eQ investors

In the crossfire:

Sustainable investing in 2025 and beyond

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2025 Investment Update

Executive summary

> **"The world around us is changing fast. From ageing populations and rising global temperatures to material breakthroughs in healthcare and artificial intelligence (AI), we're seeing big shifts that are reshaping how we live, work, and invest.**

At EQ Investors (EQ), we see these changes not just as challenges, but also as opportunities. Sustainable investing is about finding great businesses whose financial success is linked to solving real world problems, whether it's improving healthcare, building cleaner energy systems, or helping communities adapt to climate change.

In this white paper, we explore six key themes that are driving long-term growth. We look at how the healthcare sector is adapting to new demands, why sustainability-linked infrastructure spending is booming, and how AI is creating fresh momentum for clean electrification.

We also highlight why environmental, social and governance (ESG) factors still matter—despite recent market headwinds—and how the sustainable investment universe has grown, giving us more ways to build resilient, future-proofed portfolios.

Right now, our portfolios are trading at a discount to traditional markets but with stronger growth potential. That means investors can access high-quality, forward-looking businesses at attractive prices. It's a good reminder that investing sustainably isn't just about doing good—it's about making smart, informed choices to generate strong consistent returns for the future.

As this report explores the case for sustainable investing has never been stronger. By embracing change, we're positioned for long-term progress and consistent returns.

Six key themes:

1. Shifting demographics are creating social challenges and opportunities.
2. Underappreciated ESG risk.
3. AI-powered electrification.
4. Adapting to the impacts of climate change.
5. Sustainability-linked capital expenditure showing strong growth.
6. A growing toolbox of sustainable finance solutions.

We hope you enjoy this update and come away as excited as we are about the future of sustainable investing.

1 Shifting demographics are creating social challenges and opportunities

> **"The healthcare sector is at the forefront of solving several of the world's major challenges and market-creating innovation, from adapting to changing demand due to demographic shifts, to developing new drugs and treatments that can radically alter how we deal with diseases.**

And yet, optimism towards this sector has taken a hit as the new Trump administration discusses how the US can extract better value for money from its eyewatering healthcare spend.

So, what is changing in healthcare? One of the great hallmarks of the late 20th century was a significant rise in the global population, with the number of people more than doubling from 2.5 billion in 1950 to 5.3 billion in 1990.

This led to many countries experiencing a demographic dividend where the share of working-age population (defined by the OECD as ages 15 to 64) compared to non-working-age (under 14, and 65 and older) rose, resulting in a sustained period of economic and productivity growth.

In stark contrast, the 21st century has seen populations getting older while at the same time experiencing a collapse in fertility rates, placing upward pressure on old age dependency ratios.

This creates fresh social challenges for the world, with vast implications on society from education, to social security, to healthcare. On the current trajectory, almost 25% of the world's population will be over 60 years old by 2050, representing a doubling from current levels.

Health Care stocks are trading at their widest discount versus the market since the global financial crisis

Source: Bloomberg. Data as at 15/06/2025.

While an ageing population isn't a new trend, the weakness we have seen in recent valuations across the sector suggests that the market has been indiscriminate in its selling, allowing our underlying fund managers to uncover some highly interesting opportunities.

As it stands, the sector – which has historically had exceptionally resilient characteristics – is trading at a discount compared to the wider market, not seen since the global financial crisis, which we do not think is warranted.

Looking forward, many businesses caught up in this valuation dislocation are well positioned to benefit from an ageing demographic. This includes those whose therapies lean into the shift in spending priorities away from hospital-related care, and instead towards long-term care.

Additionally, those businesses whose focus is on preventative care can help pursue a healthier population that is less likely to engage with the healthcare system, reducing systemwide costs. AI also brings an exciting new angle to the healthcare sector.

Technology is already helping to assist in early disease detection, reducing human error and streamlining administrative tasks. This leads to better patient outcomes while lower overall costs.

We have previously written about the emergent opportunities in obesity drugs, where companies held in the portfolios such as Novo Nordisk and Eli Lilly offer treatments that can lead to significant weight loss. These treatments are revolutionary as they are also proven to reduce the risk of type 2 diabetes, cardiovascular disease, liver disease and hypertension.

