Sustainable Log

565

Mark Brandon is the Managing Partner of First Sustainable (http://www.firstsustainable.com), a registered investment advisory catering to socially responsible investors. In addition to Socially Responsible Investing (SRI), he may opine on social venturing, microfinance, community investing, clean technology commercialization, sustainability public policy, green products, and, on occasion, University of Texas Longhorn sports.

Wednesday, January 18, 2006

A Rundown of SRI ETF's

In only a few years, exchange traded funds have grabbed an astounding share of invest-able assets. They have existed for years, going by the un-sexy moniker "closed end funds". In the late 1990's, the American Stock Exchange jumped on the indexing bandwagon and listed sexier-sounding closed-end index funds that went by the names Spiders (to reflect the S&P 500 index) and Diamonds (to reflect the Dow Jones Industrial Index). As investors awakened to the high costs and underachievement of their actively managed mutual funds, these simple instruments caught fire.

Today, there is an ETF for virtually every flavor of index, including SRI and its various off-shoots. I am going to discuss the pros and cons of these funds, but first a rundown of the options out there.

1. Powershares WilderHill Clean Energy Portfolio (PBW) - Meant to reflect the WilderHill Clean Energy Index, the fund has returned approximately 14% since its inception last March, far outpacing the S&P 500. The expenses are capped at .6%. The components can be found on the AMEX web site.
2. KLD Select Social Index Fund (KLD). Part of the Barclays iShares family, the index has underperformed the S&P 500 over the last year. The expense cap is at .5%.

There are other indexes without corresponding ETF's that track fuel cells, clean water, environmental, and other SRI styles.

Pros

1. **Simplicity**. ETF's give you instant diversification in one security.
2. **Liquidity.** Unlike open-end funds, these symbols are traded throughout the day, giving you the option to buy and sell at any time.
3. **Low Transaction Fees.** Unlike many open-ended funds, the cost to get in and out of these funds is just a commission for the trade, which depending on your broker can range from $0 (such as offered at First Sustainable) to much more than that. Many SRI open-ended funds charge a front end load, and possibly a back end load as well.
4. **Relatively low expenses.** Compared to the actively managed SRI funds, expense ratios in the half percent range sound great.

Cons

1. **Automatic Investment may increase transaction charges.** Since an ETF consists of placing a stock trade, you may get dinged this transaction charge every time you invest. For example, if you are saving $100/month, but your broker charges you $10 every time you purchase, you are getting dinged 10% up front every time.
2. **"Relatively low" expenses does not mean "low".** In the pros, I mentioned relatively low expenses compared to open ended funds. However, the largest ETF's charge five basis points as a management fee. Why does it take ten times that to run these passively indexed funds? These funds do not need to keep up with investing and redeeming shares. I believe that they are taking advantage of the SRI customer, who is typically willing to pay more for any product to be assured of its social responsibility. This irks me, as I believe it prevents the mainstreaming of the SRI strategy.
3. **Tax Inefficiency.** Just like all mutual funds, ETF's are required to pass through capital gains and dividends. However, they are not able to pass through losses, only those losses offsetting gains. Owning individual stocks can make managing your tax bite more favorable.
4. **Premiums and Discounts.** It is important to track the market cap of the ETF compared to the Net Asset Value of the underlying shares. The WilderHill ETF for example has a 20 percent premium right now. This means that if the fund were liquidated, you would not get your full investment back. Theoretically, this can work the other way with discounts, but if a discount to NAV gets too pronounced, a fund board just votes to open up the fund, and *poof* the fund starts trading at NAV again.

Again and again, I have stated in this space that the key to long term success is reducing costs and adhering to passive styles. To that end, ETF's are great, especially for small investors. For large investors (those with $50,000 or more), I still recommend the Folio Method of investing.

posted by Mark Brandon at 7:03 AM

0 Comments:

Post a Comment

<< Home

Join Our Mailing List

Email:

Go

-
-
-
-
-
-
- Blogroll Me!
-
-
-
-

? austinbloggers # >>

About Me

Mark Brandon

Austin, Texas, United States

Mark Brandon has 13 years of usiness, helping customers assess and reach th early part of his career at nationally respected investme er Jaffray. In

1997, he took on the role of Managing Par [...] here he held the General Securities Principal and Financ [...] guiding the firm until its eventual sale to Yourtrade.co [...] ble, a Registered Investment Advisory catering t [...] omer funds are held by FolioFN investments and insured b [...] Corp. Brandon obtained both undergraduate and graduat [...] s at Austin. He holds a B.A. in History (1992) and an M.S. [...] cialization (2005). He resides in Austin, TX with his w

View my complete profile