

The evolution of investing: from stagnant sectors to dynamic themes

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Key Takeaways

- **Sector investing's stagnation:** Despite being around for decades, sector investing has failed to evolve in line with the rapidly changing market and economy, limiting its effectiveness in the modern investment landscape.
- **Advantages of thematic investing:** Thematic investing offers several benefits over sector investing, including a broader perspective, future orientation, flexibility across traditional sector boundaries, better diversification, the potential for higher returns, and alignment with personal values. It focuses on long-term trends reshaping society and the economy across multiple sectors.
- **WisdomTree Megatrends UCITS Index:** This index represents a multi-thematic investment approach, covering 16 themes across three megatrends (as of July 2024). It provides access to pure players, maintains low overlap with traditional indices and mega-caps, employs multiple levels of alpha generation, and has outperformed the MSCI ACWI net total return index in backtested data over 20 years.
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Sector investing has been around for decades but has failed to evolve with time

As a distinct investment strategy, sector investing emerged and gained prominence in the 1980s and 1990s. However, its roots can be traced back to earlier developments in the financial markets. The concept of sector investing evolved from the broader trend of categorising stocks and creating specialised investment products. This evolution was driven by several factors:

- **Development of sector indices:** In the 1970s and 1980s, financial data providers began creating sector-specific indices, allowing investors to track different industries' performance more easily
- **Expansion of mutual funds and the introduction of ETFs:** The 1980s saw significant growth in mutual funds, including sector-specific funds focused on particular industries or economic sectors. The launch of the first exchange-traded fund (ETF) in 1993 and competition in the industry thereafter also paved the way for sector-specific ETFs

- **Technological advancements:** The rise of computerised trading and improved data analysis capabilities in the 1980s and 1990s enabled more sophisticated sector-based investment strategies
- **Economic shifts:** The increasing importance of certain sectors, such as technology, in the overall economy during the 1990s drew more attention to sector-based investing

While the concept of investing in specific industries has existed for much longer, the formalisation of sector investing as a widespread strategy, supported by specialised financial products and indices, primarily took shape in the 1980s and 1990s. This period saw the birth of sector investing as we know it today, with investors able to easily allocate their portfolios based on specific economic sectors or industries.

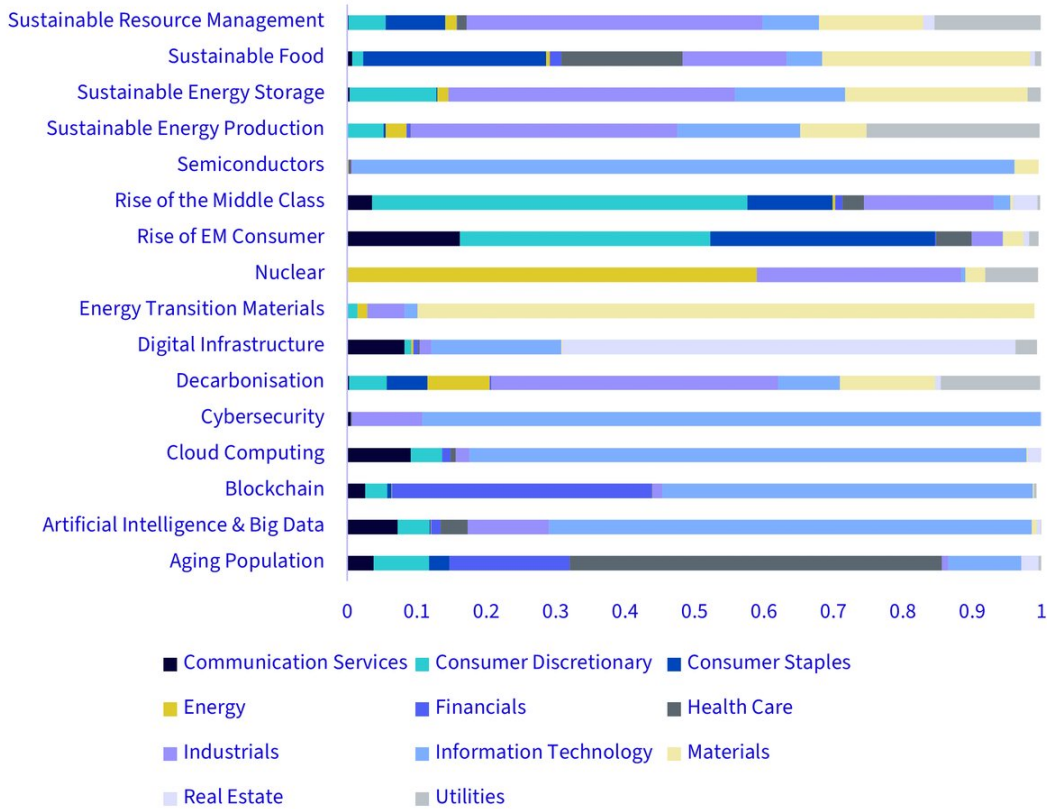
Thematic investing could offer better exposure to trends while improving diversification

