Haas Socially Responsible Investment Fund

Annual Report

May 2008

University of California
Berkeley
Haas School of Business

Center for RESPONSIBLE BUSINESS
Redefining good business.

UNIVERSITY OF CALIFORNIA, BERKELEY FOUNDATION

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HSRIF Beginnings

Launched in 2003, the Center for Responsible Business (CRB) at the Walter A. Haas School of Business at the University of California at Berkeley is one of the premiere academic institutions committed to the advancement of responsible business practices. As a catalyst and innovator, the Center's mission is to create a new generation of business leaders who are knowledgeable about and committed to Corporate Social Responsibility (CSR). To accomplish this goal, the Center exposes all of its constituents to the complex issues of a corporation's role and responsibility to society beyond simply maximizing shareholder value. The Center serves as a bridge between academia and the corporate world. The research and teaching strengths of UC Berkeley, combined with the Center's experiential learning approach, connects CSR-focused knowledge and research to students, faculty, companies, and the community.

The Director of the Center, Dr. Kellie McElhaney, conceived of a student managed social investing fund through conversations with Haas alumnus and Sierra Global Management founder Charlie Michaels and his wife, Doris. The idea of a fund that would bring students face to face with the challenges and opportunities of social investing made it a natural extension of the CRB’s other experiential learning programs. The CRB launched the Haas Socially Responsible Investment Fund (“HSRIF” or “the Fund”) in the fall of 2007 with the generous support of a $250,000 gift from Charlie and Doris Michaels. The student managed fund is one of the first if its kind in an MBA program in the United States.

The launch of the Fund attracted significant attention from the media, the students at Haas, and the greater Haas community. Haas alumnus Al Johnson, BS 62 and MBA 69, and his wife, Marguerite, committed a $1,000,000 gift to the Fund, which helped the CRB quickly exceed its fundraising goal prior to initiating investments. Alumnus Larry Johnson, BS 72, also gave $75,000 to support the fund. This level of support from members of the Haas community is a testament to the innovative nature of the Fund and the recognized value in giving students the opportunity to learn and study the capital markets and portfolio management through a "hands-on" investment experience. Students participating in the HSRIF will learn how to research and evaluate potential investments, and how to structure and manage a portfolio within socially responsible guidelines.

The Fund’s inaugural team of portfolio managers was selected in the fall of 2007 and spent the 2007-2008 school year devising the Fund’s operational practices and investment approach.

Portfolio Management Team

The inaugural portfolio management team was selected from a pool of applicants from both the full-time MBA and the Masters in Financial Engineering (MFE) programs at Haas. Four second-year MBAs and two MFE students were chosen to bring a mix of capital markets experience, a passion for social change, and a commitment to learning about social investing.

The inaugural management team includes:

Ambuj Chaudhary, MFE 2008

Prior to joining Haas, Ambuj worked with Oracle Corporation as a Senior Applications Engineer. Ambuj brings with him more than four years of experience in designing and developing solutions for banking, treasury, investment management, and supply chain domains. While at Oracle he played an active role in an industry wide collaboration for data interchange and transfer standardization under the aegis of the UN's Center for Trade Facilitation and Electronic Business. He was also highly involved with voluntary community services organized by Oracle Volunteers. Ambuj received a BS in Electrical Engineering from the Indian Institute of Technology. He is a CFA level II candidate and wants to pursue a full time career in investment management.

Lance Durham, MFE 2008

Lance earned an MBA and MSME from MIT in 2002. After ½ a year on religious missions in Asia, he returned and worked at Booz Allen Hamilton until joining Haas. At Booz Allen, about ¼ of his consulting projects focused upon overseas development. Lance believes that the purpose of business is to serve people, not to 'make a profit'; rather, 'making a profit' is the strategy by which the business raises the capital necessary to serve people, just as 'asking for donations' is how charities raise the capital to serve people. Lance received a BS in Mechanical Engineering from Northwestern University. He is pursuing full-time opportunities making BOP–focused investments.

Margot Kane, MBA 2008

Margot has a background in international development and public health. She has worked for non-profit NGOs in the U.S. and East Africa, and is highly engaged in corporate social responsibility and social entrepreneurship at Haas. Last summer, she worked at socially responsive investment management firm Walden Asset Management, performing investment strategy and equity research for their small cap portfolio. Margot received a BA in History and Spanish from Macalester College. She will be working for NCB Capital Impact, a non-profit community development financial institution, after graduation.

Michael Pearce, MBA 2008.

Prior to attending Haas, Michael spent six years at UBS Investment Bank, raising over $1.5 billion in 30 transactions in the telecom, technology, biotech, medical device and business services sectors. Last summer, he worked for Pacific Community Ventures, analyzing, structuring and closing new portfolio investments; including financial modeling, valuation analysis, industry research, and company diligence. Michael received a BS in Finance with a minor in Mathematics from Georgetown University. He will be working for Cambridge Associates following the completion of his MBA studies, serving as an investment consultant for universities, foundations, non-profit organizations, and institutional investors.

Clayton Schloss, MBA 2008

Clayton brings eight years of personal investing and six years of professional equity market experience to the HSRIF. As an undergraduate he was an inaugural member of the Davidson College Investment & Finance Association, a student team that managed $250,000 of the College's endowment by investing in individual stocks. As an investor relations consultant with Thomson Financial, he provided strategic advice to senior management teams and investor relations officers at the world's largest technology companies regarding the trading dynamics of their common stock. Clayton interned with Apple as a business analyst in worldwide product marketing last summer. He received a BA in Economics from Davidson College. Clayton will be working for L.E.K. Consulting upon graduation from Haas, providing management consulting and private equity due diligence services to clients across various industries.

