



2009 Principles for Responsible Investment

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Beyond Risk: Notes toward Alternative Theories for Investment

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Notes toward Alternative Theory

Part One

- Weakness of Modern Portfolio Theory Approach

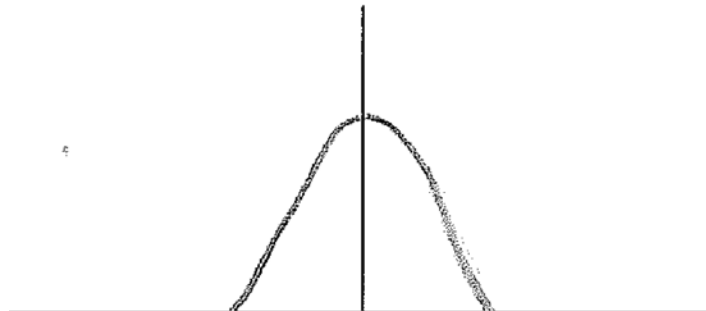
Part Two

- Benefits of Alternative Asset-Based Investment Approach



MPT: Stock Returns are Randomly Distributed

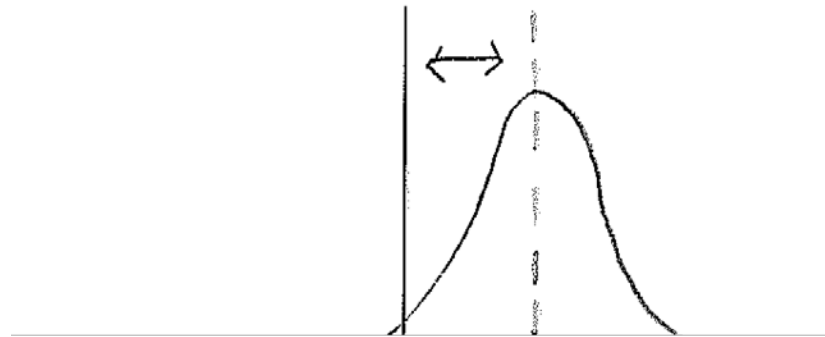
Figure 1. Bell Curve of Even Distribution of Stock Returns





MPT: Investors Benefit from Market Growth

Figure 2. Bell Curve of Distribution of Stock Returns with Market Growth





MPT Doesn't Account for Fat-Tail Events

Figure 3. Bell Curve of Stock Distribution with Fat-Tail



Fat-Tail Events Hurt Market Growth

Figure 4. Bell Curve of Stock Distribution with Fat-Tail and Negative Market Growth



Alternative Theory of Investment

- MPT—Wrong Answer to Wrong Question—Zero Sum Game, Only Works for Some, Some of the Time
- Alternative—Right Approach—Aligns Investments with Markets, Works for Markets As a Whole



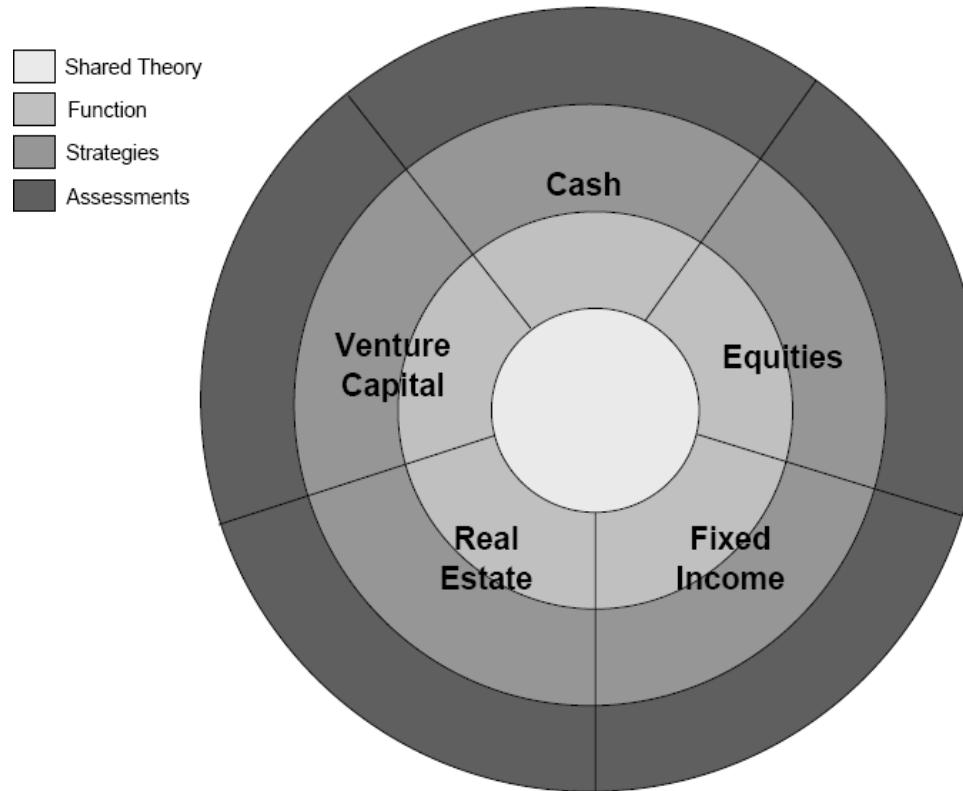
Asset Classes Have Different Functions and Benefits

- Cash—Promote Community Economic Development
- Fixed Income—Fund Public Goods
- Public Equities—Discipline Large-Scale Enterprise
- Venture Capital—Create Revolutionary Change
- Real Estate—Build Livable Communities



Process of Asset-Based Investment

Responsible Investment Research Schematic





Current Use of Cash for Responsible Investment

Table 1. Current for Urban Revitalization

Asset Class	Investor	Investment
Cash	Socially Responsible Investors	CDFI Banks and Credit Unions
Fixed Income	Mainstream Banks	CRA-Qualified Mortgage-Backed Securities
Real Estate	State Pension Funds	Economically Targeted Investments



Potential Use of Asset Classes for Responsible Investment

Table 2. Potential for Urban Revitalization

Asset Class	Investor	Investment
Cash	<ul style="list-style-type: none">- Mutual Funds- Endowments- Corporate Cash Managers- Socially Responsible Investors	<ul style="list-style-type: none">- Community Banks- CDFI Banks and Credit Unions- Microfinance Banks
Fixed Income	<ul style="list-style-type: none">- Mainstream Banks- Insurance Companies- Investment Banks- Trust Officers- Pension Funds	<ul style="list-style-type: none">- Municipal Bonds in Low-Income Regions- Federal Infrastructure Bonds- Quasi-Governmental Economic Development Bonds- CRA-Qualified Securities
Real Estate	<ul style="list-style-type: none">- Pension Funds- Insurance Companies- Endowments	<ul style="list-style-type: none">- Transit Oriented Development- Workforce Housing- Urban Infill- Smart Growth Projects- Economically Targeted Investments



Asset-Based Approach Enhances

- Fairness—Discourages Investment Benefits Available to Only the Few
- Lawfulness—Discourages Complicated Financial Techniques that Don't Work as Billed
- Good Governance—Discourages Self-Seeking at Government As Well As Investment-Community Level