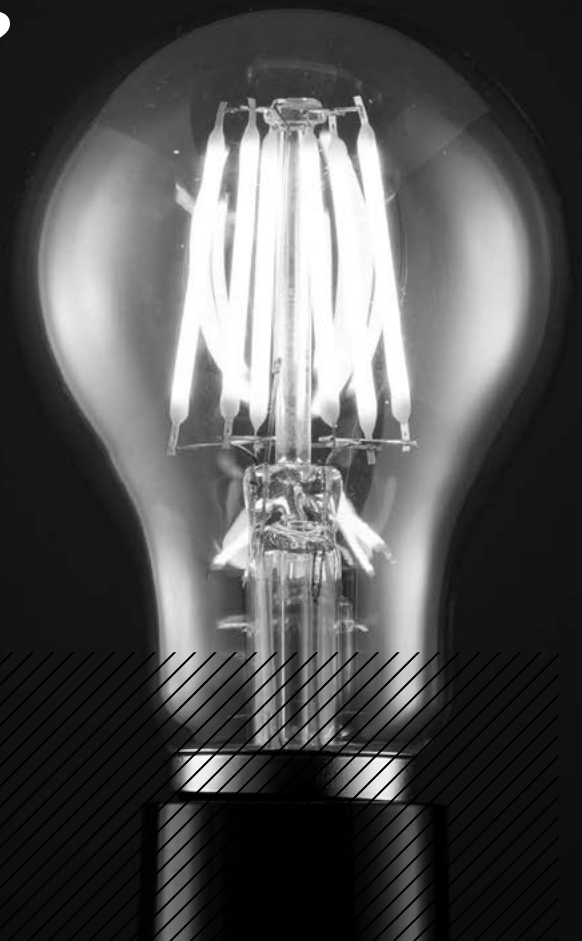


**Thematic investment
shows rapid growth.
Are investors ready?**

Thematic strategies are taking off



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Foreword

There are major structural trends in motion across the world that are coming about due to the rapid progress that our society is going through. These changes are affecting every dimension of our lives: environmental, demographic, socio-economic, as well as behavioral.

These trends will contribute to shape the global economy and the corporations within it. Accordingly, many investors are asking themselves: “Who will benefit from these changes?” Thematic investing aims to answer this question.

The goal of thematic investing is to focus squarely on anticipating changes and to take advantage of them, by identifying today the potential structural winners of tomorrow. In addition, and at its heart, thematic investing is about investing in themes that are relevant, diversifying to your portfolio and that you care about. And investors have shown they care. For example, currently, around 90% of professional investors with assets under management in excess of 50 billion US dollars already have a fifth of their portfolios invested in thematic strategies. So thematic investing is a core theme on the minds of large investors.

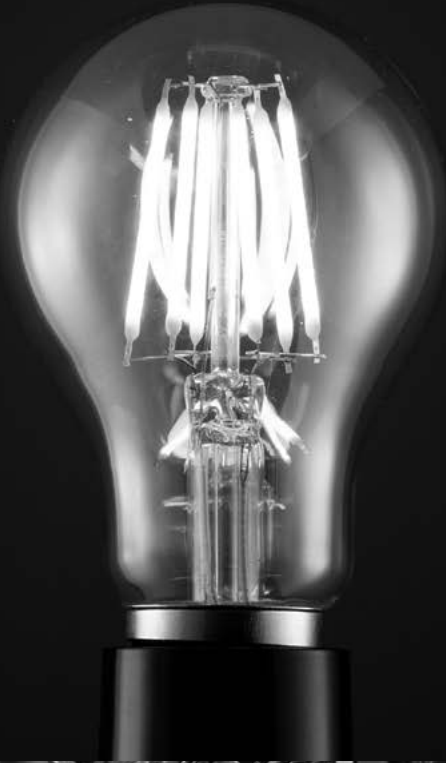
As part of our thematic investing campaign, we wanted to learn and share with you how professional investors think about thematic investing. What themes are they looking at? Are they increasing their allocations? What are their concerns and how do they manage risks in their thematic portfolios? To find answers to these and other questions, we commissioned a study of 300 intermediary and institutional investors to get an in-depth analysis of what is shaping the thematic investing landscape and what are the possible future challenges and opportunities.

I am confident you will find this study enlightening and that it will help you to adapt and thrive despite the investing challenges of today. So read on to learn how your peers are navigating the world of thematic investing.

Christel Rendu de Lint

Deputy Head of Investments

Electricity generated from waste can provide 24/7 power for a smarter and greener grid.



Introduction

Growth in demand for thematic investment funds has accelerated over the past 12 months, with both active funds and passive vehicles picking up significant inflows. Assets under management in thematic exchange-traded funds more than doubled during 2020.¹ And in the active space, thematic funds defied the outflows seen in most sectors in 2020.²

This remarkable growth reflects a broad range of drivers. Even before the pandemic, several big-picture themes – including climate change, technology transformation, and demographic shifts – were attracting significant attention. But Covid-19 has served as a catalyst for many of these, and the market cycle also appears to have shifted in favor of thematic drivers.

This research therefore sets out to answer key questions. To what extent have institutions and intermediaries embraced a thematic approach to asset allocation? Which themes do investors and intermediaries find most compelling? And how are leading thematic investment product providers seeking to respond to this appetite?

Investors are enthusiastic

Our survey of 300 leading institutional investors and intermediaries across Europe suggests that investors' approaches to thematic investment are evolving and maturing. Some of these investors are changing their asset-allocation strategies in the light of the pandemic, as their views shift about where the greatest opportunities lie. Many are increasing their exposures to thematic funds and developing more holistic approaches, often encompassing multi-asset remits.

As part of this evolution, investors are thinking anew about how to capture opportunity while managing risk, maintaining diversification, and monitoring performance. For most investors, the debate is no longer about whether to invest thematically, but about how to do so most effectively – including whether to use active or passive funds. They recognize the powerful structural reasons to invest thematically and are implementing their strategies with greater sophistication.

What comes next?

There is scope for greater demand for thematic investment strategies and vehicles. Our research reveals appetite for increased allocations to a broad range of themes – particularly among investors who have only made modest thematic investments so far. Those with greater allocations are also optimistic, but they are more cautious about the outlook.

