

Transforming Capitalism into a Positive Tool for Conservation

Pax World CEO, Joseph F. Keefe, honored as 2008 Pinchot Distinguished Lecturer

For all its benefits, capitalism has also stood accused of being the root cause of natural resource depletion and environmental degradation in many parts of the world. The standard economic models used to track productivity in most capitalist countries don't help either. They largely fail to account for resource depletion or dirtier air, and count the economic activity generated by environmental disasters, such as the Exxon Valdez oil spill or the cleanup following Hurricane Katrina, as positive contributions to GDP.

But Joseph Keefe thinks he has a formula for turning capitalism into a positive tool for actually conserving natural resources and cleaning up the environment. The idea is "sustainable investing," and it was the topic of the 2008 Pinchot Distinguished Lecture, an event hosted annually by the Pinchot Institute for Conservation in Washington, DC. Keefe was honored as this year's lecturer for his "outstanding contributions to the theory or practice of natural resource conservation," notably his groundbreaking efforts to reframe socially responsible investing (SRI) into a broader context of ecological, economic, and social sustainability.

Keefe is the president and CEO of Pax World Management Corporation and Pax World Funds. In 1971, Pax World launched the nation's first socially responsible mutual fund, and currently manages approximately \$2.7 billion in assets across six mutual funds focusing on sustainable investing.

Sustainable investing, according to Keefe, is the full integration of environmental, social, and governance (ESG) criteria into investment analysis and decision making. "Through a combination of rigorous financial analysis with equally rigorous ESG analysis, a sustainable investing approach seeks to identify companies whose business models and practices are more sustainable than their competitors," stated Keefe. "The theory underlying sustainable investing is that these companies, because they are more

forward-thinking and are developing more sustainable business models, are better long-term investments." This doesn't mean that each and every individual company displaying such characteristics will necessarily outperform its less enlightened competitors but "investment *portfolios* comprised of such companies, or designed with such ESG metrics in mind, will outperform investment portfolios that ignore such factors over the long term."

Sustainable investing is an outgrowth of socially responsible investing, but it takes a positive rather than negative outlook. Conventional SRI has typically been defined by the exclusion of certain "sin stocks" in industries such as alcohol, gambling, tobacco, or firearms, based on individual value choices. Sustainable investing, by contrast, is positively motivated to seek out opportunities to invest in companies with strong sustainability performance.

"Sustainable investing, at its core, is fundamentally an effort to induce markets to start pricing in—to begin ascribing value to—certain critical long-term metrics that once upon a time were derided as 'intangibles,' or as 'subjective,'" said Keefe.

Positive correlations between a company's environmental performance and its stock performance were long seen as anecdotal or qualitative, but the correlations are becoming more direct and increasingly quantifiable. He offers several illustrative examples, among them:

- ✿ In 2007, Goldman Sachs introduced GS Sustain, a focus list of companies that Goldman's analysts believe are attractive from an integrated ESG/financial perspective. The stocks of companies included on Goldman's list outperformed the MSCI World Index¹ by 25 percent over the past two years.
- ✿ A recent report from the UN Environment Programme based on 20 peer-reviewed academic studies provides compelling evidence that good ESG performance is positively related to good financial performance.



✿ A study by the World Resources Institute estimated the impact of impending environmental issues on the capital expenditures and future earnings of 13 leading public companies in the US pulp and paper industry, and found that 7 of them carried environmental liabilities that could reduce the value of the companies by 10 percent in the future; for some, it was as much as 20 percent.

✿ A study by Innovest Strategic Value Advisors found that “there is increasing evidence showing that superior performance in managed climate risk is a useful proxy for superior, more strategic corporate management, and therefore for superior financial value and shareholder value creation.” Innovest’s latest global analysis shows that companies that do the best in managing their carbon emissions surpassed the returns of companies rated below average in carbon emission management by an annualized rate of return of 3.06 percent.

Integrating sustainability concerns into investment strategies may benefit investors from a financial perspective, but how can they become what Keefe terms “transformative investment strategies” which can actually help reverse unsustainable resource extraction and environmental degradation? Can investment strategies go beyond just influencing companies at the margins, and actually move the markets themselves?

Keefe believes this is already happening. As an example he cites the February 2008 decision by the California Pension and Employee Retirement System (CalPERS), one of the largest pension funds in the United States, to invest \$2 billion in forestry enterprises certified as sustainable by independent third-party forest certification programs. Other pension funds and large institutional investors have taken notice, and are considering similar investment policies. This is essentially rewarding responsible companies by making available substantial new investment capital to expand and grow their businesses. The lesson is not lost on other companies, who also see opportunities to tap into new sources of investment capital by adopting sustainability policies.

Like informed consumers, informed investors can vote with their pocketbooks. When these pocketbooks represent \$2 billion in investment capital, their combined effect can indeed move entire markets—and help turn capitalism into a positive force for conservation and sustainable forest management.

Sustainable investing is quickly moving beyond being just a niche market. As Keefe puts it, “the investment world has discovered the environment.” It has become fashionable. Joel Makower of GreenBiz.com says, “green

is the new black.” Venture capital investments in clean energy have grown from \$468 million in 1999 to \$2.4 billion in 2006—nearly 10 percent of all the venture capital investment in the US. A recent survey by Allianz Global Investors, cited by Keefe, found that 71% of investors rated environmental technology as a “buy” and the most desirable sector in which to invest; 54% described investing in the environment as an “important focus” of their future investments; 49% of those surveyed said they would likely invest in a company or mutual fund that is providing solutions to environmental problems.

Even a “greening” of property investment has begun. University endowments are another major category of institutional investors. For example, Boston College, together with the University of Arizona, has launched the Responsible Property Investment Center. However, in recent years, several well-endowed universities—including some with high-profile schools of forestry or environment—have been stung by allegations that their drive to maximize returns has led them to invest in activities quite contrary to principles of ecological or economic sustainability.

Further effort is needed to achieve the “transformation” Keefe describes—the full integration of environmental, social, and governance values into financial analysis and business decision making. Sufficiently large numbers of individuals making independent investment decisions can have the same impact as a large institutional investor with \$2 billion to spend. Keefe concludes that “just as we must integrate sustainability into our consumption patterns, our lifestyle patterns, our voting patterns, so we must integrate it into our investment patterns . . . It is something we simply must do. It is an obligation our generation owes to future generations.”

Notes

1. The Morgan Stanley Capital International (MSCI) World Index is a weighted market capitalization index composed of companies representative of the market structure of 22 developed market countries in North America, Europe, and the Asia/Pacific Region. It provides a consistent, time-tested global view of the world equity markets.

The full text of Joseph Keefe’s 2008 Pinchot Distinguished Lecture can be found at www.pinchot.org.