Strategic: Invest in transformational innovation

Invest in transformational innovation

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- **Why?** 1) Innovation remains a key driver of long-term equity performance and an important feature of enduring market leaders. 2) Structural shifts in AI, energy infrastructure, and health care are expanding global profit pools and reshaping industries. 3) We expect our TRIO themes to offer durable, structural growth that we believe can persist well beyond short-term market volatility.

Diversified exposure to AI, power and resources, and longevity can capture structural growth while reducing reliance on a narrow group of market leaders. Source: Anna Evans_Unsplash

Historically, the stock market has mirrored transformational structural changes. In the US, the Dow Jones Industrial Average has been variously dominated by steel, automobile, internet, and pharma companies as technological innovations have blossomed. Our analysis also shows that between 1990 and 2020, just 2.4% of US companies and 1.4% of non-US firms account for 100% of stock market returns.

Picking the right themes and the right companies at the forefront of those themes is therefore crucial for long-term equity returns. So, we identify three enduring market drivers, exposure to which should be investors' first task when building long-term stock allocations as part of a well-diversified portfolio.

These Transformational Innovation Opportunities (TRIOs) are *AI*, *Power and resources*, and *Longevity*.

AI

The AI rally is in its fourth year, but the narrative is evolving. We project the total AI addressable market to reach USD 3.1tr by 2030, growing at a 30% CAGR from 2026. The sharp rise then rebound in many semiconductor companies and other AI-linked parts of the market this year has heightened the risk of single-stock concentration.

Looking ahead, we expect AI capex to rise further, with supply bottlenecks in key segments requiring significant time and investment to resolve. While higher spending and strong earnings are a tailwind, any reversal in this momentum could quickly shift investor attention back to monetization.

While we acknowledge the recent, high-profile, and coordinated calls to pace AI development on safety concerns, we would caution against equating stronger safeguards with an end to the AI capex cycle: First, AI compute demand stems from both training models and running them, a process known as inference, with the latter estimated to account for roughly two-thirds of demand. Importantly, inference demand is driven primarily by real-world adoption and monetization, in our view, with the practical challenges of integrating AI into existing enterprise operations a greater constraint than current model capabilities. Training demand, by contrast, is more directly tied to the costs and expected returns of developing more capable models. We retain our 2027 AI industry capex forecast of USD 1.2tr, a rise of 33% from our estimate of USD 900bn this year.

We think the value-creation story is broadening beyond US technology, with opportunities emerging across the enabling (semiconductors, cloud), intelligence (software, algorithms), and application layers. Within semis and hardware, our top three areas of focus are currently semiconductor capital equipment, foundries, and compute names, particularly CPU-related.

Power and resources

The intersection of AI-driven demand, energy market disruption, and geopolitical risk is sharpening the focus on energy security and infrastructure resilience. Elevated energy prices reinforce the importance of resolving grid bottlenecks and accessing essential materials. We expect capital allocation to remain directed toward power, grid, and critical resources, with the current investment cycle shaped by structural growth drivers and tactical risk mitigation considerations.

Ballooning data center demand is continuing to accelerate investment in power and grid infrastructure, with global grid investment projected at USD 500bn in 2026 and annual sector investment reaching USD 3tr by 2030. Opportunities span grid resilience, renewables, nuclear, industrial automation, and critical minerals, with companies at the core of this transition reporting record order backlogs and robust demand.

While we note that in recent weeks the Power and resources theme has suffered due to seasonality, a dearth of large positive corporate announcements, and rising interest rate expectations that weighed on valuations of growth categories and yield-oriented utilities, we believe the momentum unwind has caused far too punitive a valuation derating. With a brightening catalyst calendar, including the removal of the US midterm election overhang, and the high probability of robust third-quarter results, we note that company dialogue continues to indicate resilient demand for electrical equipment and power supply.

Major utilities are now putting numbers around the load: signed agreements of 188GW in the US at the end of the second quarter and a pipeline in discussion of 350GW (albeit with double counting likely). Grid, storage and dispatchable-generation spending remain essential as interconnection delays and equipment lead times constrain delivery. The conflict in the Middle East is likely to spur significant investment in energy security over the medium term. And above all, scarcity of much-needed electricity supply persists.

