DR. ROBERT J. SCHWARTZ

Dr. Robert J. Schwartz is an economist and investment advisor who for over a decade has specialized in socially responsible investments (S.R.I.) He received his M.A. from Columbia University and Ph.D. from the American University. He is a former U.S. Treasury official and has participated in international conferences abroad and at the United Nations. In 1953, Dr. Schwartz returned to New York as a senior officer of the Amalgamated Bank and, since 1966, has worked for two major Wall Street companies. He has also been an Adjunct Associate Professor at Baruch College teaching a graduate class in Finance, a guest lecturer at a number of universities, in this country and abroad and written many articles concerned with economics, and in recent years, particularly, socially responsible investments.

He is a Vice President of Shearson/American Express, Inc. having joined the predecessor firm of Shearson in 1969. Dr. Schwartz is a member of the American Economic Association; Board of Trustees, Inter-Racial Council for Business Opportunity; member, American Arbitration Association; a member of the Board of Advocates for Children and the National Board of the Committee for a Sane Nuclear Policy.

Dr. Schwartz is married to Josephine Diaz Martin (M.D.) and they reside in Manhattan and East Hampton.
Dr. Robert J. Schwartz

Mr. Chairman and Members of the Committee:

It is gratifying to be asked to testify before your Committee today. An associate, Michael Moffitt, is here with me. The proposed legislation requiring the city of Washington, D.C. to withdraw investments from the companies doing business in South Africa is most timely and important.

First, I want to make it very clear that I appear here as an individual and do not necessarily represent any company or institution. In my "Letter to Investors" and in other writings the following legend appears: This letter contains the views of the writer and is not intended to represent the views or policies of Shearson/American Express, and, in fact, in some instances, may be contrary to such views.

Nonetheless, it is a notable feature of our democratic process that one of America's largest investment entities allows me, as an officer and employee, to express views which are at times in conflict with its own corporate positions. We have in this democratic practice an honorable constitutional right, one which requires eternal vigilance to protect.
Such a right is possible the most single simple difference between the United States and South Africa. In our deliberations today, you are attempting to alter that disparity both by protecting democracy here and trying to change the oppressive practices in South Africa.

I have testified before legislative committees in Oregon, Michigan, and before the Philadelphia City Council. The last two have passed legislation restricting investments in U.S. companies doing business in South Africa, and U.S. banks lending money to the South African Government.

While I want to separate my personal views on Apartheid from my work as an economist and investment advisor, being here in the District, in the Nation's Capital, brings forth memories which warrant my asking a minute of personal indulgence. It may shed a light on the special kind of investment work I do.

My professional career began in Washington at the United States Treasury Department in 1941, coming directly from graduate school. It was a period that saw the end of the New Deal and the beginning of World War II. With the exception of several foreign assignments and two years as a Marine Officer with service in Pacific combat, I lived and worked in Washington, D.C. until 1953. When I arrived, this city was typical of the South. Blacks rode in the back of the buses and trolleys, did not eat in the same public restaurant or stay in the same hotels as whites. The blacks in government service were messengers. Years later I told Mrs. Roosevelt the story of my protesting a traffic ticket which the police officer
said was for not stopping long enough at a stop sign; however, I was convinced I received the citation because a black woman was riding in the front seat with me. We've come a long way since those days, but there still is a great deal to accomplish. Some say it is easier to oppose discrimination in a distant community; but today, by considering opposition to South Africa our position is strengthened here. For as we speak out against racial oppression in another country, we reveal and act upon a standard that applies to our own.

My purpose this morning is to present information on relative profitability of socially responsible investments. In my years of experience with the matter of divestment of securities in U.S. companies, three issues have consistently been raised.

The first is that the process of divesting securities will be costly in brokerage commissions and be a drain on the investment portfolio. It is true that rearranging portfolios will result in increased commissions during the process of divestiture. However, commissions are typically such a small part of any cost that they should not be a serious consideration. Particularly since negotiable rates began in 1975, institutional investors have been paying small commissions which, seen as a percentage of market costs, would not be significant in performance. During the normal operation of any tax-exempt institutional portfolio the annual turnover in the equity portion usually runs anywhere between 25 and 75 percent.
So it is reasonable to infer that, in time, the number of remaining holdings in companies with operations in South Africa and Namibia may be quite small.

