have higher financial risk. All statistics were gathered from Invest Management, Inc. and the Center for Fiduciary Studies.

During the three-year period ending December 31, 2001, 10 of the 19 broadly screened mutual funds (53%) achieved higher returns than 50 percent of the mutual funds in their respective peer groups. Four funds (21%) performed in the top 25th percentile (or better) of their peer groups. Being in the 25th percentile means those four funds had a higher financial performance than 75 percent of all funds. In this analysis, this performance level is also represented as the lowest 75%.

Figure 1
Screened Mutual Funds Risk vs. Return
In the three-year period ending December 2001, 53% of social mutual funds had returns better than the median of all funds in their peer group, while 58% had a higher risk level.

		Risk: Lower	Risk: Higher
Return	**Higher**	6 (32%)	4 (21%)
	Lower	2 (10%)	7 (37%)

Note: The division between low and high is the 50 percentile ranking for each fund in comparison to its peer group according to Morningstar.

Social mutual funds had risk levels slightly above their peer groups' medians. Of the 19 funds examined, eleven funds (58%) had standard deviations higher than 50 percent of their respective peer groups. Viewing risk and return together, six of these funds (31%) demonstrated both higher returns and lower standard deviations than 50 percent of their respective peer groups, while seven funds (37%) demonstrated high risk and low returns.[4] Summarized in Figure 1 is the relative performance of social mutual funds in terms of risk and return. Shown in Figure 2 is the quartile ranking of each of the 19 funds.

Using the Large-Cap Blend category as an example, the analysis examined the performance of the Domini Social Equity Fund, the Calvert Social Equity Fund, the MMA Praxis Fund, and the Smith Barney Social Awareness Fund. As shown in Figure 3, one of the four socially and environmentally screened funds had a financial return better than 75

Figure 2
Quartile Rankings of Screened Mutual Funds
Percentile ranking of 19 social mutual funds, based on risk and return, in comparison to all mutual funds in their respective peer groups, as defined by Morningstar, for the 3-year period ending December 31, 2001.

Low<------ R E T U R N ------>High	Low <--------------------------R I S K------------------------------> High			
	1st Quartile	**2nd Quartile**	**3rd Quartile**	**4th Quartile**
1st Quartile	- Parnassus Equity Income (large-cap value)	- Ariel Appreciation (mid-cap blend)	- Calvert Social Equity (large-cap blend)	- Parnassus Fund (large-cap value)
2nd Quartile	- Ariel Fund (small-cap blend) - MMA Praxis (large-cap blend) - Smith Barney Soc. Awar (large-cap blend)	- Pax World Balanced (domestic hybrid)	- Calvert New Vision (small-cap blend)	- IPS Millennium (large-cap growth)
3rd Quartile	- Dreyfus Third Century (large-cap growth)	- Calvert Capital Accum. (mid-cap growth) - Citizens Emerging Growth (mid-cap growth) - Citizens Core (large-cap growth)	- Neuberger Berman (large-cap value)	- Citizens Global (world stock)
4th Quartile		- Calvert World Values (foreign)	- Domini Social Equity (large-cap blend) - Calvert Social Bal. (domestic hybrid)	

percent of the funds in the Large-Cap Blend category, while two funds had returns better than 50 percent of the funds.[5]

