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First Socially Responsible Investing Portfolio Devoted to Diversity Launched

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Minority-owned Creative Investment Research conceived of the portfolio to promote corporate diversity while targeting women and minority investors for economic empowerment.

SocialFunds.com -- Socially responsible investing (SRI) has a long history of promoting corporate diversity through positive screens and shareowner advocacy--for example by filing resolutions for more race and gender diversity on the board or a commitment to sexual orientation non-discrimination. However, there has not been an SRI portfolio exclusively focusing on diversity until last week's launch of the ***Diversity Index Portfolio by Creative Investment Research***, a Minneapolis-based minority owned social investment advisory firm. The portfolio consists of between 40 to 60 large-cap US companies with strong diversity performance.

"While other socially responsible funds may consider workforce diversity as one factor among many, the Creative Investment Research Diversity Index Portfolio makes it the top selection criterion," explains Bill Cunningham, CEO of Creative Investment Research and the fund's investment advisor. "Companies in the Portfolio all have a proven track record in four key measures of diversity: human capital, CEO commitment, corporate communications, and supplier diversity. We research hundreds of companies each year, using data from multiple public sources including NAACP, Urban League, Operation PUSH, and others, and rank them on financial and diversity-related performance," Mr. Cunningham told SocialFunds.com.

Mr. Cunningham contends that strong diversity performance can correlate with strong financial performance. For example, back-testing of a model of the Diversity Portfolio resulted in significant outperformance, generating 11.35 percent returns over the one-year period ending July 25, 2006, compared to 5.02 percent for the S&P 500.

Bolstering this contention is the strong performance of the 2006 DiversityInc Top 50 Companies for Diversity Index, which measures the financial performance of this year's lists of the strongest corporate diversity performers as determined by DiversityInc, the field's foremost publication. Over a ten-year period, this index outperformed the S&P 500 by 24.8 percent and the Nasdaq by 28.2 percent.

The portfolio's top five holdings include Harris (ticker: HRS), BellSouth (BLS), Ikon Office Solutions (IKN), AT&T (T), and Embarq (EQ). Other holdings include Bank of America (BAC), Citigroup (C), Coca-Cola (KO), Ford (F), Procter & Gamble (PG), and Sprint (FON). The portfolio's exclusive focus on diversity (it applies no other SRI criteria) means it may contain companies screened by other SRI funds. For example, the CREF Social Choice Account, the largest SRI retail fund in the US with $8 billion in assets, recently dumped Coke when it was deleted for environmental, social, and governance reasons from the index upon which it is based, the KLD Broad Market Social Index (BMSI).

"While better than average on the diversity front, these firms are not perfect," admits Mr. Cunningham. "Creative Investment Research monitors the portfolio to maximize social return through advocacy, education, and consultation. I am a Quaker, so I believe in being proactive and collaborative," he adds. "We think selecting these companies based on diversity may allow for advocacy concerning other SRI issues--hopefully, we can make these firms better."

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The very structure of the portfolio may help facilitate this engagement. The portfolio is essentially a basket of companies chosen by Creative Investment Research for investment through FOLIOfn, an electronic investing platform.

"One of the great things about Folio is that it allows you to vote proxies, since shareholders are actually holding shares of stock in the individual companies directly, and not through a mutual fund company," says Mr. Cunningham. "We hope to educate shareholders about diversity issues and get them to advocate, too."

With an expense ratio ranging from 0.6 to 0.8 percent, the portfolio specifically seeks to attract women and minority investors, who typically have less investing experience and less money, according to Mr. Cunningham. In this way, it supports the economic empowerment of classes of people who have been historically disenfranchised. This dynamic at the individual investor level coincides with the goal of the portfolio at the corporate level of promoting social justice.