In this report, we hear the views of these institutions and intermediaries.

- **What are their plans for thematic investments and how will they execute them?**
- **What issues are they struggling to overcome?**
- **How are they managing risk and return within their portfolios?**
- **And how will they judge long-term success?**

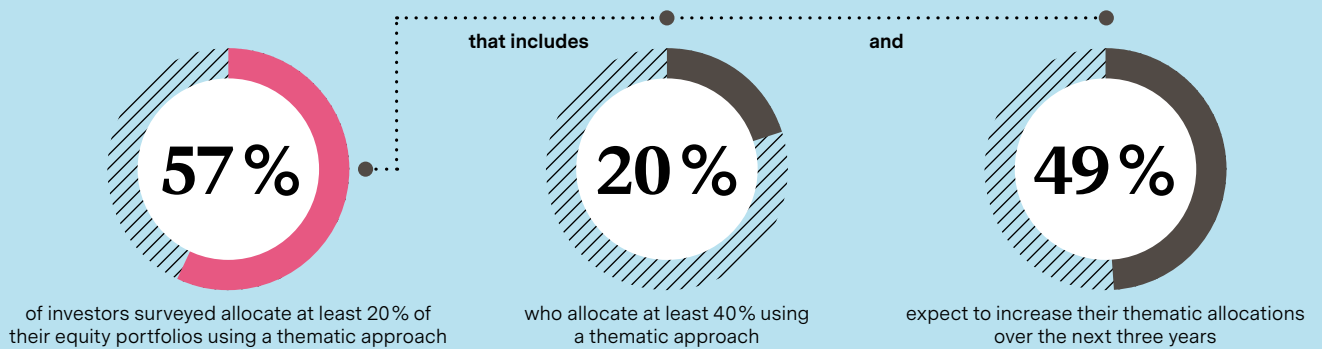
¹ <https://www.morningstar.co.uk/uk/news/208785/the-rise-of-thematic-etfs.aspx>

² <https://www.ftadviser.com/investments/2020/08/21/the-pursuit-of-thematic-happiness>

Thematic investing: Are you ready to invest with purpose?

Our new research finds Europe's institutional investors and intermediaries reaching for thematic strategies.

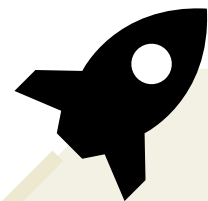
Thematic exposures are set to soar



Some countries are powering ahead on thematic investing

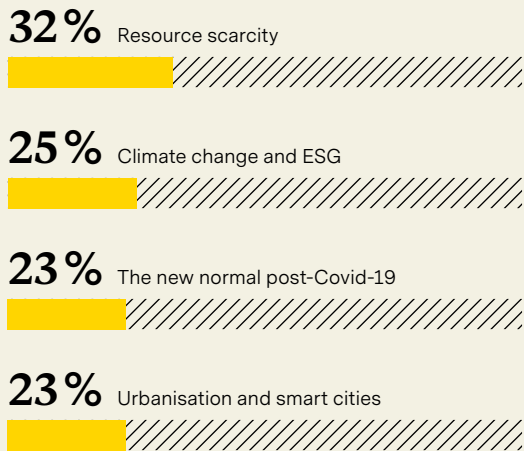


Could Covid-19 put a rocket under those numbers?

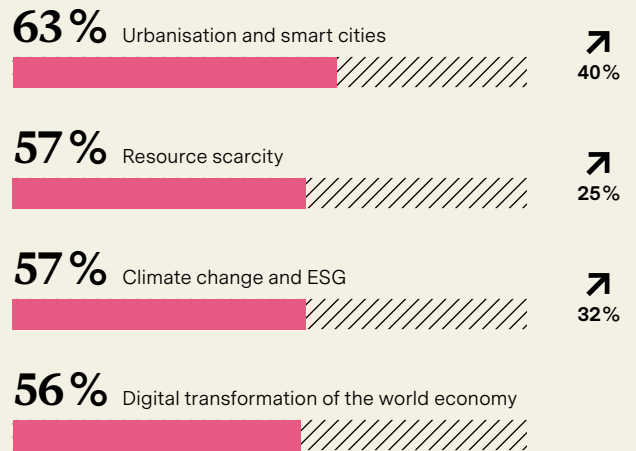


What themes are popular now—and what is rising up the agenda?

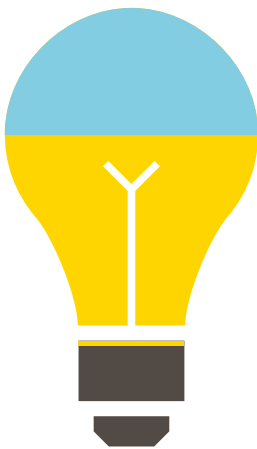
Top themes now



Top themes in the next 1–3 years



Active trumps passive in the move to thematic funds



Active

29%
favor an explicitly active approach to thematic investment

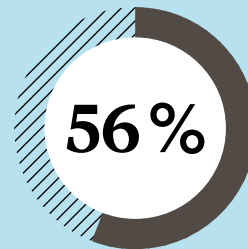
A bit of both

48%
prefer a bit of both

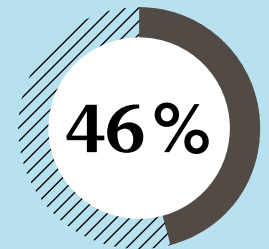
Passive

23%
favor an explicitly passive approach

Risk management is a crucial driver of the shift to thematic strategies



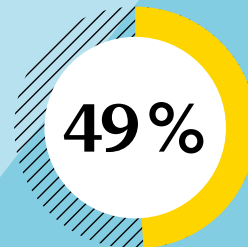
believe their thematic approach can help offset portfolio risk



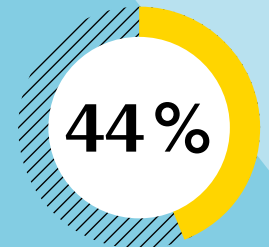
believe they will secure diversification benefits



And as volatility leads to uncertainty ...



believe that the current uncertainty makes this the wrong time to significantly shift asset allocation



warn that some themes have been undermined by the pandemic

Investors are looking to diversify their thematic providers

67%

of institutional investors and intermediaries expect to diversify their thematic investment providers as allocations increase

**New technology using
the sun can turn salt-
water into drinking water
in 30 minutes.**



Part 1

Thematic investment gathers pace

Ambition revealed

Is demand for thematic investment set to grow? In this research, 84% of all respondents – spanning intermediaries and institutional investors - have now started to adopt thematic approaches in their portfolios, and the remainder say they are interested in doing so in the months and years to come.

