Opportunities and challenges of thematic investing: how to diversify your exposure

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Key Takeaways

- 92% of professional investors surveyed have existing investment in thematic strategies
- Investors continue to face investment barriers in thematics, such as too many strategies, too high overlap with market indices, and difficulty in choosing themes.
- In response to those difficulties, more and more investors are turning towards thematic investment experts and multi-thematic strategies.

Thematic investing has gained significant traction amongst investors. In our annual professional investor survey, an impressive 92% of investors indicated that they allocate capital to thematic strategies[2]. Total assets under management (AUM) globally in the thematic space now stands at $554.2 billion as of end of November 2024[3].

Thematic strategies: an established investment

The appeal of thematic investing is undeniable. Technology advancements, demographic shifts, or sustainability initiatives can drive growth over long periods of time and create the giants of tomorrow. This allows investors to align their portfolios with long-term trends, invest early in future winners, and potentially yield substantial returns.

Over the last few years, more and more investors have turned to thematic strategies, with exchange-traded fund (ETF) strategies proving a popular investment vehicle for thematic exposures: nearly a quarter (24.7%) of investors exclusively use ETFs and just over a quarter (25.2%) use both ETFs and active funds[4].

The paradox of choice

Despite the enthusiasm for thematic strategies, several barriers hinder effective allocation. One of the most significant challenges is the number of themes themselves (and then the number of available strategies for each theme). Over 21% of survey respondents cited ‘too many strategies to choose from’ as a key barrier[5]. It appears the overwhelming variety can lead to analysis paralysis.

Theme selection and allocation can be further complicated by timing. Identifying the right theme to invest in and the right moment to overweight or underweight that theme can be challenging. This difficulty is echoed in the survey results, where nearly 19% of professional investors expressed concerns about existing products following fads rather than sustainable trends[6].

Thematic strategies with a high market overlap can also cause problems within a portfolio. A lack of differentiation can dilute the intended benefits of thematic investing and its diversification potential. High overlap between themes can also be an issue when constructing a multi-thematic portfolio: 20.44% of investors noted that they often encounter too much overlap with existing portfolio allocations when considering new thematic investments[7]. This overlap can lead to unintended risk concentrations and hinder overall portfolio diversification.

The case for multi-thematic strategies

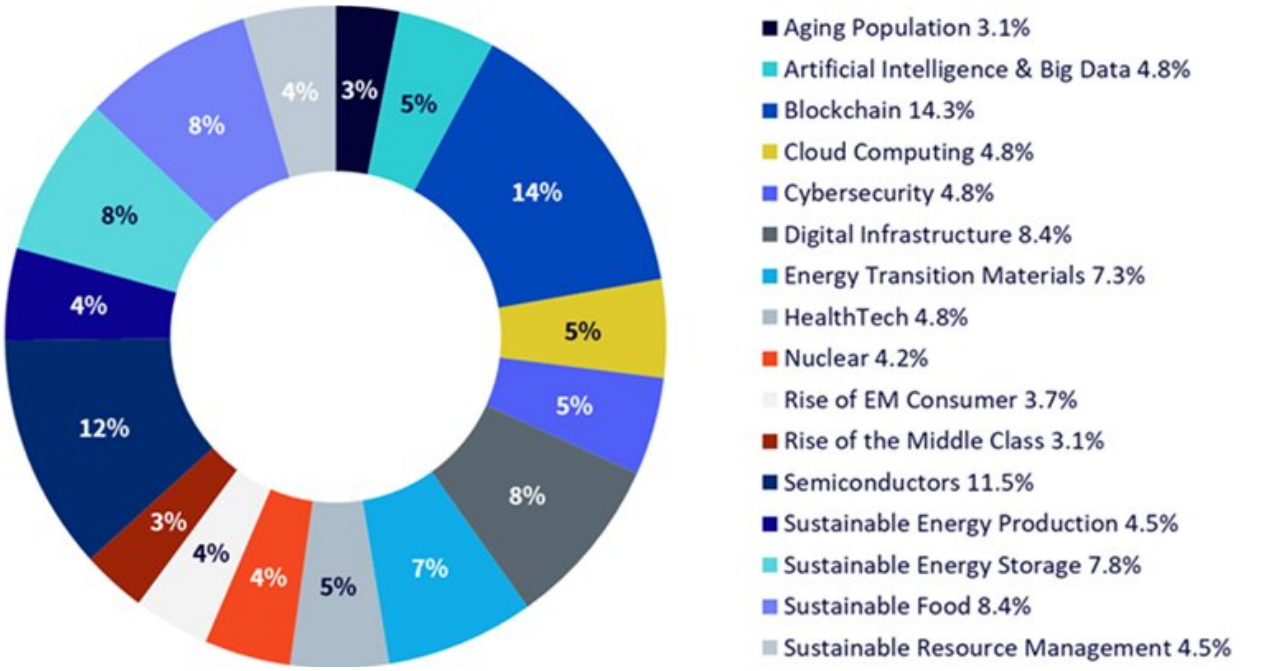
Given these challenges, delegating thematic investment decisions to a specialised manager may be a prudent approach. Multi-thematic strategies allow investors to tap into various themes without the burden of selecting individual themes or timing their investments perfectly. Multi-thematic strategies can provide a one-stop shop solution to investors and offer a more diversified exposure, while mitigating some risks associated with single-theme investments.
Single-theme strategies saw a period of dominance between 2019-2021, which led to the proportion of thematic assets invested in multi-thematic strategies dropping to 10% at the end of 2021. Since then, multi-thematic strategies have had a resurgence, and now account for 17.5% of all thematic assets[8].

