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Socially responsible (ethical) investing in South Africa

Suzette Viviers

Abstract. More South African investors are integrating their personal values into their investment decisions. Research on the performance of socially responsible investment (SRI) funds, also called ethical funds, yields conflicting results. In this study, the risk adjusted performance of 14 local SRI funds have been evaluated vis-à-vis their respective benchmarks. The results of the Treynor and Sharpe ratios indicate that the majority of funds outperformed their respective benchmarks over the period 1 July 2001 to 31 June 2004 and all but one fund posted positive Alphas. These results thus appear consistent with previous research which shows that ethics indeed pays.

Key words: Socially responsible investing, fund performance, Sharpe ratio, Treynor ratio, Jensen's Alpha

Introduction

Classic portfolio theory suggests that investors should construct investment portfolios which are well-diversified and which would render them the highest expected return for any given level of risk (Bodie, Kane & Marcus, 2002:223). For many years investors have relied purely on financial criteria, such as Price/Earnings ratios, to select suitable securities for inclusion in their investment portfolios. A new generation of investors, so-called ethical or socially responsible investors, are increasingly calling for the use of non-financial performance measures to evaluate investment opportunities.

This process of integrating personal values and societal concerns with financial imperatives has given rise to the phenomenon called socially responsible investing (SRI). Interest in SRI has gained substantial momentum in recent years in countries such as the USA and UK. In South Africa, as in many other developing countries, SRI funds have however not received the same amount of attention from investors. This has been attributed to the lack of a proper definition of SRI and scepticism regarding the financial returns of such funds.

Critics often argue that the returns on SRI funds are lower than those of conventional portfolios. International research on the risk adjusted performance of SRI funds yields conflicting results although the most recent findings indicate that "ethics pays" (Otten & Bams 2002:75; Bauer, Koedijk & Otten, 2002:1). No research of this nature has been undertaken in South Africa.

The purpose of this study was thus to examine the risk adjusted performance of 14 South African SRI funds over a 36-month period. On the basis of this problem statement, a number of research objectives were formulated namely:

- to provide a background to and definition of SRI;
- to indicate the size of the SRI market globally and in South Africa;
- to highlight the risk adjusted measures used to evaluate SRI fund performance, and
- to empirically evaluate the risk adjusted performance of SRI funds in South Africa over a three-year period, namely 1 July 2001 to 30 June 2004, relative to their respective benchmarks.

Given the small size of the SRI market in South Africa, the sample consisted of the entire population of 14 local SRI funds as contained in the Alexander Forbes Asset Consultants quarterly survey of Targeted Development Initiatives. For brevity's sake the abbreviations "AFAC" and "AFAC TDI survey" will be used in the remainder of this paper. Three risk adjusted portfolio performance measures, namely the Treynor and Sharpe ratios and Jensen's Alpha were used to evaluate the performance of the SRI funds *vis-à-vis* their respective benchmark indices.

In the following section a review of the relevant literature will be provided followed by the research design and methodology, the results of the empirical investigation as well as the conclusion and recommendations.

Background to and definition of SRI

Schwartz (2003:195) captures the essence of SRI by stating that it is "... a set of approaches which include social or ethical goals as well as more conventional financial criteria in decisions regarding the selection, retention and realisation of particular investments".

The Quakers in America were the first investors to actively practise SRI as early as in the 17th century. On the basis of their beliefs they refused to trade in war

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related activities or slaves and invented the concept of negative or exclusionary screening. In the 20th century various religious groups such as the Roman Catholics and Methodists declined to invest in companies that manufactured alcohol or tobacco products (Schueth, 2003:189). In the 1970s and 1980s socially responsible investors in the USA, UK and Western Europe refrained from investing in South African companies due to the political dispensation of the country at the time (Kinder & Domini, 1997:12).

In the past decade or two, other SRI strategies have become popular, namely positive (qualitative) screening, shareholder activism and community/targeted investing, all of which will now be discussed in greater detail.

