PORTFOLIO INSTITUTIONAL SEPTEMBER–OCTOBER 2025

pi

INVESTING IN TECH: STILL AN ENGINE OF GROWTH?

Market concentration
Risky business

Passive v active
The big debate

Net zero
Losing allies

Issue No. 145 | www.portfolio-institutional.co.uk | Independent analysis for institutional investors

The tech experts

No form of investment has been as much discussed in recent years as that of investing in technology companies. The case of the so-called Magnificent Seven has been a constant source of analysis and investment commentary. The inevitable outcome has been to wax lyrical about these tech investments.

There can be no doubt that those institutional investors who embraced tech investments have been decently rewarded. The question now is: can institutional investors still be as confident about the benefits of investing in tech going forward? This question is explored from page 10.

The negative side of investing in tech is the concentration risk created in the market by the dominant force of the Magnificent Seven. How problematic is this for investors? And does it remain a challenge? These questions are explored from page 14.

Another long-standing argument within the investment community has been between active and passive investments. Morningstar's Eugene Gorbatikov investigates the performance between the two approaches using new analysis. You can read Eugene's findings from page 6.

In October, *portfolio institutional* is holding its annual ESG conference. One issue that will come up is the backtracking of ESG initiatives within the investment world. This trend is evident with the decline of net-zero alliances, which were created to transition the financial sphere towards one that is predominantly net zero. ShareAction's Jeanne Martin explores why this is happening. She does offer a hopeful outlook, putting investors at the centre of what to do next. You can read her piece from page 16.

And former pensions minister Steve Webb notes in the Last Word that there is a disconnect between pension investment and what should be fun pensions. Possibly the first time fun and pensions have been mentioned together.

I hope you enjoy the issue.

If you have any comments, or even suggestions for future features, do not hesitate to contact me.

Andrew Holt
Editor

a.holt@portfolio-institutional.co.uk

Contents

In this issue

The active versus passive performance debate

Eugene Gorbatikov **assesses how active funds perform compared to their passive counterparts.**

The debate over skill in active asset management is unlikely to end soon. True performance persistence is rare because returns are often noisy and fluctuate significantly over short and medium-time periods.

This volatility makes it difficult to distinguish between genuine skill and chance. While statistical methods can shed light on whether skilled managers exist, identifying them in advance remains extremely challenging.

That doesn't mean nothing can be done. Some market segments show greater pricing inefficiencies, giving active managers more opportunities to spot mispricing and generate excess returns.

Identifying which segments of the market offer these opportunities is key for investors deciding how to allocate between active and passive strategies.

Although measuring the exact scale of inefficiencies is difficult, we can still compare how active managers perform across different areas of the market.

This comparison gives investors a practical basis for choosing when active management is worth the cost and when passive funds may be the better option. To support those decisions, Morningstar publishes its Active/Passive Barometer every six months.

The study evaluates how active funds perform compared to their passive counterparts. Its primary metric, the success rate, measures the percentage of active funds that both survive and outperform existing passive alternatives over various time horizons.

A key strength of this approach is that it uses actual investable options as the benchmark, rather than an index that investors cannot directly buy.

Long-term lessons

Over more than a decade, the study has revealed several key insights. First, active funds tend to post higher success rates over short periods than over the long term, suggesting that much of outperformance may be driven by luck.

Second, over extended horizons, fees become a decisive factor: lower-cost active funds reliably outperform pricier peers after expenses.

Third, results vary sharply by market segment: success rates are typically lower in competitive, efficiently priced areas like large-cap equities, while small-cap categories often achieve more than twice the success rates of large caps.

These patterns may sound obvious, but taken together, they make a strong case for passive investing in many areas.

In the Active/Passive Barometer study, we primarily focus on the short-term performance trends of active managers. Tracking these shorter-term outcomes is essential, as it helps investors identify emerging trends, assess manager skill during periods of market volatility, and make timely allocation decisions.

US exceptionalism begins to weaken

The first half of 2025 proved especially dynamic for the asset management landscape.

It may be remembered as the period when the long-standing idea of US exceptionalism began to weaken. President Trump's trade tariff policy and fiscally expansive budget plans rattled financial markets already wary of the heavy sector concentration in US equities.

Policy uncertainty surged, with the Economic Policy Uncertainty Index hitting an all-time high in April. A weakening US dollar prompted investors to shift portfolio allocations away from US assets toward Europe, particularly the eurozone.

US equities experienced sharp volatility, with the tech-driven rally of 2024 fading early in the year after news that

Eugene Gorbatikov is an analyst for passive strategies at Morningstar.

China's DeepSeek had developed a low-cost AI model rivalling market leaders.

These extreme levels of uncertainty did little to benefit US active fund managers. In fact, success rates fell sharply across all US categories. In the large-cap blend equity segment – one of the most popular among investors – the one-year success rate dropped to about 20% in June, compared with nearly 40% a year earlier.

Over longer horizons, performance was even more dismal, with fees dragging the 10-year success rate down to just 4.4%.

Eurozone benefits from capital rotation

Eurozone equities benefited greatly from the shift away from US dollar assets, supported also by local factors such as fiscal expansion to fund higher defence budgets.

Active managers capitalised on these opportunities: the one-year outperformance rate for eurozone large-caps rose to 23.5% in June, up from 15.6% in December 2024 and 18.8% in June 2024.

However, over the long term, the impact of fees works decisively in favour of passive options, with the ten-year outperformance rate at just 4.7%.

UK equities: A resilient market for active managers

In the first half of 2025, large-cap UK stocks posted gains despite a challenging economic outlook that weighed on mid and small-cap shares. Persistent fund outflows over the past five years have left the UK market under-owned and undervalued.

This lack of investor interest has created opportunities for skilled stock-pickers. Reflecting this, the one-year success rate for active managers in UK large-cap equities rose to 46.5% in June, up from 42.1% a year earlier, and notably higher than in other developed markets.

How does fixed-income fare?

In fixed-income, security selection is based on different principles. For government bonds, active managers have traditionally enhanced performance through effective duration management.

However, in early 2025, they faced increased volatility driven by US trade tariffs, fiscal expansion, and local challenges such as uncertainty around the UK budget.

Consequently, one-year outperformance rates fell to 32.1% for the euro and 53.3% for sterling government bonds, down from previous levels. In contrast, global government bond managers saw their outperformance rate rise to 69.8%, likely benefiting from relative value trades amid a weaker US dollar.

Credit spreads narrowed in 2025, supported by strong investor demand for yield, reduced corporate bond issuance, and rate cuts. In favourable market conditions, passive funds tend to capture most gains, making it harder for active managers to outperform.

