

by Mari Kane / mkane@buyside.com

Amy Domini

Domini Social Equity Fund

The Domini Effect

Amy Domini is not your average fund manager. As the president and co-founder of the Domini 400 Social Index, the Domini Social Equity Fund, and author of *Ethical Investing*, she is a financial trailblazer who created a mutual fund with the aim of sparking social change. More importantly, the fund has amassed a superb record, with three- and five-year returns beating those of the S&P 500 index. So what is the Domini theory?

"I'm an advocate of integrating social criteria into the investment decision-making process because I believe, as was the case in the South Africa debate, the integration of social criteria can lead to positive results and actual change in people's behavior," says Domini.

In 1984, 40 U.S. companies pulled out of South Africa, with another 50 following suit in 1985. In October 1986, the U.S. Congress passed sanctions against and banning many South Africa imports. By 1990, Apartheid was a thing of the past.

Those events proved to be a watershed for Domini. "What I took from that was that in order for civic society to function, it needs to know what's going on. A method for people to

know what is going on is socially responsible investing. By purchasing companies that meet certain social criteria you

study companies and you create a new kind of dialogue between corporations and society."

There was one major hurdle Domini faced 11 years ago. Everyone knew that applying social criteria to investment decision making would cost money. This was an inescapable fact thanks to the body of literature reinforcing the concept that anything that limits your investment universe limits your return.

Domini knew that to take SRI mainstream, there would need to be a method for evaluating corporate impact. The first step was to construct a way to measure what it would cost. Once the cost was

made known, people could decide if it was worth it to them.

"That was why we started the index," says Domini. "I wanted to remove the barrier that existed, and the main barrier was that you couldn't make money this way. And it didn't seem logical to me that you couldn't, so I was just going to track how much it cost."

Against this backdrop, Steven Lydenberg, Peter Kinder and Amy Domini created a company to perform the research, and launched the Domini 400 Social Index in May 1990. On June



Amy Domini is the president and founder of the Domini Social Index and the Domini Social Equity Fund, the first mutual fund to track stocks through social screens. As the mother of two teenage boys, Domini is concerned about the future of American society's spirit of altruism.

1, 1991, the Domini Social Equity Fund was born.

To determine a methodology for managing the fund, KLD defined what the typical socially responsible investor cared about. What they determined was that people cared about avoiding certain things and emphasizing others. KLD also wanted to find a methodology that would have “the advocacy purpose of being comparable with some methodology that people on Wall Street respected.” KLD chose as its benchmark the S&P 500.

They noted the characteristics, such as that it replaces a company when one is lost, it doesn't have high product turnover and it doesn't have any particular lockstep rule. KLD wanted to include a number of companies that were not automatically generated, but were generated with consideration to the kind of companies the classic SRI would invest in.

“So we found out what the typical social investor wanted and found a methodology that we thought had legs to it. We proxied the other mutual funds in the field and found out what kind of screens they are applying [such as tobacco, alcohol, nuclear power, supply services to gambling operations, and military weapons]. Those things are all at the first level; i.e., the manufacturer of the weapon, but not the reseller.

“The other side is the stakeholder analysis,” says Domini. Each corporation affects the well-being of its customers, communities, employees and the natural environment. We try to assess the corporate impact on these areas and this is done through a much more complex measure. By policy, roughly 250 companies that are on the S&P are also on the Domini, and roughly 150 of the Domini are not on the S&P.”

Challenges abound in the brave new world of SRI, according to Domini. The biggest challenge has been the high rate of mergers and acquisitions. Socially responsible companies that get bought by irresponsible ones assume the bad rep of their new parent company, and out they go. The fund's turnover previously ran at five percent, but Domini estimates that it's currently running at more than 20% with all the M&A action.

Domini also files shareholder resolutions with the companies in the fund. Domini Social Equity Fund was the first mutual fund to post actual proxy voting on its website. The

companies they've filed against read like a who's who of brand names: Walt Disney, McDonald's, Wal-Mart and Sears on contracting supply, or sweat shops; Merrill Lynch on the underwriting criteria of raising money for China; Dana Corp. on the environment; and RR Donnelley on equal pay and comparable worth. Their resolutions against Coke have resulted in an agreement to increase the amount of recycled plastic in Coke bottles.

“We file more shareholder resolutions than any other mutual fund, which is not saying much since the others file two or three in a given year,” Domini says. Right now, out of 8,000 total mutual funds, 144 are SRI, according to Morningstar. Of those, only 20 meet Domini's standards.

“Gallup has done a study that [shows] one out of eight households owns SRI funds. The Social Investment Forum does a trend report every two years and we've found it doubling. My fund has doubled in assets every year and we're the fifteenth fastest growing mutual fund in America. And it has really mushroomed worldwide. There are over 40 ethical funds in England, seven in Spain, 17 in France, two in Morocco, four in Japan and 10 in Australia. Wall Street is not thrilled with my approach to things, but they see how I've built market demand and market niche. I think that the fact that Vanguard and TIAA-Cref last May launched socially screened index funds of their own indicates that the initial purpose of the index creation, which was to take this field mainstream, worked out.”

Domini cites the book *The Tipping Point*, by Malcolm Gladwell, science reporter for the New Yorker, as one which makes the case for catalysts that generate dramatic turnarounds in society.

“I think we could be at a tipping point in history here and we could slide toward the better,” muses Domini. “We've got baby boomers coming to corporate leadership positions. If you grew up during civil rights and the Vietnam War, you were formed in that era, and those things are part of who you are. That leadership is going to have a very different mentality from the World War II leadership. I think it is a good context for a tipping point in history and I think social investing can bring it there.”

DOMINI SOCIAL EQUITY FUND TOP 10 HOLDINGS	
Company	Ticker
Intel Corp.	INTC
Cisco Systems	CSCO
Microsoft Corp.	MSFT
Wal-Mart Stores	WMT
Lucent Technologies	LU
American International Group	AIG
Merck & Co.	MRK
E.M.C. Corp.	E.M.C.
SBC Communications	SBC
Sun Microsystems	SUNW