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New rules for do-good funds

Portfolios that seek to combine moral values with stock values are getting a makeover, says Fortune's Jia Lynn Yang.

By Jia Lynn Yang, Fortune reporter

(Fortune Magazine) -- People who invest in socially responsible mutual funds have been paying for their principles. Such funds tend to avoid energy and mining companies - and those have been two of the market's hottest sectors in recent years. The average socially responsible fund has lagged the broad market for the past three years, returning 8.5 percent from 2004 through the end of 2006, vs. 10.4 percent for the S&P 500, according to Morningstar.

But there's change afoot in the world of socially responsible investing (SRI), aimed both at boosting performance and at developing more sophisticated rules for screening stocks. The result should be more choices for socially conscious investors and, with luck, better returns too.

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Ever since, SRI funds have tended to focus more on what companies were doing wrong than what they might be doing right. The limitations of that simplistic approach were highlighted in 2005 when Pax, which manages nearly $2.5 billion, had to drop Starbucks (Charts) from its portfolio after the company licensed its name to a Jim Beam coffee liqueur.

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Pax isn't the only SRI fund updating its criteria. Barbara Krumsiek, CEO of Calvert, which manages $13 billion, says the company is considering whether to invest in nuclear power companies, since that technology could be a way of slowing global warming.

Calvert funds, too, have had trouble keeping pace with the S&P index the past four years, but the Calvert Large Cap Growth fund (CLGAX), run by John Montgomery, who founded Bridgeway Capital Management, is still worth a look for its consistent quality. The fund's average annual return has been close to 12 percent since its inception in 1994.

One of the best-known SRI funds has undergone a different kind of change. When Domini Social Equity (DSEFX) was launched in 1991, it was an index fund, tracking the Domini 400 Social index created by Amy Domini in 1990. In the late '90s the fund thrived, thanks to its large holdings of tech stocks. But returns have lagged since 2003, and in November the fund, which has $1.2 billion in assets, switched to active management, asking venerable investment firm Wellington Management of Boston to handle the stock picking. The fund's expense ratio, however, has risen from 0.95 percent to 1.15 percent, and it's a little too early to say whether that extra cost will be worth it.

Domini is also going global. In December it launched two new international options: PacAsia Social Equity (DPAFX) and EuroPacific Social Equity (DUPPX). They will also be run by Wellington, which is off to a strong start already with Domini's one-year-old European Society Equity (DEUFX), which had a 32.5 percent return last year, vs. 23.8 percent for the MSCI Europe index.

…. And 2005 saw the debut of the first-ever SRI exchange-traded funds aimed at socially responsible investors (exchange-traded funds, or ETFs, are low-cost portfolios that trade like stocks): the Power-Shares' WilderHill Clean Energy Portfolio (PBW), ….

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Are there renewable-energy stock funds?