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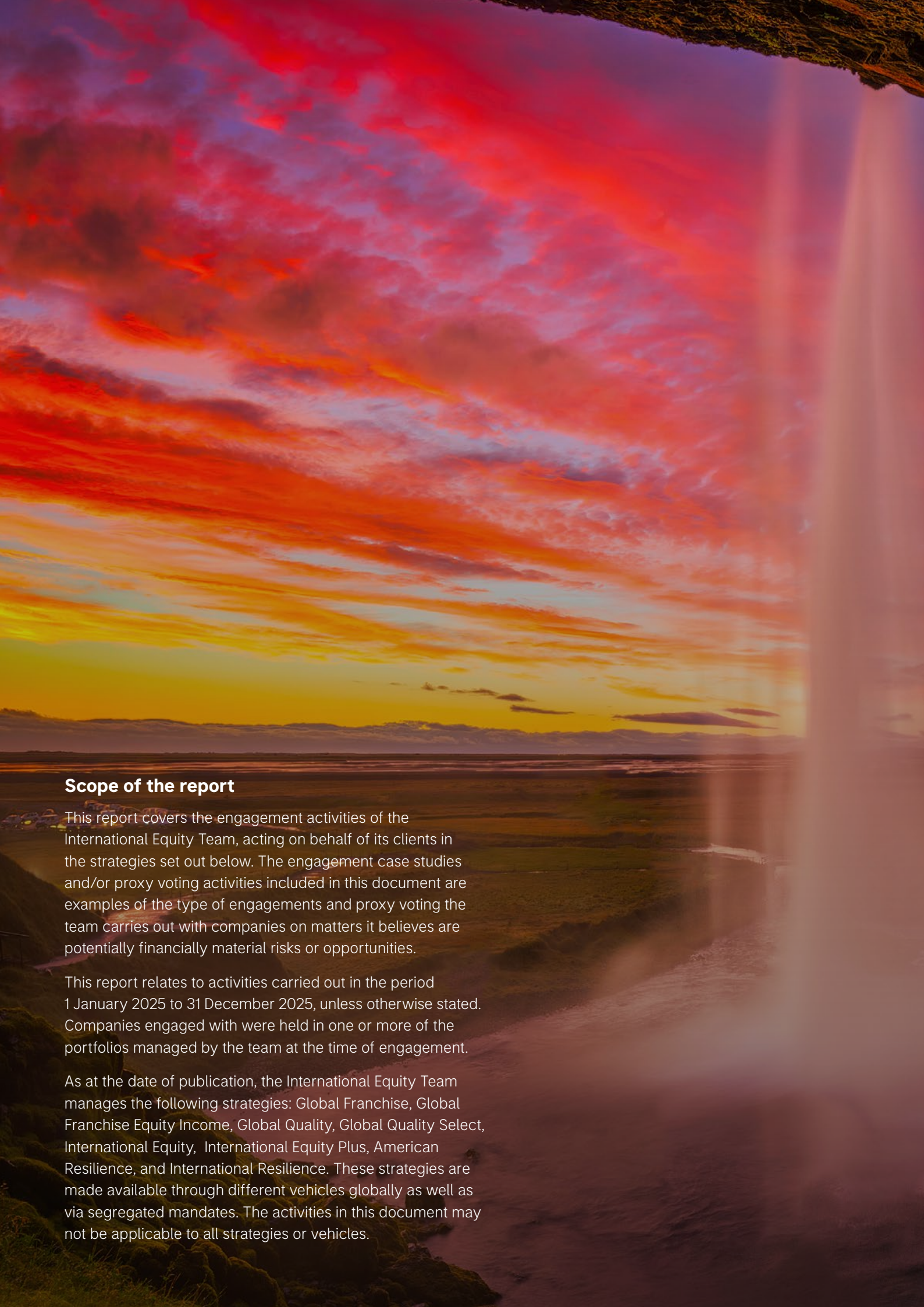
INVESTMENT MANAGEMENT

# Engage

ENGAGEMENT REPORT | SPRING 2026

INTERNATIONAL EQUITY TEAM





## Scope of the report

This report covers the engagement activities of the International Equity Team, acting on behalf of its clients in the strategies set out below. The engagement case studies and/or proxy voting activities included in this document are examples of the type of engagements and proxy voting the team carries out with companies on matters it believes are potentially financially material risks or opportunities.

This report relates to activities carried out in the period 1 January 2025 to 31 December 2025, unless otherwise stated. Companies engaged with were held in one or more of the portfolios managed by the team at the time of engagement.

As at the date of publication, the International Equity Team manages the following strategies: Global Franchise, Global Franchise Equity Income, Global Quality, Global Quality Select, International Equity, International Equity Plus, American Resilience, and International Resilience. These strategies are made available through different vehicles globally as well as via segregated mandates. The activities in this document may not be applicable to all strategies or vehicles.

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International  
Equity Team

# Sixty second snapshot

## **Operational resilience and supply chain risk**

In this piece we report on our engagement with a leading multinational beverage corporation we hold — including a site visit to the company's largest franchise bottler's Jundiaí facility in São Paulo, as well as follow-up discussions with the beverage company's sustainability team — to assess how potentially financially material operational risks such as water availability, packaging, and climate resilience are being managed following the company's December 2024 revision of several sustainability targets.

## **Physical climate risks: terroir-dependent risks and opportunities**

Physical climate risks — such as shifting temperature patterns, water scarcity, and soil degradation — are emerging as potentially financially material considerations for global beverage producers. These risks are particularly pronounced for companies whose products depend on specific growing conditions, or terroir, where subtle environmental changes can affect quality, yields, and brand integrity. While regulatory and transition risks often dominate climate discussions, in this piece we cover our engagements with two alcoholic beverage companies, which focused on how physical climate impacts could manifest across time horizons and how the companies are positioning themselves to mitigate these effects.

## **Cybersecurity: bending, not breaking**

Given the increasing risk and relevance of cybersecurity for companies within our portfolios, and the potentially financially material consequences of a cyberattack, we conducted a thematic engagement programme to better understand how companies are managing the risk. Including a case study of a company demonstrating mature cyber governance, this piece covers eight key takeaways from the thematic engagement programme.

## **Supply chain resilience in the semiconductor sector**

The semiconductor value chain remains one of the world's most complex and globally interdependent manufacturing ecosystems. Recent geopolitical tensions, export controls, energy constraints, and post-pandemic logistics shocks have reinforced the need for robust, regionally diversified, and technologically resilient supply chains. Against this backdrop, we engaged with three semiconductor companies we hold in our portfolios to assess how leading companies are navigating these pressures. In this piece we look at how their strategies highlight a spectrum of approaches, from parallel production capacity and multi-sourcing to strategic partnerships, regional clustering, and selective technological substitution.

## **Responsible AI: transparency, governance and business-model resilience**

Artificial intelligence (AI) is reshaping business models across sectors, from Health Care and Financial Services to digital content and entertainment. While AI may bring meaningful opportunities to improve efficiency, product innovation and customer experience, it also raises questions around transparency, data governance, regulatory compliance and long-term value protection, all of which could pose potentially financially material risks to companies. In this piece we outline our engagements with companies, which illustrate how responsible AI considerations vary across sectors - and why robust oversight, disclosure and long-term planning are becoming increasingly important.

## **Product safety in personal care**

Given rising consumer scrutiny of cosmetic ingredients and a litigious U.S. environment, in 2025 we held multiple engagements with a multinational personal care company we own, meeting with Investor Relations team, Chief Sustainability Officer, and CEO to discuss product safety, ingredient innovation, and transparency. The company continues to face product safety litigation in the U.S. and broader questions from consumers and NGOs around ingredient safety, which we believe may pose a potentially financially material risk. In this piece we look at how the company is managing these risks.

AUTHOR



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# ESG in 2025: divergence, supply chains, and AI

In our previous outlook, we described an ESG landscape defined by divergence, a sharper focus on supply chains, and artificial intelligence (AI) emerging as a material ESG issue. Those themes not only persisted through 2025 but intensified as ESG became less about signalling ambition and more about navigating trade-offs in a shifting policy, geopolitical and physical environment.

## **Regulatory fragmentation as a structural feature**

Our assessment that global ESG approaches would fragment rather than converge proved prescient.

In the United States, the policy backdrop favoured corporate autonomy and economic competitiveness, with heightened scrutiny of stewardship and shareholder engagement. During proxy season, environmental and social shareholder proposals remained numerous, but investor support waned, reinforcing a declining appetite for proposals perceived as prescriptive or weakly linked to financial outcomes<sup>1</sup>. SEC<sup>2</sup> changes to the interpretation of what constitutes “influence” in engagement, alongside increased scrutiny on the proxy advisory ecosystem itself, contributed towards the evolution in the stewardship environment. At the same time, while corporate transition commitments largely remained, there were signs of reduced momentum, with U.S. renewable investment lagging other regions, and a notable decline in utility-scale solar and onshore wind financing compared with the previous year<sup>3</sup>.

Europe’s trajectory differed but was no less complex. 2025 was the first year of annual sustainability reporting under the Corporate Sustainability Reporting Directive (CSRD). Early surveys suggested companies broadly viewed the framework positively, with 89% agreeing the rules strengthened ESG strategy and risk assessment and some companies voluntarily reporting<sup>4</sup>. 2025 was also a year of recalibration. The European

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<sup>1</sup> Source: <https://www.morningstar.com/sustainable-investing/amid-new-curbs-esg-shareholder-resolutions-companies-may-lose-useful-signals-investors>

<sup>2</sup> U.S. Securities and Exchange Commission.

<sup>3</sup> BloombergNEF: Record Renewable Energy Investment in 2025 — Three Things to Know. Record Renewable Energy Investment in 2025: Three Things to Know — BloombergNEF.

<sup>4</sup> PWC ‘In search of sustainable value: The CSRD journey begins, April 2025. Source: [https://www.pwc.com/gx/en/issues/esg/sustainability-csrd-first-reporters-study.html?utm\\_source=chatgpt.com](https://www.pwc.com/gx/en/issues/esg/sustainability-csrd-first-reporters-study.html?utm_source=chatgpt.com)



“In 2025, ESG became more fragmented, more operationally complex and more tightly linked to real-world constraints.”

Commission's "Omnibus" agenda<sup>5</sup> sought to streamline requirements amid concerns that regulatory complexity could weigh on competitiveness, including proposals to cut two thirds of the datapoints in the European Sustainability Reporting Standards.<sup>6</sup>

Across Asia, progress was incremental but consistent. Japan stood out, with steady improvements in governance standards, capital efficiency and board oversight of sustainability risks. Elsewhere in the region, regulators prioritised pragmatic disclosure requirements aligned with global standards such as ISSB<sup>7</sup>, rather than more prescriptive rules such as mandatory human rights due diligence.

## Geopolitics and the reshaping of supply chains

2025 demonstrated that geopolitics can define the operational reality for companies. Tariffs, export controls, and import bans become mainstream industrial policy tools. It was a strong reminder of the value of supply-chain management and due diligence to commercial resilience. Where COVID was a shock, last year's geopolitical realignment appeared structural, posing a challenge for many companies reliant on complex supply chains and/or dependent on key geographies for critical supplies.

Key inputs into electrification and AI were particularly exposed. Trade measures targeting rare earths, battery components, and energy commodities exposed the fragility of globalised supply chains. Companies with concentrated sourcing or limited traceability faced not only reputational risk but real financial consequences:

disrupted market access, stranded inventory, and rising costs.