Elizabeth Singleton, MBA 2008

Elizabeth brings a variety of nonprofit experience in education, international health, and natural resource management to Haas. Elizabeth came to Haas after four years in Arusha, Tanzania as the Director of the Tanzania Natural Resource Forum, a nonprofit dedicated to the equitable, sustainable, and transparent management of Tanzania's natural resources. At Haas, she has been exploring the field of CSR and the power of corporations to create positive social and environmental impact through their core businesses. Elizabeth continued that focus outside the classroom, interning with Dow Chemical's corporate sustainability group over the summer. She has a BA from the Woodrow Wilson School of Public and International Affairs at Princeton University, where she minored in Environmental Studies and African Studies. Elizabeth will be returning to Dow Chemical after graduation as program manager for corporate sustainability.

Management Team Transition

In the spring of 2008 the student management team solicited applications from first-year MBA students to join the Fund in advance of the annual management transition. As a student managed fund, HSRIF will continually face challenges of knowledge management and transition. Each year a new team of MBA and MFE students will take control of the Fund on May 1 for the following 12 months.

Six first-year students were chosen to join the management team, an increase in numbers based on the time demands experienced by the inaugural team. The first year students were asked to join the team at the beginning of the spring semester in order to give them as much exposure to the Fund prior to the official transition. The first-year students were a tremendous asset to the team, committing generously of their time and energy to getting the Fund prepared to make its initial investments.

The second class of HSRIF managers includes:

Ben Biddle, MBA 2009

Ben brings a combination of finance and social sector work experience to the fund. He started out as a full-time Americorps volunteer working in microfinance for ACCION New York. After his term of service ended, Ben went on to spend three years at Citigroup's Corporate & Investment Bank. Over his tenure there, he held a variety of positions in areas ranging from risk management to technology product management. Ben received a BA in Spanish and Economics from Boston College. He came to Haas to pursue his MBA with an interest in early stage ventures. Apart from the Fund, Ben is active in the Entrepreneurs Association and the Berkeley Energy & Resources Collaborative. Ben will be working for Infosys Consulting this summer in Bangalore, India and Fremont, California.

Matthew Blair, CFA, MBA 2009

Prior to attending Haas, Matthew worked for five years at Quellos Capital Management, a fund of hedge funds. He is an avid fan of the stock market, and has been managing his personal equity portfolio since college. Matthew received a BA in International Political Economy from the University of Puget Sound, where he studied international trade, development, and lending institutions like the IMF and World Bank. He is currently an equity research intern at Mosaic Investments, and will be spending the upcoming summer as a high yield credit analyst at Franklin Templeton Investments.

Limiao Cheng, MBA 2009

Prior coming to Haas, Limiao spent four years in the investment sector in China, first in the futures arena and then in venture capital as an associate for Focus Ventures, a leading expansion venture capital firm in Silicon Valley. Limiao also worked in business development in China and in private equity working with the Mingly China Growth Funds. This diverse experience in China's rapidly growing economy stimulated Limiao's interest in the opportunities for socially responsible investing, especially in the areas of energy efficiency, renewable energy, and recycling, as well as advanced materials for green buildings and cities. Limiao received her B.S. degree from Capital Normal University in Beijing. At Haas, she is focusing on finance.

Megha Doshi, MBA 2009

Megha has a background in public health and sustainability research. Prior to Haas, she worked at KLD Research & Analytics, a socially responsible investment research firm, where she researched the social, environmental, and governance performance of domestic and international publicly traded companies. She also worked at the California Department of Health Services researching public and private sector solutions to address environmental and public health triggers of obesity and physical inactivity. Megha received a BA in Bioethics and Policy from Harvard University. At Haas, she is focusing her studies on strategic corporate responsibility, social venture finance, and marketing strategy. Megha will be interning at Nike in the company’s CSR department this summer.

Mike Lee, MBA 2009

Mike is a first-year MBA and the Co-President of the Haas Net Impact Club. Prior to Haas, Mike spent two years as a social sector consultant at LaFrance Associates where he managed social impact evaluation projects for nonprofit, public sector, and philanthropic clients. He has also worked at Ashoka, a global social venture fund, and is an alumnus of the Coro Fellows Program in Public Affairs, a year-long public service leadership training program. Michael graduated magna cum laude from Harvard University with an interdisciplinary degree in Social Studies.

Brandon Purcell, MBA 2009

Brandon managed the equities division of AGS Specialists, LLC at the American Stock Exchange prior to pursuing his MBA at Haas. In his role as Equity Product Manager, Brandon oversaw trading in 95 listed equities and communicated directly with the companies' CEOs and CFOs to explain price and volume fluctuations. Brandon came to New York from Chicago, where he traded options on various indices and ETFs such as the S&P 500 and the NASDAQ for Ronin Capital, LLC. Before his stint at Ronin, Brandon served as a Peace Corps volunteer in Benin for two years. In the town of Save (pronounced "Sah-vay"), he taught English, computer skills, and HIV prevention, and also worked with a Girls' Club to battle the problem of gender disparity in Benin's schools. At Haas, Brandon plans to synthesize his trading floor and Peace Corps experiences in order to make a positive impact in the developing world.

This new class of managers took primary control of the Fund on May 1, 2008. Over the academic break through the summer, the team will be responsible for monitoring the Fund's current positions, but no new investments are expected to be made until the start of the next academic year in August. The Fund's Advisory Board liaison, Lloyd Kurtz, will assist the team in monitoring the portfolio over the summer.