As more clinical data emerges, there is also growing evidence around the benefits these drugs deliver against dementia, kidney disease, addictions and sleep apnoea.

2 Underappreciated ESG risk

> **"ESG assessments help investors understand material risks inherent in an investment.**

Whether an industrials company has a track record of polluting in rivers, if a technology company has sufficient protocols in place to protect customer data, or whether any businesses' executive remuneration incentivises the right strategic decision-making– are all examples that sit under the ESG umbrella.

While sometimes more difficult to quantify, we believe these non-financial factors are nonetheless deeply material to the investment case of a company and as such should be part of all investors' decision making.

There has been a lot of academic evidence to support the benefits of ESG integration over the years; many studies suggest that companies with strong ESG credentials generate better returns over the long-term and that ESG leadership positively affects corporate profitability. This is in part because ESG-leading companies limit the chance of brand damage, financial sanctions, or other regulatory breaches that could harm the investment case.

As companies with strong ESG credentials are inherently better "quality" investments, there has historically been an ESG valuation premium reflecting an appreciation by the market of the superior financial characteristics. Investors were willing to pay more to invest in quality companies with better risk management.

As shown on the graph, over the last year, this ESG premium has almost completely disappeared. This has undoubtedly been a contributing headwind to sustainable investment returns over the last 18 months.

The long-established ESG valuation premium has evaporated

Source: Bloomberg. Data as at 15/06/2025.

One of the reasons for this is that since the invasion of Ukraine by Russia, investors have placed less attention on ESG matters. There has also been political pressure from the new US president and some US regulatory bodies on ESG leading companies, including criticism for their voluntary commitments that go beyond regulatory minimums on climate or diversity.

Completely opposed to a sustainable investor's mindset, and historic evidence, recent legal challenges from US states (such as on the value of Diversity, Equity & Inclusion policies) claim that corporate ESG initiatives and disclosures increase costs and thus undermine short-term profits to investors.

Despite this US-driven sentiment, what is happening on the ground shows a different picture. While we are still early in the Trump presidency, in most cases CEOs are now choosing to communicate differently about ESG targets while keeping the commitments because they believe it makes financial sense.

So-called "greenhushing", where companies deliberately keep quiet their environmental efforts and achievements, may become more prominent.

One such example is the renaming of a chief "diversity" officer to chief "belonging" officer at the US grocery giant Walmart, while keeping all their previous responsibilities.

Regulatory bodies such as the European Union and even the Californian state legislature strongly believe in ESG materiality and continue to encourage companies to address ESG issues, like climate change or human rights in supply chains.

Overall, we expect that leading companies are still addressing ESG risks and this action remains material to drive better performance.

This lets us conclude that if the ESG valuation premium stays close to the current levels of around 0% for a prolonged period (which is possible) then sustainable investors should remain reassured knowing they can buy a diversified portfolio of future-proof companies that carry inherently lower levels of risk for the same valuation as the wider market.

Investing in ESG leading companies, as our portfolios do, is like adding a free risk insurance policy to your investments.

3 AI-powered electrification

"Following decades of meagre growth in energy demand across the developed world, changes in consumer habits such as the increased use of electric vehicles and changing heating and cooling needs are ushering in a new era of growth in electricity demand.

With new low carbon sources of electricity continually being added to the grid, shifting demand to electricity rather than traditional fossil fuels is a logical path to decarbonisation.