"Almost everyone agrees that equal opportunity is a laudable goal, and it has been codified in many laws in the U.S. Consequently, many people think the best way to achieve equal opportunity is a merit-based system that is completely colorblind," says Mr. Cunningham. "This is certainly the ideal, and one that we hope will be a viable solution in America someday. However, it makes one fatal assumption: that the history of injustice is no longer relevant to today's society," he adds. "Sadly, this is not true. Consequently, a colorblind outlook strikes us as hopelessly out of touch with the reality of life in the United States and the world," Mr. Cunningham concludes. "Fortunately, there are solutions, and we believe The Creative Investment Research Diversity Portfolio can be a positive force for social change."

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The Wall Street Journal - FUND TRACK
Pax May Bless Some 'Sin' Stocks
By DIYA GULLAPALLI, September 1, 2006; Page C1

Maybe sin isn't quite as bad as it sounds.

That is what Pax World Funds, one of the biggest of the "socially responsible" mutual-fund families, has decided. In a few weeks, the company will hold a shareholder meeting where it will take action on the most significant change to its investment practices since it was launched about 35 years ago.
[track]

Socially responsible investing, or SRI, generally involves avoiding so-called sin stocks -- for instance, breweries, casinos and weapons makers. Pax was one of the first to give this strategy a try, and has maintained its approach since its founding by two Methodist ministers in Portsmouth, N.H.

Now, Pax wants to tone down that objective. Shareholders in August were sent a proxy statement to vote on whether to eliminate a zero-tolerance policy specifically against alcohol and gambling. The change would enable Pax to selectively invest in these industries based on a company's "entire social-responsibility profile."

But in other areas, the fund is trying to add new ways to screen out companies it might disapprove of. Shareholders will also vote on whether fund managers should consider a company's record on environmental issues, for instance.

These shifts illustrate how SRI funds are trying to tweak their strategies amid sagging returns. SRI investors are sometimes willing to exchange a few points of returns for socially conscious stock picking.

But many SRI funds have faltered because they tend to focus on "large growth" stocks, or big companies that offer fast-climbing earnings, an area that has done poorly in recent years. Large-growth funds have returned about 1% in the past year, but large-growth SRI funds have returned just 0.21% for the 12 months through July. Pax World Balanced Fund has returned only 4% in the 12 months through July, trailing more than half its peers.

By contrast, funds like Vice Fund -- which actively seeks out sin stocks -- have handily beaten most SRI funds recently. In the past three years, Vice Fund has posted a 20% average annual return.

A host of other SRI funds are also fiddling with their approaches. In December, Domini Social Investments LLC will abandon its traditional approach of passively tracking an index of socially responsible companies in its Domini Social Equity Fund, and instead will become an actively managed fund, picking its own stocks to invest in. Last year, it launched a new fund, Domini European Social Equity Fund, which was actively managed from the start. In May TIAA-CREF, the teacher's-pension giant, announced the formation of a new social and community investing department, and Ariel Capital Management LLC started Ariel Focus Fund last year.

In recent months, a slew of new SRI funds have cropped up that reflect this changing landscape. Parnassus Workplace Fund started last year to focus on companies that treat employees well, **and minority-owned Creative Investment Research in Minneapolis launched the Diversity Index Portfolio this summer that uses employee diversity as a selection criterion.**

Even exchange-traded funds, which trade on exchanges like stocks, are getting in on the do-gooder action. Barclays Global Investors has an SRI ETF and filed with regulators in August to launch another, iShares KLD 400 Social Index Fund, which would track a popular SRI index.

For Pax, the move comes after it had to sell a lucrative stake in Starbucks Corp. last year when the company set up a deal to launch a coffee liqueur with whiskey maker Jim Beam. The funds' 375,000 shares were valued at $23.4 million at the time, and had to be relinquished even though some SRI researchers estimate liquor-related sales contributed less than 1% to Starbucks's revenue. Similarly, Pax sold its stake in Yahoo Inc. last year after discovering that company had business ties to Internet gambling.

