ClearBridge
A Franklin Templeton Company

ESG Outlook 2026: Resilience and Evolution

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Key Takeaways

- Sustainable investing showed itself to be resilient and evolving in an eventful and volatile 2025, with policy support and growing AI power demands emerging as tailwinds for renewables by year end.
- Biodiversity, the social impact of AI and shareholder rights will be among the top environmental, social and governance issues in 2026, respectively.
- Policy on defense stocks in Europe is shifting, while nuclear is gaining acceptance as a critical component of both energy security and sustainability, especially for powering data centers and the energy transition.

For a detailed overview of the topics that will define the landscape of sustainable investing in 2026, we recently spoke with ClearBridge Head of ESG and Portfolio Manager Mary Jane McQuillen.

How are you thinking about portfolio-level sustainability opportunities right now?

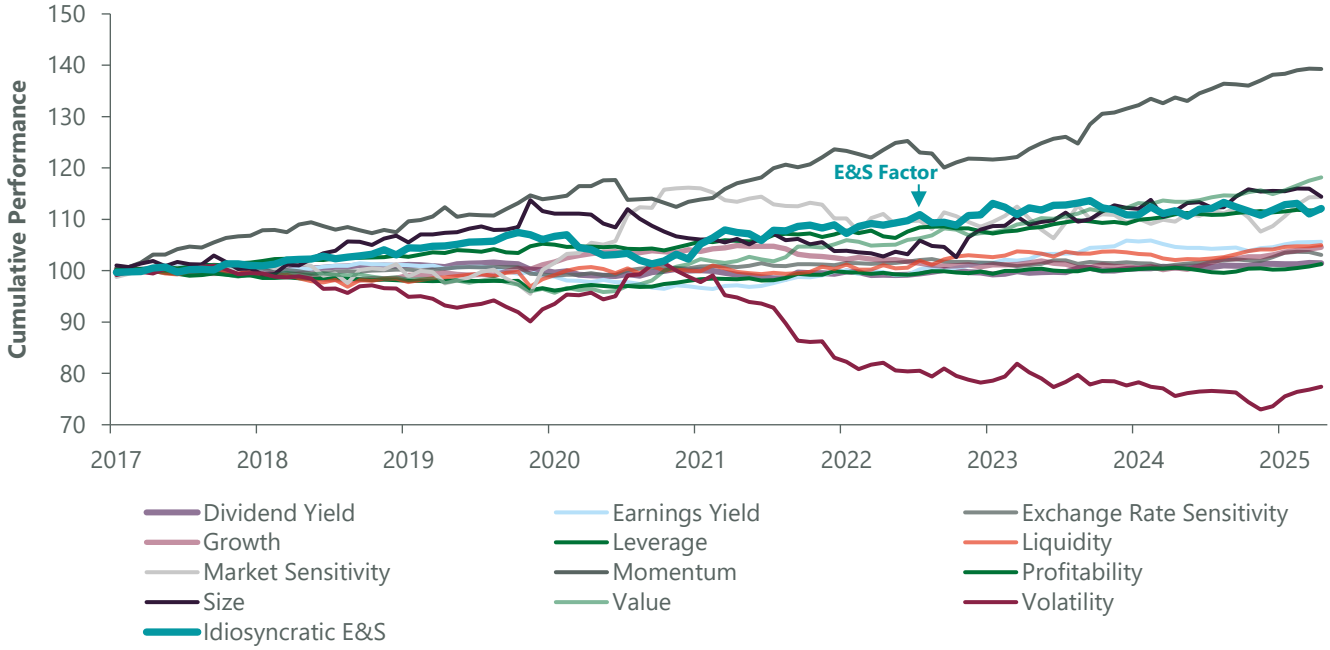
Sustainable investing showed itself to be resilient and evolving in an eventful and volatile 2025. We entered the year with elevated interest rates and some political pressure weighing on renewables; at the same time, a heavily concentrated AI-driven market was a headwind for diversified investors seeking sustainability opportunities across economic sectors.