The one-year outperformance rate for active managers in euro corporate bonds dropped to 46.7% in June from 63.9% a year earlier, while in sterling corporate bonds it fell to 54.7% from 76.7%.

Nevertheless, credit remains one of the few fixed-income sectors where active management delivers consistently stronger long-term results, with 10-year outperformance rates of 42.2% in euro and 33.7% in sterling corporate bonds.

Context matters

One important point to remember is that the study does not address the relative performance of different investment categories. High success rates can coincide with poor absolute returns, and vice versa.

This study isn't about identifying the best investment styles; rather, it focuses solely on whether active management is likely to add value.

Caroline Escott is co-head of sustainable ownership and head of investment stewardship at Railpen.

Shifting AI stewardship from theory to practice

***Caroline Escott* reveals how Railpen developed a framework for achieving AI governance.**

Formerly the stuff of science fiction, artificial intelligence (AI) is now a very real force shaping markets, economies, and societies. For investors, this transformation presents both significant opportunities for their portfolios but also risks. As stewards of capital, we need to ensure that the companies we invest in are not only harnessing AI's potential but doing so responsibly.

That's why Railpen and Chronos Sustainability developed and recently launched a framework for achieving effective AI governance – one that we hope will serve as a guide for all investors who are wondering how best to tackle this rapidly evolving issue. At the heart of our approach is a simple and straightforward premise: good governance is essential, and the foundation upon which companies can build resilient, responsible and forward-looking AI strategies.

Governance, in recent years somewhat the 'poor cousin' of ESG, is not just about compliance or risk mitigation; rather, it is about enabling effective oversight that allows organisations to seize AI opportunities while managing the complex and evolving risks that AI can present.

Our research indicates that AI is developing at a pace that outstrips traditional regulatory and oversight mechanisms. In 2024, 72% of companies had adopted AI in at least one business function, and over 60% of S&P companies acknowledged material risks related to AI. Yet only 9% felt prepared to manage those risks. This disconnect between adoption and preparedness is concerning for investors who care about financially material risks impacting good outcomes for clients and beneficiaries.

It underscores the need for investors to engage with companies and provide their own valuable insights as governance specialists who understand how to ask the right questions, assess risk, and help drive accountability. Our focus on governance is deliberate.

AI's rapid evolution means that long-term risks and capabilities remain largely unknown, though short- and medium-term risks – such as bias, data privacy breaches, cyberattacks, and adverse generated content – are already materialising. Such risks can have significant financial and reputational consequences. Ensuring companies have the right governance arrangements in place means they will be well-placed to tackle not only these near-term developments, but also longer-term AI trends and transformations.

The AI Governance Framework (AIGF) we propose is not theoretical, it is designed to be used, translating responsible AI principles into actionable practices. It is built around four pillars: governance, strategy, risk management, and performance reporting: **Governance**: the oversight of AI management and related policies. **Strategy**: AI's relevance to the business. **Risk Management**: Identifying AI-related risks while managing impacts and stakeholder engagement. **Performance Reporting** ensures transparent reporting on AI to the public.

These pillars provide a structured way for investors to assess how companies are managing AI risks and opportunities.

Alongside this framework, we provide guidance for investors to help them conduct high-level assessments of portfolio risks using the criteria in the report, engage with priority companies using the AIGF, and advocate for policy and regulation that supports responsible AI use.

Importantly, we recognise that investors are not necessarily deep AI experts. But we are experts in governance, and we bring valuable insights from our stewardship work across sectors and geographies.

Railpen is actively exploring the long-term opportunities presented by AI and its portfolios are structured to benefit from the growing integration of AI across industry and we have already begun exploring how to apply this framework to our own investment activities.

We are committed to engaging with portfolio companies, monitoring developments, and refining our approach as our understanding grows. But we also know that systemic issues like AI cannot be addressed by one investor alone. That's why we are sharing this framework – to support other investors in their work to help ensure companies, markets and economies are as prepared as possible for whatever the future of AI may bring.

Cadi Thomas is head of sustainable investment at Isio.

Asset managers and sustainability

Sustainable investing continues to expand beyond simple ESG integration, says *Cadi Thomas*.

The sustainable investment (SI) landscape has evolved significantly over the last decade, becoming a key agenda item for investors, regulators and asset managers. No longer are the days where sustainability is reserved only for those who consider themselves 'niche' investors.

At Isio, we have worked extensively with asset managers within our research universe to assess and drive change within ESG integration standards across multiple asset classes, recognising the nuances of different asset classes and funds. We reviewed more than 140 funds across 65 asset managers and evaluated ESG integration across such categories as risk management, stewardship and reporting.

The Isio annual *SI Survey* seeks to highlight the sustainable capabilities and improvements of asset managers, as well as provide a starting point for investors to pursue 'greener' and more robust portfolios. Sustainable developments have come in leaps and bounds, however, like every success story, there are also political and regulatory challenges.

Despite recent sustainability backlash, particularly within the US, the levels of ESG integration remain strong, and progress continues. From a firm-level perspective, we found the trend for improved sustainable action was generally positive, with a moderate increase in asset managers committing to the UK Stewardship Code (69% in 2025 versus 65% in 2024) and Net Zero plans (65% in 2025 versus 58% in 2024). This is promising considering there have been many high-profile withdrawals, mostly from US-based asset managers, from climate initiatives such as Climate Action 100+, and concerns around product labelling within the UK's new Sustainable Disclosure Requirements (SDR).

However, asset managers appear to be erring on the side of caution when it comes to ESG objective-setting – down by 10% compared to 2024 – potentially as a result of the increased labelling scrutiny. Within reporting, we have seen improvements across climate, nature and social disclosures, with over two-fifths (41%) of funds now aligned to TCFD, and nature and social disclosures increasing to 17% and 39% respectively, compared to 12% and 33% in 2024.

However, the differences across asset class and public v private markets are clear: with private assets falling behind due to data limitations and methodological inconsistencies.

Risk management remains a key foundation for long-term integration, with many asset managers reflecting a greater understanding of ESG factors and risks. It was pleasing to see an increase in the utilisation of climate modelling (from 49% to 62%) and a high proportion of asset managers using an ESG scorecard: up to 77% across all asset classes.

The developments within stewardship reflect changing societal attitudes and a greater emphasis of taking responsibility within investment decisions. In response, many asset managers have increased their in-house stewardship teams.

However, the impact of political pressures is apparent, as the US passivity rules and challenges to DEI legislation have tightened the rules around ESG information requests, increasing engagement-related procedural hurdles. Sustainable investing has never been without its challenges, and these have been touched on within the ISIO SI Survey.

These include three important areas.