"I thought these were absurd results," says Joe Keefe, Pax's chief executive, who took that job last year. Mr. Keefe says he voiced this opinion during his interview for the job, and has been reading competitors' prospectuses to decide the best way to change the wording of Pax's own mandate.

SRI experts think dropping the ban on alcohol and gambling makes sense for Pax, because it will still try to avoid companies that derive substantial revenue from these areas. The company saw its biggest inflows in its history last year, roughly doubling its assets to more than $2 billion across its funds, and it is continuing to expand.

On Tuesday, Citizens Funds, another SRI fund company in Portsmouth, disclosed in a filing that it has signed a nonbinding letter of intent for Pax to buy its funds, which have about $800 million in assets. Terms weren't disclosed.

"I think it makes sense what they're doing," says Bill Rocco, an analyst who helps cover SRI funds for Morningstar Inc., the fund-research company. Some of his family members own Pax World Balanced Fund, he says, but "I also drink beer in moderation."

Jay Falk, president of SRI World Group Inc., a research company, agrees. "A screen on alcohol is a bit puritanical," he says.

The Pax funds are also taking steps to focus more on the corporate governance of the companies they invest in, such as whether the board of a company is sufficiently independent from management.

Separately, the Securities and Exchange Commission has been inquiring into issues related to the financial reporting at Pax's high-yield funds for more than a year. The SEC is also looking at potential conflicts of interest, given that the family of Pax's chairman owns Pax World Management Corp. and part of Pax's distribution company. Mr. Keefe declined to comment about the SEC inquiry.

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Other SRI funds say they won't change their own sin-stock mandates just yet, with each varying slightly in guidelines like numerical cutoffs. Domini generally doesn't invest in companies that derive more than 1% of sales from alcohol production or more than 15% from alcohol retailing. Sometimes it can be even stricter than that. Domini decided not to buy toy maker Hasbro Inc. a few years ago despite the fact it made less than 1% of its money from licensing its Monopoly brand name to casino slot machines. Domini concluded it was inappropriate to use a children's game for gambling purposes.

For now, alcohol and gambling is "a place where Domini is not going to change," says Jeffrey MacDonagh, an SRI portfolio manager at Domini.
Ariel Capital Management, another large SRI fund company, doesn't screen for alcohol or gambling but does avoid tobacco and weapons companies. Unlike Domini, this has allowed the Ariel Fund to hold Hasbro among its 40 or so stock positions. Another SRI fund group, the Calvert Funds, won't invest in companies that derive more than 20% of revenue from selling or distributing alcohol, or 10% from weapons sales.

Still, such funds have changed other screens in recent years. Ariel added a screen against handguns in 2003, and Calvert added one about preserving the rights of indigenous people in 1999. Others have added more contemporary factors like nondiscrimination based on sexual orientation.

How Will SRI Screens Evolve?

Article published on Aug 18, 2006
By Lisa Lacy

There's a new fund in the socially responsible universe that is homing in on diversity as its No. 1 selection criterion. While the extremely focused strategy and its future effectiveness are being met with mixed reviews, its very existence may speak to screens in the future.

The fund, the Diversity Index Portfolio from Creative Investment Research, intends to promote diversity and target women and minority investors.

There aren't many socially responsible funds that use a similarly narrow focus, observers say, but the **Diversity Index Portfolio** isn't entirely alone. The Women's Equity Fund, which launched in 1993, invests in companies that "advance the social and economic status of women in the workplace."

"The reason we started in the first place was to use the power of shareholders and their right to have a dialogue with the company to break the glass ceiling," says Linda Pei, president of Women's Equity.

The fund screens company stocks to make sure there is an adequate number of women on the board and in senior management. It also screens to make sure women are paid equally and that the employer offers benefits such as child care.

After 13 years, the fund has more than $35 million under management without doing much in the way of advertising.

But Pei had to start from the ground up, using the fund to attract clients one at a time rather than starting out with an existing client base. An overwhelming 90% of the shareholders today are women.

