Cybersecurity: A Clear Requirement, but Rough Returns So Far in 2024

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Key Takeaways

- WisdomTree categorizes U.S.-listed thematic ETFs into over 40 topics, with cybersecurity seeing significant outflows and semiconductors experiencing substantial inflows in the first half of 2024.
- Despite significant outflows in early 2024, the WisdomTree Cybersecurity Fund (WCBR) had strong performance in 2023.
- WCBR leverages insights from Team8, a group with deep cybersecurity expertise to guide stock selection and strategy.

At WisdomTree, we put together our Thematic Classification, which places U.S.-listed thematic exchange-traded funds into more than 40 distinct topics. This allows us to see how investors are participating in the space—both where the money is being allocated and where the money is leaving.

For the first six months of 2024, cybersecurity was the second biggest outflow generator of all the thematic topics we track, with roughly $1.1 billion coming OUT from funds in this category.1

For reference, the semiconductor category over this same six-month period took in $5.8 billion, meaning that it almost achieved an average inflow per month of $1 billion.1

When we speak to investors about the six thematic investments in our own range:

- **Cybersecurity:** No one needs to be convinced that it is necessary. While it is not certain what specific software will be used for security purposes, it is certain that any company without a cybersecurity strategy is taking a significant risk. Yet, this necessity for the topic has not translated at all into returns in 2024.
- **Artificial Intelligence:** This theme has generated a lot of attention and excitement, but the biggest question out there, at least as of August 2024, is how to marry the massive capital investments with appropriate money-making opportunities. As of this writing, there are more questions than answers in this regard. Returns of the Magnificent 7 companies (Nvidia, Microsoft, Amazon, Alphabet, Apple, Meta Platforms and Tesla) have faced challenges during the early reporting period after the June 30, 2024, quarter ended.2

- **BioRevolution:** Of all the topics we discuss in the thematic equity space, investors tend to be most excited about biotechnology. It's also true that there is a difference between a general person getting through their emails 20% or 30% faster versus getting personalized medical treatments. Biotechnology has the potential to change how we live our lives—but the timeline for a lot of these innovations is very uncertain. Returns in recent years have also been challenging.
- **New Economy Real Estate:** Related to the AI discussion and capital spending, a lot of that is being funneled toward data centers. So far, the opportunity for generating returns has been more tilted toward the hyperscalers—the companies seen to provide the platforms for running the AI applications—but it will be interesting to see if there comes a time when the data center REITs begin to perform more strongly.

Cybersecurity Stands Out

In thinking of these six topics, five of them have a lot of outstanding questions. One of them, cybersecurity, has almost no questions about the topic's potential, but it has a disproportionate number of questions around the lackluster returns during the first seven months of 2024.

As we move through August 2024, we see a few different elements potentially setting up:

- WisdomTree's strategy, the WisdomTree Cybersecurity Fund (WCBR), delivered a return of nearly 70% in 2023, helped dramatically when the world believed, during the last two months of the year, that U.S. Federal Reserve policy rate cuts would occur in early 2024. This expectation was incorrect, so we believe a lot of this year's lackluster return represents a correction of this mistaken expectation rather than a view of whether or not the growth prospects of cybersecurity companies are still there. **The period from September to December of 2024 may see interest rate cuts—maybe the responsiveness in WCBR's performance from 2023 rears its head again.**
- For the better part of the past two years, C-suite managers across public companies were almost required to mention AI. We agree that this is a big topic, but adoption of these types of technologies will take time—we won't see AI making an impact across all industries in the next six months. However, chief information security officers (CISOs) need to secure their systems now, and there are not enough people with the appropriate expertise they can hire. Using software-oriented solutions is a necessity, and it is hard to cut cybersecurity budgets.

WisdomTree Works with a Unique Expert

On August 1, 2024, we saw the below tweet on the X platform:

It's interesting to see this from a former FBI assistant director. The context was a discussion about being able to access the phone of the individual involved in the assassination attempt on Former President Trump, and how Israel has better capabilities to get into smartphones than the FBI. Over the course of its existence, Israel has been required to be very capable—its defense has depended on it. Within the Israeli Defense Force (IDF), there is a specific unit, 8200, that is focused on cyber activities. With the requirement of military service, this unit has access to some of the best and brightest citizens coming out of high schools across the nation.

The WisdomTree Cybersecurity Fund (WCBR) is designed to track the total return performance, before fees and expenses, of the WisdomTree Team8 Cybersecurity Index. Our expert partner, Team8, is analyzing the specific cybersecurity offering of all constituent companies on a semiannual basis. The "8" in Team8 and the "8" in 8200 is not the same by coincidence. A lot of the cyber expertise at Team8 comes from people exiting Unit 8200 and seeking employment in the private sector.

While returns can never be guaranteed, the fact is that the group doing the analysis semiannually to determine the best ways to gain exposure to future trends in cybersecurity has unquestioned global expertise on the topic. Insights from Team8 help to drive the stock selection of the WisdomTree Team8 Cybersecurity Index on a semiannual basis, refreshed in March and September of each year. It remains to be seen what impact Fed policy and other macro factors will have on this thematic space for the remainder of 2024.

1 Sources: WisdomTree, Morningstar, Bloomberg. All data as of 6/30/24 and based on WisdomTree's internal classification of thematic funds. Performance is based on monthly returns from Bloomberg and Morningstar.

2 Source: Lucy Brewster, “Big Tech Is Down Bad", *Brew Markets*, 6/25/24. https://www.morning-brew.com/brew-markets/stories/2024/07/25/tech-stock-selloff-ai-rally-bear-market.

3 Source: Andrew Change, "Midyear 2024 IT Forecast Update: Robust Cloud Spending Offsets Still-Cautious Enterprise Budgets", *S&P Global-*. 7/17/24. https://www.spglobal.com/ratings/en/research/articles/240717-midyear-2024-it-forecast-update-robust-cloud-spending-offsets-still-cautious-enterprise-budgets-13183985.

4 Source: Agnes Chang & Keith Bradsher, "Can the World Make an Electric Car Battery Without China?", *The New York Times,* 5/16/23. https://www.nytimes.com/interactive/2023/05/16/business/china-ev-battery.html.

5 Source: https://www.crowdstrike.com/falcon-content-update-remediation-and-guidance-hub/.

6 Source: "Investor Relations", *Solarwinds,* https://investors.solarwinds.com/overview/default.aspx.

Important Risks Related to this Article

For current holdings of WCBR, please click here. Holdings are subject to risk and change.

There are risks associated with investing, including the possible loss of principal. The Fund invests in cybersecurity companies, which generate a meaningful part of their revenue from security protocols that prevent intrusion and attacks to systems, networks, applications, computers and mobile devices. Cybersecurity companies are particularly vulnerable to rapid changes in technology, rapid obsolescence of products and services, the loss of patent, copyright and trademark protections, government regulation and competition, both domestically and internationally. Cybersecurity company stocks, especially those which are internet related, have experienced extreme price and volume fluctuations in the past that have often been unrelated to their operating performance. These companies may also be smaller and less experienced companies, with limited product or service lines, markets or financial resources and fewer experienced management or marketing personnel. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. The composition of the Index is heavily dependent on quantitative and qualitative information and data from one or more third parties, and the Index may not perform as intended. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.