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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.



Diversifying across the AI value chain can help investors capture growth opportunities while managing concentration and execution risks. 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 accounted 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

Three features distinguish this new wave of generative AI from past versions: Its ability to generate diverse human-like content; the scale of data inputs, model parameters, and compute; and its adaptive learning.

We expect resilient growth to continue and have raised our AI capex forecasts to USD 900bn for 2026 (+84% y/y) and USD 1.2tr for 2027 (+33% y/y); this reflects broad-based cost inflation across the AI server supply chain in recent months. The strong capex outlook for 2026 and 2027 reinforces our constructive view of semiconductor and hardware demand. Against this backdrop, we expect growth in AI infrastructure spending to normalize in 2028.

There are three layers in the AI value chain: It starts with the enabling layer, which powers the intelligence layer, which in turn feeds the application layer. The enabling layer is the physical layer of data center infrastructure and compute that is necessary to train and run generative AI models. The intelligence and application layers are both software layers and refer to the data and algorithms that are used to build models for applications such as generating a piece of text on a particular subject area. Our AI portfolio identifies beneficiaries in those three layers and across sectors and regions.

We are in the fourth year of the AI rally, and we continue to see long-term potential gains in the structural theme. Looking ahead, incremental AI capex alone may not be sufficient; investors will likely focus more on monetization. While the theme's initial gains so far have been led by semiconductors due to their dominant presence in the enabling layer, we see appealing opportunities ahead, including beneficiaries in other sectors and regions as the AI investment opportunity broadens.

AI-related growth should drive overall S&P 500 earnings growth of 28%. But increasingly concentrated market performance and the potential for stock-specific volatility reinforce the importance of portfolio resilience. We see ways investors can further diversify their sources of return and strengthen portfolio defenses. This includes structured

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strategies that can tailor equity exposure to different market outcomes.

Investors concerned about an AI-led correction but keen to retain equity exposure can consider put warrants, which may help limit losses on stocks they already own. For those looking to add AI exposure cautiously, capital preservation strategies can provide participation in a market recovery while seeking to protect some or all of the initial investment at maturity. Income-seeking investors may consider reverse convertibles in parts of the AI value chain where implied volatility remains elevated. These strategies can be tailored to investors' outlook, objectives, and risk appetite, but they carry risks including issuer default, limited liquidity, and potential capital losses.

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.

We remain confident about the prospects for power and resources stocks at this juncture, supported by the robust pipeline of electrical infrastructure investment and rising evidence of a nascent cyclical recovery. While recent market rotation has reduced valuations across our universe, our primary research suggests earning power continues to accelerate, providing a very attractive risk-adjusted expected return, in our view.

After recent portfolio changes, the power and resources strategy has 43% exposure to equipment/solutions, 32% to utilities, 12% to facilitators, and 13% to raw materials. By region, the strategy has 52% exposure in North America, 33% in Europe/the UK, and 15% in Asia Pacific, though revenue exposure is very geographically diverse.

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 re-acceleration will likely take until 2027, leaving the sector without a near-term catalyst.

Our longevity portfolio theme is currently dominated by the health care sector, with the companies we expect to drive the longevity curve inflection carrying the largest weights. Medical device companies that both enable greater lifespan and benefit from growth in the elderly demographic also feature in our selection. We have identified consumer, real estate, and financial companies that already have a significant exposure to the theme, while others might be added over time as they will benefit from growth in the elderly demographic through 2030 and beyond.

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&As 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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