Negative (exclusionary) social screening

Investors who employ negative screens in constructing investment portfolios generally refrain from investing in certain countries, such as those with poor human rights records, or certain industries, such as those involved with gambling or the manufacturing and/or sale of alcohol, tobacco, defense equipment and nuclear activity (Kurtz & DiBartolomeo, 1996:35).

An ethical case for such an avoidance strategy follows from the prima facie argument that investors should exhibit consistent standards of behaviour in all areas of their lives, including investment behaviour. Larmer (1996:397) contends that holding a share in a business suggests approval of their activities and that approving an immoral action is immoral. Mills (1996:3) likewise supports the view that owning a security and earning a return from it indicates some acquiescence to or support for the activities of the business in question. He furthermore states that: "the righteousness of any monetary return is conditional upon the absence of the exploitation of customers, workers, creditors and suppliers".

In dealing with the subjective nature of "unacceptable corporate behaviour", fund managers typically use a maximum percentage, e.g. 10%, of a business's turnover in a problem area as an exclusionary threshold. According to Sparkes and Cowton (2004:45), the use of such acceptability thresholds, poses a problem in principle. The justification of an arbitrary cut-off point rather than absolute avoidance in effect condones the presence of certain apparently undesirable attributes in an investment portfolio.

Sparkes and Cowton (2004:46) state that, although many socially responsible investors favour exclusionary screening when making investment choices, many others have come to recognise that negative screening fails to encourage businesses to become more responsible corporate citizens. As a result, increasing numbers of investors have come to adopt a more comprehensive investment approach by integrating positive or qualitative screens alongside their basic avoidance strategy.

Positive (qualitative) social screening

A great deal of research was undertaken in the 1980s and 1990s to determine which criteria on corporate social performance (CSP) investors ought to use as qualitative screens and how these should be assessed (Aupperle, Carroll & Hatfield 1985; Wood 1991; Pinkston & Carroll 1996). Several multi-dimensional indices have since been developed across the world covering a wide range of issues such as community relations, fair treatment of employees, a business's impact on the environment and corporate governance (Ethical Investment Research Service, 2005; KLD Research & Analytics Inc 2005).

Qualitative screens are more difficult to administer than exclusionary screens, as investors cannot simply look at the nature of a business in its broadest sense. Instead, investors have to examine the impact of corporate policies and practices on a range of stakeholders. Information on CSP is often not accessible to the public or is in a format that is difficult or expensive to analyse. Moreover, once investors have evaluated CSP, they are often left balancing performance across diverse areas, for example a company that does very well in some areas may do very poorly in other areas (Knoll, 2002:683).

Shareholder activism

A third SRI approach namely "shareholder activism" or "active engagement" refers to the notion of shareholders communicating with management on specific social, ethical or environmental issues. Their actions include filing resolutions, using their voting rights at annual general meetings and ultimately divesting from businesses that fail to transform (De Cleene, 2002:4).

According to Guay, Doh and Sinclair (2004:12), shareholder resolutions urging busineses to adopt more responsible practices are commonplace in the USA and gaining popularity, especially among institutional investors. Clarke (2002:44) confirms this trend and states that commercial banks, pension funds and mutual funds with significant SRI accounts are increasingly pressurising businesses to improve their corporate social performance by means of shareholder resolutions. A similar trend has been noted in South Africa by Temkin (2003b:7).

Targeted/community investing

Whereas some SRI investors wish to change corporate behaviour by means of social screening and shareholder activism, others wish to improve social

conditions in disadvantaged communities. Such investments improve access to formerly unavailable resources and services such as housing, health care, electricity, telecommunications, transport, water, sanitation and further promote small business and property development in disadvantaged areas. This type of SRI has a direct impact on the "real economy" and often takes the form of private equity investments (Schueth, 2003:191).

Beckwith (2004) and O'Reilly (2001:19) show that targeted/community investing is an SRI approach that is increasingly supported by institutional investors in developed countries. Despite a growing need for greater community investing in South Africa, many institutional investors still shun the idea as they question the financial viability of such projects.

