

SRI Funds deliver once again

Once again the median sustainable (or socially) responsible fund has outperformed the S&P/ASX 200 over one, two, three and five years. As per previous studies of the industry by AMP Capital Investors, the SRI median returns underline that considering social and environmental factors is providing insights towards selecting better performing companies.

The results draw together the median returns of the 12 Australian SRI Funds in the periods to 30 June 2007. Unlike earlier studies, there is now a track record of the full universe (ie all 12 funds) over all periods analysed, including five years.

Relative returns have been particularly strong in recent times with the SRI Median Fund outperforming the benchmark index by over 1.5% over 1 year and 2.0% in the 2 years to 30 June 2007.

SRI industry outperforms

In table 1, the SRI median results are compared to the returns of the ASX 200, in addition to the performance of the growth, value and small-companies indices¹. The SRI Median calculates the median monthly performance returns of Australian shares SRI funds². It draws together SRI Managers' returns from both wholesale and retail investment manager surveys³.

The period has also been characterised by strong absolute returns, with the SRI Median delivering 30.2% over one year, 26.7% over three years and 19.3% over five years.

Returns

	1 year	2 years	3 years	5 years
ASX 200	28.66%	26.27%	26.30%	19.22%
SRI Median	30.21%	28.34%	26.67%	19.29%
SSB Value	29.29%	25.48%	25.50%	19.29%
SSB Growth	27.97%	28.76%	29.37%	20.70%
Small Ords	44.43%	34.62%	32.17%	24.88%

With a significant depth of the universe over five years (12 funds), this study may provide greater insight for investors who often look over longer time frames to make an assessment of the success of an investment approach.

Comparable risk levels

To provide a risk indicator, we show in Table 2 below the standard deviation of the SRI Median relative to the value, growth and small cap share indices over the same periods. The SRI Median risk level

is between the value and growth indices, indicating a moderate outcome. Again this trend has been consistent over the last couple of studies.

Risk

	1 year	2 years	3 years	5 years
ASX 200	6.02%	8.60%	8.33%	8.95%
SRI Median	6.25%	9.02%	8.88%	9.68%
SSB Value	5.46%	7.50%	7.40%	8.57%
SSB Growth	7.18%	10.71%	10.02%	10.27%
Small Ords	7.74%	9.45%	10.40%	10.51%

Performance in value and growth markets

The SRI Median has delivered outperformance in both Value and Growth markets. Over all periods the SRI Median outperformed the S&P/ASX 200.

These returns point to the quality insights that can be delivered from environmental and social factors across a range of market conditions. Some of these longer term issues we address later in the paper (and in earlier documents).

With respect to market specific issues it is interesting that some SRI fund relative returns (in the year to 30 June 2007) benefited from being underweight (and not holding) companies who returned below the broader share market (ASX 200) including: PBL (7.6%) and Fosters (16.6%).

Some SRI Funds will also have benefited from being overweight small companies which are focused on emerging sectors and have strong sustainability orientation.

Global market themes supportive

Global market themes have also been driving better returns from environmentally oriented companies. This has been evident in the international SRI Funds, with the median return of international funds (within the Mercer Wholesale June 2007 survey) clearing the benchmark MSCI World by over 1.9% over one year and 1.2% over three years. Some key themes which have been delivering strong returns for international SRI Managers include cleaner energy, environmental services and water⁴.

While there a range of factors at play here, one of the drivers in this area has been the formalisation of carbon markets, associated with the implementation of legal framework for pricing and trading carbon. In Europe after establishment in 2005, the carbon market has grown rapidly, with \$US24 billion trades occurring in 2006. Additionally, in voluntary markets some 23.7 million tonnes of carbon dioxide were traded in 2006.

It will be interesting to see the impact of a carbon trading regime in Australia on local securities. This trading regime is mooted for 2012, regardless of which political party is in power.

Stronger longer-term outperformance

The competitive returns of SRI Managers continue to be supported by long term environmental and social drivers. There is an ever-growing body of evidence that if a company manages its social and environmental issues well, it will also be more likely to deliver better financial performance.

