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TIP SHEET: Socially Responsible Funds Take On Emerging Markets
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NEW YORK (Dow Jones)--Investors with a distaste for alcohol, cigarettes and guns, but want to take advantage of opportunities in emerging markets, are gaining some options.

With the launch of its "socially responsible investment" fund, MMA Praxis Mutual Funds, is the latest in a small but growing number of such funds seeking to piggyback on the booming demand for emerging-market securities from the broader investment community.

The problem is marrying the choosy strategies of these funds with emerging markets is harder to do than with developed markets, where socially responsible investing, or SRI, tends to abide by reasonably clear-cut definitions.

SRI funds with environmental criteria, for example, will likely have a harder time finding appropriate companies in China, where environmental regulations are much looser, said David Kathman, mutual fund analyst at investment research firm Morningstar.

In addition, just finding out whether companies match social screens is a major challenge, as companies in developing economies typically provide less disclosure about their finances, let alone environmental and labor practices.

"Disclosure tends to be not as good, and that makes it tough to be sure that things are socially responsible," Kathman said.

Still, it is tough for SRI funds to stand back while other investors exploit the boom in emerging markets. In 2010, emerging-market equity funds set a new inflow record, at $92.1 billion, up nearly 11% from $83.2 billion in 2009, according to fund tracker EPFR Global. Developed-market equity funds, by comparison, had outflows of $62.4 billion last year.

"Emerging markets have much better growth potential and lot of them have better public-finance profiles than the developed markets," said Cameron Brandt, global analyst with EPFR.

So, in order to both accommodate clients' personal values and the growing demand for emerging-market returns, SRI funds may have to make compromises--and do extra leg work.

The MMA Praxis International Index Fund, which hopes for 20% emerging-market exposure, aims to screen out the worst companies, said Chad Horning, MMA Praxis chief of investment, but it can't expect every single requirement to be met. The fund screens for companies that produce tobacco, alcohol and weapons as part of its multiple criteria.

"We also understand that we have a mandate to be productive from an investor point of view," he said.

Horning wouldn't reveal the size of the Indiana-based fund, which has ties to the Mennonite Church, since it just launched on Jan. 3. It's a start-up fund, so it's small, though adequately funded, he said. He also wouldn't highlight any specific countries or companies since they will not be disclosing fund holdings until later this month.

Also, the fund follows the MSCI All Country World ex-US Index, so it's harder to push investments toward one specific country over another when it's tracking the index (except for companies that are screened out, of course).

These types of funds also typically need to do more thorough research in key markets to determine whether a company is a match.

The Amana Developing World Fund, which invests according to Islamic principles, or Sharia, set up an office in Malaysia in order to do its own on-the-ground research on Asian companies.

The Washington-based fund from Amana Mutual Funds Trust started in 2009, and currently has $15 million in assets, with 80% of its stock portfolio in emerging markets, said deputy portfolio manager **Monem Salam**. The fund avoids investments in tobacco, gambling, liquor and financial services, among other businesses.

Two local analysts, and one from the company's U.S. office, use the Malaysia base as a springboard for visits to companies in Indonesia, Thailand, China and India.

Salam said this level of research is crucial to make sure a company matches the fund's values, especially when dealing with murky corporate governance and incomplete financial disclosure in emerging-market companies.

"You really have to look deep into the company and do country research," he said.

In that light, Salam highlighted Indonesia and its biggest cement manufacturer, PT Semen Gresik (SMGR.JK).

"If you are looking for opportunities, one of the hidden gems is Indonesia," he said.

It has a lot of infrastructure plays, including a new highway that is about to be built between two major cities, the middle class is growing, and there are expectations for increased demand for consumer goods there, he said. In addition, Indonesia, unfortunately, is very natural-disaster-prone, meaning that there is consistent demand for infrastructure work and building materials.

Semen Gresik, which is majority-owned by the Indonesian government, handles a lot of infrastructure needs for building roads. The road work is in constant demand, especially with expanding infrastructure.

Amana's other analysts fly to Latin American nations and other developing countries to conduct company visits and research as well.

Research challenges could ease in the future, however, as emerging-market companies realize that better disclosure attracts more foreign investments, Salam added.

In the meantime, emerging-market exposure still will remain on the forefront for investors.

"As more investors begin to realize that the growth is happening outside the U.S.,...those that are socially responsible are going to be demanding it from their fund companies," Salam said.

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