And allocations to thematic strategies appear to be increasing rapidly. Already, more than half of respondents (57%) now allocate at least 20% of their equity portfolios according to a thematic approach, and that figure includes 20% that hold 40% or more of assets thematically.

“In the past year we have witnessed a huge interest in thematic funds compared with prior to the pandemic,” says Luis González, Thematic Equity Fund Selector at BBVA Quality Funds in Spain. “That partly reflects better understanding of some of these themes as they have delivered more than expected, performing much better than the market.”

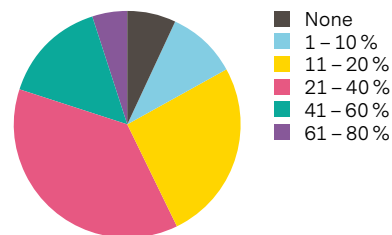
However, adoption rates vary by geography and by size of firm. Respondents in Switzerland and the Benelux countries are particularly likely to have high allocations to thematic strategies, with 76% and 75% of respondents respectively citing allocations of more than 20%; companies in Germany (40%) and France (44%) are a little behind (see Chart 1). And larger businesses are more likely to have embraced a thematic approach: 89% of respondents with assets under management (AuM) of more than \$50 billion have 20% or more invested this way.

Still, the move towards thematic investment is a market-wide phenomenon. It is significant that while thematic styles are a much-discussed topic among intermediaries, the institutional investors in this research are more likely to have allocated more assets in this way. While 61% of institutions now hold more than 20% of equity portfolios in thematic strategies, the figure for intermediaries is 55%.

Source: Vontobel Thematic Investing survey 2021

Chart 1: More than half of respondents allocate at least 20% of their equity portfolios according to a thematic approach

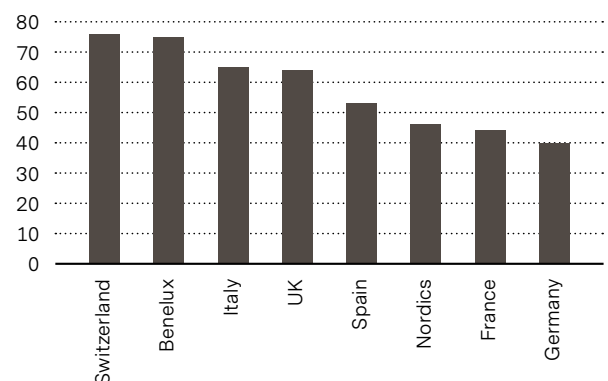
Looking at your equity portfolios, what percentage of your current holdings are allocated to a thematic approach?
In %



Allocations are highest in Switzerland

Proportion of investors allocating more than 20% to thematic funds

In %



“In the past year we have witnessed a huge interest in thematic funds compared with prior to the pandemic.”

Luis González, BBVA

“Investors have become more educated and they understand the potential of very specific themes and the innovation that is going on.”

Werner Leithenmüller, 3 Banken-Generali

Thematic investment goes beyond equities

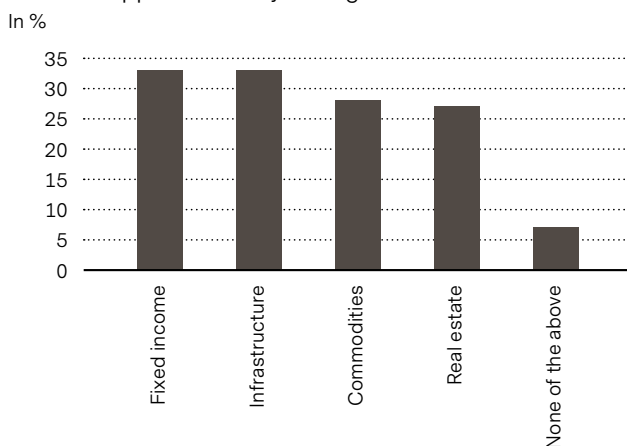
But thematic investment is not an equity-only strategy, with substantial numbers of respondents already employing a thematic approach across a broad range of asset classes (see Chart 2). Larger respondents by AuM are particularly likely to have thematic exposures in these asset classes.

Examples include infrastructure, where 33% of respondents now employ a thematic approach. That might include infrastructure funds offering exposure to energy efficiency and green energy, for example, or vehicles focused on digital transformation, with investments across a range of digital and communications infrastructure. One-third of respondents also cite thematic exposures to fixed-income assets, with growing numbers of funds pursuing strategies similar to those pursued in equities.

Elsewhere, respondents also see potential for a thematic approach to currency, commodities, and real estate. Many respondents are beginning to invest this way on a multi-asset basis, shaping exposures across all their holdings according to the mega trends and themes they are seeing.

Chart 2: Thematic investment beyond equities includes fixed income and infrastructure

In which of the following asset classes do you employ thematic approaches at your organization?



Growth is not over

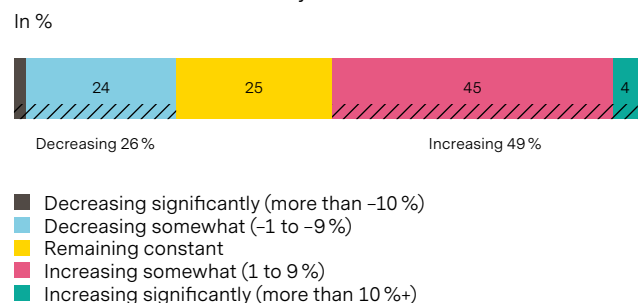
The growth of thematic investment looks set to continue. Almost half of respondents (49%) anticipate increasing their allocations to thematic strategies over the next one to three years (see Chart 3).

