Scientific Portfolio Market Review

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Scientific Portfolio
An EDHEC Venture

Examining ESG in Active U.S. Equity Funds

Introduction

The journey of ESG (Environmental, Social, and Governance) integration within U.S. actively managed equity funds has reached a critical and contentious juncture. Once heralded as an unstoppable trend, ESG is now facing headwinds of political polarization, investor skepticism, and market complexities that challenge even the most thoughtful investors.

Behind the noise of public debate lies a set of uncomfortable but essential questions: how many active managers in U.S. equity markets genuinely integrate ESG in a way that aligns with meaningful sustainable investment objectives? How compatible are common investment strategies, such as growth and value, with real-world ESG constraints? And what are the trade-offs for investors who wish to remain committed to ESG principles while seeking competitive returns in an evolving U.S. market landscape? In this analysis, we examine the current ESG profiles of active U.S. equity funds through a quantitative lens.

ESG integration in U.S. Active Equity Funds: A Changing Slimate

Despite widespread discussion of ESG principles and a decade of momentum, formal ESG integration in actively managed U.S. equity funds remains limited and, more worryingly, has stagnated. According to Morningstar's 2024 *Sustainable Investing Landscape Report*, only 37% of actively managed U.S. equity funds claim to integrate ESG in their investment processes, compared with 45% of European counterparts. Recent trends suggest that the upward trend in the number of sustainability-oriented funds has slowed: this subject was examined in a previous Scientific Portfolio market review (Climate Exclusions Need Investor Scrutiny).

As anti-ESG sentiment becomes more entrenched in some parts of the U.S. political and legal landscape, U.S.-headquartered asset managers are treading more carefully with their public commitments, their strategic approaches and their investment processes. In doing so, they must navigate a global client base, with European investors showing no signs of retreating on the ESG theme – with recent decision by the UK People's Pension to pull £28 billion out of State Street providing a headline-grabbing example. Moreover, market concentration in large technology stocks poses a challenge[1]: while most of these companies have typically scored well on ESG metrics, the changes taking place in this industry raise significant concerns over ongoing ESG assessments. Both subjects are discussed further below.

Assessing the Stock-Level Holdings of Active Equity Funds

Identifying a meaningful universe of large-cap actively managed U.S. equity funds is itself more complicated than it might first appear. Traditional fund labels, such as "growth" or "value," and metrics like tracking error, are sometime misleading. Some funds labeled as "growth" demonstrate value-like factor exposures, while certain systematic strategies deviate substantially from benchmarks without offering true active management. For this analysis, we focused on a set of 353 large-cap U.S. equity

1 - The performance and risk dimensions of concentration were discussed in a previous review: The Concentration Conundrum: A Closer Look at U.S. Equity Performance.

mutual funds, all of which 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 — the kind of process that clients should reasonably expect when they are paying for expertise and skill of an active manager.

From this set, 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.

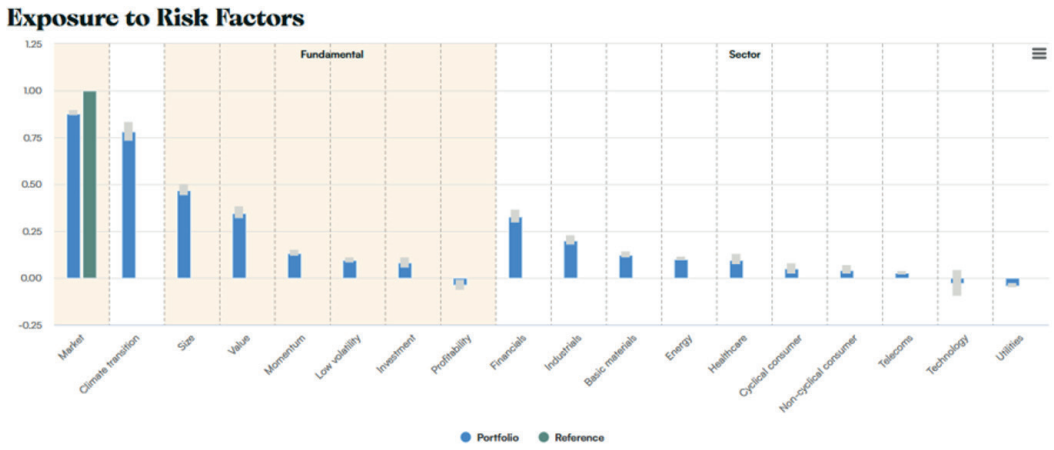
Exhibit 1: Large cap U.S. equity mutual funds (>$100 million, >3 year track record, >50bps adjusted expense ratio)

	Number	Proportion
Total	353	
Growth	124	35%
Value	89	25%
Other	140	40%

Source: Scientific Portfolio, eVestment.

