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A Guide for
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News

February 01, 2005

Two Socially Responsible Investment Exchange Traded Funds Launch

by William Baue

The iShares KLD Select Social Index Fund seeks broad diversification and low risk, while the PowerShares WilderHill Clean Energy Portfolio ETF invests in renewable energy companies.

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Socially responsible investment (SRI) is commencing the new year by moving into a new arena: exchange traded funds (ETFs), which resemble mutual funds by bundling securities but differ by allowing trades all day to exploit market flux instead of setting net asset value (NAV) once daily. Late last month, [Barclays Global Investors](#) launched the iShares KLD Select Social Index Fund (ticker: KLD), which uses an optimization technique to overweight and underweight companies based on social and environmental performance, on the New York Stock Exchange ([NYSE](#)). And later this month, the American Stock Exchange ([Amex](#)) will begin listing the PowerShares WilderHill Clean Energy Portfolio (PBW), comprised of companies that promote renewable and alternative energy.

While most SRI products use negative (exclusionary) and/or positive (best-in-class) screens that limit diversification and introduce risk, the [KLD Select Social Index](#) (upon which the iShares ETF is based) minimizes risk while retaining broad inclusion across all sectors (except tobacco). Instead of screening, the index overweights companies with strong social and environmental performance and underweights companies with weak sustainability performance, thereby answering mainstream institutional investors' call for wide diversification and risk minimization. Such optimization tilts the index in an ethical direction that may also positively impact financial performance, as empirical academic studies in aggregate correlate strong corporate responsibility performance with strong corporate financial performance.

"In the past, SRI funds have focused on values-based investors--those who do not want to hold companies or sectors for ethical reasons," said Peter Kinder, president of Boston-based SRI research firm [KLD Research & Analytics](#). "These investors tend to be willing to give up some diversification and some return in exchange for consistency with their values."

"More recently, we've seen growing interest from investors who want to take advantage of the insights of social analysis but are more risk averse than values-based investors," Mr. Kinder continued. "Their interest led KLD to devise a portfolio approach that addresses both their fiduciary concerns and their wish for greater exposure to companies that rate highly on particular social screens."

The index is comprised of approximately 250 to 350 large capitalization companies drawn from the [S&P 500](#) and the [Russell 1000](#). The latter serves as the index's benchmark, with a tracking error (or deviation) of less than two percent instituted for additional risk control. The index's top three holdings (as of December 31, 2004) were Wells Fargo ([WFC](#)), Microsoft ([MSFT](#)), and Procter & Gamble ([PG](#)).

From its June 2004 inception until December 31, 2004, the KLD Social Select Index rose 9.63 percent, slightly lagging its benchmark, as the Russell 1000 gained 9.75 percent over the same period. The iShares KLD Select Social Index Fund carries an expense ratio of .50 percent, and is widely available through brokerage firms, financial advisors, and online brokers.

KLD corporate responsibility analyses evaluate performance on environmental, labor relations, community relations, diversity, product safety, human rights, and corporate governance arenas, in addition to promoting strong sustainability reporting through its proxy-voting guidelines.

In contrast to the broad diversification of the iShares KLD ETF, the PowerShares WilderHill Clean Energy Portfolio ETF focuses on companies that support renewable and cleaner energy production. Managed by [PowerShares Capital Management](#), the ETF tracks the WilderHill Clean Energy Index ([ECO](#)), a portfolio comprised of 37 companies listed in the US that ply in green energy, such as wind, solar, and hydrogen fuel cells.

The top three holdings in the index (as of February 1, 2005) are Distributed Energy ([DESC](#)), a company that produces hydrogen and fuel cell technology among other renewables, Evergreen Solar ([ESLR](#)), a solar panel producer, and Zoltek ([ZOLT](#)), a carbon fiber company. Since its August 16, 2004 launch, the ECO index has risen 25.4 percent.

The PowerShares WilderHill Clean Energy Portfolio ETF is slated to launch around February 23, according to Dr. Robert Wilder, managing director of WilderShares, which manages the index in collaboration with Amex.

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