This trend is particularly notable in Germany (62%) and France (52%) – two countries where thematic exposures are currently lower. Conversely, institutional investors (53%) are a little more likely to plan increases than intermediaries (47%), despite already having larger allocations in many cases. Similarly, more respondents with greater AuM also plan to increase the proportions of their portfolios held thematically, despite already being ahead of their smaller peers.

Werner Leithenmüller, a portfolio manager at 3 Banken-Generali, believes this reflects the growing experience and expertise of investors in specific areas. “Investors have become more educated and they understand the potential of very specific themes and the innovation that is going on,” he says. “They recognize the exciting changes in so many areas, whether that’s automation, digitalization or immunotherapy, say.”

Chart 3: Thematic equity allocations set to increase particularly in Germany and France

Thinking about your equity holdings, how do you envisage your current allocation to thematic investments changing over the next one to three years?



Indeed, amid the consensus that thematic allocations are likely to increase, but individual institutions and intermediaries take different views about which themes interest them most. There is also some evidence of respondents focusing on groups of ideas.

For example, favored themes today include resource scarcity and climate change, which fall under the broader banner of sustainability, or the broader environmental, social and governance (ESG) movement. Significant numbers also cite ideas related to the Covid-19 pandemic, such as the move to home working, though this may come to be seen as a tactical shift (see Chart 4).

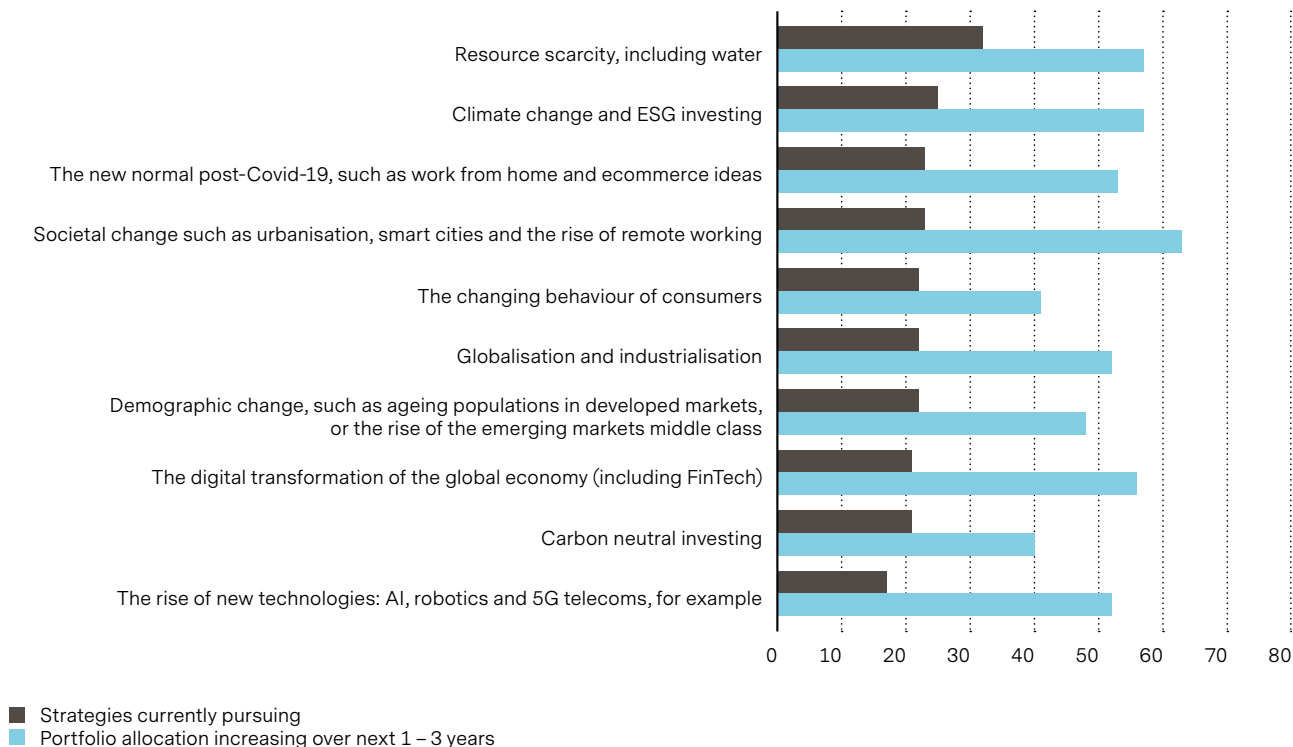
And while today’s most popular themes look set to attract further investment, a second group of trends, which might be described as technology themes, is also poised to gain more traction. For example, 63% of respondents plan more exposure to urbanization and smart cities, and 56% are interested in digital transformation; new technologies such as artificial intelligence (AI) and robotics also score highly (52%).

Interestingly, the investors that already have high allocations to thematic assets are particularly likely to plan moves toward these areas: 80% plan to increase their exposure to urbanization, and 71% are focusing on digital transformation. These investors may now be looking beyond sustainability and ESG themes to potentially higher-growth areas.

Chart 4: Favored themes include ESG and technology – today and in the future

Which of these are thematic investment strategies that you are pursuing in one form or another? How do you envisage your current portfolio allocation changing over the next one to three years?