Growth strategies: 59 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), plus 65 funds labelled 'growth' (excluding 'dividend growth' label). Value strategies: 56 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 33 funds labelled 'value'.

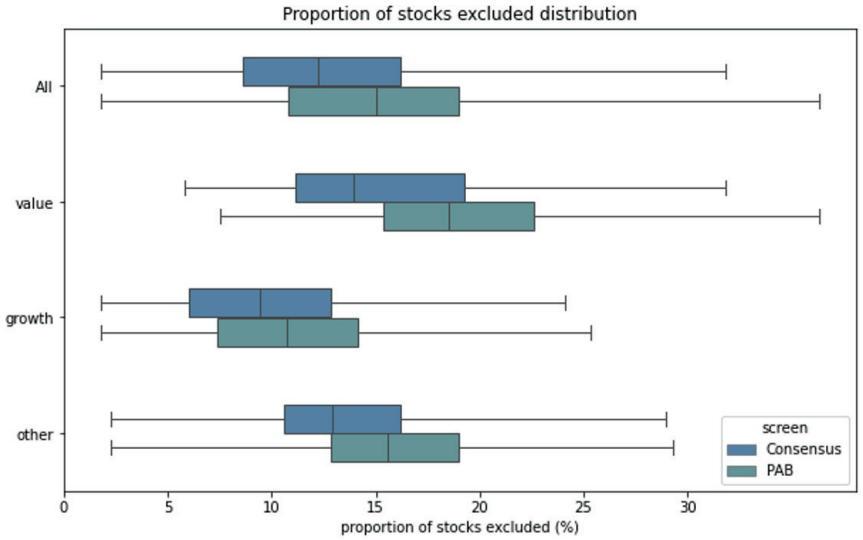
Exhibit 2: An actively managed fund's risk factor exposures mapped – in practice



Source: Scientific Portfolio Platform

We then applied two types of screening to these funds: one based on what we call a 'consensus' approach, considering the exclusions and commitments that many large, sophisticated institutional investors have now undertaken; the other based on screening out stocks that do not appear in Paris Aligned Benchmark indices. Both screens can be used directly on the Scientific Portfolio platform and applied to any portfolio, fund, or index. This analysis—shown in Exhibits 3—highlights that the impact of ESG screening on fund holdings is deeply intertwined with investment style.

Exhibit 3: Proportion of stocks excluded from Active US Equity funds if SP 'consensus' ESG screen or PAB screen are 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.

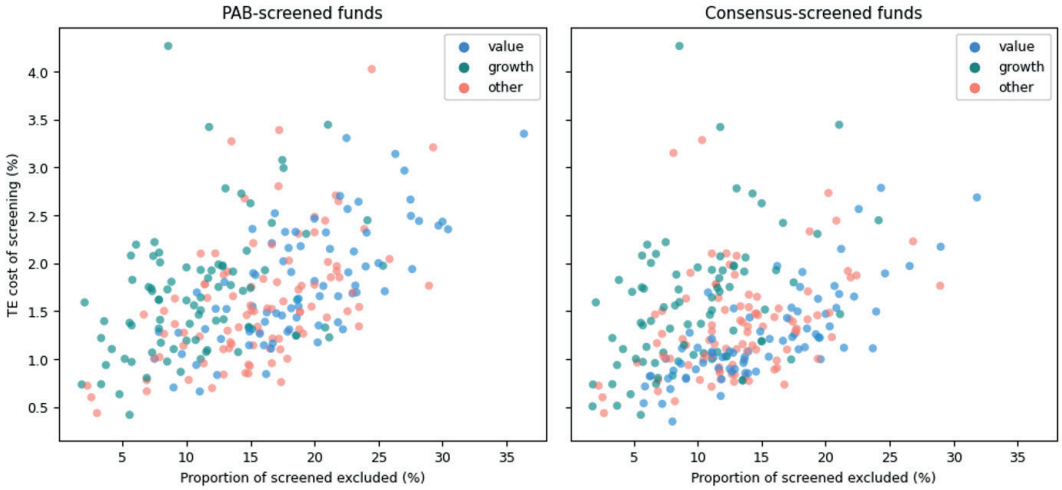
Growth funds, often with heavy allocations to sectors such as technology and healthcare, are typically less affected by ESG screens. Value funds, by contrast, tend to hold more significant exposures to energy, utilities, and industrials — sectors more frequently targeted by exclusionary ESG screens, whether due to carbon intensity, social issues, or governance concerns. Quantitatively, we found that the median growth fund would need to exclude approximately 10.7% percent of its holdings to comply with a Paris-Aligned Benchmark (PAB) screen and about 9.5% percent for a broader consensus ESG screen. In contrast, value funds face notably steeper hurdles, with the median value manager needing to exclude roughly 18.5 percent of holdings for a PAB screen and nearly 13.9 percent for a consensus ESG screen.