1. Balancing diverging regional regulations and legislative pressures. This is perhaps the most topical of all challenges, as divergence between the US and Europe continues, particularly in relation to collaborative engagement and detailed reporting. Asset managers with global exposures must navigate a difficult environment and conflicting priorities.

2. Data limitations and a lack of industry standardisation. While there has been some progress in data coverage, there are still limitations within data quality and inconsistencies across modelling methodologies. By developing an industry standard, it could provide valuable direction for asset managers, particularly for private assets.

3. Expanding Net-Zero commitments. There remains the risk that asset managers' Net Zero commitments are being used as a tick-box exercise, without supporting, rigorous action plans. Investors want to see asset managers proactively taking steps to align with their commitments, including ensuring these commitments cover a higher proportion of assets under management.

Investing in tech: still an engine of growth?

Institutional investors with tech companies in their portfolios have reaped real rewards. Will investing in tech be as beneficial going forward? *Andrew Holt* reports.

Investing in tech has been a lucrative business for those institutional investors taking the tech plunge. The so-called Magnificent Seven of tech stocks: Apple, Microsoft, Amazon, Alphabet, Meta Platforms, Nvidia, and Tesla have been outperforming the broader market for more than a decade.

"It really has been a case of investors needing to keep up exposure to these companies to enhance portfolio returns," says Daniel Casali, chief investment strategist at wealth manager Evelyn Partners.

The post-Covid acceleration in big data, e-commerce and artificial intelligence (AI) helped to cement the dominance of the Magnificent Seven. In 2025 this is reflected in their earnings forecasts for the second quarter: they are expected to post an aggregate annual earnings increase of 14%, compared to just 3% for the remaining S&P 493 constituents. "Their financial leadership is not just a matter of trend – it's a structural advantage," says Casali.

But Morningstar data highlights a shift in fund exposure over the past decade: Apple and Alphabet have seen the largest declines among the Magnificent Seven, while Nvidia has surged from 1.17% to 22% ownership in global portfolios. Interestingly, Morningstar sees a 25% upside for Alphabet.

But risks remain. As explored in the following pages 14-15, stock market concentration is chief among them: when most of the market's gains come from just a few stocks, a single piece of negative news or a disappointing earnings report from one can pull down the entire index.

These seven firms now represent 34% of the S&P 500's market capitalisation, with the broader IT sector reaching 33% – levels reminiscent of the dot-com bubble. Yet unlike that era, today US non-financial corporates in aggregate run a financing surplus, meaning they generate enough money to fund their investments.

Valuation risk is often cited as another concern. The group trades at an average price-to-earnings ratio of 30 times, though still below the 2021 peak of 38. This compares to 19 times for the rest of the S&P 500. The Magnificent Seven may seem expensive – but their earnings growth seems to justify the premium.

"In the short term, valuation might be a bit stretched which could weigh on performance. However, we are still convinced that investing in tech will be rewarding for institutional investors," says Johan Van Der Biest, global head of thematic global equity at Candriam. "This is because there is no other sector that combines significantly above average margins with significantly above average earnings growth."

Tech rewards

So does investing in tech still reap the rewards it once did? When looking at the recent market performance of the seven, a complex picture emerges. Although after a steep drawdown of roughly 25% in early April, the Magnificent Seven stocks have rebounded strongly.

Performance within this cohort also varies significantly. Nvidia, Microsoft and Meta Platforms have surged more than 20%, led by AI momentum and solid business demand for related technology services and products.

Amazon has made a modest 4% gain this year, while Apple has lost 14%, reflecting pressure from trade tariffs. Tesla, meanwhile, is the laggard with an 18% decline, a possible hangover from Elon Musk's tenure in President Trump's administration.

Tech still reaps the investment rewards, "but the sources of value are shifting," says Fawaz Chaudhry, partner and head of equities at Fulcrum Asset Management. He sees AI as the next great general-purpose technology that will reshape entire industries.

"Investors have been sceptical on the return of investment for GenAI given the size of the investments, creating volatility in the AI trade," notes DJ Cross, portfolio manager and senior investment analyst for American Century Investments.

Looked at another way, have we possibly reached the peak in performance for the Magnificent Seven? The jury is more out on this question. "The Magnificent Seven have been incredible engines of growth, but investors need to recognise that future outperformance may not be evenly distributed among them," notes Chaudhry.

"The companies that create the most shareholder value will be those embedding AI into their businesses to raise revenues and expand margins, whether that's automating advertising, personalising ecommerce, or scaling content creation," he adds. "Meta stands out because it's building AI into the fabric of its business: AI tools are already lifting performance for advertisers and lifting Meta's top and bottom lines."

Van Der Biest says performance and earnings are key when investing in tech. "The interesting thing about the Magnificent Seven is that their performance has been completely in sync with the earnings evolution, meaning that their valuation hasn't changed meaningfully. As long as they continue to deliver on the growth side, we still see upside," he says.

DJ Cross agrees that investing in tech still offers benefits to investors. "In general, we view the Magnificent Seven favourably over the long-term given their massive scale,

The opportunities of UK tech

The case for UK technology investment is a compelling one, says the British Growth Partnership. *Andrew Holt* hears the case.

Looking at investing in tech from a different perspective: that is aside from the Magnificent Seven, and with more of a UK focus, Ian Connatty, managing partner of the British Growth Partnership presents a different tech investment narrative.

"The case for technology investment continues to be compelling and the UK has a strong pipeline of high potential companies, with tech-led scale ups across climate tech, deep tech and fintech," he says.

Indeed, while established tech giants headlined as the Magnificent Seven continue to deliver remarkable returns, the question now should be – what companies will become a pivotal part of an institutional investor portfolio?

"From the UK's venture ecosystem, we are seeing the next generation of tech companies emerge. These are companies that are creating a greener world, they are driving productivity through AI, they are pushing new boundaries of quantum computing and nanotechnology," says Connatty. "There's no doubt that there are future tech titans among the companies leading these fields."

For institutional investors, there are untapped investment opportunities in UK unlisted high potential companies, yet these are often underappreciated, notes Connatty.

A key stat is that pension funds only represent 10% of the UK's venture capital pool, compared to 72% in the US. "This is despite the fact that the *British Business Bank's VC Financial Returns 2024* report showed UK venture capital returns were above the US and the rest of Europe for older vintages," says Connatty.

UK funds established between the 2002-2007 vintage period outperformed both the US and the rest of Europe on DPI and TVPI measures.

So the investment opportunities are clearly evident. "By uncovering these opportunities and investing in that long-term potential now, institutional investors can achieve a proportionate, prudent and definite rebalancing of portfolios to include more growth oriented, return-generating equity assets," Connatty says.

accelerating innovation, and competitive advantage, which we expect to drive sustainable free cash-flow growth."