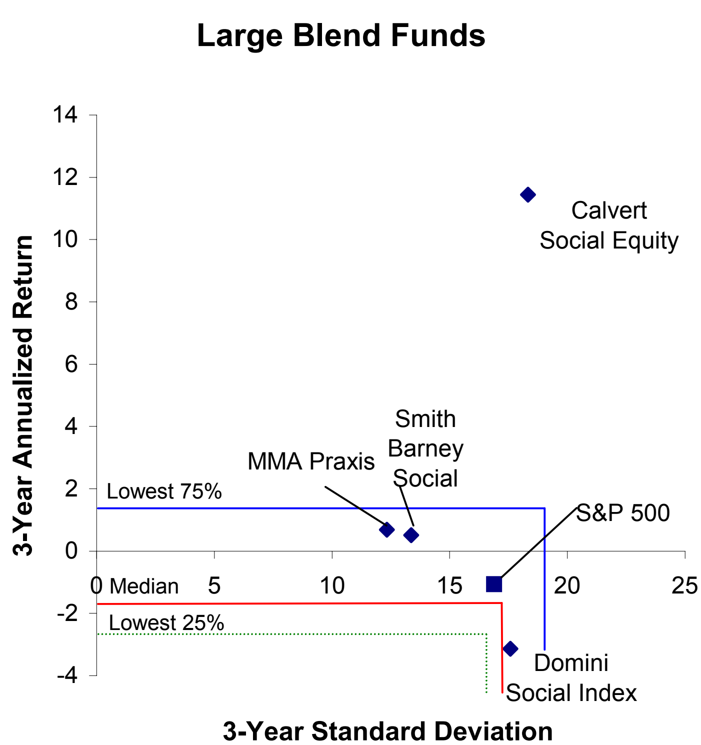
This financial performance is comparable with the performance of unscreened peer funds. In addition, three of the funds performed better than the S&P 500, which is also plotted on the graph. One fund, the Domini Social Equity Fund, over the three-year period, is slightly behind the performance of the S&P 500 in terms of risk and return. Additional charts for each fund category are available at the end of paper.

Weisenberger, a financial reporting agency, completed an analysis in 2000 that shows results similar to those obtained by SRI World Group. Of the 48 socially and environmentally screened mutual funds Weisenberger reviewed, 25 (52%) performed in the top quartile of their respective categories for the three years ending December 31, 2000.[6]

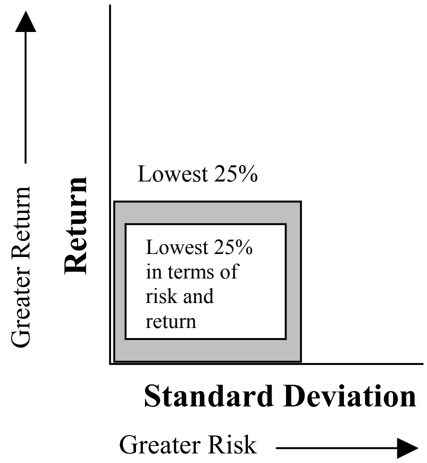
In addition to examining the risk vs. return for the 19 largest social mutual funds, SRI World Group also reviewed the performance ratings

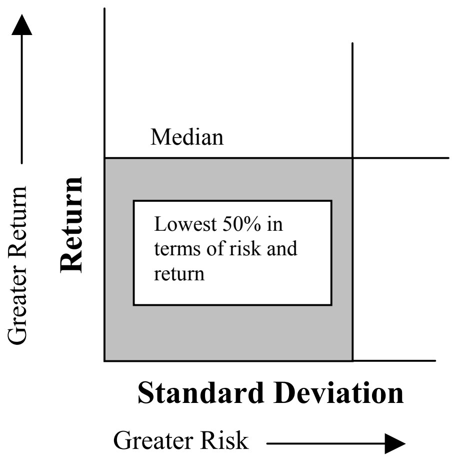
Figure 3
Percentile Rankings of Large-Cap Blend Mutual Funds

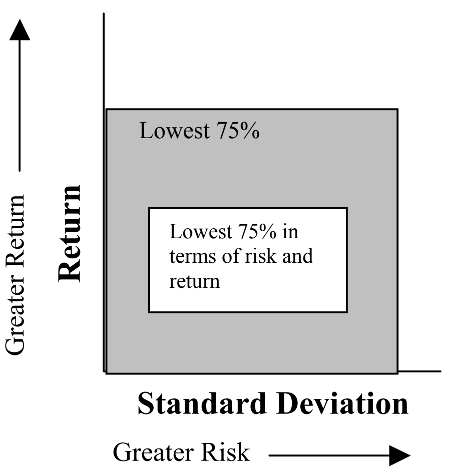
One of the four socially and environmentally screened funds in the Large-Cap Blend category had a financial return better than 75 percent of peer funds. Two had a return better than 50 percent of other funds. In addition to the four funds, the benchmark S&P 500 is plotted on the graph.