A second position frequently taken asserts that is the bottom line which counts, that the business of the United States is business and if the government didn't want investments to be made in South Africa, we would have laws prohibiting them. However, the members of this Committee know well that much of the democratic change in our history has come about through the actions of the people, not the government. In early American history, Thomas Jefferson advised that it is the responsibility of the people to alter any tyrannical form of government. If passed, your proposed legislation would join with existing divestment laws in six states and a number of cities to help bring about such an alteration.

The third issue is the one raised most frequently and requires careful examination. Many are concerned that the exclusion of companies and banks which operate in South Africa will result in poorer investment performance. Here the assumption is that narrowing the universe necessarily limits financial opportunities and brings about a lower rate of return. First, investment performance depends to a considerable extent upon the investment manager. Within certain limits, working from a smaller universe may require greater competence. However, if those securities eliminated from consideration are those with less satisfactory
performances, then narrowing the universe would be a process of positive natural selection.

Some relevant recent studies have been done on actual and model portfolios which exclude South African investments. In its January 24, 1983 issue, Barron's, in an article by Michael Brody entitled "Pure-Play Investments", cites figures from two such studies. The first, a survey, conducted by an endowment-fund center at the Chemical Bank of New York, states that South Africa is "the most commonly cited aversion among clients." A spokesperson for the bank is quoted: "There is definitely a groundswell of interest in making investment decisions precluding companies with involvement in South Africa. We have made a study--we have not had it updated through 1982, because we're waiting for the final numbers to come in--but taking the universe of stocks that Chemical Bank analysts follow, which is about 400, roughly 40% of those stocks have no direct involvement with the government of South Africa or its affiliates. And we have shown, in studies of an unweighted portfolio, that one can do as well in a portfolio with no involvement in South Africa."

A second study ran the S & P 500 stocks for a recent period of 6 years with and without companies in South Africa. The performance of the portfolios without companies in South Africa were consistently better over this time period. The Barron's article refers to a set of data from the U.S. Trust Co. of Boston which is as follows:
"The most useful performance data currently available, however, are those of U.S. Trust of Boston, which has just become portfolio manager for the Calvert Social Investment Fund. Although its figures break out "socially sensitive" accounts from all discretionary portfolios only from 1980 on, the performance is impressive. Their conservatively managed discretionary accounts (including social accounts) outperformed both the Dow Jones Industrials and the S & P 500 on a total-return basis through the Seventies, often lagging the indexes in bull markets, but more than making up for it in bad years.)"

The article goes on to quote Steve Moody, Sr. Vice-President of U.S. Trust Co. of Boston and a long time fellow worker in socially responsible investments. "We've tracked performance separately for only three years, but we've seen no significant difference quarter by quarter between the median account in the department and the median socially concerned account. And for the first 18 months that we've been tracked, the department has been in the top 1% of Merrill Lynch's universe of fund managers."

As for my own accounts, I have clients whose criteria exclude a far broader spectrum of investments than would this legislation. My Socially Responsible Investment (SRI) accounts have concerns ranging from favoring investing in pro-union companies to avoiding defense stocks, nuclear power, the tobacco industry, environmental polluters and some special interest.
Despite these more stringent directives I have maintained as primary objectives good performance and an increase of assets for my clients. There is no instance in which a socially responsible account under my management has gone to another advisor. I have been satisfied with my performance record as apparently have all my clients. Since the accounts are balanced funds (equities and fixed income), an average of the major indices of stocks and bonds were used for comparison.

The State of California commissioned the Council on Economic Priorities to conduct a major study of the California State Teachers' Retirement System (S.T.R.S.) and the Public Employees' Retirement System, the two largest state pension funds in the country. The study, Pension Funds and Ethical Investments 1980, analyzed in-depth how the $17 billion funds would be affected by the exclusion of a variety of companies from their investment portfolios. Both funds have written policies that address the ethical consequences of their investments. The S.T.R.S. Statement of Investment Responsibility says, in part:

The System's responsibilities extend to its participants and beneficiaries and to the general public. In addition to its fiduciary responsibilities to its members, the Board has the social and ethical obligation to require that corporations in which securities are held meet a high standard of conduct in their operations.

