

SRI managers outperform once again

In a difficult investment environment the median sustainable (or socially responsible) manager has outperformed the S&P/ASX 200 once again over one, two, three and five years. This outperformance over all periods analysed is consistent with earlier studies (2006, 2007), supporting the proposition that considering social and environmental factors can provide valuable insights towards selecting better performing companies.

The results draw together the median returns of the 12 Australian Socially Responsible Investment (SRI) managers in the periods to 30 June 2008.

Although still outperforming, relative returns have been affected in the last year in part by the poorer relative returns of small companies which SRI managers tend to be overweight in. Additionally the market has been characterised by negative returns in the last year, reflecting the impact of the global credit crisis and slowing economic conditions.

SRI industry outperforms

In table 1, the SRI median results are compared to the returns of the S&P/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 managers². It draws together SRI managers' returns from both wholesale and retail investment manager surveys³.

The recent period has been characterised by negative and subdued returns, with the SRI median delivering -13.35% over one year, 5.76% over two years and 11.72% and 16.39% over three and five years respectively.

Table 1: Returns as at 30 June 2008

| | 1 year | 2 years | 3 years | 5 years |
|------------|---------|---------|---------|---------|
| ASX 200 | -13.40% | 5.55% | 11.35% | 16.23% |
| SRI Median | -13.35% | 5.76% | 11.72% | 16.39% |
| SSB Value | -22.09% | 0.37% | 7.05% | 13.43% |
| SSB Growth | -5.19% | 10.15% | 16.27% | 20.23% |
| Small Ords | -20.46% | 7.18% | 12.97% | 18.42% |

Past performance is not a reliable indicator of future performance.

Comparable risk levels

To provide a risk indicator we show in Table 2 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 below the growth index over all periods and typically marginally above the risk of the S&P/ASX 200.

While the comparative risk levels are similar to earlier studies, it is worth noting that the overall market volatility has risen substantially in the last year reflecting the significant market moves investors have been experiencing. Previously standard deviation had been below 10% over all periods analysed and over one year at 6.25%, indicating a marked change in the investment environment.

Table 2: Risk

| | 1 year | 2 years | 3 years | 5 years |
|------------|--------|---------|---------|---------|
| ASX 200 | 16.80% | 13.59% | 12.78% | 10.95% |
| SRI Median | 16.07% | 13.64% | 13.17% | 11.33% |
| SSB Value | 16.61% | 14.12% | 12.84% | 11.03% |
| SSB Growth | 18.70% | 14.49% | 14.22% | 12.14% |
| Small Ords | 22.17% | 18.35% | 16.20% | 14.22% |

Relative performance in the face of poorer small company returns

The last five years to 30 June 2008 has been characterised by outperformance of the growth index vs the ASX 200. At the same time small companies have underperformed over one year, while outperforming over longer periods of time. Within this environment the SRI median has delivered consistent outperformance against the S&P/ASX 200.

These returns tend to support the view that quality insights 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).

In the year to 30 June 2008, the SRI median still managed to outperform the broader market, even though SRI funds are often overweight small companies. The small companies position can be due to a combination of negative exclusions of certain large companies and the targeting of more sustainable industries (eg renewable energy) which often have companies with smaller market capitalisation.

The better relative SRI returns in the past year can in part be explained by certain companies, which are typically avoided by SRI funds, falling considerably in value in the year to 30 June 2008. In particular both Tabcorp (-37.3%) and Tatts (-45.3%) Group were negatively affected by the loss of the Victorian Gaming Operation Licences and consequently their duopoly, effective from 2012.

This policy change led some to question what part social issues, such as problem gambling, played in the government acting to remove the protection of the large incumbents. Other stocks to fall below the S&P/ASX 200 included Aristocrat (-51.2%) and Gunns Limited (-22.9%).

Stronger longer-term outperformance

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.

Detailed below is some research, including AMP Capital findings in the area:

The growing role of intangibles

AMP Capital has analysed the growing contribution of intangibles in the valuation of companies. We have assessed that as at 31 December 2007⁴, in the ASX top 100, 75% of valuations could be attributed to intangibles. These include such factors as employee and customer relationships, supply chain and intellectual property. Work done by AMP Capital indicates that intangible factors 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 outperformed the lower rated companies over four and 10 years to 31 December 2004 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, environmental and financial performance.

Some of these studies include:

Waddock and Graves⁵ (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 Mayor⁶ (1997) reviewed more than 50 studies from 1970–1994 on the relationship of sustainability and financial performance.

They concluded that 33 studies showed positive relationships between environmental/social indicators and financial performance, nine were neutral/unclear and 20 studies were negative.

Statman⁷ (2000) found 'socially responsible investors performed better than conventional funds of equal asset size'.

Orlitzky, Schmidt and Rynes⁸ (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 manager has posted outperformance of the S&P/ASX 200 over one, two, three and five years to 30 June 2008. 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 2008 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 the Mercer Australian Shares Specialist Survey and Morningstar Survey.
4. Financial payback from environmental and social factors, M.Rey and T. Nguyen, AMP Capital Investors 2005, available at www.ampcapital.com.au
5. Sandra Waddock and Sam Graves, "Finding the Link between stakeholder Relations and Quality Management", [<http://socialinvest.org/Areas/research/Moskowitz/1997.html>], January 2002.
6. As quoted by ABN Amro, "Do Socially Responsible Equity Portfolios perform differently from Conventional Portfolios?", September 2001, p34.
7. Statman, Meir 'Socially Responsible Mutual Fund', Financial Analysts Journal, 2000.
8. "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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