Due to the different academic schedule for the MFE program, three new MFE students will be selected in May 2008.

Investment Approach

The inaugural portfolio management team worked closely with key advisors to devise an innovative approach that would make the most of the unique opportunity presented by the Fund to push the boundaries of social investing. The portfolio managers agreed in the early stages that the Fund would not rely on traditional criteria to screen out companies based on their businesses or their practices, commonly referred to as negative screens. The Fund's aim is to contribute to the field of social investing by defining and exploring new ideas around unlocking hidden value based on companies' environmental, social and governance (ESG) practices. The Fund seeks to test recent academic, data-driven hypotheses on the materiality of certain ESG factors in corporate performance, as well as explore undervalued opportunities in various arenas to be captured by sustainable and innovative business practices, products, and services.

Each team member will independently research an idea or investment thesis, based on both student interest and areas of SRI research where opportunities exist. Some examples of these ideas fall roughly into the ‘themes’ outlined below. It is anticipated that as the Fund evolves the students will add to these themes in the future.

Students will propose topics of research that fall under one of these themes, and identify individual companies which will be evaluated on the most relevant social criteria to both the topics and theme with regards to both the investment thesis and core business operations. For example, a student wishing to test an idea around CEO compensation in financial services would weight a company’s compensation practices more heavily than its sustainability practices, while a student investigating airlines might weigh carbon generation and offsetting activities more heavily than compensation practices.

Investments will also be evaluated in relation to industry peers in both social and financial performance – in other words, a ‘best in class’ analysis, which allows more flexibility with regards to industries such as extractives, health care, and chemicals.

Theme 1: Reputation

Reputation has become increasingly important to companies, as more and more value of a company lies in intangibles, such as brand. Additionally, consumers and other business stakeholders are demanding more of companies in terms of their license to operate. Companies are increasingly expected to be good corporate citizens, but it is unclear how much of company’s reputation for citizenship is based on public relations versus sound company practice and strategic investments. This research theme will seek to primarily identify industries and sectors in which reputation is a critical factor in a company’s financial success and growth. Then, companies’ ESG practices will be assessed to determine the basis for both current and future reputation that would be beneficial to the companies. The Fund seeks long positions in companies with outstanding ESG practices and a deserved reputation, as well as in companies with solid and emerging practices that have yet to reap the financial and/or reputational benefits of their current policies.

Theme 2: CEOs and Corporate Governance

Companies will be evaluated based upon CEO performance and compensation. Long opportunities will be characterized by moderate, performance-based CEO compensation, employee pay equity, and a humble, “Level 5” leadership style at the CEO level. Turnaround stories or short opportunities will arise from companies that have excessive CEO compensation (by type of compensation), a CEO with “superstar” status who actively seeks publicity, and entrenched senior management.

The issue of CEO compensation and personality traits overlaps with corporate governance. The Fund will evaluate companies on the independence of their boards and compensation committees with regards to executive pay, performance evaluation, and decision-making. Investment opportunities will be selected from "best" and "worst" in class along certain corporate governance metrics identified as strong correlates to overall corporate performance, including ratings on Board Independence, shareholder rights, and employee stock options issuance. Companies will be evaluated within industry and peer practices and selected not only upon excellent or poor corporate governance factors, but also upon the materiality of these governance factors with regards to corporate performance in a specific environment or industry.

Theme 3: Sustainable Business Practices and Supply Chain

Investment opportunities will be selected from companies that operate in industries that depend heavily on upstream supply chains for raw materials, labor, manufacturing, and finished goods. Long opportunities will be evaluated on sector-specific best practices in managing natural resource use, waste production, workers rights, supplier relations, and local community impact as relevant to a variety of industries. This investment thesis will focus on the following sectors with significant supply chain exposure: food and beverage, consumer products, apparel, metals and mining, consumer electronics and technology, utilities, and forestry and paper. Investment analyses will attempt to identify the financial materiality of managing supply chain risks on the premise that sustainable supply chain management practices (supporting fair trade, paying decent wages, practicing sustainable agriculture, implementing water conservation efforts, etc.) can benefit the bottom line rather than merely be considered added costs.

Theme 4: Alternative Energy and Energy Efficiency

While our other investment themes are focused on a particular aspect of a company's business, we decided to create one industry-focused investment theme around alternative energy and energy efficiency. Given the environmental, geopolitical, and economic implications of the world's energy needs, and the massive scale of the issue, there exists a significant opportunity to profit from investing in companies helping to responsibly meet the world's energy needs. The Fund will seek to identify companies whose products provide an energy source other than fossil fuels, including solar, wind, biofuels, and hydrogen fuel cells. The Fund also will search for companies focused on energy storage technologies and improving the efficiency of energy use and delivery, which includes electric utilities. Given the early stage of development for most alternative energy sources, and the inherent business and technology uncertainty surrounding them, the Fund has initially steered away from investing in pure play alternative energy stocks. Instead, the Fund has focused on larger companies that either have a significant part of their business focused on alternative energy or that have a strong focus on energy efficiency.

Theme 5: Accounting, Accruals, and Quality of Earnings

Although this theme requires further development, the Fund intends to identify short opportunities in companies with questionable accounting practices. The treatment of accruals, and the resulting quality of earnings, will be part of this analysis. Conversely, the Fund also intends to search for long opportunities in companies whose accounting practices have been too conservative and may see an unlocking of value in the future through different, yet ethical, accounting practices.

