

Parnassus Investments: A Leader in Sustainable Investing

Fund Spy | 03-06-18 | by Andrew Daniels, CFA, CMA

Jerry Dodson founded Parnassus Investments in 1984 as a responsible investing firm. Since then, Parnassus has grown to \$26.5 billion in assets under management—more than twice that of the next-largest sustainability-focused asset manager—and has become an unequivocal leader in sustainable investing. The firm’s strong investment culture and disciplined approach distinguish it from peers, even those without sustainable investing mandates. In fact, of its four funds that receive Morningstar Analyst Ratings, three are Morningstar Medalists—including Silver-rated Parnassus Core Equity (PRBLX) and Parnassus Mid-Cap (PARMX)—signaling our conviction they will outperform their bogies over a full market cycle.

A Strong Investment Culture

From 1984 to 2001, Dodson was the sole manager for each of the firm’s funds, and he was initially the only listed manager for each fund it has since launched. But he has handed off much of his responsibility and is now a manager for just two. Still, he has kept the investment team lean at 13 members, consisting of nine managers; one analyst focused on fundamental research; and three analysts focused on environmental, social, and governance (or ESG) research. The team will also add two analysts this upcoming summer to bolster its fundamental research efforts. On the face of it, the number of analysts may seem small. The investment team’s modest size likely limits the breadth of its research, but it meets this challenge with significant collaboration among its managers, who run focused, low-turnover portfolios. In fact, the similarity among the January 2018 holdings of the firm’s four U.S. equity funds illustrates this combined effort, as shown in the table below. For example, the most similar portfolios are large-blend siblings Parnassus and Parnassus Core Equity, which have a common-holdings score of 40% (this metric accounts for both the number of stocks held in common and their respective portfolio weights).

	1	2	3	4
1 Parnassus	1.00			
2 Parnassus Core Equity Investor	0.40	1.00		
3 Parnassus Endeavor Investor	0.38	0.33	1.00	
4 Parnassus Mid-Cap	0.29	0.35	0.08	1.00

Source: Morningstar Direct. Data as of January 2018.

Because each member is an integral part of this tight-knit team, the firm thoroughly vets incoming analysts. Like other firms, it has a competitive summer internship program. But Parnassus’ internship program is a rite of passage for investment professionals. Except for Jerry Dodson and Samantha Palm, manager for Parnassus Fixed Income (PRFIX), the entire investment team began their careers here as interns. This has helped ensure each candidate’s cultural fit, and as a result, newcomers tend to stick around. The team has not been immune to turnover, but departures have been few and far between. Indeed, the average team member has been with the firm for more than 11 years. What’s more, the firm is 100% employee-owned, which allows many to participate in its economic success and incentivizes employees to build lasting careers here.

The Parnassus Approach

The team executes a consistent high-conviction, long-term-oriented approach at each of its equity funds. The approach is straightforward: The team targets high-quality companies—characterized by sustainable competitive advantages, increasingly relevant products or services, and exemplary management—and aims to purchase them when they’re out of favor with the market. Often, when the managers identify a good business, they first place it on a watchlist, then wait to buy at a more attractive valuation. Because the managers prefer quality firms battling temporary headwinds over mediocre firms trading at fire-sale prices, the firm’s funds tend to land in the blend section of the Morningstar Style Box. When the managers buy a stock, they’re willing to allocate a significant stake and tend to hold on for the long

term. Indeed, each fund holds between just 30 and 40 names, and portfolio turnover at each fund has trended below that of its typical Morningstar Category peer.

ESG analysis is integral to the investment process, as well, and portfolio companies must have ethical business practices. The team's ESG screens are like others; it avoids companies deriving significant revenue from alcohol, tobacco, weapons, nuclear power, or gambling, or those with ties to Sudan. But its ESG analysis extends further than these exclusionary screens, and it emphasizes positive ESG criteria. The team performs a qualitative assessment of potential investments, evaluating each firm's corporate governance and business ethics, employee benefits and corporate culture, stakeholder relations, products, customers, supply chain, and environmental impact. These considerations align with Parnassus' preference for responsible companies, but also help the team uncover business risks or opportunities that fundamental analysis may overlook. For example, companies with poor environmental practices may suffer costly fines or brand damage; meanwhile, environmentally friendly practices may promote a positive corporate image. This can directly affect a company's bottom line, so integrating it into the team's fundamental research provides a more complete understanding of potential investments.

For the most part, Parnassus has delivered strong results. Indeed, over the trailing 10 years ending February 2018—which represents close to a full market cycle—all four of the firm's U.S. equity funds have finished in the top quintile of their respective Morningstar Categories. While the firm's expertise lies in mid- and large-cap domestic equities, it has experimented in other asset classes with less success. Parnassus merged away its small-blend fund, Parnassus Small-Cap PARSX, in 2015. It will also liquidate its Diversified Pacific/Asia fund, Parnassus Asia PAFSX, later this month. The firm is still finding its footing in fixed income, but has taken steps recently to improve this effort, including hiring an outside manager in 2013 to guide its intermediate-term bond fund, Parnassus Fixed Income.

So, there are certainly areas in which the firm can improve, but all things considered, investors looking for solid ESG options can do well by turning to Parnassus.

