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VOLUME 25 | EDITION 04

Can I make an impact without sacrificing investment performance?

BY JAMES L. MCCABE

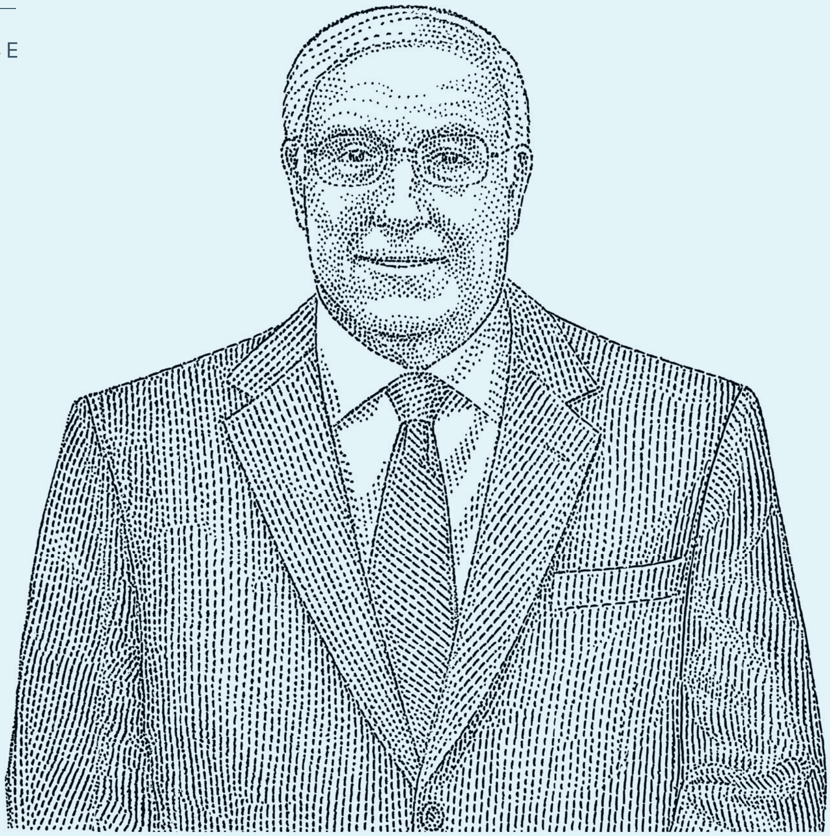

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ILLUSTRATION BY KEVIN SPROULS

Many acronyms and terms are associated with impact investing, including socially responsible investing (SRI); mission-related investing (MRI); and environmental, social and governance investing (ESG).

While each has specific attributes, all address the desire to align one's investments with a social cause or causes one believes in. In 2015 research by U.S. Trust, 85 percent of millennials, 70 percent of Generation Xers and 49 percent of baby boomers surveyed agreed that the social or environmental impact of an investment was important in making investment decisions.[1]

So, while for all investors, the bottom line is most important, the question here is: Can impact investing have a double bottom line?

Over the last 40 years, impact investing has evolved from exclusionary provisions to investments in mission-related mandates with a direct, measurable impact on the environment or society. These mandates have historically been difficult to quantify, but today an increasing number of firms rate companies on their social, environmental and governance track records. Using these ratings, numerous studies have shown that good governance and risk management practices have beneficial results for shareholders and creditors alike.[2] As argued by Michael Porter and Mark Kramer in the business concept they called "creating shared value," "Companies must take the lead in bringing businesses and society back together." Shared value, they said, enhances the competitiveness of a company while also advancing economic and social conditions.[3]

Various instruments facilitate impact investments, including publicly traded stocks, bonds and private equity investments.

> "Can impact investing have a double bottom line?"

Some investors investing for impact select specific industries or corporate practices to include or exclude, and their investment managers limit their portfolios to publicly traded securities. The robustness of these social screens varies, however. So, investors must also ensure that their managers incorporate these screens directly into the investment process, which tends to make financial returns more competitive as well.

A rule of thumb for investors is to know that their ability to measure the impact of their investments increases as liquidity decreases. For example, liquid equity strategies or mutual funds will have direct impact on the environment and society through corporate policies, but their effects are often difficult to measure.

In contrast, sound projects with less liquidity, ranging from clean energy to social programs, are financed with municipal and corporate debt, often with backstops from the government at the state or local level—and even the World Bank, in the case of Green Bonds. Here, the purpose of the financing tends to be observable or quantifiable.

Finally, illiquid direct investments in projects or private equity funds enable investors to finance very specific interests where the impact is measurable. These investments may be debt or equity, or a combination of the two—and risk varies materially, dependent upon numerous factors, but expected returns must be high enough to attract private capital.

It turns out, then, that investors can achieve a double bottom line, generating attractive risk-adjusted returns while creating an impact.[4] But these strategies must be carefully implemented.

Prudent investors will utilize advisers with impact investing experience, to assist with due diligence. Furthermore, aligning with an organization that shares their beliefs may provide them additional insight and opportunities. ●

[1] U.S. Trust Insights on Wealth and Worth Survey. *U.S. Trust Bank of America Private Wealth Management, 2015.*

[2] *Gunnar Friede, Timo Busch and Alexander Bassen,* ESG and Financial Performance: Aggregated Evidence From More Than 2,000 Empirical Studies, 2015; *From: Gordon L. Clark, Andreas Feiner and Michael Viehs,* Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance, *2015;* Introducing the Impact Investing Benchmark, *Cambridge Associates and Global Impact Investment Network, 2015.*

[3] *Michael E. Porter and Mark R. Kramer, "Creating Shared Value."* Harvard Business Review, *January 2011.*

[4] *A March 2015 published meta-study found that, "80 percent of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance." From: Gordon L. Clark, Andreas Feinerand Michael Viehs,* Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance. *2015.*

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FOUNDED IN 1980, DREXEL MORGAN CAPITAL ADVISERS HAS EARNED A REPUTATION FOR SERVING CLIENTS WITH INTEGRITY, INTELLIGENCE AND INDEPENDENCE. As an independent boutique, the firm takes a hands-on approach and acts decisively in making consistent recommendations. Drexel Morgan Capital Advisers' expertise extends beyond traditional asset classes to include alternative investments, international developed and emerging markets and socially responsible investing. James L. McCabe, PhD, president and founder, is responsible for investment strategy and research, portfolio structuring, asset allocation and manager selection. James founded McCabe Capital Managers Ltd. in 1980. The firm joined Drexel Morgan & Co. in 2010 as a subsidiary and changed its name to Drexel Morgan Capital Advisers Inc. in 2012. James serves on the firm's investment committee and board of directors. ●

James L. McCabe, PhD
President and Founder

Drexel Morgan Capital Advisers
Three Radnor Corporate Center, Suite 305
Radnor, PA 19087
Tel. 610.971.1901

jim@drexelmorgancapital.com
www.drexelmorgancapital.com

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