Principles and Profits Working Together

THE CLEAN YIELD

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Getting the Goods on the Good Life

Pardon us, but have you seen a revolution around here? Underneath the blanket of transnational megacorporations supersizing and homogenizing, there's a hotbed of small, local businesses sprouting up. And much of this new entrepreneurial foment seems less motivated by money and more by personal lifestyle choices fertilized by visions of a healthier world.

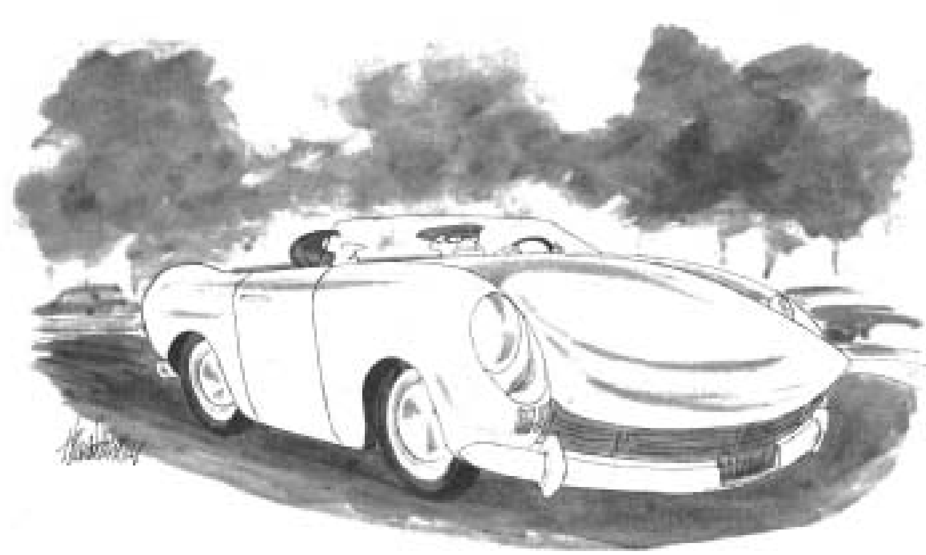
"Money isn't everything, but it's way ahead of whatever's in second place." That timeworn quip goes right to the core of traditional economics: the premise that it is dollars that spur us humans to act as we do. Presumably, "everything" is getting at the idea of personal wellbeing or happiness. The pat formula is that we'll all work productively, get rich, and buy our way to bliss. Two flaws: much of our work produces "bads," as well as goods and services, and happiness isn't buyable. A new generation is apparently taking notice, snubbing pecuniary considerations, and putting some of those "whatevers" into first place.

The old economy has been good to many of us, but now its byproducts are taking us toward a dead end. The way our economic engine has evolved, it isn't focused on people's wellbeing as such, but rather on generating abundant goods and services—at any and all cost. Climate change, peak oil, deforestation, soil depletion, drought, species extinction, acid rain, desertification…we're all painfully aware of the environmental disasters that lurk in our future if we don't change course. And then there are the social consequences, including squalid ghettos, child labor, resource wars, wage slavery, the loss of indigenous cultures, the threat of nuclear holocaust, personal alienation, and on and on.

In Western culture, in particular, we hold a bedrock conviction that having limitless personal choice is the basis of life's happiness. From there, it's practically axiomatic that money affords choices. The paradox is that most of us know full well that money can buy only limited kinds of choices, mostly material ones, and at that, having lots of choices doesn't perforce lead to happiness. Yet, money still dangles there in the foreground, a powerful carrot even for those who already have plenty of it.

It turns out that it's not quite right to say that money doesn't buy happiness. The science behind measuring wellbeing is still inchoate, with few conclusions that can be generalized, but among the consistent findings—across cultures, age ranges, and decades—money and happiness are, in fact, quite closely linked. But here's the kicker: the link holds true only for the first $12,000 or so of per capita annual income. After that, the relationship becomes far less robust, and nonfinancial factors begin to overtake the financial. At that point, happiness tracks with factors like having close personal friendships, being married (but *not*, apparently, having kids!), being engaged at work and involved in clubs and social activities, and living in communities with stable institutions and high trust levels. According to studies cited by *Wall Street Journal* columnist Sharon Begley, a "life-satisfaction" survey of the "*Forbes*

continued on page 4



"This lovely car has not brought us happiness. You agree, Morris? That is why I am now thinking in terms of having the entire house recarpeted."

