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AI Disruption

As with any hype, there has been concerns with AI valuations and the ability to deliver on these growing expectations. Earnings downgrades could be highly detrimental given the concentration of certain markets, which is why diversification is pivotal. It is reported that AI stocks now account for roughly 44% of the S&P500 market capitalisation (based on JP Morgan's top 30 AI plays). This includes Hyperscalers and cloud service providers, AI model developers, specialist AI chip manufactures, AI application developers, and then networks, storage and cooling systems.

Since the turn of the year, markets have become increasingly volatile, driven by AI disruption fears, with several sectors in the cross-hairs following the release of more sophisticated tools by the US company Anthropic. In particular, software stocks felt the brunt of it as fears grew that AI could in effect replace much of what these companies have traditionally done.

More broadly, this wave of pressure has led markets to question the impact of AI in every sector. Other sectors of note that felt the effects of this were wealth management and logistics. Buy the dip investors have largely been absent in these sell offs as well. Instead, investors are seeking companies that expose them to the picks and shovels of AI infrastructure build-out given significant spending capital expenditure plans made by the hyperscalers, and to sectors that will benefit from the application of AI rather than risk being displaced by it.

We have been analysing those stocks which are highly correlated to the AI narrative and we have been managing exposure, adding to equity exposure that has a lower correlation, such as water and waste and Emerging Markets in general.

Building out AI - Infrastructure Winners

The infrastructure build out related to AI has created a number of investment opportunities. Whilst the market has become increasingly sceptical of the expected returns from the level of investment from big tech names such as Microsoft, portfolios have benefited from the so-called picks and shovels makers who have seen a growth in demand for their products related to grid upgrades and energy demand for data centres.

> *"Picks and shovels" refers to an investment strategy of buying stocks in the suppliers, tools, or infrastructure supporting a booming industry rather than the companies producing the final, risky product. Originating from the California Gold Rush, it signifies investing in the "enablers" who profit regardless of which specific, risky venture succeeds.*

Examples companies include:

Schneider Electric provides critical data-centre infrastructure, including power, cooling, security, IT deployment, prefabricated modules, UPS systems, and monitoring software. Data centres underpin much of its Energy Management division, which drives growth and contributes roughly 25% of total revenue. Competitors like **ABB** and **Siemens** offer similar services, but data centres represent a smaller share of their revenues.

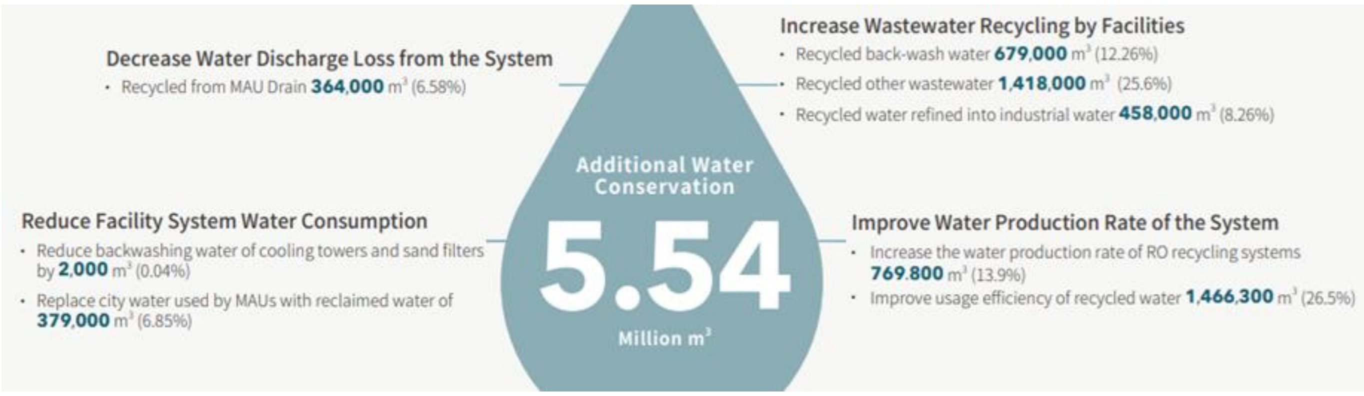
Trane Technologies supplies air-cooling systems essential for data centres, alongside broader climate products such as heat pumps and energy storage. Although more efficient chips may reduce future cooling needs—pressuring sentiment—the company has still delivered around a 130% return over the past two years.