Size of the SRI market

Research reveals that $2.16 trillion or 13% of all US funds under professional management in 2003 were managed according to SRI principles (Knoll, 2002:681). This translates into a 200% increase in funds invested in the USA based on SRI principles compared with the position in 1992 and shows SRI moving from a fringe investment strategy to a mainstream consideration. Outside the USA, the most rapid growth in SRI funds has occurred in the UK where funds invested on the basis of SRI strategies have been doubling every two years over the past decade (Whitten, 2004:20). Strong growth has also been noted in Europe and the Asia-Pacific region (Socially responsible investment taking root in Europe 2002:17; Holland, 2002:49). The improved performance of SRI funds in recent years is one of many factors which have contributed to the growth of the SRI markets in developed economies.

According to the International Finance Corporation only 0.1% or $2.7 billion of global SRI funds is invested in emerging markets, mainly upcoming Asian markets (Baue, 2003). Despite being the largest SRI market on the African continent, only 1,1% of all funds in South Africa are invested according to SRI principles (AFAC TDI Survey, 2004; Visser, 2004:3). Despite slow growth in the local SRI market in the past, expectations are that such funds will draw more capital in future, especially from those employing qualitative social screens and those with a shareholder activism mandate (Bacher, 2004:4; Bonorchis, 2004:5; Temkin, 2003a:15).

Measuring SRI fund performance

Advocates of SRI argue that investors can "do good by doing good". By this they imply that investors can earn a fair rate of return on their investment whilst promoting social change. Several international studies in this regard however yield inconsistent results. International studies indicate that SRI funds tend to perform on par with traditional funds and benchmark indices and that some SRI funds even show superior performance, but then only in the long-term (Bauer *et al*., 2002; Cummings 2000; DiBartolomeo, 1996; Diltz 1995, Kurtz & Kurtz, 1997; Otten & Bams, 2002; Vermeir & Corten, 2000). Most of these studies employ three generally accepted risk adjusted portfolio per-formance measures, namely the Treynor and Sharpe ratios as well as Jensen's Alpha.

In South Africa no study has focused exclusively on measuring the risk adjusted performance of SRI funds, a shortcoming which was addressed by this research.

Treynor's ratio

The first composite measure of risk adjusted portfolio performance was developed by Jack Treynor in the early 1960s (Treynor, 1965:63). He differentiated between risk produced due to general market fluctuations and risk resulting from unique fluctuations in a portfolio. Treynor reasoned that a completely diversified portfolio is only subject to systematic or market risk and that the Beta of such a fund should thus be the appropriate measure of portfolio risk. Treynor's ratio can thus be calculated as follows:

$$\text{Treynor's ratio} = (rp - rf) / \beta p \quad (1)$$

Where:
rp = Average return on the portfolio
rf = Average risk free rate
βp = Beta of the portfolio

The Treynor ratio thus divides a portfolio's excess return by its systematic or market risk which suggests that investors would want to maximise this value.

Sharpe's ratio

At more or less the same time, William Sharpe developed a similar measure of risk adjusted portfolio performance (Sharpe, 1966:119). The only difference between Sharpe's and Treynor's ratios is that Sharpe's favours total risk (or the standard deviation of a portfolio's returns) as a measure of risk rather than only considering *systematic* or *market* risk (as measured by Beta) (Reilly & Brown, 2000:1140). Therefore Sharpe's ratio evaluates a portfolio's performance based on both rate of return performance

and diversification. As indicated in Equation (2), Sharpe's ratio presents excess return earned per unit of total risk:

$$\text{Sharpe's ratio} = (rp - rf) / \sigma p \quad (2)$$

Where:
rp = Average return on the portfolio
rf = Average risk free rate
σp = Standard deviation of the portfolio's returns

As in the case of the Treynor ratio, all risk adverse investors would prefer to maximise this value.