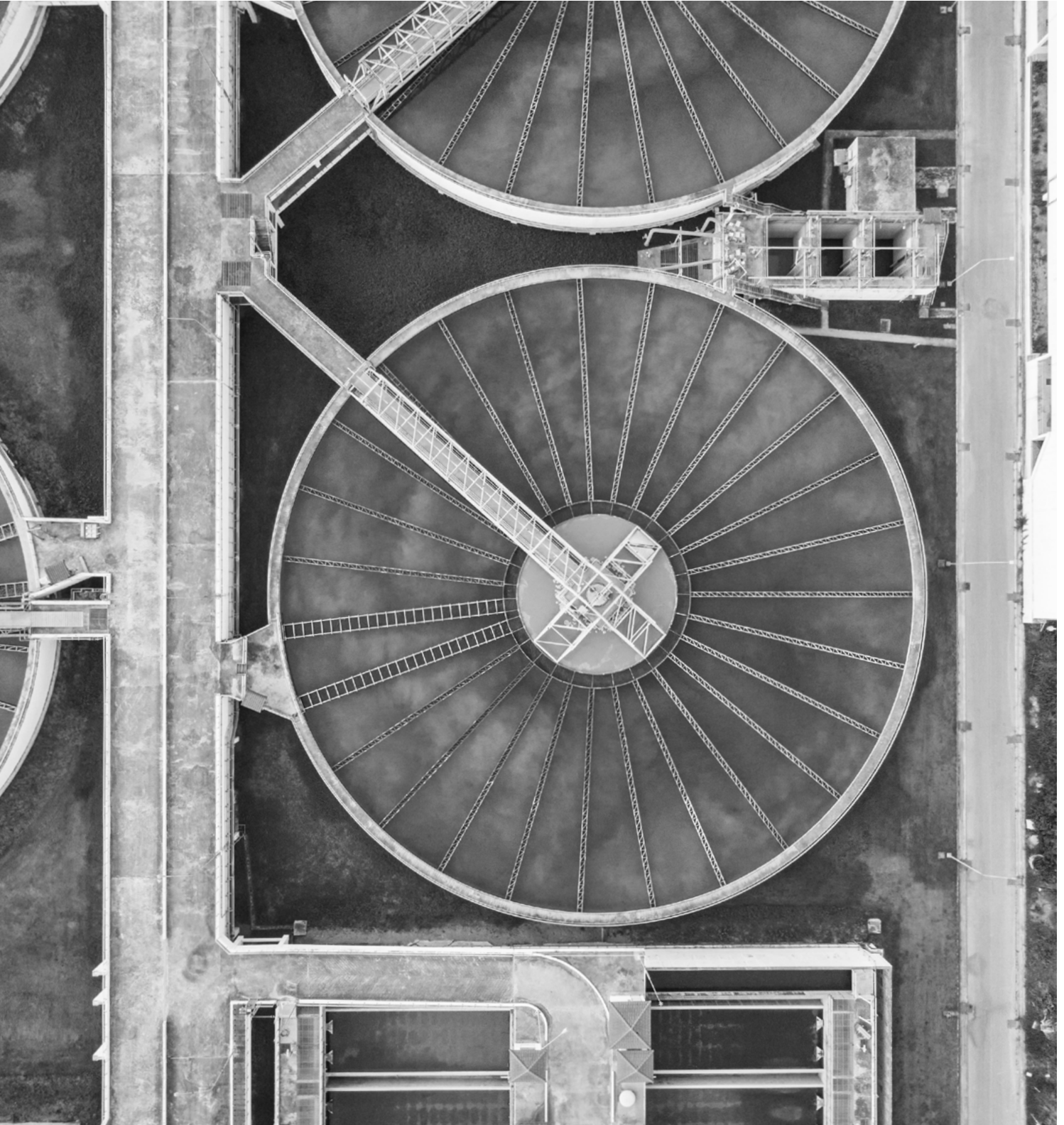
In%



Source: Vontobel Thematic Investing survey 2021

“ESG is absolutely a driver of thematic investment, but I do not think it is really a theme.”

Fabio Catalano, BancoPostaFondi



What is driving this increased demand for a broad range of thematic investment strategies? There is a broad range of drivers. Six in 10 respondents (61%) say that the themes they are focused on will be where growth is to be found in the future, and 59% reject traditional investment approaches as backward-looking (see Chart 5).

Jakob Trefz, Head of Product Management at MLP Banking, says that part of the story is the changing nature of the investing public – and a growing demand for investments that reflect their own experiences.

“Is this a new type of investing? I don’t think it is – it already existed,” he says. “The massive public interest in investing, especially from younger generations, is what is new. The link between investing and specific lifestyles is new, too. Customers might now have different perceptions of what the themes actually mean. The expansion of 5G networks might be of interest to a customer with a mobile phone or internet at home, and customers are looking at renewable energy sources, too. These thematic investments are more tangible.”

Is ESG a theme?

The growth in thematic investment also partly reflects surging demand for investments made according to environmental, social and governance (ESG) criteria, which is another recent trend. In this research, 57% of respondents say that thematic investment can be a route into ESG.

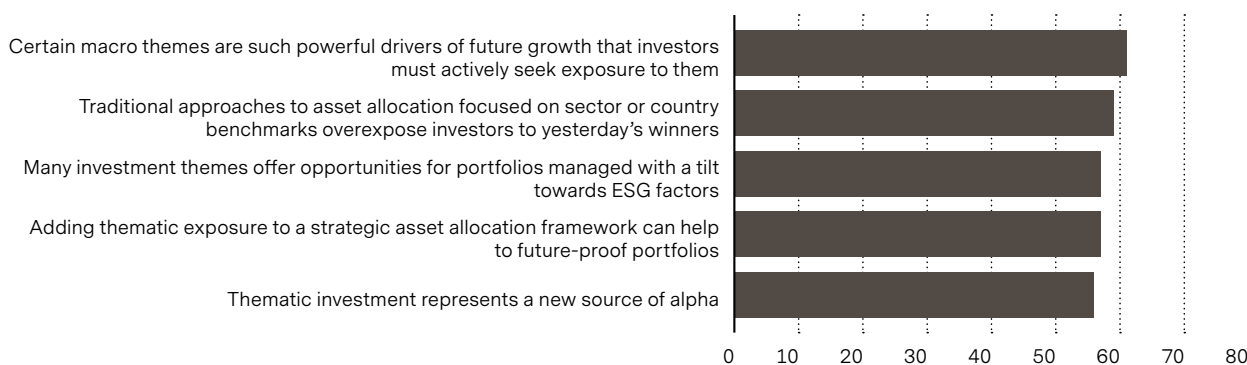
However, it is debatable whether ESG should be treated as a theme in itself. Instead, many of the specific themes identified in this research simply speak to its importance.

“ESG is absolutely a driver of thematic investment, but I do not think it is really a theme,” argues Fabio Catalano, Third Party Fund Selector and Analyst at BancoPosta-Fondi. “This is something that is a change that defines the whole world, and I think in three or five years most of the market will be on their side.”