This year Lance sought a quantitative way to identify firms with fraudulent financial statements. Using firms that the SEC identified as fraudulent as a base, he identified their competitors, downloaded their financial statements and ran a logistic regression on the raw data, on certain ratios and on z-scores based upon the data (z-scores were calculated by competitive grouping). In the end, a clearly successful strategy was not identified.

Nonetheless, some opportunities for future work exist. 1) Identifying fraudulent firms that all had the same type of fraud (revenue fraud, for instance). With only one kind of fraud to identify, the logistic regression might work far better. By doing this for many other types of fraud (expense fraud, for instance), several successful logistic regression could be created. 2) Running the statistical test, but removing the financial services industry firms. The financial industry is often quite different from other industries. 3) Opening the regression up to alternative data, such as the presence of independent audit committees, independent boards, etc.

Theme 6: CSR Turnarounds

CSR turnaround opportunities are similar to traditional investing strategies targeting distressed companies that have suffered a decline in stock price but still have good management, sound financials and intriguing prospects in their sector. The CSR turnaround theme seeks to use these traditional distressed investing indicators, and apply them to companies that find themselves in this position from a revelation of an ESG issue, while still demonstrating a credible effort to reform. In essence, the goal is to identify opportunities where the main drivers of undervaluation are ESG factors.

Other themes under consideration include Base of the Pyramid business and sustainable products and services.

Accomplishments

The HSRIF team made significant progress in taking the Fund from concept to reality during the 2007-2008 academic year.

Upon selection to manage the Fund, the students participated in a Social Investing class taught by Lloyd Kurtz. Meanwhile, one team member attended the annual *SRI in the Rockies Conference* in an effort to learn more about the SRI field and promote the Fund within the SRI community.

The first task as a team was to draft a prospectus and governance documentation. The prospectus details the composition of the Fund's student Investment Committee and external Advisory Committee and the Fund's overarching objectives. It also discusses investment objectives, strategy, criteria, and processes, as well as an overview of the SRI space. The governance document lays out the details surrounding several Fund processes. The students determined the application process for subsequent classes of student principals and the roles the two respective classes would play while working on the Fund. The governance document features more detail on the Fund's investment decision making processes and reporting expectations.

Once the managers had drafted these documents to guide the operation of the Fund, they set out to establish relationships with various financial and ESG research providers to guide investment efforts. The students were able to access financial data such as First Call analyst research and Bloomberg through on campus resources at UC Berkeley. Meanwhile, HSRIF secured a relationship with Innovest Strategic Value Advisors to gain unlimited access to the firm's ESG research reports and Societe Generale to receive both the firm's SRI and traditional research products. The Fund has also been in discussions with several other ESG research providers, including KLD, Asset4, and Aperio Group, and may partner with them in the future. Exploratory calls were also held with Barclays Global Investors, E*Trade, and SustainAbility in order to learn about potential partnerships and promote the Fund among the traditional investment and SRI communities.

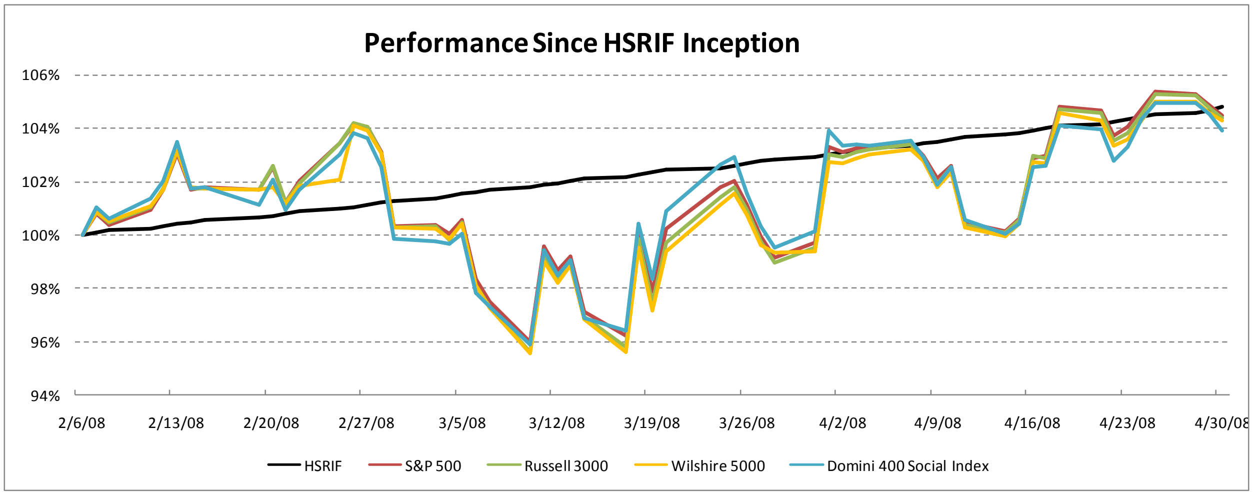
The Fund's research relationship work coincided with the creation of a general investment template and more detailed information on specific ESG investment themes, including process guidelines for arriving at an investment idea.

A key accomplishment during the year was the selection of the next year's class of student principals to manage the Fund and their integration into the Fund's day to day operations.

Finally, the student Investment Committee successfully launched the Fund and put money to work. The team spent over a month developing investment themes, narrowing those themes down to individual investment ideas, and gathering the feedback and information necessary to inform our first trades. The team proposed investment ideas in March and April and executed its first trades in May, shortly after the close of the fiscal year.