Jensen's Alpha

The third measure of risk adjusted portfolio performance is Jensen's Alpha. This measure is based on the Capital Asset Pricing Model (CAPM) and states that the historic (realised) rate of return on a portfolio should be a linear function of the risk free rate plus a risk premium that is dependent on the systematic risk of the portfolio plus a random error term (Jensen, 1968: 389). This is illustrated in Equation (3):

$$\text{Jensen's Alpha} = \alpha_p = rp - [rf + \beta p(rm - rf)] + \varepsilon \quad (3)$$

Where:
αp = Alpha for the portfolio
rp = Average return on the portfolio
βp = Beta for the portfolio
rf = Average risk free rate
rm = Average return on the market index
ε = Error term

Equation (3) can be re-arranged to show that the excess return earned on the fund equals the Beta of the fund times the market risk premium plus an error term. In this form, an intercept for the regression line is not expected if the realised return equals the required return. Superior fund performance will thus allow for an intercept that measures any positive difference from the model, i.e. risk averse investors will seek funds with positive Alpha values (Reilly & Brown, 2000:1142).

With having defined SRI funds as portfolios which employ a social screening, shareholder activism or targeted/community investing approach and having explained the three most important measures of risk adjusted portfolio performance, attention will now be shifted to the research design and methodology of this study.

Research design and methodology

The methodology employed in this study can be described as positivistic or quantitative in nature since data on the entire population of SRI funds in South Africa were statistically analysed.

Sample

The population consisted of all 14 funds included in the AFAC TDI quarterly survey on 30 June 2004. Although an analysis of the investment mandates of the SRI funds in this sample falls outside the scope of this study, an overview shows that the majority of funds employ some form of negative social screening, mainly for compliance with Shari`ah or Islamic investment principles. The largest funds, as measured by the size of assets managed, are however those investing in targeted/community projects or bonds with a strong emphasis on social infrastructure development. Only one fund has a shareholder activism mandate at present. Details of the funds' classification according to the Collective Investment Schemes Act (No 25 of 1997) and their respective benchmark indices are outlined in Table 1.

Fund classification

A *unit trust* can be described as open-ended investment as there is no limit to the number of investors participating in the fund. Pooled and segregated funds on the other hand can be classified as closed-ended funds as there is a finite number of shares available in each fund (Oldert, 2005:19).

Unlisted or private equity funds with just a SRI focus were excluded from this study as they are not valued frequently enough to provide sufficient information for a detailed performance analysis. Cummings (2000:83) also argued that such funds should be excluded as they are not exposed to the same degree of investor buying/selling durability and market conditions as listed funds.

Balanced funds invest in a spread of securities in the equity, bond, money and property markets and generally hold a long-term view. *Equity* funds require an investment of at least 75% in equities and 5% in cash whereas the remaining 20% can be invested according to the discretion of the fund manager. *Alternative* funds generally invest in socially beneficial projects while *fixed interest* funds invest in bond and money market instruments. Finally, as the name suggests *property* funds invest predominantly in retail property (Equinox, 2004).

Benchmark indices

The FTSE/JSE All Share index (Alsi) is used by many traditional and SRI fund managers as a portfolio performance benchmark. The index includes those shares listed on the JSE Limited that fall within 99% of the market capitalisation of the overall market and thus reflects movements in the underlying equity market (Van Zyl, Botha & Skerritt, 2003:309). Fund managers of the OMAM Community Growth and Gilt funds remarked that the Alsi is not their ideal benchmark as it has a high

TABLE 1
Information on SRI funds and benchmark indices included in the sample

Fund	Classification		Benchmark index
African Harvest/Nedcor Renaissance Fund	Unit Trust	Balanced	Domestic AA prudential high equity unit trust mean
Stanlib Corporate Wealth Development Fund	Pooled	Balanced	Consumer price index (CPI)
Metropolitan Futurebuilder Fund	Pooled	Balanced	CPIX (CPI with mortgage bond repayments stripped out) + 4%
Momentum Supernation Fund	Pooled	Balanced	Composite weighting of the underlying funds' benchmarks
OMAM Community Growth Fund	Unit trust	Equity	FTSE/JSE All Share Index (Alsi)
Fraters Earth Equity Fund	Unit trust	Equity	FTSE/JSE Alsi – 50% to resources
Futuregrowth Albaraka Equity Fund	Unit trust	Equity	FTSE/JSE Alsi
Oasis Crescent Equity Fund	Unit trust	Equity	FTSE/JSE Alsi
Oasis Crescent International Fund of Funds (FoF)	Unit trust	Equity	Dow Jones Islamic index
OMAM IDEAS Fund	Pooled	Alternative	CPI + 7%
African Harvest Infrastructure Bond Fund	Segregated	Fixed interest	25% Govi + 75% Othi
OMAM Community Gilt Fund	Unit trust	Fixed interest	All Bond Index (Albi)
Futuregrowth Infrastructure Bond Fund	Pooled	Fixed interest	Albi
Futuregrowth Community Property Fund	Pooled	Property	CPI + 4%