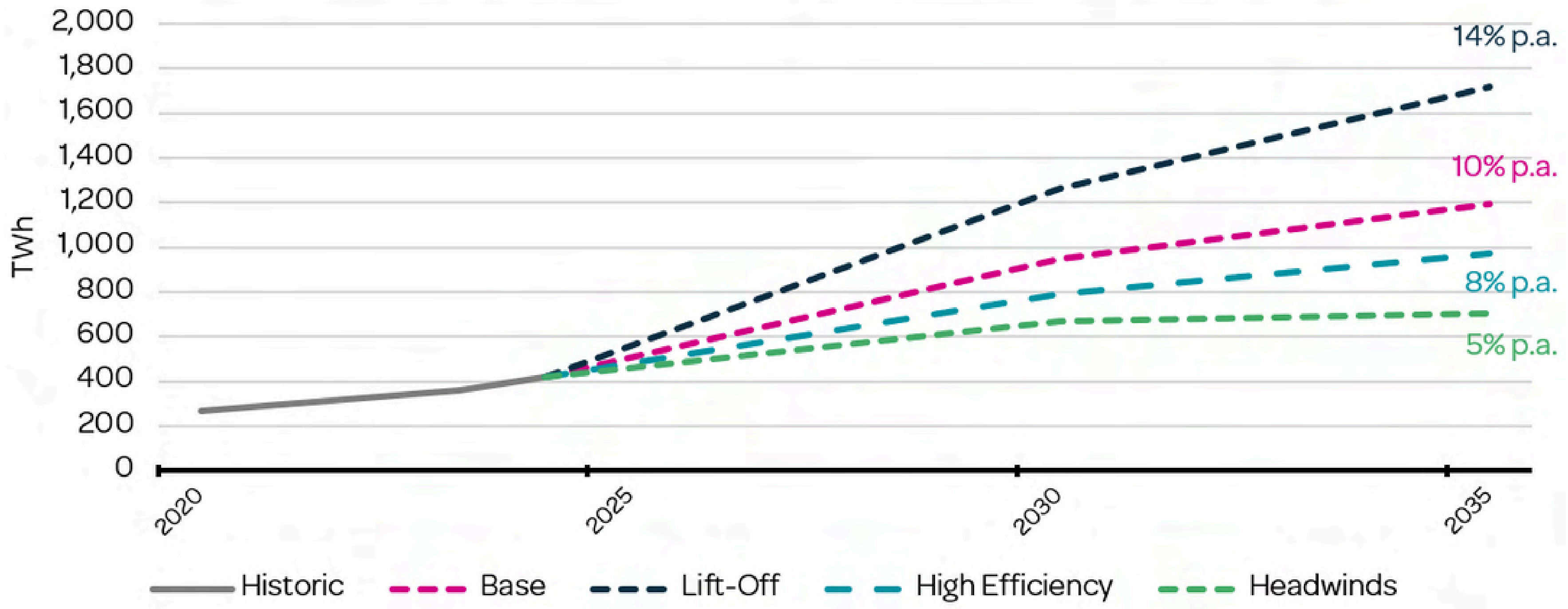
The rapid build out of AI infrastructure is the latest in a series of developments that are placing upward pressure on electricity demand. This massive upscaling in computing power brings several challenges to the surface, most notably the energy intensity associated with operating large data centres. In practical terms, these data centres can place major strain on local electricity grids which are often in desperate need of upgrade.

Other considerations around how dirty or clean the local energy mix is also brings attention to the carbon footprints of data centre operators.

Rising emissions is at odds with many of the climate commitments made by mega cap technology companies to limit greenhouse emissions. This is why we have seen a targeted increase in demand for low carbon sources such as wind, solar or nuclear.

To give an idea of the scale of electricity growth the market is starting to expect, the renowned International Energy Agency, an intergovernmental body that provides policy recommendations for the global energy sector, has produced a report on the impact of AI.

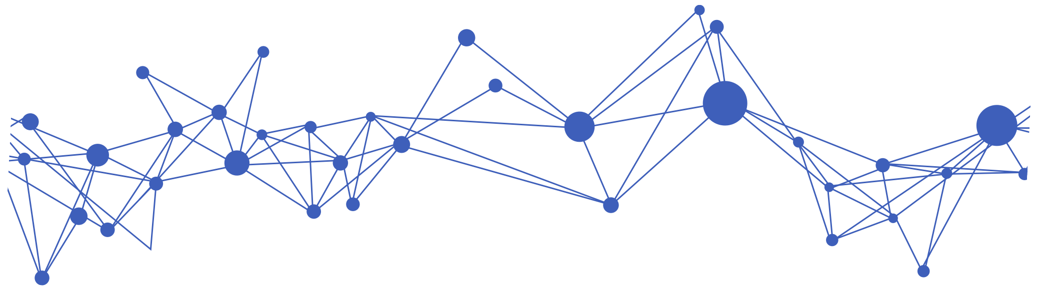
Even in the most pessimistic forecasts, global data centre electricity demand is set to grow



Source: International Energy Agency. Data as at 15/06/2025.

