Are megatrends the crystal ball that investors need?

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Key Takeaways

- Thematic investing offers what could be the closest thing to a crystal ball to investors. Spotting trends early is a lot easier than spotting exponential growth stocks early.
- The valuable knowledge delivered by a thematic lens can be leveraged into a portfolio that maximises investors' chance to catch tomorrow’s mega caps early.
- Investing in megacaps or overconcentrating thematic investments are the two fundamental mistakes investors should avoid if they want to benefit from the insight offered by a thematic lens.

Investing with the ability to predict the future is a tantalising notion, one that has almost become a Hollywood trope. How many movies or TV shows feature characters who amass wealth using future information for investments? Who would not want to return to the 1970s and buy a few Apple shares? Yet, the truth for any investor is far from this fantasy. There is no crystal ball, time machine, or certainty.

However, investors still have a wealth of information and tools at their disposal to make informed decisions. One such tool is pattern recognition. Consider factor investing, which involves identifying which stocks have performed well or poorly in the past and using that knowledge to build successful portfolios. But what if there was a pattern that could have guided investors to exponential growth stocks, like Apple or Amazon, before their exceptional run and became household names? Surprisingly, there is. It's called thematic investing.

Is thematic the new crystal ball for growth stocks?

Reflecting on the past, we can discern a pattern between leading megatrends, or structural shifts in the world, and the rise of megacaps. One of the most significant trends in the 1970s and 1980s was the economic miracle of the rise of Japan. It is no coincidence that the biggest companies in the world in the 1990s were Japanese stocks, with Nippon T&T, Bank of Tokyo Mitsubishi and Industrial Bank of Japan as the three biggest. Similarly, from the end of the 1990s, a driving source of disruption has been the internet and the subsequent digitalisation of our world. Again, it is not a coincidence that Amazon, Alphabet and Meta are among the biggest companies in the world 20 years later.

In other words, history teaches us that to invest early in the biggest companies of the 2030s and 2040s, investors need to look at what trend or technology is structurally changing the world now. While finding the next Apple is hard, finding those structural drivers is not as hard. There is already quite a large consensus around the following five: Artificial Intelligence, Digitalisation, Energy Transition, Health Tech, and Blockchain. In many ways, it sounds obvious that the next exponential growth companies will be strongly linked to one or more of those. We don't even need to wait to validate this thesis, two companies have already unlocked some of the growth from those nascent trends: Tesla and Nvidia.

Figure 1: The world mega caps over the last few decades

	1980	1990	2000	2010	2020	2030
1	IBM	Nippon T&T	Microsoft	Petrochina	Microsoft	**Which company is on its way to the top 10?**
2	AT&T	Bank of Tokyo-Mitsubishi	General Electric	Exxon Mobil	Apple	
3	Exxon	Industrial Bank of Japan	NTT DoCoMo	Microsoft	Amazon	
4	Standard Oil	Sumitomo Mitsui Banking	Cisco	ICBC	Google	
5	Schlumberger	Toyota	Walmart	Walmart	Facebook	
6	Shell	Fuji Bank	Intel	China Construction Bank	Alibaba	
7	Mobil	Dai-Ichi Kangyo Bank	Nippon T&T	BHP Billiton	Tencent	
8	Atlantic Richfield	IBM	Exxon Mobil	HSBC	Johnson & Johnson	
9	General Electric	UFJ Bank	Lucent Technologies	Petrobras	JP Morgan Chase	
10	Eastman Kodak	Exxon	Deutsche Telekom	Apple	Exxon Mobil	

How not to invest in thematic

While extremely useful, we still don't have a "thematic crystal ball" as much as we have a "thematic lens." We are not able to extract a single ticker by applying this technique. Therefore, there are two important mistakes to avoid.

1. The first is for an investor or a portfolio manager to become arrogant and overestimate their abilities. Applying this thematic lens in the late 1990s would have easily led investors to look at and invest in Internet stocks. However, this would have pointed us toward Amazon and eBay, as well as Yahoo, Lycos, and InfoSpace. Without a real crystal ball or time machine, there would have been no way to differentiate between the future winners and losers that early. So, the mistake would be to overplay our hand and try to guess things we can't guess to select between them. At the end of the day, an investor who would have bought the 10 biggest internet stocks in 1998 would have beaten the markets easily over the following two decades (even if seven out of those 10 stocks disappeared and lost money), while an investor who would have picked the biggest one, Yahoo, would have not.

