VOLUME 18
NUMBER 1
2017

Do Social Responsibility Screens Matter When Assessing Mutual Fund Performance?

Reviewed by Devin Ekberg, CFA®, CPWA®

Socially responsible (SR) mutual funds are suddenly a major market for the asset management industry, growing rapidly in the past decade to more than $8 trillion USD in assets under management in the United States in 2016 (Social Investment Forum 2016). Much has been written, and many opinions formed, about the merits of SR screening in general and its performance in particular. Researchers Brière et al. (2017) propose a new approach to isolate the effects of SR screening in mutual funds when conducting performance-attribution analysis.

Previous studies relied on sample comparisons of average mutual fund performance, matched with conventional peers or a benchmark index. Although informative for making broad conclusions on the merits of SR screening, the results tend to mask subtle insights such as the level of dispersion in returns, industry or style effects, or situational performance.

In contrast, the proposed method builds on an existing model using three classic determinants of the variability of portfolio performance—market return, asset allocation policy, and active portfolio management—identified by Brinson et al. (1986) and later clarified by Xiong et al. (2010). A fourth component, the effects of SR screening on a fund's return variability, is added to disentangle the effects of other sources of performance, especially active management.

Brière et al. (2017) used data from two portfolio peer groups, U.S. and global equity funds classified as "socially responsible" or ""ESG' (environmental, social, governance)." The researchers performed return-based style analysis to determine both SR and conventional benchmarks for the funds, allowing them to characterize the funds' performance. Additionally, they constructed geographic, industry, and style benchmarks. Once the proper benchmarks were identified and constructed, they screened the compositions to include "all the companies that were rated strictly above BBB by the MSCI ESG STATS database for corporate social responsibility."

Performing a series of multi-factor regressions, in line with the previous performance variability studies mentioned earlier, the results showed that SR screening contributes modestly to the variability of mutual fund performance, along with asset allocation policy and active management. The contribution "is, on average, between 4% and 10%," or about half the average contribution made by active management.

Although this analysis highlights the role SR plays in the variability of returns, prior empirical evidence that absolute returns for SR funds and traditional funds, on average, are rather similar still stands. These facts may help soften some critics' view that an SR approach is a certain path to underperformance. In other words, SR investors "can achieve portfolio performance equivalent to that of conventional funds while also achieving socially responsible objectives."

Indeed, equal performance is at least the minimum threshold for SR investing compared to the traditional approach. But the research also shows diversity of the SR contributions along geographic, industry, and style factors. The new methodology allows for the detection of additional investment opportunities and the possibility for an SR portfolio manager to not only avoid underperformance but perhaps achieve superior performance results.

Devin Ekberg, CFA®, CPWA®, is the managing director of education at Investments & Wealth Institute. Contact him at dekberg@i-w.org.

REFERENCES

Brière, M., J. Peillex, and L. Ureche-Rangau. 2017. Do Social Responsibility Screens Matter When Assessing Mutual Fund Performance? *Financial Analysts Journal* 73, no. 3: 53–65.

Brinson, G. P., L. R. Hood, and G. L. Beebower. 1986. Determinants of Portfolio Performance. *Financial Analysts Journal* 42, no. 4: 39–44.

Social Investment Forum. 2016. *Report on US Sustainable, Responsible and Impact Investing Trends 2016*, 11th ed. (www.ussif.org/trends).

Xiong, J. X., R. G. Ibbotson, T. M. Idzorek, and P. Chen. 2010. The Equal Importance of Asset Allocation and Active Management. *Financial Analysts Journal* 66, no. 2: 1–9.