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WEALTHREPORT

# Beware Socially Responsible Portfolios Being Overweight Stocks

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**There's a risk that too many ESG- and socially responsible-leaning investment ideas are over-exposed to stocks rather than asset classes. This article examines what the risks and alternatives are.**

*With the recent selloffs to markets weighing on minds and concerns about a spike in volatility, now is a suitable time to think about asset allocation. Setting up a suitable allocation takes a new turn these days because of the rising interest in environmental, social and governance-related (ESG) approaches to holding assets. These approaches come in different forms, such as when investors impose a negative screen to weed out companies, for example, that produce tobacco or pornography, or which pollute rivers and the air, or hire labor without suitable rights protections, etc. There are also other approaches where investors actively work with firms to make them change course. This is still an evolving area, and this publication continues to track it.*

*The advent of such ESG approaches has implications for investment decisions and the type of risks in a portfolio. And not all of the risks that might attend the various approaches are obvious at first glance. It is therefore very useful to carry these views from Elyse Cherry, chief executive of BlueHub Capital. The editors of this news service are pleased to share these views and invite readers to send in their feedback, but do not necessarily endorse all views of guest writers. Email tom.burroughes@wealthbriefing.com*

On August 22, the US stock market celebrated its 3453rd day of gains, becoming the longest running bull market in history. Since 2009, when the rise began, the S&P 500 has quadrupled. (1) Stock investors, including socially responsible investors, have seen dramatic increases. Even now, more than six weeks past this milestone, the S&P 500 and other major stock indices continue to rise.

Still, no bull market lasts forever. Though most market observers see no immediate trigger for a correction, as the yield curve flattens we are closer now to a market downturn than we were a year or two ago.

That's a particular problem for socially responsible investors, who have expressed their values via portfolios that are heavily weighted toward stocks. Only 15 per cent of the nearly 2,000 socially responsible funds tracked by Bloomberg invest in fixed income, while 62 per cent invest in equity. Assets under management in these funds are even more imbalanced with just 3 per cent of the $491 billion invested in socially screened funds allocated to fixed income (2).

Fortunately, socially conscious investors in search of fixed income exposure have a number of options. One is green bonds, or fixed income investments issued by companies, states, local governments, and non-governmental organizations to finance environmentally beneficial projects like renewable energy, pollution prevention, and conservation. Individuals can invest in green bonds through a number of focused mutual funds and ETFs, though some experts caution that the relatively small pool of issues available makes these funds concentrated and exposed to risk.

Another option, CDFIs or **Community Development Finance Institutions**, promote investment in economic and social equality, while providing competitive returns. CDFIs link low-income communities to sources of capital that have traditionally been closed to them, providing alternative financing for housing, business development, health centers, schools, and other institutions that support growth and inclusive prosperity. CDFI loan funds offer individual investors a number of compelling benefits.

They can provide attractive yields, even in the current low interest rate environment. For instance, Blue Hub Capital's Loan Fund now offers 3 per cent returns on all loans with a five-year maturity, even though our default rates are extremely low and reserve levels are high. Our loan loss rate over more than three decades is less than one-half-of 1 per cent and no investor has ever lost a dime.

CDFIs also offer a great deal of investment flexibility. Investment minimums are as low as $1,000, enabling even investors with modest assets to support values-based investments. Investors can tailor their holdings to their risk tolerance and time horizon, too, since CDFIs offer a range of maturities, from one to more than five years.

However, not all CDFI funds are equal. It's important to invest carefully. Look for funds that have a long history and a track record of delivering both financial performance and positive social impact. Issuers should be able to demonstrate a low default rate and a consistent ability to generate above-market yields.

Finally, people and their vision and expertise matter. Seek out funds with experienced, capable management teams and strong partnerships with local community organizations.

By adding CDFIs to socially conscious investment portfolios, investors can achieve competitive returns, reduce overall risk, protect against sudden sharp drops in stock prices and smooth out year-to-year variation in returns.

Just as importantly, CDFIs are more than just a vehicle for generating yield and reducing risk. Socially conscious investors can see real, measurable impact of their CDFI investments in underserved communities. For instance, BlueHub Loan Fund recently partnered with other CDFIs and organizations to provide financing for a $33 million loan to revitalize the former Swift Factory in north Hartford, one of Connecticut's poorest communities. The 82,000-square-foot Northeast Hartford development is expected to create an estimated 225 construction jobs and 150 permanent jobs and has already secured several anchor tenants, including a producer of food products for wholesale distribution to supermarkets and other retailers, and an indoor farming company that will grow fresh produce for the region. The project will also include a community health center, shared office space for local businesses, and an incubator with kitchen space for food businesses.

Other projects have funded schools, affordable housing, community health clinics and small business incubators, all initiatives that rebuild communities plagued by poverty, unemployment, foreclosure and poor educational prospects.

The rapid growth of socially conscious investment has coincided with the longest bull market for equities in history, and it's no surprise that many values-based investors have become overexposed to stocks. Now is a great time to rebalance socially screened portfolios by adding fixed income vehicles. Investors can reduce their overall exposure to risk while still making the world a better place, one dollar at a time.

**About the author**

Elyse Cherry is the CEO of BlueHub Capital, a mission-driven national nonprofit organization founded in 1985. Formerly known as Boston Community Capital, BlueHub Capital's mission is to help build healthy communities where low-income people live and work.

Footnotes

1. *"Market milestone: This is the longest bull run in history" by Matt Egan, CNN Money, August 22, 2018*

2. *"As ESG investments boom, asset managers seek out fixed income options," Bloomberg News, August 30, 2018.*