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Q4 2025 Market Commentary
The Real Economy Strikes Back: Investing in Energy, Infrastructure, and Resilience

Adam Bernstein, Impact Analyst

Looking Back at 2025

We end 2025 with US pandemic-driven liquidity[1] receding, monetary system cracks deepening, and the S&P 500 still climbing, amidst a volatile world increasingly focused on resource scarcity. Back in January, we noted that structural changes *"provide a tailwind for thematic alpha that does not exist for traditional asset allocation strategies such as the 60/40 portfolio."*[2] That call has aged well.

Last month, in their Long-Term Capital Assumptions 2026 report, J.P. Morgan asserted that, *"Success in the coming decade will depend on maintaining forward looking discipline. To capitalize on opportunities, investors need to focus on developing a long-term investment strategy and leveraging unique sources of alpha to reduce portfolio volatility."*[3] We agree.

The liquidity-driven rally that started in 2020 has masked the economy's underlying softness. Much of what appears to be market strength is nominal - asset prices are rising because they're denominated in a currency that is losing purchasing power. This is evident when comparing dollar-denominated assets like the S&P 500 to real assets such as gold and commodities. In real terms, equity returns have flattened or reversed. The gains investors are receiving appear to be driven more by monetary expansion than sustainable economic growth.

In this environment, strategies focused on real assets, resource efficiency, and physical infrastructure are better positioned to capture genuine, inflation-adjusted growth because their underlying cash flows are linked to tangible supply and demand dynamics. Therefore, our core theses ("Climate Adaptation" and "Energy Addition") are no longer just forward-looking ideas. They are currently delivering measurable alpha and proving themselves aligned with this evolving reality.

The Climate Mitigation "Split Screen"

While we have long been thematic investors focused on climate topics, we've always taken a pragmatic approach - doing our own research and asking lots of questions. As such, we try to take a broader view than what is delivered by the news cycle and political rhetoric alone. A case in point in the last quarter: at the U.N. General Assembly, President Trump dismissed climate change as a "con job," signaling that national security, not decarbonization, now anchors U.S. energy and

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resource policy. Yet, that same week across town, Climate Week NYC gathered the world's largest investors, insurers, and corporates to discuss financing climate adaptation, securing supply chains, and creating resilient portfolios for a warmer, riskier world.

On the surface, these things seem diametrically opposed, but both point to an increasingly acute focus on tangible infrastructure and natural resources. The overlap of national security and decarbonization houses durable investment opportunities, such as grid improvements, water resources, and resilient infrastructure, all of which we've been allocating to for several years.

Recent government interventions are narrated by the security storytellers, but decarbonization can be a co-beneficiary. For example, the recent announcement that the U.S. Government will partner with Cameco, Westinghouse, and Brookfield Asset Management to build $80 billion+ of nuclear power plants[4] and the direct equity investment into Lithium Americas can both deliver emissions reductions. This may seem like a "Pollyanna" view given the backdrop. However, Carlyle's recent report, "The New Joule Order" stated that "[t]he energy security transition [1973-1993] reduced fossil fuels from 94% to 85% of total joule consumption, whereas the Net Zero 2050 transition took it from 85% to 81%… France has one of the lowest carbon footprints in the world, but it didn't get there because its leaders wanted to save the climate—it got there because they wanted energy independence."[5]

From a market perspective, we're seeing strength in energy-transition themes: uranium miners are up more than 80% year-to-date,[6] solar is +40%,[7] wind is +35%,[8] grid infrastructure is +30%,[9] and battery storage at +50%.[10] Per the above commentary, these are not speculative rallies: they reflect the recognition that scarcity, security, and reliable throughput are key opportunities. The mitigation theme is facing political challenges, but it's still very much alive.

China and the Rise of Western State Capitalism

One area of alignment across Climate Week attendees this year, and those of differing political stripes, relates to China's technological prowess. While some question marks remain regarding AI and semiconductor leadership, at least one race has been called: China won the industrial production race to produce renewables and several other clean technologies at scale. More than 80%[11] of solar panels are manufactured in China and its domination of critical minerals supply chains including rare earths, graphite, and lithium give it an advantage in batteries and electric vehicles. Energy independence was clearly a stronger motivator for China than the Paris Agreement. Coal generation has expanded enormously, but given China's continued renewables

