

Scientific Portfolio Market Review

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How Compatible Are Active Equity Funds with ESG Needs? A Closer Look at European vs. U.S. Strategies

Introduction

The past few months have brought a growing transatlantic **polarization** of attitudes and practices relating to Environmental, Social and Governance (ESG) investing. Where the ESG debate in the U.S. has become more politically contentious¹, European investors remain more committed to the principles of managing both the risks and opportunities, supported by regulatory and industry dynamics.

For global investors, however, this produces challenges. European and U.S. investors, while still typically regionally biased in their equity exposures, have global investment portfolios and seek to invest in both markets (whether via global mandates, regional mandates or both).

In this article, we compare European and U.S. strategies using two specific lenses, although there are, of course, many quantitative and qualitative criteria to consider when taking an ESG-oriented approach. Firstly, a 'Paris Aligned Benchmark' (PAB) lens is applied, in order to determine how many stocks would have to be excluded from active managers' portfolio for an investor that did not wish to have exposure to non-PAB companies and consider some tracking error implications. Secondly, we take a brief look at a measure of **carbon footprint** for the two fund manager groups. Key takeaways include:

- European active large cap equity mutual funds contain a **far lower proportion** of stocks that do not appear in Paris Aligned Benchmarks, making them theoretically more compatible with a PAB screen (for an investor that wishes to apply one or move in this direction).
- The median European equity fund has a **higher carbon footprint** than their U.S. counterpart – a side-effect of the larger proportion of 'growth' funds in the market.
- This picture is continually evolving and investors must not be complacent. For example, a strategy that currently appears quite PAB-friendly (and thus minimally affected by screening) may not necessarily remain so.
- ESG-oriented investors should scrutinise asset managers' changes at both corporate and strategy level with care, as well as underlying portfolios.

Regional Investors, Global Exposures

Large ESG-oriented institutional investors typically have exposure to both U.S. and European equity markets. These exposures can take the form of global mandates, regional mandates or a combination of the two. Indeed, with shifting macroeconomic and market conditions, sentiment—which for a long while favoured persistent U.S. over-exposure—may have tilted in favour of European allocations.

The theme of ESG polarization now raises difficult questions—both qualitative and quantitative—for ESG-oriented investors with global exposure. The challenges are no less significant for investors that are prohibited from or unwilling to invest in ESG strategies: as they look towards European holdings, they must find strategies that do not contravene their own priorities and intentions.

On the more qualitative side, investors are thinking about the watering down or abandonment of fund managers' **Diversity, Equity and Inclusion** policies (even if such erasure supposedly only affects

1 - Many of the world's largest asset managers, including BlackRock, State Street, and Vanguard, have softened their public ESG commitments. Shareholder support for climate-related resolutions has plummeted to just seven percent, according to ShareAction. States such as Florida, Texas, and West Virginia have gone so far as to withdraw pension investments from asset managers deemed too ESG-focused. Conversely, European clients of U.S. firms (such as the aforementioned People's Pension) may show low tolerance for a watering down of ESG approaches.

the U.S. division or U.S. parent company), the editing of **firm-level ESG** policies, and the adjustment of **fund-level** investment policies. Questions of **active stewardship** are also increasingly on the radar, as portfolio companies shift away from ESG-friendly policies themselves. ESG-oriented investors must seek to differentiate style from substance and remain vigilant against ‘green-washing’. Investors might ask: should the location of the manager’s headquarters (not the same as the location of the investments) be viewed differently? U.S.-headquartered asset managers, it must be said, have focused heavily on international diversification of their client base over the past fifteen years.

On the *quantitative* side, investors must consider the extent to which portfolios are currently suitable (and are likely to remain suitable over the medium-to-long term) for their needs. A variety of **metrics** can be used to think about this subject (this article considers only two). This subject is a complex one and relates not only to the fund manager’s current positioning but the way in which markets are evolving.

Identifying a Sample: European and U.S. Equity Funds

This article builds on the methodology outlined in a prior article, which focused on U.S. large cap equity funds: Examining ESG in Active U.S. Equity Funds.

For this analysis, we take the earlier dataset of 353 large-cap U.S. equity mutual funds (outlined in that article) and place it alongside a group of **146 large-cap European equity funds**. In both cases, the strategies are required to have more than \$100 million in assets under management, a minimum three-year track record, and an adjusted expense ratio greater than 50 basis points. This cost filter serves as a proxy for genuine active management: while definitions of ‘active’ are often vague, any client paying this amount of money should reasonably expect a degree of expertise and skill with respect to the active bets being taken.