Cross estimates that this growth rate will be at a premium to non-Magnificent Seven stocks, which Cross thinks will be rewarded by the market. "That said, each of the companies within the Magnificent Seven have varying business models and fundamental drivers," says Cross. "For example, we are positive on Microsoft given their public cloud leadership and relationship with OpenAI, and more negative on Apple given limited innovation and a high valuation."

Moreover, the Magnificent Seven remain essential to understanding market dynamics. With robust earnings, deep cash reserves, and strategic positioning in AI and cloud infrastructure, these firms potentially present not only resilience, but opportunity. "For investors seeking exposure to growth and innovation, it is hard to ignore the attraction and potential further upside in these Magnificent Seven companies," says Casali.

AI arms race

The tech sector can also be said to be shaping up in other ways. "We think that AI has become an arms race between the largest, and most sophisticated, companies in the world, notably Microsoft, Amazon, Google, and Meta," adds Cross. "Models are being developed and are evolving at a very fast pace. In the medium-term, we see significant potential for GenAI to drive productivity benefits and to disrupt non-tech markets like industrial and auto."

Taking a step back of all the moves within the tech world, how should investing in tech sit within an institutional investor portfolio? "When we talk about tech today, we inevitably talk about AI, as it is the engine driving the sector's next phase of returns," says Chaudhry.

"And AI deserves a dedicated place in institutional portfolios because it is the defining megatrend of this era, adds Chaudhury. "Portfolios without exposure risk missing the next structural growth driver."

China the disruptor

Looking at the next tech trend, much market commentary has focused on China as the big tech disruptor. "We see greater disruption from China on US tech," says Cross. "For example, in semiconductors, China has been restricted from purchasing the most advanced manufacturing equipment from ASML and the highest performing graphic processing units from Nvidia."

This has resulted in significant innovation by China's domestic companies in areas like semicap equipment and in AI semiconductors.

In addition, DeepSeek's AI model released earlier this year

An investor guide to the Magnificent Seven

***Monika Calay*, director of UK manager research at Morningstar, gives her assessment of the Magnificent Seven.**

Microsoft: The heavyweight

Microsoft remains the heavyweight. Since 2018, it's held the largest share of ownership among the Magnificent 7. Institutional confidence remains strong, driven by Azure's 30% growth, deep enterprise ties, and its leading position in AI through OpenAI. Microsoft is the only member of the Magnificent Seven to consistently account for over 20% of total fund ownership in global equity portfolios every year for the past decade, a testament to its enduring institutional appeal.

Apple is slipping

Apple remains a top holding, but it's slipping. After years of commanding a significant share, ranging from 20-23%, of institutional ownership, its representation in global equity funds dropped to 16.11% in 2025. Geopolitical exposure is a growing risk: Apple's supply chain is a geopolitical risk story. The company relies heavily on Foxconn and TSMC, meaning any disruption between China, Taiwan, and the US could choke off production. Meanwhile, China has discouraged iPhone use by government officials, a red flag for future sales in a key market.

Nvidia: Facing a ceiling

Nvidia's rise has been nothing short of explosive. Its share of total fund ownership surged from 1.17% in 2015 to 22.00% in 2025, it now rivals Microsoft in portfolio exposure. Nvidia went from niche to necessary. The AI boom, combined with its dominance in GPUs, CUDA software, and expansion into networking and services, has made it a top choice for funds chasing growth. But geopolitical tensions, especially US export restrictions to China, pose a ceiling on its global reach.

Alphabet: AI rebound

Alphabet is rebounding with AI at the core. While its share of institutional ownership has slipped in recent years, its recent earnings and product integration, such as AI Overviews and AI Mode, have reinforced its staying power. Its engine remains dominant and deeply embedded in marketing budgets. Growth in Google Cloud and disciplined reinvestment add to its long-term appeal, despite lingering regulatory scrutiny and cash burn from Other Bets.

The Meta bounce

Meta has bounced back after years of doubt. Its share of fund ownership fell from a high of 13.02% in 2017 to a low of 4.85% in 2022, it's rebounded to 10.55% in 2025. Meta's reach is unmatched. With nearly 4 billion monthly active users across Facebook, Instagram, and WhatsApp, the firm is growing ad inventory through features like Stories, Reels and Threads. Risks remain around regulatory threats and Reality Labs' continued losses.

Amazon: Dominant, but shrinking

Amazon's position is shrinking in relative terms. Once accounting for 15.59%, it now stands at 12.45% of fund ownership. Amazon is still dominant, but it's been overshadowed. AWS and advertising continue to grow, but the firm's focus on fulfilment and logistics expansion may weigh on cash flow. Regulatory pressures and slower traction in international markets and luxury categories also limit upside.

Tesla: Under pressure

Tesla is under pressure from multiple angles. Elon Musk's political activity, including plans to form a new party, risks becoming a major distraction. It also further politicises the brand and could alienate consumers in key markets such as the US and Europe.The early termination of the EV tax credit, included in the recent Republican spending bill, may materially impact demand starting in 2026. While Tesla still holds significant potential as a leader in EVs and energy technology, its position among the Magnificent Seven now faces greater scrutiny.

