Portfolio strategy

Good corporate citizen, better investment

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Smart investing means containing risk, but how?

Diversifying with stocks and bonds or guaranteed investment certificates is what protects you against the kind of stock market volatility we saw this week, but there’s another aspect to risk. It relates to a company’s behaviour in the community, the boardroom, the environment and in dealings with employees.

Concentrating on companies that score well in these areas is called responsible investing (RI) and it’s a quietly hot trend in the investment business. “It’s the fastest growing area of my business,” said Patti Dolan, an adviser who specializes in RI investing with Raymond James in Calgary. “I don’t actually prospect [for clients] – people call me.”

The Responsible Investment Association, representing investment companies, advisers, research firms and others, says retail and institutional (pensions, foundations and such) assets that have at least some degree of RI screening applied jumped 68 per cent to more than $1-trillion in 2012-13 alone. RI mutual fund assets grew 52 per cent over that period, compared to 30 per cent for the broader fund industry.

RI investing has been around for decades and used to be known as socially responsible investing, or SRI. The relatively recent name change reflects a more business-like approach. Where SRI began as a way to screen out companies in areas like armaments, tobacco and porn, RI is more about addressing a broader range of issues that can affect the case for owning a stock. If you buy financially sound companies that are well-governed, treat their employees and the environment well and are good in the community, you minimize risk.

“The trend over the past 15 years has been to focus more on risk management,” said Deb Abbey, CEO of the Responsible Investment Association. “There’s more and more evidence that this has an impact on portfolio performance.”

Ms. Abbey cites a 2012 study by Deutsche Bank Climate Change Advisors that found environmental, social and governance factors – they’re called ESG – were correlated to higher market returns for stocks. Basically, the best ESG performance was rewarded with higher share prices.

Here's a real-life example: Canada's only RI exchange-traded fund, the iShares Jantzi Social Index ETF (XEN-TSX), delivered an average annual total return of 8.1 per cent over the last five years to July 31 (that's share price gains plus dividends). The comparable iShares S&P/TSX 60 Index ETF (XIU) made 7.4 per cent.

The Jantzi ETF highlights RI's appeal, but also a weakness relevant to individual investors. If you want to be a responsible investor, the selection of products available is thin and challenging to research. ETFs have been gaining popularity in recent years because of their low fees and transparency, but XEN is the only broadly diversified responsible ETF investing option on the TSX. There are a few others listed on the New York Stock Exchange, as well as some clean energy options. But, for the most part, people interested in responsible investing must use mutual funds with fees that can be comparatively expensive to own.

Comparing RI funds to see if they match your values as an investor can be laborious. "Clearer information on their mandates would be useful so we know what they're trying to accomplish," said Tyler Field, an RI specialist at Starboard Wealth Planners in Halifax.

More clarity would be a particular help to investors interested in a growing sub-theme of RI that seeks to avoid companies involved in production of fossil fuels like oil and coal. The general council of the United Church of Canada voted recently to eject fossil fuels from its investments and move money to renewable energy. Late last year, Concordia University in Montreal became the first university in Canada to start the process of selling off its holdings in stocks related to fossil fuel.

RI mutual funds have long used a "best in sector" approach, which means there will be oil and gas stocks. There's an argument that by owning the shares of these companies, RI investors can engage them and try to advocate for better corporate practices. But lately, some RI funds have either eliminated fossil fuel producers from their portfolio or begun the divestment process.

Examples of funds that do not invest in fossil fuels are IA Clarington Inhance Global Equity SRI Class and AGF Global Sustainable Growth Equity Fund (here's a link to AGF's thinking on fossil fuel divestment). NEI Investments, a big player in RI through its Ethical mutual fund lineup, is an example of a firm that believes in engaging the most responsible fossil fuel companies and does not plan to divest.

Laurie Stephenson, principal of Halifax's Starboard, said she primarily uses three mutual fund companies for RI clients – the Inhance lineup at IA Clarington, NEI's Ethical funds and the Meritas funds from OceanRock. "We're trying to lobby to get more funds on the product shelf," she said.