Sources: Du Preez (2005:40); Equinox (2004); AFAC TDI survey (2004)

mining and resources component. They view this as problematic as many local mining companies do not currently meet a number of social, ethical and environmental criteria (Du Preez, 2005:37). The fund manager of the Fraters Earth Equity Fund echoes criticism of this shortcoming of the Alsi and subsequently reduces the weight of mining and resource companies in the Alsi by 50% before using it as a performance benchmark.

The All Bond Index or Albi consists of the top 20 listed bonds in South Africa, ranked by market capitalisation and liquidity. Van Zyl *et al*. (2003:280) point out that seven of these bonds are primary dealer bonds while the other 13 include the most liquid bonds traded on the Bond Exchange of South Africa (BESA). It is important to consider the fact that government or RSA bonds make up 85% of the Albi.

The African Harvest Infrastructure Bond Fund's benchmark index is the "25% Govi 75% Othi" index. The first component, namely the "25% Govi", reflects the performance of government bonds in which the primary dealers are obliged to make the market whereas the "75% Othi" component consists of all other bonds listed on BESA (Van Zyl *et al*., 2003:280; BESA, 2004).

A number of fund mangers use the Consumer Price Index (CPI) as a relevant performance benchmark, either as an absolute standard or as CPI plus a target return. The CPI is an index of the prices of a representative "basket" of consumer goods and services of a typical South African household and thus reflects the general price level in the economy. The South African CPI is constructed on a monthly basis by Statistics South Africa (South African Reserve Bank, 2004).

The Domestic AA prudential high equity unit trust mean, which is the relevant benchmark for the African Harvest/Nedcor Renaissance Fund, is the mean average of all the domestic AA unit trusts with an equity exposure of between 60% and 75%, hence the name *high* equity prudential fund (Equinox 2004).

The Dow Jones Islamic index was created for investors who wish to invest according to Shari`ah or Islamic investment guidelines, i.e. avoiding businesses associated with alcohol, pork-related products, conventional financial services (e.g. banking and insurance), entertainment (e.g. hotels, casinos/gambling, cinema, pornography and music), and tobacco manufacturers, as well as defense companies and weapon producers (Dow Jones, 2004).

Data collection

In order to analyse the risk adjusted performance of the SRI funds in the sample *vis-à-vis* their respective benchmark indices, the following data had to be gathered for the period 1 July 2001 to 30 June 2004:

- monthly returns of the 14 local SRI funds;
- monthly returns of the 14 relevant benchmarks;
- monthly returns of a risk free investment; and
- monthly returns of a market index.

This particular period was chosen to correspond with the existence of the AFAC TDI quarterly surveys. No

consistent data prior to 1 July 2001 existed for SRI funds in South Africa.

The monthly returns of the SRI funds and their respective benchmarks have been sourced from AFAC which is a leading, international asset management company.

All three portfolio performance measures incorporate the use of a nominal risk free rate. According to Bodie *et al*. (2002:200) the risk free rate of return is the rate that has no default risk and no correlation with other investments. Government securities are often used as proxies for the risk free rate. Correia and Uliana (2004:71) highlight the debate on whether long or short term securities are better estimates. They propose the use of the negotiable certificate of deposit rate as risk free rate in South Africa given the historic government regulations which affected the liquidity and pricing of government stock. Another approach was taken in this study based on the advice of two experts in the field of unit trust analysis (Buijs, 2005; Personal communication Coetzee, 2004). They suggested that a money market rate is a better proxy of the risk free rate as small investors, who generally only purchase "affordable" unit trusts, are more prone to use a money market fund as an investment benchmark than a government bond. Firer and McLeod (1999:17) also used a money market rate to determine the risk free rate on short-term data. Consequently the Alexander Forbes Money Market index was used as a proxy for the risk free investment.