However, it would be incorrect to conclude that all value managers are incompatible with ESG mandates or that all growth funds are natural fits. There is considerable diversity within both categories. Some value funds demonstrate a more ESG-friendly profile than might be expected, while some growth funds, depending on their specific sector allocations, might raise substantial ESG concerns. The result is a landscape where ESG alignment must be evaluated fund by fund, rather than assumed based on broad style categories. This is where deep direct analysis of holdings, illustrated in Exhibit 4, becomes valuable.

The Cost of ESG Screens: Tracking Error and Performance

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 a scatter diagram—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 (LHS) and consensus-screened funds (RHS) versus actual funds



Source: Scientific Portfolio, eVestment[2]

Although growth funds tend to require fewer exclusions than value funds, applying a PAB screen to growth funds often generates significant tracking error relative to the original holdings. The results show huge diversity, but the average of the growth group (green) is roughly 1.7%. Value funds, which may face exclusions as high as 18.5 percent, show tracking errors only slightly higher, again varying very widely, with the average at approximately 1.8% percent. The figures for the 'consensus' screen are even more surprising: here, the average tracking error is actually higher for the growth funds (1.6%% vs. 1.2%).

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 impacts. 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.

Carbon, SDGs and beyond

Of course, 'Consensus Screens' and 'PAB screens' are only a starting point for thinking about the quantitative dimensions of ESG within the U.S. active manager landscape. We may also consider carbon footprint (Exhibit 5), Sustainable Development Goal alignment, and more. Furthermore, there are many non-quantitative elements, such as evidence of active engagement and the results of that engagement.

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

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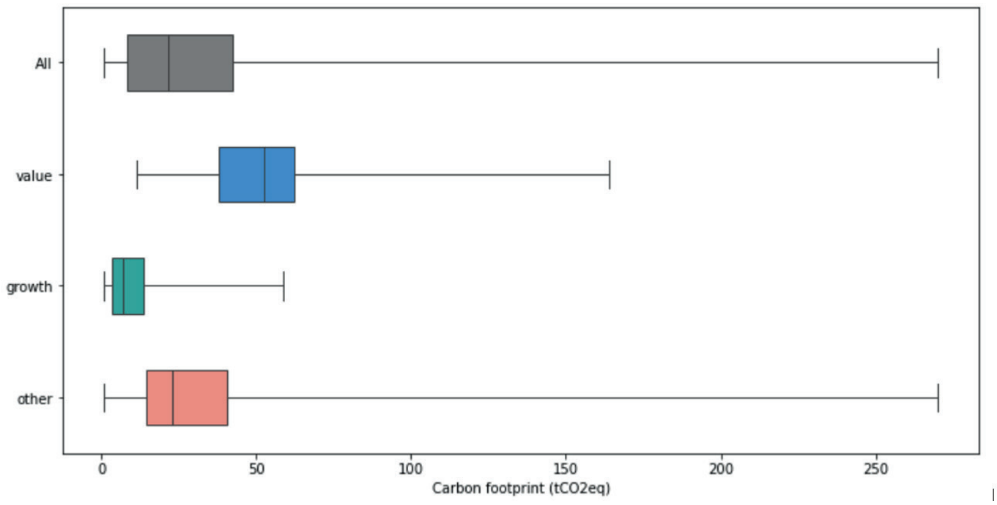
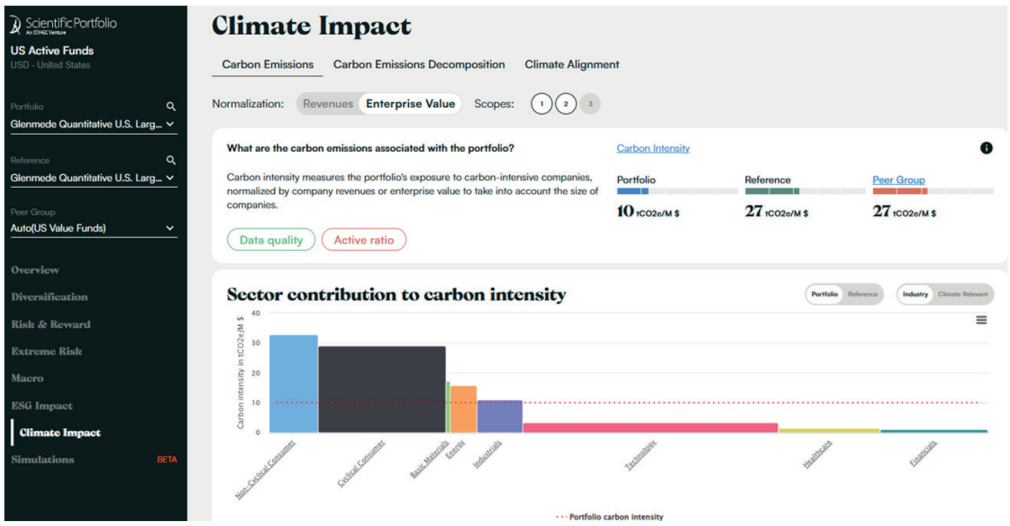
2 - Note: The annualised tracking errors cost of screening is calculated using a sample covariance matrix normalised with the methodology proposed by Ledoit and Wolf (2003) based on daily equity prices over the last 5 years (2020-2025). Funds composition data as at January 2025, ESG data as at December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