Geopolitics also shifted the ESG views on defence as Europe implemented policy action in the face of heightened security concerns. Measures were introduced to facilitate capital flows into defence, including initiatives to classify certain activities as compatible with sustainable finance frameworks. Investors followed suit, with many revising exclusion policies to enable investment in defence-related technologies. Geopolitical risk was not just a backdrop to the year, but a driver of capital allocation.

## Artificial intelligence and ESG

In 2025 AI emerged as a fully-fledged ESG issue.

Having come into force in 2024 the EU's Artificial Intelligence Act moved into the implementation stage. Key provisions – including prohibitions on "unacceptable risk" uses of AI and new risk management requirements – came into effect, supported by new enforcement structures<sup>8</sup>. Regulatory developments were accompanied by litigation and compliance challenges, with lawsuits and enforcement actions on algorithmic bias, privacy violations, copyright and intellectual property infringement, and discrimination<sup>9</sup>. Although still early days, it is becoming clear that governance failures may pose real legal and financial risks for companies.

Attention also turned to what the International Energy Agency (IEA) termed the new "age of electricity," as the rapid expansion of data centres brought concerns around grid capacity, permitting, pricing and reliability

<sup>5</sup> Omnibus I modifies the Corporate Sustainability Reporting Directive (CSRD), Corporate Sustainability Due Diligence Directive (CSDDD), EU Taxonomy, and Carbon Border Adjustment Mechanism (CBAM). It was largely finalised in December 2025. There are also other Omnibus packages, including Omnibus IV which seeks to modify rules on circular economy, industrial emissions and permitting and Digital Omnibus which sought to streamline rules on AI, data access and cyber security.

<sup>6</sup> In December 2025 the European Financial Reporting Advisory Group (EFRAG) recommended that the European Sustainability Reporting Standards be streamlined, cutting as much as two thirds of data points.

<sup>7</sup> The International Financial Reporting Standards Foundation's (IFRS) International Sustainability Standards Board (ISSB), whose two inaugural standards around climate-related disclosures and general ESG disclosure came into effect in January 2024.

<sup>8</sup> The establishment of an EU AI Office and coordinating AI Board to support consistent enforcement across member states.

<sup>9</sup> Source: <https://copyrightalliance.org/ai-copyright-lawsuit-developments-2025/>; <https://www.wilmerhale.com/en/insights/blogs/wilmerhale-privacy-and-cybersecurity-law/20260202-year-in-review-2025-artificial-intelligence-privacy-litigation-trends>

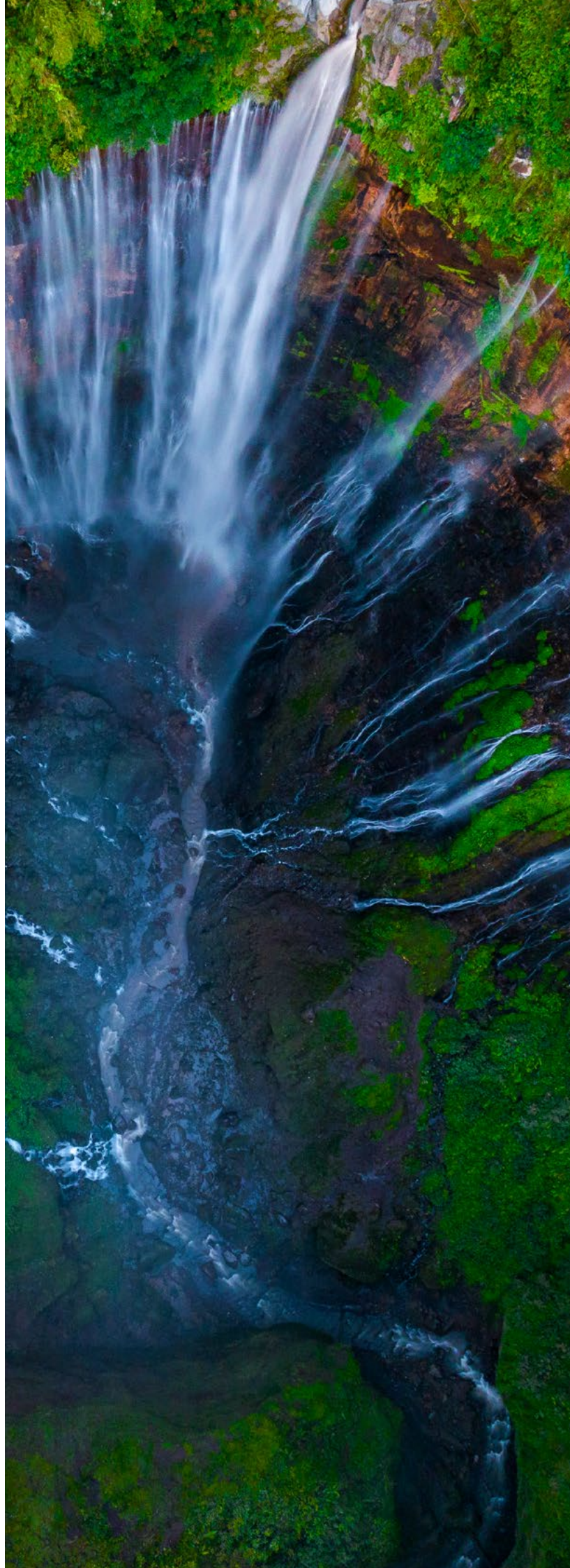
to the fore. Access to reliable and affordable electricity emerged as a material strategic issue. In the United States, local opposition emerged as a material constraint. Northern Virginia’s “Data Center Alley” saw multiple projects delayed or blocked amid concerns over electricity demand, water use and community impact, with reports suggesting more than \$60 billion in planned investment facing uncertainty.<sup>10</sup> By contrast, projects that engaged early with utilities and communities were more successful, demonstrating that energy strategy and stakeholder management are increasingly material to project viability.

## Conclusion

If 2024 was about anticipating complexity, 2025 was about operating within it. ESG became more fragmented, more operationally complex and more tightly linked to real-world constraints—from energy systems and supply chains to geopolitics. For long-term investors, the challenge was not whether ESG mattered, but how to navigate a landscape where sustainability, resilience and competitiveness are increasingly inseparable.

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<sup>10</sup> Source: <https://www.datacenterwatch.org/report>



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# Operational resilience and supply chain risk

In the latter half of 2025, we engaged with a leading multinational beverage corporation we hold — including a site visit to the company’s largest franchise bottler’s Jundiaí facility in São Paulo and follow-up discussions with the beverage company’s sustainability team — to assess how potentially financially material operational risks such as water availability, packaging, and climate resilience are being managed following the company’s December 2024 revision of several sustainability targets.





Having identified sugar as a significant potentially financially material risk for the beverage company, we began our engagement with the company on that subject, discussing product-mix and regulatory exposure. Full-sugar beverages still dominate global volume, keeping the company structurally exposed to sugar-sweetened beverage taxes. It aims to mitigate this through portfolio diversification, expansion of low- and no-calorie options, and policy engagement that emphasises nutrient-based taxation frameworks. We encouraged greater transparency on the company's public-policy activity given the financial materiality of these issues.



Moving on to potentially financially material operational risks, although the beverage company has largely exited direct bottling, it has not outsourced the underlying operational exposures. While the bottlers manufacture, package and distribute the company's finished beverages, issues at this level — whether water scarcity, rPET<sup>11</sup> cost pressures, climate-related disruptions or digital-security failures — could have direct implications for its supply chain, margins and reputation.

During our on-site engagement with the beverage company's largest bottler by sales volume, water availability was repeatedly cited as the most material operational challenge, reflecting increasingly volatile rainfall patterns and the importance of maintaining community access, particularly in Mexico where notable reforms to water regulation are underway. This remains financially relevant for the beverage company: water scarcity or loss of local licence to operate could constrain output or trigger regulatory pressure. Although the beverage company has withdrawn its system-wide water-efficiency target, the bottling company continues to prioritise efficiency, achieving a leading Water Use Ratio (WUR) in the system. We were encouraged to see water efficiency embedded deeply in the culture at Jundiaí, with a clear focus on minimising use throughout operations. The bottling company is the leader on water efficiency within the beverage company's system, and this was evident during our visit. During our engagement with the beverage company, we requested a clearer quantification of "water cost" across operations and the agricultural supply chain, which during our in-person engagement we learned represents over 75% of the company's total water footprint.

Packaging costs are another pressure point. We discussed with the beverage company its decision to soften its 2024 plastic related targets, which the company attributed to rising costs and insufficient recycling and collection infrastructure across key markets. Our site visit and engagement with the bottling company provided useful corroboration.

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<sup>11</sup> Recycled polyethylene terephthalate.



The bottling company emphasised that rPET availability and pricing have become increasingly stretched due to escalating competition for material from sectors such as fashion, alongside a growing number of collectors. rPET can be as much as 50% more expensive than virgin plastic, creating a significant cost trade-off for bottlers. While it is focusing on improving recycling and collection infrastructure to secure more favourable pricing from suppliers, system-wide progress remains uneven.

Physical climate risks are already financially visible. In 2024, severe flooding in Brazil shut down one of the bottling company's facilities, removing around 10% of national capacity for an extended period of time and requiring over US\$150m in reconstruction and resilience investments<sup>12</sup>. This illustrates a broader challenge for the beverage company's system: climate related disruptions can quickly translate into meaningful financial impacts. For the beverage company itself, prolonged disruption at concentrate manufacturing facilities would represent a significant risk. For bottlers, building climate resilience requires meaningful near term investment.

While the beverage company maintains close collaboration with its partners, the decentralised nature of the system means risk exposure is uneven. Direct engagement with bottlers therefore provides a necessary complement to its own disclosures. Our engagement with the bottling company reinforced the view that water, plastic and physical climate risk remain potentially financially material issues for the beverage company's system. The bottling company is taking tangible steps to address these challenges, from embedding water stewardship across operations, to strengthening plastic collection systems, to investing in climate resilient infrastructure. As investors in the beverage company, the engagement provided greater confidence that the company is taking appropriate steps to build a more resilient system by tackling these ESG risks.

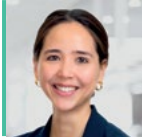
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<sup>12</sup> Source: <https://mexicobusinessdaily.com/stories/coca-cola-femsa-reopens-porto-alegre-plant-post-flood-recovery/>

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# Physical climate risks: terroir-dependent risks and opportunities

Physical climate risks — such as shifting temperature patterns, water scarcity, and soil degradation — are emerging as potentially financially material considerations for global beverage producers. These risks are particularly pronounced for companies whose products depend on specific growing conditions, or terroir, where subtle environmental changes can affect quality, yields, and brand integrity.



While regulatory and transition risks often dominate ESG discussions, our recent engagements have focused on how physical climate impacts could manifest across time horizons and how companies are positioning themselves to mitigate these effects.

### **Regenerative agriculture as a core adaptation strategy**

We met with a French wine and spirits company's Chief Sustainability Officer (CSO) and investor relations team to discuss the company's assessment of physical climate risks and their potential impact on its terroir-dependent product portfolio, notably cognac. The company's scenario modelling covers both 1.5°C and 4°C warming pathways, projecting climate-related cost increases through 2030, 2040, and 2050. Under the most severe scenario—representing a case of inaction—the company has modelled yield declines of up to 47% by 2040, underscoring the sensitivity of cognac production to temperature variability.





“For companies whose products depend on specific growing conditions, or terroir, subtle environmental changes can affect quality, yields, and brand integrity.”

