

# UBS ETF *Market Matters*

## *Socially Responsible Investing – A Passive Approach*

- MSCI's major SRI indices have outperformed conventional parent indices in risk-adjusted terms since inception.
- MSCI SRI portfolios generally have higher price-to-book value ratios, similar dividend yields, and lower trailing earnings, when compared to their respective parent indices.
- The additional capital gain, on top of conventional portfolios, shows investors are willing to pay a premium for a positive social tilt achieved with the SRI approach.

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In addition to conventional financial criteria, Socially Responsible Investing (SRI) takes into account social aspects of an investment. In general, socially responsible investors encourage corporate practices which explicitly deliberate what are often referred to as ESG factors: environment, social justice, and corporate governance. The SRI investment approach may either focus on the inclusion of certain companies which promote ESG rules, or exclude a set of companies from the broad investment portfolio involved in particular industries deemed as non-compliant with ESG criteria, such as tobacco, nuclear power or GMOs. Whereas the first approach is typically executed by an SRI fund manager who may provide an individually customized portfolio, the latter investment approach may be achieved by getting exposure to a portfolio of securities filtered from a broad universe, after running through pre-defined ESG compliance filters.

The aim of this study is to look into the performance of ESG investing using a passive solution. The passive investment approach entails the selection of a preferred SRI index which typically captures a subset of companies (ESG-screened) from the corresponding parent index. While a fully comprehensive comparison of different index providers or multi-asset comparison is beyond the scope of this study, this analysis centres on the MSCI SRI family.

### ESG-based approach

MSCI SRI indices exclude companies which do not meet specific SRI-based criteria. Companies involved in activities listed in Table 1 are typically excluded from the SRI index after a certain revenue threshold is exceeded or a defined type of involvement (producer, distributor, supplier etc.) is met ("MSCI Global Socially Responsible Indices Methodology").

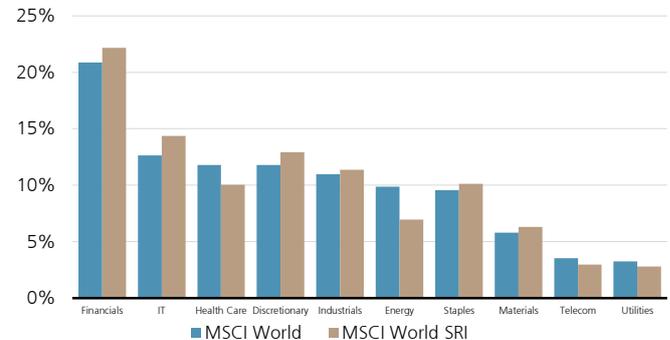
**Table 1: MSCI SRI-based limited activities**

Alcohol	Civilian Firearms
Gambling	Nuclear Power
Tobacco	Adult Entertainment
Military Weapons	Genetically Modified Organisms (GMO)

Source: MSCI Global Socially Responsible Indexes Methodology, March 2014

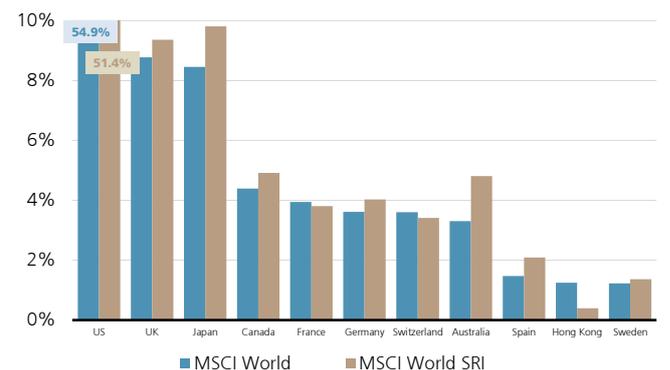
The indices further target companies with high ESG ratings relative to their sector peers, to ensure the inclusion of the best-in-class companies from an ESG viewpoint. The SRI index targets 25% free float-adjusted cumulative market capitalization of each sector of the parent index, starting from regional exposure aggregated upward to a world index. This approach implies that a stock in the SRI index has approx. four-fold higher index weight as compared to its weight in the parent index, whilst the sector as well as region breakdown and diversification is preserved, as seen in Figure 1a and Figure 1b for the MSCI World SRI.