We classified funds into growth and value strategies, not only based on their stated labels but also using factor exposure analysis to ensure alignment with their true investment styles. This approach allows for a more nuanced understanding of how ESG constraints interact with different investment philosophies. Necessarily, however, the sample sizes for ‘growth’ and ‘value’ funds are considerably smaller in Europe (where these strategy groups are less popular and prevalent). Nonetheless, we have included them for the purpose of comparison, noting that the growth versus value segmentation (in terms of risk profile) also remains relevant for performance analysis purposes in both the US and in Europe. Indeed, a three-year performance attribution exercise reveals that ‘top quintile’ funds (outperforming relative to the market) in the U.S. exhibit a growth profile, while their European counterparts exhibit a value profile.

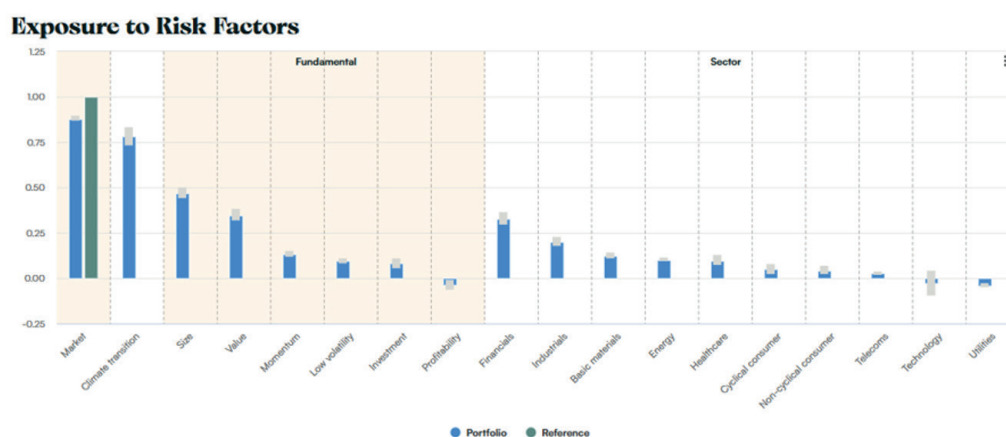
Exhibit 1: Large cap European equity mutual funds (>\$100 million, >3 year track record, >50bps adjusted expense ratio, ESG data available)

	Number	Proportion
Total	146	
Total with available expo	73	50%
Growth	22	15%
Value	17	12%
Other	107	73%

Source: Scientific Portfolio, eVestment.

Growth strategies: Funds whose factor exposures have strong growth profile (based on appropriately low exposure to value [significantly <0], investment [significantly <0] and low volatility [≤ 0] factors, using a significance threshold of 5%), plus funds labelled ‘growth’ (excluding ‘dividend growth’ label). **Value strategies:** funds whose factor exposures have strong value profile (based on appropriately high exposure to value [significantly >0], investment [significantly >0] and low volatility [≥ 0] factors), plus funds labelled ‘value’.

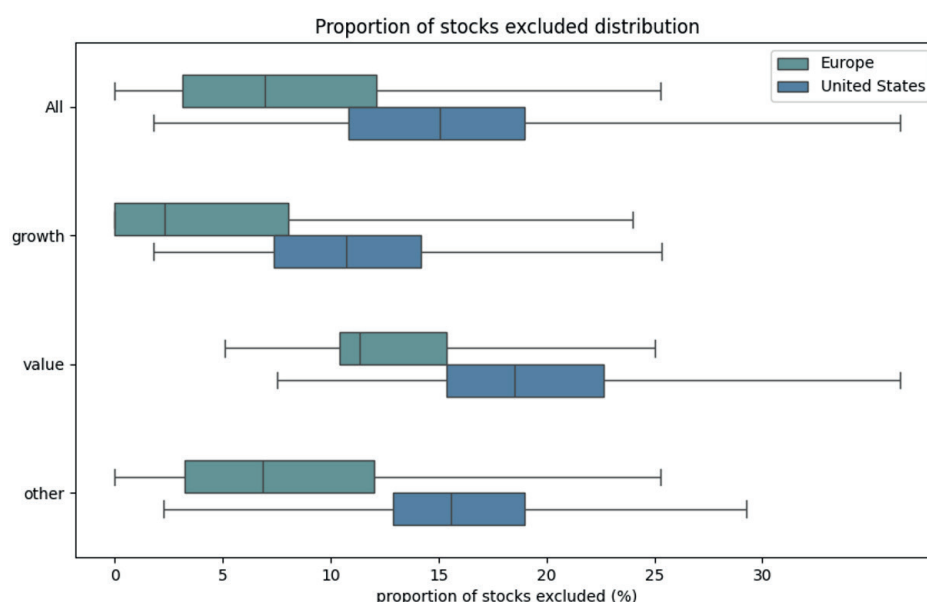
Exhibit 2: An actively managed fund's risk factor exposures mapped – in practice



