

Summer 2018

Responsible Investing: Delivering competitive performance

Study found no significant differences in RI stock index returns and risk vs. broad market benchmarks

INTRODUCTION

While investors are rapidly embracing responsible investing, financial advisors overall remain skeptical. Despite mounting evidence to the contrary, many advisors believe that responsible investing (RI) means sacrificing performance. More than half of advisors say that RI does not provide the same rate of return as other strategies — a group that increased from 47% in 2015 to 53% in 2017, according to Nuveen's Third Annual Responsible Investing Survey. Survey results suggest that advisors may be missing an opportunity, considering that most investors express a preference for RI.

WHAT'S THE BASIC ARGUMENT FOR RI SACRIFICING INVESTMENT PERFORMANCE?

Skeptics assume that RI limits opportunities by excluding a large portion of the securities that would otherwise be eligible for investment. Over time, limiting opportunities must result in worse performance, they argue. Nuveen tested this assumption by comparing the long-term

performance of five leading RI stock indexes against two broad market indexes. Our findings:

RI indexes provided similar performance, despite holding fewer stocks

- Statistical analysis found no systematic differences in the long-term performance of five leading RI stock indexes, compared to two broad market indexes, the S&P 500 and Russell 3000. Any return differences appeared to be random. The analysis covered RI index track records since inception, ranging from 15 to 27 years, as of 29 Dec 2017. Exhibit 1 on page 2 shows the similarity of returns over time.
- The finding is remarkable considering the RI indexes included only a portion of the stocks in broad market indexes, ranging from 24% to 81%. The RI indexes select eligible stocks by ranking them based on environmental, social and governance (ESG) factors and, in some cases, excluding certain industries, such as alcohol, tobacco and firearms. RI indexes generally try to match the performance of the broad market. For example, they may try to match the characteristics of stocks in a broad market index, such as size (market capitalization) or industry exposure (sector weights).
- Nuveen's findings mirror the results of a growing body of industry research. Morningstar noted in its January 2018 review of RI funds,

Sustainable Funds U.S. Landscape Report: The “weight of research evidence suggests no systematic performance penalty associated with sustainable investing and possible avenues for outperformance based on reduced risk or added alpha.”

Exhibit 1: Investment returns were similar between RI indexes and the broad stock market

Cumulative returns: Five U.S. RI stock indexes vs. S&P 500 and Russell 3000 indexes (1990 - 2017)



Data through 29 Dec 2017. Series indexed to 100, inception dates: S&P 500, Russell 3000, and MSCI KLD 400 Social, 04 May 1990; DJSI U.S., 01 Jan 1999; Calvert U.S. Large Cap Core Responsible, 28 Apr 2000; MSCI USA IMI ESG Leaders, 22 Dec 2000; and FTSE4Good US, 03 Jan 2003. MSCI indexes include aggregated, multisource histories prior to acquisition on 01 Sep 2010.

It is not possible to invest in an index. Performance for indices does not reflect investment fees or transactions costs.

Sources: FactSet Research Systems Inc., Morningstar, Inc., MSCI Inc., and Nuveen.

RI DOES NOT REQUIRE TAKING ON ADDITIONAL RISK COMPARED TO BROAD STOCK MARKET INDEXES

- The difference in volatility (standard deviation) between RI indexes and broad market indexes averaged a fraction of one percent (26 basis points) over the 10-year period ended 29 Dec 2017 (Exhibit 2).
- Risk-adjusted returns (the amount of return for the risk taken) were similar, ranging from slightly lower to slightly higher. The analysis compared Sharpe Ratios for the five RI indexes vs. the S&P 500 and Russell 3000 (Exhibit 2).

- Results suggest that incorporating ESG criteria in investment decisions doesn't require taking on additional risk relative to broad market benchmarks.

Exhibit 2: Volatility and risk-adjusted returns were similar for RI indexes and broad market benchmarks

Average standard deviation and Sharpe Ratio for the 10-year period ended 29 Dec 2017

	10-year average (2008 - 2017)		
	Volatility (standard deviation)	Volatility difference vs. broad market index***	Risk-adjusted returns (Sharpe Ratio)
Calvert U.S. Large Cap Core Responsible*	16.53%	0.13%	0.88
Dow Jones Sustainability Index U.S.**	17.31%	0.68%	0.81
FTSE4Good US**	15.99%	0.29%	0.92
MSCI KLD 400 Social**	16.96%	0.14%	0.83
MSCI USA IMI ESG Leaders*	17.12%	0.06%	0.83
RI index average	16.78%	0.26%	0.86
S&P 500	16.67%		0.88
Russell 3000	17.18%		0.86

Data based on weekly returns for 10-year period through 29 Dec 2017.

* Benchmark: Russell 3000.

** Benchmark: S&P 500.

*** Differences reflect the RI index volatility minus benchmark volatility (absolute value).

Sources: FactSet, Morningstar, MSCI, and Nuveen.



investors say:

they want their investments to deliver competitive returns while promoting positive social and environmental outcomes

[Nuveen Third Annual Responsible Investing Survey, December 2017.](#)

CONCLUSION

- Results suggest that investors can pursue social goals without necessarily sacrificing performance or increasing risk.
- Financial advisors may be missing an opportunity if performance concerns prevent them from offering RI.

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