Interpreting Percentile Graphs







given to these funds by Morningstar over a three-year period. As shown in Figure 4, 17 of the 19 funds received a Morningstar rating of three or better. Indeed, social mutual funds appear to equal their peers according to these generalized Morningstar rankings.

Figure 4
Three-Year Morningstar Rankings of Screened Mutual Funds (as of 12/31/01)

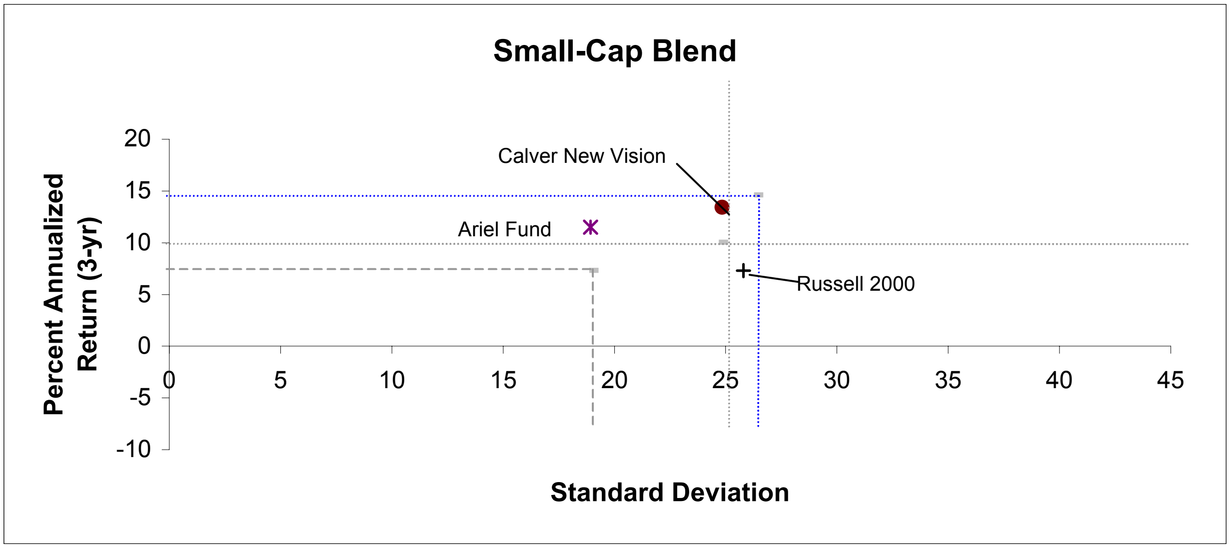
Of the 19 social mutual funds considered in the study, 32% received a 4 or 5 star Morningstar rating, which is nearly identical to their unscreened peers.

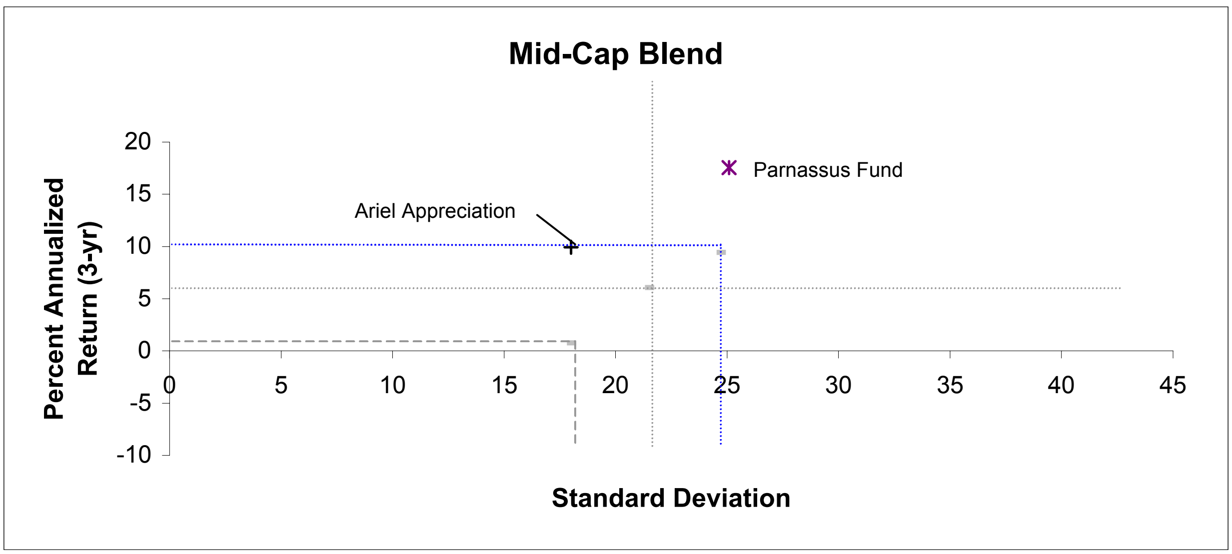
Morningstar Rating	Interpretation	SRI Funds with Rating	
★★★★★	Top 10% of broad asset class (domestic stock, international stock, taxable bond, or municipal bond)	3	16%
★★★★	Next 22.5% of broad asset class	3	16%
★★★	Middle 35% of class	11	58%
★★	Lower 22.5% of class	2	10%
★	Bottom 10%	0	0%