Performance Summary

By remaining in cash throughout much of the spring semester the Fund was able to avoid a period of significant market turmoil as the economy began to show signs of weakness stemming from the collapse of the sub-prime mortgage sector. The Fund's brokerage account officially opened on February 6, 2008, which will be used as its formal launch date going forward. HSRIF's performance since inception is detailed below:



HSRIF opening value (2/6/08): $1,143,144
HSRIF current value (4/30/08): $1,198,275
HSRIF total return: 4.82%

Future annual reports will show Fund performance for the current fiscal year and since inception.

Portfolio Commentary

Current Positions

The Fund's fiscal year runs from May 1st to April 30th. As of April 30th, 2008, the Fund had not invested in any individual securities. In early May, the Fund initiated two positions: ABB (ABB) and PG&E (PCG). Based on our expectation that the Fund, when fully invested, will contain 20-30 positions, the average position size will be in the range of $38,000 - $57,000. We purchased $40,000 of each stock and plan to gradually invest the rest of the Fund's assets as new investment ideas are generated by subsequent student management teams. Details on our first two positions are below:

ABB Ltd. (ABB)

The Fund invested in ABB as part of our environmental leadership and energy efficiency investment theme. Based in Switzerland, ABB is a $70 billion industrials company that is focused on creating energy-efficient products and systems for its clients. In the Power segments, ABB helps utilities and industrial firms with power generation, transmission, and distribution issues. In the Automation segments, ABB produces products and systems for manufacturing firms seeking to improve product quality, operational efficiency, and consistency in factories, buildings, and continuous production functions.

With the assumption that continuing high energy prices will make energy efficiency a necessity, our main investment thesis was that all parts of ABB's business benefit from global investments in energy efficiency. Furthermore, the Power segment is poised to do well in both emerging markets, which have a demand to build out power grids to fuel industrial development and support industrialization, as well as mature markets like Europe and North America, which will need to upgrade infrastructure for power and industrial systems and incorporate alternative energy sources of production into traditional power systems.

ABB was analyzed using the "Growth at a Reasonable Price" model. The company will help diversify the Fund's portfolio with its international exposure. The intended holding period is either 3 years or a P/E ratio of 25, whichever comes first.

Pacific Gas & Electric Corporation (PCG)

The Fund initiated a position in PG&E as part of our corporate governance and environmental leadership investment themes. PG&E is a $14 billion holding company and utility engaged in the generation, procurement, and transmission of energy in California, and one of the largest utility holding companies in the U.S. It is currently significantly invested in expanding the natural gas supply to the Western U.S. as well as alternative sources of energy, particularly solar, in California. PG&E's senior management team, put in place after California's 2001 energy crisis and PG&E's resulting governance breakdown and the bankruptcy, has been tested through the trying years of bankruptcy and public litigation and has turned the company around to profitability and increasing responsiveness to the public sector.

PG&E was recommended on the basis of their high-quality and democratic corporate governance practices; their good reputation in governance metrics; their early and promising attempts to promote energy efficiency and environmental responsibility in an industry where this has been ignored until very recently; and their willingness to innovate within the role of a regulated electric & gas power utility. Given recent environmental legislation and public opinion, PG&E's relatively low carbon footprint, cooperative and responsive corporate governance, and its willingness to follow the environmental leadership of California's public sector should afford it greater protection in the upcoming challenges for U.S. energy producers and distributors.

Given a strictly regulated return on equity and a challenging industry, PG&E is a conservative investment amid a challenging market. We view the stock as having limited upside, but it offers valuable insulation from any further deterioration in the macroeconomic environment. Exit considerations include a major resurgence in the U.S. economy, failure of the U.S. to implement any meaningful energy or cap-and-trade policy, or a degradation of its corporate governance practices and status.

In addition to the two positions the Fund initiated in May, the Fund also is close to adding a third company to the portfolio: VF Corporation (VFC). Substantial due diligence has been performed on VF, and pending some further research it may be voted upon by the incoming class of Fund principals.

In future years the Fund's annual report will disclose information on the portfolio, including an analysis of the portfolio along asset class (equities, bonds, cash, etc.), market capitalization (large cap, mid cap, small cap), investment style (Income, Value, GARP, Growth, Aggressive Growth/Momentum), and industry lines. It also will detail the Fund's largest winners and losers on a dollar and percentage basis.

The Fund's cash position has temporarily been invested in Schwab Bank, the default sweep account for all Charles Schwab brokerage accounts. However, we have investigated other options for our cash position and expect to reallocate our cash soon. One option is to purchase money market funds and/or CDs managed by ShoreBank. These federally insured products will allow the Fund to earn a competitive rate of return on its cash while providing necessary liquidity and driving social impact through ShoreBank's community development investments. Another option includes the Calvert Social Investment Fund Money Market, which seeks to invest in high quality money market instruments of companies and other enterprises that demonstrate positive ESG performance.

Portfolio Optimization

Traditional Portfolio Optimization requires a benchmark. With the benchmark, the investor can get (1) a prediction of alpha and (2) a prediction of the Tracking Error. With these predictions, the investor can optimize the portfolio according to the usual mean-variance criteria. After running the optimizer, the investor will know exactly how large the positions/ weightings should be. However, the appropriate benchmark for the Fund remains an open issue that has been discussed at length. Some possibilities for the benchmark and a short commentary on the possibilities follow:

Traditional Benchmarks: S&P 500, Russell 1000, Russell 3000, Wilshire 5000, etc.

- These are the traditional benchmarks for active investors. The idea of a benchmark is to compare our 'actively managed fund' against a 'passively managed fund'. While non-SRI investors might like these benchmarks, they do include certain 'sin stocks' that SRI investors might want to avoid.
- Also, it could be argued that any of the other possible benchmarks could be supplemented by deep-in-the-money calls or futures on 'sin stocks'. The 'delta' on these products would be approximately equal to one, so it is possible to get a portfolio that owns no 'sin stocks', but perfectly replicates one of these indexes.