Since 2016, the company has pursued adaptation strategies centred on regenerative agriculture, aiming to preserve soil health and enhance resilience without compromising product quality. As stated in the company's annual report, and flagged again during our engagement, all cognac vineyards now operate under regenerative practices, and the company is also experimenting with new grape varieties designed to withstand changing climatic conditions while maintaining flavour integrity. Similar pilot initiatives are underway in agave cultivation, first tested on company-owned land and gradually extended to suppliers.

While the company recognises regenerative agriculture as the most viable long-term strategy, it also acknowledges its limitations, ranging from cultural and operational challenges to uncertain payback periods. On a short-term horizon (3-5 years), we believe it appears well-positioned to deepen its resilience efforts. Over a longer timeframe (10-20 years), however, we question whether resource allocation will be sufficient to safeguard both product quality and brand equity as climate impacts intensify.

This engagement contributed to our determination that physical climate risks are a long-tail risk for this company. In terms of the immediate future however, it did not lead to a change in the investment case.

### **Early-stage efforts to map and quantify physical risks**

Our engagement with an Italian spirits company focused on understanding how physical climate change risks may affect its portfolio of terroir-dependent raw materials, including grapes, agave, barley, and sugarcane, and how these dynamics could influence brand equity, sourcing strategies, and product quality.

The company acknowledged that it remains in the early stages of assessing physical climate risks. The company has only recently begun mapping key agricultural inputs and conducting qualitative supplier assessments on water and biodiversity. However, it has not yet completed a comprehensive group-wide scenario analysis or quantified potential revenue impacts stemming from climate-related supply disruptions. While a due diligence process is underway, including human rights compliance reviews via Sedex,<sup>13</sup> the spirits company has not yet disclosed the percentage of sales potentially at risk from climate impacts on raw material supply chains.

We encouraged the company to accelerate its climate scenario analysis and to enhance disclosures regarding input cost exposure, sourcing flexibility, and long-term quality implications. Although flagship brands appear relatively resilient at present, we believe that a more systematic understanding of physical climate risks will be essential to sustaining brand value and investor confidence over the long term. While this engagement had no direct impact on the investment thesis at this stage, follow-up engagement will focus on tracking progress in this area.

### **Summary**

Both drinks companies are exposed to the physical effects of climate change through their reliance on terroir-sensitive crops. The French wine and spirits company has adopted a proactive and technically informed approach through regenerative agriculture, while the Italian spirits company is still building its analytical foundation. We will continue our engagements with a focus on how each company translates climate awareness into measurable risk management outcomes, balancing the costs of adaptation against the imperative to preserve brand quality and long-term competitiveness.

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<sup>13</sup> A global technology company that supplies data and analysis on supply chains.

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# Cybersecurity: bending, not breaking

Given the increasing risk and relevance of cybersecurity for companies within our portfolios, and the potentially financially material consequences of a cyberattack, we conducted a thematic engagement programme to better understand how companies are managing the risk.

Data security and privacy is a commonly identified risk when completing material risk indicators (MRIs) for our companies, especially the data rich compounders across Financials (Payments, Exchanges, Insurance Brokers and Rating Agencies), Industrials (Professional Publishers and Credit Bureaux) and Software.

The risk is increasing as the severity and frequency of cyberattacks are on the rise. An American consumer credit company we hold reported responding to more than 15 million cyber threats in 2024 – that’s nearly 175 hostile attempts every second and a 25% increase from 2023<sup>14</sup>. Meanwhile in the UK alone, a spate of attacks in 2025 saw a ransomware attack at a major British retailer halt online orders for almost six weeks, leading to an estimated £300 million hit to operating profit,<sup>15</sup> while a six week production stoppage caused by a cyber-attack at a British automobile manufacturer contributed to a £485 million quarterly loss, a 24% year over year revenue decline, and an additional £200 million in direct response costs.<sup>16</sup>

While companies need to focus on protecting themselves from this wave of attacks, no system is infallible. Breaches are inevitable, which means reducing the potential impact of a successful attack is equally as important as preventing them in the first place.

Across our engagements, the companies we consider most resilient share familiar features: clear board accountability and oversight; empowered security teams; “assume breach” design (zero trust, segmentation, multi factor authentication); rehearsed recovery; and a willingness to learn openly from incidents. In a landscape where pressure is constant, we believe the strongest programmes are those that can bend rather than break.

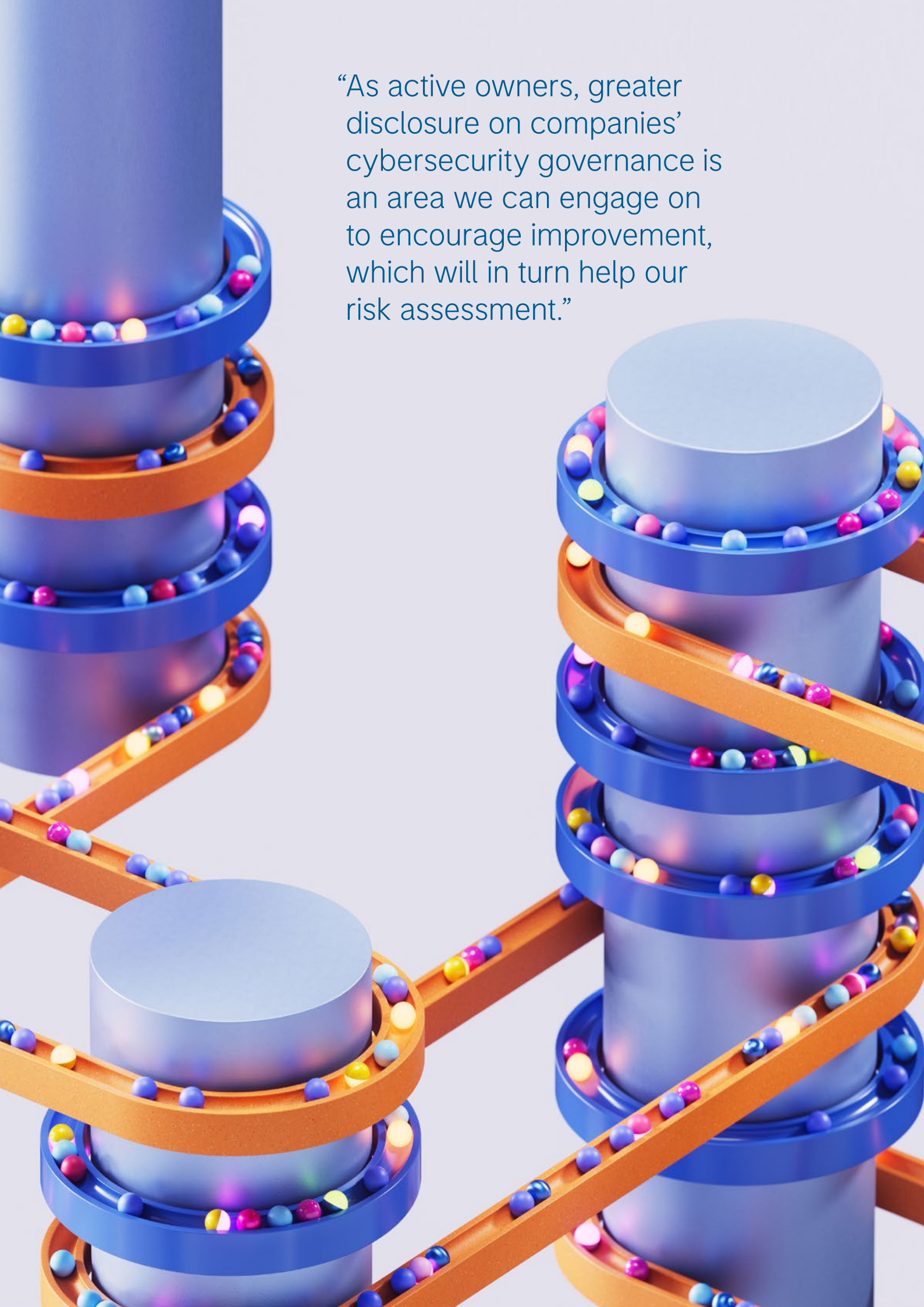
<sup>14</sup> Equifax Annual Security Report 2024.

<sup>15</sup> Source: <https://www.theguardian.com/business/2025/may/21/cyber-attack-cost-marks-and-spencer-lost-sales-company-results-reveal>

<sup>16</sup> Source: <https://www.theguardian.com/business/2025/nov/14/jaguar-land-rover-loss-cyber-attack>



“As active owners, greater disclosure on companies’ cybersecurity governance is an area we can engage on to encourage improvement, which will in turn help our risk assessment.”



## Key takeaways

While a material cyberattack can never be ruled out, we believe the companies we have assessed and engaged with are generally managing the risk appropriately. Our main takeaways are:

### 01

#### Worsening threat landscape driven by GenAI

This was unanimously recognised by the companies we engaged with, both in their disclosures and our engagements. As an American insurance brokerage we hold stated, *“it will become increasingly difficult to detect, defend against and remediate cybersecurity incidents and data breaches given the continuously evolving cyber threat landscape”*.

**Takeaway:** Given the prevalence of cybersecurity risk across our portfolios, we believe we must be more attuned than ever to how our companies are managing cybersecurity risks as they evolve.

### 02

#### GenAI is a double-edged sword

While GenAI is accelerating the scale, sophistication and speed of attacks, it can also be used to strengthen cybersecurity defences. During our engagements the companies we met with generally told us how they are upgrading their tools and using GenAI to enhance their defences including threat detection. For example, a digital payments network we hold has reduced the mean time to detect threats by 30% using GenAI.

**Takeaway:** Given the prevalence of cybersecurity risk across our portfolios, we believe we must be more attuned than ever to how our companies are managing cybersecurity risks as they evolve.

### 03

#### While costs are generally going up, AI is increasing efficiency of spend

Effective cybersecurity is expensive. While none of the companies we met with would disclose exact numbers, the trend is generally upwards, but with AI enabling security teams to become more efficient. One CEO told us cybersecurity is a nine figure spend, while another company has hired 1,000 people.

**Takeaway:** If a company isn't using GenAI to improve efficiency, find out why.

### 04

#### Third-party and M&A risks are serious<sup>17</sup>

These are key vectors which increase the attack surface; supply chain attacks are rapidly rising. During our engagements we encountered multiple examples of companies terminating vendor relationships and even declining acquisitions when cybersecurity standards fell short.

**Takeaway:** Firms taking cybersecurity risks seriously are more likely to integrate cybersecurity into supplier and M&A decision-making, monitor standards, and have contractual cybersecurity provisions.

### 05

#### Disclosures lack quantitative metrics

Many companies we assessed only disclose their governance and oversight framework, which is table stakes. Very few disclose quantitative metrics which help investors assess the effectiveness of controls (e.g. mean time to detect and respond to threats).

**Takeaway:** As active owners, we believe greater disclosure is an area we can encourage improvement via engagement, and will help our risk assessment.

### 06

#### Best approaches balance risk mitigation and impact minimisation

No defence is 100% foolproof, so the ability to respond effectively to incidents is equally important. One company we engaged with, demonstrates a leading approach on limiting the “blast radius” of an attack.

**Takeaway:** A lack of balance between mitigation and minimisation may indicate a weaker approach to cybersecurity.

### 07

#### External assessments build confidence

Cybersecurity is technical and there is only a certain amount of detail companies are willing to disclose. We believe evidence of periodic external audits, insurance and third-party assurance are positive signals that companies have been properly assessed by experts.

**Takeaway:** While some of the companies we engaged with, such as the American insurance brokerage, are in the process of getting enterprise-wide independent assurance of their controls, this is another area we may choose to engage on, to encourage those companies yet to take this step. risk assessment.