Assessing social mutual fund performance is valuable because it allows investors to gauge the overall performance of sustainable and responsible investing. It is clear from this analysis of mutual funds that including social and environmental criteria in the investing process yields competitive investment performance but may have slightly higher levels of risk than investing in unscreened funds.

End Notes

[1] Statman, Meir. "Socially Responsible Mutual Funds." *Association for Investment Management and Research*, 2000. p. 34.
[2] Hamilton, Sally, Jo Hoje, and Meir Statman. 1993. "Doing Well While Doing Good? The Investment Performance of Socially Responsible Mutual Funds." *Financial Analysts Journal*, Vol. 49, No. 6. (November/December), pp. 62–66.
[3] SRI World Group examined only those funds that have been in existence for more than 3 years and that have more than $75 million in assets. These criteria are consistent with the Center for Fiduciary Studies' first two due diligence screens for the minimum fiduciary standards for advisors and trustees (ERISA, UPIA and MPERS). While this framework does not necessarily give a good picture of the performance of all socially responsible mutual funds, it does provide information about those screened portfolios in which institutional investors are most likely to invest.
[4] The standard deviation provided on the x-axis of our graphs measures the amount by which the return of the fund "deviates" from the expected normal returns. Given that risk can be defined as the chance that an investment's actual return will be different than expected, the standard deviation of a portfolio is the measure of the risk that an investor takes when he or she purchases that investment. In most cases, higher risk correlates with a greater opportunity for high returns.
[5] SRI World Group drew first quartile (lowest 75%), median (lowest 50%), and third quartile (lowest 25%) lines for each investment style based on standard deviation and annualized return information about that particular peer group. Twenty-five percent of all funds in the investment style had returns and risk lower than those that fall on the first quartile line, while 50 percent of all funds in the investment style had returns and risk lower than those that fall on the median line. Seventy-five percent of all funds in the investment style had returns and risk lower than those points on the third quartile line.
[6] "7 out of 8 Largest Social Funds Get Top Performance Marks for 2000." Social Investment Forum News Release, January 30, 2001, www.socialinvest.org.


Small-Cap Blend
Calver New Vision
Ariel Fund
Russell 2000
Percent Annualized Return (3-yr)
Standard Deviation
20
15
10
5
0
-5
-10
0
5
10
15
20
25
30
35
40
45


