The Evolution of SRI

A Matter of Choice

Socially Responsible Investing (SRI) has grown rapidly over the last several decades. Investors of various beliefs and principles (generally mission-based, faith-based, and increasingly environmentally or sustainability focused) are allocating funds to socially screened investment vehicles - mutual funds, separately managed accounts, hedge-funds, and private equity. They are aligning their investments with their convictions.

Over the years, SRI has been referred to in different terms such as ethical, biblical, mission-based and socially aware investing, to name just a few. More recently, investors have referred to it as ESG (Environmental, Social and Governance) investing. However, in its simplest form, SRI is about choice. It is the choice of an individual or institution to invest or not invest in a company that is aligned with or against their social mandate.

"Be the change you want to see in the world."

- Mahatma Gandhi

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Socially Responsible Investing Defined

In its most basic form, Socially Responsible Investing can be defined as the discipline of incorporating social and environmental criteria into the investment decision-making process. Investors ranging from individuals to institutions, and everyone in between, are attempting to marry two concepts – attaining an overall investment objective while at the same time having a positive impact on society. While traditional SRI strategies have focused on social and environmental benefits, there is no doubt that one could argue that on an ancillary basis this approach has the potential to yield stronger overall corporate social responsibility and long-term benefits for all shareholders.

However, historically SRI has meant something different to each group of investors. Some hold social issues in higher regard such as workplace diversity, child labor or "sin" stocks such as tobacco, alcohol or gaming. Some investors are more focused on environmental issues. Regardless of one's point of preference, SRI has always been about the aligning of an institution or individual's investments with their convictions.

Terminology & Strategies

Over the years, a variety of terms and practices have emerged in the field broadly known as "Responsible Investing." Although there is no universal standard for use of any of these terms, the variations all share the fundamental goal of incorporating social and environmental factors into the investment decision-making process. The range of implementation appeals to investors who may have different motivations for engaging in responsible investing which can encompass diverse goals.

Responsible investing comes in many shapes and forms, and can be referred to in different terminology and used in various strategies, some of which include:

- **Negative/Exclusionary:** excluding certain companies or entire industry sectors in order to comply with an investment's social mandate. This has historically been the approach to SRI, especially with faith-based clients. This strategy has been, and continues to be one of the more prominent strategies employed by investment managers on behalf of their clients.

- **ESG Integration:** there has been a movement over the last several years, influenced by the UN Principles for Responsible Investment, of integrating Environmental, Social and Corporate Governance (ESG) factors into the traditional financial analysis of company investments. Many investors would argue that ESG is an evolution of traditional investing rather than SRI. Analysts and portfolio managers at many firms view it as an extension of the traditional research analysis or process that they employ. Issues such as climate change, workplace and board diversity and natural resource shortages have forced analysts to determine whether they are material to future financial performance.

- **Positive/Best-in-Class:** some investors employ a strategy of only investing in what they perceive to be the "best" companies within a given sector as determined in relation to peers or based on some set of ESG factors. This approach may be one course of action in working with investors who are seeking ways of addressing fossil fuel free portfolios in identifying those companies that are actively focused on sustainability and alternative fuels. Of course key financial metrics such as valuation should not be forsaken in exchange for a best-in-class approach.

- **Impact Investing:** investors who are attempting to address a specific social or environmental issue may employ a targeted approach in solving this problem. This is typically done in the private markets.

- **Sustainability Themed Investing:** targeted investments in areas such as water or clean tech, amongst others. This is not too different from how a nonscreened investor may look at sector specific investments or funds.

The History of Socially Responsible Investing

Socially Responsible Investing has existed for several centuries as faith-based investing. These investment decisions were exclusionary in nature, i.e. a decision to not invest in specific activities. For example, the Roman Catholic Church may not invest in companies involved in birth control and pornography. Islamic law calls for an avoidance of companies involved in alcohol, tobacco, and pork products, and broadly excludes investments in companies whose earnings are derived from charging interest (usury). These early religious based investment decisions were the seeds of SRI.