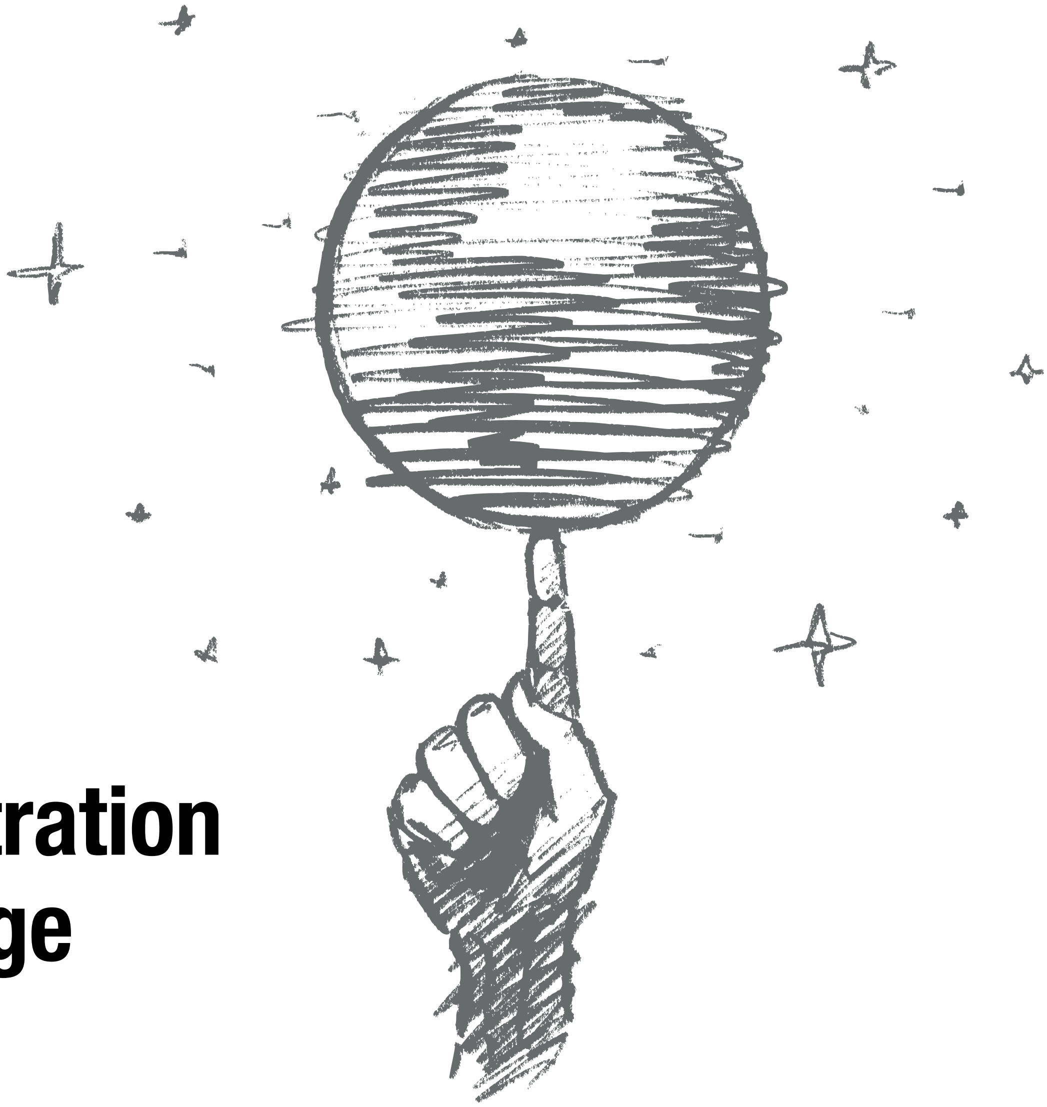
is an example of leadership in AI model building, without the use of the highest performant semiconductors.

"We think the US and China are in race for AI. We expect accelerating technology innovation in China, which has the potential to disrupt US technology companies," says Cross.

"China creating its own tech industry will weigh on the Western technology sector and could be a drag on the performance of the sector. Investing in some of the Chinese IT companies could be a way to help mitigate this risk," notes Van Der Biest.

Chaudhry agrees China is a clear and present threat. "China is no longer just catching up. In some areas, it may be moving faster – launching cutting-edge open-source models with radical cost and efficiency breakthroughs," he says. "For long-term investors, this isn't just a risk to watch but a structural opportunity," Chaudhry notes. "China's innovation engine is becoming one of the most interesting places to allocate capital in global tech."

The new age of tech investing may therefore be more complicated than the previous incarnation, but still as appealing. The challenge for investors, like in the past, will be identifying and backing the tech winners.



The concentration risk challenge

Global markets have become increasingly concentrated. But what does the future hold? *Andrew Holt* investigates.

It has become a big point of discussion among many market commentators in recent years about how global stock markets have become increasingly concentrated – at a country, sector and individual stock level. It has not gone unnoticed that the 'Magnificent Seven' have dominated returns, raising concerns about diversification and concentration risk.

But is concentration risk now falling? As discussed in the investing in tech feature, the investment appeal of the Magnificent Seven could be on the wane.

This trend is becoming slowly evident in the investment breakdown of exchanges. At the end of June 2025, the US represented two-thirds of the MSCI AC World Index. This compares with almost 70% at the start of this year. It might not sound like a huge difference, but it's a step change in the dominance of the US.

"It's partly because US stocks fell almost 3% in the first half of this year, while other markets have gained," says Kate Marshall, lead investment analyst at Hargreaves Lansdown. Most noticeably, the European stock market has grown over 14% so far in the 2025. Areas such as defence, banks and other industrials have been the stand out performers.

"The potential for more investment from Europe in areas like defence, following Trump's calls for greater spending in this sector, and infrastructure has been viewed positively," she adds.

The UK is also up an impressive 9% this year. With sectors like aerospace and defence, including BAE Systems, performing strongly, and banks have boosted returns as they are benefiting from higher interest rates.

The chancellor Rachel Reeves has also announced reforms which aim to increase investment in the stock market and drive growth across the UK. Although whether this will change the direction of investment in any way, is very open to question.

The rhetoric around trade tariffs, defence spending, and other geopolitical risks have also played a key part in how markets have performed in the first half of the year, which naturally shapes where investment does and doesn't go.

While global markets have been volatile, gains have been spread more widely and not isolated to a handful of names, such as Nvidia, Apple, and Microsoft that had previously led the market.

These moves have not been enough to knock the tech giants off their top spot in global indices yet, but it could be said to be a stark reminder of the need for diversification in client portfolios. “Recent political and economic volatility has led to questions around the safe-haven [status] of the US, which has driven onshoring and divestment from the US into alternative markets,” says Nuwan Goonetilleke, head of capital markets at Phoenix Group.

“None of this is to say that concentration risk has disappeared,” notes Marshall. “The US, and technology companies in particular, remain dominant. The Magnificent Seven still carries substantial influence in global markets.”

The significant globalisation and reach of the US has meant Trump’s policies have knock-on effects not limited to the US market, diminishing the value of geographical diversification somewhat, at least as a countermeasure to concentration risk. But Marshall notes: “Recent data suggests there’s been some rotation in markets, towards some more economically sensitive sectors, value-oriented regions, and companies outside the usual tech titans.”

There are no guarantees this will be a full regime change. It is a big point of discussion among the investment community about whether ‘US exceptionalism’ is over. But the breadth of potential returns is expanding, and the evidence suggests concentration risk may have peaked.

Offering advice given this situation, Marshall says investors should stick to the basics. “Investors should maintain diversified portfolios, given different countries, themes and styles of investing will come in and out of favour over time,” she says.

It can also lead to investors thinking more about their portfolio says Goonetilleke. “Concentration risk is a key consideration for institutional investors when considering sustainable portfolio construction, ensuring proper diversification and portfolio management across sectors, geographies and asset classes,” he says.

The challenge for investors is that it has been a truism that global economic and technological developments have driven disproportionate growth and investment in certain sectors in recent times – and continue to offer the potential for outsized return. “However, the risk associated with highly concentrated portfolios should be carefully managed,” adds Goonetilleke.