Alongside a base case scenario which would see global electricity demand from data centres double by 2035, the organisation has put forward three alternative scenarios which could see rapid growth in AI (lift-off), significant progress in reducing the energy footprint of data centres (high efficiency), and a scenario where AI adoption is significantly lower than expected (headwinds). Even in its most pessimistic headwinds forecast, electricity demand will continue to rise highlighting the need to improve efficiencies.

As mentioned, one of the key priorities we expect to emerge in the coming years alongside resilience and reliability is efficiency, or in other words how the consumption of resources can be reduced without compromising on the quality of the product. Given the high levels of energy intensity inherent with AI, we view efficiency not just as a sustainability requirement but as an economic necessity.



A key way for data centre operators to improve profitability will be to lower the amount of electricity needed on an ongoing basis whilst maintaining operations.

As we look to the wider grid, we see key growth areas in not only energy efficiency, but also grid management, transmission and distribution, and electric utilities. It is at this intersection that we believe the sustainable investment case is at its strongest.

4 Adapting to the impacts of climate change

> **"Climate change is no longer a distant threat; its effects are already being felt with severe societal and financial consequences.**

Concerningly, 2024 was the warmest year on record, with temperature globally 1.55°C above pre-industrial levels. This rise in temperature is clearly breaching the 1.5°C target signed in Paris in 2015. Whilst this target is based on a 20-year average, the recent acceleration in temperature rises is a stark warning of the urgent need for emissions reduction.

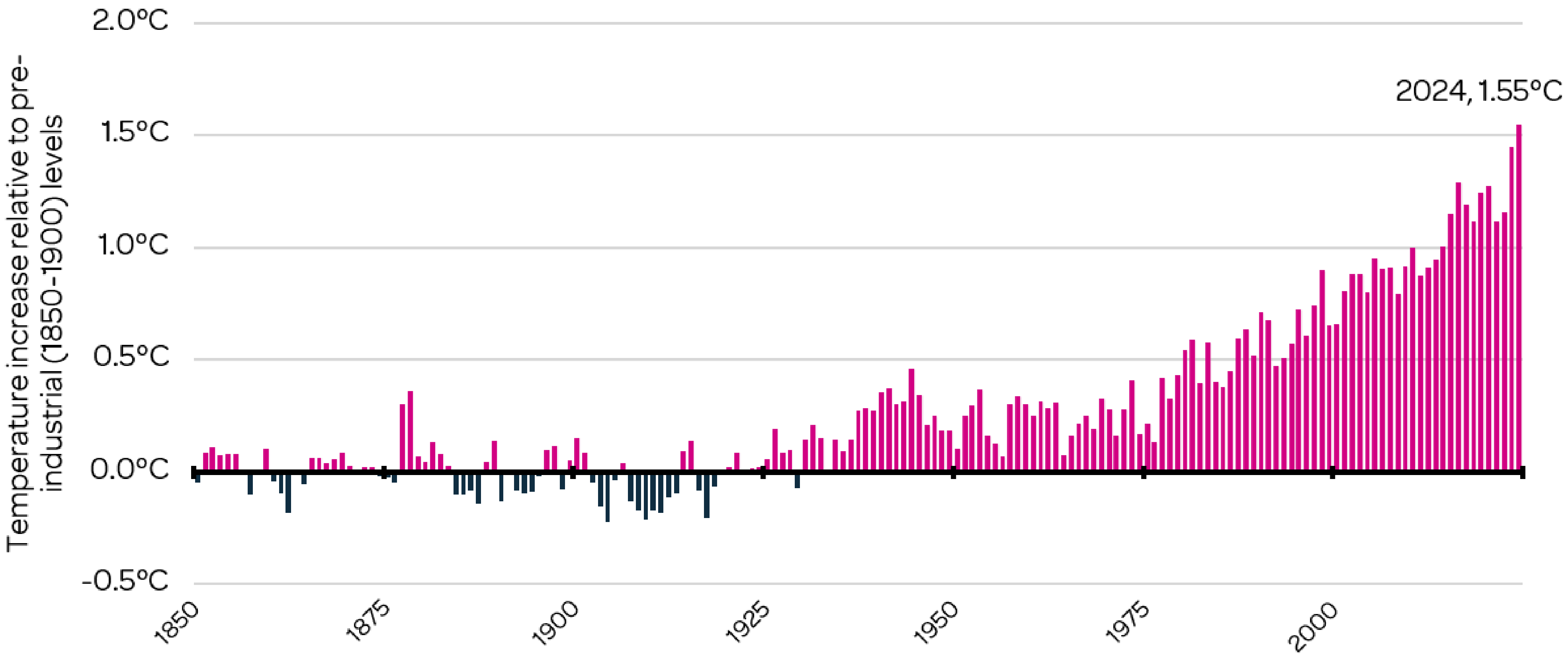
As global temperatures rise incrementally, the intensity and frequency of extreme weather events increase. Unsurprisingly, we have also seen an increase in the cost of natural catastrophes in the past 20 years, reaching $368 billion last year.