We therefore like companies with scarce capacity, credible backlogs and pricing power. Leading manufacturing indicators also point toward a second-half cyclical recovery, increasingly corroborated by management teams. With relative valuations having reset while the demand runway has lengthened, we view recent volatility as an opportunity for clients to lean into a long-duration theme focused on the indispensable physical architecture of an increasingly electrified economy.

Longevity
While ongoing geopolitical uncertainty in the Middle East has weighed on investor sentiment in more economically sensitive sectors, health care companies' revenues tend to be less affected by these developments. We think that the diversified supply chains and strict cost controls of health care companies should allow them to protect profit margins, even in adverse scenarios where energy prices remain high. In aggregate, we estimate annual revenues in the global longevity market could reach USD 8tr by 2030, up from USD 5.3tr in 2023.

We are constructive on the long-term outlook for obesity treatments as greater supply and lower pricing are enabling broader patient access. For global obesity drugs (GLP-1s), we forecast 12% revenue growth per year on average through 2030, driven by rapid adoption, potential clinical benefits stretching beyond weight-loss treatment, expanding insurance coverage, and potential launches of oral GLP-1s.

Multiple late-stage trial results in cancer, cardio-metabolic conditions, and neurology in the coming months could also provide further catalysts. And while we think the broader medical device sector is experiencing some end-market deceleration, we think medical device shares and valuations have broadly overreacted in recent months. That said, a broader reacceleration will likely take well into 2027, leaving the sector without a near-term catalyst.

How the TRIOs can complement a diversified portfolio
Structurally, we think the Longevity market is set to expand from USD 5.3tr in 2023 to USD 8.0tr by 2030. In our view, the current period stands out for its concentration of clinical milestones and regulatory events, offering potential for outsized returns in select segments. We expect 2026 to be a catalyst-rich year, with multiple late-stage pipeline readouts in obesity, oncology, and medical devices, and potentially more strategic M&A as large-cap pharma companies seek to expand their pipelines. While the risk of AI-driven disruption is present, we believe that the threat to core health care activities remains manageable and that biopharma and medtech are positioned to benefit from productivity gains.

Investors seeking exposure to CIO's Transformational Innovation Opportunities may consider a range of approaches, including portfolios reflecting CIO's thematic selections. Depending on the structure, these approaches may involve periodic rebalancing, changes to constituent holdings and the management of foreign-exchange exposure. They may also differ in terms of costs, liquidity, complexity and risk.

For investors already exposed to the "AI" and "Power and resources" themes, the "Longevity" theme may provide a source of diversification. Historical correlations between the Longevity selection and the AI and Power and resources selections have generally been low or negative relative to global equities. However, past correlations may not persist and should not be regarded as a reliable indicator of future performance.

Other possible implementation approaches include holding individual securities, investment funds or other diversified vehicles with exposure to companies associated with these themes. Structured strategies, thematic private equity and private infrastructure may also provide exposure to selected aspects of the themes, but involve additional risks. These may include market risk, concentration risk, leverage, complexity, valuation uncertainty and, in private markets, limited liquidity and long investment horizons.

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 and commonly known indices, House View scenarios, and analyst convictions over the next 12 months.
Absolute view
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.
Note: For equities, we have a five-tier rating system with two additional preferences. When equities are included with the other asset classes in the three-tier rating system, we collapse "Most Attractive" with "Attractive" and "Least Attractive" with "Unattractive."
Most Attractive: We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Least Attractive: We consider this asset class to be among the least attractive. Seek more favorable alternatives opportunities.
Relative preferences
For the multi asset view, we also include relative preferences to help investors compare between items.
Preferred: We view this item more favorably than others within its asset class.*
Neutral: We see this item similarly to others within its asset class.*
Least preferred: We view this item less favorably than others within its asset class.*
*In the case of cross-asset, compared to other asset classes.
Note: 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.

Appendix

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