Private Wealth

Indexing With Impact

NOVEMBER 26, 2013 • ANTHONY GRECO

Wealthy investors who are passionate about sustainable development and protecting the environment may find an equity strategy that enables them to put their money to work in a new custom-tailored index portfolio.

The Environmental Impact Series (EIS), developed by Aperio Group in collaboration with Imprint Capital, offers ultra-high-net-worth investors an investment vehicle that targets both market beta and positive environmental impact. Aperio uses positive and negative screening to analyze more than 2,300 public companies with strong track records of commitment to the environment and sustainability. The companies are evaluated based on the percentage of revenue they derive from each of the five sustainability themes: alternative energy, green building, sustainable water, clean technology and pollution prevention.

The result is portfolios populated with companies committed to sustainability and the environment and that track an equities index selected by the investor. Investors may further customize their portfolios by overweighting with companies involved in the specific environmental and sustainable development sectors that are most important to them.

“To the extent that we emphasize certain companies, the portfolio will behave differently from the [selected] index,” said Aperio founding partner and head of product strategies Paul Solli. “For example, if you want to have a portfolio that has 50 percent of its revenue coming from products or services around sustainability themes, you’re going to have a portfolio that is going to look quite a bit different than the index.”

Tracking error relative to a standard equity index is the primary metric of a portfolio's performance.

"That's the main beta measure," said Imprint Managing Director and co-founder Taylor Jordan. "We look at it from a tracking error perspective. So with roughly 20 percent of the portfolio in companies from environmental products or services, that's roughly a 2-percent tracking error associated with that strategy relative to, say, the S&P 500, and investors can customize it to whatever index they want to use."

"It's really for investors who understand the benefits of indexing but want to incorporate their values," said Solli. "Our whole process is to make sure we get as close to the index performance as possible. If an investor wants a portfolio that's overweighting these companies, the portfolio will have some tracking to the index but it will have a certain amount of deviation. Our job is to help advisors help their clients understand what the tradeoffs are between investment pragmatism and idealism."

EIS grew out of the firm's work with investors and advisors in creating customized impact portfolios that focused on a broad array of issues beyond sustainability, according to Solli.

"Folks who were particularly interested in the environment and sustainability were asking, 'Is there any way I can emphasize companies that are actually making the world a better place with the products and services they are delivering? What I'd really like to see in my portfolio are companies that are changing the world.' And that was the theme behind our Environmental Impact Series," said Solli.

Sausalito, Calif.-based Aperio has $6 billion in assets under management, with approximately $1 billion in customized impact investment portfolios. Imprint, with offices in San Francisco and New York, is an advisory firm that works on a non-discretionary basis and has $340 million in assets under management. The firm influences an additional $4 billion through wealth-management firms that have hired it to be their impact investment advisor, according to Jordan.

Getting With The Program

"There are a lot of advisors out there who think that investing with an environmental, social and governance agenda in mind is a waste of time or will result in below-market returns. The research we've seen and the work we've done in constructing portfolios that track standard index benchmarks indicate that's not necessarily the case," said Solli. "Even if it were the case, there are enough very high-net-worth investors out there who care about these issues. Some high-net-worth advisors may not be into it, but it's a business imperative that they be ready to address them and engage with their clients on them."

Research published by Bank of America earlier this year reinforces the notion that advisors must heed their clients' desire for impact investing options. Among the findings: 45 percent of high-net-worth investors surveyed agree that their investment decisions are a way to express their social, political and environmental values; six in 10 feel they can influence society through the companies and projects they invest in; and 29 percent say the ability to provide values-based investment choices is an important consideration in selecting a wealth-management firm

According to Imprint's Jordan, advisors to wealthy individuals, families and foundations should work to find investments that match their clients' financial criteria and impact objectives. "It takes some additional effort but there's a growing ecosystem to support them and help them move their clients into this space. This is here to stay. Clients want to have more meaning with their money," he said.