

Biblical Screens and the Stock Selection Process: Applications for a Student-Managed Fund

CHRIS BRUNE

Ouachita Baptist University

JAMES FILES

Ouachita Baptist University

ABSTRACT: The growth in socially responsible and ESG investing reflects a desire for investors to select investments that mirror their values. Christian colleges and universities that offer a student-managed investment fund may similarly desire to invest in a way that reflects biblical principles. This paper outlines a process for incorporating stock screens from the Biblically Responsible Investing Institute (BRII) into the standard stock selection process for a student-managed fund.

KEYWORDS: student-managed investment fund, ESG, stock screen, biblical screen

INTRODUCTION

Recent articles in the popular press have highlighted the role of faith in making financial decisions. Articles on faith-based advisors (Tergesen, 2017), investing (Gibson, 2017), mutual funds (Waggoner, 2017), and ETFs (Taylor, 2017), all appeared in separate publications during a six-month period in 2017. The heightened attention on faith and finance mirrors a broader conversation about socially responsible and ESG investing. Simply put, more investors are considering how their values should direct their investment strategy and are looking for congruence in the products they select.

The challenge, of course, is in finding an investment process that accurately identifies the appropriate investments. One common approach relies on stock screens to identify companies that engage in one or more prohibited activities. The use of stock screens is not a new phenomenon. Stock screening tools help investors implement socially responsible investing (SRI) goals, particularly those focused on environmental, social, and corporate governance (ESG) objectives. However, they can also be used to evaluate companies from a faith perspective.

This paper describes the implementation of a biblically based stock screen in a student-managed investment fund. We describe the screen, discuss its importance within the fund, and review the impact on student learning. Our goal is not just to reinforce the usefulness of the stock screening process, but also to provide a roadmap for others who may choose to incorporate a biblical screen in the security selection process within their student-managed portfolios.

USE OF INVESTMENT SCREENS

Environment, Social, Governance (ESG)

While socially responsible investing has existed for decades, the focus on environmental, social, and corporate Governance (ESG) investing has been around since the 1990s. ESG incorporates specific environmental and socially responsible criteria into the screening process for investment decisions. Environmental criteria include a variety of components, such as water usage and treatment, energy conservation efforts, clean air policies and practices, natural resources management, and ethical treatment of animals. Social criteria may include the fair treatment of employees,

particularly in terms of health and safety, diversity, pay, etc. Corporate governance deals with issues between the board and investors, such as transparent and accurate financial reporting, election of independent board members, and voting power on important issues.

With such varied criteria for ESG investing, constructing and using a stock screening tool can be challenging. Bajkowski (2012) studied investment techniques of many successful investors and developed a process for the individual investor. That process includes the following steps:

- Clearly define the objective of the screen, SRI, ESG, etc.
- Use the objective(s) to construct primary criteria that locate stocks that match those objectives.
- Construct a set of secondary criteria to further refine the stock selection process.
- Understand that further in-depth analysis still needs to be performed to insure the stocks fully meet all objectives.

While procedural guidelines are beneficial, defining the exact criteria and weighting for each component of the ESG screens is more difficult. As a result, studies report varied results in analyzing the performance of portfolios using ESG criteria. Capelle-Blancard and Monjon (2014) find that SRI mutual funds do not systematically outperform the market, and may result in higher costs when conducted effectively. Adler and Kriztman (2008) use Monte Carlo analysis to simulate a restricted universe of stock selections and also conclude that socially responsible investing can lead to higher costs. However, according to Kanzer (2013), their model is purely hypothetical and does not reflect actual results. He cites a study of the 18-year performance history of the MSCI KLD 400 Social Index and demonstrates a negligible impact of social screens on performance when compared to the S&P 500. Chelawat et al. (2013) provide an extensive list of studies that analyzed the performance of funds using the ESG criteria and conclude that the evidence remains inconclusive. Their own study, though limited to firms in India, finds superior performance in ethical investment yields relative to a benchmark portfolio.

Numerous SRI and ESG stock-screened investment portfolios worldwide have been evaluated empirically with mixed reviews. Therefore, using a stock screening tool does not defy conventional wisdom. However, the evidence suggests that a fund manager should thoroughly understand the challenges associated with using these tools. And given those challenges, is it even feasible to effectively apply the screening process with students in a student-managed investment fund?