WisdomTree Megatrends UCITS ETF (WMGT)

The **WisdomTree Megatrends UCITS ETF (WMGT)** employs a top-down, expert-driven approach to the construction of a multi-thematic strategy. The investment process aims to balance diversification and targeted exposure with high-growth stocks. It integrates three layers of alpha generation:

- Strategic allocation: annually select around 15 themes based on growth potential, diversification potential, and alignment with UN SDGs.
- Tactical adjustments: apply a quarterly momentum-based tactical overlay to adjust theme weights to capitalise on changing opportunities.
- Stock selection: use expert-driven stock selection to create a portfolio of pure play, future-focused companies.

Figure 1: WisdomTree Megatrends UCITS ETF (WMGT) – the thematic allocation



Source: WisdomTree. As of 18 October 2024. Historical performance is not an indication of future performance, and any investments may go down in value.

The resulting portfolio is composed of 651 stocks, with only 17.7% overlap with the MSCI All Country World, 14% overlap with the Nasdaq and 2.3% in the Magnificent Seven . The strategy, therefore, offers investors a diversified portfolio of growth-oriented companies tilting toward mid and small caps that is highly differentiated from their core investments.

Since launch, the strategy has returned 46.8%, beating the MSCI All Country World by 7.05% [10]. Despite clear headwinds in thematic equities, the strategy created outperformance thanks to the top-down approach used in the portfolio construction:

- First, the strategic asset allocation was detrimental. Overall, 2024 has been a difficult year for thematics, with 11 themes underperforming the market. This led to -6.3% of relative underperformance created by this layer.
- Second the tactical asset allocation performed very well, creating 7.6% of outperformance. The tactical allocations to Blockchain (overweighted), Artificial Intelligence (AI) (mostly overweighted), Cybersecurity (oscillating between overweight and underweight), Nuclear (mostly overweighted until recently) and Semiconductors (overweighted) were particularly positive.
- Finally, our expertise-driven, pure-play stock selection led to a contribution of +5.75% versus the benchmark, with Blockchain and Semiconductors being strong drivers[11].

Figure 2: Performance attribution since inception of the strategy (by layers)

	Relative Contribution of Strategic Allocation (vs MSCI ACWI)	Relative Contribution of Tactical Allocation (vs MSCI ACWI)	Relative Contribution of Stock Selection (vs MSCI ACWI)	Total Relative Contribution (vs MSCI ACWI)
Total	-6.30%	7.60%	5.75%	7.05%

Source: WisdomTree, Bloomberg. In USD. From 27 October 2023 to 2 December 2024. You cannot invest directly in an index. **Historical performance is not an indication of future performance and any investments may go down in value.**

Conclusion

Thematic investing presents an exciting opportunity for professional investors seeking to capitalise on long-term trends. However, the complexities surrounding theme selection, timing, and portfolio overlap make it a challenging endeavour. As such, delegating these responsibilities to a multi-thematic strategy may prove more effective in navigating the intricacies of thematic investing while maximising potential returns. The **WisdomTree Megatrends UCITS ETF (WMGT)** could mitigate some of these typical barriers to entry and prove a useful tool in portfolios.

Source

1 WisdomTree Pan European Professional Investor Survey, June-July 2024, 800 respondents, conducted by Censuswide.

2 WisdomTree Pan European Professional Investor Survey, June-July 2024, 800 respondents, conducted by Censuswide.

3 WisdomTree, Morningstar, Bloomberg. All data as of 30/11/2024 and based on WisdomTree's internal classification of thematic funds. Performance is based on monthly returns from Bloomberg and Morningstar. ***Historical performance is not an indication of future performance, and any investments may go down in value.***

4 WisdomTree Pan European Professional Investor Survey, June-July 2024, 800 respondents, conducted by Censuswide.

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6 Ibid.

7 Ibid.

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9 WisdomTree. As of 18 October 2024. ***Historical performance is not an indication of future performance, and any investments may go down in value.***

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