Ms. Dolan of Raymond James in Calgary uses RI mutual funds for smaller client accounts and portfolios of 30 or so individual stocks for large accounts. The Canadian, U.S. and international stocks are chosen with the help of in-house money managers and tend to be listed in RI indexes like the Dow Jones sustainability indexes, the Corporate Knights Global 100 most sustainable companies index, the FTSE4Good Index, Jantzi Social Index and MSCI ESG indexes.

Stocks that may appear in client portfolios include Northland Power, a renewable energy company; Sun Life Financial, an insurance company that scores well on governance, promoting community wellness and the environment; and Apple Inc., because of its use of renewable energy.

Ms. Dolan believes interest in RI picked up after the financial crisis in 2008 left people disillusioned with the behaviour of large companies and their executives. More recently, she sees social media helping to make people aware of responsible investing. The result is an increase in interest from clients, and invitations to speak on the topic. Later this year, she will do a speech on responsible investing for a group of lawyers. “It’s amazing who’s asking about it.”

Coming soon

A closer look at responsible investment tools and investment options.

The Responsible Investor

Two investment advisers show how they would structure portfolios for two different types of investors interested in responsible investing, which focuses on companies that are strong on the environment, social issues and governance.

Adviser: Patti Dolan, Raymond James in Calgary	
Investor Profile One: A millenial with $25,000 to invest and a preference for no fossil fuels	
IA Clarington Inhance Growth SRI Portfolio	
IA Clarington Inhance Global Equity SRI Class	30.50%
IA Clarington Inhance Cdn Equity SRI Class	29.10%
IA Clarington Bond Fund	26.20%
IA Clarington Inhance Monthly Income SRI Fund	13.50%
Cash	0.70%
Notes:	
- total portfolio management expense ratio is 2.5 per cent; *- has a "fossil-free" divestment policy*	
Investor Profile Two: A boomer with a large portfolio who is broadly interested in responsible investing	
30+ stocks chosen for profitability, lower volatility, RI factors and tailored to the investor's values. Some stocks that might be included in such a portfolio:	
Apple (AAPL-Nasdaq)	

Adviser: Patti Dolan, Raymond James in Calgary	
BT Group PLC (BT-NYSE)	
CIBC (CM-TSX)	
GlaxoSmithKline PLC (GSK-NYSE)	
Mastercard (MA-NYSE)	
Novo-Nordisk (NVO-NYSE)	
Rogers Communications (RCI.B-TSX)	
Sun Life Financial (SLF-TSX)	
Adviser: Laurie Stephenson, principal at Starboard Wealth Planners in Halifax	
Investor Profile One: A millennial with $25,000 to invest and a preference for no fossil fuels	
Starboard Wealth Planners Aggressive Retail Portfolio	
NEI Ethical Special Equity Fund Series A	25%
IA Clarington Inhance Cdn Equity SRI Class A	15%
IA Clarington Inhance Global SRI Class A	25%
Meritas Intnl Equity Fund Series A	20%
AGF Global Sustainable Growth Equity Fund	15%
Notes:	
- this investor would have a high risk tolerance; *- 40 per cent of the portfolio is fossil fuel free funds, the rest is low on fossil fuels;* *- total management expense ratio is 2.86 per cent;* *- portfolio risk has been lower than for Canadian and international stock indexes*	
Investor Profile Two: A boomer with a large portfolio who is broadly interested in responsible investing	
Starboard Wealth Planners Ethical Income Portfolio	
Meritas Monthly Dividend and Income Fund Series F	20%
IA Clarington Inhance Cdn Equity SR Class F	10%
NEI Ethical Select Conservative Portfolio Series F	15%
NEI Cdn Bond Fund Series F	15%

Adviser: Patti Dolan, Raymond James in Calgary	
NEI Ethical Global Equity Fund Series F	15%
IA Clarington Inhance Global Equity SRI Class F	10%
Meritas U.S. Equity Fund Series F	15%
Notes:	
- this investor has at least 10 years until she needs to draw on this money; *- total portfolio cost is 1.67 per cent, including fund MERs and advice*	

SOURCE: PATTI DOLAN, LAURIE STEPHENSON