Quanta Services focuses on energy infrastructure, including transmission lines, renewables, and grid connectivity. Rising energy demand and data-centre expansion have significantly boosted its exposure, with a record $39.2bn order backlog reported in Q3 2025 driven by the “data centre boom.”

On top of the above, semiconductors have also been flying high on AI demand, including Taiwan Semiconductor, but also name such as Nvidia and ASML. Given this growth, water scarcity is becoming an increasing ESG risk for the sector, given data centres and semiconductor fabs require continuous, high-quality water supply.

Geographic concentration (Taiwan, South Korea, parts of the US) creates single-point-of-failure risk. Semiconductor companies are highly geographically concentrated, particularity in Asia (92% of TSMC in Taiwan, 90% of SK Hynix in South Korea). This poses significant water risks for the sector, and the economy as a whole given their widespread involvement and importance. In the event of a disruption to water supplies, alternatives such as water trucks are simply impractical, given the volumes of water required.

TSMC mitigates its water risk through multiple processes to diversify its water sources. This includes water reclamation, the process of converting industrial wastewater into water that can be reused over and over again in its operations. This has allowed TSMC use over 19 million m^3 of its reclaimed water across its Semiconductor fabs in Taiwan, equating to 17% of their total water usage. Below are a few stats showing the achievements from TSMC’s water risk mitigation processes:

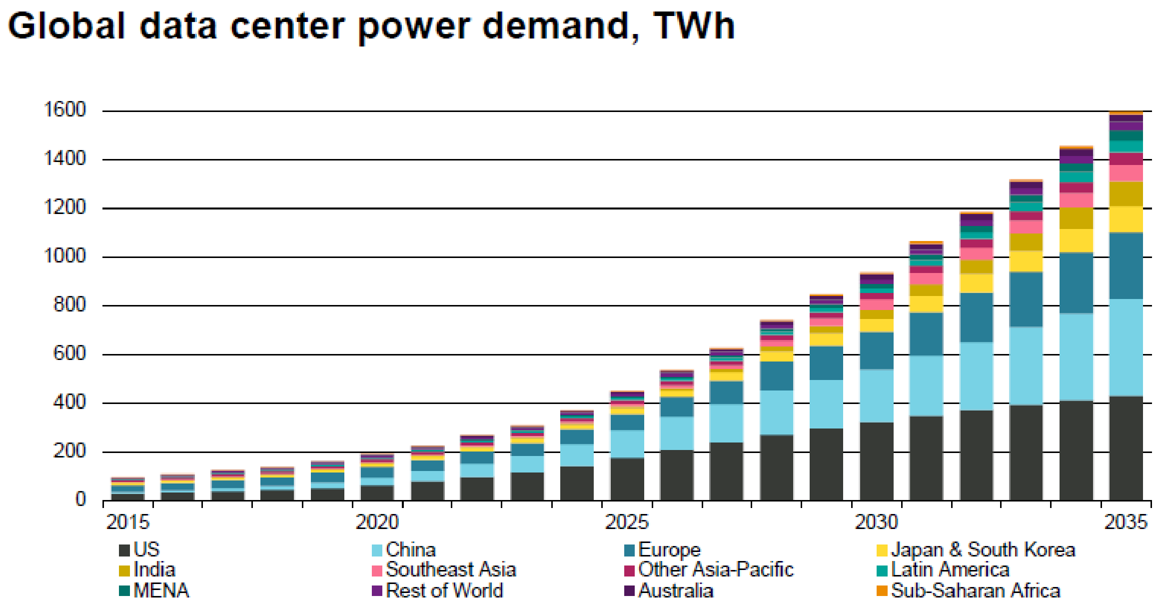


Source: TSMC https://esg.tsmc.com/file/public/2024-TSMC-Climate-and-Nature-Report-e.pdf