STUDENT-MANAGED INVESTMENT FUNDS

The use of student-managed investment funds has gained significant popularity in recent years. Early efforts to provide undergraduate students with hands-on investment experience were described by Belt (1975), Bear and Boyd (1984), and Markese (1984). Gradually, more universities began to offer similar programs and common themes and challenges were documented. Lawrence (1990) was the first to survey participating schools. More recently, his survey of 314 student-managed investment funds from around the world provides insight into the management of more than \$407 million in assets under management (Lawrence, 2008).

Other research has provided additional guidance on the use and development of student funds. Mallett and Lerro (2002) offer an overview of establishing a fund, complete with recommended guidelines, logistical considerations, and benefits. Ary and Webster (2000) discuss varying organizational structures and investment options. Neely and Cooley (2004) provide information on additional operational variables and funding sources.

Interestingly, research also exists on the use of socially responsible investing techniques in student-managed funds. Specifically, Saunders (2008) studies the investment policies of colleges and universities with religious affiliations and contrasts them with the objectives of independent private colleges and universities. He finds that approximately one third of the student-managed funds incorporate socially responsible considerations into their portfolio management process. He also notes that church-affiliated schools more commonly use a screening process while independent schools employ other techniques.

The use of socially responsible techniques in student-managed funds clearly aligns with the growing trend toward investor interest in values-based investing. However, the application of those techniques is not always easy. Additionally, for a Christian university, attempting to identify screens that align with biblical principles introduces an added layer of complexity. The remainder of this paper offers a tested method for incorporating a biblical screen as a criterion in the stock selection process.

APPLICATION OF BIBLICAL SCREENS

Biblically Responsible Investing Institute (BRII)

One provider of biblical screens is the Biblically Responsible Investing Institute, or BRII. According to the company website, www.briiinstitute.com, the mission of the

organization is to “provide Christian investors with the high quality information they need about the activities of public companies so that they can make good stewardship decisions about how to properly invest the money the Lord has entrusted to them.” The institute serves non-profit organizations, institutional investments advisors, financial product providers, and retail investment advisors.

BRII considers 70 individual parameters in screening across 12 broad categories: abortion, alcohol, anti-family activity, bioethics, contraceptives, gaming, human rights, low-income financial services, non-married lifestyle, pornography, positive activity, and tobacco. A full listing of parameters and rating guidelines is available on the company website.

After conducting the screens, BRII totals the violations and reports a total score for each of the 2,000+ public companies currently covered. In addition to the composite score, specific details of violations are made available to subscribers.

Ary Student Investment Fund

The Eddie and Phyllis Ary Student Investment Fund is an equity portfolio managed by a team of senior finance students in the Hickingbotham School of Business at Ouachita Baptist University. Students meet regularly to review current holdings and discuss any recommendations for changes to the portfolio. The current balance of the fund is approximately \$1.2 million.

Team members are selected through a formal application process in the spring before their senior year. The team is comprised of a portfolio manager, communications director, and ten equity analysts, each of whom is assigned a sector of the economy. Analysts are responsible for tracking the holdings within their sector and presenting any recommendations once a semester. The full team ultimately votes on all investment decisions for the portfolio.

The desire to screen for certain types of activities was a part of the original bylaws:

The SIF will attempt to be socially conscious in its investing by choosing firms producing products and services beneficial to mankind and pursuing policies which are fair to stockholders, employees, and customers. Investing in companies whose primary business is the production or sale of alcoholic beverages, tobacco, and/or erotic adult entertainment is prohibited. Additional specific social criteria may be defined at the discretion of the members.

Historically, the team did not have a way to systematically screen for violations. Three years ago, the team began using BRII screens as a part of the security selection process. The screens not only provide assistance in evaluating poten-

tial investments, but also frequently result in thoughtful conversations among team members.

Application of BRII to Fund Decisions

Early attempts at incorporating BRII research into an existing investment process were less than satisfying. Team members were generally receptive to the idea, but the implementation was more difficult than expected. The initial strategy was to automatically exclude stocks of any companies with a BRII total score above a predetermined cutoff. Companies with a total score near the cutoff would be considered but would have to overcome the negative BRII ranking.

The team found this approach to be ineffective as a company might accumulate a score largely on the basis on a single criterion that wasn't as important to the team. Conversely, other companies with a lower total score might have an offense deemed more egregious.

Ultimately, the team refined the process. At the beginning of the second year, the new team discussed the rating process and reviewed the parameters before making any investment decisions. First, team members discussed the parameters they found most concerning and instructed analysts to avoid companies with certain violations. Next, they identified other parameters they considered less serious that they were willing to discuss. In those cases, a high BRII score did not necessarily eliminate a stock from consideration, but it was still a negative factor in deliberations. Overall, the conversation has shifted toward the factors most important to the team, and perhaps more importantly, the client (university) they represent.