In a market-driven twist, we end the year with positives for renewables on both of these fronts: despite wind being a slight outlier, renewable energy stocks steadied following the U.S.'s One Big Beautiful Bill passing in July, whose safe harbor update provided some relief and clarity to the renewable space. At the same time, the AI boom's large power demands have given renewable energy an additional tailwind as hyperscalers sign power purchase agreements to secure low-carbon sources of energy, including nuclear. Roughly 90% of incremental power added to the U.S. grid in 2025 was from renewables.[1] Despite negative rhetoric on U.S. renewables, the reality is that renewables form a relatively high percentage of power, both being built today and planned for the immediate future.

We also continue to see data pointing to outperformance of sustainability-leading companies; one performance-tracking model has found that an environmental and social factor has produced positive alpha independent of other style factors, suggesting active sustainability managers have an attractive opportunity set (Exhibit 1).[2] Similarly, one measure of sustainable-themed stocks found that most cohorts (16 of 28) outperformed global equities in 2025, led by materials supporting a circular economy, grid efficiency and green capex dominate thematic cohorts.[3]

[1] Office of Energy Projects Energy Infrastructure Update For July 2025. Data updated Sept. 2025.
[2] The Reliability & Livelihood Imperatives: Thematic investing and sustainability in 2026. Goldman Sachs.
[3] Ibid.

Exhibit 1: Environmental and Social Factor Has Delivered Alpha



Data as of Aug. 2025. Courtesy of Goldman Sachs Global Investment Research. Source: Bloomberg, FactSet, Morningstar, LSEG Data & Analytics, Goldman Sachs Global Investment Research. Note: With the exception of ROW 50 and WO 50 lists, all other stock lists reflect constituents as of the GS SUSTAIN latest publication on the theme. The performance of the ROW 50 and WO 50 cohorts reflect changes in constituents made on Jan. 1, 2025, and May 1, 2025.

Sustainable allocations are also shifting in certain subsectors, as defense and energy security have grown as policy priorities alongside the energy transition, particularly in Europe. This has led to Europe's Defense Readiness Omnibus bill in June 2025 and the clarification under EU Sustainable Finance rules that defense companies' contribution to safeguarding peace and security make them eligible for inclusion in Article 9 funds, which are required to disclose impact outcomes relative to their sustainable investment objectives. Supporting energy security in Europe, nuclear energy is also increasingly on the table for European sustainable investors, as well as in the U.S., where nuclear has been in demand as a power source for data centers.

Looking at sector exposures of sustainability portfolios, the largest overweight relative to global equities broadly is to industrials, likely reflecting interest in energy efficiency, electrification, the renewable energy supply chain and the circular economy / resource efficiency.[4]

What sort of demand for sustainability investment do you foresee in 2026?

Sustainable investing remains in demand around the globe. Recent surveys show 86% of asset owners expect to increase allocations to sustainability strategies in the next two years; energy efficiency and renewable energy are the top two investment priorities for nearly 1,000 institutional investors surveyed across North America, Europe and Asia Pacific, with climate adaptation ranked third.[5] In another survey of 500 global institutional investors, 73% report growth in assets aligned with sustainable criteria, with Southeast and South Asia at 80% and the U.K. at 78%.[6] Natural capital strategies — such as biodiversity — aligned with the energy transition are also in demand.[7]

What are the main sustainable investment themes you foresee in 2026?

While policy support remains dynamic, the reality of climate change has kept climate solutions — decarbonization as well as climate adaptation strategies — very relevant. Companies with products and services that help us adapt

[4] JPMorgan Sustainable Investing Research, Sustainable Investing 2026 Outlook, Dec. 2025.
[5] Morgan Stanley Institute for SI Survey (Nov. 2025).
[6] HSBC Sustainability Pulse Survey 2025 (Dec. 2025).
[7] bfinance MI & Market trends (Nov. 2025).

to climate change are seeing their opportunities expand. Investable categories we're looking at in particular for 2026 include: water scarcity and management to handle droughts and intensifying water stress; grid hardening and resilience via utilities; disaster response needs driving demand for rebuilding materials as well as generators and pumps for emergency response. Other ways to address climate change include climate-resilient construction and materials including insulation, roofing and HVAC systems; wildfire prevention and air quality via monitoring and personal protective equipment; climate-resilient agriculture solutions such as precision agriculture technology and irrigation infrastructure; and climate and environmental data needs in support of supply chains, insurance companies and governments.