Chart 5: Investors are embracing thematic funds for their growth potential

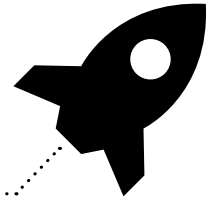
Which of the following factors are potentially driving this increase?

In%



“Covid has really accelerated changes in the sustainability area, this applies particularly to global themes, such as health and safety, wellbeing, improving connectivity, and making transport more efficient.”

James Clark, Hawksmoor Investment Management



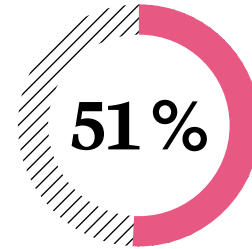
Some are reducing their exposure to thematic investments

The desire for a further shift toward thematic investment is not shared by all, however: 26% of respondents are planning to cut back on thematic exposures, though in most cases they plan modest adjustments rather than radical reductions.

This appetite for reduced exposure is particularly acute in the UK, where 34% plan to trim holdings, and among those respondents that already have the largest allocations. This may indicate that early adopters of thematic styles now feel that the trends they have invested in have run their course. Indeed, 41% of those planning to move away from thematic styles say one motivation is that future growth is already priced in (see Chart 6).

There are also practical concerns: 41% of respondents say they are finding thematic investment challenging to implement, while 39% worry that they do not yet know enough about it. Regulatory constraints are another issue. Many of these respondents will need support if they are going to be persuaded to retain thematic exposures – let alone to add to them.

Could Covid-19 put a rocket under those numbers?



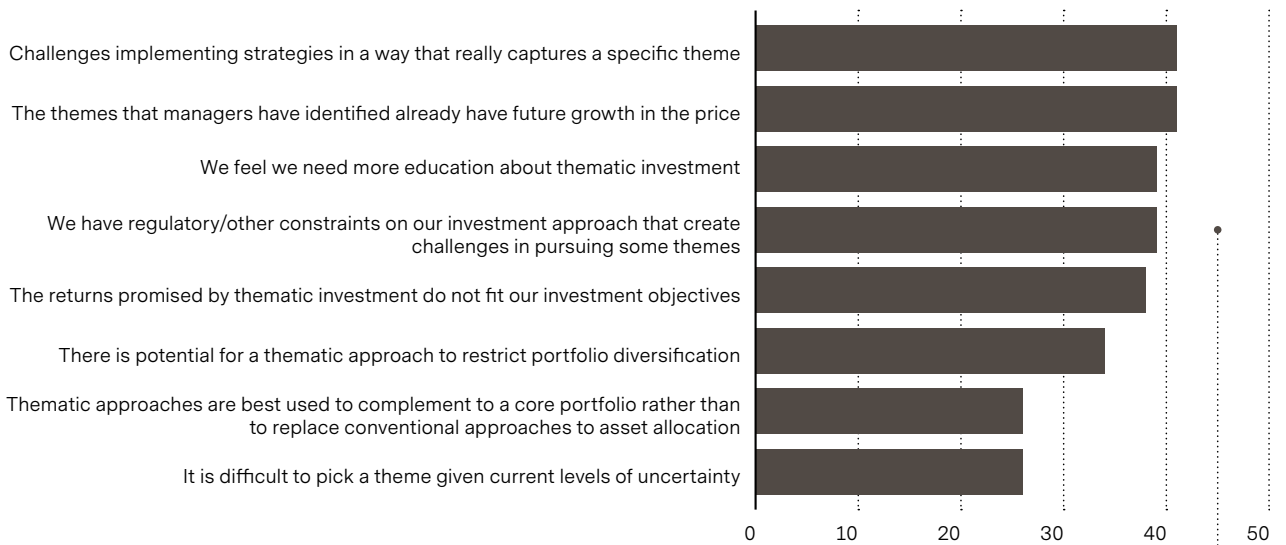
believe that the pandemic has boosted the case for a thematic approach



expect the themes they have invested in to gather pace because of the pandemic

Chart 6: Some respondents are cutting thematic exposures due to valuation concerns and practical challenges

Which of the following factors are potentially driving this decrease?
In%



Regulatory restrictions and other constraints are the number 1 problem for 18% of respondents cutting allocations

Covid-19 and thematic investment

More than half the respondents in this research believe that Covid-19 will encourage more widespread take-up of thematic investment, and 50% think many of the themes to which they are already exposed will be accelerated by the pandemic (see Chart 7). That rises to 58% among institutional investors and to 57% among investors with greater AuM.

There are good reasons for this optimism, with many of the impacts of Covid-19 accelerating the momentum behind key trends such as digital transformation. “What happened during the Covid-19 pandemic was that there were some themes that performed very well as their underlying trends gained momentum,” says BBVA’s Luis González. “For example, the shift to e-commerce accelerated by five years.”

Covid-19 is also seen as a catalyst for many of the themes related to ESG, says James Clark, Senior Fund Analyst at Hawksmoor Investment Management. “Covid has really accelerated changes in the sustainability area,” he says. “This applies particularly to global themes, such as health and safety, wellbeing, improving connectivity, and making transport more efficient.”

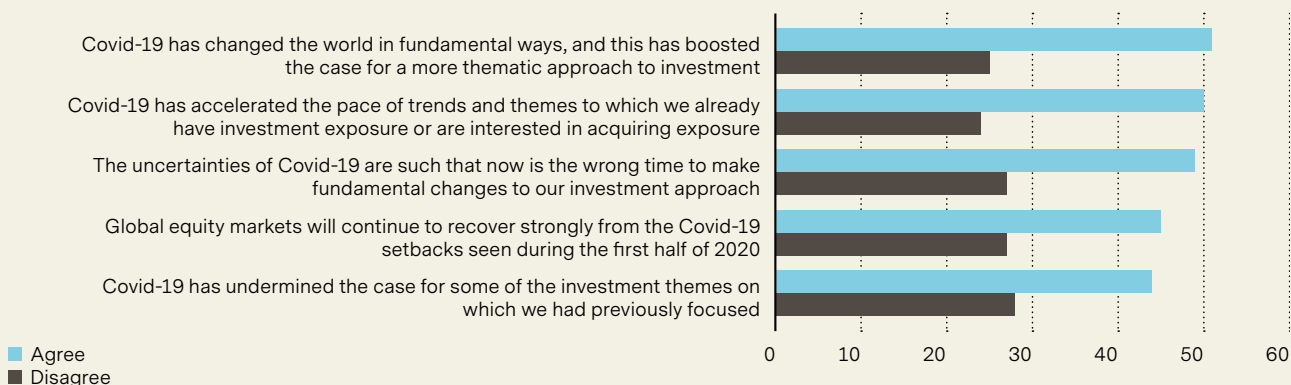
However, the anxiety and volatility caused by the pandemic has been deeply unsettling – and there is no guarantee that the crisis is over. Nearly half (49%) of respondents believe the current uncertainty makes this the wrong time to contemplate significant shifts in asset allocation policy.