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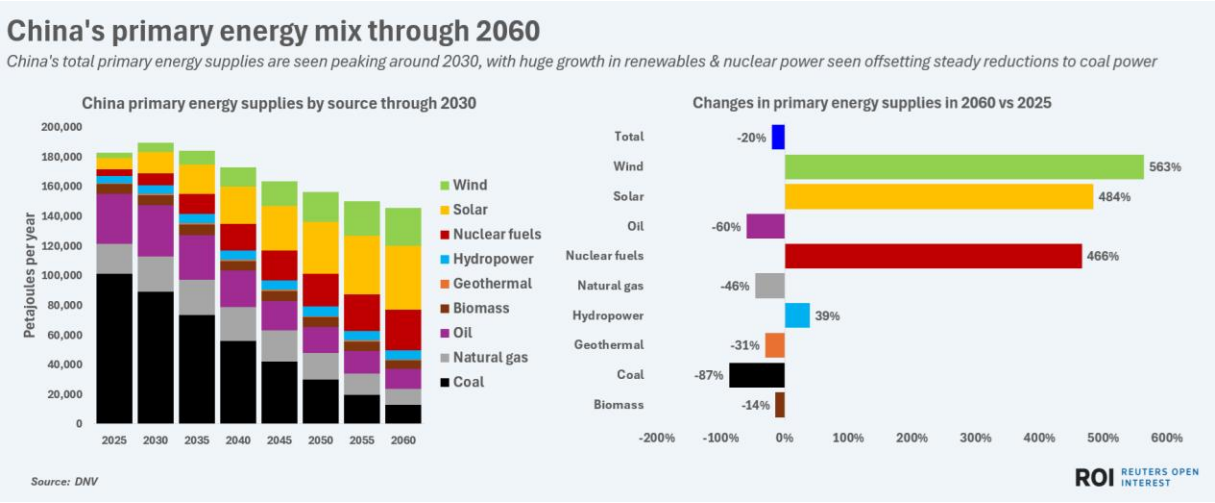
and nuclear energy buildouts, coal's dominance is decreasing. Its energy system is forecast to be ~75% low carbon by 2060.[12]



Source: Reuters[13]

How did they do it? Since joining the WTO in 2001, Beijing's central planning, state subsidies, and low-cost financing de-risked sectors long before the economics would have passed a U.S. private investor's hurdle rate. The result was a wave of cheap Chinese state-backed production that flooded global markets, supplanting Western competitors. Unlike U.S. markets, which penalize redundancy and excess capacity, China built strategic oversupply by design, a lever that now functions as geopolitical leverage. Now, when Beijing imposes export controls, it influences what can be built in the U.S., Europe, and elsewhere. Hence, the international scramble for raw materials and the rise of Western state capitalism.

For decades, the U.S. and other countries benefited from the positive deflationary and environmental effects from China's industrial boom. We offshored emissions and pollution, financialized our economies, and invested billions in attention-eroding software. Meanwhile, China kept investing in industry (and in engineers), recycling surpluses into U.S. Treasuries, keeping U.S. borrowing costs low and deficits affordable.

As we face up to our debt-driven vulnerabilities and atrophied heavy industry, industrial policy is coming at us fast. The Inflation Reduction Act under the Biden Administration sought to correct imbalances and let the market decide where to allocate capital. The Trump Administration's approach is the opposite. Direct government investments into specific companies may help protect and even catalyze some industries, but we can't rebuild them all overnight. We're out of practice in many areas with a lack of skilled workers in sectors that have gone out of fashion.

