Vista Adds a New Socially Conscious Portfolio

Introduction

There's been plenty going on in the world we could discuss in this letter, but we'd like to unveil something we've been working on for quite a while.

Over the past few years, we've been asked increasingly about values-based investing. It sometimes goes by SRI, for Socially Responsible Investing, or ESG, which refers to investing in companies with good Environmental, Social and Governance characteristics. In the past, we shied away from the area because there were few standards and little structure to the products being offered, and the fees tended to be unreasonably high. We've been watching closely and now believe that the industry has evolved to the point in which we feel comfortable putting together an alternative portfolio for clients with these interests.

This piece will summarize the evolution of the industry, and how we are approaching the construction of a socially conscious portfolio. Note that this will be an alternative portfolio that we can employ if you are interested. We will not be making any changes to your portfolio (outside the normal rebalancing parameters) unless you explicitly direct us to do so. If you decide to change to this new portfolio, you would need to sign a new Investment Policy Statement.

What is “Socially Conscious” Investing?

The concept itself is one that has evolved over time. Prior to about 2002, most of the socially conscious investment portfolios were tied to religious values. They typically excluded companies profiting from alcohol, tobacco, gambling, weapons, and other social concerns. Over time, this expanded into environmental concerns, which excluded most energy, lumber firms using clear-cutting, agricultural firms that genetically modified foods, etc.

As investors, excluding large swaths of the overall market made it extremely difficult to generate returns that were consistent with global markets. The fees associated with these funds were also exceedingly high, with many above 1.5% per year. In short: expensive funds with returns that we couldn’t rely on for our long-range planning.

We’ve seen these ideas undergo major changes in the last few years as more and more investors have demanded that their investments be directed to companies who are not only profitable, but who are also good citizens (fees have also dropped). Now, rather than placing a blanket exclusion on entire industries, these styles apply various screens across the market to determine which companies should be over/under weighted, or eliminated, based on their impact. Some examples include:

- Companies in heavily polluting industries who are trying to transform them, such as oil companies that invest heavily in alternatives like wind and solar energy.
- Older companies improving their social status by recognizing employee diversity or applying better governance, such as making a concerted effort to add more women and minorities to their boards.
- Just a few years ago, only 12% of companies in the S&P were reporting on “non-financial issues” and now that number has risen to 81%.

How Has Vista's Approach Evolved?

At Vista, we've recommended investing for the best risk-adjusted returns, then donating a portion of the portfolio gains to the organizations that had the greatest impact on the values that were most important to the client. However, social investing has evolved to where we can offer an alternative that comes close to our existing Traditional portfolio with:

- Broad diversification,
- Tilts toward companies that are comparatively inexpensive (value) and smaller (small cap),
- Low costs and,
- Most importantly for this purpose, social overlays to highlight companies that are "doing good."

What Was Vista's Approach To Creating This New Portfolio?

Our guiding principle with the creation of this new, transformational, portfolio was to stay true to our core investment philosophy of low costs and global diversification.

However, this portfolio also emphasizes those companies that are actively advancing and transforming, either through environmental sustainability, social justice, or corporate governance.

We wanted to create a portfolio that is well-diversified while making sure there is a heavy weighting towards companies that are trying to transform themselves, their industries, or the world at large. Examples include: increasing safety standards to reduce the number of workers' injuries, reducing water usage, or increasing the diversity of their boards.

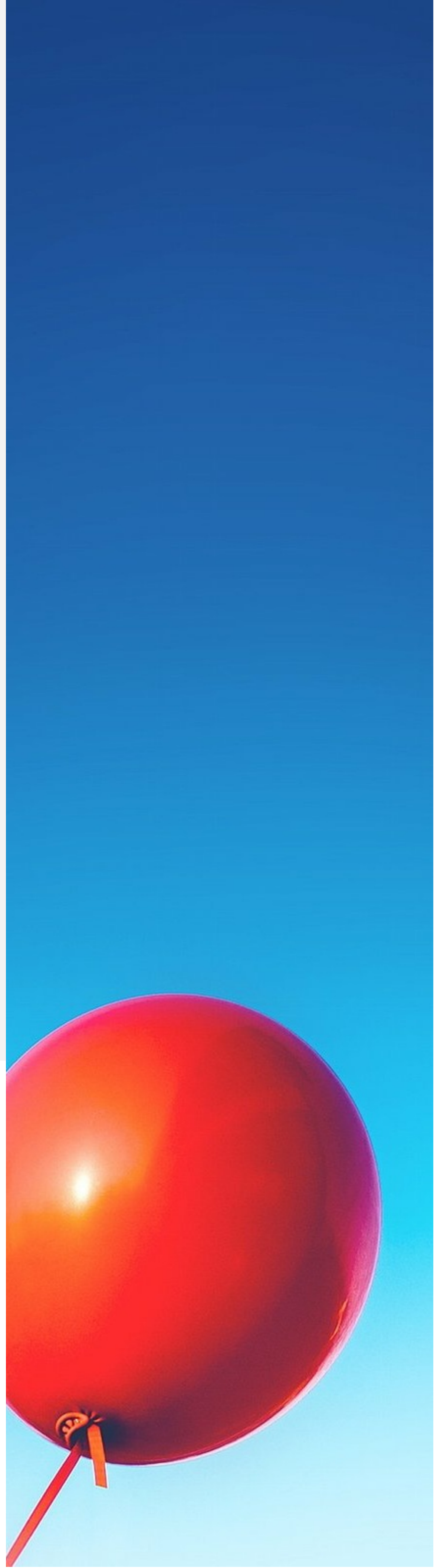
As with our Traditional portfolio, we began with the global market, and then used funds with high sustainability ratings, meaning they rated positively for key indicators and are or have been advancing towards higher social goals. We then looked across the various asset classes to find funds that had the best combination of sustainability ratings, asset class diversification, factor tilts, and low fees.

Note that we decided to invest in Real Estate Investment Trusts (REITs), even though there is not yet a fund that focuses on sustainability issues in that space. Several companies are developing funds as this is being written.

This method of investing is quickly evolving with more products frequently becoming available. As these new products become time-tested, fees decline, and sustainability screens improve, we will continue to refine this portfolio.

Should I Expect This Portfolio To Perform The Same As Vista's Traditional Portfolio?

While this area is still very new and constantly evolving, we have created a portfolio that is globally diversified with tilts towards small cap and value, so we do expect this portfolio to perform similarly to our Traditional portfolio over long periods of time.



That said, there are still some factors that may cause performance differences, especially in the short term, such as:

1) We only have about 15 years of data to look through and many funds have just been created in the past two years. We've done our best to create this portfolio to capture the returns of the market while focusing on those "doing good," but with the lack of a track record for these funds it's possible the returns will vary from the overall market.

2) Historically, sometimes “value” companies are weighted to “dirty” industries, such as oil and gas. Other times, value companies are weighted toward clean industries, such as finance. Therefore, there will be times when portfolios with sustainability mandates will have different performance from our Traditional portfolios: in our example, if oil and gas is cheap and suddenly does well, a sustainable fund may not do as well as a fund with a standard value mandate. Intentionally missing opportunities like this has historically reduced returns between one-quarter and one percent per year.

3) We decided to invest in emerging markets. As you can probably surmise, companies in those markets generally tend to be more damaging to the environment and there are few sustainable options. The fund we’re using is focused on social issues such as the exclusion of companies in the gambling, weapons, and alcohol industries. Excluding industries may reduce performance over certain time periods.

Thanks

We hope this letter was of interest to you. If you are interested in learning more about these new portfolios, please contact your Advisory Team to start the conversation.

Your Vista Wealth Management Team