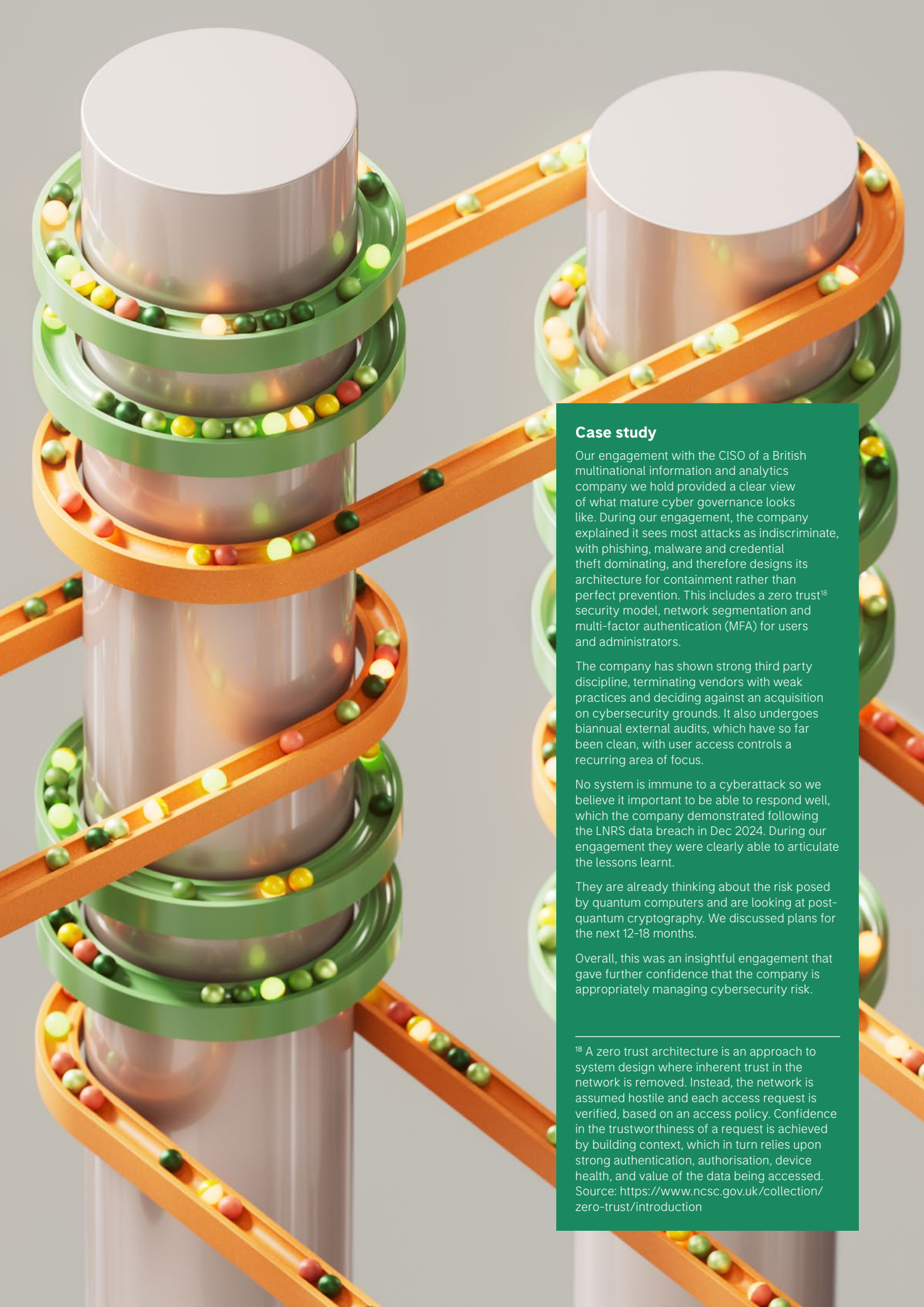
### 08

#### Awareness of quantum risk but wide levels of maturity

Quantum computing was described as the “atomic bomb of our generation” by one Chief Information Security Officer (CISO) we spoke with, as it will change cryptography. Some of the companies we engaged with are already thinking about quantum risks and how to protect themselves; for example, one company is already undertaking performance testing of new cryptography standards.

**Takeaway:** While not as immediate as some of the other cybersecurity risks being addressed, quantum computing is a long-term risk we believe we must be aware of and engage with companies on.

<sup>17</sup> M&A: mergers and acquisitions.



### Case study

Our engagement with the CISO of a British multinational information and analytics company we hold provided a clear view of what mature cyber governance looks like. During our engagement, the company explained it sees most attacks as indiscriminate, with phishing, malware and credential theft dominating, and therefore designs its architecture for containment rather than perfect prevention. This includes a zero trust<sup>18</sup> security model, network segmentation and multi-factor authentication (MFA) for users and administrators.

The company has shown strong third party discipline, terminating vendors with weak practices and deciding against an acquisition on cybersecurity grounds. It also undergoes biannual external audits, which have so far been clean, with user access controls a recurring area of focus.

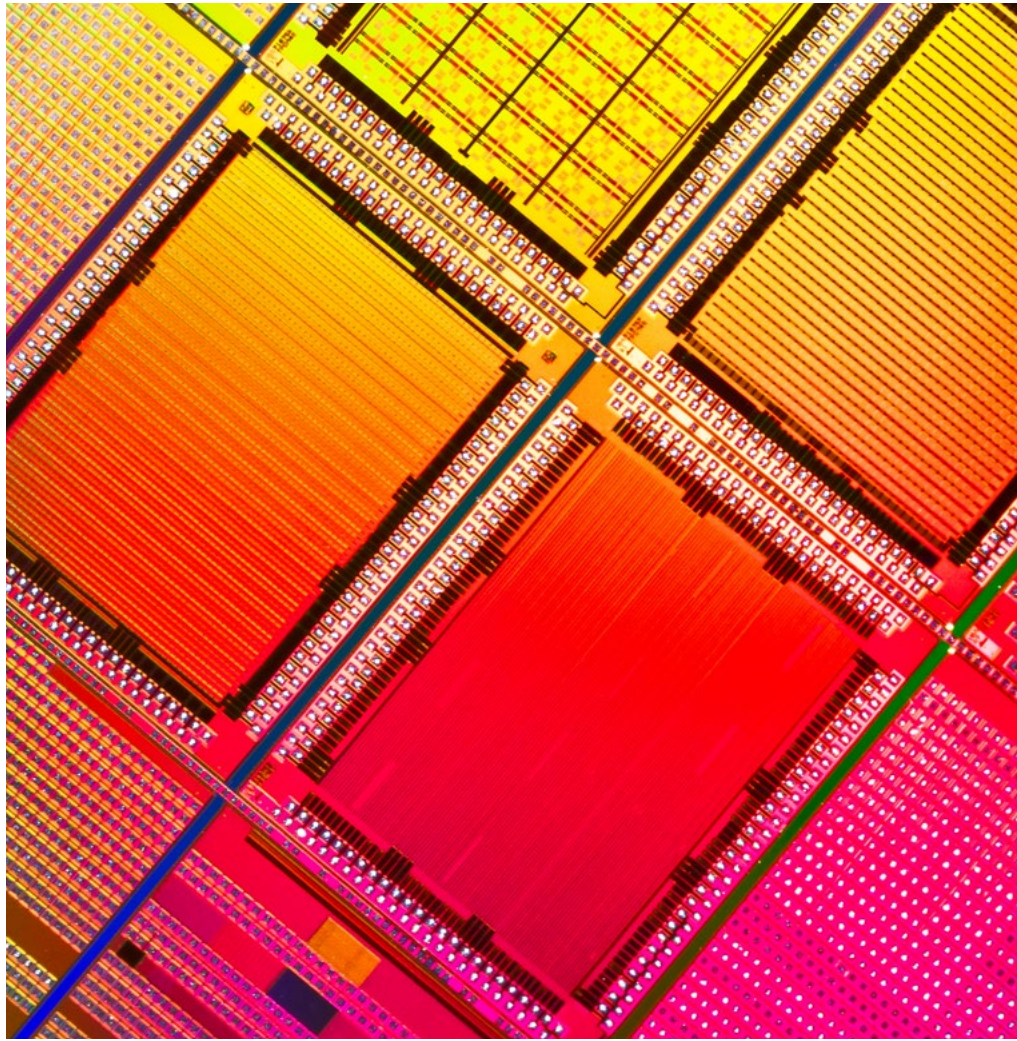
No system is immune to a cyberattack so we believe it important to be able to respond well, which the company demonstrated following the LNRS data breach in Dec 2024. During our engagement they were clearly able to articulate the lessons learnt.

They are already thinking about the risk posed by quantum computers and are looking at post-quantum cryptography. We discussed plans for the next 12-18 months.

Overall, this was an insightful engagement that gave further confidence that the company is appropriately managing cybersecurity risk.

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<sup>18</sup> A zero trust architecture is an approach to system design where inherent trust in the network is removed. Instead, the network is assumed hostile and each access request is verified, based on an access policy. Confidence in the trustworthiness of a request is achieved by building context, which in turn relies upon strong authentication, authorisation, device health, and value of the data being accessed. Source: <https://www.ncsc.gov.uk/collection/zero-trust/introduction>



#### AUTHORS



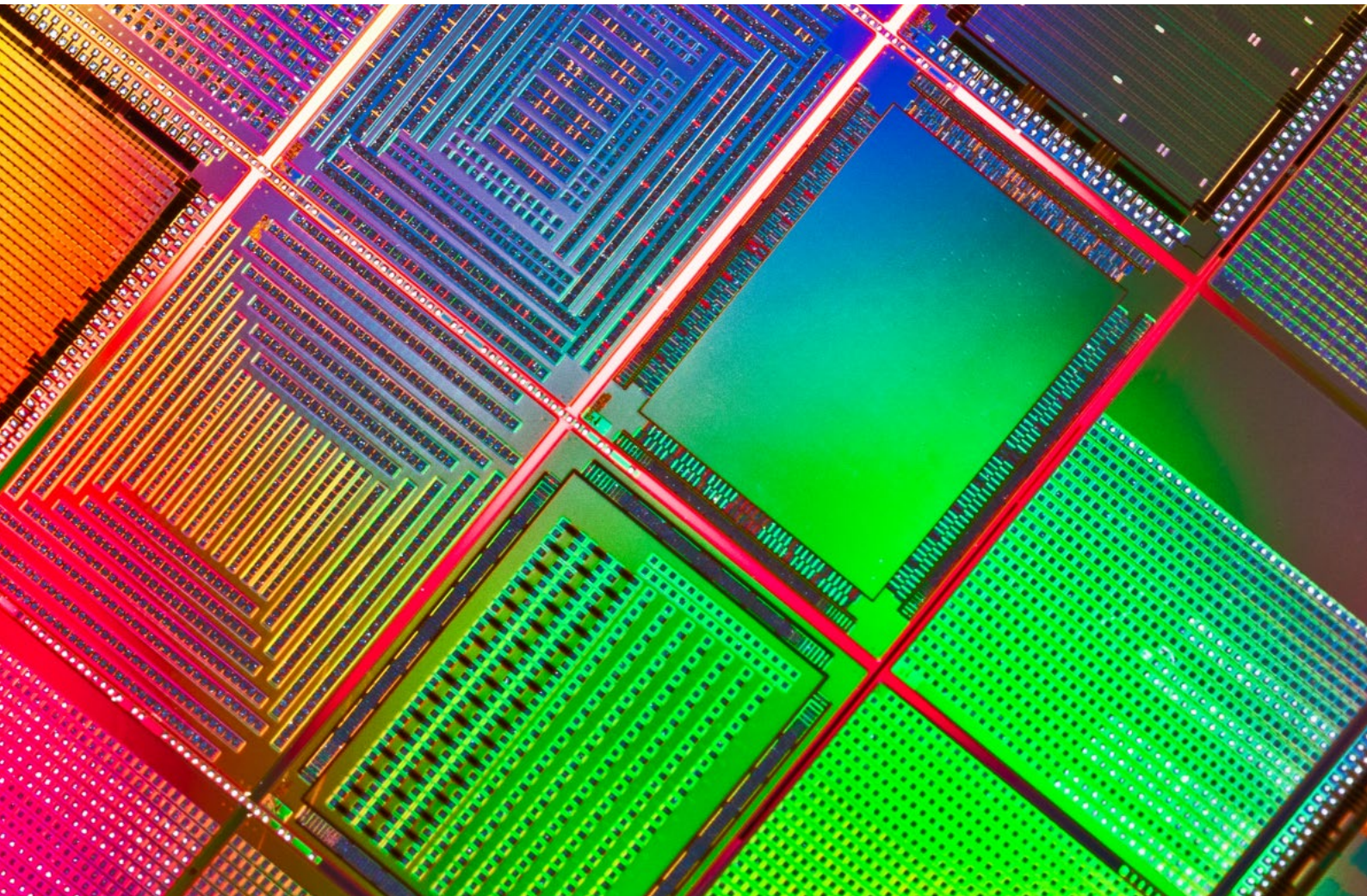
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# Supply chain resilience in the semiconductor sector

