Passive ESG:
a strong three-year start

Three years in, and Parmenion's Passive ESG portfolio has delivered strong performance, both in absolute terms and relative to the IA sector peer group, since its launch in March 2022.

Navigating market challenges

Despite some challenging conditions for ESG investing, the portfolio has remained resilient. Its launch in 2022 coincided with Russia's invasion of Ukraine, which drove 'unethical' sectors like defence, oil and gas to outperform. At the same time, inflation – fuelled by the re-opening from COVID lockdowns - forced central banks globally to raise interest rates. This caused all assets (bonds and stocks) to decline, but particularly ESG investments, which tend to be more growth orientated and are therefore more sensitive to interest rate movements.

By 2023-2024, markets began to recover, mainly driven by investor appetite for AI, which led to the rise of the 'Magnificent 7' technology companies (Nvidia, Amazon, Microsoft, etc), while inflation began to moderate and central banks started cutting interest rates. This in turn led to a more sustained rise in performance which has largely lasted up until this year. However, markets continued to be dominated by large cap US technology firms, chiefly the Mag-7. This created an additional headwind for ESG investors, who are often underweight versus the general market as some of the companies are excluded on ESG grounds (Meta/Facebook on data privacy concerns for example).

Gaining strength in an evolving market

Markets now appear to have turned a corner. By the end of 2024, Parmenion's Passive ESG solution was performing close to or above its benchmark (the IA sector peer group), as the market rally broadened beyond the Mag-7 companies.

This sets-up a favourable backdrop for performance going forward, and we expect the outlook for the portfolio - and ESG investing - to continue its positive trajectory. In our view, these strong economic trends far outweigh the political noise and anti-ESG tone seeping out of the US. With key industries like renewable energy playing an ever-larger part of the global energy mix, and costs becoming much more competitive, even Trump can't change these long-term shifts.

It's also worth bearing in mind the structural changes required for the transition to a net zero and sustainable economy will also be beneficial to the types of companies that this portfolio tilts towards.

The shifting ESG landscape

Over the last few years the sustainable/ESG landscape has started to splinter shaped by where the individual fund houses, and their clients, are based.

After flows into European ESG products slowed following 2021 highs, in line with a tougher investment environment, this is now starting to turn around and passive ESG strategies in particular have seen solid inflows over recent months. We're very pleased that, despite its relatively short track record, our Passive ESG solution has already grown to over £30m of assets held across clients with over 40 adviser firms, and we have a strong pipeline of interest in the solution as we approach the 3-year track record on 31 March 2025.

US back-sliding

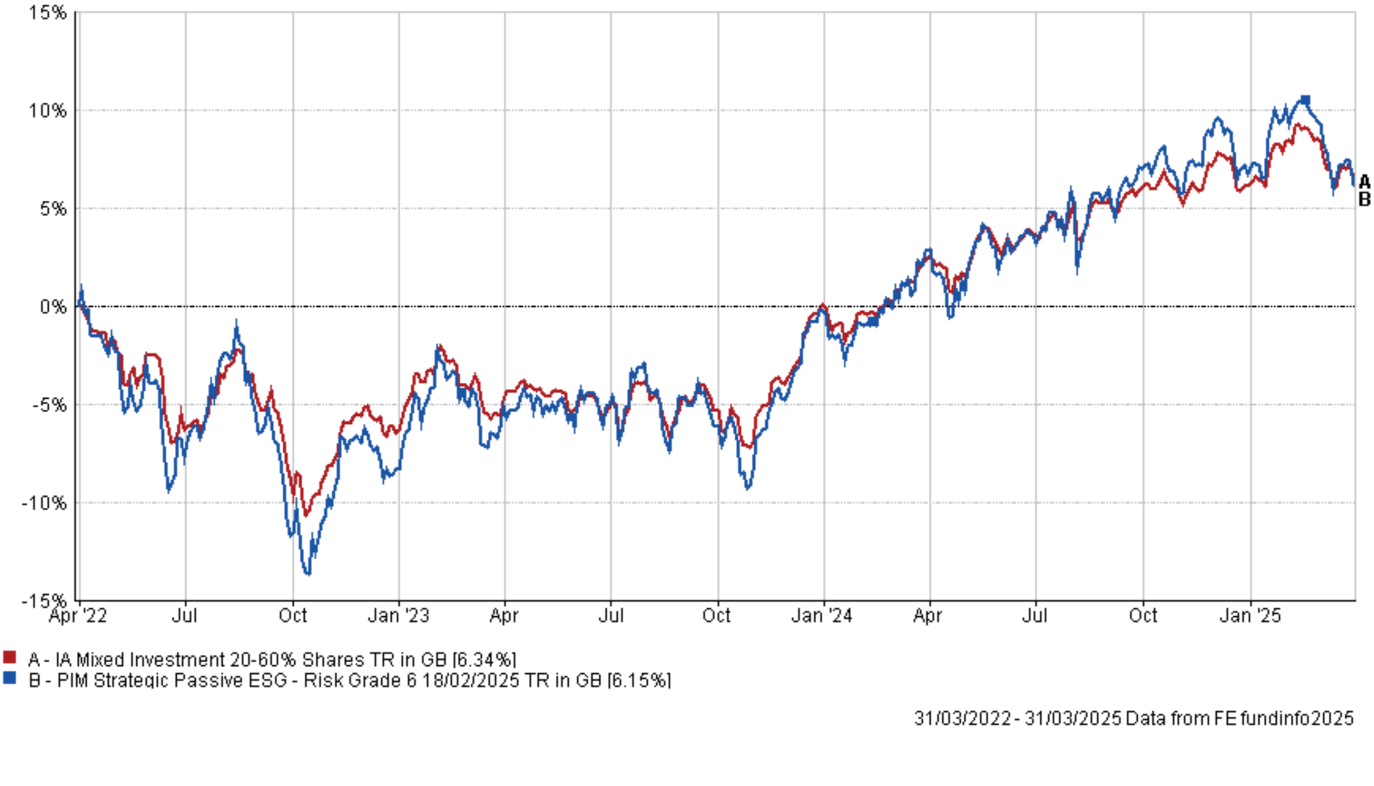
A growing divide towards ESG investing is emerging between UK/European investors and US investors, particularly in stewardship activity - how fund managers vote and engage with investee companies. While support for ESG-based company resolutions has remained consistently strong among UK/European-based fund managers (despite a small dip since 2023), support in the US has fallen sharply, from an already low base.