“Investors should continue to use strong governance processes to ensure portfolios remain within their respective risk appetites,” says Goonetilleke, leaning into a more traditional approach investors can use when dealing with concentration risk challenges.

In relation to portfolio diversification, this, says Goonetilleke, could include policies and triggers such as the maximum geographical/sector allocation for the portfolio, a maximum single name holding as a proportion of the portfolio, and for multi-asset portfolios, a robust process for overall portfolio construction. .

There is also a key difference in how active and passive investments are viewed by concentration risk. For active investors, this could mark the start of a more favourable environment. If markets broaden in terms of countries, sectors, and individual companies, this could improve diversification and create more opportunities outside of the index heavyweights investors have grown accustomed to in recent years.

“Passive investors remain more vulnerable to increased concentrations caused by disproportionate growth within indices,” says Goonetilleke. “The outperformance of the US equity market and in particular technology companies has led to the illusion of diversification in indices such as the S&P 500, where the Magnificent Seven make up 30% of the market cap, leaving passive investors prone to more concentration risk than would appear,” .

The potential demise of concentration risk is creating opportunities. “Commitments to future European defence spending are creating investment opportunities. At this stage these remain as commitments only,” says Goonetilleke. “Individual regions will need to demonstrate the affordability of these commitments amidst a backdrop of high debt levels and running ongoing fiscal deficits,” he adds.

Although looked at from a different direction, is there an argument for saying concentration risk is overrated? No, says Goonetilleke. “Concentration risk is now more pertinent to effective portfolio management than ever before in this ever-evolving geopolitical climate, for which we are seeing widespread conflict, tariff uncertainty alongside equity all-time highs and credit spread historical tights,” he says.

“Portfolio diversification and balance will likely be key to effective risk management, with the global economy at a potential inflection point,” adds Goonetilleke.

Investors will be closely watching US inflation, jobs reports and the Fed in the coming months. The geopolitical landscape in Europe and the Middle-East will also continue to be a focus. In this sense risk – concentrated or otherwise, will always be present. And institutional investors would not have it any other way.

Changing the Central Administrator or AIFM: Which Factors are Relevant for Success?

IntReal Luxembourg S.A. has steadily expanded its market presence in recent years. In addition to launching new real asset funds in asset classes such as real estate, infrastructure or private debt, the company has also increasingly focused on taking over the central administration or AIFM function for existing funds. In this interview, Ilva Diaco and Jan-Hauke Fast, both serving as Conducting Officers in the senior management of INTREAL Luxembourg, share their thoughts on which factors are the key drivers of success.

Ms Diaco, Mr Fast, in what ways have the business focus of INTREAL Luxembourg and the requirements of your clients changed over the past years?

Ilva Diaco: INTREAL Luxembourg has systematically expanded its service offering in recent years, for instance by acquiring licences for the "infrastructure" and "private debt" asset classes. At the same time, we have continued to invest in recruiting key staff and in our technical resources. This has put us in an excellent position to support existing and prospective clients in the implementation of their current projects. With the stagnation of the real estate market in 2023 and 2024 now behind us, we are beginning to see a slight recovery in Luxembourg. In addition to the private equity and real estate segments, private debt and infrastructure are increasingly moving into focus.

Jan-Hauke Fast: We have expanded our range of asset classes and have focussed on providing services for asset managers and advisers. Our modern and continuously evolving IT structure and high degree of digitalisation enable us to execute processes in a very efficient manner. By ensuring the reliable procurement and processing of data, for example, we free up the advisor to concentrate on his core competence, which is to manage the asset at hand.

In addition to launching new investment funds, you manage your accounts as central administrator or AIFM of existing funds. How significant is this business line for INTREAL Luxembourg?

Jan-Hauke Fast: These services are requested more and more often now, and we see considerable potential for growth here, especially in the area of central administration. This is largely explained by the structures that have crystallised in Luxembourg over the past decades. Traditionally, each of the various tasks used to be handled by a different small-scale player.

Could you please give us an example of this?

Ilva Diaco: You see, whenever services related to the central administration are delivered by different service providers, it requires stringent coordination among them, which generates costs for several third parties on top of in-house costs. INTREAL, by contrast, provides the entire central administration as a one-stop shop, eliminating the extra costs. Moreover, we can respond to certain requests and requirements of our clients more quickly and more flexibly because we don't need to coordinate with any third parties. Another example is accounting, which – in the case of multi-tier structures – used to be available for certain aspects only

Ilva Diaco
Conducting Officer
Portfolio Management &
Business Development

Jan-Hauke Fast
Conducting Officer
Fund Administration & Finance

rather than for the structure as a whole. This can have an adverse effect on quality. Our services, by contrast, cover the entire structure on all levels.

> **"We combine the best of two worlds – the strength of a leading German group with the agility of a boutique – close to our clients and flexible in a fast-changing market.**
>
> Ilva Diaco

Is the switch from one central administrator or AIFM to another not relatively costly and complex when compared to the costs of launching a new fund?

Jan-Hauke Fast: With our experience we know that the transfer process needs to be well prepared and can be challenging, but it pays off and provides you with the opportunity to streamline the structure and process for sustainable efficiency gains. The complexity therefore presents an opportunity to optimise things rather than being an obstacle. Not least because certain aspects are easier to solve in Luxembourg than in Germany. For instance, AIFM service providers are not usually recorded in the land register here – the way they are in Germany – and this simplifies the transfer to another AIFM. In addition, we have developed procedures and methods to ensure that we support our clients in holistic and professional ways through each step of the transfer process from one central administrator to another. The approach is very well received and is very much appreciated by our clients.

How important is it for INTREAL Luxembourg to be part of the German INTREAL Group?

Ilva Diaco: Being domiciled in Luxembourg lets us combine the best of two worlds. Luxembourg's fund sector has always been characterised by its close proximity to customers, yet this began to be lost when many AIFM were taken over by major players. We at INTREAL Luxembourg continue to prioritise close customer relations and a key account approach, but at the same time we benefit from the expert team and technical resources of a leading third-party AIFM in Germany's real asset segment. We are a part of a large German group, but at the same time we operate very efficiently on the ground and are as close to our clients as a boutique firm. This gives us agility and flexibility, which are two crucial characteristics in a fast-changing market.

Jan-Hauke Fast: Another very important competitive advantage is that we combine our IT infrastructure with our comprehensive experience in regard to compliance with regulatory requirements. Based on our digital solutions, we can automate a lot of processes – from reporting all the way to risk analysis. Many investors still have the feeling they are not getting all the information they need or getting it too late. We, on the other hand, take a look-through approach and provide our clients with a dashboard that grants insights into risk assessments, portfolio management aspects and appraisals. This way, our clients get precisely the level of transparency from us that they expect.

