



Investing in the world's future

Designing a differentiated high-growth multi-thematic strategy



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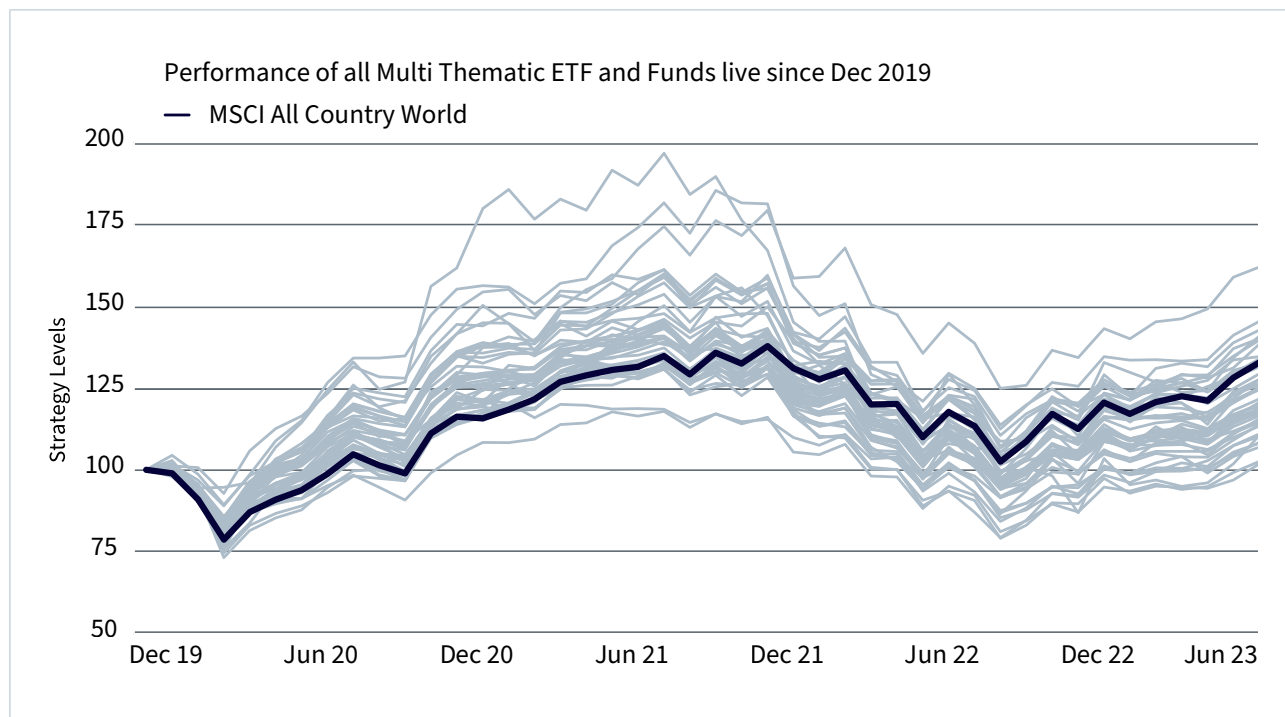
Investing in the world's future. Designing a differentiated high-growth multi-thematic strategy

Thematic investments offer a forward-looking perspective for investments, aligning portfolios with world-changing structural trends and providing the potential for higher long-term growth. By leveraging today's megatrends to identify tomorrow's mega caps, investors gain valuable insights to funnel into potentially high-growth portfolios.

However, building a multi-thematic portfolio can be challenging as there are many pitfalls that can lead to subpar results. An overly concentrated portfolio, a lack of control around the allocation between themes, a lack of focus on smaller, high-potential companies or a lack of discipline and expertise in stock selection can all diminish or even erase the impact of thematic investments.

Looking at all the multi-thematic strategies domiciled in Europe having been launched before December 2019, we observe that 37 out of 47 have underperformed the market (the MSCI All Country world) after fees over the period (from December 2019 to July 2023). This is a clear indication of the potential difficulties of building such a multi-thematic strategy and the need for a clear plan to achieve the potential long term growth.