Power demand – renewed uptake in clean energy

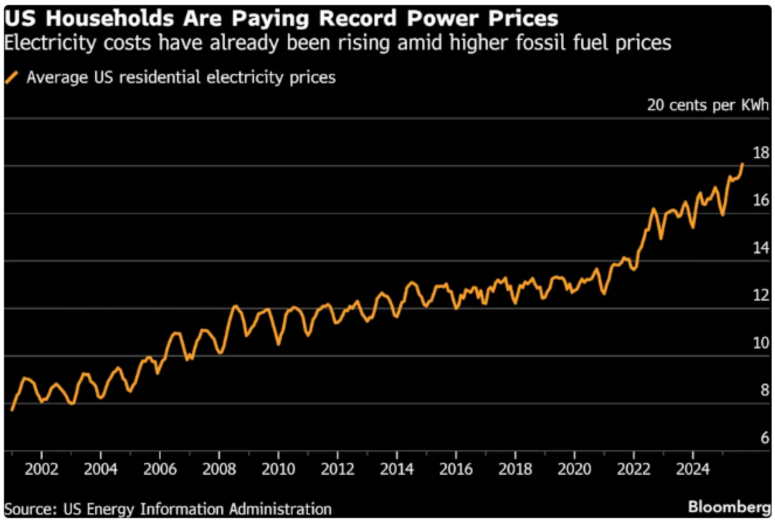
Energy efficiency has played a major role in keeping power demand subdued, but now data centres are a major force in the rising demand for electricity.

This rapid expansion has re-shaped energy systems due to the huge power demand required to feed these energy hungry operations, with datacentre energy demand growing by over 400% in the past 10 years.[1] Not only are the numbers rising dramatically, the size of the projects and their data needs are jumping as well. To put this into perspective, it's reported that a single ChatGPT query can require nearly 10x more electricity than a Google search.



Source: BNEF, "Global Data Center Power Demand Outlook 2025"; Goldman Sachs, "Reliability and the rise of Energy Storage", November 2025.

This is feeding through to higher electricity prices, which has raised policy makers concerns given the focus on energy affordability. In recent months, this has led to a number of US states to consider pausing new data centre build outs in order to consider the resiliency of the grid. One of the major concerns is the impact the datacentres have on the local environment and community, given they provide more limited benefits. Donald Trump has been vocal in a push for tech firms to pay for this rise. Whilst we are not there yet, in extreme situations, there could be energy rationing or regulation to protect energy systems, which too could impact some of the growth expectations for AI.



[1] https://about.bnef.com/insights/clean-energy/new-study-shows-sustainable-energy-technologies-met-rising-demand-growth-in-2025-despite-uncertainty/

Renewable energy has been a strong beneficiary of the AI infrastructure build out given the focus on bringing more energy sources online. Existing or repowered fossil fuel plants are able to meet near term needs, but renewable energy will meet higher demand as utilities seek sustainable long term energy sources. Renewables such as solar are able to come online in a quicker timeframe than gas turbines or nuclear power plants, with the latter taking up to ten to fifteen years to plan and commission.

Leading names such as Vestas (who manufacture Wind Turbines) and First Solar (Utility solar) have had a strong 6-12 months. The data centre operators are seeking huge amounts of energy to power their centres and there is a big focus on low carbon, so nuclear has also benefited as a result. These returns, amongst others, have helped drive the clean energy sector higher, as detailed below:

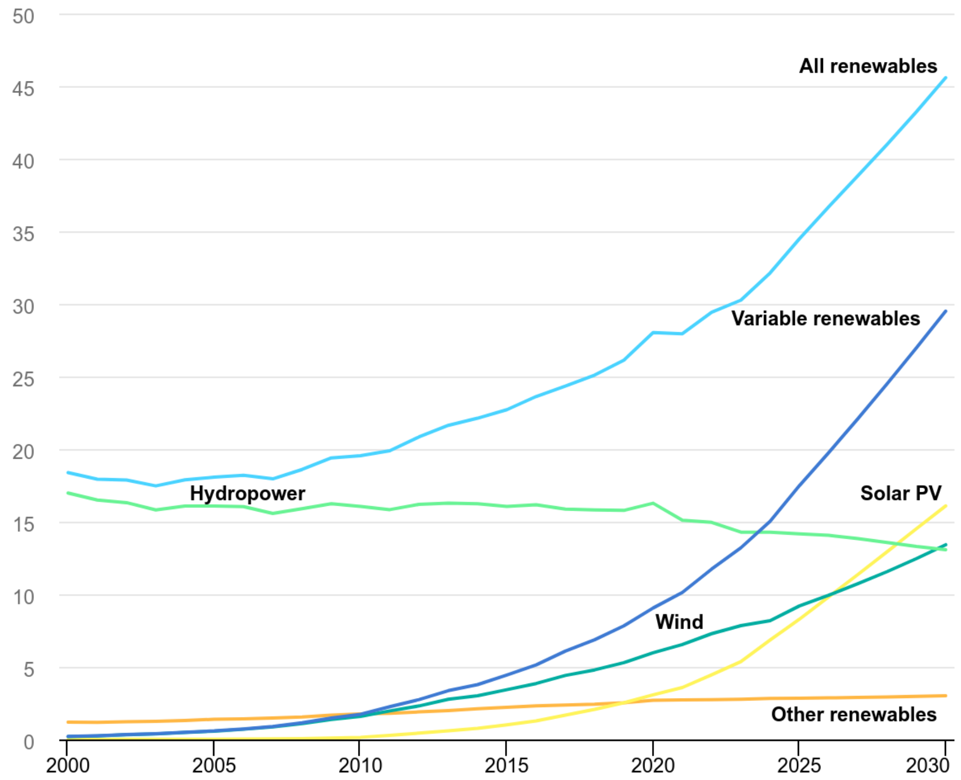
Source: FE Analytics 2025 returns for Clean Energy ETF VS MSCI World