And Pei sees big potential. "If all working women understood why we have this fund and how powerful our message is, the fund could easily be $1 billion or more," she says. "I also know from listening to those who finally find us and invest in the fund. Their passion confirms my belief."

Passion is certainly a core element in socially responsible investing and has been since the beginning. But as the number of SRI funds grows, there is also a greater opportunity to diversify, along with more screens that have entered the mix, says Steve Schueth, president of First Affirmative Financial Network, an RIA that specializes in managing portfolios for socially conscious clients.

He speaks of a "palate" that has changed based upon "things people care about." Those concerns range from events that took place in South Africa in the mid- to late 1980s to environmental concerns in the early 1990s and, most recently, corporate governance.

But not everyone agrees that the screens have seen major changes. For his part, Lipper senior research analyst Jeff Tjornehoj feels screens have largely remained the same over the years.

Anita Green, vice president of social research at the $2.2 billion Pax World Funds, says both diversity and the environment have been important screens for the firm's SRI funds from the very beginning. Interestingly enough, Green says Pax has found advocacy, or trying to invoke change at a company it invests in, more effective than trying to find firms that are socially conscious from the beginning.

But if what Schueth says is true, what happens next?

Bill Cunningham, CEO of Creative Investment Research, expects to see more fully developed screens and funds in the future. "The market sees the need for additional investing styles and screens," he adds.

While not exactly advocating Cunningham's strategy per se, Schueth says part of the reason for growth in the SRI industry is investor demand. And growth is also an important factor in the launching of new funds. Because it is an industry that has reached a certain level of maturity, there are new providers that are trying to carve out their own niche where they can dominate, such as the Women's Equity Fund.

The question is whether there are enough investors for these focused funds. Many, including Schueth, argue that most socially conscious investors care about more than one issue and might not be attracted to a fund that stakes its claim solely on diversity.

However, pointing to Pei, Social Investment Forum president Tim Smith says the very fact that the Women's Equity Fund has existed for so many years using similar criteria bodes well for Cunningham, and that he can have "a profitable fund as well as a fund that's responsive to social issues."

Not everyone is so optimistic. Lipper's Tjornehoj says the Women's Equity Fund "hasn't developed into a name brand."

Furthermore, he says sometimes it's an uphill battle to convince people that a particular brand of socially conscious investing is better than another because they're essentially cannibalizing other socially responsible funds.

Detractors also say most socially responsible funds already use diversity as one of many screens.

Tjornehoj expects the Diversity Index Portfolio to have some trouble attracting assets unless there's initial backing for an expensive marketing campaign or it has been tied in with a sponsorship deal with a progressive group.

The problem is that "diversity is not necessarily an investment strategy — it's a value," Tjornehoj says.

Perhaps these funds are just a bit before their time.

Schueth says, "[The fact that] there are no other funds that take this very focused approach is telling in that maybe the market is not quite ready."

He mentions a gay and lesbian fund that was eventually absorbed into a fund with a broader set of criteria.

Investors who are attracted to these very specific funds — and socially responsible investors as a whole, for that matter — tend to be very loyal as their investments are tied to beliefs, and so their "money tends to be sticky," Tjornehoj says.

Smith notes that such funds market to a very specific clientele and have the added bonus of finding companies that are innately good rather than merely weeding out the bad ones.

In the early days, Schueth says, "it was all about avoiding the bad guys. Today it's far more about finding the best companies because the avoidance stuff is really easy."

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Index opens new front in ethical investing

-A portfolio of stocks based on a company's diversity was created last month in Minneapolis. No Minnesota firm is in it.

Kara McGuire, Star Tribune

There are investment portfolios that shun tobacco and alcohol companies and portfolios that appeal to different religious groups.

Why not one that makes choices based on a company's diversity practices, thought Bill Cunningham, an investment adviser and CEO of Creative Investment Research Inc. So he created the Diversity Index Portfolio last month from his office in Minneapolis' Uptown.