Source: Scientific Portfolio Platform

We then applied an analysis that screened out stocks that do not appear in Paris Aligned Benchmark indices. (This screen can also, incidentally, be found on the Scientific Portfolio platform and applied to any equity portfolio, fund, or index free of charge). Exhibit 3 showcases the impact of ESG screening on fund holdings, both for the overall sample (‘All’) and for the smaller groups (‘Growth’ and ‘Value’).

Exhibit 3: Proportion of stocks excluded from Active European and Active US Equity funds if PAB screen is applied (range and quartiles)



Source: Scientific Portfolio, eVestment. The ‘top five’ managers with the fewest number of excluded stocks in each group are listed in the Appendix.

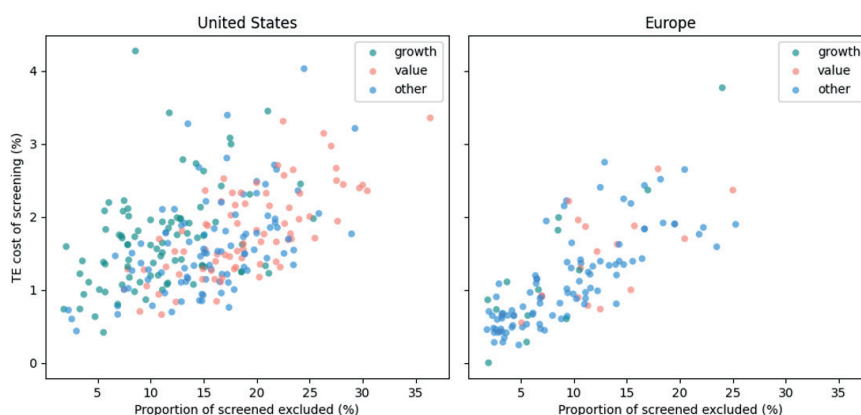
Firstly, and most powerfully perhaps, the median active European equity fund would only need to exclude 7.0 % of its holdings in order to comply with a PAB screen, while the median U.S. fund would need to eliminate more than 15% of stocks. Both samples also showcase the lighter effect of a PAB screen on growth funds than on value funds, although again—in both cases—European funds are already closer to the mark. Specifically, the median European growth fund would have to exclude 2.3% of stocks (versus 10.7% in the U.S.), while the median European value fund would exclude 11.3% of stocks (versus 18.5% in the U.S.).

The chart also highlights manager **dispersion**, since it would of course be incorrect to conclude that all value managers are incompatible with ESG mandates or that all growth funds are natural fits. Some value funds demonstrate a more ESG-friendly profile than might be expected, while some growth funds could provoke concerns. The result is a landscape where ESG alignment must be evaluated fund by fund, rather than assumed based on broad style categories.

The cost of ESG Screens: Tracking Error

When considering the breadth of stocks that a screen may affect, it is simultaneously important to review the tracking error that results from screening out specific companies or sectors. Interestingly, our analysis reveals that the relationship between ESG screening and tracking error is more complex than commonly assumed. Exhibit 4 shows scatter diagrams—one point per fund—to illustrate what happens when one screens stocks out of portfolios as discussed, and then considers how much tracking error the resulting strategy would have versus the original strategy.

Exhibit 4: Tracking error of PAB-screened funds vs. the actual funds (U.S. and Europe)



Source: Scientific Portfolio, eVestment²

Although growth funds in both markets tend to require fewer exclusions than value funds, applying a PAB screen to growth strategies often generates significant tracking error relative to the original holdings. This underlines that the specific characteristics of excluded stocks—and their weight within the portfolio—matter more than raw exclusion numbers when it comes to understanding tracking error impact. For investors considering segregated mandates where they wish to impose their own ESG screens on active managers, these findings underscore the importance of careful analysis. Tracking error penalties do not align neatly with the headline number of exclusions, and working through the specifics of each fund's holdings is essential.