2. The second important lesson investors need to remember is that while megacaps have probably benefited from exponential growth at one point in the past, it cannot continue indefinitely. If Nvidia, with its 3 trillion market cap, were to increase 10x in price, which is something that an investor would be looking for in an exponential growth stock, it would get close to the size of the full US equity market, which seems improbable. So, exponential growth stocks are overwhelmingly smaller cap but still have the runway to deliver outsized returns.

A thoughtful strategy design is necessary to leverage the potential of thematic investment

The WisdomTree Megatrends UCITS ETF (WMGT) provides exposure to 16 high-conviction themes and leverages the "thematic crystal ball" while trying to avoid both issues. To do so, the thematic stock selection in the strategy follows three guiding principles:

1. It is expert-driven

2. It focuses on pure players

3. It differentiates itself from the market

This means that we leverage the theme knowledge of industry experts with which we have a partnership (a different expert for a different theme) to answer the key question for thematic investing: **"Is this company highly relevant to this theme or not?"**.

The portfolio for each theme is then built in a diversified way to invest in the relevant companies without trying to predict which one will win the theme, ensuring that the portfolio includes future winners. By focusing on highly relevant companies, in other words, pure players, the portfolio tends to include smaller cap, earlier-stage companies instead of diversified megacaps that are involved in many themes but at the margin. As illustrated in figures 2 and 3, this creates a portfolio that is, almost by definition, less similar to the market or core investment and includes companies with higher growth potential (as they are smaller).

Figure 2: WisdomTree Megatrends offers very low overlap vs MSCI All Country World and Nasdaq 100

17.9%	16.1%
overlap vs MSCI All Country World	**overlap vs Nasdaq 100**

overlap vs MSCI All Country World

overlap vs Nasdaq 100

Source: WisdomTree. As of 19 April 2024. You cannot invest directly in an index. Historical performance is not an indication of future results and any investments may go down in value.

Figure 3: Weight of MSCI All Country World and Nasdaq 100 top 10 holdings vs WisdomTree Megatrends

Top 10	MSCI All Country World	WisdomTree Megatrends
Microsoft	4.1%	0.1%
Apple	3.5%	0.1%
Nvidia	3.1%	1.6%
Amazon	2.3%	0.1%
Meta	1.5%	0.1%
Alphabet	2.3%	0.1%
Eli Lilly	0.9%	0.3%
Taiwan Semiconductors	0.8%	1.6%
Broadcom	0.8%	1.6%
JP Morgan Chase	0.8%	0.0%
	20.0%	**5.4%**

Top 10	Nasdaq 100	WisdomTree Megatrends
Microsoft	8.8%	0.1%
Apple	7.4%	0.1%
Nvidia	6.3%	1.6%
Amazon	5.2%	0.1%
Meta	4.8%	0.1%
Broadcom	4.4%	1.6%
Alphabet	4.9%	0.1%
Tesla	2.4%	0.0%
Costco	2.4%	0.0%
Advanced Micro Devices	2.1%	1.4%
	48.7%	**4.9%**

Source: WisdomTree. As of 19 April 2024. WisdomTree Megatrends = WisdomTree Global Megatrends Equity Index. You cannot invest directly in an index. Historical performance is not an indication of future results and any investments may go down in value.

Conclusion

A thematic lens applied to stock selection helps investors see the future and isolate companies with the potential to grow exponentially. However, it is easy for investors to miss out on that opportunity through execution. First, a thematic strategy should focus on pure play, smaller companies that have not yet realised the potential that their underlying megatrends lend them. Second, a thematic strategy should lean into the uncertainty at the heart of disruption and innovation. It is impossible to predict the final form of an exponential growth company. Amazon started as a bookshop and look what it has become! So, diversification and humility must be at the heart of the process.

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