Figure 1: Historically, existing multi-thematic strategies have failed to deliver the expected outperformance



Sources: WisdomTree, Morningstar, Bloomberg. From December 2019 to July 2023. This represents the performance (based on NAV) of all funds and ETFs classified in the Diversified Thematics cluster in the WisdomTree Thematic Classification. **Historical performance is not an indication of future performance and any investments may go down in value.**

Looking at those existing multi-thematic funds—we observe that the average number of holdings historically is 99. Since such strategies aim to invest in a dozen or so themes, this feels like a very low number. By overconcentrating their portfolio, they take two main risks:

+ A lack of exposure to pure players

Those portfolios are built using mainly existing mega caps to give the impression that many themes are covered (Microsoft could be considered an artificial intelligence company, a cloud company and so on). This results in a Nasdaq-like exposure with little differentiation from the market making it impossible to outperform.

+ A risk of missing the long-term winners

With only 99 stocks to cover a dozen themes, less than 10 stocks can be used for each theme, leading to impossible choices between high-potential companies. This increases the risk of missing out on the next Amazon-like opportunity.

What to look for in a multi-thematic strategy

At WisdomTree, we believe that to unlock the potential of thematic investing, a multi-thematic strategy should aim to

- + Gain exposure to the long-term structural trends that are changing our world
- + Invest early in tomorrow's mega caps
- + Leverage the inherent diversification that exists between themes to lower the overall risk

This could be achieved through 6 guiding principles listed in figure 2.

Figure 2: Harnessing the power of megatrends in a multi-thematic portfolio



Concentrate on the most important themes



Benefit from short-term trends in thematic



Maximise the growth potential



Maximise diversification between themes



Focus on pure play, up-and-coming companies



Minimise exposure to mega caps

Source: WisdomTree.

WisdomTree’s approach to building a multi-thematic strategy

In order to build a strategy that ticks all of the above 6 boxes, we argue that it is necessary to build the portfolio around 3 layers of alpha generation.

1. The **Strategic Thematic Asset Allocation** that provides a curated exposure to the most promising themes while maximising diversification between the themes across different Megatrends
2. The **Tactical Thematic Asset Allocation** that allows the strategy to lean in and overweight themes when a combination of positive factors creates a virtuous cycle for a given theme. This was evident with Cloud during COVID in 2020, or with AI in 2023.
3. The **Thematic Stock Selection** where different theme experts help us pick the most relevant up-and-coming companies for each theme. In our multi-thematic strategy we leverage our different thematic partners to deliver the best portfolio of stocks for each theme.

Figure 3: 3 layers of alpha generation for a multi-thematic portfolio

01	02	03
Strategic Thematic Asset Allocation	Tactical Thematic Asset Allocation	Thematic Stock Selection
<ul style="list-style-type: none"> + Create the foundation of a multi-thematic portfolio. + Focus on highly diversified, high-conviction themes with exposure to structural changes. 	<ul style="list-style-type: none"> + Capitalise on theme-specific dynamics. + Incorporate tactical overlays based on momentum or news can enhance performance and deliver an improved risk-return profile. 	<ul style="list-style-type: none"> + Use expert-driven selection of each theme. + Balance selectivity and diversification is key to mitigating risks. + Momentum can help select stocks further.

Source: WisdomTree.

The Strategic Asset Allocation

The Strategic Thematic Allocation—that is, the selection of themes—is key to some of our main objectives: the long-term growth potential, the diversification and the alignment to structural changes. It is therefore logical that theme selection is a combination of picking themes:

- + with the highest growth potential as proxied by how key they are to our society's future
- + with the highest diversification

In other words, it is about picking the highest conviction themes with the highest growth potential as well as focusing on a basket of investment themes that are different from each other.

Figure 4: WisdomTree Strategic Thematic Allocation

Technological Shifts	Environmental Pressures	Demographic & Social Shifts	Geopolitical Shifts
Artificial Intelligence & Big Data	Sustainable Energy Production	Aging Population	Rise of Tension
Blockchain	Sustainable Energy Storage	Rise of EM Consumer	
Cloud Computing	Sustainable Food	Rise of the Middle Class	
Cybersecurity	Energy Transition Materials		
Digital Infrastructure	Nuclear		
HealthTech			
Quantum Computing			
Rise of China Tech			
Semiconductors			

Source: WisdomTree.

