Positive Screening:

Steps Toward an Ideal World

A thought piece by SFE's Chief Investment Officer

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In the same way consumers pushed organic farming into the mainstream, investors are bringing socially responsible investing front and center. Like shoppers reading the ingredients on a can of soup, investors are examining their portfolios to see how companies make their money. It's no longer enough to apply a negative screen and exclude alcohol, tobacco, or firearms manufacturers. These socially aware investors want to own stock in companies whose products or services or business practices are viewed as trying to make the world a better place.

Welcome to positive screening, an important development in socially responsible investing (often abbreviated to SRI and used interchangeably with "sustainability investing"). Positive screening is more nuanced and complex than negative screening, and it's easy to see why. Anyone can create a "don't buy" list of stocks. There's not much downside if you're wrong. By contrast, constructing a portfolio of companies that are "doing well by doing good," as the cliché goes, presents a challenge.

Step One is defining "good". At SFE Investment Counsel, where we have been implementing positive screening for more than a decade, we have found that even the most well-intentioned companies have flaws—kind of like humans. On the one hand, an engineering firm has expertise in remediation of waste sites. But it also derives significant revenue from contracts with the U.S. military. Another promising candidate has questionable activities abroad. The criteria, moreover, keep changing as society's concerns evolve: Is the company paying its employees a living wage? Is it responding to the implications of the #Metoo movement?

Our checklist, the SFE Sustainability Quotient™, begins with the simple question, "Is there an Ideal World sustainability attribute that led us to this company?" Next, we ask ourselves if the company produces a product or provide a service because the world needs it, or simply because it's saleable?

Because we believe in concentrating our portfolios, we have focused our search for investable companies primarily on three market sectors; healthcare, environment, communications. We add a final "bucket" to include companies that behave responsibly towards their stakeholders—their employees, community members, suppliers.

(Of course, to win a spot on our list, the company must also have a solid financial history and a promising future.)

Finally, we check our companies using a system that rates them in terms of their adherence to environmental, social and governance principles, or ESG. (There is a whole approach to SRI based on those factors, but in our approach they feature less than our positive screening.)

Historically, investors shied away from SRI because they felt forced to choose between conscience and performance. Indeed, in the early years of SRI, many SRI funds underperformed the market. But recent research suggests that SRI, in and of itself, is ***not*** the reason for the strategy's underperformance. It appears that it is negative screening that leads to underperformance; at a minimum it reduces the investable universe.

Even before we formalized our SRI strategy in 2008, SFE had moved beyond negative screening because we found it too limiting. Instead of finding companies to eliminate from consideration, we put our energies into finding companies deemed to be contributors to society. Our guiding principle is that admirable companies, ones whose products, services and/or treatment of people make the world a better place, will increasingly be recognized for these efforts not just by investment management firms, but individual investors as well.

About the Author: Charlie is the son of a prominent US diplomat who spent his childhood in Russia, France and the Philippines. Prior to joining SFE in 2001, Charlie worked in a variety of corporate settings, including banking and international finance. Charlie graduated magna cum laude from Harvard College with degrees in History and Literature. Charlie then attended Yale where he studied Law. Charlie was admitted to the Bar in California, Minnesota, and the District of Columbia. He is chairman of the Bishop W. Bertrand Stevens Foundation board of directors and serves as treasurer of the Antaeus Theatre Company.

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