Morgan Stanley

ONLINE REPORT

CONSULTING GROUP

Doing Well by Doing Good

SUMMARY

Increasingly, many investors want their financial holdings to reflect their social, ethical or religious values. At the same time, most investors still want to earn a reasonable return on their portfolio. Socially responsible investing (SRI) seeks to reconcile these two objectives by helping investors create diversified portfolios that strive to deliver acceptable performance while excluding companies that don't meet their ethical criteria. With some investment planning and the appropriate trading systems in place, investors can incorporate SRI into their investment strategies to help meet their long-term goals.

INTEREST IN SOCIALLY RESPONSIBLE INVESTING CONTINUES TO RISE

Many investors have strong opinions that don't involve their views on interest rates and stock prices. This might include support for a clean environment or concern for the poor and the disadvantaged–just to mention a few well-known causes.

Increasingly, these investors want their holdings to reflect their social, ethical or religious values. They wish to avoid companies that profit from activities they oppose, and support companies that behave in ways they consider appropriate or responsible. At the same time, however, most investors still want or need to earn a reasonable return on their portfolios.

Socially responsible investing ("SRI") seeks to reconcile these two objectives by helping investors create diversified portfolios that strive to deliver an acceptable level of performance, while at the same time excluding companies that don't meet their ethical criteria. SRI investing recognizes that corporate responsibility and societal concerns are an important part of many investment decisions—particularly with the world's increased focus on sustainability and climate change, among other subjects.

Typically, this is done through the use of specific tests, or "screens," to identify companies active in industries or lines of business that the investor wishes to avoid. These industries could include tobacco, alcoholic beverages, pollution or pornography, to name a few.

INCREASING INTEREST IN SRI

While socially responsible investing has received heightened attention recently, it has actually been around for centuries. Many historians credit 17th century Quakers with bringing the concept to the United States. These merchants and farmers refused to profit from war or from the slave trade.

Over the last several decades many investors have shown an increased appetite for socially responsible investing. The Social Investment Forum, a nonprofit group that promotes socially responsible investing, calculates the total number of assets under professional SRI management rose from $629 billion in 1995 to $3.07 trillion at the start of 2010. In fact, the Forum estimates that one out of every eight dollars under professional management in the US today—or 12.2% of the $25.2 trillion in total assets under management tracked in Nelson Information's Directory of Investment Managers—is involved in socially responsible investing.[1]

Interest in socially responsible investing reached a high point in October 2006, when Muhammad Yunus, a 65-year old from Bangladesh, and the Grameen Bank were recognized for their achievement in the micro-credit field with the award of the Nobel Prize for Peace. Together, Mr. Yunus and the bank helped more than 6.5 million low-income borrowers build their community and overcome poverty. Moreover, Mr. Yunus and the bank were able to do this with a 99% repayment rate.[2]

Why has socially responsible investing gained in popularity? One of the reasons may be that investors posed themselves a question similar to this one: *while my number one investment goal will always be to create a properly diversified portfolio based on my personal risk tolerance levels, how can I also do a bit of good for the environment, for the world or to improve the condition of mankind?*

A second reason for SRI's popularity is that some of the nation's most prominent institutional investors have increasingly added a socially responsible focus to their investment decisions. These institutions, many with significant assets and often with great public, political and media clout, often carry both a big stick and use a loud voice. Some have become well-known advocates for social issues and this is often carried out through their investments in socially-responsible projects. An example is found in the California Public Employees' Retirement System (CalPERS), one of the world's largest public pension funds.

CalPERS has pursued SRI goals on its own and in 2006 announced support for the United Nation's Principles for Responsible Investment, a menu of possible global actions on environmental, social and corporate issues.[3] Today, CalPERS participates in a number of SRI-based initiatives.

A third reason for increased interest in SRI is the simple fact that it's now much easier to access professionally managed SRI vehicles. Many investment firms have created specific investment processes that exclude companies that, in the investor's view, focus on non-socially responsible or acceptable activities. Once these decisions have been made, the manager constructs a diversified portfolio within the desired constraints. The goal is to deliver performance consistent with the investor's return objectives and tolerance for risk. Of course, portfolio performance will vary depending on both the manager's skill and on the particular constraints imposed by the investor. However, assessing the impact of both has become easier thanks to the development of several broad "socially defined" benchmarks. Two of the most common social indices are:

- **MSCI KLD 400 SOCIAL INDEX™** The MSCI KLD 400 Social Index™ (formerly the Domini 400 Social Index) is a capitalization-weighted index of 400 U.S. Companies that have passed multiple, broad-based social screens. Created by the research firm of KLD Research & Analytics, the index consists of approximately 90% large cap companies, 9% mid-cap companies that provide comparable industry representation, and 1% small cap companies judged to have strong socially responsible characteristics.
- **CALVERT SOCIAL INDEX™** The Calvert Social Index™ takes the 1,000 largest companies in the U.S. stock market, based on total market capitalization. The Calvert Group, an investment firm, audits each company on a number of different socially responsible criteria, including product safety, environmental sensitivity, workplace issues and human rights. Stocks that meet the firm's socially responsible criteria are included in the index.