During the 1960's and 70's, investors began actively screening out investments through the lens of military and environmental issues. Investors became more proactive and established formalized doctrines, such as the Sullivan Principles, to combat injustice through their investments (or lack of investment). The Sullivan Principles focused on non-segregation as well as equal and fair employment practices in South Africa. Their widespread adoption by SRI investors put significant pressure on companies conducting business in South Africa, and eventually contributed to the end of apartheid. This was a major victory for SRI investors, whereby voting with their investments drove a significant social change.

Similarly, environmental catastrophes at Chernobyl, Bhopal, and the Exxon Valdez oil spill as well as the more recent Deepwater Horizon spill in the Gulf of Mexico and Fukushima nuclear disaster in Japan, have brought to the forefront investor concerns over pollution and the environment. As a result of these disasters, investors began questioning the viability of companies operating in these industries. In many respects, this was the precursor to investor concerns over fossil fuels and the ongoing search for the best way to reduce our world's consumption of a depleting resource.

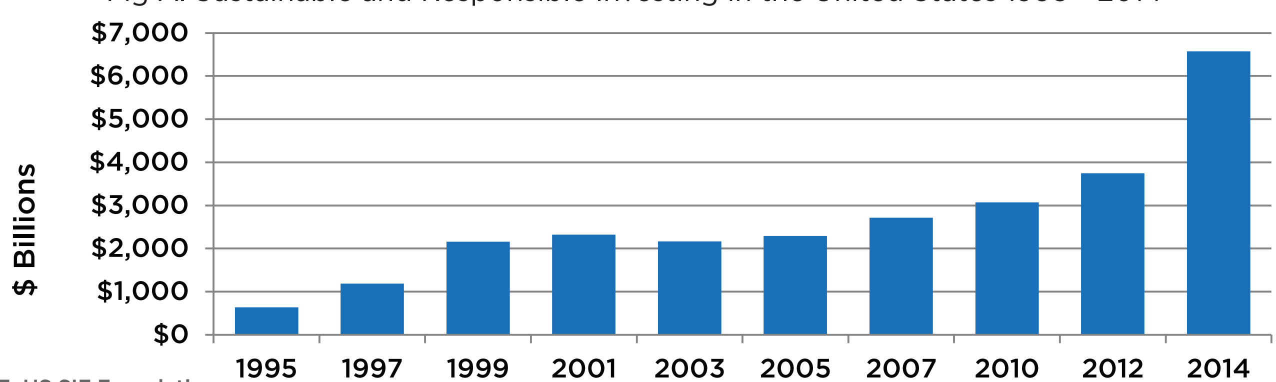
More recently, we have seen investors focus on the tragedies in Sandy Hook, Aurora, CO and several others in calling for more prudent gun control. This has led to many investors divesting gun companies and weapons manufacturers from their portfolios. According to the Social Investment Forum Foundation, investment policies restricting investments in military and weapons companies affected $355 billion in assets, a 383% increase from just two years earlier.

Furthering the idea of divestment is the call from many Universities and Foundations, and now faith-based organizations, to manage fossil-fuel free portfolios. We are seeing many of these institutions instructing their managers to divest from fossil fuel companies within their portfolios. The challenge will be in how managers and investors put this plan into action. Some will opt for full divestment from any companies involved in coal, oil and gas. Others will decide the best approach is to target the largest or the biggest polluters within this space, while still others will extend into industries such as automotive and utilities. Clearly this movement is only beginning as investors contemplate the best course of action.

Growth of SRI & Emerging Trends

According to a recent study completed by the Social Investment Forum, professionally managed SRI assets have grown to nearly $6.6 trillion in 2014 from $639 billion in 1995.

Fig A. Sustainable and Responsible Investing in the United States 1995 - 2014



SOURCE: US SIF Foundation

According to Cerulli and Associates, this represents nearly 18% of the $36.8 trillion in total assets under management. Since the US SIF Foundation's first report on the size of the US sustainable and responsible investing market in 1995, the SRI universe has grown tenfold – a compound annual growth rate of 13.1% - accounting for one out of every six dollars under management today in the United States.