And 44% of respondents worry that some themes have been undermined by the pandemic. Might the drivers of urbanization be weakened by widespread working from home, for example? And could the patchy roll-out of vaccines hit fast-growing developing economies?

Interestingly, the heavier adopters of thematic investments – those with larger existing allocations – are more likely than others to feel nervous about Covid-19’s impact on key themes, and less bullish about its positive impacts. One reason for this could be their higher exposures to the effects of the pandemic on thematic strategies.

Chart 7: Investors believe that Covid-19 is an accelerator of thematic investing

Thinking specifically about the impact of the Covid-19 virus, to what extent do you agree with the following statements? In%





Life-time emissions
from electric cars
are up to 70% lower
than petrol cars.

Part 2

Implementing a thematic approach: from theory to execution

Towards maturity

For many respondents in this research, their move toward thematic investment is at a relatively early stage. For example, 55% simply provide managers with house views on certain themes and leave the shifting of asset allocations up to them (see Chart 8). Only 6% of respondents say they pursue a thematic approach on a multi-asset basis.

But this picture varies by geography and type of respondent. For example, Nordic and Benelux respondents are more likely to have embraced more mature approaches to thematic investing; the same is true of intermediaries compared with institutional investors.

As we have seen, many respondents intend to increase equity allocations to thematic styles, and many already have exposures in other assets classes. As this continues, respondents will think hard about whether to formalize their approach to thematic investing.

Investors with higher existing allocations to thematic strategies are more likely to have more advanced approaches, suggesting maturation will continue as other investors raise their holdings. Right now, 29% hold views across their portfolios or invest on a multi-asset basis, compared with 18% of respondents with smaller allocations.

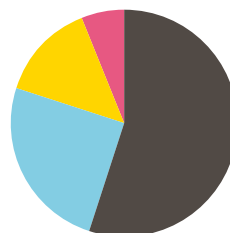
“We do need tools to understand risk, because there are potential traps in thematic investments.”

Werner Leithenmüller, 3 Banken-Generali

Chart 8: Most investors pursue thematic overlays, but few are multi-asset

Which of the following descriptions of thematic investment best fits your approach?

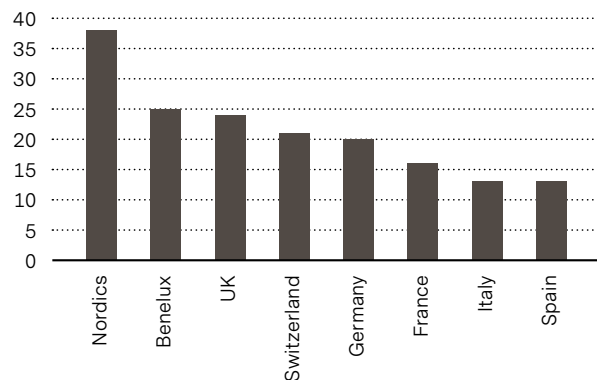
In %



- You have a thematic overlay on your portfolios, enabling managers to shift asset allocations according to house views on
- You pursue a thematic investment approach in a specific asset class
- You develop thematic views with the current risk limits and structures of your current portfolios
- You pursue a thematic investment approach on a multi-asset basis

Proportion of investors with thematic views across current portfolio or on a multi-asset basis

In %



Active wins out over passive

In the meantime, respondents are thinking about how to execute thematic investments. Respondents are more likely to favor active styles for pursuing their thematic ambitions, with 29% employing mostly or entirely active approaches (see Chart 9). But passive funds, which are so in favor across the investment industry, certainly have a role to play in thematic investment, with 23% of respondents favoring a passive style most or all the time.

So the picture is by no means clear cut. Among those who favor an active approach, only a small proportion say they always use active funds. And among those who veer toward passive styles, a significant majority still have space for active funds in their portfolios. Almost half of respondents, meanwhile, say they use both (48%).

One factor may simply be the reality of what is available. “One advantage of passive is that it can be easier to launch a new fund if you have a new trend,” says BBVA’s Luis González. “E-commerce, for example – with a passive fund, if there are enough companies, it is easy to launch that. The asset manager puts all the ecommerce companies in an index and that is all; the flip side is that some risks are not managed, such as high valuations or changes in the underlying outlook.”

But respondents have to tread carefully, warns MLP Banking’s Jacob Trefz. “We are seeing a lot of thematic ETFs [exchange-traded funds] in recent months, and these are getting massive inflows,” he says. “The question is: what kind of passive investment is it when somebody puts together an index and then gives it a name? What is actually in the products? Is it what it says on the label?”

“What kind of passive investment is it when somebody puts together an index and then gives it a name? What is actually in the products?”

