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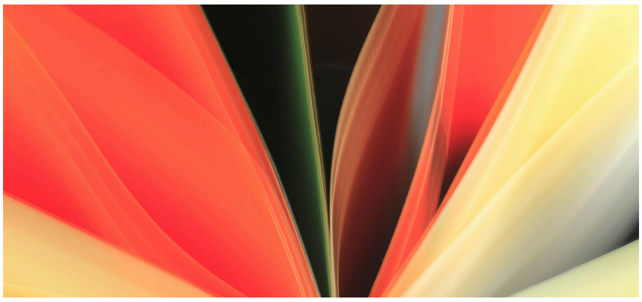
Strategic: Go sustainable

Go sustainable

Author: Sagar Khandelwal, Strategist, UBS Switzerland AG

Why? 1) Sustainable investing can deliver competitive returns and alignment with sustainability goals. 2) While the Trump administration's shift in priorities may impact parts of the SI market, there are still opportunities. 3) We favor diversification across asset classes, exposure to less-policy-sensitive areas (like ESG leader equities), and exposure to private impact investments (subject to their unique risks).



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CIO identifies a number of transformational innovations that look set to shape global equity markets in the years to come. Each is closely linked to sustainability. *Artificial intelligence*, *Power and resources*, and *Longevity*, which represent CIO's three Transformational Innovation Opportunities (TRIOs), are all themes that invest in companies addressing challenges and opportunities across varied fields like resource efficiency and food and water security to rising clean energy demand.

These topics align with the priorities driving the global sustainability transition, where investment momentum has been building. According to BloombergNEF (BNEF), global investment in the energy transition reached a new high of USD 2.1 trillion in 2024. The International Energy Agency (IEA) has reiterated that to remain on a net-zero pathway, annual clean energy investment must increase to USD 4.5tr by 2030. Financial gaps remain in other key climate areas, such as water usage. While investment in water-related technologies continues—PitchBook reports USD 196 million was raised by the water tech sector in the first quarter of 2025—the World Economic Forum (WEF) identifies a USD 7tr global investment gap, which calls for private and public investments. Data from CDP further highlight that water risks are financially material, with at least USD 77 billion of corporate value at risk in supply chains, of which nearly USD 7bn is at immediate risk.

We therefore believe the secular case for investing in a diversified sustainable portfolio approach across equities, bonds, hedge funds, and private markets remains firm.

Nevertheless, greater investor caution has arisen over questions about how the Trump administration's policies may affect sustainable investing, including the implications of rising geopolitical tensions on what sectors or industries investors regard as "sustainable." While some sustainability-related policies may be rolled back in the years ahead, we do not anticipate wholesale changes to the fundamental case for sustainable investing and continue to see attractive growth opportunities.

All major asset classes, including equities, bonds, hedge funds, and private markets, offer sustainable options, which historically have shown similar return characteristics to traditional investments, though risk characteristics differ particularly for alternatives. We believe that the longer-term performance of diversified sustainable investing strategies will be driven more by investment fundamentals and the economic environment than by politics.

In stocks, we believe investors can consider the equities of companies that are demonstrating improvements or leadership in environmental, social, and governance (ESG) principles, as well as ESG engagement strategies.

ESG leader strategies aim to be sector-neutral, meaning global performance isn't driven by sector or country tilts. This may help navigate a US political environment where the performance difference between perceived policy winners and losers widens. ESG leaders have shown resilience through less favorable policy periods in the past.

ESG leaders, as an investment screen, correlate with growth and quality equity factors. So, they typically enjoy a valuation premium compared to benchmarks. We think this is also justified by consistent empirical research that shows a positive relationship between companies' management of sustainability issues and their financial performance (Friede, et al. 2015, Whelan, et al. 2021).

ESG improvers are companies that are demonstrating positive momentum in addressing ESG risks and opportunities. They are not yet "leaders," but their performance on various ESG criteria shows signs that they could become leaders in the future. Momentum is a well-known strategy in the investment industry. It consists of buying stocks that have an upward trending price and selling those that have had poor returns in recent months, based on the tendency of the price to move in the direction of the trend.

Within engagement strategies, we believe investors should diversify into sectors beyond climate that exhibit strong economic fundamentals and have a proven ability for engagement on sustainability to drive higher profits and real-world change. While we acknowledge that this approach has faced challenges from shifting regulations and a bias toward small- and mid-cap companies that have historically suffered in times of economic and geopolitical uncertainty, we reiterate that this remains the only public market strategy with impact investing potential. As the practice broadens in the industry, investors explicitly seeking impact investing goals should remain critical of manager selection, ensuring engagement is targeted and accountable.