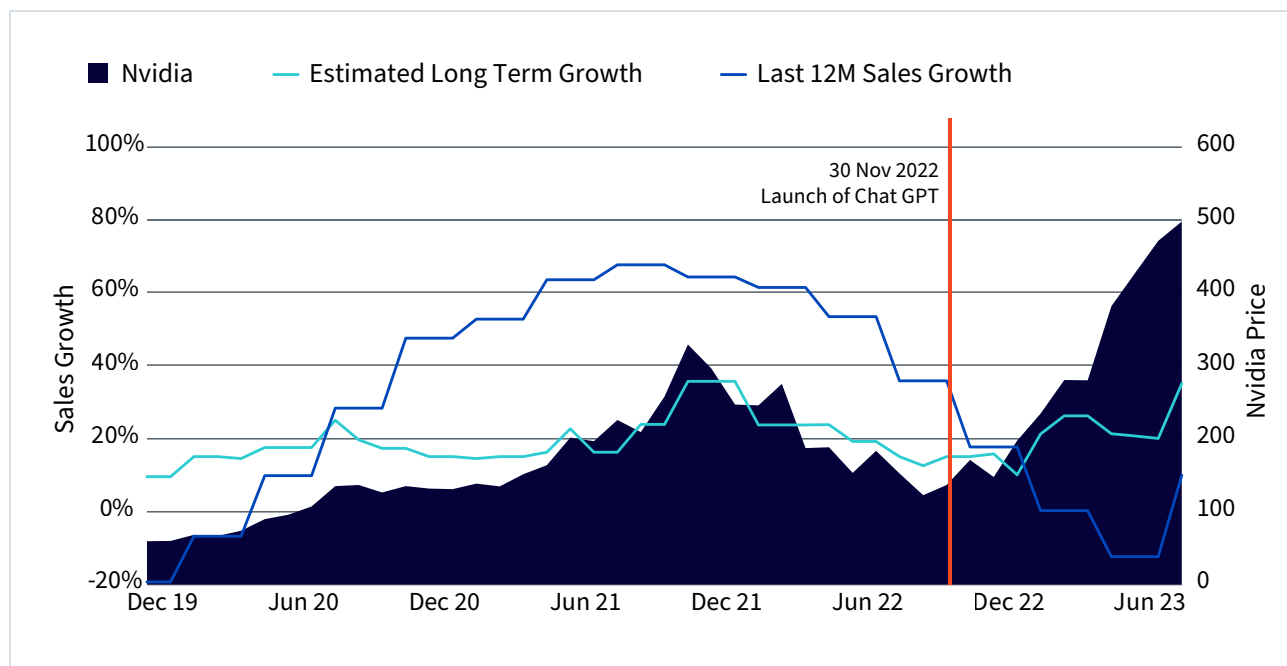
The Tactical Asset Allocation

Thematic investing is a long-term endeavour. The performance potential of such an investment is the consequence of worldwide, structural changes that can span decades. However, those changes do not happen linearly over time, they tend to go through fits and starts. Looking back to the last few years, it is easy to see how this phenomenon applied to cloud computing in 2020 and artificial intelligence more recently. By using theme-specific information, investors could then improve their thematic portfolio's risk-return profile over time. Over-weighting, cloud computing early in 2020, just before the COVID rebound and under-weighting in 2022 would have been very beneficial for example. Overweighting artificial intelligence in November 2022 when ChatGPT launched would also have worked very well.

Very often investors rely on their experience with other types of equity strategies to try to draw conclusions for the thematic space, leading to valuations and fundamentals being discussed as a way to time thematics. We think that this may not be the best approach and that focusing on the valuations of a theme may be detrimental to the long-term potential of thematic investment as it could lead to missing those periods of strong outperformance.