Thematic investing became more relevant in the 2000s with the rise of the internet and rapid technological advancements. While sector investing focuses on specific industries, thematic investing takes a broader approach by identifying and capitalising on long-term trends that are expected to reshape society and the economy across multiple sectors.

Thematic investing can be considered advantageous over sector investing in several ways:

- **Broader perspective:** Thematic investing looks at the bigger picture, identifying powerful cross-cutting trends that can drive growth across various industries and regions rather than focusing on a single sector
- **Future-oriented:** It allows investors to buy into a vision of the future, potentially capitalising on transformative forces shaping the world. It allows investors to hold smaller pure-play companies aligned with long-term trends and on the road to becoming large/mega caps
- **Flexibility:** Thematic investing is not constrained by traditional sector boundaries, which have not kept pace with the market evolution, allowing for more adaptable investment strategies as trends to evolve
- **Diversification within themes:** A single theme can encompass companies from multiple sectors. For example, a "clean energy" theme might include energy companies, electric car manufacturers, and battery producers, and an "artificial intelligence" theme might be focused on semiconductors, information technology, and even financials and real estate
- **Potential for higher returns:** By identifying and investing in emerging trends early and in turn focusing on the next potential mega caps, thematic investing may offer the potential for higher returns compared to broader market indices, which tend to be concentrated on mega caps of today
- **Alignment with personal values:** Thematic investing often allows investors to align their portfolios with their beliefs and values, making it appealing for those seeking both financial and impact-driven outcomes

Figure 1: Themes traverse through sectors and provide diversification

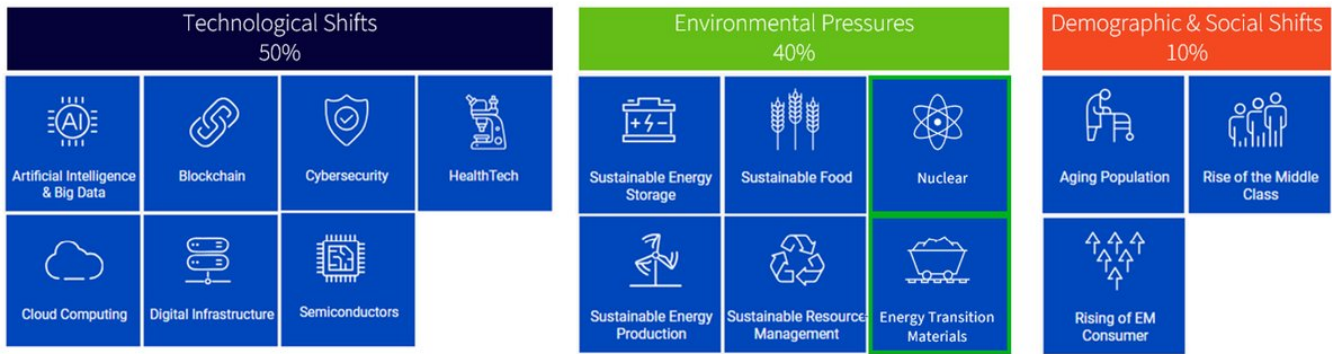


Source: WisdomTree, FactSet. As of 29 Mar 2024.

