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Rethinking Eco-Friendly Investing

A new kind of fund sees green in some surprising sectors

By: *Ellie Winninghoff*



Light Green Advisors co-founder Jonathan Naimon enjoying the environment he's helping to sustain through his system of eco-investing. - *(Photo by Dan Lamont)*

CROSS A Wall Street quant, an investigative reporter and an environmental activist and what do you get? Light Green Advisors LLC (LGA), the sometimes politically incorrect but always common sense eco-investment firm co-founded and run by 47-year-old Jonathan Naimon.

Naimon's hardly a household name. His approach to picking companies by looking in detail at a company's environmental record has, for years, been available only to institutional investors. But among insiders Naimon is recognized as a pioneer in the rapidly growing field of environmental investing.

"Jonathan is the unrecognized and unsung godfather of the second stage of environmental investing," says Richard House, who worked on a similar approach for the Center for Financial Innovation, a U.K.-based think tank. "He contributed the underlying intellectual equity and gravitas of the environmental investment movement and gave away the core ideas that other people have turned into an industry."

Naimon's approach may soon increase its popularity in the U.S. In December, LGA began offering, together with Chicago-based Claymore Securities, a fund aimed at consumers.

However, the approach is controversial. Included in Naimon's "environmental" picks are defense companies like Boeing and oil companies like Exxon. These are companies that would most likely be excluded by many "socially responsible" funds.

Naimon's rationale is: instead of excluding an entire business sector, why not choose the most environmentally responsible companies in every sector based on concrete data? British Petroleum does not qualify, Naimon says, because, despite its superb advertisements about climate change, it has a poor environmental record. BP's pipeline in Bellingham exploded in 1999, and the company has faced criminal penalties for violating environmental laws in Alaska. Picking the best of every sector, Naimon argues, gives companies an incentive to improve their behavior, rather than just do a better job of marketing.

"The reality is that we really use plastics and metals," says Naimon. "Getting a 5-percent improvement in terms of material use efficiency in the metals industry has a bigger impact than all the windmills in the U.S." Not only do such measures save energy, he explains, they also boost profits.

For the last five years, LGA's Eco-Performance Portfolio of 80 stocks has beaten the S&P 500 benchmark by 1.62 percent, and has outperformed the Domini Social Index, an index that measures the performance of socially responsible funds, by nearly 27 percent.

"LGA's assessment tool is an indicator of good corporate management and good environmental stewardship," says former Washington Treasurer Dan Grimm, an LGA investor and director at Doughty Hanson PLC, the U.K.-based private equity firm. He has a simple explanation. "It maximizes profitability and minimizes liabilities."

GREEN PRACTICES BOOST FINANCES

To have an advantage in stock investing, you need information that others don't have, says Glenn Anderson, senior vice president of Institutional Investments in Structured Products for the EFG Bank in Sweden. "That's what [Naimon's system] is."

Almost every step of Naimon's career has contributed to the development of his investment system. After graduating from MIT, Naimon worked for the House Energy & Power Subcommittee in Washington, D.C. His mentor there was Peter Hunt, who created the Corporate Auto Fuel Efficiency (CAFE) standards now widely used. Later, he obtained a master's degree in environmental management at the University of North Carolina.

The next stop was ICF Consulting Group, Inc., where Naimon conducted economic analyses of environmental regulations in the metals, wood preserving and biotech industries. The analyses were used by the Environmental Protection Agency. "Somebody has to do an analysis, so you don't bankrupt the country," Naimon says.

Naimon discovered something odd. Everybody assumed there was a trade-off between doing the right thing for the environment and doing what was best for the economy. The assumption was that environmental regulation would stunt growth. But Naimon saw no such correlation.

His next job was with Asea Brown Boveri Environmental Services, where he studied ways to prevent oil spills. It was here that Naimon realized the entire notion of cost-benefit analysis was flawed. "A lot of technologies – like secondary containment around ground storage tanks – were actually saving companies money," he says.

When the Exxon Valdez oil spill exposed Exxon to billions of dollars in liabilities, institutional investors clamored for a way to avoid such environmental risks, recalls Scott Fenn, formerly of the Washington, D.C.-based Investor Research Responsibility Center (IRRC) and now managing director of policy at Proxy Governance Inc., based in Vienna, Va. Fenn hired Naimon to find a way to quantify the risk and turn it into IRRC could sell.