This really highlights the importance of selecting managers that align to your own ESG principles and reaffirms our choice to work with European managers UBS and Amundi as our key providers for equity and corporate bonds since this solution's inception. Individually, both providers also score very highly on ShareAction (an independent NGO) annual ranking of global asset manager voting and engagement records. This supports the detailed due diligence we have conducted on UBS and Amundi alongside our Ethical Oversight Committee.

This is in stark contrast to familiar passive giants in the US, who've begun shying even further away from the timid ESG support shown in previous years - withdrawing from initiatives such as the Net Zero Asset Managers Initiative.

The results speak for themselves

The launch of Passive ESG coincided with a difficult period for ethical investing. However, despite this, the below chart shows how Risk Grade 6, as an example, has performed consistently and is broadly in line with its benchmark since inception.



31/03/2022 - 31/03/2025 Data from FE fundinfo2025

Performance over the last 12 months has also been strong, as a moderate decline in interest rates, as well having exposure to certain cohorts of the Magnificent 7 (it holds Nvidia, Microsoft and Tesla), have led the portfolio to broadly keep up with the benchmark over this period. More recently, our overweight allocations to the UK and Emerging Markets versus our peers have been beneficial as these regions have outperformed the US.

28/03/2024 - 31/03/2025 Data from FE fundinfo2025

Ethical boundaries

Alongside ESG integration and strong stewardship, the Passive ESG solution has a number of negative screens (exclusions) to avoid unethical or contentious areas.

The below table compares exposure to various contentious industries across our Ethical range versus the benchmark. As expected, the stricter the portfolio, the lower the exposure. Thanks to its combination of negative screens and ESG integration, Passive ESG maintains very low exposure to these industries.

The main exceptions are animal testing and abortive/contraceptive/stem cell products. The first of these is because medical-related animal testing cannot be fully screened out using a data based passive investing approach. The second of these is because many healthcare and insurance companies also have (relatively small) revenue from these areas. Beyond these areas, exposure is minimal - and in most cases much lower than the benchmark.

Product Involvement %	Profile A	Profile B	Profile C	Profile D	Passive ESG	Index
Adult Entertainment	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Alcohol	0.24%	0.01%	0.01%	0.00%	0.04%	1.04%
Animal Testing	10.52%	12.25%	9.97%	7.80%	16.29%	16.31%
Abortive/Contraceptives/Stem Cell	5.87%	7.12%	5.56%	4.60%	8.45%	7.54%
Controversial Weapons	0.00%	0.00%	0.00%	0.00%	0.17%	1.70%
Fur & Specialty Leather	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Gambling	0.00%	0.00%	0.00%	0.12%	0.00%	0.26%
GMO	0.00%	0.00%	0.00%	0.00%	0.01%	0.08%
Military Contracting	0.03%	0.62%	0.21%	0.00%	0.10%	2.66%
Nuclear	0.36%	0.00%	0.00%	0.37%	0.10%	1.06%
Palm Oil	0.00%	0.00%	0.00%	0.00%	0.05%	0.03%
Pesticides	0.00%	0.00%	0.00%	0.00%	0.07%	0.16%
Small Arms	0.00%	0.00%	0.00%	0.00%	0.18%	1.03%
Thermal Coal	0.06%	0.10%	0.06%	0.00%	0.02%	0.99%
Tobacco	0.00%	0.00%	0.00%	0.00%	0.15%	1.09%
Thermal Coal Extraction	0.00%	0.00%	0.00%	0.00%	0.66%	1.34%
Thermal Coal Power Generation	0.43%	0.42%	0.19%	0.78%	0.10%	2.25%
Oil and Gas Production	3.14%	1.87%	2.00%	2.98%	1.45%	9.17%
Oil and Gas Power Generation	3.58%	2.55%	2.29%	3.29%	0.52%	6.36%
Oil and Gas Products and Services	11.01%	15.28%	11.40%	10.20%	10.70%	13.40%
Arctic Oil and Gas Exploration	0.09%	0.00%	0.00%	0.00%	0.04%	3.42%
Oil Sands Extraction	0.00%	0.00%	0.00%	0.00%	0.00%	3.39%

Source: Morningstar Direct. The index is the Morningstar UK Moderately Adventurous Target Allocation index

This data is also published quarterly in our Quarterly Solution Reports (QSRs) for all of our Ethical solutions.