In fixed income, we like bonds issued by multilateral development banks (MDBs) or those with stated green intentions, as well as credit strategies with an active approach.

MDBs are supranational financial institutions backed by multiple sovereign governments, with the purpose of supporting economic, social, and environmental development, mostly in emerging countries.

They have strong fundamentals, appealing yields, and resilience to weakening in the credit quality of their member countries, so they do not trade at a credit risk premium over benchmark government bonds like US Treasuries in USD or German Bunds in EUR. They do, however, offer some extra yield over government debt given lower market liquidity for the largest institutional investors. This ranges from five to 30 basis points (bps) across the cycle, depending on the bond tenor and overall market volatility. Investors can continue to benefit from MDB bonds' stability and diversification effects in their portfolios, in our view.

In alternatives, risk-tolerant investors can consider sustainable hedge funds. Such funds incorporate ESG factors into their investment processes, aiming to exploit market inefficiencies related to ESG issues. They thus may offer differentiated investment opportunities.
And in private markets, we believe impact investments in climate technology that aim to help companies meet their decarbonization commitments reduce overall greenhouse gas emissions, and drive the overall transition to a low-carbon economy represent a significant investment opportunity.

Renewables play a critical role in decarbonization and in meeting the growing global energy demand. According to the IEA, renewables currently account for 35% of the global energy mix, a figure projected to rise to 46% by 2030. This growth is largely to be driven by improved cost efficiency, with renewables achieving cost competitiveness with fossil fuels since 2015. Globally, renewables dominate new capacity additions, while oil and gas have contributed minimally to recent growth. We think solar energy remains highly attractive due to technological advancements that have substantially reduced manufacturing costs. Additionally, the scalability of solar energy offers lower long-term costs, further enhancing its appeal.

Despite earlier concerns over tariffs on solar panel imports and the phase-out of federal tax credits, investment appetite for renewables remains robust. Surging power demand and tightening supply-demand dynamics drove a notable recovery in infrastructure deal activity in the first half of 2025, with renewables standing out as a key driver of this rebound. Policy developmentssuch as the passage of the OBBBA (One Big Beautiful Bill Act) and the US Treasury's safe harbor updatemay provide projects with greater demand visibility through the end of 2030.

Outside the US, policy support remains strong, particularly in Europe and Asia, where favorable regulations continue to drive new investments in renewable energy.

Nonetheless, private market investors need to consider risk factors like leverage, potential defaults, and concentration risks. Investing in private market vehicles also requires a tolerance for illiquidity and comes with limited disclosure and control over holdings.

For those looking to invest in climate tech, CIO sees opportunities in funds focusing on early-stage and growth-stage companies, providing the capital needed to scale their technologies and bring them to market. We believe such funds have the potential to deliver venture-like returns, while also generating measurable environmental impact.

Moreover, investors can explore co-investment opportunities, which allow them to invest alongside experienced fund managers in specific deals. This approach provides access to high-quality assets and the ability of seasoned investors, enhancing the potential for strong returns. Additionally, secondary markets offer liquidity options for investors looking to exit their positions or rebalance their portfolios.

Appendix

Non-traditional asset classes are alternative investments that include hedge funds, private equity, private credit, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. **An investment in an alternative investment fund is speculative and involves significant risks.**

Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- **Hedge Fund Risk:** There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- **Managed Futures:** There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- **Real Estate:** There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- **Private Equity:** There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- **Private Credit:** There are risks specifically associated with investing in private credit. This could include losses stemming from defaults on loans, which in significant adverse circumstances could result in a substantial loss of investment.
- **Foreign Exchange/Currency Risk:** Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

Global asset class preferences definitions
The asset class preferences provide high-level guidance to make investment decisions. The preferences reflect the collective judgement of the members of the House View meeting, primarily based on assessments of expected total returns on liquid, commonly known stock indexes, House View scenarios, and analyst convictions over the next 12 months. Note that the tactical asset allocation (TAA) positioning of our different investment strategies may differ from these views due to factors including portfolio construction, concentration, and borrowing constraints.
Most attractive – We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Attractive – We consider this asset class to be attractive. Consider opportunities in this asset class.
Neutral – We do not expect outsized returns or losses. Hold longer-term exposure.
Unattractive – We consider this asset class to be unattractive. Consider alternative opportunities.
Least attractive – We consider this asset class to be among the least attractive. Seek more favorable alternative opportunities.

Appendix

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