Driving the growth over the last several years has been an expanded definition of what ESG investing entails as many firms report on general strategies that utilize some form of ESG integration. The bi-annual survey by the Social Investment Forum included money managers who give "consideration" to ESG factors in making portfolio decisions as well as those firms who are actively incorporating these factors into their research analysis and by default, their portfolios. For some firms, it has been a philosophical decision to do so. For others, it has been an element they have added to their research process. Finally, for other firms, client-driven requests have been the impetus behind the movement.

Not to be left out is an increasingly informed millennial generation. This generation will inherit trillions of dollars from their parents over the coming years as well as an investing landscape that is in many ways much more difficult than previous generations. They are bringing to the table a different view of the global economy, human rights and education and they are increasingly insistent that their investments reflect these views. In addition, women are earning, spending, and investing at a greater rate than ever before and have displayed a desire to align their investments with their values in a socially responsible manner.

Socially Responsible Investing continues to evolve from its faith-based roots. Investors have discovered that investing in a socially conscious manner does not require foregoing performance, but actually could lead to outperformance. Increasingly analysts and portfolio managers are incorporating environmental, social, and governance factors into the investment process. At GAMCO, we believe the experience and ability to manage a socially screened portfolio in accordance with varying guidelines ultimately leads to a win-win situation for the investor.

The Gabelli Advantage

GAMCO Investors, Inc., (GBL-NYSE), with eight offices across the globe, was founded in 1976. As of March 31, 2015, we manage in excess of $46 billion on behalf of institutions and private clients around the world in separately managed equity accounts, open-end and closed end mutual funds and investment partnerships. The firm is based on the premise that by providing superior risk-adjusted returns for our clients, we will create wealth for our shareholders. Our investment approach focuses on analyzing and determining the value of each company, the quality and strategic position of its business, and management's desire and ability to operate the firm successfully and to maximize shareholder value.

GAMCO has a nearly 30-year history of socially responsive investing beginning with the management of a Catholic institution's retirement assets in 1987. Since this first SRI mandate, the SRI client roster has grown to include foundations, endowments, family offices, and individuals. GAMCO manages socially responsive mandates across the market cap spectrum in a separate account format. In 2007 we launched the Gabelli SRI Fund – a socially screened open-end mutual fund. Today, many institutions have entrusted GAMCO with a portion of their assets to be managed in accordance with their socially responsive principles.

"Learning is not attained by chance, it must be sought for with ardor and diligence. "
- Abigail Adams

Research Process

Our investment process is best summarized as follows:

- GAPI: Gather, Array, Project and Interpret the data
- Sticking to companies and industries which are within our Circle of Competence
- Viewing each company we analyze through the prism of our unique methodology of Private Market Value with a Catalyst™
- Requiring a Material Discount to PMV before investing

GAPI refers to our fundamental, bottom-up research process. We read regulatory filings (including 10-Ks, 10-Qs, and proxy statements), comb through footnotes, read trade journals, attend industry conferences, and perhaps most importantly for us, meet with management, preferring to visit companies where they are headquartered. We distill all this information we gather into our proprietary, cash-flow focused models, through which we value companies on a segment-by-segment basis. We attempt to project out a company's earnings and cash flow generation over the next five years, roughly mirroring our long term holding period for our investments. Analysts communicate their investment cases through written reports, as well as at our daily morning meeting.

Circle of Competence refers to the industries and companies on which we choose to focus, and over time have built compounded accumulated knowledge. We do not attempt to follow every company or industry in any given benchmark; in fact, we are "indexagnostic" when investing. We will not chase the latest hot stock or sector simply because it is performing well at the moment. We pick and choose companies and industries that we believe are advantaged over the long term, and often share one or more of the following attributes: strong brands, pricing power, recurring revenue, economies of scale, a unique technology, and strong free cash flow generation. We believe in industry specialization, and expect our analysts to dominate the knowledge of their assigned industries. We are also "size agnostic" in our research, and our investments range from small, micro-cap companies to large multinationals.

Some of the industries in which we choose to specialize in include:

- Aerospace
- Auto
- Beverages
- Cable/Satellite
- Consumer
- Food
- Lodging
- Media
- Telecommunications
- Utilities
- Waste
- Water

"Everybody has got a different circle of competence. The important thing is not how big the circle is...the important thing is staying inside the circle. "

-Warren Buffett

Finally, we only invest when we believe a company is trading at a Material Discount to what we believe it is worth. We build diversified portfolios on a company-by-company basis, looking for the highest quality businesses trading at a meaningful discount to Private Market Value with one or more potential catalysts to surface value.