The semiconductor value chain remains one of the world's most complex and globally interdependent manufacturing ecosystems. Recent geopolitical tensions, export controls, energy constraints, and post-pandemic logistics shocks have reinforced the need for robust, regionally diversified, and technologically resilient supply chains. Against this backdrop, we engaged with three semiconductors we hold to assess how leading companies are navigating these pressures. Their strategies highlight a spectrum of approaches, from parallel production capacity and multi-sourcing to strategic partnerships, regional clustering, and selective technological substitution.



### **Long-standing business continuity and growing regionalisation**

With roughly 20% revenue exposure to China, an American multinational semiconductor company we invest in faces heightened risk from tariff volatility, retaliatory measures, and China's tightening classification system for semiconductor imports based on wafer origin. We engaged to understand how the company is adapting its supply chain to potential regulatory shifts and broader geopolitical uncertainty.

During our meeting, the company described a well-established business continuity system covering critical inputs such as feedstocks, gases and lead frames. It has built redundancy, multi-sourcing, and buffer-inventory protocols into operations for decades. Following Russia's invasion of Ukraine in 2022, for example, the company rapidly secured alternative sources of noble gases - demonstrating agility in managing supply shocks.

We also explored its manufacturing footprint. Approximately 30% of fabrication occurs outside the U.S., including Japan and China, complemented by parallel redundancy<sup>18</sup> across assembly and test sites. The company is increasingly dual-qualifying products and enabling faster re-routing of logistics flows to manage regional shocks. It aims to align regional supply chains with regional revenue, reflecting a more distributed operational model.

The company recognises that China remains a complex operating environment, with potential for sudden regulatory intervention. While it is not pursuing a full "China-for-China" model, it is building the flexibility necessary to support customers' regional-compliance requirements—especially in the automotive and industrial end markets. The company does not directly use rare earth elements, but it acknowledges second-order impacts, including customer hesitancy in capital spending due to export-control uncertainty.

<sup>18</sup> Strategic redundancy (in a manufacturing context) refers to the deliberate creation of overlapping or duplicated production capacity, suppliers, locations, or processes to reduce reliance on any single site or region and to improve resilience against geopolitical, natural, or operational disruptions.

These dynamics have contributed to slower recovery cycles relative to prior downturns. Despite this, we believe that the company's approach demonstrates mature continuity planning and a pragmatic shift toward regionalisation, though macro uncertainty in China remains a structural risk.

We believe the company's supply chain strategy demonstrates a sound appraisal of geopolitical and operational risks, with resilience measures well integrated; accordingly, there is no change to our investment view.

## **Managing chokepoint dependencies and deepening supplier governance**

As the sole supplier of EUV<sup>19</sup> lithography tools and a critical node in the global semiconductor supply chain, a Dutch multinational company we hold faces unique systemic vulnerabilities. We engaged to understand how the company is strengthening resilience amid export controls, material shortages, and multi-tier supplier fragility.

During our meeting, the company highlighted a sophisticated supplier governance framework. While a German manufacturer of optical systems and optoelectronics remains its single most critical partner, supported by an exclusivity agreement, the company has increased its attention to Tier 2 and Tier 3 vulnerabilities<sup>20</sup> following COVID-era disruptions. REE-dependent<sup>21</sup> magnets represent a key focus area; China remains the dominant global supplier, and the company is pursuing alternative sourcing and technological substitutes to reduce dependence.

With approximately 80% of the supply base located in Europe, the company benefits from geographic proximity to its Dutch manufacturing hub, improving coordination and lead-time management. It has also made selective acquisitions to secure access to critical technologies without pursuing full vertical integration. Efforts to increase upstream visibility and selectively dual-source where feasible reflect a measured approach to building resilience.

Geopolitically, the company acknowledged the long-term implications of expanding export controls, including prohibitions on shipping EUV and certain advanced DUV<sup>22</sup> systems to China. While this reduces near-term addressable market opportunities, the company sees such controls as unlikely to reverse. It also noted the emergence of "stacking tariffs," creating uncertainty around who — supplier or customer — absorbs incremental cost.

We believe the company's responses demonstrated a highly advanced understanding of systemic risk, balancing technological leadership with realistic expectations about regulatory constraints. The company is also integrating climate-resilience measures across its operations, including smart grid deployment and long-term renewable energy purchasing. In our assessment, its multi-layered approach to supply chain management reflects a mature, forward-looking resilience strategy, befitting its strategic importance to the semiconductor ecosystem.

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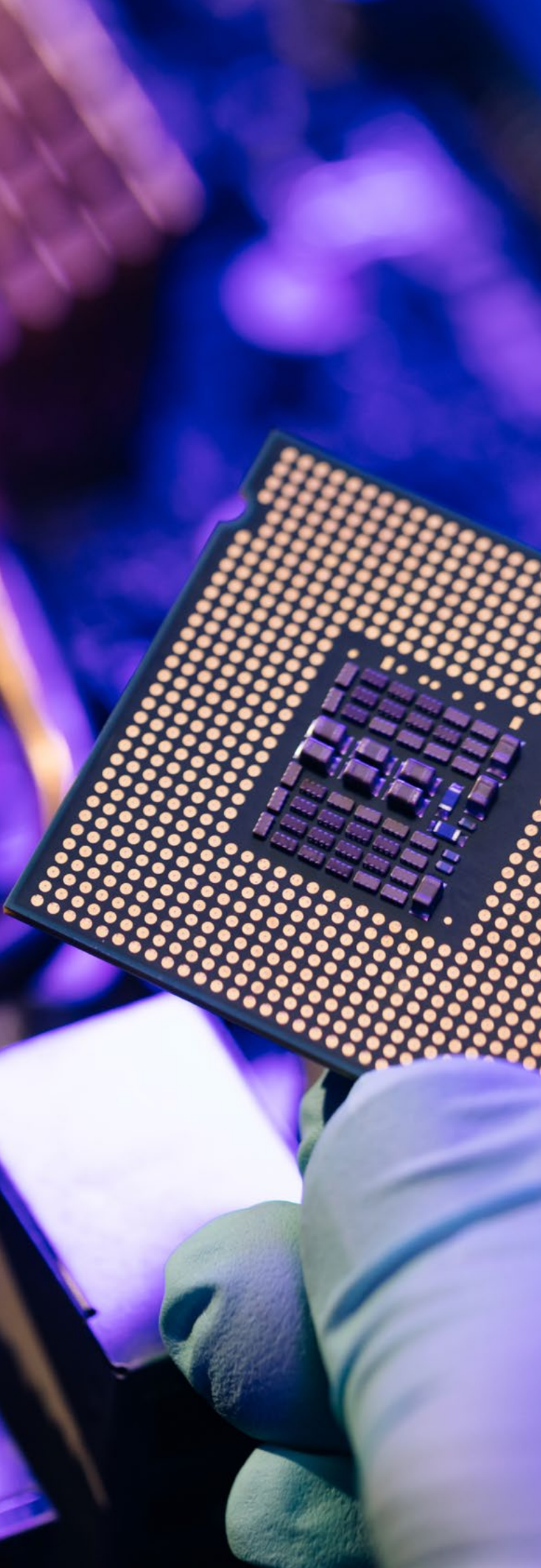
<sup>19</sup> Extreme ultraviolet (EUV) lithography is a technology used in the semiconductor industry.

<sup>20</sup> Tier 1 suppliers: direct suppliers of the final product. Tier 2 suppliers: suppliers or subcontractors for Tier 1 suppliers. Tier 3 suppliers: suppliers or subcontractors for Tier 2 suppliers.

<sup>21</sup> Rare earth element (REE).

<sup>22</sup> Deep ultraviolet systems (DUV).





The engagement provided reassurance that the company's supply chain risk mitigation reflects its structurally critical position in the semiconductor value chain (its role as a critical bottleneck) which has matured in line with that responsibility.

### **Regional redundancy and measured expansion within existing hubs**

A German semiconductor device manufacturer we own is navigating a landscape marked by geopolitical risk, tariff exposure, and shifting customer behaviour - particularly in automotive and industrial markets. We engaged to evaluate how the company balances in-house manufacturing, outsourced production, and regional diversification to maintain supply continuity.

The company conducts around 60% of production in-house, retaining power and sensor component manufacturing to protect intellectual property and maintain differentiation. Outsourced production is concentrated in connectivity chips and mature technologies, where partners offer competitive advantages. The company's fabs<sup>23</sup> in Dresden, Austria, and Malaysia provide meaningful operational redundancy. Most products are qualified<sup>24</sup> at two sites, enabling production shifts when required, though flexibility is not absolute. While concentration risks persist in some outsourced components, the company is participating in collaborative European initiatives such as the ESMC investment in Dresden to strengthen regional capacity for automotive and industrial chips.