MARKET NOTES

Tumbling Markets, Rising Value

At first we were planning to use this space to discuss Clean Yield's approach to gold, since a number of clients have recently asked about it (reminds us of the early '80s). But then it occurred to us that it might be more fruitful to discuss our investment strategy when the market is plunging and the financial markets are awash in doomsday scenarios. After all, the sudden spike in gold prices is tied directly to the flight to safety brought on by the free-falling markets.

Pension consultants and other analysts who have examined Clean Yield's investment style put us in the GARP (growth at a reasonable price) camp, with an emphasis on "value." "Value" means that we search for and buy companies that have been overlooked by the market and are selling below what we believe are intrinsic financial values. The tools we employ to find these companies are ratios that examine a stock's relationship to a company's earnings, book value, dividend, cash flow, and sales.

What does this have to do with "plunging" stock prices? Price is always one part of our value ratios, the numerator. Thus, if a stock price is falling, the stock is getting cheaper according to all of our ratios. In a bull market, it is dicey to be a value investor. A buyer is relegated to looking at very few stocks, and the ones that are most appetizing are usually the stocks of companies that have suffered some bad company-specific event. That's what made them cheap. To buy at that point, an investor doesn't just have to hope that the company is able to turn itself around, she also has to hope that the market continues its bullish bias.

In contrast, value investors operate best in a bear market, just what we have today. It isn't that they don't suffer; like all investors, they hate to watch their assets shrink. However, a bear market allows value investors the opportunity to expand their universe of holdings, because even the best companies are pulled down by

continued on page 3

ADOBE SYSTEMS, INC. (ADBE)

Revenues: $3.16 Billion
EPS: 2009E $2.05
2008E $1.62
2007A $1.21
Web site: www.adobe.com

Projected Annual Growth Rate: 15%
Dividend: None
52-Week High–Low: 48.47 – 32.08
Risk: Medium

Market Acrobat

It's difficult to spend five minutes on the Web without running into an Adobe product. From PDFs accessed by Acrobat Reader and video content delivered through Flash, to retail sites that allow customers to zoom into and rotate products using Scene7, Adobe software enhances many work and entertainment digital encounters. For creative professionals such as graphic designers, photographers, and Web site developers, Adobe software is central to business. Adobe's ubiquity also extends beyond the U.S.—more than 50% of revenue comes from international sales. That kind of brand recognition and market share computes to a stock that piques our interest.

Adobe hit the desktop with its groundbreaking Pagemaker publishing software 25 years ago and has managed to stay on top of this high-speed market ever since. It has primarily done so through acquisitions, including that of Macromedia for $3.5 billion in late 2005. That purchase ate into Adobe's 2006 profits but has added key video and mobile segments to Adobe's offerings. In the past two years, the company also launched updated versions of its most popular offerings, Creative Suite 3 and Acrobat 8, and so far customers appear to be eager for the increased functionality. In 2007, Adobe's stock price broke through its old tech-bubble high but has recently retraced that move by more than 30%. With no change in fundamentals, including no debt and strong earnings growth, we think this has presented a buying opportunity.

Corporate Responsibility: Adobe excels in most of the areas which are of greatest concern to social investors. A regular on *Fortune's* "100 Best Places to Work" list for the past eight years, the company puts emphasis on respecting and encouraging its employees. Adobe received a score of 100% by the Human Rights Campaign for its equal treatment of the GLBT community and avoidance of corporate activities that would undermine equal rights. Management also attempts to be transparent and accessible, including the CEO's promise to answer all employee questions within 24 hours. As with many tech behemoths, employee benefits packages are generous (in fact, compensation for board members and the top executives could use a little trimming), and the company has a strong philanthropy program focusing on youth education. On the environmental side, Adobe is decreasing its energy use by retrofitting old buildings, recycles close to 100% of all waste, and provides on-site composting. ■

