Environmental Finance

The best performing funds of 2014: Green Century Equity Fund

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Ditching fossil fuels was a catalyst for outperforming its benchmark, says Erin Gray

Erin Gray: Dodged the effects of falling oil prices. When the Green Century Equity Fund went fossil fuel-free, on 1 April 2014, its divestment could hardly have been better timed.

The following months saw a massive fall in oil prices which hammered many conventional energy stocks.

A lack of exposure to some of these falling stocks helped the $120 million fund return 11.97% in the three quarters since it went fossil fuel-free, compared with its benchmark, the S&P500 Index, which returned 11.65%.

However, for the full year of 2014, which includes the first quarter before divestment, the fund returned 12.81%, underperforming its benchmark, which was up 13.69%.

Its full-year performance was still strong enough to make it the best performing US-based open ended mutual funds that have an SRI and environmental focus, according to Morningstar data.

A breakdown of the performance of the S&P500 and the fund in the final three quarters of 2014 reveal that ditching fossil fuels was the single biggest factor in the fund's outperformance in the following months.

In the nine months following the divestment, the fund had no exposure to the energy sector, while the S&P500 had nearly 10% exposure to that sector. The energy sector of the S&P500 returned minus 8.51% in this period.

"[The lack of exposure to energy stocks] contributed a positive 65 basis points outperformance for the fund, the most significant factor in the overall outperformance of the fund against the S&P500 Index of 32 basis points," says Erin Gray, head of marketing and strategy at Boston-based Green Century Capital Management, the investment advisor to the fund.

"The energy sector is volatile - we see tremendous risk"

She adds that the fund was also overweight on the IT sector, which was the second best performing sector in the period.

The fund had previously tracked the MSCI KLD 400 Social Index, an environmental, social and governance index that excludes stocks such as tobacco, alcohol, gambling and fire-arms.

But a decision was taken to go fossil fuel-free, mainly in response to the growing ‘stranded assets’ argument, that fossil fuel reserves are in danger of being rendered ‘unburnable’ if there is a strong policy response to global warming.

Gray says it “made sense to align the fund to be fossil fuel-free”, seeing as the firm was founded by a partnership of environmental advocacy organisations in 1991.

She adds that sister fund, the Green Century Balanced Fund, has been fossil fuel-free since 2005.

Green Century customised the KLD 400 index by removing stocks of companies that explore for, extract, process, refine or distribute coal, oil or gas.

In addition, the fund removed companies with significant fossil fuel reserves. It did so with the help of a list of 200 companies with the largest carbon reserves drawn up by NGO the Carbon Tracker Initiative.

As a result, some 26 companies of the 400 in the KLD index were removed from the fund.

The changes were implemented by Northern Trust, which is a sub-advisor to the fund.

But doesn’t Gray worry that the fund will now lose out if oil stocks rally, as many predict?

“We are taking a longer-term perspective,” she responds. “The energy sector is volatile – we see tremendous risk. Longer-term, there is potential for regulation to leave stranded assets.”

Currently the fund’s investors are mainly private individuals but there are also a handful of corporate pension schemes.

NGOs the Sierra Club and the League of Conservation Voters in September started adding the fund to their retirement plans, joining others such as 350.org, As You Sow, and Environment America.

Gray adds that interest in the fund is growing.

“We are now having more and more conversations with larger institutions who want to put a portion of their portfolio into a deeper green investment,” she says. “We want to give people a place to go.”

Top 5 holdings (as of 31 December 2014):

Procter & Gamble Company 3.42%

Verizon Communications 2.68%

Intel Corporation 2.49%

Merck & Company 2.27%

Oracle Corporation 2.22%