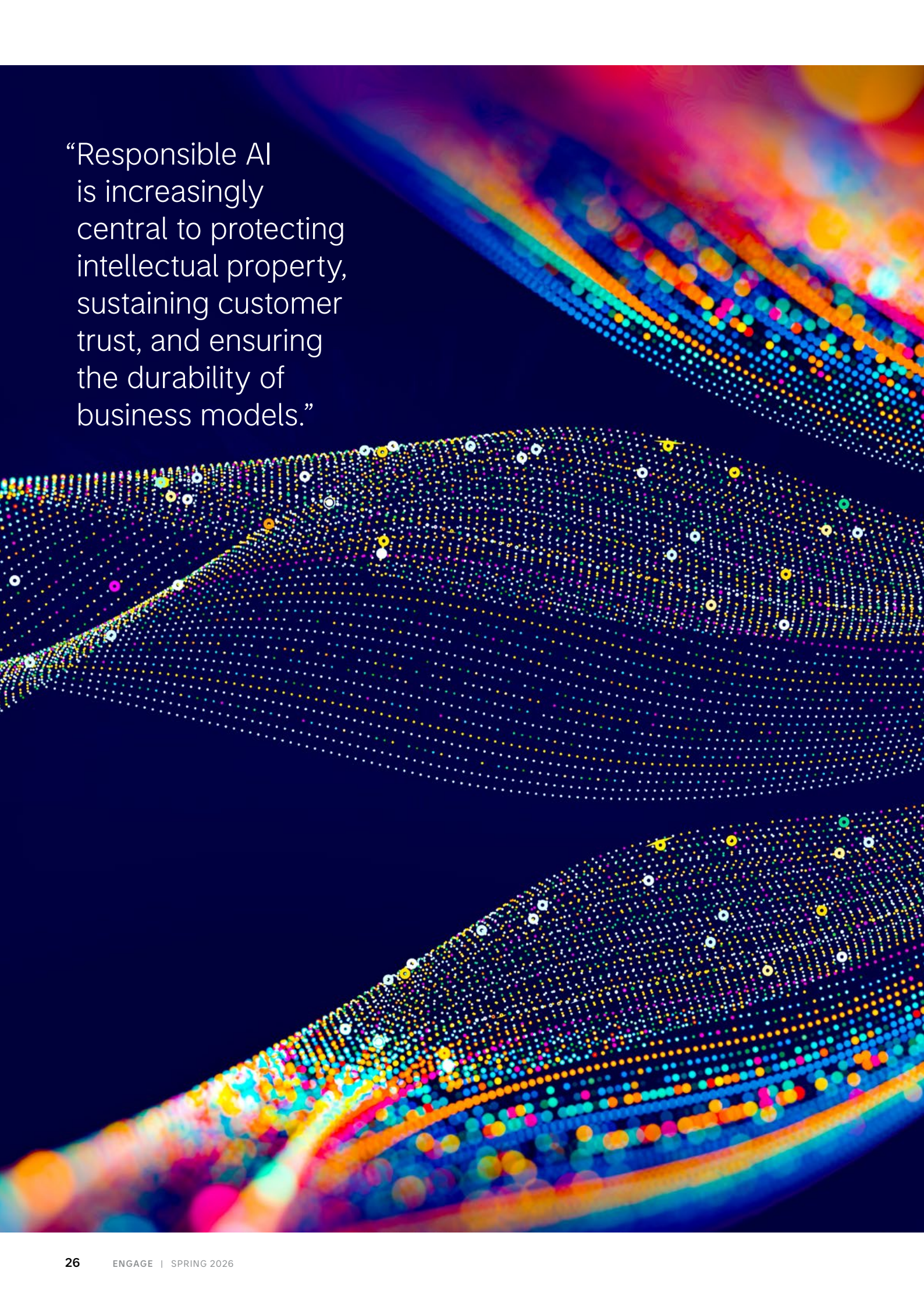
While geopolitical uncertainties remain, we believe the company appears well-positioned through balanced sourcing, cautious capex allocation, and alignment with regional industrial-policy initiatives. This was a constructive and informative engagement which did not materially change our investment rationale.

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<sup>23</sup> Fabrication plants.

<sup>24</sup> Product qualification proves the form, fit, function and reliability of the final product, including chip, package, chip/package interaction, and design.  
Source: <https://www.infineon.com/quality/quality-management/qualification-reliability>

“Responsible AI is increasingly central to protecting intellectual property, sustaining customer trust, and ensuring the durability of business models.”





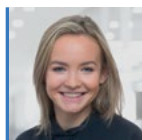
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## Responsible AI: transparency, governance and business-model resilience

Artificial intelligence (AI) is reshaping business models across sectors, from Health Care and Financial Services to digital content and entertainment. While AI may bring meaningful opportunities to improve efficiency, product innovation and customer experience, it also raises questions around transparency, data governance, regulatory compliance and long-term value protection, all of which could pose potentially financially material risks to companies. Our engagements illustrate how responsible AI considerations vary across sectors - and why robust oversight, disclosure and long-term planning are becoming increasingly important.

### **Establishing foundations for responsible AI in research and development (R&D)**

During our engagement we established that the animal health care company we own is in the early stages of AI adoption. The company does not currently maintain an externally facing responsible-AI policy, although it has developed internal guidance documents governing AI use in research and development.

With rising regulatory scrutiny—particularly the Corporate Sustainability Reporting Directive (CSRD)<sup>25</sup> and adjacent requirements that intersect with data privacy, we encouraged the company to formalise and communicate its responsible AI principles, especially as AI applications expand across R&D, diagnostics, and product development. We also discussed practical governance mechanisms: oversight structures, data-quality standards, and processes to manage model bias and validation.

The company was receptive to the need for a clearer articulation of responsible AI practices. While in the early stages, the company reported that it views responsible use as core to safeguarding scientific integrity and maintaining stakeholder trust. We expect further development of policy frameworks that map to upcoming regulations and enhance transparency around AI in R&D. Our engagement with the company did not result in a change to our investment thesis.

### **Embedding responsible AI governance in a regulated environment**

During our engagement with a consumer credit reporting company we hold, it emphasised that AI is not used in lending decisions, a critical point given the regulatory sensitivity of credit assessments, but acknowledged that AI is an evolving risk area. The company described a structured internal approach to AI oversight across both B2C (business-to-consumer) and B2B (business-to-business) operations, focusing on transparency, fairness, and data protection. With the emerging EU AI Act<sup>26</sup> and tightening global standards, the company's governance approach regarding AI is increasingly relevant.

Our engagement explored how the company's internal AI governance aligns with upcoming regulatory frameworks and how its responsible-AI principles support product development, particularly in personalisation tools. We assessed how the company's innovation takes safeguards

that protect customer data and prevent unintended bias into account.

The company provided reassurance that its responsible-AI architecture is mature, well-resourced and aligned with regulatory expectations, emphasising its view on and approach to responsible AI: quality data inputs, good governance mechanisms, and the ability to drive financial inclusion. This engagement strengthened confidence in the company's B2C strategy, particularly its contribution to financial inclusion through accurate, ethically governed data tools. Continued transparency will remain an important area of monitoring as new regulations crystallise.

### **Generative AI as a structural challenge to catalogue value**

Our engagement with one of the world's leading music company's Investor Relations and Head of Digital Strategy focused on how the company is addressing AI-generated music and its potential to disrupt the value of artist-led catalogues. The company articulated a clear strategy to defend artists' rights and create opportunities



<sup>25</sup> The Corporate Sustainability Reporting Directive is an EU directive that requires in-scope companies to disclose information on what they see as the risks and opportunities arising from social and environmental issues, and on the impact of their activities on people and the environment. Source: [https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting\\_en#:~:text=EU%20rules%20require%20large%20companies,impact%20people%20and%20the%20environment](https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en#:~:text=EU%20rules%20require%20large%20companies,impact%20people%20and%20the%20environment)

<sup>26</sup> Source: <https://artificialintelligenceact.eu/>

by asserting control over content orchestration, offence/defence strategies, and legal protection. It emphasised a strong stance on fair use and the need for AI companies to obtain licenses from rights holders.

We discussed contractual safeguards (AI clauses), verification tools for human authorship, and the implications of AI-enabled content creation for long-term monetisation. We also examined the durability of catalogue value if intellectual property (IP) protection and platform policies evolve more slowly than AI capabilities.

We believe the company is managing near-term risks effectively, but structural questions remain. Generative AI could compress content differentiation, weaken artist identity and challenge traditional value-capture models over time. While no immediate portfolio action is required, we view long-term risks as being potentially financially material.

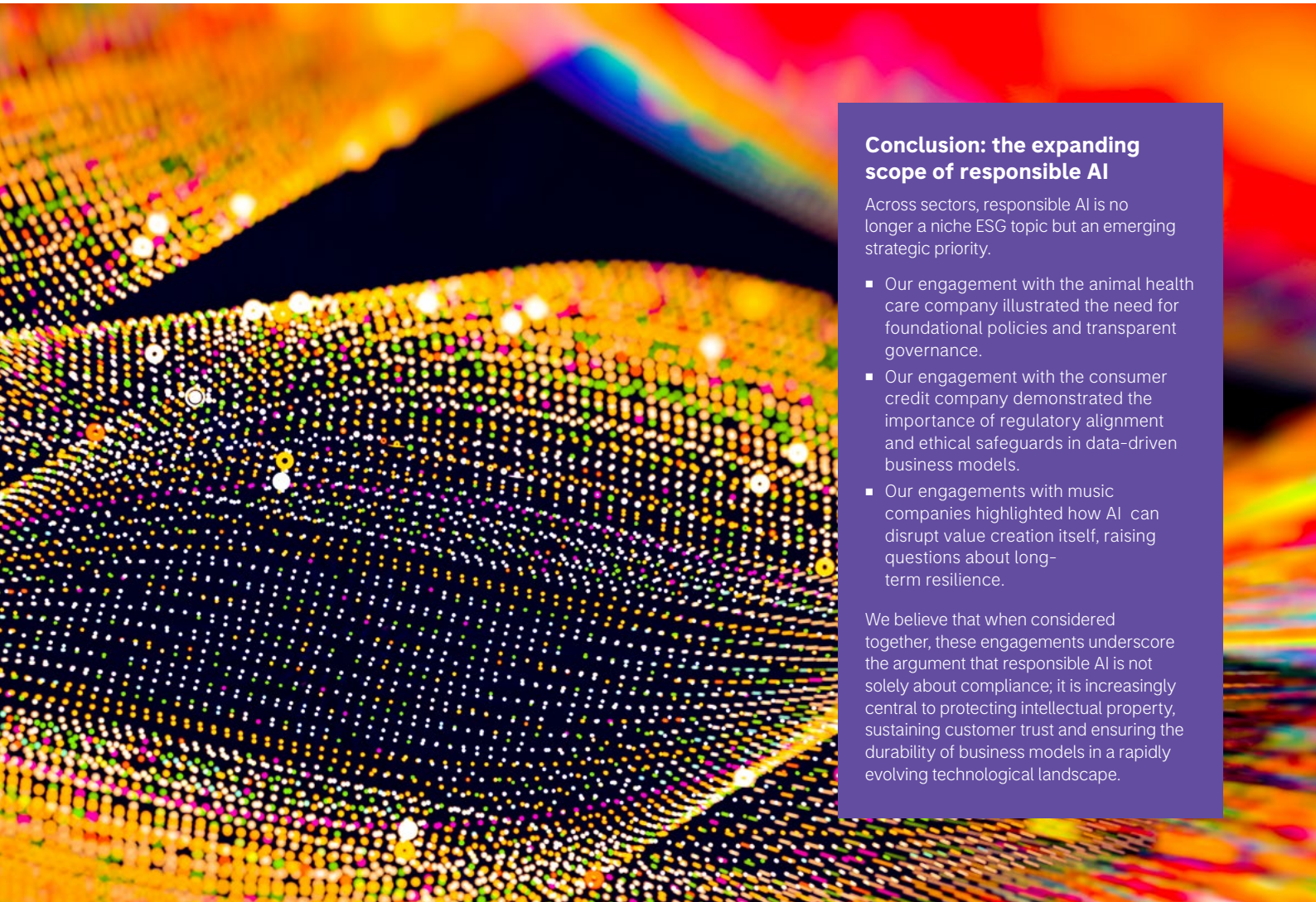
### **AI-driven uncertainty around catalogue ROI and content durability**

We met with a Japanese multinational conglomerate's IR and SVP Finance to understand how AI influences its

music-business strategy. The company has invested several billion dollars in catalogue acquisitions, with declining returns on capital. Management maintains that evergreen catalogues generate stable cash flows, but acknowledges scaling premium monetisation strategies remains challenging as AI-generated content proliferates.

