

## Analysis of the performances of the “Best of SRI” and “Worst of SRI” portfolios of Euro Stoxx 300

An empirical contribution  
regarding the impact  
of SRI selection on portfolio performance

One of the most widespread preconceptions in the financial community is the association of the socially responsible investment approach with financial underperformance. This seemingly persistent belief prevails among theoreticians and practitioners alike and is applied as much to the financial results of companies as to the performance of their shares in the stock market and, by extension, of the portfolios that invest in them.

In the «corporate finance» version, this conviction is reflected in the notion that the manager who does not focus exclusively on shareholders' wealth (i.e. who devotes energy to social responsibility considerations) will inevitably underperform (Milton Friedman). In the «capital markets» version, derived from Markowitz and Sharpe's Modern Portfolio Theory, reducing the investment universe through screening it on the basis of non-financial criteria inevitably has an adverse impact on the efficient frontier and results in sub-optimal portfolios.

From a purely theoretical perspective, **the specific risk premium provides a way to link these two approaches that deal respectively with corporate profitability and share price performance**, by transforming expectations of company earnings into market valuations. At the same time, this premium reintroduces into the stock valuation a medium-and long-term perspective that is important to CSR proponents and SRI managers who are convinced that **those companies that voluntarily internalise their external costs** (environment, employees, customers and suppliers) **reduce their medium-term risks. The practice of a CSR approach by the company**, on the one hand, **and the inclusion of non-financial criteria for building portfolios**, on the other hand, **are therefore not necessarily synonymous with underperformance.**



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While much literature has been devoted to this subject, definitive conclusions have never been reached for a number of reasons: methodological, historical (insufficient historical depth of data) and even ideological. Far from ignoring the importance of the first question (will those companies that are today concerned by CSR achieve better or worse performances in the future?), **we wanted to concentrate on the second issue, namely the performance of the portfolios, by drawing upon experience built up over several years within a Group specialised in this approach.**

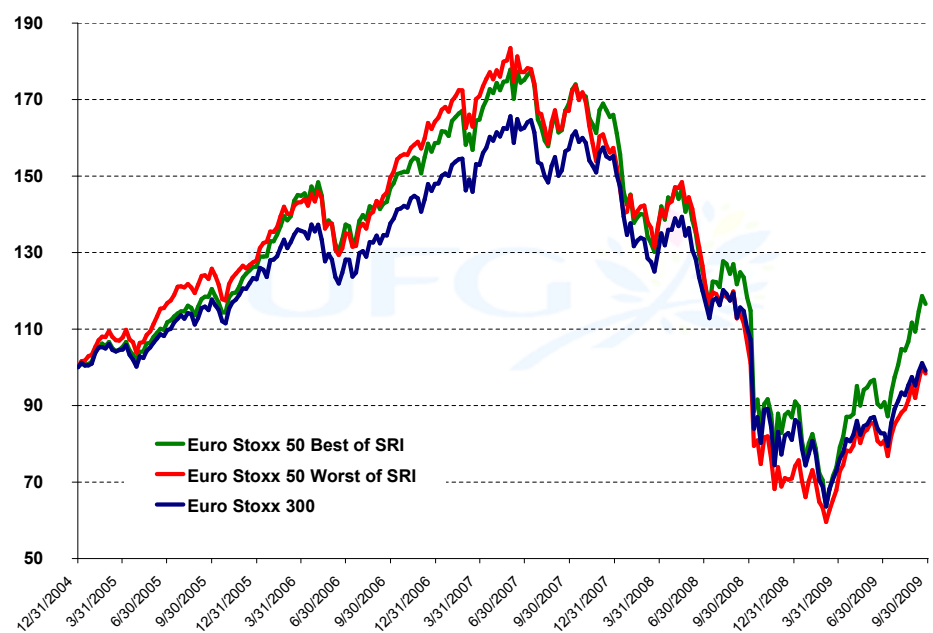
Most studies that have focused on the subject have failed to provide conclusive results because they are based on the historical performances of funds claiming the “SRI” label but that in reality apply very heterogeneous approaches and are moreover enhanced by various management biases (style, sector, weighting, alpha or beta of the manager). **For this reason it is essential, in order to try to isolate the contribution of the “responsible and sustainable” selection criteria, to eliminate performance bias,** a process that more often than not results in a non-significant residual performance (alpha awarded to SRI).