INTREAL

The decline of net-zero alliances

***Jeanne Martin* highlights the trend of banks to exit net-zero focused initiatives, but also presents a plan for investors going forward.**

The world's biggest climate alliance of top banks is facing its second wave of departures this year. The first exodus was driven by Wall Street towards the beginning of the year, with the second now being spearheaded by major European lenders, including HSBC in July, and Barclays and UBS announcing their exit recently.

Set up by banks in 2021 with the backing of Mark Carney, the Net Zero Banking Alliance (NZBA) was a landmark achievement in bringing the world's largest banks together under a public commitment to the net zero transition and moving lenders toward setting decarbonisation targets to meet this goal.

A pushback against reducing global warming and responsible investment has been taking place over the past couple of years in America, driven by the fossil fuel industry. Cracks in the NZBA particularly started to show following the change of administration and attacks on the alliance by Republican politicians.

JPMorgan Chase and Bank of America were among the US and Canadian banks that exited after Trump's election, which was then followed by the alliance's announcement that it would soften its climate target rules.

Concerningly, the NZBA decided to water down its guidelines on 1.5C following significant lobbying by its members. This took place whilst historic droughts and catastrophic floods were taking place around the globe.

Now, despite being accountable to less stringent standards, the alliance is facing another spate of high-profile departures, though this time European banks are leading the charge.

As many European banks are further ahead than their American counterparts in their decarbonisation commitments and sustainable finance strategies, this has come as a surprise to some.

Broadly speaking, the initial NZBA exodus seemed unlikely to impact European capital, where the financial motives for the net-zero transition appeared to be better understood.

Concerning signals

Prior to leaving last month, however, the first European bank to leave the umbrella group had been sending some concerning signals around whether managing the rapidly multiplying risks of global heating remained one of its priorities.

HSBC dropped its chief sustainability officer from its executive committee and announced plans to review its climate targets and policies in February.

In response, 30 concerned investors managing £1.2trn in assets called on the bank at its annual general meeting to restate its commitment to the net zero transition. Given its exposure in Europe and Asia, HSBC is even more vulnerable than some of its peers to climate risks such as the effects of extreme weather.

It is also uniquely positioned to finance the transition in areas that need it most. Regardless, the bank's departure sent yet another troubling signal around the bank's commitment to addressing the climate crisis.

Barclays followed just three days after it published a transition update reiterating its commitment to be a net zero bank by 2050. A few days after, UBS also left the alliance, though there had been speculation for some time over whether the bank would remain.

Blurred picture

All is not lost for the NZBA – several major European banks have retained their membership, including BNP Paribas and Standard Chartered.

However, none of this amounts to a very clear picture for investors and governments of the direction of the sector on climate and the banks commitments in the long-term to net zero.

NatWest and Santander, while remaining in the NZBA, have both recently backtracked on their fossil fuel commitments. HSBC hasn't made major policy changes yet, but alongside NatWest it is undertaking a review of its climate targets.

Barclays, despite leaving the group, has restated its net zero commitment. Meanwhile Standard Chartered publicly criticised banks for dropping out of the NZBA and rolling back on their green ambitions, and Credit Agricole vowed to remain a member of the alliance and affirmed their commitment to addressing the climate emergency.

Amidst these mixed signals from European lenders, heatwaves driven by climate change blasted the continent and tripled its death toll in June.

What's more, the evidence for the long-term devastation climate change will cause to our economies is crystal clear: the Climate Policy Initiative estimates an economic loss of $1.266trn – that's more than the entire GDP of Switzerland – by 2100 if we continue "business as usual" rather than keeping global warming to 1.5C temperature rise.

Smarter regulation

To ensure the financial sector remains resilient to systemic climate risk, we will clearly need more than voluntary initiatives to stimulate the clean energy transition at the pace required.

Part of the solution to this is smarter regulation that can properly embed attention to climate in the business operations of the banks. The UK government opened a consultation in June on transition plans, which are a vital link in the chain for turning climate promises into action and moving companies towards a greener and fairer future.

It's crucial that the government makes these mandatory for companies, including Britain's sizeable banking sector, to ensure it plans for the transition in a timely way.

Investors can and must play a role in this too. Responsible, long-term minded investors have made some great strides this year in making it clear that climate should remain a priority even if political headwinds have shifted. For example, pension funds in the UK publicly set expectations for asset managers to incorporate consideration of the net zero transition into how they invest their money.

From the conversations we have with investors at ShareAction, it's clear that it is disconcerting for banks who have touted themselves as 'leaders in sustainability' to suddenly pivot away from this strategy.

There should be consequences for backtracking on climate commitments and investors have the power to make this happen, for example, voting against directors where banks have rolled back on green ambition.

Banks are absolutely necessary for protecting the long-term resilience of our economy. As climate change affects food security, disrupts ecosystems and drives up extreme weather, it is not the time for banks to step away from appropriately managing risk. They should be demonstrating to investors and governments they are taking the steps needed to prevent the worst effects of global heating.

Jeanne Martin is co-direct of corporate engagement at ShareAction.

Unpacking perceived inequity: Performance fees in the UK DC market

The UK Defined Contribution (DC) pension system is undergoing a significant transformation. For the first time, UK DC savers are on the cusp of gaining meaningful access to private markets, as operational, regulatory and governance tailwinds converge. This shift presents a compelling opportunity to enhance member outcomes through greater diversification, improved long-term returns, and positive real-world impact.

From a risk/return perspective, the benefits of private markets can be profound, with the value proposition extending beyond financial performance. By allocating capital to businesses, assets, and projects that drive innovation, support job creation, and address environmental and social challenges, DC schemes can play a pivotal role in shaping a more sustainable and inclusive economy. The recently signed Mansion House Accord, represents a landmark policy initiative, expected to catalyse a new era of investment innovation, with long-term societal benefits.

However, despite the strategic appeal of private markets, their integration into DC portfolios introduces significant operational and governance challenges. Chief among these is the prevalence of performance-based fees, which can be a common feature of private market funds. These fees are typically designed to:

- Align the interests of fund managers and investors.
- Incentivise long-term performance.
- Attract and retain investment talent.
- Manage fund capacity and investor access.

As the Value for Money (VfM) framework continues to evolve, the focus of regulators and trustees is shifting from an emphasis on cost to a broader assessment of value delivered to members. This shift should bring new types of investment strategies – including those with performance fees – onto the radar of DC scheme investment researchers and consultants.

This evolution presents a dilemma: how can schemes access the full spectrum of high-quality investment opportunities while ensuring fair and transparent treatment of members, particularly in relation to fees?

