

9 things to watch in thematic in 2023 (Part 2)

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The start of 2023 was marked with a comeback of risk appetite in equity markets. Expectations of a Federal Reserve (Fed) pivot by the end of H1, and somewhat improving odds of a soft landing amidst resilience of the job market, have sparked positive sentiment for risk assets. In this environment, many thematic strategies confidently outperformed the global equity benchmark, MSCI ACWI.

However, continued resilience of the job market in the United States, and a higher-than-expected inflation print in January, was followed by a series of commentaries from Fed officials indicating more interest hikes are needed to combat inflation. Most recently, Jerome Powell's testimony to the Senate Banking Committee resulted in markets pricing in a higher terminal rate and a half-point increase in the March Federal Open Market Committee (FOMC) meeting.

Just a few days later, equity markets, and bank stocks in particular, were hit further with a failure of Silicon Valley Bank (SVB), one of the most important banks for tech start-ups. SVB fell victim to a bank-run after announcing a fire sale of its \$21 billion bond portfolio resulting in a \$1.8 billion after tax loss. SVB's fallout caused the market to reverse to earlier expectations of a pivot by the end of H1.

These events have undoubtedly propelled the macro environment to take centre stage in any investment decisions in the short term. Investors might be shunning risk assets, including thematic, until there is a clearer macro path forward. However, for any thematic investors in search of long-term opportunities or re-assessing their current portfolio, we continue our discussion of 9 things that investors should watch in thematic in 2023. In [Part 1](#), we discussed the first 4, in this blog we will cover the remaining 5 points.

5. Theme-focused strategies vs diversified themes

When it comes to thematic strategies, investors in Europe have a vibrant palette to choose from. Key distinctions between the strategies, however, lie not just in the different themes that the strategies tap into, but the selection of investment opportunities within those themes. Thematic strategies can also differ in their approach to target one defined theme or several themes at once. In Figure 1, we show a comparison of focused themes vs multi-themes in Europe and trends we see in exchange-traded funds (ETFs) and open-ended (OE) funds.

Figure 1. Thematic strategies in Europe targeting one theme (focused) vs strategies targeting multi-themes

Source: WisdomTree, Morningstar, Bloomberg. As of 28 February 2023. AuM and flows data presented in \$millions. All data based on WisdomTree's internal classification of thematic funds.

Historical performance is not an indication of future performance, and any investments may go down in value.

First of all, we note how thematic assets in ETFs are mostly represented by the focused themes, while assets in OE funds have around a 60/40 split between the focused and multi-theme strategies. The focused themes are, overall, more popular among the asset managers as the number of focused funds is more than twice as high. However, we note that the multi-theme strategies hold more assets per fund due to the impact from OE funds, \$461 million vs \$384 million. Turning to the year-to-date flows into ETFs and OE funds, it's clear that investors were preferring, however, the focused funds to the multi-theme strategies.

There are a range of benefits associated with investing in the focused-theme funds vs multi-theme funds: 1) ease of incorporating expertise in one theme vs multi-themes; 2) potential trade-off of purity for liquidity in a multi-theme portfolio holding fewer liquid names in each given theme; 3) ease of expressing views on a given theme, for example, investing in the artificial intelligence theme in the wake of developments around large language models and ChatGPT.

6. Flows into tech themes vs green themes

The last two years have seen the dominance of green themes, or the “Environmental Pressures” cluster, in Europe in terms of flows. However, in the first two months in 2023, tech-focused themes have been bucking the trend, buoyed by strong performance and flows going into “Artificial Intelligence & Big Data” and “Semiconductors”. In addition, “Environmental Pressures” suffered from outflows in multi-theme funds as well as “Agriculture” and “Sustainable Food” themes, while “Sustainable Energy Production” continued to generate strong interest.

Flows going into “Environmental Pressures” in 2022 could have been associated with the increased focus on such topics as energy and food security, as well as the relative resilience of green themes performance-wise. Similarly, given the magnitude of the 2022 correction across tech-focused thematics, the share of flows going into tech themes in 2023 might suggest wider expectations of a Fed pivot or might be indicative of any major developments happening in the space. Thus, a comparison of flows going into green and tech themes can add additional colour on the sentiment in the equity markets and potential shifts in it.