The study thus proposes to address the problem through a completely reverse approach, namely backtesting portfolios built exclusively under SRI criteria according to a unique and consistent method over time and for which historical data is effectively available. **This is the method applied by UFG - Sarasin AM (ex Sarasin AM France) since 2005,** derived from the Sustainability Matrix® methodology that Bank Sarasin has used since 1989. **The excess returns of these portfolios, that have been computed backwards,** compared of those of the universe from which they were extracted, **may be attributed in full to the sustainability approach,** notably because both of them strictly replicate the breakdown of the index, in terms of sectors or market capitalisation, subject to verification that unintentional biases do not exist.

**The comparative study of performances was accordingly conducted over the 2005-2009 period, by creating two equal-weighted portfolios of 50 stocks** from the universe of euro zone listed companies included the Euro Stoxx 300 index. **These portfolios were built by selecting at the beginning of each quarter, for the first one the stocks with the highest SRI ratings (“Best of SRI” or Bol), and for the second one those with the lowest SRI ratings, (“Worst of SRI” or WoI).** The two portfolios accordingly represent, within the Euro Stoxx 300 universe, the performance of the 50 best SRI stocks and the 50 poorest performers without introducing any other bias (style, sector, weighting, alpha or beta of the manager).

This method made it possible to create portfolios displaying clearly differentiated SRI ratings: the average Bol rating (1.40/2) is virtually double the Wol rating (0.75/2) and clearly above the benchmark (1.05). In addition, the lower ratings inside the Bol were constantly equal to or greater than the higher ratings inside the Wol.

**Analysis of performance demonstrated that with a positive return (annualised 2.89% ex-dividend over the study period versus -0.23% for Euro Stoxx 300), the Best of SRI portfolio continuously outperformed its benchmark, whether during bull markets (2005-2007) or periods of severe crisis (2007-2009). The Worst of SRI portfolio in contrast clearly underperformed, (annualised -0.74%), posting outright underperformance during the crisis.**



Source : UFG-LFP research

	Best of SRI	Worst of SRI	EuroStoxx 300
<b>2005-2009</b>	16.28%	(1.63%)	(0.87%)
<b>2005</b>	26.01%	27.90%	23.00%
<b>2006</b>	25.57%	28.38%	20.28%
<b>2007</b>	4.66%	(4.18%)	4.91%
<b>2008</b>	(47.65%)	(54.91%)	(47.80%)
<b>2009</b>	34.11%	38.67%	22.35%

Source : UFG-LFP research

As the crisis contributed to homogenising behavior and even created an adverse bias against those stocks that remained the most liquid, the risk analysis (volatility, extreme risks) does not display significant differences. Comparisons of risk-adjusted performances are consequently favourable to the Best of SRI portfolio.

**These results not only demonstrate that choosing stocks on the basis of non-financial criteria does not weigh on the financial performance but also that excluding the stocks with the lowest non-financial ratings improves the risk/reward profiles.**

**This empirical demonstration confirms the intuition of SRI supporters regarding the contribution of non-financial criteria in the asset allocation process, on top of traditional top-down approach or thematic management. Far from acting as a negative screen limiting performance, the SRI approach would appear as a positive discriminator of the investment universe. This conclusion has to be shored up, in the future, by a study of the evolution of ex-ante risk premium in order to determine whether this experimental conclusion is based on discernible trends of recognition by the market of the positive contributions of CSR.**

The full study by the UFG-LFP Research Centre can be consulted at the following address:

[http://www.groupe-ufg.com/fileadmin/docs/etudes/etude\\_recherche\\_200911\\_en.pdf](http://www.groupe-ufg.com/fileadmin/docs/etudes/etude_recherche_200911_en.pdf)

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