Until now, climate financing has focused on climate mitigation – aiming to reduce emissions - but increasingly climate adaptation is coming to the fore.

We see three sectors offering climate adaptation solutions with particularly strong growth potential, these being; insurance, water management and smart grids. In addition, we need more resilient infrastructure and drought resilient-crops for a wider adaptation strategy.

With only 40% of last year's economic losses covered by insurance, the insurance industry has a pivotal role to play in climate adaptation.

Average annual global surface temperature increases have crossed 1.5 degrees



Source: Copernicus, European Commission. Data as at 15/06/2025.

We believe the insurance industry is well positioned to act not just as a risk assessor, but also as a driver of resilience. Insurers are already experts in risk management and can use their knowledge to identify the physical risks associated with climate change, such as flooding, wildfires, storms, and heatwaves. They can then factor these risks into their pricing and product offerings, incentivising policyholders to adopt climate-resilient practices.

Water is another area that faces particularly acute issues in a warmer world. Companies can partially address water stress through water efficiency, water waste and treatment solutions. But as temperatures increase, water scarcity will become more widespread, with an increasing number of geographies exposed to droughts and water shortages.

Effective management of water systems will be integral to climate adaptation, but as we have also just explored, emergent technological breakthroughs in areas such as AI have the potential to improve efficiency too.

Climate change, through extreme weather events and rising temperatures, also affects power grids and can cause outages, damage to infrastructure, and reduced efficiency.

When combined with the expected increased electricity demand discussed previously, smart grid solutions via digital technologies, advanced communication networks, and data analytics will be paramount to optimise the generation, transmission, distribution, and consumption of electricity.

Our analysis shows that most investors are not paying much attention to the physical climate risks that companies are exposed to and how this translates into potential future financial considerations.

Sustainable investors are more likely to understand the balance of both short, and longer-term risks and opportunities these industries face as climate warming continues.

5 Sustainability-linked capital expenditure showing strong growth

> **" Governments around the world are advancing a new set of priorities which place emphasis on resilience, reliability and efficiency.**

Germany's recent federal election highlights just how these priorities have been elevated. The new coalition has pledged €1 trillion over the next decade to be split across defence and infrastructure modernisation, with the explicit need to improve the country's resilience in the face of global instability.