DC schemes are inherently intergenerational, with members joining, contributing, and retiring at various times. While fixed annual management fees are straight forward to allocate equitably across members, performance-based fees introduce complexity. Their variable nature and dependency on fund performance and timing can result in inequitable fee allocation, where some members may bear a disproportionate share of costs or benefit unevenly from returns.

This paper addresses this challenge, placing the member journey at the centre of its analysis. Our research indicates limited resistance to the concept of performance fees; however, ensuring fairness in their application is paramount.

To address these challenges, the paper first looks to quantify potential inequity and second, explores a range of structuring, fee and fund models that help mitigate timing-related disparities and support fairer outcomes across member cohorts. While inequity between members cannot be removed completely, we believe the following recommendations will reduce disparities as DC scheme private market programmes evolve and mature:

- Private markets programme composition (increasing diversification)
- Fee negotiations
- Linearisation of fees (removing the lumpiness)
- Programme diversification

Nick Groom
Head of UK DC Strategy & Sales
Natixis Investment Managers

Our research does not advocate for or against performance fees. Rather, it recognises their prevalence – especially within the private assets market. The aim is to provide a practical framework for their implementation within DC schemes – one that supports informed decision-making, promotes fairness, and ensures that the benefits of private market investing is equitable, thus safeguarding member outcomes and their journey to retirement.

We hope this can serve as an industry blueprint.

Natixis Investment Managers believes that private market investments, including those that charge performance fees, should form part of DC schemes. There are many others in the industry that feel the same, including the government. Many hurdles have already been overcome, but one of the biggest remaining ones is the concern that such allocations may lead to inequity between members of UK DC schemes.

This paper, in our opinion, goes a long way to removing that barrier. Our decision to look at the potential inequity between members of UK DC pension schemes for members of default arrangements was predicated on the understanding that most other barriers had now been overcome and there was a collective shift to increase their allocation to private markets including ones that have performance fees.

If you are going to do this: do it well.

Request white paper

- Discover how incorporating private markets into UK DC pensions can revolutionise returns and member outcomes.
- Explore the evolving landscape of performance fees and their role in driving investment success while ensuring fairness among scheme members.
- Understand the methods for quantifying potential member inequity and strategies for achieving equitable treatment across diverse investment cohorts.
- Dive into the transformative potential of private markets in driving both financial gains and social progress in pension portfolios.

NATIXIS
INVESTMENT MANAGERS

Investment and fun pensions

A decade ago, "pension freedoms" set us all free to do what we wanted with defined contribution pension pots.

But what if the advice we now give, and the investment strategies we have developed since then, are standing in the way of people making the most of those freedoms?

In short, are we stopping people from having fun in their retirement?

For hundreds of thousands of people who would previously have been forced to lock in to rock-bottom annuity rates, pension freedoms came just at the right time.

But managing a pension pot in the face of inflation risk, investment risk and longevity risk is a tough challenge, even for investment professionals.

To help out, the pensions industry is designing post-retirement 'journeys' which will become the default outcome for millions of people who have saved through a workplace pension and don't make active choices to do something different.

Many of these solutions are 'hybrid' products involving – in various combinations – a flexible drawdown pot, a later life annuity pot and perhaps a cash pot for short-term cash needs.

But although these products are being designed for members, surprisingly little research has been done on what people actually want in their retirement.

So, along with colleagues at Bath University, I've been studying data on over 100,000 pensioners, surveyed over the last fifty years, to see how people manage their spending profile through the retirement years.

The results are very striking.

For people who still have a rent to pay in retirement, a minority, but a growing minority, spending tends to be flat or rising in real terms through retirement. Not surprisingly, if you don't have a lot of money to begin with and have hefty, committed outgoings for household bills and rent on top, you don't have a lot of discretion over what you spend.

Steve Webb **on the potential disconnect between investment strategies and pension freedom.**

Reckless prudence

But what is fascinating is the way that homeowners choose to spend.

The LCP research report is entitled 'downhill all the way' – a reference to our finding that people who don't have major housing costs to meet tend to 'frontload' their spending in the first half of their retirement.

What are they doing with their money?

In two words – having fun!

We're still studying the data in depth, but the signs are that people are spending on a holiday, or holidays, of a lifetime, replacing the clapped out car, doing up their house and sharing their wealth with the children and grandchildren.

What is particularly striking is that people were doing this 'frontloading' at a time when in large measure their income was fairly steady through retirement, whether in the form of a state pension, company pension or annuity.

This raises the interesting question: as we move to a DC world where people are not forced to take their retirement income evenly through retirement, will they 'frontload' even more?

And if that's what they want to do, should we who 'know best' not reflect that much more in our financial advice and the design of our post-retirement strategies?

Although most of the discussion about retirement planning is a worry that people will run out of money, my concern is the opposite.

That they will, to borrow a phrase, fall victim to 'reckless prudence' where they hold back from spending for fear of running out, and end up with a pile of money in later retirement that they no longer have the energy, health or inclination to spend.

Much discussion of saving for retirement is couched in very 'hair shirt' language – young people should sacrifice their avocados and lattes in favour of building a house deposit and a pension pot.

But when they get to retirement we still talk about sustainable withdrawal rates and being careful not to run out.

Maybe if we looked at what people actually choose to do and want to do in retirement, we might help them have fun, rather than standing in their way?

Steve Webb is a partner at pension consultants LCP and was pensions minister 2010-15.

Calendar

Topics for upcoming *portfolio institutional* events*

Conferences

01 October – ESG Club Conference

Roundtables

11 November – Real Estate Debt, London

Regional discussions

6 November – LGPS Confidential, London
20 November – LGPS Confidential, Birmingham
03 December – LGPS Confidential, Bristol
March 2026 – LGPS Confidential, Cardiff

Contacts

For information on sponsorship, contact:
Clarissa Huber
c.huber@portfolio-institutional.co.uk

To attend an event, contact:
Sabrina Corriga
s.corriga@portfolio-institutional.co.uk

*Subject to change

Publisher
portfolio Verlag
Smithfield Offices
5 St. Johns Lane
London
EC1M 4BH
+44 (0)20 7250 4700
london@portfolio-verlag.com

Editor
Andrew Holt
a.holt@portfolio-institutional.co.uk

Commercial Director
Clarissa Huber
c.huber@portfolio-institutional.co.uk

Marketing executive
Sabrina Corriga
s.corriga@portfolio-institutional.co.uk

Speaker acquisition & stakeholder engagement Manager
Mary Brocklebank
m.brocklebank@portfolio-institutional.co.uk

Subscriptions
Claudia Ajagbe
c.ajagbe@portfolio-verlag.com

Design and production
portfolio Verlag

ISSN: 2045-3833