Mid-Cap Blend
Parnassus Fund
Ariel Appreciation
Percent Annualized Return (3-yr)
Standard Deviation
20
15
10
5
0
-5
-10
0
5
10
15
20
25
30
35
40
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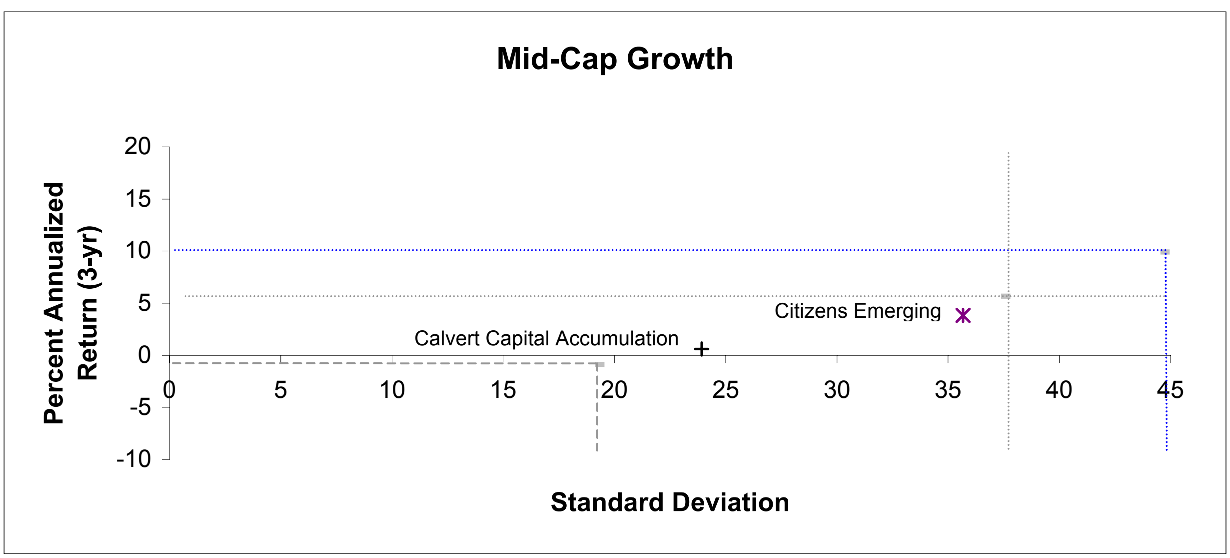
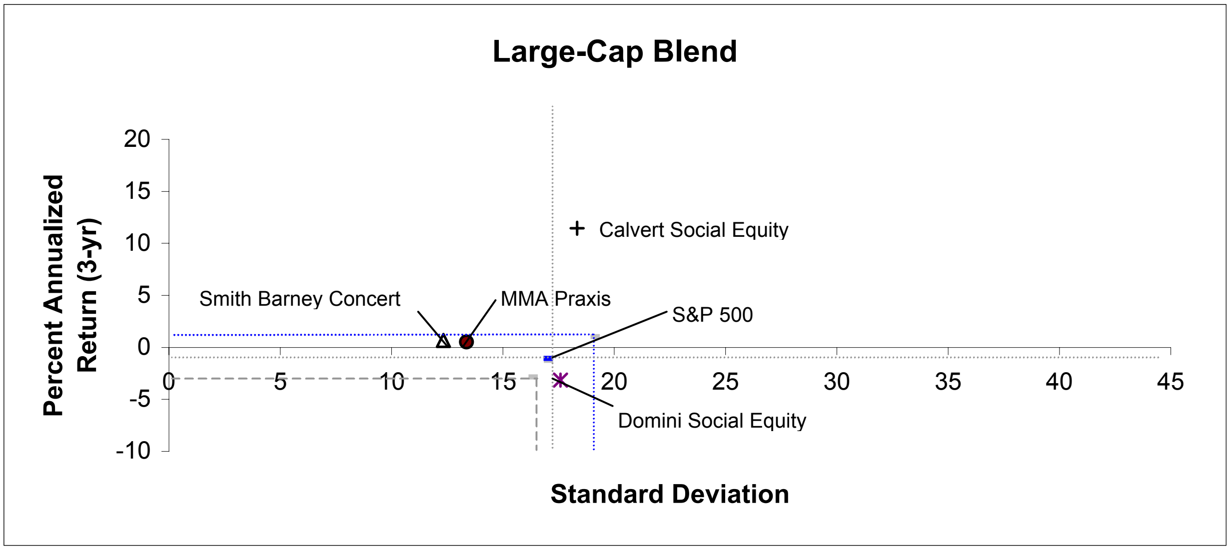

Mid-Cap Growth
Citizens Emerging
Calvert Capital Accumulation
Percent Annualized Return (3-yr)
Standard Deviation
20
15
10
5
0
-5
-10
0
5
10
15
20
25
30
35
40
45