Exhibit 5: Carbon footprint of 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

US Active Funds and ESG: A Changing Climate

The political landscape in the U.S. has made ESG investing far more contentious. Throughout 2023 and into 2024, nineteen Republican-led states introduced legislation aimed at banning or limiting the use of ESG criteria in state pension fund investments, arguing that ESG principles undermine fiduciary responsibility. In response, many of the world's largest asset managers, including BlackRock, State Street, and Vanguard, have softened their public ESG commitments, and 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 cumulative effect of these actions has been to weaken ESG's influence in U.S. markets, while

simultaneously encouraging corporate issuers to relax their own ESG disclosures — particularly as the regulatory momentum behind mandatory ESG reporting slows under current political leadership.

Another challenge for ESG investors arises from the growing concentration of U.S. equity markets around a handful of mega-cap technology firms. Although these companies often score well on traditional ESG metrics, evolving controversies over artificial intelligence, social media oversight, labor practices, and the potential rise in carbon emissions associated with industry trends raise questions about their future ESG profile.

Conclusion: Careful Scrutiny is Called For

In this rapidly developing landscape, ESG-oriented 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 indices and upload **their own equity portfolios** to examine performance and exposures.*

Access the Scientific Portfolio Platform

Appendix

Exhibit 7: Asset managers with the fewest non-PAB stocks in each category

Style	Fund name	% of screened equities
value	Parnassus Value Equity Fund	7.5%
	Boston Trust Walden Equity Fund	7.8%
	DWS ESG Core Equity Fund	9.0%
	Fidelity Blue Chip Value Fund	9.4%
	Glenmede Quantitative U.S. Large Cap Core Equity Portfolio	9.6%
growth	**AB Growth Fund**	**1.8%**
	The Hartford Growth Opportunities Fund	**2.0%**
	PGIM Jennison Focused Growth Fund	3.3%
	Brown Advisory Growth Equity Fund	3.3%
	BNY Mellon Research Growth Fund, Inc.	3.6%
other	**Impax U.S. Sustainable Economy Fund**	**2.3%**
	Parnassus Core Equity Fund	**2.6%**
	Domini Impact Equity Fund	**3.0%**
	TCW Select Equities Fund	6.7%
	Sterling Capital Special Opportunities Fund	6.9%

Exhibit 7: Asset managers with the fewest 'non-consensus' stocks in each category

Style	Name	% of screened equities
value	Boston Partners All Cap Value Fund	5.8%
	Boston Trust Walden Equity Fund	5.9%
	American Beacon Man Large Cap Value Fund	6.3%
	Virtus NFJ Dividend Value Fund	6.4%
	Glenmede Quantitative U.S. Large Cap Core Equity Portfolio	7.2%
growth	**BNY Mellon Research Growth Fund, Inc.**	**1.8%**
	AB Growth Fund	**1.8%**
	The Hartford Growth Opportunities Fund	**2.0%**
	PGIM Jennison Focused Growth Fund	3.3%
	Brown Advisory Growth Equity Fund	3.3%
other	**Impax U.S. Sustainable Economy Fund**	**2.3%**
	Parnassus Core Equity Fund	**2.6%**
	Domini Impact Equity Fund	2.7%
	Neuberger Berman Sustainable Equity Fund	5.3%
	TCW Select Equities Fund	6.7%

Source: Scientific Portfolio, Morningstar. Top five funds across the three styles are highlighted in bold.

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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