Investment Philosophy

GAMCO's value-oriented stock selection process is based on the fundamental investment principles first articulated in 1934 in the iconic book Security Analysis by Benjamin Graham and David Dodd, two professors at Columbia Business School. They emphasized the importance of fundamental research and of analyzing asset values and cash flows. Importantly, they also highlighted buying businesses trading at a material discount to intrinsic value. This approach and philosophy was further augmented by Mario Gabelli in 1977 with his introduction of the concept of Private Market Value (PMV) with a Catalyst™ into equity analysis.

Private Market Value is the price an informed industrialist would pay to own an entire business. PMV can be calculated based on what a financial buyer (private equity firm) could pay for a business to get its required return on investment, or what a strategic buyer may pay, which would typically be higher due to potential synergies. To determine these values we evaluate several factors: cash flows of the business, potential leverage and cost of leverage, synergies available to acquirers, and multiples paid within industries. We also make adjustments based on any on- or off-balance sheet assets or liabilities. We are biased towards companies that are growing PMV over time through growth of the business, margin improvement, and productive uses of cash flow, such as debt repayment, share repurchase, or accretive M&A.

We also look for Catalysts that have the potential to surface value for our investments. One of our favorite catalysts is industry consolidation, which may result in the takeover of a company. Another hard catalyst that has been frequently used by many companies in recent years is what we call "financial engineering", such as spin-offs, split-offs, and sales of a division. These restructurings can have the potential to surface value in the public markets, as well as lead to M&A down the road for the spun-off company or the parent. There can also be softer catalysts, such as new management, a regulatory change, a change in cash flow allocation, or a new product cycle. Finally, shareholder activism, which has risen to prominence in recent years, may lead to companies improving their performance, or adopting shareholder-friendly measures, including one or more of the catalysts mentioned.

Our SRI screening process

GAMCO has been managing separately managed SRI accounts since 1987. In doing so, we utilize client specified criteria through which we exclude unwanted companies or industries from client portfolios. In addition, securities are screened with the help of a third party provider, currently, MSCI ESG Research. MSCI ESG Research is a webbased service that provides access to a proprietary social research database on public companies. This service supplements our internal, fundamental analysis of a business and helps us make a more holistic investment decision. We are also a member of several SRI related organizations and also may attend various conferences to obtain a more complete understanding of current social issues and topics.

For the Gabelli SRI Fund, we utilize a social screening overlay process to identify companies that violate current guidelines around various social issues such as tobacco, alcohol, gaming and abortion as well as companies that generate significant revenue as defense or weapons contractors. More recently, as a result of broad concern with the effect that drilling for natural resources is having on the environment, the Fund has broadened its focus on a pro-active approach to the environment through the addition of criteria identifying and avoiding publicly traded fossil fuel (coal, oil & gas) companies.

Conclusion

Socially responsive investing is subject to varying degrees of interpretation/acceptance of principles. The Gabelli advantage is our long track record of managing SRI portfolios according to client-specific guidelines, combined with our proprietary Private Market Value with a Catalyst™ approach which has provided clients with superior risk-adjusted returns since we began managing portfolios in 1977.

The Gabelli SRI Fund provides a single vehicle that invests according to the same allcap, PMV with a Catalyst™ style of investing, while screening out the companies and industries most commonly avoided by SRI-focused individuals, corporations, or other entities. We believe the recent addition of a restriction on fossil fuel investments reinforces the Gabelli SRI Fund's position as a leading vehicle through which investors can seek a portfolio invested in a socially responsible manner.

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Investors should carefully consider the investment objectives, risks, charges, and expenses of the Fund before investing. The prospectus, which contains more complete information about this and other matters, should be read carefully before investing. To obtain a prospectus, please call 800-GABELLI or visit www.gabelli.com.

Stocks are subject to market, economic and business risks that cause their prices to fluctuate. When you sell Fund shares, they may be worth less than what you paid for them. Consequently, you can lose money by investing in the Fund.

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