**Figure 1a: MSCI World and MSCI World SRI sector breakdown**



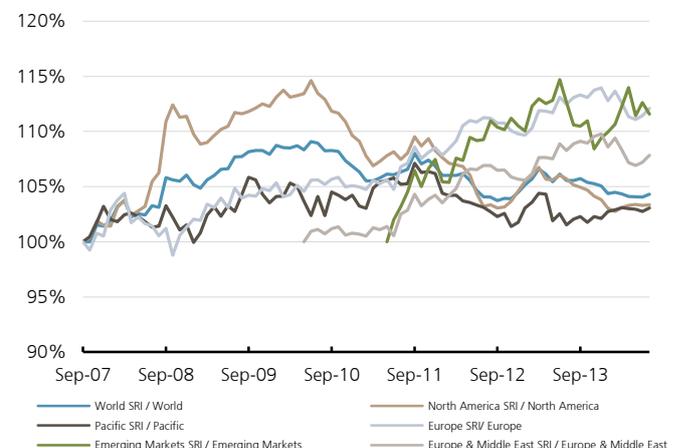
Source: MSCI, UBS Global Asset Management, as of 31 July 2014

**Figure 1b: MSCI World and MSCI World SRI country breakdown (Top 10 countries)**



Source: MSCI, UBS Global Asset Management, as of 31 July 2014

**Figure 2: MSCI SRI (large + mid cap) relative performance (Total Return Net in USD, since inception)**



Source: MSCI, UBS Global Asset Management, as of 31 July 2014

For all charts: Past performance is not a reliable indicator for the future.

## MSCI SRI performance

Figure 2 shows the relative performance of the major MSCI SRI indices over the corresponding parent indices since inception in September, 2007 (certain indices followed up later, e.g. Emerging Markets SRI index was introduced in May, 2011). The performance is measured in net total return terms, thus accounting for dividend payments and assuming these proceeds are reinvested. The major SRI indices have outperformed the broad parent exposures since introduction by 5% to 15%. This also holds true for price indices, thus suggesting that any difference in dividend income cannot fully explain the SRI's better performance.

## Some Facts

The ESG research aims to integrate sustainability analysis into the index construction process so that the resulting SRI indices are comprised of best-in-class stocks from an ESG viewpoint. While equivalent sector/country diversification is achieved by applying rules of SRI index construction, the open question is whether the value-added of high ESG rankings is somehow reflected in the financial data. Given that corporate and social responsibility may potentially impact profitability and cost structures, it is worth comparing valuation ratios and risk-adjusted performance. The major findings can be summarized as follows (data available since 2007):

1. Dividend yields are at similar levels for the SRI indices and their respective parent indices (Figure 3).
2. Price to book ratios are higher for SRI portfolios (Figure 4).
3. Trailing earnings-per-share are generally lower for SRI, indicating that the exclusion of certain activities impacts the overall profitability of a SRI portfolio (Figure 5).
4. Annualized returns and Sharpe ratios are higher for all major SRI indices vs. their respective parent indices (Table 2).

**Table 2 Performance measures based on monthly net returns (Since introduction, in USD)**

Statistics	Index	World*	North America*	Pacific*	Europe*	Europe & Middle East**	Emerging Markets***
Ann. Return %	SRI	3.55	5.47	1.42	1.88	15.87	3.25
	Parent	2.91	4.97	0.98	0.19	13.79	-0.26
Sharpe Ratio <sup>^</sup>	SRI	0.24	0.35	0.13	0.16	0.84	0.26
	Parent	0.20	0.32	0.10	0.09	0.72	0.07

Source: MSCI, UBS Global Asset Management, as of July 31, 2014

\* Since Sep. 28, 2007; \*\* Since May 26, 2010; \*\*\* Since May 31, 2011

<sup>^</sup> Sharpe Ratio calculated with the risk free rate BBA Libor 1M

The findings detailed above prove that high ESG compliance is reflected in financial data and shareholder value. Two features are remarkable: higher valuation and lower trailing earnings. Performance-wise, the MSCI SRI portfolios have delivered higher returns and better Sharpe ratios. For example, MSCI Emerging Markets SRI yields a positive annualized return of 3.25%, whereas its parent Emerging Markets index has a negative annualized return of -0.26%. Clearly, corporate and social responsibility can enhance shareholder returns, by reducing reputational risk and by providing a positive social tilt.