Below are some key findings of our studies on the sector.

Growing role of intangibles

AMP Capital has analysed the growing contribution of intangibles in the valuation of companies, specifically we have assessed that as at 31 December 2006, in the ASX Top 100, 77% of valuations could be attributed to intangibles. These include such factors as employee and customer relationships, supply chain and intellectual property, which can be extensively linked to a company's performance on environmental and social issues.

AMP Capital 'Financial Payback' study

In 2005, AMP Capital produced a statistical study, the results of which support the proposition that companies with higher ratings on corporate social responsibility on AMP Capital's internal ratings outperform the lower rated companies over four and 10 years to 31 December 2004⁵ at a statistically significant level.

Studies considering links to company and social and environmental performance

A range of non-AMP Capital studies have also found that links exist between social and environmental and financial performance.

Some of these studies include:

Waddock and Graves⁶ (1997) found strong positive correlations between market measures of management quality (from the Fortune 500 'Most Admired Companies' list) and social indicators (such as employee, customer and community relations).

Griffin and Mayor⁷ (1997) reviewed more than 50 studies from 1970–1994 on the relationship of sustainability and financial performance. They concluded 33 studies showed positive relationships between environmental/social indicators and financial performance, nine were neutral/unclear and 20 studies were negative.

Statman⁸ (2000) found socially responsible investors performed better than conventional funds of equal asset size.

Orlitzky, Schmidt and Rynes⁹ (2003) performed a meta-analysis of 52 studies on the relationship between corporate social

performance and corporate financial performance. The study found a positive and statistically significant association between these factors across various industries.

Conclusion

Once again the Australian SRI median fund has been delivering competitive returns, posting outperformance of the ASX/S&P 200 over one, two, three and five years to 30 June 2007. These findings are consistent with earlier AMP Capital studies and run in parallel with a range of international studies on the impact of analysing social and environmental factors that point to the long term competitive nature of SRI funds.

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- 1 SSB Value is the Salomon Smith Barney Value Index, SSB Growth is the Salomon Smith Barney Growth index while the small companies index is the ASX/S&P Small Ordinaries Index.
- 2 We have attempted to identify any SRI Manager as at 30 June 2007 which have publicly available Australian equity histories of 12 months or more. The 12 Fund histories we have used are the AMP Capital Sustainable Future Australian Share Fund, Australian Ethical Equities Trust, BT Institutional Australian Sustainability Fund, BT Institutional Ethical Sector Trust, Challenger Socially Responsive Investment, Hunter Hall Australian Value Trust, ING Sustainable Investment Trust, IOOF Wholesale – Socially Responsive Shares Trust, Perennial Socially Responsive Shares, Perpetual Ethical SRI Fund, SAM Sustainability Leaders Australia and Warrakiri Charitable Aust Equities. Performance is before fees and taxes.
- 3 Data is sourced from Mercer Australian Shares Specialist Survey and Morningstar Survey.
- 4 For example within Henderson Global Investor's Industries of the Future SRI Portfolio the top performing themes of Cleaner Energy, Environmental Services and Water Management each delivered over 30% in UK Sterling in the year to 31 December 2006.
- 5 Financial payback from environmental and social factors, M.Rey and T. Nguyen, AMP Capital Investors 2005, available at www.ampcapital.com.au
- 6 Sandra Waddock and Sam Graves, 'Finding the Link Between Stakeholder Relations and Quality Management', [<http://socialinvest.org/Areas/research/Moskowitz/1997.html>], January 2002.
- 7 As quoted by ABN Amro, 'Do Socially Responsible Equity Portfolios Perform Differently from Conventional Portfolios?', September 2001, p34.
- 8 Statman, Meir 'Socially Responsible Mutual Fund', Financial Analysts Journal, 2000.
- 9 'Corporate Social and Financial Performance: A Meta Analysis', Marc Orlitzky, Frank L Schmidt & Sara L Rynes, 2003, available at http://business.auckland.ac.nz/newstaffnet/profile/publications_upload/000000556_orlitzkyschmidtrynes2003os.pdf

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