Large-Cap Blend
Percent Annualized Return (3-yr)
20
15
10
5
0
-5
-10
0
5
10
15
20
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30
35
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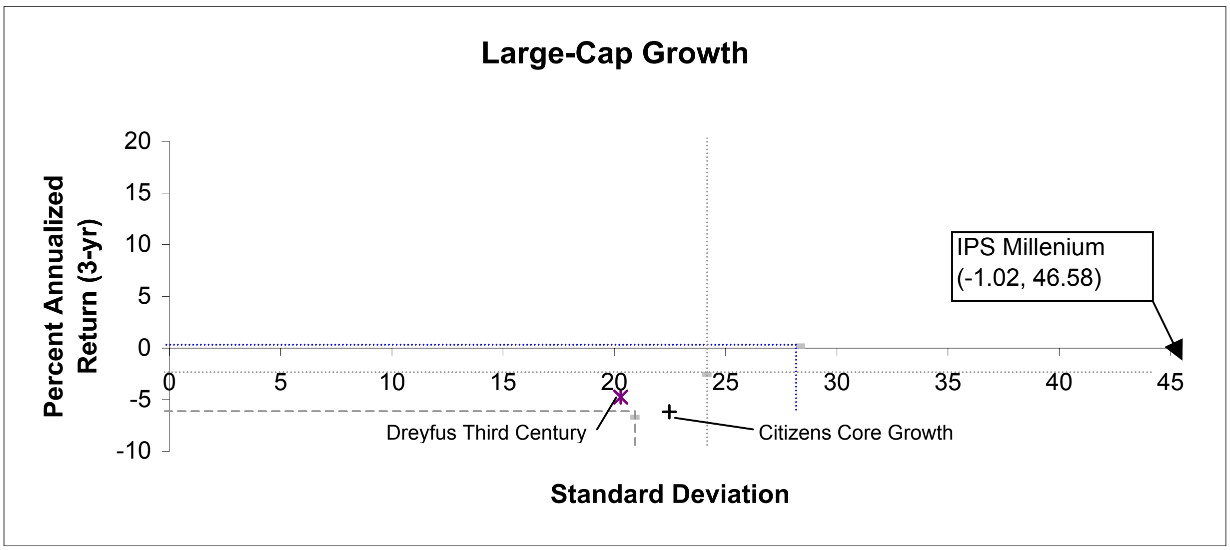
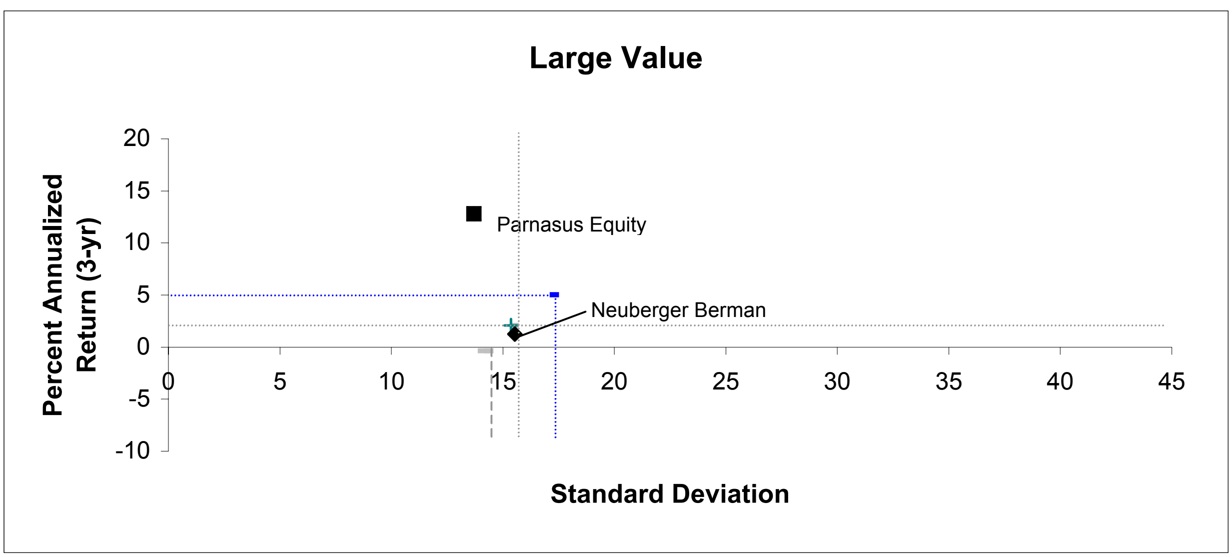
45
Calvert Social Equity
Smith Barney Concert
MMA Praxis
S&P 500
Domini Social Equity
Standard Deviation