"Nobody had pulled together the available data and assembled it so it could be useful," says Fenn. "Jon was familiar with where the EPA had its data hidden away and how to get access to it."

It took three years, a team of analysts and \$1 million. The group collected government data, such as the volume of toxic releases and the number of oil spills for each company. Like an investigative journalist, Naimon had to request the information under the Freedom of Information Act. "They don't just give it to you," he explains.

Teaming up with Mark Cohen, a conservative economist from Vanderbilt University, Fenn and Naimon conducted a five-year study to determine the relationship between environmental compliance and 12 measures of financial performance, including returns on assets and equities. Their conclusion was that, over time, companies with a demonstrable environmental advantage performed better financially.

The analysis became the basis for the notion of “best of class investing.” The idea is that companies should be judged based on how environmentally responsible they are relative to the other companies in their sector. For example, rather than ban all power companies that use nuclear power, you would choose the ones whose facilities are managed in the most environmentally responsible way.

“It’s a risk management idea,” Naimon says. “It’s similar to the type of analysis insurance underwriters routinely do.”

The approach appeals to institutional investors, who prefer a diversified portfolio to help balance risk. But Naimon argues that his approach is also more effective at inducing change. “If you have a standard like no clear-cutting,” he says, “you cut out all the commercial forestry products in the world.”

That approach, he argues, isn’t going to persuade forestry companies to become more responsible. Former Sierra Club Chairman Michael McCloskey, an original LGA board member and investor, favors the “positive” approach for another reason. “People in the chemical industry are not asked to compete with somebody in banking,” he says. “You are not asking them to do impossible things – only things their competitors are doing who are in business to make a profit in that industry.”

Naimon also considers his approach more holistic. “The idea that there’s a clean sector and dirty sector is fundamentally naive,” he says. “You think electricity is clean? Look behind the switch. It’s a coal mine.”

But Pierre Trevet, managing director at Innovest, an environmental research firm based in Toronto, complains that Naimon’s focus is too compliance-driven. Looking at how well a company has complied with various regulations isn’t necessarily a good determinant of the company’s overall impact on the environment.

But Naimon defends the approach, insisting that his research shows compliance is highly correlated to financial performance. He says he supplements that research by looking at a firm’s ecological footprint – including more than over 300 types of chemical emissions as well as nontoxic waste generation. What’s important, says Naimon, is not just the total amount of a company’s emissions, but also whether it is taking effective measures to reduce those emissions.

EUROPE SAYS ‘YES,’ U.S. ‘MAYBE’

In 1992, Naimon hit the conference circuit to evangelize his approach to investing. The United States was not receptive, but Europe was another story. Naimon moved to Oslo to teach at the Norwegian School of Management and to consult. Two of the companies he worked with – Storebrand (the Norwegian insurer) and Union Bank of Switzerland (now UBS AG) – subsequently used his approach to launch “best of class” funds. Today, more than \$10 billion is invested in a variety of European sustainability funds that define “best of class” in different ways.

Not so in the U.S., where such a strategy is exceedingly rare. In December 1997, Naimon moved to Seattle to start LGA with Mark Sten, co-founder of The Hartman Group, the health and wellness market research firm. LGA was committed to providing U.S. investors with true “best in class” investment products that tapped the competitive advantages of environmental leadership.

The firm’s first institutional product, the Global Eco Index, was composed of a global set of firms that LGA selected for the way they addressed the top sustainability challenges for their industry (e.g., Anglo-Dutch Unilever was selected for taking on sustainability of its fish supply). LGA developed an 80-stock 500-based product called the Eco Performance Portfolio for U.S. investors seeking best-in-class opportunities. Maine, the first state in the country to move from green grandstanding to green investing, selected LGA to help it invest in green

companies. California's pension funds have launched their own, larger "green" investment initiative. During the last six months, over \$1 billion has been invested by individual investors in alternative energy ETFs, a popular type of fund. In December an ETF based on LGA's Eco Index will be launched. Perhaps the green investment wave in the United States is finally beginning to break.

Ellie Winninghoff is a Seattle-based journalist.