Investment Insights

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Socially conscious bond funds a rare breed

Investment vehicles prefer 'positive' screens over 'negative' ones

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Though the options are relatively few, there are places socially conscious mutual fund investors can go for exposure to bonds. Of the 173 mutual funds that Morningstar Inc. identifies as applying social or religious screens, only 20 invest in bonds.

Unlike socially conscious stock funds, which typically use “negative” screens to rule out particular companies, socially conscious bond funds tend to rely upon “positive” screens to uncover companies considered to have progressive environmental, social and corporate-governance practices.

Environmental, social and corporate governance, or ESG, is “the new buzzword” in socially conscious investing, according to David Kathman, a Morningstar analyst.

“People associate ESG with positive screens,” he said. “People are starting to think of [socially conscious investing] as old-school screening out.”

Socially conscious bondholders favor positive screens even though they tend not to have as much leverage over corporate management as stock investors do. For example, bondholders don't get to vote at high-profile shareholder meetings.

Bondholders do, however, have the right — and often the ability — to track the way bond proceeds are used.

“We're always looking at where the cash flow is going, so we know if we're buying a bond, the proceeds will go to the right project,” said Barbara VanScoy, senior portfolio manager of the $1.1 billion CRA Qualified Investment Fund (CRATX).

The fund, launched in 2007 by Community Capital Management Inc., is a classic example of positive screening in the fixed-income area. It invests only in bonds that meet the criteria of the Community Reinvestment Act, which means a focus on job creation, affordable housing and the promotion of economic development, largely through municipal bonds and mortgage-related bonds.

“If we're financing something, we stay on it, and that means if they say a project will result in 30 new jobs, we want to see those jobs,” Ms. VanScoy said.

How it works is illustrated by the city of Jonesboro, Ark., which last year issued $20 million in municipal bonds to cover the cost of building and equipping an industrial facility for Nordex SE, a German wind turbine manufacturer.

Issuing municipal debt to support a private enterprise is expected to result in 700 new jobs at the facility by 2014.

But as Morningstar analyst Kathryn Young pointed out, these kinds of social and environmental benefits can come at a cost.

The CRA Qualified Investment Fund and the $540 million Access Capital Community Investment Fund (ACCSX) from RBC Global Asset Management represent two of the purest plays in this category because they don't own corporate debt or Treasury bonds.

“The complete lack of corporate bonds means it will lag its peers in credit-driven rallies,” Ms. Young pointed out.

CAN BE VOLATILE

The less-than-impressive two-star ratings from Morningstar for both funds underscore a reality of strategies that don't stray from the stated mission.

“Investors need to understand what they're getting,” Ms. Young added.

Compared with the benchmark Barclays Capital U.S. Aggregate Bond Index, which includes both corporates and Treasuries, these specialized fixed-income funds can be volatile.

Year-to-date through last Wednesday, the CRA Qualified Investment Fund had gained 6.17%, and the Access Capital fund had gained 4.6%, compared with a 6.49% gain for the benchmark over the same period.

As Ms. VanScoy pointed out, however, beyond just putting investment dollars to a more socially beneficial use, a pure-play strategy also can result in oft-needed portfolio diversity.

“A lot of bond funds might overreach in corporates in order to pick up the additional spread, and that could result in more corporate exposure than some investors might be expecting,” she said. “We're using mortgages for that additional spread.”