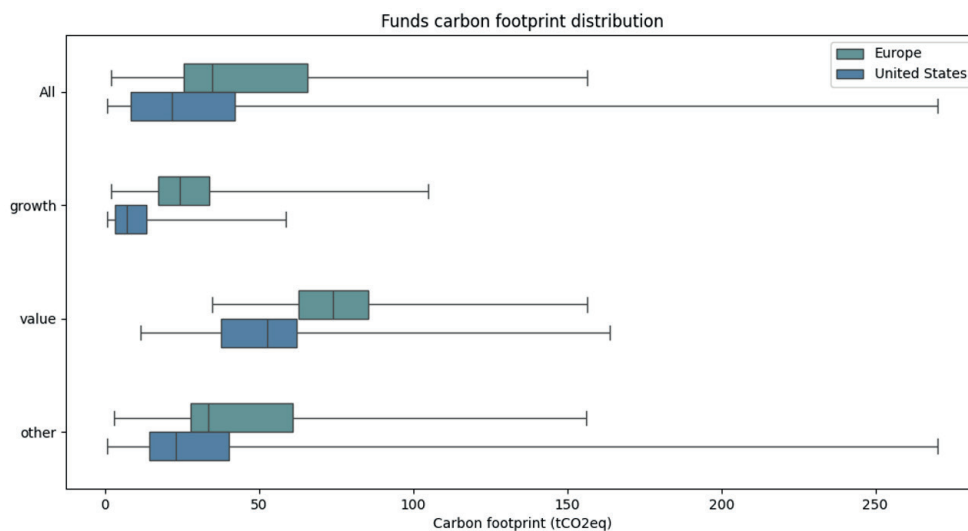
2 - Note: The annualised tracking errors cost of screening is calculated using a sample covariance matrix normalised with the methodology proposed by Ledoit and Wolf (2003) based on daily equity prices over the last 5 years (2020-2025). Funds composition data as at January 2025, ESG data as at December 2024.

Carbon Footprints and More

Of course, the 'PAB screen' is only one starting point for thinking about the quantitative dimensions of ESG within the active manager landscape. We may also consider carbon footprint (Exhibit 5 gives one carbon metric although there are several others), Sustainable Development Goal alignment, temperature alignment, common ESG screens (such as controversial weapons, tobacco et al) and more. Furthermore, there are many non-quantitative elements to evaluate, such as evidence of active engagement and the results of that engagement.

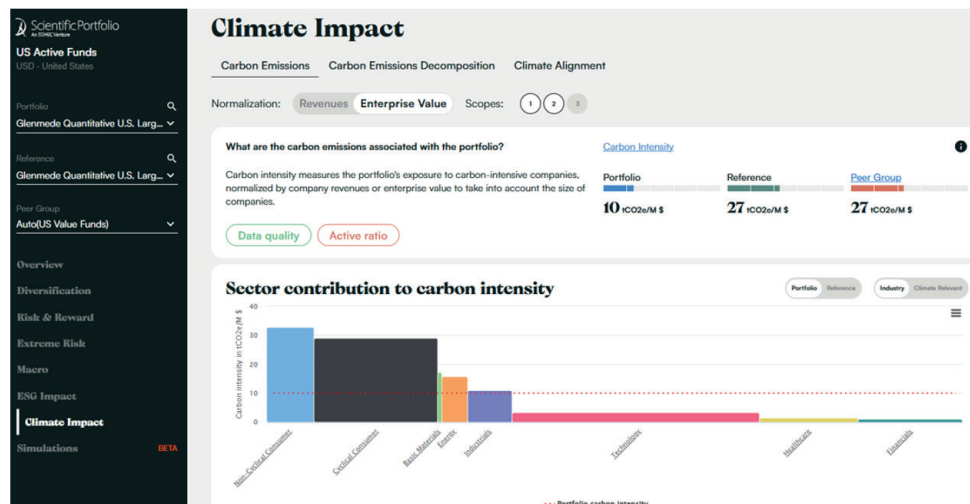
The carbon footprint analysis is particularly interesting: the median European large cap active equity manager actually has a higher carbon footprint than their U.S. counterpart, although we must consider this in light of the way in which large technology firms have increasingly dominated the U.S. equity market in recent years). This higher median footprint is also evident across the growth and value sub-categories.