The portfolio, for which he will make buy, sell and rebalancing decisions only once a year, consists of 40 to 50 stocks, including the likes of Coca-Cola, Wells Fargo, Federated Department Stores, Time Warner, even Ford. Not a single Minnesota company is on the list.

Cunningham, the sole adviser, picks companies based on the number of racially diverse, gay, lesbian, transgendered, female or disabled employees and board members; senior management's commitment to diversity through policies such as domestic partner benefits and whether they communicate those policies to the public, and the volume of business a company does with diverse suppliers.

He also factors in basic financial fundamentals so a company with great diversity practices and awful performance won't make the cut.

Part of the reason for a lack of Minnesota companies in the portfolio is size. The portfolio tracks large-cap companies, defined as those with more than $10 billion in market value. Except for companies in the league of Target and UnitedHealth Group, the majority of Minnesota-based companies are too small.

But the omission also speaks to the need for the state to attract a more diverse population and to reduce the income and education gap between the racial groups that live here today, Cunningham said.

"If there's one company that's likely to be in future portfolios it's probably Target," he said, although to date he feels it has underperformed compared with others in its industry. He omitted UnitedHealth Group largely because of its corporate governance practices. And General Mills, an award-winner for its diversity efforts, lost to Kraft Foods. "[Kraft] just does a better job getting the message [about diversity] out there," he said.

For Minnesota companies to make the grade, Cunningham wants to see more diversity awareness training, mentoring and multicultural marketing.

Investing with heart

The number of socially responsible investment choices almost quadrupled in the past decade, from 55 mutual funds in 1995 to 201 last year, according to the Social Investment Forum's 2005 Trends Report.

Values-guided investment doesn't mean sacrificing return. Cunningham's index would have beaten the Standard & Poor's 500 index of large-company stocks over the one-year period ended Sept. 13, returning 17.63 percent vs. the S&P 500's 9.46 percent. Cunningham believes that companies sensitive to diversity will outperform competitors that are less so, because employees will be less likely to leave and more likely to be innovative in an environment where they feel included.

Cunningham hopes the portfolio will grow to $1 billion in five years and will attract pension plans, 401(k) providers and individual investors. But while the portfolio is ready to accept money, no one has invested, not even Cunningham.

He blames inertia, not a lack of confidence, and plans to transfer money from other assets in the next couple of months. Personally, I prefer investments with a manager who has some skin in the game.

An Ohio-based supermarket company and two Illinois-based pension funds are considering the portfolio, he said.

The hesitation may stem from Cunningham's nonexistent track record managing a stock portfolio. His background is in financial research, consulting and managing mortgage backed securities for pension funds.

Can go it alone, with time

Individuals could substitute the Diversity Index Portfolio for a broader index of large-company stocks such as the S&P 500, although it's heavier on financial, automotive, consumer discretionary and utility stocks and lighter on technology and oil companies. It also wouldn't be too difficult to create a diversity portfolio of one's own using diversity stock lists published by magazines such as Diversity Inc. and Hispanic Business, although you'd have to have a lot of time for analysis and a lot of money lying around to buy shares of 50 stocks.

Unlike investors in mutual funds, investors in Cunningham's portfolio, which he manages online using a service called Foliofn (www.foliofn.com), own shares of stocks directly. The platform costs a fraction of a traditional brokerage, keeping the portfolio's expenses to 0.80 percent of the fund's assets plus a $25 annual account fee.

Direct shareholders can voice their opinions about company practices at shareholder meetings or through proxy voting. Mutual fund investors can vote on fund matters but not on matters of the companies held in the fund.

He thinks a portfolio that allows investors to get more involved and incite change within corporate America will appeal to Minnesotans, who he said have a history of "community sensitivity and social responsibility." Cunningham also hopes the portfolio will do well with women, people of color and others who are likely to have experienced insensitivity and discrimination at work and would want to invest in companies committed to preventing such experiences from happening within their walls.

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