The Council examined the records of these two funds and their holdings with respect to two ethical issues: equal employment, and investment in South Africa. The goal: to
determine the financial and legal barriers to incorporating these criteria in the investment process.

The report examined transaction costs, what ethical investment practices would cost pension funds, divestment and exclusion of a given set of companies with offensive practices, and the legal considerations, including the "prudence rule." The Council used a computer model that constructed portfolios excluding two sets of companies, those that were Equal Employment Opportunity violators and those that invested in South Africa. These portfolios were compared with an optimum portfolio, with no companies excluded, and the report concluded:

The model reveals that exclusion produces a slight increase in risk. Yet the universe of still-available securities remains large enough to construct a highly efficient portfolio.

The Council report of 165 pages was summarized in a release of November 17, 1980.

There are important conclusions to be drawn from our experience with and knowledge of divestment of U.S. securities in South Africa.

1. No previous investment data is any guaranty of future performance. No investment advisor whether concerned with divestment or not can assure any future investment performance.

2. Studies such as the ones I have summarized here may have very specialized factors which must be
taken into account for a full picture. For example, major petroleum companies are in South Africa and their performance over recent years has been poor, tending to pull down the overall performance of the group of companies which invest in South Africa.

3. In recent years (particularly before the stock market rally which began in August of last year), smaller companies have outperformed the conglomerates and large companies in general.

As one measure, the American Stock Exchange performance in 1979 (+64.10) compares most favorably with the New York Stock Exchange Index (+15.53) as it did in 1980 (+44.56) as against (+24.19). In 1982 a most volatile year, the American Stock Exchange (+6.2) did not perform as well as the New York Stock Exchange composite index (+14.0). However, the NASDAQ Over the Counter Market outperformed the NYSE Composite index (18.7% to 14%).

5. South Africa poses a risk in future years every investor should consider. It is a country which is becoming more politically and militarily explosive. In a speech last October at the University of Witwatersrand in South Africa, Robert McNamara—former Secretary of Defense and former President of the World Bank—drew attention to the escalating social tensions created by apartheid and stated that "South Africa may become as great a threat to the peace of the world in the 1990s as the Middle East is today."
If this is correct, firms with large fixed investments face the risk that armed conflict in the country will destroy property and have a negative impact on earnings.

6. The proposed legislation is directed toward three pension funds the portfolios of which contain both equities and fixed income. The latter usually consists of bonds, notes, bills, certificates of deposit and other short term paper. Any competent fixed income portfolio manager should be able to shift all fixed income investments of companies in South Africa to other fixed income or certificates of deposit of comparable maturity, quality, and yield. If held to maturity, there should be no loss in such transference. Moreover, if done carefully, additional income may be generated.

7. There should be no hesitation from an investment perspective to divest securities which by sale incur a loss. The question should be: will the proceeds from any particular sale likely bring a better return from another investment or is the holding in question one with a good near term potential appreciation and so should not be sold now. The two year timing outlined in your proposal seems very adequate to me.

We received the portfolio inventory of your funds, a quarterly report as of December 31, 1982, only two days before our testimony was to be submitted. However, even this cursory review makes clear some fundamentals. There is a significant percent invested in C.D.'s
and fixed income which should simplify divestment. Only 38% of the total of the three funds is invested in equities. Purchases as recent as late December, 1982 have been made in companies involved in South Africa. Thus, it appears that as of now, no instructions to avoid South African investments have been given to the investment managers. The material which you sent has no performance measurement for any time period in which the accounts have been involved.

I suggest that those responsible for the investment of your pension funds obtain full performance figures for recent years which include the record of those securities invested in South Africa as against the other holdings and compared with indices of accepted measurement.

During consideration of the pending legislation, one or two of the money managers involved might be instructed by the appropriate investment Board to avoid investments in companies doing business in South Africa. In so doing, you could begin a rough appraisal of the results, not forgetting one major factor: the quality of the money manager.

I hope this statement will be of some help in your deliberations. Any legislation you pass here in the nation's capital will have reverberations in many places.