Social Benchmarks: KLD, Calvert Social Indexes, etc.

- These are large SRI funds. The idea of this type of benchmark would be to compare the 'actively managed' HSRIF against other, though larger and more long-lived, 'actively managed' funds. Values investors might find these benchmarks more relevant, as they would not include 'sin stocks' and are commonly mentioned as 'SRI indexes'.

Customized Social Index

- This type of benchmark would be a customized portfolio created to match the values of the Fund's managers and to minimize tracking error against one of the traditional benchmarks. As it would match the values of the Fund, it would not include certain 'sin stocks' and could be skewed toward 'do-good stocks'. The premise of this benchmark is that SRI investors (1) should not judge one fund against another actively managed fund and (2) are not interested in an index that includes certain 'sin stocks'.

No Benchmark

This leads the fund toward a simple focus on absolute returns. Although easier, it leaves the MFEs with less to do and the Fund principals without a basis for performance comparison.

Risk Management

As of now, the Fund's holdings are almost completely in cash. There is little need for Risk Management techniques such as Value at Risk (VaR). The purchases of PG&E and ABB can only add diversity to the Fund's holdings and push returns towards whatever benchmark is ultimately selected. In the future, however, VaR and Extreme Value Theory should be used. This will educate the team and provide experience for the MFEs.

Closing Thoughts

It has been an exciting year of firsts for the Fund. Over the course of the last nine months the Fund developed from concept stage, secured seed capital, and recruited an external advisory board. An inaugural group of student portfolio managers was selected, and their successors also were incorporated into the Fund's operations. Research relationships were established, and the Fund executed its first trades.

The unprecedented nature of the Fund led to a significant amount of learning through trial and error at the institutional and individual level. One of our biggest takeaways from this experience, as one of our student portfolio managers astutely observed, is that "managing a fund is really hard." Indeed, participation in this new endeavor at Haas has been a fun and rewarding challenge for all parties involved. It has been an invaluable learning experience, and the inaugural student portfolio management team leaves the Fund heartened by the progress that we made and the fact that the Fund will be placed in very able hands going forward.

Those able hands belong to the new group of student principals with whom we worked during the spring semester. They brought much needed enthusiasm, new ideas, various areas of expertise, and energy to the Fund, and we would like to thank them for their commitment to the Fund throughout this early stage of its development.

We would like to thank Kellie McElhaney, Katharine Brewer, and Cecilia Pracher for their continuous guidance throughout the year. Without Kellie's vision and the support of the CRB's staff this project would not have been possible.

We also owe our gratitude to the Fund's principal donors, Charlie and Doris Michaels, Al and Marguerite Johnson, and Larry Johnson. Their generosity was inspiring and is greatly appreciated.

We would like to thank the HSRIF Advisory Committee, whose members donated their time to provide us feedback on the Fund's development. Their input on our workflow and the investment management and Fund operation process was extremely helpful, and their continued involvement with the Fund in subsequent years will be integral to its success.

Lastly, the student managers of the HSRIF would like to extend a special thank you to Lloyd Kurtz. Lloyd has been an invaluable resource throughout the entire year. His class on social investing served as an introduction to the world of SRI for most of us, and he has been a wealth of knowledge throughout the development of the HSRIF. He has been extraordinarily generous, sharing his time, insight, and resources with us to ensure our success.

We hope that those with whom we interacted while working on the Fund enjoyed the experience as much as we did. We wish the next class of student investment principals the best of luck with the Fund.

Sincerely,

Ambuj, Lance, Margot, Michael, Clayton, & Elizabeth

Advisory Committee Biographies

From the inception of the Fund, our Advisory Committee has . The Advisory Committee is currently comprised of 12 individuals, and we expect that number to fluctuate somewhat over time

Margo Alexander is currently the Chair of the Acumen Fund, a non-profit global venture fund that uses entrepreneurial approaches to solve the problems of global poverty.

Margo was formerly a senior executive of PaineWebber, where she spent the greater part of her thirty-three year career in the financial services industry. Beginning as a research analyst, she later became Director of Research, then Director of Institutional Equity and, in 1995, CEO of Mitchell Hutchins Asset Management. She was a member of the PaineWebber executive committee until the firm's acquisition by UBS in November 2000.

Ms. Alexander is a graduate of the University of California at Berkeley and the Harvard Graduate School of Business Administration, where she met her husband, Robert Alexander. She has lived in New York since 1970 and has two sons.

Ms. Alexander is a member of the advisory boards of the Haas School at Berkeley and The New School, serves on the board of the Eleanor Roosevelt Legacy Committee and is a member of The Council on Foreign Relations.

George S. Dallas is Director, Corporate Governance at F&C Investments in London, which manages over £100 billion in assets on behalf of more than 3 million people. He is a member of F&C’s Governance and Sustainable Investment team, where he leads all aspects of F&C’s global policies relating to corporate governance, including proxy voting, remuneration and engagement matters. He joined F&C in January 2008, prior to which he was a Managing Director at Standard & Poor’s in the area of analytical policy and research. Mr. Dallas began his career as a corporate lending officer at Wells Fargo Bank before joining S&P in 1983, initially as an analyst. At S&P he served in a range of analytical and managerial roles, including global head of both Governance Services and Emerging Markets, regional head for S&P’s Ratings Services in Europe and head of the firm’s London office. As global practice leader for corporate governance at S&P, Mr. Dallas led the development of S&P’s governance analysis and built a global team of governance analysts. He has conducted governance evaluations on companies across the globe and contributed to the formal linking of these to the overall credit rating process. He has also served on a working group to develop an S&P emerging markets index focused on corporate governance and sustainability. Mr. Dallas has written extensively on corporate governance and international finance and edited the book Governance and Risk (McGraw Hill, 2004). Mr. Dallas holds a BA degree, with distinction, from Stanford University and an MBA from the Haas School of the University of California at Berkeley. He has dual US/UK nationality and speaks German and French.