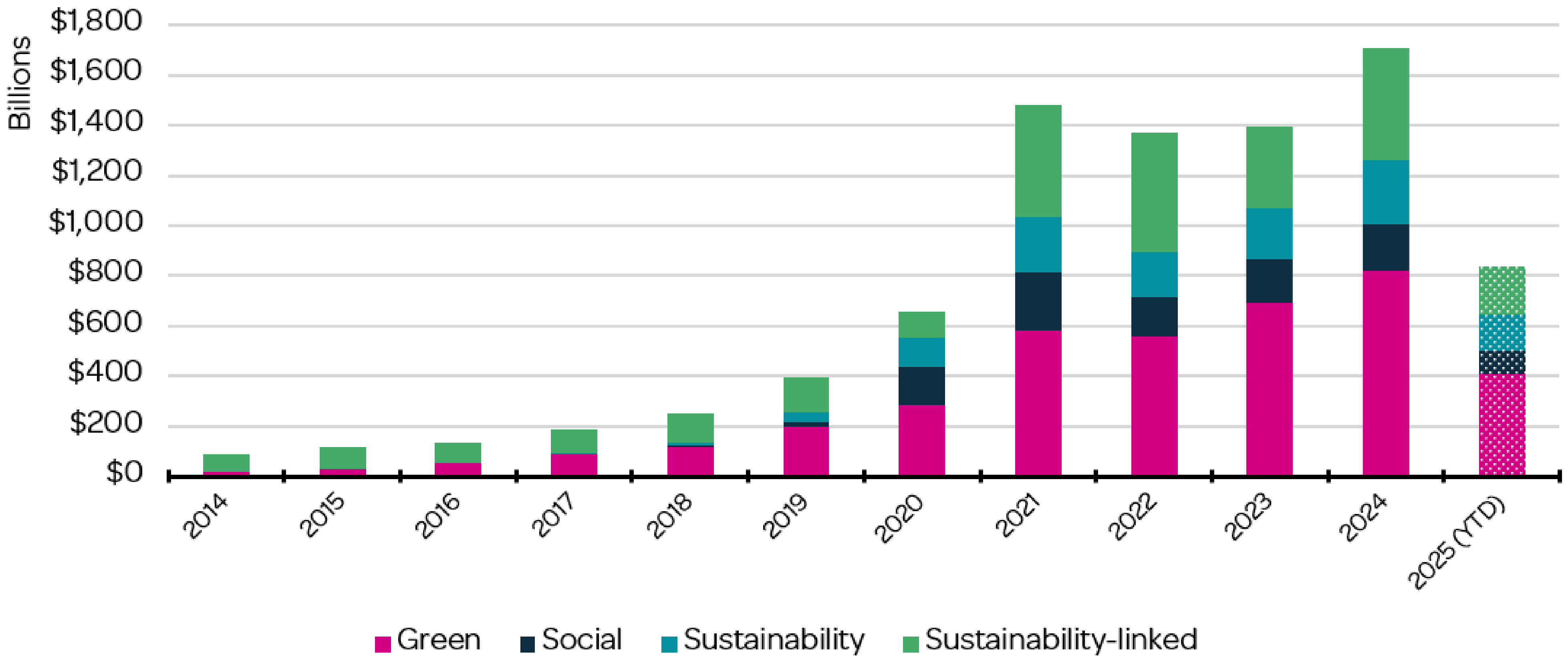
Even in the US, where the major ambition of the Trump administration is to reshore manufacturing through a new aggressive trade policy, the underlying intention appears to be to improve reliance within the domestic supply chain with a view to improving US resilience on the world stage.

To understand how strong the drivers are behind sustainability-linked capital expenditure, we follow the value of Green, Social, Sustainability and Sustainability-linked bond (GSSSB) issuance.

With lending terms for these types of bonds explicitly linked to the use of proceeds, capital raised via these bonds will almost certainly be directed towards sustainable development projects. Green bonds are the most well-known example as they have established rules and requirements with regards to the type of projects they can fund.

Examples include projects providing energy efficient technologies, financing new low carbon energy infrastructure, or funding water infrastructure projects.

Sustainable bond issuance hit record levels in 2024



Source: Bloomberg. Data as at 15/06/2025.

Reflecting on the last few years, it is clear to us that the Inflation Reduction Act, the flagship climate financing package passed under the Biden administration, did not unfold how we may have expected.

As such, we have adapted how we approach gaining exposure to the growth in sustainable capital expenditure, diversifying our investments throughout companies' capital structure (from equity to fixed income) which maintains the ambition of our sustainability outcomes while improving the portfolio's financial outcomes.

Having learnt from recent experiences, we view the best risk-adjusted opportunities within equity markets as those well-established businesses that are highly profitable and not dependent on government subsidies to generate attractive returns.

This provides a relative margin of safety as the investment case supporting these businesses is attractive before adding in government spending packages.

These companies are typically larger in size and align well with our investment approach to generate performance that is comparable to traditional markets.

These types of businesses are naturally an overweight in our most ambitious portfolios.

Outside equity, labelled bonds are a major part of our fixed income allocation. These bonds will offer near-identical characteristics to non-labelled bonds and will behave in a wholly expected way. This allows access to sustainable projects without taking on additional risk factors.

Examples of sustainable bonds that our portfolios invest in include multi-lateral development bank bonds, green bonds, and social bonds.