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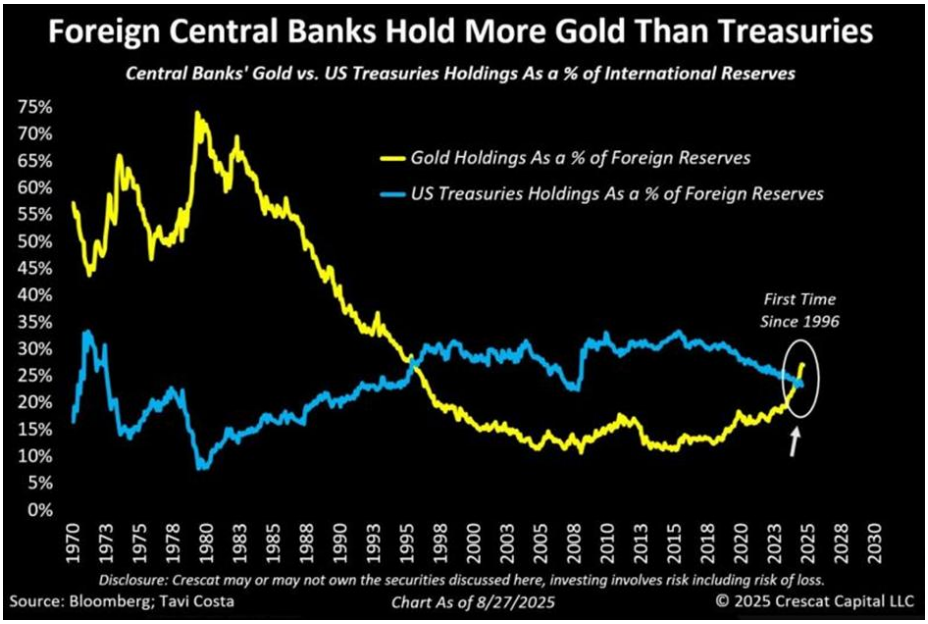
China is also catalyzing a shift in the global monetary order. Now less interested in holding U.S. Treasuries, China and its trade partners are also reducing the global proportion of dollar-denominated, cross-border transactions. In addition, more countries are now issuing (or considering issuing) debt in yuan, while gold is overtaking U.S. Treasuries as a bigger share of central bank reserves for the first time in decades. More government spending in the US - whether on equity investments in mining and industrial companies or broader fiscal initiatives - likely only adds momentum to this real-asset rotation.



Source: Crescat Capital

So, Where Does Climate Fit in?

Adaptation Takes Center Stage

At the end of the day, climate adaptation is largely about infrastructure, whether it's labeled with climate vernacular or not. As U.S. policy attention migrates from emissions targets to jumpstarting real economy sectors, adaptation is inevitable. Infrastructure is a key enabler: from water to energy, grids, raw materials, and insurance-linked financing. Microsoft disclosed a 60% increase in water consumption since 2020, underscoring that even digital infrastructure depends on physical resilience.[14]

Adaptation investments are fragmented, cutting across sectors, geographies, and asset classes. They don't fit neatly into a single taxonomy, making them harder to benchmark, structure, and dedicate capital. That fragmentation creates inefficiency and opportunity, especially for those (like

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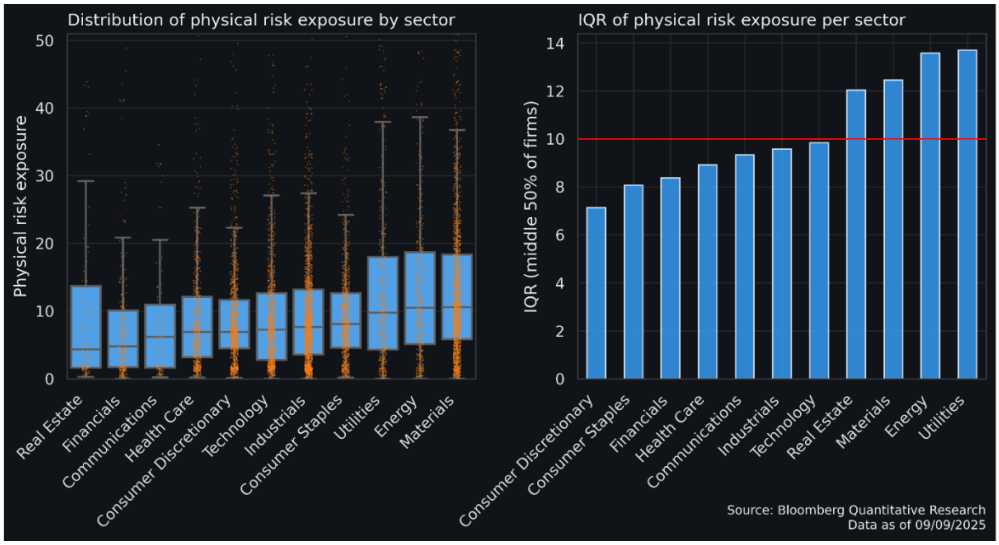
us) who have been allocating capital to these themes for several years. Adaptation is vital, and also under-owned. However, many adaptation-related industries are already profitable and quietly compounding.