Bradfield (2003:47) points out that market capitalisation weighted indices are preferred to equally weighted indices because they are superior proxies to the true market portfolio. Hence he suggests that the Alsi ought to be used in the South African context. Correia and Uliana (2004:67) however warn that the use of the Alsi could result in biased measures and consequently unreliable results. They base their argument on the fact that the market capitalisation of companies listed in the resources sector, make up 40% of the entire market capitalisation of the JSE. In this regard Bowie and Bradfield (1993:6-22) noted that "many investors regard mining shares (and more particularly gold shares) as representing a different type of risk and hence forming a different market". Given the exploratory nature of this study, a decision was made to use the Alsi as a proxy for the market return, despite its shortcomings.

Data analysis

In order to calculate the Sharpe and Treynor ratios as well as Jensen's Alpha the following statistics had to be calculated:

- the annualised returns of the 14 SRI funds;
- the annualised returns of the 14 benchmarks indices;
- the annualised risk free rate;
- the annualised standard deviation of the 14 SRI funds;
- the Betas of the 14 SRI funds using ordinary least squares regression and
- the annualised return on the market index.

It should be noted that the Beta estimations were neither corrected for the regression bias nor for thin trading in this study. These shortcomings will be addressed in future research.

In the following section the Sharpe and Treynor ratios as well as the Jensen's Alphas for the 14 SRI funds and their respective benchmarks will be discussed.

Results of the empirical investigation

Table 2 shows the Sharpe ratios for the SRI funds (S_{FUND}) as well as their respective benchmark indices (S_{BENCH}). It also shows whether a fund under- or outperformed its benchmark based on the Sharpe ratio and provides a ranking of funds based on the difference between S_{BENCH} and S_{FUNDS}. A ranking of (1) indicates the best performance *vis-à-vis* the benchmark and a (14) the worst relative performance. It is important to highlight that the rankings are not an indication of absolute performance, or indicative of "better" funds to invest in. This is due to the fact that different benchmarks have been used by which to evaluate performance.

The vast outperformance of the Futuregrowth Community Property Fund *vis-à-vis* its benchmark should be seen in light of the benchmark used (CPI + 4%), which was fairly low over the period of analysis. All of the *fixed interest* funds, which mainly invest in social infrastructure development projects, outperformed their benchmarks, as did all the *equity* funds. This could be attributed to the strong growth in the construction, retail and financial industries in South Africa over this period. These industries are generally favoured by SRI investors as they often score high on issues relating to corporate social performance (Balabanis, Phillips & Lyall, 1998:25; De Cleene, 2002:5).

Table 3 shows the Treynor ratios for the SRI funds (T_{FUND}) as well as their respective benchmark indices (T_{BENCH}). It also shows whether a fund under- or outperformed its benchmark index and provides a relative performance ranking.

As in the case of the Sharpe ratio, 10 of the 14 funds outperformed their benchmark indices on a risk adjusted based over the period 1 July 2001 to 30 June 2004. Although the Futuregrowth Community Property Fund showed the best performance vis-à-vis its benchmark using the Sharpe ratio, it shows the weakest performance using the