IMPACT ON STUDENT LEARNING

The faculty advisor to the fund has witnessed several significant effects of the BRII screens on student learning. The first relates to the group discussions of acceptable and unacceptable violations described in the last section. Students quickly realized that the violations they find most offensive may not be as offensive to others. Working through those differences was an eye-opening process for some.

Second, students were directly confronted with questions about how to integrate their faith with their investment decisions. They learned that some of those decisions may not always be easy. For example, as representatives of a Baptist university, the team easily agreed that stocks of alcohol manufacturers should not be held in the portfolio. But what about companies engaged in the distribution of alcohol? Should major grocery chains be excluded? What

about major retail stores or restaurants? Regardless of the ultimate decision, team members are forced to examine their beliefs, consider how those beliefs should impact their decision-making process, and learn how to best articulate those beliefs to others.

CONCLUSION

This paper introduces the use of biblical stock screens with a student-managed investment fund. Student investment funds are typically established as a vehicle for student learning. As fund balances grow and endowment funds are at stake, portfolio performance becomes increasingly important. However, the student experience remains primary. As students at Christian institutions learn to manage investor portfolios, it only seems appropriate that they also learn to apply their faith as a key component of that process.

REFERENCES

- Adler, T., & Kriztman, M. (2008). The cost of socially responsible investing. *Journal of Portfolio Management*, 35(1), 52-56.
- Ary, E. J., & Webster, R.L. (2000). A survey of university student investment funds, *Midwest Review of Finance and Insurance*, 14 (1), 9-18.
- Bajkowski, J. (2012, December). Constructing winning stock screens, *American Association of Individual Investors*. Retrieved from <http://www.aaii.com/journal/article/constructing-winning-stock-screens>.
- Bear, T., & Boyd, G. M. (1984). An applied course in investment analysis and portfolio management, *Journal of Financial Education* 13(Fall), 68-71.
- Belt, B. (1975). A securities portfolio managed by graduate students, *Journal of Financial Education*, 4(Fall), 72-76.
- Capelle-Blancard, G., & Monjon, S. (2014). The performance of socially responsible funds: Does the screening process matter? *European Financial Management*, 20(3), 494-520.
- Chelawat, H., & Trivedi, I. V. (2013). Impact of ethical screening on investment performance in India. *IUP Journal of Financial Risk Management*, 10(4). 16-34.
- Gibson, D. (2017, May 31). Doing good and doing well: Faith-based investing converts the skeptics, *USA Today*. Retrieved from <https://www.usatoday.com/story/news/nation/2017/05/31/faith-based-investing/102351062/>.
- Kanzer, A. (2013, June 4). Exposing false claims about socially responsible investing: A response to Adler and Kriztman. *Advisor Perspectives*. Retrieved from <https://www.advisorperspectives.com/articles/2013/06/04/exposing-false-claims-about-socially-responsible-investing-a-response-to-adler-and-kritzman>.
- Lawrence, E. C. (1990). Learning portfolio management by experience: University student investment funds, *Financial Review*, 25(1), 165-173.
- Lawrence, E. C. (2008). Student managed investment funds: An international perspective. *Journal of Applied Finance*, 18(2), 67-83.
- Mallet, J. E., & Lerro, A. (2002). Establishing and running a student managed investment program. Unpublished manuscript.
- Markese, J. D. (1984). Applied security analysis and portfolio management, *Journal of Financial Education*, 13(Fall), 65-67.
- Neely, W. P., & P. L. Cooley. (2004). A survey of student managed funds. *Advances in Financial Education*, 2(Spring), 1-9.
- Saunders, K. T. (2008). Student managed investment funds in religiously affiliated and independent colleges and universities. *Christian Business Academy Review*, 3, 26-35.
- Taylor, C. (2017). Gotta have faith: The rise of religious ETFs. *Reuters*. Retrieved from <https://uk.reuters.com/article/religion-etf/gotta-have-faith-the-rise-of-religious-etfs-idUKL2N1LG2HY>.
- Tergesen, A. (2017, April 5). Financial advisers put faith in religion-based investing. *The Wall Street Journal*. Retrieved from <https://www.wsj.com/articles/financial-advisers-put-faith-in-religion-based-investing-1490363559>.
- Waggoner, J. (2017, December 22). Faith-based funds shine in 2017. *InvestmentNews*. Retrieved from <http://www.investmentnews.com/article/20171222/FREE/171229957/faith-based-funds-shine-in-2017>.