Critical minerals are also on our radar, with electrification, the energy transition, AI and defense needs all driving demand for commodities such as copper, aluminum, silver, platinum and lithium. Both independently and as part of Advance, a PRI-led stewardship initiative for human rights and social issues, ClearBridge is engaging mining and metals companies on key ESG issues such as the environmental impact of their operations, their community impact as well as employee health and safety.

What are your expectations for biodiversity as an investable sustainability theme?

Biodiversity has been garnering more discussion in the past few years, and companies, investors and governments are making strides in how they measure and approach it. We generally approach biodiversity through major subcomponents such as forestry, water and climate, which are often related. Forestry topics are especially relevant to homebuilders, home improvement retailers, makers of wood alternatives and consumer staples companies manufacturing paper products, all of which we own or have owned recently.

Biodiversity is also a concern for AI data centers. In a study on data center growth and water use in Phoenix, a booming data center hub, Ceres found that annual water use associated with data center electricity consumption is expected to increase by 400%, from an estimated 2.9 billion gallons to over 14.5 billion gallons, based on planned facilities — enough to supply the entire city of Scottsdale, Ariz. (population 244,000) for over two years.[8] Water stewardship is therefore a major topic of engagement for companies in the AI data center value chain, including hyperscalers. Cooling data centers using air requires more energy than with water, making water the lower-emissions choice; however, more data centers are being built in water-stressed areas, creating potential operational and environmental risks.

Climate and biodiversity are deeply interconnected, as effects of climate change on temperatures, rainfall and seasonality affect how and where species thrive, while biodiversity helps control the climate: forests and wetlands absorb and store carbon dioxide, for example. Companies with products and operations that affect both carbon emissions and biodiversity — both on land and in the water — are relevant investments.

New biodiversity metrics and tools we're exploring to better understand nature-related opportunities and risks include AI-driven geospatial analytics, which use location-based data provided by satellites to identify company asset location and determine operational exposures at the site level. These analytics can then leverage ecological data, such as habitat degradation, species distribution and ecosystem services and components (such as water and pollination) to estimate a company's impacts and dependencies on the ecosystem.

Human rights will continue to be monitored and considered for company engagements where best practices can be applauded, or weak policies and oversight could lead to negative implications, such as in a company's supply chain.

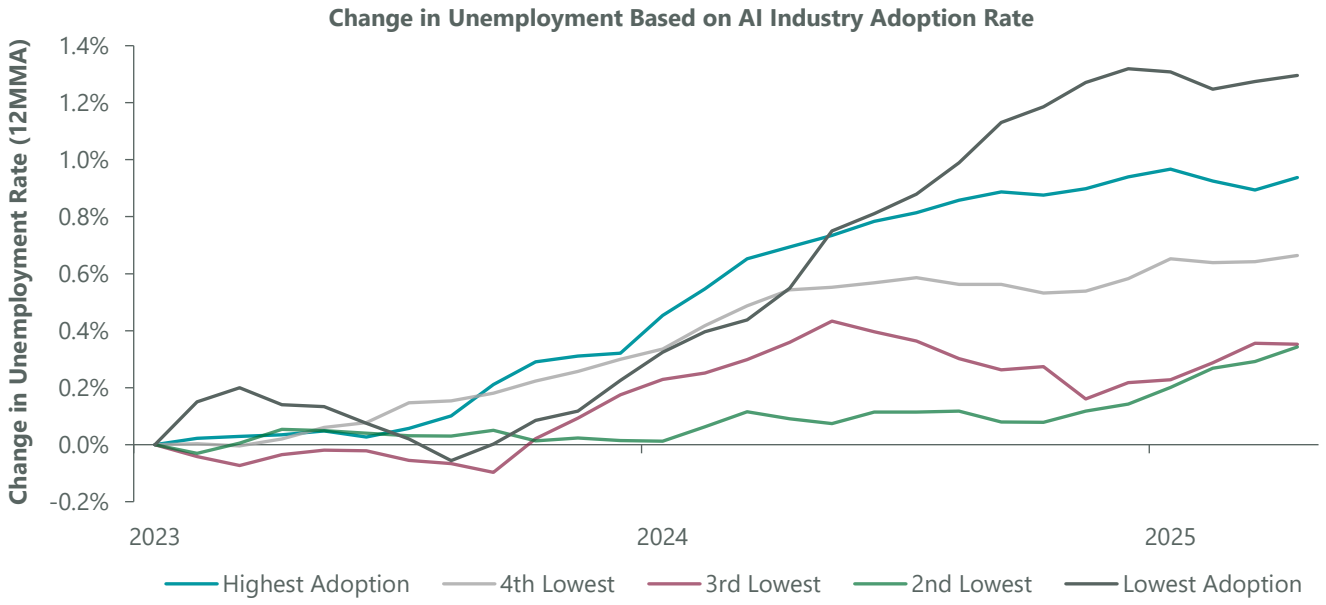
What is the most pressing development on the social side?