CANON, INC. (CAJ)

Revenues: $41.98 Billion
EPS: 2009E $ 3.82
2008E $ 3.68
2007A $ 3.31
Web site: www.canon.com

Projected Annual Growth Rate: 10%
Dividend: 2%
52-Week High-Low: 60.16 – 38.44
Risk: Medium

Fit to Print

From its roots as a 35mm camera manufacturer in Japan in 1937, Canon has grown into one of the world's largest producers of printers, copiers, cameras, and other optical products. With a recession looming, we have zoomed in on the fact that Canon markets to both businesses and consumers spread around the globe; more than 65% of sales are outside of the U.S. Over the past two years, Canon focused on making color printers and copiers standard items in offices and homes. It did so by improving the equipment and pricing it competitively. To make sure that it isn't missing out on a potentially lucrative new market, Canon has recently allied with two other Japanese companies to produce flat-panel screens—Canon's contribution is the OLED (organic light-emitting diode), which makes for a sharper picture with decreased energy use.

Canon is twelve years into its Excellent Global Corporation Plan, the goals of which are to strengthen financial health, become the top player in all of its fields, and rank among the top 100 global companies through "innovation and sound growth." After a period of stagnating sales in the early 1990s, this plan has resulted in steady growth. Currently the company exceeds its peers in many financial measures, including profit margins and cash flow, allowing it to spend enough on research to stay at the head of the pack. Despite its strong financial situation, the stock price shuttered in December and has fallen more than 20% with jittery world markets. With management's impressive ability to mix their business acumen and values, we expect that 2008 will see slow but steady growth for Canon.

Corporate Responsibility: Canon's corporate philosophy is *kyosei*, which it translates as "living and working together for the common good." The company started collecting and reporting environmental information in 1983 and now produces extensive annual sustainability reports. Canon aims to be environmentally friendly with both its internal processes and product lifecycles. To a customer this means a Canon printer comes from a factory that has been optimized to have low energy usage and emissions, it is made with less plastic, and its components have traveled more efficiently. It also means that the printer itself uses less energy and can be recycled. On the social side, Canon supports a variety of causes financially, including organizations and events that promote education and environmental initiatives, and the rights of people with disabilities. It also supports programs that help the local communities that host its facilities. ■

continued from page 2

the market's slide—no company escapes. Value investors are realists at heart, betting on a near certainty—that the market will turn up at some time in the future. This isn't to say that the stock a value investor buys during a bear market won't get cheaper in the short term; it may. But it is to say that two or three years hence, the outsized return that the investor will secure from that purchase will reward the courage of being able to put aside the anxious emotions that accompany all market meltdowns.

We believe that both companies profiled in this issue, Canon and Adobe, are good candidates to chalk up such returns.

SOCIAL NOTES

✷ Corporate social responsibility reports are in vogue these days. While many are just glossy releases from PR departments, some are self-critical, independently audited documents adhering to the state-of-the-art Global Reporting Initiative (GRI) guidelines. Diminutive **Green Mountain Coffee Roasters** recently joined with food behemoths Nestlés, Bunge, and Tyson Foods to develop sector-specific GRI guidelines for processed food.

✷ **H. J. Heinz Co.** just released its 2007 social responsibility report. Though the publication is not in GRI format, the company does merit bragging rights for using 100% recycled glass in its iconic glass ketchup bottles. Also, since 2001, employees and the company foundation have funded the Micronutrient Campaign, which has distributed free "Sprinkles"—single-serve packets containing vitamin A, iron, and iodine—to some 1.2 million malnourished children around the world.

✷ Trivia question: Where's the largest solar-power system in New England? Answer: Dayville, Conn., on the rooftop of **United Natural Foods.** Just installed, it will generate electricity equivalent to powering 67 average homes.

continued from page 1

400" richest Americans have respondents at a high 5.8 on a 7-point scale. But surprisingly, that's exactly the same score as the Inuit peoples of Greenland and the cattle-herding Masai of Kenya.