TABLE 2
Sharpe ratios of SRI funds and benchmark indices

Fund	Classification	S_{FUND}	S_{BENCH}	Diff	Performance vs benchmark	Ranking
Futuregrowth Community Property Fund	Property	19.97	10.97	9	OUTperform	1
Momentum Supernation Fund	Balanced	3.84	2.61	1.23	OUTperform	2
Fraters Earth Equity	Equity	2.45	1.46	0.99	OUTperform	3
Oasis Crescent Equity Fund	Equity	2.12	1.21	0.91	OUTperform	4
Futuregrowth Albaraka Equity Fund	Equity	2.05	1.21	0.84	OUTperform	5
OMAM Community Growth Fund	Equity	1.74	1.21	0.53	OUTperform	6
Futuregrowth Infrastructure Bond Fund	Fixed interest	4.17	3.78	0.39	OUTperform	7
Oasis Crescent International FoF	Equity	1.1	0.72	0.38	OUTperform	8
African Harvest Infrastructure Bond Fund	Fixed interest	4.19	4.07	0.12	OUTperform	9
OMAM Community Gilt Fund	Fixed interest	3.86	3.78	0.08	OUTperform	10
African Harvest/Nedcor Renaissance Fund	Balanced	2.15	2.29	-0.14	UNDERperform	11
Stanlib Corporate Wealth Development Fund	Balanced	4.84	10.98	-6.14	UNDERperform	12
OMAM IDEAS Fund	Alternative	3.45	13.39	-9.94	UNDERperform	13
Metropolitan Futurebuilder Fund	Balanced	2.74	15.93	-13.19	UNDERperform	14

TABLE 3
Treynor ratios of funds and benchmarks

Fund	Classification	T_{FUND}	T_{BENCH}	Diff	Performance vs benchmark	Ranking
Momentum Supernation Fund	Balanced	2.12	0.92	1.2	OUTperform	1
Fraters Earth Equity	Equity	1.82	0.9	0.92	OUTperform	2
Futuregrowth Albaraka Equity Fund	Equity	1.77	0.87	0.9	OUTperform	3
Oasis Crescent Equity	Equity	1.71	0.87	0.84	OUTperform	4
OMAM Community Growth Fund	Equity	1.35	0.87	0.48	OUTperform	5
Oasis Crescent International FoF	Equity	1.09	0.71	0.38	OUTperform	6
Futuregrowth Infrastructure Bond Fund	Fixed interest	1.02	0.92	0.1	OUTperform	7
African Harvest Infrastructure Bond Fund	Fixed interest	0.95	0.92	0.03	OUTperform	8
OMAM Community Gilt Fund	Fixed interest	0.95	0.92	0.03	OUTperform	9
African Harvest/Nedcor Renaissance Fund	Balanced	0.84	0.88	-0.04	UNDERperform	10
Metropolitan Futurebuilder Fund	Balanced	-0.39	0.91	-1.3	UNDERperform	11
OMAM IDEAS Fund	Alternative	-0.74	0.92	-1.66	UNDERperform	12
Stanlib Corporate Wealth Development Fund	Balanced	-1.54	0.86	-2.4	UNDERperform	13
Futuregrowth Community Property Fund	Property	-37.41	0.89	-38.3	UNDERperform	14

Treynor measure. This could be attributed to the fact that these two ratios use different measures of risk. In this regard Reilly and Brown (2000:1140) note that poorly diversified portfolios often exhibit contradicting Sharpe and Treynor ratios. Another example of this is apparent in the rankings of the Futuregrowth Albaraka Equity Fund which invests in Shari`ah compliant companies. The strict type of negative screening employed by this fund drastically reduces its degree of diversification and thus introduced a higher degree of total risk.

According to the Treynor ratio, all funds in the *equity* and *fixed* interest categories also outperformed their benchmarks (as was the case with the Sharpe ratio). The best performing fund *vis-à-vis* its benchmark according to the Treynor ratio is the Momentum Supernation Fund, which invests heavily in social infrastructure development. In comparison with the other SRI funds, this fund also offered investors the highest excess return (2,12%) per unit of systematic or market risk.

Jensen's Alpha, as mentioned earlier, compares the realised rate or return of a portfolio with its required rate of return. Due to the nature of the Jensen's Alpha it is impossible to calculate the Alpha for the market fund i.e. the FTSE/JSE Alsi which is used as a benchmark by a number of funds in this sample. The Jensen's Alphas for the SRI funds on their own nonetheless provide some valuable insights into their risk adjusted per-

formance. The Jensen's Alphas for the 14 SRI funds are presented in Table 4 where a ranking of (1) indicates the best performing fund and a (14) the worst performing fund.