In addition, our Passive ESG consistently receives the highest ESG rating from Morningstar Sustainalytics, with a 5 'Globe' rating, highlighting how the portfolio manages material ESG risks versus peers. This independent assessment is another validation of the high standards we aim to maintain within the solution.

Evolving asset allocation

As with all of our in-house investment solutions, we complete an annual review of the strategic asset allocation for our passive ESG solution, to optimise the risk-adjusted returns for each of the 10 risk-graded portfolios.

Following the 2024 review, we introduced global smaller companies' equity as a new asset class from risk grade 5 and above. The addition enhances diversification and gives exposure to an asset class we see as attractive over the medium to long term. This move could prove well-timed, as small-cap stocks are currently trading at record low valuations compared to their larger peers, giving them plenty of opportunity for growth - especially as economic conditions begin to shift in their favour.

For 2025, we made further adjustments in line with our annual process to optimise the risk-adjusted returns. This includes small reductions in UK, Europe and Asia equity, with small increases in US and Japan equity, depending on the risk grade.

Keeping ESG standards in check

We take a rigorous approach to our analysis and selection of Passive ESG providers and products. Working alongside our Ethical Oversight Committee (EOC), over the last few years we've researched 11 different fund managers, scrutinising their approach to passive ESG portfolio construction, voting and engagement activity. To date, only two providers – Amundi and UBS – have met our high ESG standards for the equity and corporate bonds allocation and have products in these asset classes aligning with our ESG mandate for this solution.

Working with the EOC, we hold annual due diligence meetings with Amundi and UBS to assess their continued suitability and review any updates, for instance changes to their index methodology, team or engagement priorities.

For these providers we also produce in-depth quantitative analysis every six months, scrutinising everything from charges, tracking errors, replication methods, and stock lending policies in order to determine which provider is best suited for our portfolio.

As the passive ESG market continues to expand, we continue to broaden our research of new investment managers and strategies. This year we'll be reviewing another three promising new offerings from providers not yet included in the solution.

Scaling up ESG expertise

To support our in-depth research of funds and providers, we now have a team of four in-house investment managers focused on our ESG solutions - Mark Foster, Simon Molica, Mollie Thornton and Joe Yallop. This is a significant commitment, a 1/3 of our 12-person investment team.

In addition, our Ethical Oversight Committee includes four independent consultants with over 80 years of experience in sustainable investing. Within the last three years we've also integrated ESG data from Sustainalytics into our research process, as well as significantly broadening out the information we analyse on fund houses' voting and engagement policies.

To enhance support for advisers, we've improved our range of literature for our ESG solutions, including adviser guides, quarterly reporting with ESG-specific metrics and a new fortnightly ESG newsletter to support conversations with clients.

Sustainability at the core

At a wider business-level, 2024 saw Parmenion publish our first annual **TCFD report,** which involved measuring our emissions and setting an ambitious target to achieve net zero by 2040, across both our operations and in-house investment solutions.

We've also been independently assessed by the United Nations Principles for Responsible Investment (UN PRI) and have been awarded an outstanding 4-star rating across all assessment areas. These high ratings show just how hard we've been working to embed ESG factors in our investment selection, management, and oversight across all our in-house investment solutions – something we're extremely passionate about. Further information can be found in our summary **assessment report** and more detailed **full transparency report.**

Looking ahead: ESG at Parmenion

With the ESG landscape evolving rapidly, we are dedicated to staying at the forefront of these changes. We expect that the growing demand for sustainable investment solutions will lead to further enhancements and refinements in our portfolio.

The next few years hold exciting possibilities, and we're eager to be part of this dynamic journey, pushing the boundaries of what responsible investing can achieve.

Important information:

This document for financial professionals only. Any news and/or views in this document are meant as general information and shouldn't be seen as financial advice, or a personal recommendation. Parmenion accepts no duty of care or liability for loss to any person acting or refraining from acting because of reading anything in this document. Past performance is not an indicator of future performance and investment returns can go down as well as up. All data sourced from FE fundinfo.

Get in touch

If you'd like to chat to us, please get in touch.

Phone:

03300 945 900

Email:

mail@parmenion.co.uk

Parmenion
Investment Management

Registered Office: Aurora, Counterslip, Bristol, BS1 6BX.
Website: www.parmenion.co.uk

Parmenion Investment Management is a trading name of Parmenion Capital Partners LLP which is authorised and regulated by the Financial Conduct Authority. FCA Number 462085. Registered in England and Wales OC322243.

Version date: 03/04/2025