Many workers and governments are concerned about the social impacts of AI, for example on employment, as well as the responsible and ethical uses of AI. While some have feared elevated job losses due to AI, a closer look reveals a more nuanced picture. When evaluating job creation and AI adoption by industry, labor weakness has been most evident in industries with the lowest AI adoption rates (Exhibit 2). This suggests other dynamics are

[8] Drained by Data: The Cumulative Impact of Data Centers on Regional Water Stress. September 2025.

playing a larger role than AI in slowing job growth — perhaps changing immigration and trade policy and an aging U.S. population, for example.

Exhibit 2: AI Adoption as Dominant as Believed in Labor Market Weakness



Data as of Sept. 30, 2025, latest available as of Nov. 30, 2025. Source: ClearBridge Investments, Wolfe Research, Haver Analytics.

Echoing this, a report from the Budget Lab at Yale University sees a labor market more stable than disrupted since ChatGPT's release. Among other things, it finds much less observed usage of AI than expected in occupations such as sales, office and admin support, management and business and financial operations, while computer and mathematical occupations as well as arts, design, entertainment, sports and media have higher than expected usage.[9] It also finds that, comparing different periods of technological change, the job mix shift for AI is faster than for other periods, but not excessively so.

Nevertheless, like these past periods of technological change, AI will certainly have a large impact on industry and labor over time and will require diligence in monitoring.

Likewise, we regularly and proactively engage companies on the responsible and ethical use of AI, for example connected to the use of creative intellectual property, customer data and privacy and improving the quality of results. We highlight to companies the need to make AI systems fair, transparent, accountable, safe, privacy-respecting, secure, environmentally sustainable, aligned with human values and with meaningful human oversight.

What major governance issue will dominate 2026?