Exhibit 5: Carbon footprint of European and U.S. active equity managers



Source: Scientific Portfolio

Exhibit 6: A manager's carbon intensity before and after Paris Aligned Benchmark screening



Source: Scientific Portfolio Platform

Conclusion: Careful Scrutiny is Called For

In this rapidly developing landscape, investors must take an active, hands-on approach to fund selection and portfolio analysis. Reliance on labels is not sufficient. Investors can examine fund holdings in detail, assess both quantitative and qualitative ESG alignment, and stay alert to political and thematic shifts that may have significant future implications. Direct analysis of portfolios can support investors in understanding exposures and help them to engage deeply with their portfolios and external asset managers in the pursuit of sustainable investment goals.

Data from the Scientific Portfolio platform. Users can access analytics to conduct analyses of available funds and upload **their own equity portfolios** to examine performance and exposures.

Access the Scientific Portfolio Platform

Appendix

Exhibit 7: "Top five" asset managers with the fewest non-PAB stocks in each category

style	rank	name	Proportion number of screened equities
growth	1	Metzler European Growth Sustainability	0.0%
	1	Comgest Growth Europe	0.0%
	1	Comgest Growth Europe Opportunities	0.0%
	1	Comgest Growth Europe Plus	0.0%
	1	Fidelity Funds - European Dynamic Growth Fund	0.0%
	1	Allianz Global Investors Fund - Allianz Europe Equity Growth	0.0%
	1	DNCA Invest SRI Europe Growth	0.0%
	1	Allianz Global Investors Fund - Allianz Europe Equity Growth Select	0.0%
	1	Morgan Stanley Investment Funds - Europe Opportunity Fund	0.0%
value	1	MFS Meridian Funds - European Value Fund	5.1%
	2	DNCA Value Europe	7.0%
	3	DNCA Invest Value Europe	7.0%
	4	Allianz Global Investors Fund - Allianz Europe Equity Value	9.5%
	5	SEB Aktienfonds	10.4%
other	1	JSS Sustainable Equity - Switzerland	0.0%
	1	Pictet CH - Swiss Equities	0.0%
	1	UBS (CH) Equity Fund - Switzerland Sustainable (CHF)	0.0%
	1	Pictet CH Quest – Swiss Sustainable Equities	0.0%
	1	AMC PROFESSIONAL FUND - BCV Systematic Premia Swiss Equity	0.0%
	1	OLZ 1 - Equity Switzerland Optimized ESG	0.0%
	1	SGKB (CH) Fund II - Aktien Schweiz	0.0%
	1	BL-Equities Europe	0.0%
	1	Carmignac Portfolio Grande Europe	0.0%
	1	Vontobel Fund - European Equity	0.0%
	1	BlackRock Global Funds - European Special Situations Fund	0.0%
	1	BNP Paribas Funds Belgium Equity	0.0%

Source: Scientific Portfolio, Morningstar

About Scientific Portfolio

Scientific Portfolio is the latest commercial venture incubated within the research ecosystem of EDHEC Business School (EDHEC), one of the world's leading business schools.

Scientific Portfolio has assembled a team with a broad range of expertise and backgrounds, including financial engineering, computer science, sustainable and climate finance, and institutional portfolio and risk management. It proudly carries EDHEC's impactful academic heritage and aspires to provide investors with the technology they need to independently analyse and construct equity portfolios from both a financial and extra-financial perspective.

To achieve this, it offers investors three sources of value through its portfolio analysis & construction platform:

- Helping investors to analyse their equity portfolios, identify actionable insights and enhance portfolios with allocation functionalities. Indeed, Scientific Portfolio likes to promote portfolio analysis as a means to the concrete goal of building portfolios that are both more efficient and better aligned with their investment objectives.
- Providing investors with an integrated framework where financial and extra-financial (ESG) considerations are jointly captured in analysis and portfolio construction. The ability to incorporate ESG-related insights in the portfolio allocation process is now a common requirement among many investors.
- Giving investors access to a Knowledge Centre catering to all types of learners and providing guidance through the portfolio analysis and construction process. This aligns with Scientific Portfolio's commitment to remaining connected with its academic roots and bridging the gap between investors and academia.

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