Artificial intelligence in 2023 offers us a case in point. Clearly, many stocks linked to AI benefitted from the launch of ChatGPT in November 2022 and have enjoyed stellar performance. Following that news, all AI stocks jumped up. Nvidia, for example, gained 237.8% from 30 November 2022 (ChatGPT launch date) to 31st August 2023. Looking at Figure 3, we tried to link the performance of Nvidia in 2023 to its fundamentals. Clearly, this performance was not “Nvidia-driven”, it was not the result of particularly attractive fundamentals.

Figure 5: The Impact of the launch of ChatGPT on Nvidia’s performance



Sources: WisdomTree, Bloomberg. From December 2022 to August 2023. Returns are calculated in US dollars. **Historical performance is not an indication of future performance and any investments may go down in value.**

At the end of the day, themes are driven by various factors over time, from regulatory changes to technological advances. Those factors have a significantly higher impact on performance than the fundamentals of companies relevant to that theme.

Therefore, when it comes to timing thematic investment, we think that price momentum is a great tool to catch those waves of outperformance or underperformance in themes.

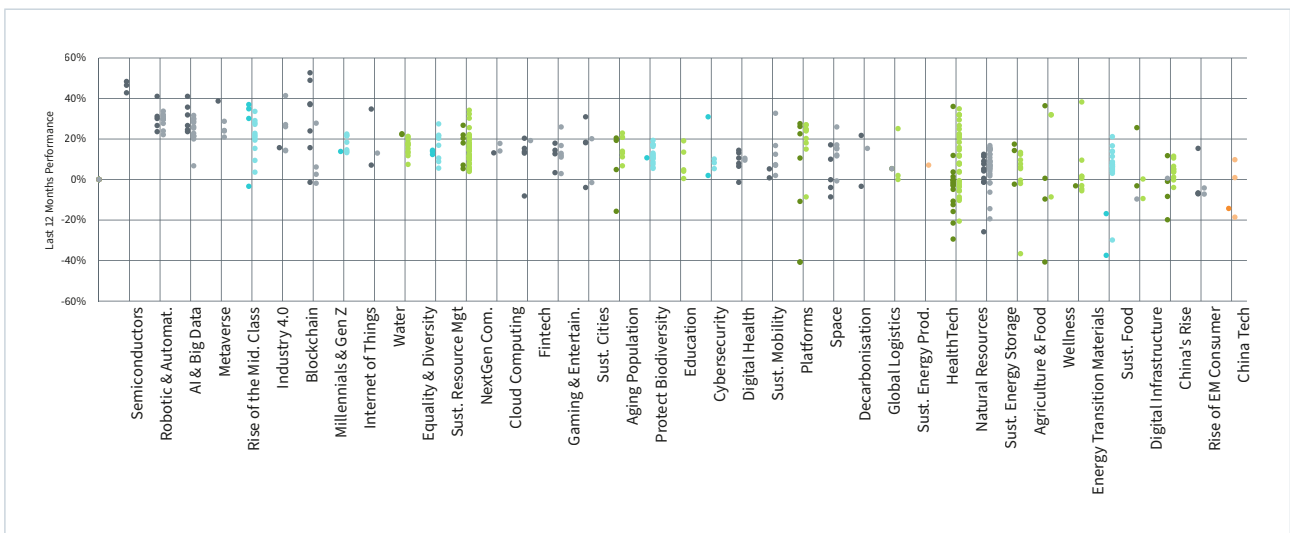
The Thematic Stock Selection

The Thematic Stock Selection—that is, the stock picking inside each theme—is key to fully unlocking the potential of thematic investment. While the work of investment managers usually consists of selecting the best stocks in a well-defined pool of companies (US small-cap stocks or emerging market large-cap equities), for thematic investments, they must first identify that pool of stocks. In other words, they must also identify which companies have a real, fundamental link

to a theme's success and which do not. This is usually a task for which they are not well equipped, lacking technical knowledge or theme-related experience. This also leads to wide disagreement in stock selection and variation between portfolio managers. As discussed at length in (DEBRU & KURAMSHINA, April 2021), the result is a wide dispersion of performance between strategies that are supposed to invest in the same theme.

