HOW TO DO WELL WHILE DOING GOOD

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4 Steps to Giving Your Cash a Cause

(Second of a two-part series)

IN 2007, billionaire investor Warren Buffett spent two days with MBA candidate Hesham Gad and approximately 40 of his classmates from the University of Georgia. During the private visit, Gad asked: Is there a moral connection to whom you give your money and why?

Buffett answered with an anecdote about warehouse club Costco, which Harris Interactive named the 10th most reputable company in the U.S. last year based on six criteria, including corporate social responsibility. "They are the No. 3 distributor in the U.S. of cigarettes, but you wouldn't avoid buying (Costco stock) because of that," he said. "You'll drive yourself crazy trying to keep track of these things."

Buffett was right at the time: Seven years ago, searching for ethics in equities was an exercise in futility. Today, however, the rapid adoption of socially responsible investing (SRI) means it's easier than ever to mingle money with morals. The following four strategies will help you successfully achieve that balance.

1. Prioritize Your Principles

A socially responsible investor must begin with defining his or her values. "The first thing you need to do is figure out what's most important to you," said Ann Logue, author of "Socially Responsible Investing for Dummies."

There are two ways to approach the question of values: negative screening (what you want to avoid) and positive screening (what you want to support). "Negative screening means there (are) certain industries you want to avoid — for instance, alcohol, tobacco, gambling, weapons or pornography," said Adam Strauss, of Chicago. a portfolio manager of the Appleseed Fund, a socially responsible mutual fund. "With positive screening, you're looking for companies that have a positive impact on human health, the environment or human rights."

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2. Diversify Your Holdings

Investors typically take one of two approaches to SRI. Investors who take a "pure play" approach purchase individual stocks in individual companies. Those who take a "diversified" approach, on the other hand, purchase mutual funds and exchange-traded funds (ETFs), which are baskets of pooled investments.

Financial planner Dan McElwee recommends the diversified approach. "Investors have to be careful about how they're deploying their assets, especially in their retirement years," said McElwee, executive vice president and wealth manager at Ventura Wealth Management in Ewing, N.J. "It's a time for achieving consistent growth without taking unnecessary risks, and there's typically higher volatility in individual positions than in group positions."

Logue agreed. "For most individual investors, their best bets are going to be mutual funds and ETFs," she said. "There are a lot of those on the market that have social criteria, or that invest in specific industries. They're easy to find with a Google search."

3. Do Your Homework

Research is key to meeting both social and financial goals.

"I would start with Morningstar, which does a great job of evaluating funds," Strauss said. "They have a bronze-, silver- and gold-star rating system for identifying funds that they think are particularly well-managed and perform well over the long term."

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You also should review a fund's prospectus. "Many different ethical mutual funds use various criteria to establish their parameters," McElwee said. "Looking at basic information, like manager tenure, cost of investment, long-term returns and volatility, is equally as important when investing in a socially responsible fund as it is a traditional fund. Investors should look for firms with long, successful track records whose investment philosophies mirror their personal beliefs."

And consider doing additional research on funds' individual holdings. "Look at a company's annual report — its Form 10-K — to get a sense of what their business is and what liabilities they have lurking," Logue advised. "Many companies also publish corporate social responsibility reports, which can be very helpful."

If you communicate your values clearly, a financial adviser can do a lot of the work for you.

4. Set Realistic Expectations

It's important to be pragmatic about financial as well as social returns.

Financially, investors must take a long view. "It's important for investors to figure out what their long-term investment strategy is, find good managers and stick with them," Strauss said. If alternative energy is important to you, for instance, don't panic if the solar market takes a short-term dip. "Let your strategy play out over time."

Socially, you've got to cut yourself some slack. If you're anti-tobacco, for example, don't feel as if you have to be against everything else that's addictive, too, which could include everything from candy and soft drinks to video games. "Like the perfect job or the perfect boyfriend, the perfect investment does not exist," Logue said. "If you get hung up on finding an investment that suits all of your values, you'll never invest in anything."

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It's like Buffett said: You can drive yourself crazy. With clear priorities and a little due diligence, however, you can master the madness and give your cash a cause.

Also see: Socially Responsible Investing Can Make Cents

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