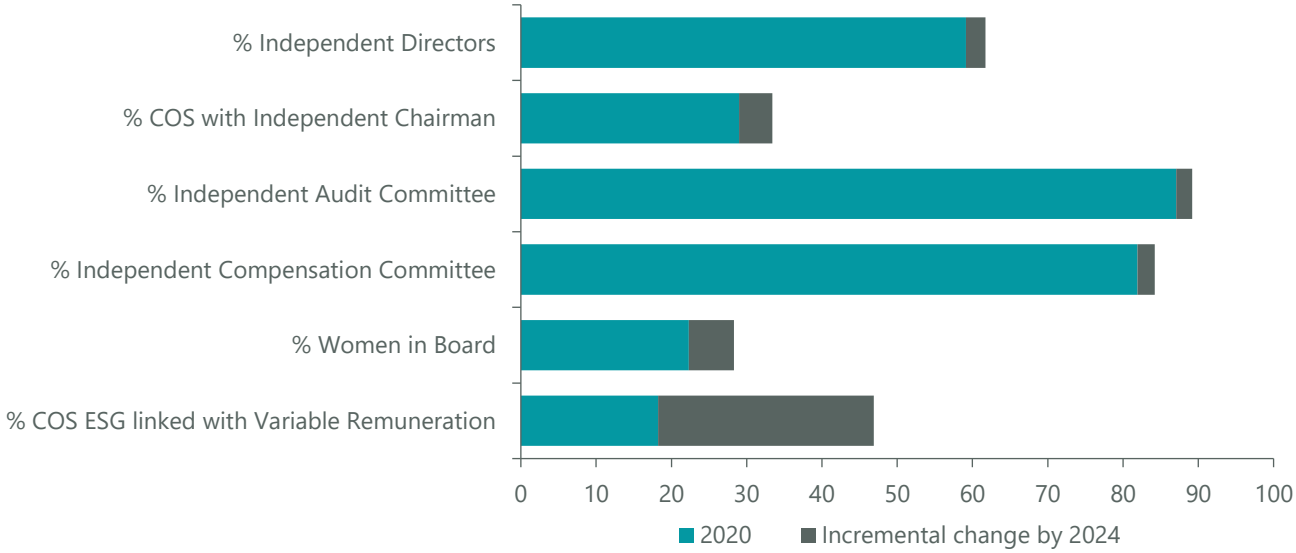
Shareholder rights will be a governance issue to watch in 2026. In early 2025, the SEC tightened parameters for shareholder proposals, strengthening the grounds on which they can be excluded from annual meetings due to lack of economic relevance, lack of significance for the particular company in question (as opposed to a broad societal issue), and concerns of micromanaging if a proposal is overly detailed in its proposed methodology or time frame.[10] Then in November, in a major policy shift, the SEC announced it would no longer "respond to no-action requests for, and express no views on, companies' intended reliance on any basis for exclusion of shareholder proposals under Rule 14a-8," with minimal exceptions. The likely result of this decision will be to enable companies to exclude proposals without having to seek SEC approval, leading to fewer shareholder proposals making it to a vote. We will be monitoring the potential impact of these actions as they play out across the 2026 proxy season.

[9] "Evaluating the Impact of AI on the Labor Market: Current State of Affairs," The Budget Lab, by Martha Gimbel, Molly Kinder, Joshua Kendall and Maddie Lee, Oct. 1. 2025.
[10] Staff Legal Bulletin No. 14M.

As shareholder rights become a developing concern, along with management issues such as board independence and executive compensation, it is critical that investors uphold their fiduciary obligations by actively engaging with companies on governance and related matters, which we believe could ultimately enhance a company's financial performance or avoid governance risks.

We continue to view good governance as a catalyst for value creation: board and chair independence reduces insular oversight; separating CEO and board chair roles reduces the potential for conflicts of interest; diversity on the board leads to more varied views and strengthens governance; board tenure should balance experience with innovation; linking compensation with sustainability factors could improve environmental stewardship and ensure the social license to operate. These goals are all worthy of supportive company dialogue, and we have seen incremental improvements across many of them in recent years (Exhibit 3).

Exhibit 3: Incremental Improvements in Governance Factors (Global)



As of Nov. 2025. Courtesy of Bernstein Societe Generale Group, "Sustainability Research: Beyond compliance – governance as a catalyst for informed stewardship." Source Bernstein analysis, Bloomberg. Combined universe: STOXX 600, S&P 500, MSCI APAC.

Conclusion

Demand for sustainability investments in 2026 will focus on energy efficiency, renewables and climate adaptation as top priorities. Biodiversity is also gaining traction as an investable theme connected to decarbonization, deforestation and water, with new metrics and AI-driven analytics being explored. On the social side, concerns largely center on AI's impact on employment, though evidence suggests broader factors are at play. Human rights continue to be monitored. Governance issues will focus on shareholder rights, with regulatory changes prompting closer investor engagement. Adaptation, innovation and active stewardship will be key for sustainable investing in 2026.

About the Author

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- 29 years of investment industry experience
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