Stephen Etter is a Partner at Greyrock Capital Group. Prior to joining the Greyrock Principals in 1996, Stephen held positions at GE Capital, Barclay's Bank and Citicorp for the preceding 9 years where he focused on senior and mezzanine debt. From 1983 to 1987 he worked for Price Waterhouse where he obtained his CPA.

Stephen received his undergraduate degree and MBA from the Haas School of Business, University of California at Berkeley, where he has been a Finance Lecturer for the past 10 years.

Stephen is a member of Board of Directors for the San Francisco Giants Community Fund and currently serves as a Trustee on the University of California Berkeley Foundation.

Lawrence R. Johnson retired in 2007 from Milliman, a worldwide employee benefits consulting and actuarial firm based in Seattle, WA. Mr. Johnson was the Founder and CEO of Lawrence Johnson & Associates, a national retirement plan recordkeeping firm and InvestorLogic, LLC, a Registered Investment Advisory firm. Both of these firms were merged with Milliman in 2006 and 2007 respectively. Mr. Johnson had overall responsibility for ensuring that the firm's retirement plan clients had access to the full recordkeeping and investment advisory resources of both organizations.

He has over 35 years of tax and investment experience, of which the last 30 have concentrated on qualified retirement plans. Mr. Johnson is a nationally recognized expert in retirement plan design and administration. He has extensive experience in IRS and DOL compliance and audit issues and lectures frequently on fiduciary responsibilities affecting qualified retirement plans. Mr. Johnson served on several administrative and investment committees on behalf of the firm's clients. Mr. Johnson currently serves on the U.C. Berkeley Foundation Board of Trustees; and the Investment Committee– U.C. Berkeley Foundation. Mr. Johnson received his B.S. degree in Business Administration from the University of California, Berkeley.

Lloyd Kurtz is a senior portfolio manager at Nelson Capital and lead PM for socially responsible investing (SRI). Before joining Nelson Capital in 2004, Lloyd was a Senior Vice President at Harris Bretall Sullivan & Smith in San Francisco where he served as Director of Quantitative Research and provided research coverage for the healthcare, basic industry and energy sectors. Before joining Harris Bretall in 1995, he spent four years as Senior Research Analyst at KLD, a Boston research firm specializing in social investment research. At KLD, he did much of the initial quantitative work in the development of the Domini Social Index.

Lloyd is a Research Fellow at the U.C. Berkeley Haas Business School's Center for Corporate Responsibility, and serves as Program Administrator for the Moskowitz Prize. He has published numerous articles on SRI in academic journals, and authored a chapter on SRI for the Oxford Handbook of Corporate Social Responsibility, which will be published in 2007.

He holds a B.A. from Vassar College, an M.B.A. from Babson College, and is a Chartered Financial analyst. In 1999, he received the SRI Service Award for his contributions to social investing.

Lisa Leff is a Vice President and Portfolio Manager with Trillium Asset Management, the oldest and largest independent investment management firm devoted exclusively to socially responsible investing. Before joining the firm in 1999, Lisa served as Director and Portfolio Manager with the Social Awareness Investment program at Smith Barney Asset Management in Manhattan. While in New York, Lisa founded the Social Investment Security Analysts group and served on the Board of Directors of the Social Investment Forum. More recently, Lisa has served on the boards of the Idaho Conservation League; the Fund for Idaho, and Ten Thousand Villages, Boise, and currently serves on the board of the EcoLogic Development Fund. Lisa was named Idaho's Progressive Businessperson of the Year for 2004. She is currently an active member of the Idaho Women's Charitable Foundation. Lisa holds a B.S. in Business Administration from California State Polytechnic University and an M.B.A. from the Wharton School. Lisa is a member of the Association for Investment Management and Research and the New York Society of Security Analysts, and is a Chartered Financial Analyst.

Kellie A. McElhaney is the John C. Whitehead Faculty Fellow of Corporate Responsibility and the Executive Director of the Center for Responsible Business at the Haas School of Business, University of California, Berkeley. She developed and launched this new center in January 2003, which has helped place corporate responsibility squarely as one of the core competencies and competitive advantages of the Haas School. Kellie teaches multiple courses on Strategic Corporate Social Responsibility in all of the Haas School's degree programs, which include in-depth student consulting engagements with companies on high-visibility strategic CSR challenges. Her research focus is in the area of analyzing companies' CSR strategy, and its fit with their core business objectives and core competencies. She consults to several Fortune 500 companies in developing an integrated CSR strategy, bridging her academic focus with the practitioner world.

She is a member of the UN Global Compact Faculty and serves on the Association for Corporate Growth Strategic Philanthropy Advisory Committee. Kellie was recently named a 2005 Faculty Pioneer for Institutional Impact by the biennial report, Beyond Grey Pinstripes. Prior to joining Haas, she spent nine years at the University of Michigan Business School, where she was adjunct professor of corporate strategy and managing director of the Corporate Environmental Management Program (CEMP). Before joining academia, she was in the mergers and acquisitions area of commercial banking. Kellie holds a Ph.D. from the University of Michigan, a M.A. from Ohio University, and a B.A. from the University of North Carolina, Chapel Hill.