Renewables – beyond AI

Renewable energy is expanding rapidly, with the International Energy Agency expecting capacity to more than double by 2030, significantly reducing CO_2 emissions. While AI has driven near-term electricity demand, longer-term growth is led by industry and transport electrification, reinforcing the need for grid modernisation and keeping the decarbonisation theme intact.

China is the world's largest clean-energy developer, now holding more renewable capacity than fossil fuels and accounting for around 60% of new global renewable installations. It reached its 2035 wind and solar targets five years early, though profitability has suffered due to oversupply and heavy price discounting.

This issue is most evident in solar, where Chinese overcapacity and subsidies have flooded global markets, pressuring margins for international and domestic producers. While this poses risks, portfolio exposure to solar has been limited, and from a broader climate perspective, excess Chinese capacity—particularly in solar and batteries—is helping developing countries accelerate green energy adoption.



IEA 2025; Share of renewable electricity generation by technology, 2000-2030

Staying Diversified - Water & Waste

We are able to gain exposure to water and waste through direct funds but also more general environmental focussed funds. It is a sector we increased exposure to in Q4 last year given our preference to increase defensive exposure through the likes of utilities. We identified the sector to have a low correlation to AI which was another reason for increasing exposure.

The physical element of water, waste and environmental adaptation reduces disruption and replacement risks from the growth of AI. As some sectors have been sold-off dramatically, investors have looked for so called 'HALO' stocks, these are heavy assets with low obsolescence, meaning they are unlikely to become outdated or disrupted, making them more resilient to technological or market changes. Areas such as energy, commodities, utilities and consumer staples are sectors in this, alongside many of the names within water & Waste.

Whilst the theme provides low correlations to AI, many of the companies within it are expected to benefit from the increased adoption. Monitoring, predictive analytics and real-time data flows are all important aspects of their solutions which can be optimised by AI to function alongside the physical elements.

Ecolab have developed an intelligence platform, called ECOLAB3D, which uses AI-powered predictive analytics and real-time data to support customers in optimising water usage which inherently helps businesses improve their water-usage efficiency, and therefore minimise water waste.

Staying Diversified – Emerging Markets

Since Trump's Liberation Day in April last year, flows of capital have gone out of the US and into other parts of the world as investors look to diversify. This has also seen the US dollar weaken significantly, further helping portfolio returns on a relative basis. European equities and Emerging Markets have both been beneficiaries of this, with the latter in particular benefitting from a weak US dollar, once trade policy settled down halfway through last year. Emerging markets outperformed developed markets in 2025 after more than a decade of underperformance, driven by attractive valuations and strong earnings potential alongside the currency and diversification dynamics.

Source: FE Analytics 6-month returns: Sustainable/Responsible EM funds VS MSCI World

Staying Diversified - Healthcare

The sentiment towards healthcare improved in 2025, with notable events including large pharma drug pricing agreements with the US. Policy risks do remain, as seen with the announcement of lower Medicare reimbursements and a lack of progress with US health insurance coverage from the Affordable Care Act. Healthcare returns have been more subdued in recent months, but have outperformed global equities over the last six months. There have been notable pickups in M&A activity as large companies seek to boost their product pipeline. Where ethics allow, we favour a larger focus on the defensive properties of pharmaceuticals with a partial allocation to biotech and the prospect of higher returns from drug discovery and M&A.

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