Large-Cap Growth
Percent Annualized Return (3-yr)
20
15
10
5
0
-5
-10
0
5
10
15
20
25
30
35
40
45
IPS Millenium
(-1.02, 46.58)
Dreyfus Third Century
Citizens Core Growth
Standard Deviation


Large Value
Percent Annualized Return (3-yr)
20
15
10
5
0
-5
-10
0
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10
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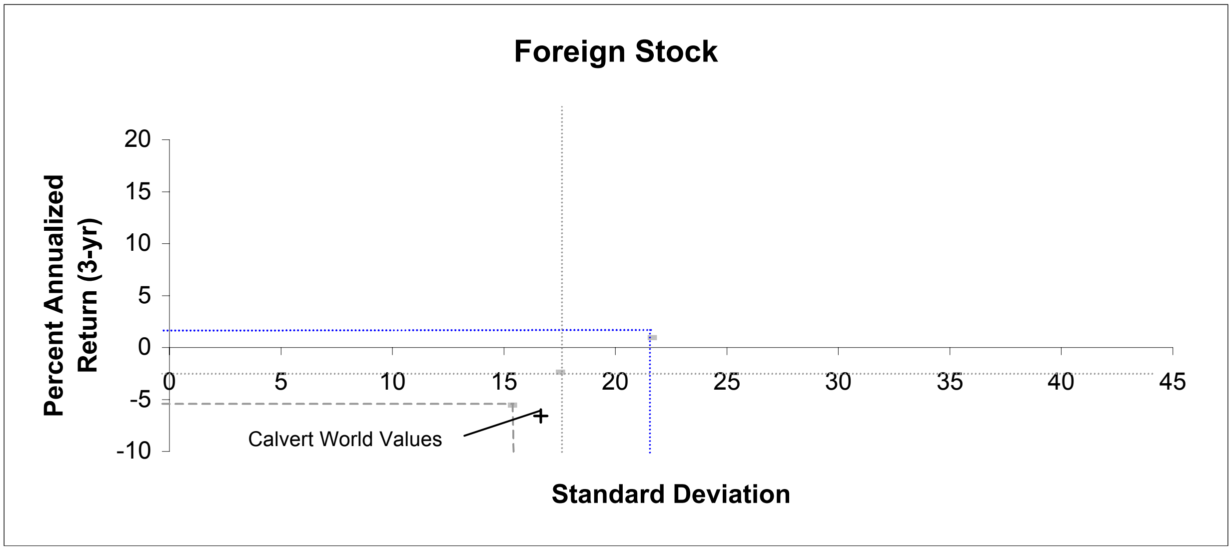
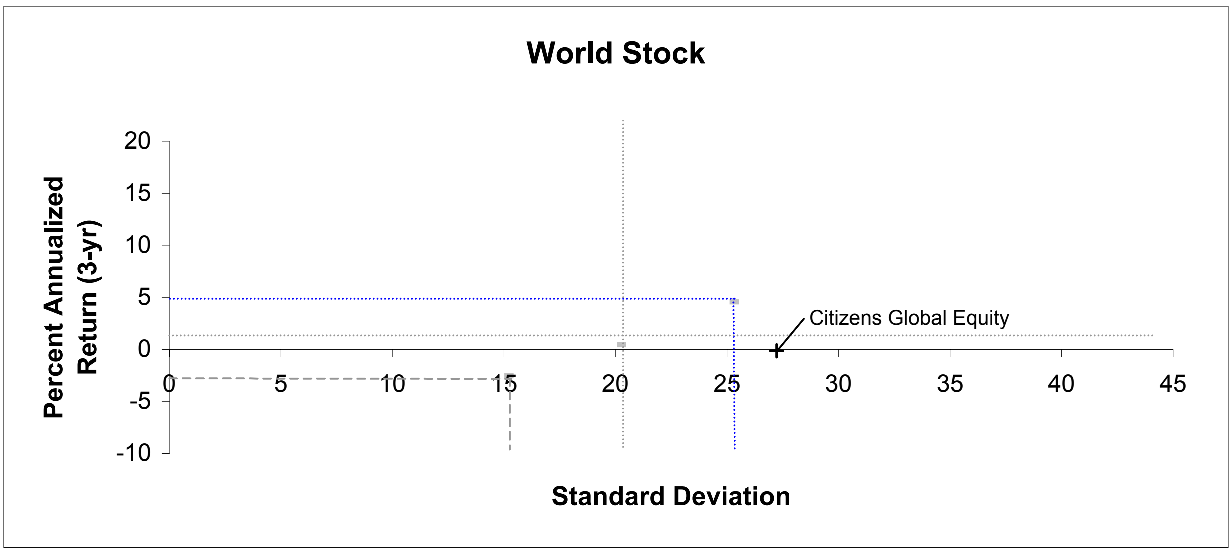
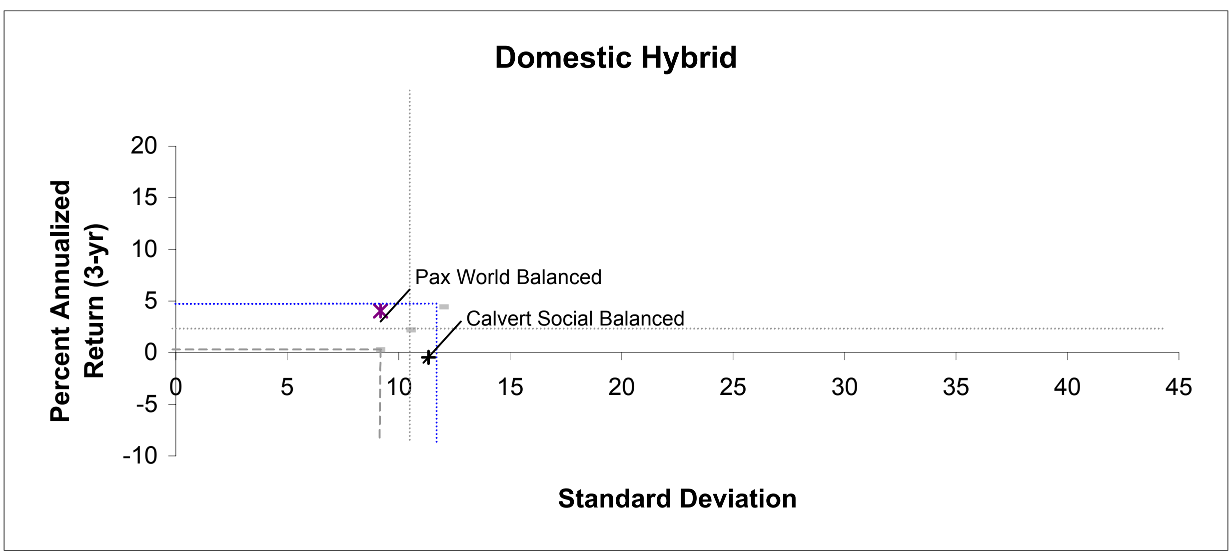
20
25
30
35
40
45
Parnasus Equity
Neuberger Berman
Standard Deviation


Foreign Stock
20
15
10
5
0
-5
-10
Percent Annualized Return (3-yr)
0
5
10
15
20
25
30
35
40
45
Calvert World Values
Standard Deviation


World Stock
20
15
10
5
0
-5
-10
Percent Annualized Return (3-yr)
0
5
10
15
20
25
30
35
40
45
Citizens Global Equity
Standard Deviation


Domestic Hybrid
20
15
10
5
0
-5
-10
Percent Annualized Return (3-yr)
0
5
10
15
20
25
30
35
40
45
Pax World Balanced
Calvert Social Balanced
Standard Deviation