Responsible Investing, Alpha, Smart Beta, Shared Values, Loaves and Fishes

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This is a "think piece" - Lots of thoughts and assertions but no data.

I recently helped compile a piece about the origins of responsible investing from the Talmud and the Koran through John Wesley's sermon, the first Responsible Investing mutual fund established by the Quakers and the Calvert Funds. All of these focused originally on avoiding investing in companies trafficking in sin and/or dishonorable business practices. Over time, more focus came on investments less concerned with sin and more focused on undesirable business practices. Undesirable could mean doing business with "bad" governments such as South Africa, "bad" governance and labor polices, "bad" environmental policies, etc. Regardless, the objective of Responsible Investing has always been to use your investments to do good - or at least no harm - while doing well financially.

The late Dr. Stephen Ross with whom I once worked considered responsible investing irresponsible from a fiduciary perspective as he asserted it necessitated sub-optimal investment returns. ERISA adopted this stance in 1987 and just reversed it earlier this decade after reviewing newer research on more sophisticated Responsible and ESG Investing techniques that went beyond negative screening. More recent studies have focused on ESG as a potential source of risk-adjusted returns ("alpha") with the most in-vogue description being Smart Beta.

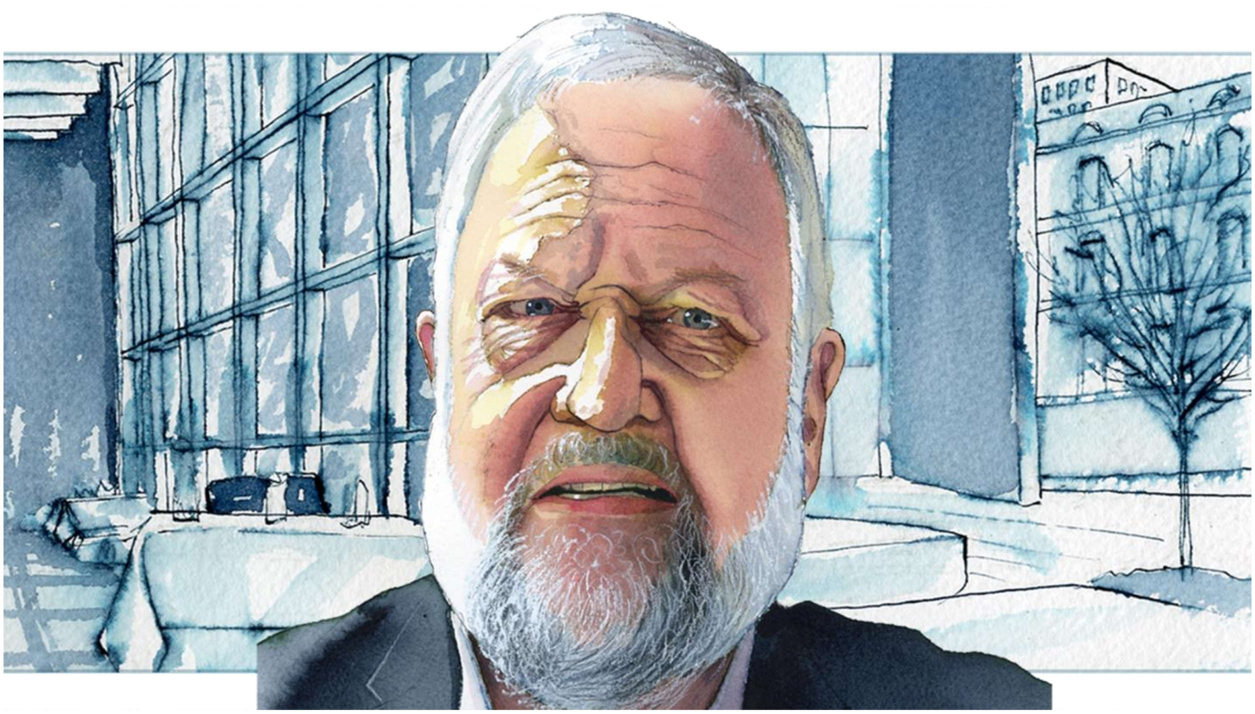
As a 37+-year investment quant, I can state unequivocally that our industry fixates in deriving pseudo-scientific conclusions from time-series data. So whether we are discussing sin avoidance, ESG, price momentum. low market cap, or book/price ratios as Smart Beta factors, we insist on providing Gaussian statistics in what we know to be a non-Gaussian space to call things drivers of excess returns "over time." In reality, at least in US equity space in the past 50 years, whether a factor provided excess returns during a given period depends directly upon the time period you select. And to assert that this is definitive proof that a given factor is superior because it prevailed over the latest 20-, 30-, 40-, etc.-year period for which we have measurable data is to ignore the cyclical and ultra-dynamic nature of capital markets' prices. The best you can say is that a factor has been a positive contributor on a Gaussian-risk-adjusted basis in one or more historic time periods. This confirms the definition of a quant - the ability to predict the past with ever greater precision.

The point I make is that investment advisors tend to focus more on managing factors relating to their clients' assets that may or may not be helpful to that client in the future than they focus on what those assets mean to the client. This is especially true in responsible investing where the client comes in saying that it's at least as important to me that my money is not used to support practices I abhor than I care about making the maximum possible return in the next quarter. This is known as investment myopia: focusing so much on the trees that you miss the forest. Most clients have a longer time horizon that the advisor should help them identify.

I write this as I head to the Kingdom Advisors (KA) Conference in Orlando FL to assist my client, James Investment Research, in explaining the indexes behind the management and benchmarking of its new ETF, JBRI. It was developed for Biblically Responsible Investing (BRI) for people interested in time-tested investing techniques applied to a universe of companies with practices in alignment with their principles and beliefs. But beyond the investment tool employed to grow the clients' assets, Kingdom Advisor programs teach more holistic techniques of stewardship. As with all implementations of responsible investing, the emphasis is on making the world a better place.

Certified Kingdom Advisors (CKAs) recognize that this also includes allocation of that growing asset pool to philanthropy, tithing, and succession plans. To accomplish this, an advisor must understand, appreciate, and to an extent, share the values of her or his client. The successful CKA strives to help the client make the world a better place by following the lessons of the parable of the loaves and the fishes. Take assets that were sufficient for few and grow and allocate them to make them sufficient to feed the hungry. Of course, this is just one of many ways that sapient human beings look at the world.

In my opinion, whether one's values focus on the moral, the ecological, or some other purpose, wealth is merely a means to an end. An advisor who focuses merely on a principled client's tangible assets rather than helping that client achieve higher goals may be missing a chance to partake in the most rewarding part of life.



In a recent Financial Times interview, David Rockefeller explained why happiness does not come from material wealth.