Our Climate Adaptation Separately Managed Account (SMA), which is largely solutions based, has outperformed the S&P 500 over the past 5 years by a cumulative 32%.[15] We're also seeing more evidence of physical risk getting priced into individual companies. Bloomberg's researchers recently published evidence that "firms with higher physical risk exposure (+10) face a +22bps premium in WACC [Weighted Average Cost of Capital], even after controlling for sector, region and size… with the premium found to be more strongly evident and pronounced in infrastructure-heavy sectors (Materials, Utilities), as well as some emerging-market regions (Latin America, Asia)."[16] Climate adaptation planning, therefore, is likely to get the same treatment that energy transition planning has already experienced: increased capital allocation towards solutions.

Company-Level Physical Risk Exposure Indicators by Sector



Source: Bloomberg

So, who will lead this new phase of the climate transition? The playing field is still open, and we already see U.S. companies creating outsized gains. Adaptation assets tend to be domestically anchored and politically durable. They are less exposed to tariff and trade policy volatility that affects mitigation supply chains, and are more aligned with insurance mandates, resilience planning, and local government spending. In addition, there is opportunity for broad support, especially where adaptation investments may support resiliency, and therefore house prices, in high-risk areas alongside other local economic benefits.

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Adaptation investing is therefore structurally bipartisan and fundamentally about protecting property, productivity, and fiscal stability. Long-term infrastructure projects must be resilient by design, expanding the potential investor base beyond climate-oriented capital and including pensions, insurers, and sovereign funds seeking predictable returns and inflation protection.

Giving Up on Mitigation? Not So Fast

Adaptation is not a "cop out" and it can coexist with mitigation; one builds resilience to the world as it is, the other prepares for a world we hope to create (one without the worst effects of planetary warming). It's a mindset shift - the acceptance that climate risk cannot be fully eliminated, only managed.

From a pure-mitigation standpoint, it's easy to feel despondent given government cutbacks in climate science, redundancies in sustainability departments across corporates and financial services, and the cancellations of projects and tax credits. But decarbonization is a marathon with many runners still on the course, including major U.S.-based companies with significant Net Zero 2050 targets and related CAPEX projects.

We also have distinct, perhaps underappreciated technological advantages in the U.S., such as nuclear energy and the potential of geothermal, but another mindset shift is needed here. Prior over-focusing on headline generation costs (i.e. Levelized Cost of Energy (LCOE))[17] favored renewables but ignored grid reliability challenges. As we wrote in Q2 2024, "It's important to separate personal and institutional biases, favoring desired outcomes rather than fully considering the complexities of transitioning to a lower-carbon economy." Our view remains that energy systems anchored solely in renewables would be impractical and inflationary, given their lower energy-return-on-energy-invested (EROEI).[18] Dependence on Chinese supply chains only compounds this issue.

However, a low-carbon baseload buildout catalyzed by industrial and artificial intelligence demand is arguably in our wheelhouse. The U.S. still has the world's largest nuclear energy fleet, powering ~20% of our electricity. Underinvestment and lost construction expertise are a huge challenge, and China has gained an advantage there too (forecasts suggest nuclear energy could grow by 56% by 2040).[19] This is arguably a worthwhile challenge if we take a long-term, climate mitigation mindset. We also have potential in geothermal, which could benefit from the same subsurface expertise that powered the shale revolution. Granted, it remains a niche technology, but the shale boom wasn't a given before it happened either!

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In addition, many energy efficiency and grid enhancement technologies are likely to deliver near-term returns. These segments align naturally with U.S. innovation strengths and also underpin emissions reductions. There are ample "picks and shovels" opportunities if you know where to look.

Looking Ahead

Going into 2026, we believe liquidity is unlikely to drive material returns. Performance will instead hinge on assets that enable growth under conditions of structural scarcity. Capital will continue rotating toward the physical systems that sustain growth: energy, infrastructure, and resilience. As this shift unfolds, the market will continue to price the thematic assets we've talked about here.

The Energy Addition Economy is accelerating. Global electricity demand is running well above its long-term average, and the U.S. is on track for record consumption as AI data centers, electrification, and reshoring strain limited grid capacity. As this transition is additive, not substitutive, new generation, storage, and grid investments are being implemented off-grid, and behind-the-meter, as well as on top of existing infrastructure. This means durable, investable opportunities are available across emerging technologies and legacy assets that are low on the cost curve.

Adaptation alpha is materializing. As climate volatility grows more costly and disruptive, the revenue opportunity for companies providing resilience solutions is expanding even faster. Resilience spending has become a balance-sheet reality, insurers are repricing risk, and governments are redirecting capital toward infrastructure hardening.

