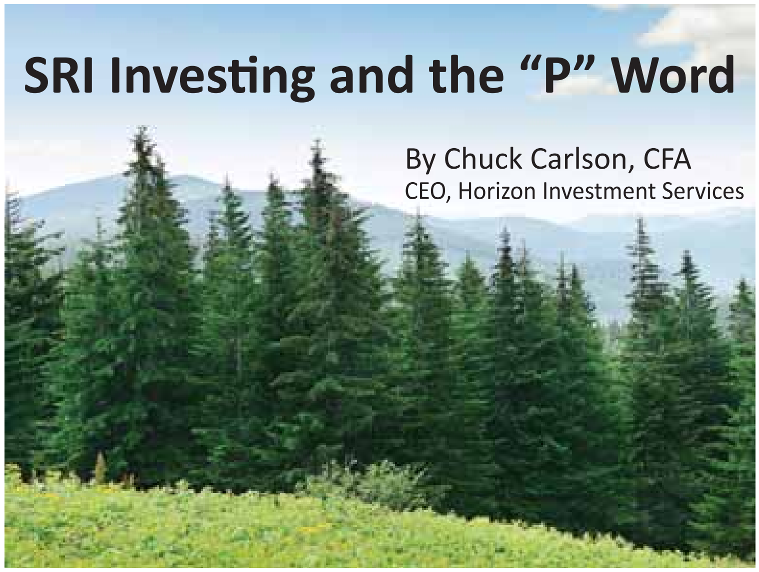

Let me just start by saying that what you are about to read may anger and possibly even offend you. That is not my intent. My goal is to bring a newbie’s perspective to the topic of socially responsible investing, especially as it relates to that “P” word — *performance*.

My firm, Horizon Investment Services (Horizon), was founded in 1997. (Horizon is the sister company of Horizon Publishing Company, one of the oldest investment newsletter publishers in the country. Our flagship publication, *Dow Theory Forecasts*, has been published weekly since 1946.) We believe Horizon brings a different perspective to socially responsible investing. Indeed, we are not a quintessential SRI investment firm in the sense that it is not our mission, as a firm, to invest in a “socially responsible” way. Rather, the mission of our firm is to provide high-performance investment solutions for investment advisors and investors. It is with that focus on performance and problem solving that we entered the SRI space in late 2008, at the behest of clients interested in socially responsible investing.

One of the long-time criticisms of SRI — and I know it is one that gets ardent SRI boosters’ blood boiling — is that you are destined to underperform if you invest in an SRI way. Truth be told, on average, any active investment management strategies — SRI or otherwise — have underperformed benchmarks over most time periods. So the criticism seems unfair to me, or at least selective.

Still, as my firm looked at the space, it seemed traditional SRI did face certain hurdles that could impede performance. By definition, SRI is exclusionary. Now I’m fully aware of the literature that states that socially responsible companies are attractive investments because they are, in fact, socially responsible. But I can also roll out a Tesla full of literature that argues that anytime you reduce your opportunity set, you hamstring performance.

Regardless of where you side in this argument, it is unarguable that there are stocks that will perform exceptionally well in the future that socially responsible investors will never give themselves even the chance of owning.

In addition to a reduced opportunity set, two other potential problems with SRI investing are:

- *Wearing too many hats*
- *Emotions*

We believe successful investing is about consistency, discipline, and especially focus. When we were asked to build an SRI solution, we approached the process with this idea that we need to focus on what we do best. We knew what we *didn't* do best was vetting companies for their particular SRI characteristics. We didn't have the tools, resources, experience, or time to do this. We discovered pretty quickly that being an expert in discerning whether a company is "socially responsible" is a full-time job. Many companies have sprawling business operations, each of them requiring an analysis as to their SRI-worthiness. And, to be frank, SRI is a heavily nuanced world, where definitions of what is or isn't "socially responsible" are hotly debated. Looking at it purely from an investment practitioner perspective, it takes a lot of time to sift through all of the opinions and information, time that is better spent focusing on what we do best, which is the investment side of the equation.

Now, I don't mean to give short shrift to the importance of doing this vetting. It's just that it is work better left to those more equipped to do it. The bottom line is that I believe that typical "SRI investment firms" wear too many hats. They try to be experts at both vetting companies and picking stocks. Perhaps a reason performance has been underwhelming in the space is that typical SRI firms may be spread too thin.

Emotion is the potential bane of any investment program. I know what I'm about to say might send many of you running to your computer to write me a nasty email, but here it is — *SRI is emotional investing*. At its core, socially responsible investing has a strong emotional element. It is investing with your head *and* your heart. It is investing in things you feel strongly about, that tie you emotionally, as well as intellectually, to a company. Unfortunately, because of this emotional bent, I think there is room for error from an investment standpoint. For example, falling in love with a stock is an occupational hazard as an investment manager, and it seems the risk of doing this in the SRI world is even greater. It may be difficult to sell a stock whose technology or corporate governance line up exactly with your socially responsible passions and beliefs. You may be willing to give the stock the benefit of the doubt from an investment perspective because it scores so many points on the socially responsible side of the ledger. But those sorts of emotional decisions could impact performance.

The good news is that an awareness of these potential problems means you can address them in a socially responsible investment program.