Andrew Daniels, CFA, CMA does not own shares in any of the securities mentioned above.

Connor Young does not own shares in any of the securities mentioned above. Find out about Morningstar's editorial policies.

**Supplemental Information to:
Morningstar March 6, 2018 Article Entitled
“Parnassus Investments: A Leader in Sustainable Investing”**

Following is the performance of the Parnassus Funds mentioned in the article:

Total % Returns as of March 31, 2018¹	1 Year	3 Year	5 Year	10 Year	Gross Expense Ratio	Net Expense Ratio
Parnassus Fund Investor Shares	6.70	7.45	13.16	11.09	0.84	0.84
Parnassus Fund Institutional Shares	6.85	7.60	13.25	11.14	0.69	0.69
Parnassus Core Equity Fund Investor Shares	11.39	8.76	11.69	10.40	0.87	0.87
Parnassus Core Equity Fund Institutional Shares	11.63	8.98	11.89	10.61	0.64	0.64
Parnassus Endeavor Fund Investor Shares	12.22	12.48	16.02	14.12	0.92	0.92
Parnassus Endeavor Fund Institutional Shares	12.42	12.69	16.14	14.18	0.72	0.72
Parnassus Mid Cap Fund Investor Shares	7.90	8.70	11.19	10.79	1.01	0.99
Parnassus Mid Cap Fund Institutional Shares	8.11	8.93	11.32	10.86	0.75	0.75
Parnassus Fixed Income Fund Investor Shares	0.33	1.01	1.31	3.07	0.82	0.68
Parnassus Fixed Income Fund Institutional Shares	0.54	1.21	1.43	3.13	0.49	0.47

¹All returns greater than one year are annualized.

Parnassus Investments has contractually agreed to reduce its investment advisory fee to the extent necessary to limit total operating expenses to 0.99% of net assets for the Parnassus Mid Cap Fund—Investor Shares, 0.85% of net assets for the Parnassus Mid Cap Fund—Institutional Shares, 0.68% of net assets for the Parnassus Fixed Income Fund—Investor Shares and 0.58% of net assets for the Parnassus Fixed Income Fund—Institutional Shares. This agreement will not be terminated prior to May 1, 2019, and may be continued indefinitely by the investment adviser on a year-to-year basis. The net expense ratio is what investors pay.

The performance of Institutional Shares will differ from that shown for the Investor Shares to the extent that the shares do not have the same expenses or inception date.

Performance data quoted represent past performance and are no guarantee of future returns. Current performance may be lower or higher than the performance quoted. All performance assumes reinvestment of dividends and capital gains. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. You can obtain performance data current to the most recent month-end by visiting www.parnassus.com or by calling (800) 999-3505.

Common stock prices fluctuate based on changes to a company's financial condition and on overall market and economic conditions.

The data for the claim, “Parnassus has delivered strong results. Indeed, over the trailing 10 years ending February 2018—which represents close to a full market cycle—all four of the firm's U.S. equity funds have finished in the top quintile of their respective Morningstar Categories” is depicted below:

Parnassus Funds		
Grouped by: Morningstar Category	3/1/2008 - 2/28/2018	
Group/Investment	"Return (Annualized)"	Peer Group Quintile
US Open-End Large Blend Category		
Parnassus	11.29	1
Parnassus Core Equity Institutional	10.68	1
Parnassus Core Equity Investor	10.46	1
Parnassus Endeavor Institutional	14.65	1
Parnassus Endeavor Investor	14.59	1
Parnassus Institutional	11.34	1
Number of investments ranked		1,022
Peer Group Median	8.83	
US Open-End Mid-Cap Blend Category		
Parnassus Mid-Cap	10.66	1
Parnassus Mid Cap Institutional	10.73	1
Number of investments ranked		308
Peer Group Median	9.08	

Methodology for the Morningstar Analyst Rating: Rating is based on the analyst's conviction in the fund's ability to outperform its peer group and/or relevant benchmark on a risk-adjusted basis over the long term. If a fund receives a positive rating of Gold, Silver, or Bronze, it means Morningstar analysts think highly of the fund and expect it to outperform over a full market cycle of at least five years. Morningstar evaluates funds based on five key pillars--Process, Performance, People, Parent, and Price--which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis. The Silver Rating indicates a Fund with advantages that outweigh the disadvantages across the five pillars and with sufficient level of analyst conviction to warrant a positive rating.

In addition to large-cap companies, the Funds may invest in small- and/or mid-cap companies, which can be particularly sensitive to changing economic conditions and have fewer financial resources or the well-established businesses of large-cap companies. Relative to stocks of large-cap companies, the stocks of small- and mid-cap companies are often thinly traded, and purchases and sales may result in higher transaction costs. Also, small-cap companies tend to perform poorly during times of economic stress.

Before investing, an investor should carefully consider the investment objectives, risks, charges and expenses of the fund and should carefully read the prospectus, which contains this information. A prospectus can be obtained on the website, www.parnassus.com, or by calling (800) 999-3505.

The Parnassus Funds are distributed by Parnassus Funds Distributor a subsidiary of Parnassus Investments and FINRA member.