Today, risk is increasingly concentrated where investors feel safest. The "Magnificent 7" and semiconductor complex have driven extraordinary EPS growth since 2022, but that expansion is now fueled by debt-financed AI CAPEX rather than free cash flow. September's $190 billion in new U.S. corporate issuance—70% from tech—highlights the shift from cash-funded to credit-funded investment. As that cycle matures, the risks associated with adding new capital to those trades multiply.[20]

In periods of rising rates, inflation, and tightening liquidity, traditional 60/40 portfolios have historically underperformed, returning just 1.7% on average from 1972–2024, versus 19.1% in easing, high-liquidity regimes. Some of the weakest stretches also coincided with geopolitical shocks, underscoring the need to move beyond static allocation models toward strategies built for these pressures.[21]

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Given the shifts across the market and economy, asset-allocation frameworks must also evolve. J.P. Morgan Asset Management's 2026 Long-Term Capital Market Assumptions notes that *"capital is in motion, creating a more favorable environment for skilled active managers across hedge funds, private markets, and thematic real assets."*

The next phase of diversification lies in the real economy—the assets that produce, transmit, and store value. Climate Adaptation and Energy Addition are not marginal themes; they are becoming the structural backbone of portfolio resilience. The goal for 2026 and beyond is simple: own the systems the economy needs for growth and be more discerning with respect to those borrowing against an uncertain future.

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[1] Liquidity here refers to *effective* market liquidity — cash available to financial markets after excluding the Treasury General Account (TGA), the Fed's reverse repo facility (RRP), and foreign repos. Our net liquidity gauge peaked at $7.1T in Q1 2021 and stands near $5.9T today, a 17% decline from the pandemic peak, though still ~25% above the 2022 floor.
[2] "Market Outlook: The Rise of Thematic Asset Allocation Portfolios", January 29, 2025, Gitterman Asset Management
[3] "2026 Long-Term Capital Market Assumptions: 30th Annual Edition". 2025. J.P. Morgan Asset Management
[4] "United States Government, Brookfield and Cameco announce transformational partnership", October 28, 2025, Cameco, https://www.cameco.com/media/news/united-states-government-brookfield-and-cameco-announce-transformational-partnership (retrieved on October 28, 2025)
[5] "The New Joule Order", March 2025, Carlyle
[6] Morningstar Direct YTD performance of the NLR ETF as of 10.27.25

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[7] Morningstar Direct YTD performance of the TAN ETF as of 10.27.25
[8] Morningstar Direct YTD performance of the FAN ETF as of 10.27.25
[9] Morningstar Direct YTD performance of the GRID ETF as of 10.27.25
[10] Morningstar Direct YTD performance of the BATT ETF as of 10.27.25
[11] https://www.iea.org/reports/solar-pv-global-supply-chains/executive-summary
[12] "Charting China's evolving primary energy mix through 2060", October 28, 2025, Reuters - https://www.reuters.com/business/energy/charting-chinas-evolving-primary-energy-mix-through-2060-2025-10-28/ (retrieved October 28, 2025)
[13] "Charting China's evolving primary energy mix through 2060", October 28, 2025, Reuters - https://www.reuters.com/business/energy/charting-chinas-evolving-primary-energy-mix-through-2060-2025-10-28/ (retrieved October 28, 2025)
[14] https://www.statista.com/statistics/1500284/microsoft-water-withdrawals-worldwide/
[15] Bloomberg performance data showing gross performance of our Climate adaptation SMA from 07.01.20-09.30.25.
[16] "Does physical climate risk carry a financing premium?", October 15, 2025, Bloomberg Professional Services, https://www.bloomberg.com/professional/insights/sustainable-finance/does-physical-climate-risk-carry-a-financing-premium/ (retrieved October 28, 2025)
[17] A measure of the average total cost to build and operate a power-generating asset per unit of electricity produced over its lifetime, expressed in dollars per megawatt-hour ($/MWh). It allows comparison of different energy sources on an equal cost basis.
[18] A ratio that measures how much usable energy is obtained from an energy source compared to the energy required to produce it. Higher EROEI values indicate more efficient and sustainable energy production.
[19] "Charting China's evolving primary energy mix through 2060", October 28, 2025, Reuters - https://www.reuters.com/business/energy/charting-chinas-evolving-primary-energy-mix-through-2060-2025-10-28/ (retrieved October 28, 2025)
[20] Bloomberg, JPMAM, Charle-Henry Monchau September 16th 2025.
[21] Bloomberg data for a representative portfolio 60% S&P500 and 40% Barclays Aggregate Fixed Income, rebalanced annually.

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