6 A growing toolbox of sustainable finance solutions

> **"Looking back over the last six years to a period starting just before the pandemic, sustainable and traditional portfolios have broadly generated similar returns, but have taken very different pathways to reach the same destination.**

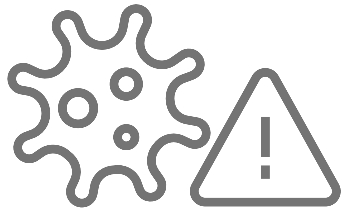
This performance divergence has been a challenge for the whole sustainable investment industry and has tested the resolve of sustainability-minded clients.

A significant part of the performance divergence can be explained by common biases we see in sustainable funds and portfolios, usually overweighting companies growing the fastest also called "growth companies" and companies of small and medium size, with usually a bigger focus on innovation.

In the decade before the pandemic, the macroeconomic environment was relatively stable, characterised by low economic growth, low inflation, and low interest rates. In this environment, market returns were primarily driven by companies delivering on earnings growth, though outperformance of growth companies versus more cyclical companies (also called "value companies") was limited.

Factors such as the size of a company also had a limited impact on relative returns. This benign period was a favourable environment for sustainable strategies.

However, since the pandemic, the picture has materially changed with factors coming in and out of favour at scale within a matter of quarters if not months.



This can be explained by a quick succession of economic and political shocks including the pandemic, the rise in inflation leading to a significant increase in interest rates bringing materially down valuations, the invasion of Ukraine, the Chinese real estate crash, the rise of AI and more recently the re-election of an unpredictable new U.S. president.

Portfolio and benchmark performance became primarily driven by factor exposure such as value vs growth, or large vs small sized companies.

Whilst the pandemic, with record low interest rates and aggressive quantitative easing programs was very supportive of sustainable strategies, driving investors towards smaller growth-orientated businesses, the subsequent increase in inflation and change in the macroeconomic regime proved to be a far more challenging environment with those factors strongly out of favour.

So how have we adapted to a volatile macroeconomic environment and future-proofed the EQ sustainable portfolios?

Since we started managing our first sustainable portfolios in 2012, we have seen a significant increase in the number of companies suitable to invest in, including a broader variety of sectors and economic stages. This has allowed us, in the past three years, to actively engage with asset managers and help support the design and launch of new sustainable strategies with complementary factor exposures to the ones we already had access to.

The addition of those strategies in our portfolios combined with an enhanced approach to risk management is making the EQ sustainable portfolios more resilient to future macroeconomic and political shocks. We are convinced that this is “the coming of age” for sustainable investing and more specifically for EQ’s ambitious sustainable portfolios.

It is worth noting that EQ’s portfolios are currently trading at a valuation discount vs traditional indices while offering higher long-term projected earnings growth. This valuation discount is a complete reversal from the 2020-21 period when EQ portfolios were trading at a material premium.

While the markets are getting increasingly worried about the concentration in traditional indices and the relative high valuation of mega cap technology companies, the EQ portfolios with a lower valuation and higher growth expectations are well positioned to generate strong returns for clients in the years to come.

Conclusion

> **In a world facing economic uncertainty, political disruption, and accelerating environmental challenges, sustainable investing has never been more vital or more promising.**

The six structural forces explored in this update, from demographic shifts to climate adaptation and AI energy demand, underscore a powerful truth: sustainability is no longer niche; it is central to the future of capital markets.

Yes, the macro environment has shifted. ESG premiums have narrowed, and political narratives have drawn attention away from long-term sustainability goals. Yet these headwinds also present an opportunity. Markets are currently under-pricing ESG risks and undervaluing the companies building resilience, efficiency, and innovation into tomorrow's economy.

EQ's sustainable portfolios are built to capture these overlooked opportunities. The portfolios are now more diversified, and more risk-aware than ever before. With valuations at compelling levels and exposure to the fastest-growing structural trends, these portfolios are positioned not only to weather volatility but to thrive beyond it.

This is the moment to lean into the future. Sustainable investing isn't just an ethical stance, it's a forward-looking investment strategy. And for those who stay the course, we believe the rewards being financial, societal, and environmental will be worth the wait.

Important information

Past performance is not a guide to the future. The value of investment and the income derived from it can go down as well as up and may get back less than you originally invested.

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