We raised concerns about the sustainability of high-value catalogue acquisitions in a market where AI can increase supply, erode differentiation, and shift consumer behaviour. We urged discipline in capital allocation and closer evaluation of catalogue paybacks under AI-driven demand scenarios.

The company's approach to AI appears more conservative than peers, reflecting an awareness of long-term uncertainty. Still, we see rising risks across multiple business lines—music, imaging and motion pictures—where content authenticity and value could be undermined by rapid advances in generative technologies.



#### **Conclusion: the expanding scope of responsible AI**

Across sectors, responsible AI is no longer a niche ESG topic but an emerging strategic priority.

- Our engagement with the animal health care company illustrated the need for foundational policies and transparent governance.
- Our engagement with the consumer credit company demonstrated the importance of regulatory alignment and ethical safeguards in data-driven business models.
- Our engagements with music companies highlighted how AI can disrupt value creation itself, raising questions about long-term resilience.

We believe that when considered together, these engagements underscore the argument that responsible AI is not solely about compliance; it is increasingly central to protecting intellectual property, sustaining customer trust and ensuring the durability of business models in a rapidly evolving technological landscape.



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## Product safety in personal care

Given rising consumer scrutiny of cosmetic ingredients and a litigious U.S. environment, in 2025 we held multiple engagements with a French multinational personal care company we hold's Investor Relations team, Chief Sustainability Officer, and CEO to discuss product safety, ingredient innovation, and transparency. The company continues to face product safety litigation in the U.S. and broader questions from consumers and NGOs<sup>27</sup> around ingredient safety, which we believe may pose a potentially financially material risk.

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<sup>27</sup> Non-governmental organisation.



During our meetings, the company emphasised its long-standing focus on scientific rigour, product safety, and transparency. Around 3% of group sales are invested in research and development, supported by 4,000 scientists<sup>28</sup>, positioning the company among industry leaders in in-house research. It is reformulating its portfolio toward bio-based and renewable ingredients (targeting 95% by 2030) and phasing out microplastics (since 2020 all of the company's rinse-off products, meaning those requiring the use of water to eliminate them, such as shower gels and shampoos, have been microplastic-free). With regard to transparency, initiatives such as the Inside Our Products platform and Eco Beauty Score labelling scheme aim to provide standardised environmental impact data. Management acknowledged operating in a regulatory "grey zone"—where some ingredients remain permitted under law but subject to consumer scrutiny—and highlighted efforts to strengthen scientific communication with stakeholders, including consumers, investors and health authorities.

We discussed how rating apps for personal care products, such as Yuka and EWG, are shaping consumer perceptions and how the company responds, including through enhanced testing, engagement with toxicologists, and continuous monitoring of scientific developments. The company reiterated confidence in its safety processes and maintains that it will prevail in ongoing U.S. litigation, while pursuing a precautionary approach through its Green Sciences innovation programme.

The competitive environment is shifting, with independent beauty brands growing over 15% year-on-year<sup>29</sup>, outpacing the broader sector (by approximately 10%<sup>30</sup>) and gaining share through greater agility, transparency, and innovation. Against this backdrop, we believe the company's scale, scientific expertise, and proactive sustainability strategy position it well to manage evolving consumer and regulatory expectations, though we continue to monitor progress on reformulation and disclosure.

<sup>28</sup> Source: company reports.

<sup>29</sup> Source: <https://nielseniq.com/global/en/insights/report/2023/the-rise-of-indie-beauty-insights/>

<sup>30</sup> Source: company reports; <https://nielseniq.com/global/en/insights/report/2023/the-rise-of-indie-beauty-insights/>; International Equity Team analysis

# Proxy voting reflections from 2025

We believe that proxy voting is an important part of the dialogue between companies and their shareholders. This means we do not outsource proxy voting and never have. Our investment team seeks to vote in a prudent and diligent manner and in the best interest of our clients, consistent with the objective of maximising long-term investment returns.

Our proxy voting is predominantly related to governance issues such as management incentives and director appointments. We also consider how to vote on proposals related to social and environmental issues on a case-by-case basis by determining the relevance of the issues identified in the proposal and their likely financial impact. We generally support proposals that, if implemented, would enhance useful disclosure or improve management practices on issues considered potentially financially material. We do not share our voting intentions with companies prior to casting our vote.

## **A snapshot of the 2025 season**

In 2025, our voting activity took place against a backdrop of a new U.S. administration, regulatory developments, and a shifting landscape of investor sentiment. We continued to see lower levels of support for environmental and social shareholder proposals, with investors focussing instead on core governance issues.

During 2025, we voted on **1,523 proposals across 93 company meetings**. Our disciplined investment philosophy means our voting record has remained consistent when compared to previous years; we voted against management 9% of the time and against management at least once at 66% of meetings. Most votes against management were related to compensation (43%), director elections (25%) and shareholder proposals (8%).

Three patterns defined the season:



# 01

## **Environmental and social shareholder proposals: falling volume and support**

The number of environmental and social proposals fell meaningfully - down roughly one third in the U.S. from 2024<sup>31</sup> - due in part to SEC rule changes that made it easier for companies to exclude such resolutions. Support levels also declined to low double digits on average, with no environmental proposal receiving majority backing.

Our own experience reflected these market wide trends. Environmental and social shareholder proposals in our universe remain concentrated at a small number of companies which together accounted for 86% of all such proposals in 2025. Where proposals addressed issues that we believe are potentially financially material, we supported them. Where proposals were overly prescriptive, lacked materiality or relevance to long term shareholder value, we did not. Overall, we supported 14% of such proposals.

### **CASE STUDY ONE**

We supported a shareholder proposal requesting that a multinational conglomerate we hold publish a human rights impact assessment of AI driven targeted advertising. Given the company's heavy reliance on AI enabled advertising and rising regulatory scrutiny, we believe the analysis may help the company identify and mitigate potentially material legal, reputational, and operational risks. The proposal received 15% dissidence.

# 02

## **Governance: continued support for shareholder rights**

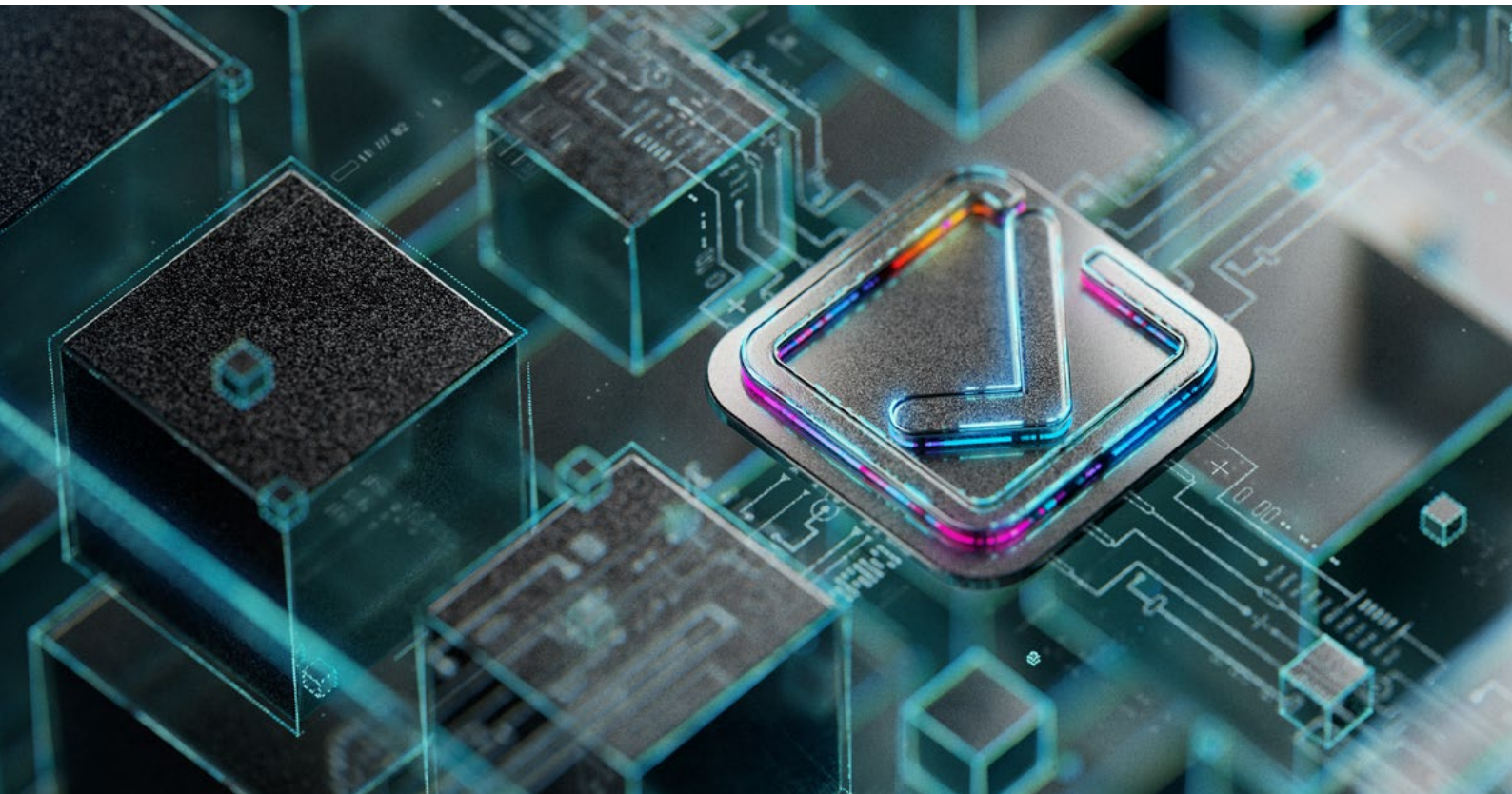
Consistent with previous years, governance related shareholder proposals were among the best supported items across the market. We supported 58% of governance related shareholder proposals, reflecting our view that shareholder rights are a foundational element of long term oversight and accountability.

We also continued our longstanding approach of voting against management proposals that we believe weaken shareholder rights including all requests by UK companies to call general meetings with two weeks' notice including a British multinational information and analytics company we own, and all proposals for virtual only AGMs at German companies including a German multinational software company we hold.

### **CASE STUDY TWO**

We supported shareholders proposals to reduce the ownership threshold required for shareholders to call a special meeting at five companies held in our portfolios. Strong shareholder rights are a hallmark of good governance and we believe lowering the threshold will enhance shareholders' rights. Levels of support for these proposals were high, ranging from 43-66%, reflecting broad investor support for enhanced rights.