Figure 2. Annual flows into thematic strategies in Europe (\$, millions)

Source: WisdomTree, Morningstar, Bloomberg. Flows data presented in \$millions. All data based on WisdomTree's internal classification of thematic funds.

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7. Strategic vs tactical use in portfolios

In [Part 1](#) of this two-part blog series, we were discussing how certain performance characteristics of thematics make them interesting both for strategic and tactical plays. Some investors choose to exploit

hype cycles associated with the development of certain themes creating lucrative short-term opportunities. Periods of correction might also reveal if the majority of investors are allocating assets to a certain theme for short-term gains or they believe in its long-term potential. Watching the trends in flows in 2023 might help investors with their own strategic and tactical decisions when it comes to thematic.

Figure 3. Flows into thematic strategies in Europe as percentage of AUM at the end of the corresponding year

Source: WisdomTree, Morningstar, Bloomberg. All data based on WisdomTree's internal classification of thematic funds.

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In 2022, as we can see in Figure 3, positive flows across “Environmental Pressures”, “Geopolitical Shifts” and “Diversified Thematics” in total comprised around 10-15% of the assets under management (AUM) in those strategies as of 31 December 2022. The corresponding figures in 2021 were 47%, 65% and 30%. At the same time, negative flows were observed in “Technological Shifts” and “Demographic & Social Shifts” and were under 6% of the AUM as of 31 December 2022. The corresponding shares in 2021 were 20% and 25%. This comparison of flows during the worst correction period in 2022 vs. 2021 allows us to assume that, generally, investors were using thematic rather strategically than tactically. If tactical use were prevalent, we would have expected to see much higher share of outflows in 2022.

8. Pace of thematic launches

One of the trends that we track as part of our WisdomTree Thematic Universe, and report on a quarterly basis in our [European Thematic Monthly Update](#), is the number of launches happening in the thematic space across ETFs and OE funds. The dynamics of launches allows us to assess the growth of the space and reflects asset managers' beliefs around thematic. In 2022, we saw thematic launches slowing down across OE funds, but setting new record in ETFs.

Overall, asset managers introduced 161 new thematic strategies in Europe. That falls only 18 funds short of the 2021 record. Launches within the “Technological Shifts” cluster dominated in 5 out of 12 months, while launches from “Environmental Pressures” prevailed in the rest. We will monitor the space in 2023 and report our findings in our quarterly thematic blog for Q1.

Figure 4. Monthly thematic launches in Europe across clusters in WisdomTree's Thematic Universe

Source: WisdomTree, Morningstar, Bloomberg. All data based on WisdomTree's internal classification of thematic funds.

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9. Launches in newly introduced themes vs saturated themes

Launches of thematic strategies can also provide insights on managers' beliefs around a theme's future potential. In this regard, one thing that is interesting to watch in launches is if asset managers are launching strategies in any new themes and if they introduce any new strategies in saturated themes. Analysing the top 5 themes by launches in 2022 in Figure 5, we can see that asset managers were launching funds in newly introduced themes such as "Metaverse" and "Protect Biodiversity". Given the costs associated with launching new funds, this trend might reflect strong beliefs of asset managers in the future of those themes.

New themes aside, the highest number of fund launches in 2022 was happening in the top 5 themes (by AUM and the number of strategies in Europe) - that is, 'saturated' themes. Any launches happening in saturated themes might indicate more differentiated and innovative ways to capture investment opportunities in those themes and thus might be interesting for investors to explore.

Figure 5. The top 5 themes by launches in Europe in 2022

Source: WisdomTree, Morningstar, Bloomberg. All data based on WisdomTree's internal classification of thematic funds.

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In this unprecedented macroenvironment, with important events unfolding pretty much every week, we will continue watching the thematic landscape and will share our observations in the review of Q1 in April 2023. Stay tuned.

Footnotes:

1. All figures are based on the WisdomTree's internal classification of thematic funds and WisdomTree's calculations using the underlying data from Morningstar and Bloomberg.

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