Charles F. Michaels, CFA is the Founder, Managing Partner, and Portfolio Manager Sierra Global Management. Mr. Michaels was born in Europe and has spent much of his personal and professional life there, including six years with Goldman Sachs & Co. in London and Zurich. Mr. Michaels served as a vice president during his nine years with Goldman, as well as a founding member of Goldman's European equities business.

Prior to Goldman, Mr. Michaels was an assistant vice president at Wells Fargo Bank in San Francisco and New York City. Mr. Michaels graduated from the University of California at Berkeley and received his MBA from the Columbia Business School.

John O'Brien is an Adjunct Professor and Executive Director for the Masters in Financial Engineering program at the Haas School of Business, UC Berkeley. Previously John was a Managing Director at Credit Suisse Asset Management, responsible for developing CSAM's first Risk Management department. Prior to CSAM, John was the Co-founder, Chairman and CEO of Leland, O'Brien Rubenstein Associates (LOR), a financial services firm that developed innovative funds, including precursors of the first exchange traded funds. Before LOR, John worked on pension investment management for A.G. Becker Funds Evaluation Group (now SEI Investment, Inc.). John joined A.G. Becker after the sale of O'Brien Associates, where he was co-Founder, Chairman and CEO. O'Brien Associates introduced modern portfolio theory and analytical risk management into the purely "Graham and Dodd" investment industry of the time. He created the first "beta" book of individual stock systematic risk, the first risk-adjusted investment performance measurement service, and the first Monte Carlo simulation of multi-asset-class return distributions for pension policy analysis and was the co-creator of the O'Brien 5000 Stock Index –re-named the Wilshire 5000. John received an MS, Engineering (Operation Research) from University of California, Los Angeles, CA and an SB, Economics and Engineering (Electrical) from MIT, Cambridge, MA.

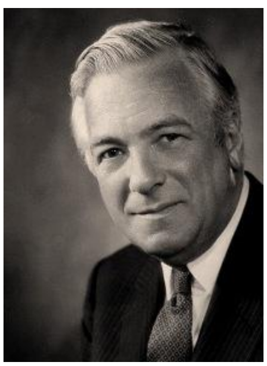
Dr. Marc Orlitzky joined Nottingham University Business School's International Centre for Corporate Social Responsibility as a Research Fellow in October 2007. He serves on the editorial review boards of the Academy of Management Journal and the Sage Encyclopedia of Business Ethics and Society and has published papers in two Oxford University Handbooks, Organization Studies (award-winning, highly influential meta-analysis of corporate social/financial performance), International Journal of Human Resource Management, Business & Society (in 2001 an award-winning article on corporate social performance and business risk and another study in 2006), Small Group Research, Personnel Psychology, Journal of Management Education, Journal of Business Ethics, Journal of Investing, Academy of Management Review, Academy of Management Learning & Education, and several other publication outlets. Previously, he served on the faculty of the Australian Graduate School of Management (AGSM) and the University of Auckland. Marc's research interests revolve around corporate social, environmental, and financial performance, corporate/business strategy, human resource management, and quantitative methods (especially measurement and meta-analysis). Dr. Orlitzky received his PhD from the University of Iowa.

Scott Pinkus retired from Goldman, Sachs and Co. in 2000, after having been a partner there since 1990. At Goldman, Scott established and headed the Credit Derivatives Group, which was responsible for the trading, structuring, and distribution of over-the-counter credit derivative contracts, credit-linked notes, and credit-intensive securitized instruments. From 1988 to 1998, he headed the Fixed Income Research Department, which developed decision support tools using the latest computer technology, building quantitative models to assist in security valuation, and creating investment and trading strategies.

Prior to joining Goldman Sachs, Mr. Pinkus founded and headed the Mortgage Securities Research Department at Morgan Stanley & Co. and before that held the same position at Merrill Lynch & Co.

Mr. Pinkus is on the Advisory Board of Home Equity Securities, LLC, a new venture that developing a standardized structure and liquid market for securitized fractional shares of home equity. He is a Special Advisor to Azimuth Asset Management, a hedge fund-of-funds. Mr. Pinkus is the Chairman of the Steering Committee for the MFE program at Haas.

Mr. Pinkus received both an MBA (1981) and a B.S. in Economics (1980) from the Wharton School at the University of Pennsylvania.



John C. Whitehead is Chairman of The Goldman Sachs Foundation. Mr. Whitehead began his professional career in 1947 at Goldman, Sachs & Co., where he worked for 38 years. He rose quickly within the company and was named Partner in 1956 and Co-Chairman and Senior Partner in 1976. He has served on the boards of numerous companies and as a Director of the New York Stock Exchange and Chairman of the Securities Industry Association.

From 1985 to 1989, Mr. Whitehead was asked to become Deputy Secretary of State. Mr. Whitehead was awarded the Presidential Citizens Medal by President Reagan.

He is a former Chairman of the Board of the Federal Reserve Bank of NY, the UN Association, the International Rescue Committee, the Greater New York Councils of the Boy Scouts, International House, The Andrew W. Mellon Foundation, the Harvard Board of Overseers, Haverford College, and the Asia Society. He is a Director of the Nature Conservancy, Lincoln Center Theater, the East-West Institute, and the Eisenhower Exchange Fellowships, and a former Director of Rockefeller University, the J. Paul Getty Trust, Outward Bound, and the National Humanities Center. Mr. Whitehead is Chairman Emeritus of the Brookings Institution and the Trustees Council, National Gallery of Art.

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