The WisdomTree Megatrends UCITS Index: An innovative approach to multi-thematic investing

For investors looking for multi-thematic exposure that can provide broad-based, pure-play exposure to themes that can provide exposure to the most relevant trends and their evolution over time, the [WisdomTree Megatrends UCITS Index](#) consists of 16 themes in three broader megatrends, as shown below.

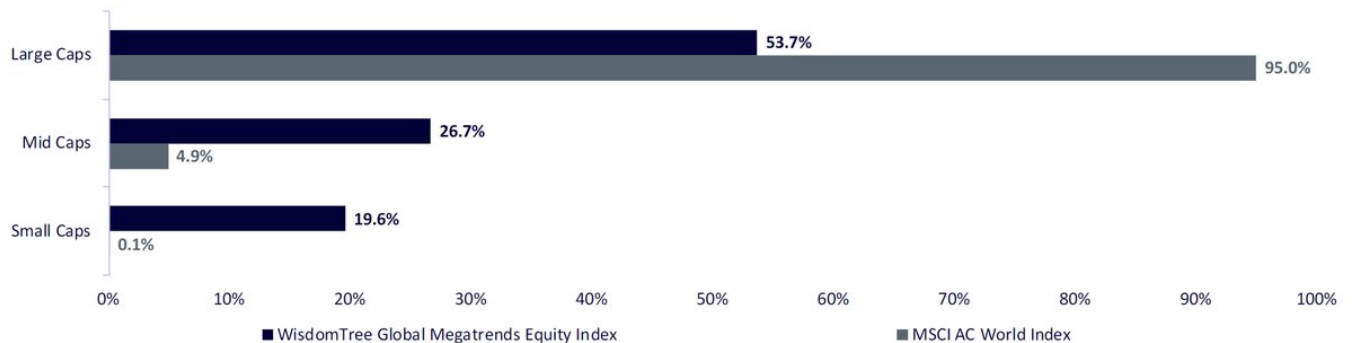
Figure 2: Themes in the WisdomTree Megatrends UCITS Index



Source: WisdomTree. As of 22 April 2024.

The MSCI AC World could be looked at as a **multi-sector** investment strategy. Contrast that to the **multi-theme** investment strategy of the [WisdomTree Megatrends UCITS index](#), which, despite taking a broad approach to include a wide range of themes, maintains low overlap with the MSCI AC World, which as of 22 April 2024 was just 17.9%. Holding true to its promise of capturing next-generation mega-caps, the overlap with the current mega-caps also remains low, with weight allocated more evenly to companies with high potential and alignment with long-term trends. This can be seen in the market cap distribution below and the overlap with the top 10 stocks in MSCI AC World.

Figure 3: Market-cap distribution versus MSCI AC World



Source: WisdomTree, FactSet, Bloomberg. As of 29 March 2024. The Index uses weights as of the rebalancing on 19 April 2024.

Figure 4: Overlap with the top stocks in MSCI AC World (Mega Caps)

Source: WisdomTree, FactSet. As of 22 April 2024.

The [WisdomTree Megatrends UCITS Index](#) deploys multiple levels of alpha generation, wherein the strategic thematic asset allocation relies on long-term trends and relevance of the themes (reviewed annually in April), the tactical thematic asset allocation overlay captures short-term trends and momentum in selected themes (reviewed quarterly), and the final overlay removing laggards from each theme to avoid stocks within themes that have underperformed the broader theme (reviewed quarterly). This alpha

generation process has added performance with each layer in the last 20 years of backtested data, all outperforming the MSCI ACWI net total return index.

Figure 5: Multiple layers of alpha generation in 20 years of backtested data



Source: WisdomTree, FactSet. From 3 Oct 2005 to 27 May 2024. **Historical performance is not an indication of future results and any investments may go down in value.**

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