Figure 6 shows the last 12 months' performance of every Europe-domiciled exchange traded fund (ETF) and open-ended fund for a given investment theme. In each of the themes below, the return differential between the best-performing and the worst-performing fund is elevated. The opportunity cost of picking the wrong thematic fund, even within a well-defined theme like artificial intelligence or Healthtech, can be very high.

Figure 6: Last 12 months' performance dispersion of the Europe-domiciled ETFs and open-ended funds across investment themes.



Sources: WisdomTree, Morningstar, Bloomberg. From 30/06/2022 to 30/06/2023. Returns are calculated in US dollars on a monthly basis. Only funds live for the whole period and classified in the 14 investment themes above are considered. **Historical performance is not an indication of future performance and any investments may go down in value.**

This shocking result highlights the importance of stock selection in thematic. In (DEBRU & KURAMSHINA, April 2021) we proposed clear steps for selecting stocks and building a single-theme sub-portfolio in a multi-thematic portfolio context. Our framework revolves constructing an expert-driven, diversified portfolio of pure play companies with low overlap to the Nasdaq 100 or established tech mega caps. It is conceptualised below in five intuitive building blocks that we believe provide the keys to building successful thematic portfolios in the long run:

+ Clarity of theme

The sub-portfolio is focused on benefitting from a well-defined theme. It is built to focus on the theme precisely.

+ Expertise

The sub-portfolio harnesses the necessary expertise to identify the companies that offer exposure to a theme and stand to benefit the most from its further proliferation.

+ Purity of exposure

The sub-portfolio is focused on pure players and companies within a given theme's ecosystem that is expected to benefit the most as themes evolve further and experience increasing adoption. At the same time, the sub-portfolio reduces the exposure to companies that only dabble in the theme.

+ Differentiation

The sub-portfolio's overlap with traditional equity benchmarks is minimal. Investment in current mega caps is minimised to improve long-term growth potential. The sub-portfolio is also very differentiated from other sub-portfolios focusing on adjacent themes.

+ Transparency, investability and discipline

The sub-portfolio is constructed for scalability and liquidity. Discipline in the investment process and time consistency are key to managing interactions with the rest of the multi-thematic portfolio.

Conclusion

By constructing thematic strategies around those 3 layers of alpha generation, it is possible to offer a unique approach to thematic investing that allows investors to get access to long term growth through a curated portfolio of themes and expert-driven stock selection in each of those themes. Investors also benefit from tactical allocation to the different themes over time to adapt to current market environments. This approach presents a compelling alternative to other multi-thematic strategies or traditional growth funds as it delivers exposure to a diversified basket of growing, up-and-coming companies instead of established tech mega caps.

Key Takeaways



Thematic Lens: A powerful sieve

Using a thematic lens to analyse stocks allows to identify and invest earlier in future winners.



Controlling theme allocations avoids concentration.

Allocating capital to each theme allows for an extra layer of diversification. Allocating capital only to stocks can hide risks as most stocks may be linked to the same underlying themes.



Momentum is your friend

Themes and thematic stocks are very news-driven. While anticipating events or tech breakthrough is impossible, Trend following is a strong choice to capture those waves.



Overconfidence is the cardinal sin

Only 4% of stocks help perform over the long term. Only one or two themes are firing up at a given time. Is it impossible to have perfect selection of perfect timing. Humility and diversification are key to success.



Expert Stocks Selection is a must

Focusing on pure players, always from the mega caps, is one of the main driver of outperformance long term.



Thematic is strategic

Thematic investing as a source of long-term growth for the portfolio is a strategic holding. Historical simulation indicate a 30% allocation in the equity sleeve.

Source: WisdomTree.

WisdomTree Megatrends Strategy

At WisdomTree, we've always been committed to pushing the boundaries of investment strategies. Since 2018, our focus has been on the development of individual thematic strategies, honing our expertise with deep thematic research and insights. Today, building on this foundation and our relationships with thematic expert partners, we're proud to introduce a new dimension in investment: a unique, differentiated, and diversified high-growth multi-thematic strategy designed to effectively harness the long-term growth potential of Megatrends – the [WisdomTree Megatrends Strategy](#).

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