> *"SRI investors encourage corporations to improve their practices on environmental, social and governance issues. You may also hear SRI-like approaches to investing referred to as mission investing, responsible investing, double or triple bottom line investing, ethical investing, sustainable investing or green investing."* [4]

IMPLEMENTING A SOCIALLY RESPONSIBLE PORTFOLIO

Consulting Group, the managed money unit of Morgan Stanley, offers clients several methods for achieving their socially responsible investing goals. One is to select an investment product that specializes in such strategies. The Consulting Group Investment Advisor Research team has reviewed and evaluated a number of socially responsible investment products, both separately managed account products and funds. Your

Financial Advisor can review those professionally managed products with you to help determine an appropriate choice.

Another alternative is to use Consulting Group's trading system to block the purchase of specific companies or industries that do not meet your social criteria. Clients can designate specific stocks for restriction, using the unique identity numbers that are assigned to all securities traded in the US markets. The system can also be used to restrict companies based on an industry criteria, such as exposure to alcohol, tobacco, gambling operations or another criteria.

To screen for socially responsible restrictions, Consulting Group relies on a software program developed by KLD Research & Analytics, the same firm that developed the MSCI KLD 400 Social Index. Using screening parameters developed by KLD, the program identifies and codes individual companies that fall within the designated categories. The CG trading system automatically blocks the purchase of the stocks or industry categories designated by the investor. When that happens, portfolio managers may select an unrestricted substitute stock, or alter their strategy to suit the restrictions imposed by the client. That choice may depend on the manager's investment style, the needs of the client, the size of the account, and other factors. This screening process is available to managers in our investment advisory programs who use Consulting Group's trading system to execute trades.

Before implementing a socially responsible investment program, make sure you incorporate these concepts and identify the appropriate restrictions in your written investment policy statement. Institutional investors should properly document their SRI principles and communicate with the board members, trustees and investment committee members. Additionally, your organization and your family can publicly support your socially responsible criteria by volunteering or donating to a local community or charity event that dovetails with your socially responsible interests.

CONCLUSION

Structuring investments consistent with social, environmental or ethical objectives offers investors a way to align their portfolios to their own objectives. SRI can be used to reflect, support and advocate your or your organization's mission.

For more information on incorporating a socially responsive component into your investment strategy, speak with your Morgan Stanley Financial Advisor.

1 Social Investment Forum Foundation. *2010 Report on Socially Responsible Investing Trends in the United States.*

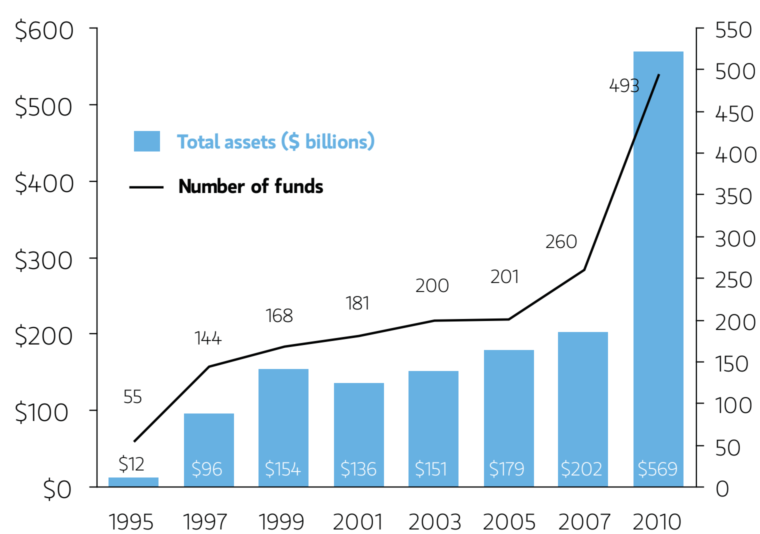
2 KLD Research and Analytics, Inc., www.kld.com.

3 "CalPERS Backs United Nations Principles for Responsible Investment." April 27, 2006, www.calpers.ca.gov.

4 "Socially Responsible Investing Facts: What is SRI?" Social Investment Forum, www.socialinvest.org/resources/sriguide/srifacts.cfm

Increased Interest in Socially Screened Funds

According to information from the Social Investment Forum, both the number of, and assets in, socially screened funds have continued to rise, despite the market turmoil of the past several years.



Funds in this composite include mutual funds, annuity funds, closed-end funds, exchange-traded funds (ETFs), alternative investment funds and other pooled products, but exclude separate account vehicles.

Source: *2010 Report on Socially Responsible Investing Trends in the United States*, Social Investment Forum Foundation.

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Past performance is not a guarantee of future results.

Investing in the market entails the risk of market volaility. The value of all types of investments may increase or decrease over varying time periods.

Diversification does not assure a profit or protect against loss.

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