Research shows the wages of sin turn out to be a bit mediocre

Madison Marriage

The notion that “sin stocks” such as alcohol, tobacco and gaming companies consistently outperform other publicly listed companies has been challenged by new academic research that could revive the debate over the merits of blacklisting such stocks.

Andreas Hoepner, associate professor of finance, and Hampus Adamsson, research assistant, both at Henley Business School’s ICMA Centre, found that previous studies demonstrating the outperformance of sin stocks failed to take into account the fact that small companies tend to outperform large-cap equivalents in their industrial sectors.

In their paper, “The Price of Sin Aversion”, the academics found that with value-weighted portfolios, “the alcohol, tobacco and sin portfolios do not exhibit any significant outperformance, and the gambling portfolio underperforms”.

They also questioned the theory that institutional investors who blacklist certain stocks “effectively pay a price for sin aversion”.

“Fundamentally, an equal-weighted [sin stock] portfolio will over-invest in outperforming small-cap stocks and underinvest in underperforming large-cap stocks. When analysing sin stocks in a value-weighted portfolio, we witness a significant decrease in financial performance,” the academics said.

Mr Hoepner said he believed the research would “increase investors’ confidence that integrating [environmental, social and governance] metrics into portfolios is not harmful”.

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He added: “Investment committee members always have a view on ESG and some might be sceptical about it. In the past, [the sceptics] might have referred to the sin stock studies — now they have this study. We are certainly the first voice to say that, statistically, sin stocks do not outperform.”

The Principles for Responsible Investment, a UN-backed group of 1,380 investors managing $59tn of assets, last week awarded the academics a prize for “best quantitative paper” at a responsible investment conference held in London.

Fiona Reynolds, managing director of the PRI, said: “People constantly say that if you divest from tobacco stocks, returns will be hampered and you will lose money, as it will shrink the universe of [investable companies].

“This will be very useful research for many investment houses when they are trying to convince people internally about [divestment].”

However, Gerry Sullivan, portfolio manager of the Barrier fund, formerly known as the Vice fund for its focus on sin stocks, countered the findings.

He said: “I believe ‘sin stock’ portfolios provide investors with a good core piece of a diversified portfolio. Future casino stock performance and the growth of non-leaf tobacco use could provide for future relative outperformance, no matter the portfolio weight.”

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