As can be seen from this table, only one fund had a negative Alpha which means that its realised returns over the three-year period were lower than investors' required rate of return. All of the others offered the required return or slightly higher returns. The worst performing funds were the *fixed interest* funds, which could be attributed to low interest rates and bond yields experienced in South Africa in recent years. Another fact to consider in the case of the *fixed interest* funds, is that the FTSE/JSE Alsi was used a proxy for the market portfolio. This index consists of all risky assets and might not be entirely appropriate for *fixed income* funds, an issue which will be addressed in future research.

A summary of the relative rankings across all three risk adjusted portfolio performance measures is presented in Table 5. From this table it is clear that fund performance varies significantly across the three measures with only one fund, the Momentum Supernation Fund, scoring relatively high rankings *vis-à-vis* its benchmark in all three measures.

TABLE 4
Jensen's Alphas of the 14 SRI funds

Fund	Classification	Jensen's Alpha	Ranking
Metropolitan Futurebuilder Fund	Balanced	3.15	1
OMAM IDEAS Fund	Alternative	2.03	2
Stanlib Corporate Wealth Development Fund	Balanced	1.39	3
Futuregrowth Community Property Fund	Property	0.96	4
Momentum Supernation Fund	Balanced	0.52	5
Futuregrowth Albaraka Equity Fund	Equity	0.52	6
Oasis Crescent Equity Fund	Equity	0.50	7
Fraters Earth Equity Fund	Equity	0.50	8
OMAM Community Growth Fund	Equity	0.32	9
Oasis Crescent International FoF	Equity	0.30	10
Futuregrowth Infrastructure Bond Fund	Fixed interest	0.09	11
African Harvest Infrastructure Bond Fund	Fixed interest	0.03	12
OMAM Community Gilt Fund	Fixed interest	0.03	13
African Harvest/Nedcor Renaissance Fund	Balanced	-0.04	14

TABLE 5
Overview of relative rankings across all three risk adjusted measures

Fund	Classification	Sharpe ratio ranking	Treynor ratio ranking	Jensen's alpha ranking
Futuregrowth Community Property Fund	Property	1	14	4
Momentum Supernation Fund	**Balanced**	**2**	**1**	**5**
Fraters Earth Equity	Equity	3	2	8
Oasis Crescent Equity Fund	Equity	4	4	7
Futuregrowth Albaraka Equity Fund	Equity	5	3	6
OMAM Community Growth Fund	Equity	6	5	9
Futuregrowth Infrastructure Bond Fund	Fixed interest	7	7	11
Oasis Crescent International FoF	Equity	8	6	10
African Harvest Infrastructure Bond Fund	Fixed interest	9	8	12
OMAM Community Gilt Fund	Fixed interest	10	9	13
African Harvest/Nedcor Renaissance Fund	Balanced	11	10	14
Stanlib Corporate Wealth Development Fund	Balanced	12	13	3
Metropolitan Futurebuilder Fund	Balanced	14	11	1
OMAM IDEAS Fund	Alternative	13	13	2

Conclusion

This study examined whether 14 South African SRI funds could outperform their respective benchmark indices on a risk adjusted basis over the period 1 July 2001 to 30 June 2004. According to the Sharpe and Treynor ratios, 10 funds outperformed their respective benchmarks over the 36-month period. All but one fund also offered investors returns in excess of what they required (based on their level of risk aversion). Performance varied significantly with only one fund, the Momentum Supernation Fund, scoring relatively high rankings vis-à-vis its benchmark in all three measures.

These results thus appear to be consistent with previous research which has concluded that "ethics pays" and that investors can indeed "do good by doing good" (Bauer *et al*., 2002; Cummings, 2000; Diltz, 1995; Kurtz & DiBartolomeo, 1996; Kurtz, 1997; Otten *et al*., 2002; Vermeir & Corten, 2000).

Recommendations

The fact that the majority of local SRI funds outperformed their benchmarks over a relatively short period (3 years) should serve as an incentive to South African fund managers to give greater consideration to SRI funds and SRI investment strategies. As these funds mature, even better performance could be expected, as is evident in international research.

Future research into this area should extend the analysis over a longer time horizon and could investigate the criteria which have a significant impact on SRI fund performance. Further investigations could also centre on a comparison of the performance of SRI funds vis-à-vis conventional funds, or those with a pertinent focus on environmental issues.

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