<sup>31</sup> Source: <https://corpgov.law.harvard.edu/2025/08/26/2025-proxy-season-in-review/>



## 03

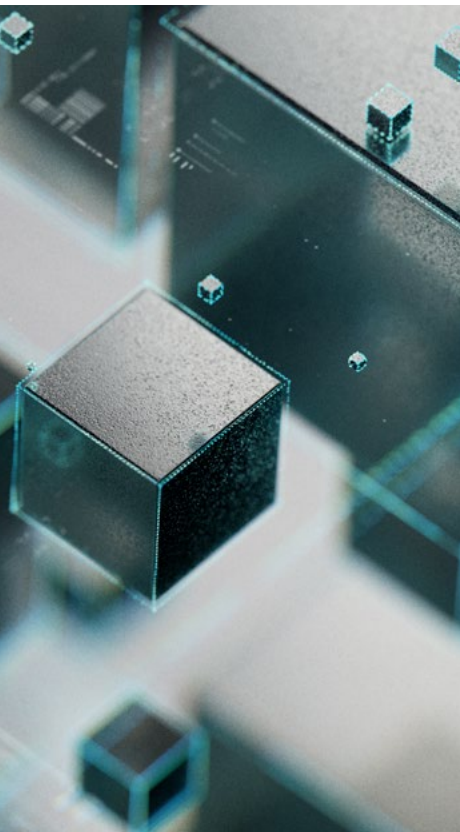
### **Executive pay: heightened scrutiny and material concerns**

We take compensation seriously, grounded in our belief that incentives drive outcomes. As long-term investors, we want the companies our clients own to have pay plans in place that encourage long-term thinking over short-term opportunism. Our concern is that the wrong incentives, for instance excessive focus on earnings per share (EPS), can encourage management to take decisions that boost profits in the short run at the expense of their companies' ability to compound over the long run. This may be a consumer company cutting advertising, or a firm making large acquisitions that, while "accretive", i.e., boosting short-term EPS, deploy a large amount of capital at low returns. By contrast, when compensation is managed effectively, it aligns key decision-makers' behaviours with the company's objectives, encouraging better performance and long-term returns to shareholders. We prefer pay plans based on performance metrics linked to company fundamentals such as organic growth, margin and free cash flow, with a particular focus on return on invested capital or return on operating capital employed.

We use our proprietary Pay X-Ray scoring framework to evaluate pay schemes where relevant and possible, engaging with companies to encourage improvement and voting against them where we are unhappy with the structures. In 2025, the team voted against 31% of management compensation-related proposals and at least once at 52% of meetings which included any such proposal. Typical issues we saw were:

- Use of non-performance-based delivery instruments including options and RSUs (Restricted Share Units)
- Poor disclosure of metrics and targets
- Overreliance on EPS and relative TSR (Total Shareholder Return)
- Short vesting periods
- Special one-time awards

In several cases, we escalated our concerns by voting against compensation committee members where there had been limited improvement year over year. Please note the team does not discuss its voting intentions with companies as part of engagement activity.



### CASE STUDY THREE

The team voted against an American multinational consumer goods company's executive remuneration plan for two main reasons. Firstly, the company does not disclose the majority of the targets, actual achievements, or weightings for the individual metrics in the annual bonus. Secondly, 50% of the LTIP<sup>32</sup> is delivered in RSUs and non-performance-linked options. We prefer Performance Shares (PSUs), which require management to hit targets to get rewarded, rather than RSUs — or “pay for stay” — where management merely has to avoid being fired to benefit. We also prefer companies to issue PSUs rather than options, as the asymmetry of options can favour excessive risk-taking, particularly once they are “out of the money”. Given we have voted against the pay plan every year since 2021, we also voted against the chair of the remuneration committee, as we did in 2024.

### CASE STUDY FOUR

A leading manufacturer of lifts' advisory say on pay vote failed, with 61% dissidence, driven by a special \$25m retention award granted to the CEO. A significant portion of the award (40%) was “pay for stay,” while the performance based element relied on the same metrics as the regular LTIP, offering no additional stretch target despite the size of the grant.

We have voted against the company's pay plan every year since 2022 due to persistent concerns over weak metrics (heavy reliance on net income and EPS), poor delivery instruments (large use of RSUs<sup>33</sup> and non performance linked options), and insufficient target rigor. While the company's use of organic revenue as a metric is a positive, it remains outweighed by these structural issues. Given the lack of progress over multiple years, we also voted against the chair of the compensation committee.

## Looking ahead

The 2025 proxy season reinforced the importance of consistent, proactive engagement paired with thoughtful voting. While environmental and social proposal volumes may continue to fall, we believe underlying issues such as AI-related risks remain central to long term value. Governance, as always, remains the backbone of effective stewardship, and we expect shareholder rights and executive pay to remain areas of intense focus into 2026.

<sup>32</sup> Long-term incentive plan.

<sup>33</sup> Restricted stock units.

AUTHOR



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# Licence to operate: sustainability at the intersection of security, technology and resilience





In 2026, ESG factors sit against a backdrop of rising nationalism, intensifying strategic competition and growing social unease. Sustainability risks and opportunities are increasingly intertwined with national priorities—energy security, industrial policy and technological leadership. Through this lens, we outline the themes we believe may shape, and be shaped by, the actions of companies, investors and policymakers in the year ahead.

### **Rising resistance to AI?**

A key bottleneck to AI's continued expansion is electricity. Despite increasing general use and complex AI use cases driving exponential growth in compute, electricity supply – particularly in the U.S. – has struggled to keep pace.

With energy bills having risen sharply in the U.S., 2026 may see AI infrastructure drawn directly into affordability debates. In 15 U.S. states with significant data centre capacity, costs have increased on average 16% since the start of 2024.<sup>34</sup>

Concerns extend beyond power prices. A 2025 survey found that roughly 50% of Americans are more concerned than excited about AI, with only 10% feeling the opposite – a marked deterioration from 2021.<sup>35</sup> This sentiment is already influencing outcomes: in the second quarter of 2025, local “not in my backyard” resistance delayed or cancelled approximately \$100 billion of data centre projects.<sup>36</sup> For hyperscalers, which are increasingly expected to shoulder the costs, this could mean higher capex, more complex stakeholder negotiations and slower capacity deployment, with ripple effects across the AI ecosystem.

These challenges may also create opportunities. Companies that can navigate stakeholder concerns may gain advantage, while energy solution providers capable of bridging supply gaps and mitigating community impacts will be critical enablers.

<sup>34</sup> According to data from the US Energy Information Administration, shared by Reuters: <https://www.reuters.com/business/energy/charting-data-center-development-roadmap-key-us-states-2026-01-22/#:~:text=Among%20the%20top%2015%20states,side%20of%20local%20rate%20inflation>

<sup>35</sup> Pew Research survey of American's perception of AI from September 2025, <https://www.pewresearch.org/science/2025/09/17/how-americans-view-ai-and-its-impact-on-people-and-society/>

<sup>36</sup> Jefferies research, using Data Centre Watch, Q5 (<https://www.datacenterwatch.org/>)

## AI and risk management

As AI adoption accelerates, so too have concerns, ranging from the loss of white-collar jobs to child safety concerns. Regardless of whether projections prove too pessimistic or too optimistic, the scale and speed of adoption over the past year have sharpened the attention of people, companies and policymakers.

In the U.S. alone, around 100 AI related laws and regulations passed last year across more than 30 states,<sup>37</sup> imposing new constraints on AI (on subjects such as privacy and child safety), despite federal efforts to limit regulatory proliferation. A notable example is the California Transparency in Frontier Artificial Intelligence Act (TFAIA), which requires developers of large frontier AI models to assess and manage catastrophic risks.<sup>38</sup> While the law's full impact remains uncertain, it suggests that rather than regulators taking a "wait and see" approach, governance and transparency expectations are rising.

This may lead to companies responding with stronger risk management, embedding responsible policies and procedures, redesigning AI workflows with "responsibility built in" and elevating board-level governance. Firms that treat responsible AI as a strategic discipline rather than a compliance exercise will be better positioned as scrutiny intensifies.

## Resilience amid geopolitical, cyber and physical risk

In recent years, systemic risks from physical risk and nature loss to geopolitical fragmentation have affected companies' operating environments. In 2026 these pressures persist.

### GEOPOLITICAL UNCERTAINTY AS A STRUCTURAL FEATURE

The World Economic Forum's annual Global Risk Report describes "uncertainty" as the defining theme of 2026, with 50% of respondents anticipating a turbulent or stormy outlook over the next two years, rising to 57% over 10 years, and only 1% expecting calm conditions.<sup>39</sup> Multilateral institutions are weakening, populism and protectionism are rising, and global cooperation is fragmenting.

2026 may well see a continued shift away from hyper-optimised global supply chains toward more flexible, sometimes regionalised models. However, companies and investors must be aware of capital allocation decisions driven by political ambitions rather than financial discipline. Shorter supply chains may raise cost and duplicated production could dampen innovation. Whilst strategic resilience is paramount, it must be balanced against economic efficiency.

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<sup>37</sup> Source: <https://www.brennancenter.org/our-work/research-reports/artificial-intelligence-legislation-tracker>

<sup>38</sup> Foundation models trained with computing power above a set statutory threshold.

<sup>39</sup> According to data from the US Energy Information Administration, shared by Reuters: <https://www.reuters.com/business/energy/charting-data-center-development-roadmap-key-us-states-2026-01-22/#:~:text=Among%20the%20top%2015%20states,side%20of%20local%20rate%20inflation>





#### **RATCHETING UP OF CYBERSECURITY RISK**

In 2026, cybersecurity is likely to remain a priority as the accelerating AI arms race between attackers and defenders scales both frequency and sophistication of threats. AI acts as a force multiplier, lowering barriers to entry for attackers while also enhancing detection and response capabilities for defenders. The prospect of quantum computing represents a step-change risk, with “harvest now, decrypt later” attacks putting long-lived sensitive data already at risk and necessitating early adoption of post-quantum cryptography. Against this backdrop, cybersecurity spending is forecast to grow at a double-digit compound annual growth rate (CAGR) through the second half of the decade.<sup>40</sup> This may provide opportunities for companies with advanced defence capabilities, or those able to help other companies implement them.

#### **MANAGING THE PHYSICAL REALITY**

Physical climate risks remain a long-term structural challenge for companies, from climate-related shifting temperature patterns and rising extreme weather to nature-related risks like water scarcity and soil degradation. The January 2025 Los Angeles wildfires caused an estimated \$250–275 billion of economic losses;<sup>41</sup> physical climate risks are predicted to have a \$1.2 trillion annual price tag by the 2050s.<sup>42</sup>

In 2026 further extreme events and the growing use of AI in risk modelling may see further investment by companies in adaptation across operations and supply chains, offering opportunities to those companies able to provide guidance in mitigating those risks.

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<sup>40</sup> Source: Morgan Stanley Research “Cybersecurity: Growing Share of IT and Investors’ Wallet”, 2 September 2025.

<sup>41</sup> Source: <https://www.weforum.org/stories/2025/03/how-climate-hazards-are-reshaping-business-realities-and-responses/>

<sup>42</sup> Source: <https://www.spglobal.com/sustainable1/en/insights/special-editorial/ceraweek-physical-risk>

# International Equity Team

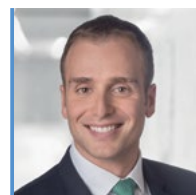
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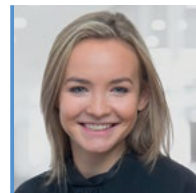
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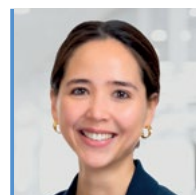
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*Vice President*



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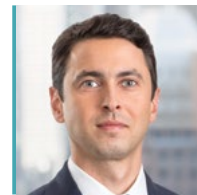
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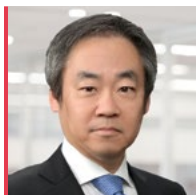


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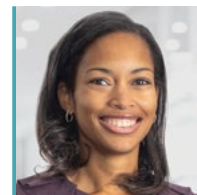
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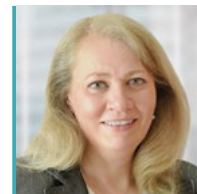
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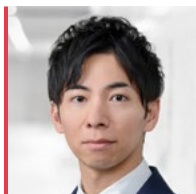
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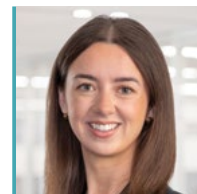
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