Researchers have also sampled the well-being of entire countries and looked at various correlates in society. The Swedes, Danes, and Irish all score higher on happiness scales than Americans, and Costa Ricans score higher than Japanese, according to economist Richard Layard. Again, it seems that once national economies are strong enough to serve basic needs, rising affluence doesn't result in rising well-being, but certain intangibles, such as strong democratic institutions and civic involvement, do. Job security does, too. Compressing extreme wage differentials and eliminating the glass ceiling and other forms of discrimination enhance it. Countries with stronger welfare programs have, in general, populations rating higher in happiness. Conversely, highly mobile populations usually have elevated endemic depression. That pollution in the living and working environment lowers average well-being is almost a tautology.

The challenge of our age is rechanneling our economy so that it supports those long-range needs of humans, as well as sustaining the ecological systems on our planet.

Fortunately, there are many far-sighted people who have begun to lead us down alternative paths. In Paul Hawken's latest book, *Blessed Unrest: How the Largest Movement in the World Came into Being and Why No One Saw It Coming* [Viking, 2007], the former businessman describes how over one million organizations, mainly nonprofits, have been redefining their

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relationship with Earth and with one another. His enormously hopeful analysis catalogs the problems we face as a civilization and describes how a loose-knit network of locally focused NGOs, often connected by the Internet, is tackling those problems.

Nonprofits are playing a crucial role, but it's small business that is at the epicenter of the revolution. Reading Bill McKibben's recent book, *Deep Economy: The Wealth of Communities and the Durable Future* [Times Books, 2007], underscored for us the possibility that small-scale agriculture and industry could replicate themselves enough to address humankind's tangible needs for food and other basics, while rebuilding the social and environmental supports that are now being sacrificed on the alter of materialism. McKibben, who lives here in Vermont, offers dozens of models of local enterprise, from manure-fueled energy production to community gardening.

At Clean Yield, we're in a small business ourselves. Much of the business is directing capital to solve social and environmental problems (and to avoid making them worse!). What's the message for us?

Where clients are invested in publicly traded companies, we are pushing those businesses to be increasingly attentive to the "second bottom line." For instance, at this writing, we're working with staff from the Domini and Calvert funds, in active dialogue with company officials from Southwest Airlines. With a strategy admittedly more evolutionary than revolutionary, we're using a client's shareholder resolution as a lever in asking Southwest to prepare a "sustainability report." If Southwest agrees, the report should provide the baseline data for tracking environmental, social, and governance progress in future years.

For two decades, we've kept a fraction of some clients' capital invested directly in below-market loans for affordable housing, micro-business, and community infrastructure such as daycare centers. We, and the SRI industry as a whole, are moving to up the ante.

In the last few years, we've been increasingly focused on boosting small, sustainable businesses through private equity investments. By now, we've directed client assets to roughly half a dozen young companies in businesses such as organic spices, fair-trade coffee, and organic dairy products.

All of us have roles to play as consumers. There's the now-obligatory switching of lightbulbs, for sure, but also patronizing small, neighborhood stores, joining CSAs (community-supported agriculture, at which, typically, the customer prepays for meat or produce for an entire growing season), frequenting restaurants that feature locally grown fare, or even attending local artists' events and listening to local radio stations. Last summer, in Virginia, Vancouver, Vermont, and across the U.S., thousands have joined "localvore" challenges, limiting themselves to food grown within 100 miles of their homes, thereby supporting the local economy.

We know we are fast approaching limits to Earth's resources and carrying capacity. We know today's dominant economic paradigm is failing to create well-being even among the monied classes, much less meeting fundamental human needs among the poor or fostering ecological balance. At least one aspect of the solution is clear, and it involves strengthening civic life, increasing human contact, and building communities—going local.

The revolution is at hand. The feel-good strategy for making the economy responsive would have it that we can still make fat profits while we go through the changes. But frankly, we don't buy it. While there may be some exceptions, this revolution is little different from others: it will require discipline, creativity, and plenty of sacrifice. What is different is that the enemy is us, and it's time for a call to arms—the kind that embrace. ■

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