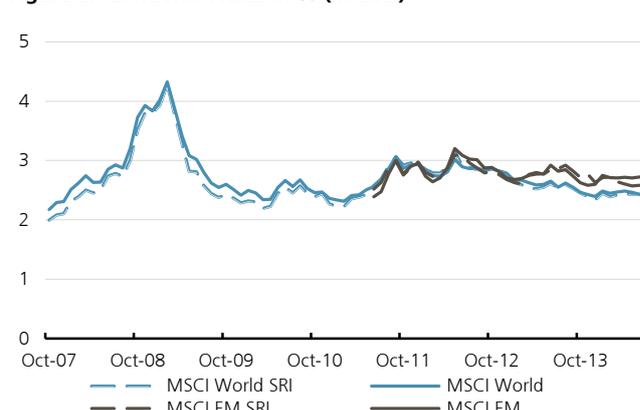
The conclusions here are based upon one family of indices, but do corroborate additional findings on the subject. The report "The Performance of Socially Responsible Investment" by Emma Sjöström (Stockholm School of Economics) puts together academic findings based on a wide suite of SRI investment vehicles, with varying results. This report based on 21 studies (excluding MSCI SRI indices) concludes that a slight predominance of increased yields and increased value to shareholders is achieved with an SRI approach. This brief study of the MSCI SRI family also shows a slight tilt towards a positive performance of SRI indices, when compared with conventional investible indices.

**Table 3: UBS ETFs - SRI offering as of July 2014**

Fund name	TER	AuM in USD m	NAV Repl- cation	Distri- bution	SIX	Listings / Key exchanges				
						XETRA	LSE	Borsa	ISIN	
<b>Socially Responsible</b>										
UBS ETF – MSCI World Socially Responsible UCITS ETF	0.38%	72	USD Physical	Yes	CHF/USD	EUR	GBP	EUR		LU0629459743
UBS ETF – MSCI Europe & Middle East Socially Responsible UCITS ETF	0.28%	19	EUR Physical	Yes	CHF/EUR	EUR	GBP	EUR		LU0629460675
UBS ETF – MSCI North America Socially Responsible UCITS ETF	0.33%	112	USD Physical	Yes	CHF/USD	EUR	GBP	EUR		LU0629460089
UBS ETF – MSCI Pacific Socially Responsible UCITS ETF	0.40%	14	USD Physical	Yes	CHF/USD	EUR	GBP	EUR		LU0629460832

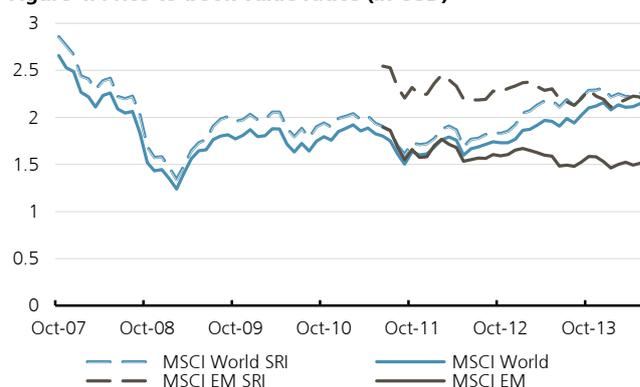
Note: AuM as of 31 July 2014

**Figure 3: Dividend Yields in % (in USD)**



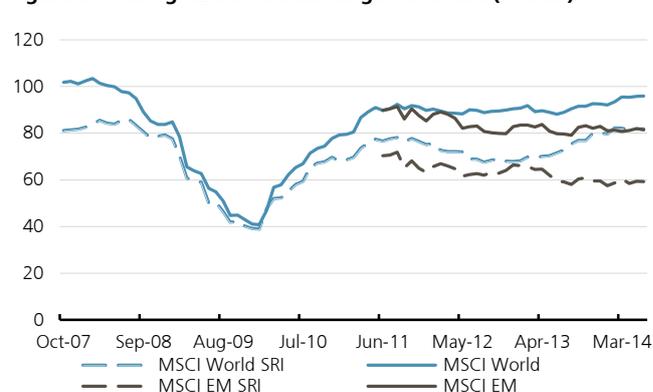
Source: MSCI, UBS Global Asset Management, as of 31 July 2014

**Figure 4: Price-to-book value ratios (in USD)**



Source: MSCI, UBS Global Asset Management, as of 31 July 2014

**Figure 5: Trailing 12 months Earnings-Per-Share (in USD)**



Source: MSCI, UBS Global Asset Management, as of 31 July 2014

For all charts: Past performance is not a reliable indicator for the future.

## How to contact us

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For more information on UBS ETFs: [www.ubs.com/etf](http://www.ubs.com/etf)



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