For example, to combat the problem of wearing too many hats, my firm works with experts on the vetting side. We take their work and apply our investment expertise. We achieve this through what we call "enhanced indexing," where we start with an underlying index or basket of expertly-vetted socially responsible stocks and then apply our investment overlay to pull out what we hope are the best stocks from an investment perspective. This division of labor allows each entity to focus on its respective strengths, thus hopefully enhancing both sides of the equation — socially responsible selection and investment selection.

To address the problem of emotions, we employ an investment approach that is designed to strip the process of all emotion — *quantitative investing*.

Quantitative investing is the process by which investments are bought and sold based on evaluating such measurable characteristics as revenues, earnings, profit margins, price/earnings ratios, and finances. Underlying most quantitative approaches is a computer-driven model that evaluates universes of stocks based on a variety of metrics. (My firm's proprietary model is our *Quadrix*® stock-rating system. Quadrix ranks roughly 4,400 stocks based on more than 90 different variables for each stock.) What usually falls out of the model is a strict "rules-based" methodology for stock selection and portfolio construction that can be tailored to fit any number of investment mandates, including SRI and its various branches (ESG, Fossil Fuel Free, Faith Based, Sustainability, etc.).

While no investment approach is infallible, we believe quantitative investing offers a number of potential advantages to traditional active SRI management:

- *Leave your emotions at the door*. Quantitative investing, with its rules-based, "by-the-numbers" approach, seeks to eliminate emotion from the investment process.

- *Tax efficiency***.** With quantitative strategies, it is easier to create strict methodologies that lend themselves to greater tax efficiency. For example, certain quant methodologies may have hard-wired into the strategy a mandatory holding period that boosts tax efficiency.

- *Improved sell discipline*. One of the hardest things to get right in an investment program is the sell side of the equation. The fear of taking a loss or the greed that comes with falling in love with a stock can have negative consequences for portfolios. Quantitative investment strategies that rely on a strict methodology for both buying and selling stocks bring consistency to the sell discipline. In fact, a part of most quantitative strategies is a scoring methodology that ranks stocks. While this ranking is useful when selecting stocks, it can prove an invaluable tool for ongoing evaluation of a portfolio of stocks.

To be sure, quantitative investing strategies do not always produce desired returns, especially during "outlier" market events, such as 2008. Still, the major strength of quantitative investing — the ability to remain disciplined, consistent, and focused at a time when investor emotions are boiling over — helped many quant strategies identify attractive values that produced solid returns in 2009.

No single approach or strategy has a monopoly on investment success. Still, we believe a strong case can be made that strategies that eliminate emotion, instill discipline and consistency, and bring a greater robustness to the stock-selection process can help tilt the odds of investment success in your favor. We believe quantitative investment strategies offer a compelling solution for creating "alpha" (a return that cannot be attributed to the market) and represent a viable approach to address some of the problems that can occur with socially responsible investing.

Horizon Investment Services currently offers four strategies in the SRI/BRI space:

- **Enhanced Socially Responsible strategy** — an all-equity enhanced index strategy that applies quantitative overlays to the MSCI KLD 400 Social Index.
- **Enhanced SRI Fossil Fuel Free strategy** — an enhanced index strategy that applies quantitative overlays to the MSCI KLD 400 Social Index, with additional screens that are designed to eliminate companies with exposure to fossil fuels.
- **Enhanced Christian Values strategy** — an all-equity enhanced index strategy that applies quantitative overlays to the MSCI USA Catholic Values Index.
- **Enhanced BRI strategy** — an all-equity enhanced index strategy that applies quantitative overlays to a universe of stocks already screened and vetted for BRI (Biblically Responsible Investing) principles by ISS Governance.

Of course, the proof is in the pudding. So how has my firm's quantitative, enhanced-index approach to socially responsible investing performed? For performance fact sheets, more information about Horizon, Quadrix, or any of our strategies please visit our website at www.HorizonInvestment.com or call Shelby Cavanaugh at 800-711-7969.

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Charles Carlson, CFA, is CEO of Hammond, Indiana-based Horizon Investment Services. For more information on the firm and its various SRI strategies, visit www.HorizonInvestment.com.

Horizon Investment Services, LLC is a registered investment adviser with the United States Securities and Exchange Commission in accordance with the Investment Advisers Act of 1940. The firm manages equity, mutual fund, income, balanced, and ETF portfolios for U.S. investors.

Horizon Investment Services claims compliance with the Global Investment Performance Standards (GIPS®). To receive a list of composite descriptions of Horizon Investment Services and/or a presentation that complies with the GIPS standards, contact Tom Hathoot at 219-852-3215, or write Horizon Investment Services, 7412 Calumet Ave., Hammond, IN 46324, or email THathoot@HorizonInvestment.com.

The Quadrix® stock-rating system is a proprietary product wholly-owned by Horizon Publishing Company, Horizon Investment Services' sister company. Horizon Investment Services has contracted with Horizon Publishing Company to use the Quadrix stock-rating system for its stock-screening processes.

An investment in these strategies involves the risk of loss. Investment return and principal value will fluctuate so that the investment, when redeemed, may be worth more or less than the original investment.

Past performance is no guarantee of future results. No formula or other device being offered can, in and of itself, be used to determine which securities to buy or sell.

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