Jacob Trefz, MLP Banking

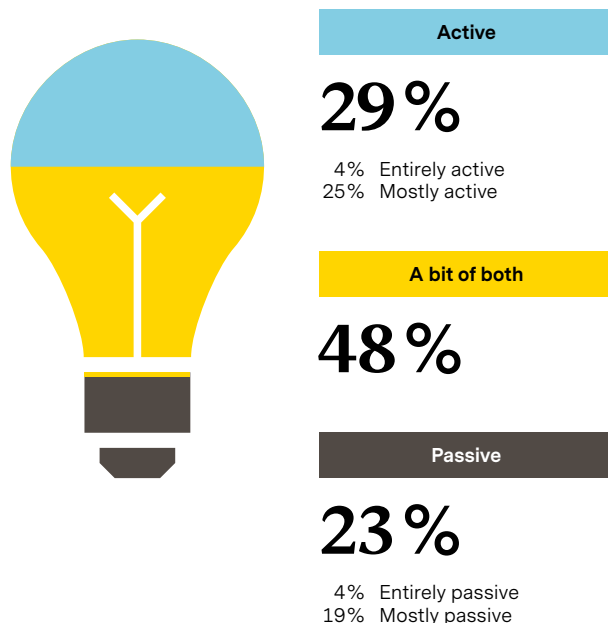
Risk is a key part of this debate. As we see in Chart 12, respondents are concerned about the need for careful risk management as the shift to thematic approaches continues. One danger of passive funds is they may leave investors overly concentrated on a relatively small basket of assets.

This is one reason why some investors are nervous about the passive approach. “We are very much active, and fitting with the sustainable approach we are 100% active,” says Hawksmoor Investment Management’s James Clark. “We are by no means big fans of passive sustainable investment.”

Either way, diversification is front of mind for many respondents. If the move into thematic approaches partly reflects a sense that these trends are where future growth will come from, there is also a determination not to focus too narrowly on only one idea – or on one manager.

Chart 9: Investors favor an active approach, but also see a role for passive

Thinking about how you execute thematic investment strategies, do you employ passive or active investment styles?





Respondents seek to diversify their thematic providers

More than two-thirds (67%) of respondents expect to increase the number of external managers they use for thematic investment over the next 12 months. Spanish respondents (73%) and larger respondents by AuM (81%) are particularly likely to be planning further hiring. And the appetite to increase the number of thematic funds they hold is almost identical whether respondents favor active or passive styles.

As respondents think about how to add these additional funds to their portfolios, when they look for an external manager they focus more on attributes such as credibility and vision than on scrutiny of past performance records.

Thematic fund managers' ability to offer compelling and thorough research material is likely to attract support from investors and intermediaries. Respondents say that quality of research and reporting and quality of vision are key reasons for choosing a manager (see Chart 10). Performance track records are a factor, but are not the be-all and end-all for fund pickers.

“Thematic investing requires a fundamental understanding of the impact of long-term economic, political and social trends on regions and sectors.”

Paolo Patelli, Crossinvest SA

Chart 10: Respondents look for quality of research and reporting from fund managers

Which criteria would you apply when selecting external managers?

In%



Investors are looking to diversify their thematic providers

67%



of institutional investors and intermediaries expect to diversify their thematic investment providers as allocations increase

This means that thematic fund managers will need to work hard to convince potential investors of their robust research processes and relevant expertise. “Thematic investing requires a fundamental understanding of the impact of long-term economic, political and social trends on regions and sectors,” says Paolo Patelli, Deputy Chief Investment Officer at Crossinvest SA in Switzerland. “This approach is best suited to investors who have a strong knowledge and understanding of the business, and who are well supported by a strong organization and infrastructure.”

Respondents with higher existing thematic allocations are particularly demanding. For example, 41% pick funds on the basis of the investment team’s expertise and experience; 37% focus on quality of vision.

The good news for thematic fund managers is that they can expect to be given time to deliver results. Respondents recognize that if the appeal of particular investment themes is their enduring relevancy, then performance needs to be judged over an extended timeframe.

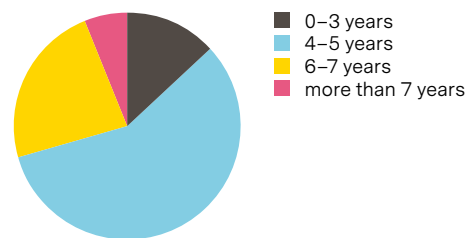
The majority intend to give their managers at least five years to produce good results (see Chart 11). The largest respondents by AuM are noticeably more long-termist: 40% would give managers more than six years to produce good results, compared with 26% of smaller firms.

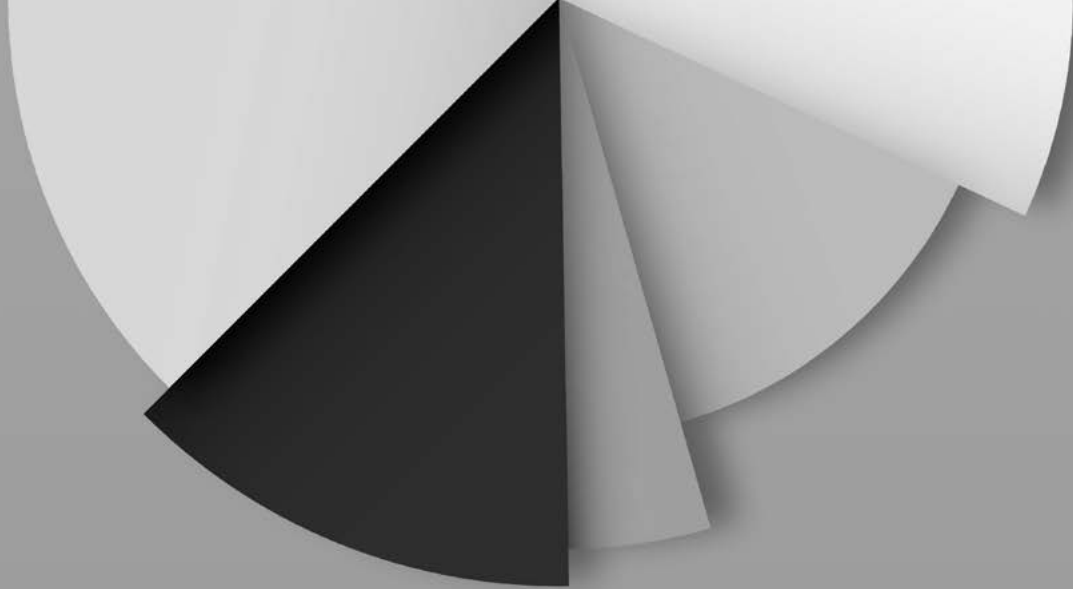
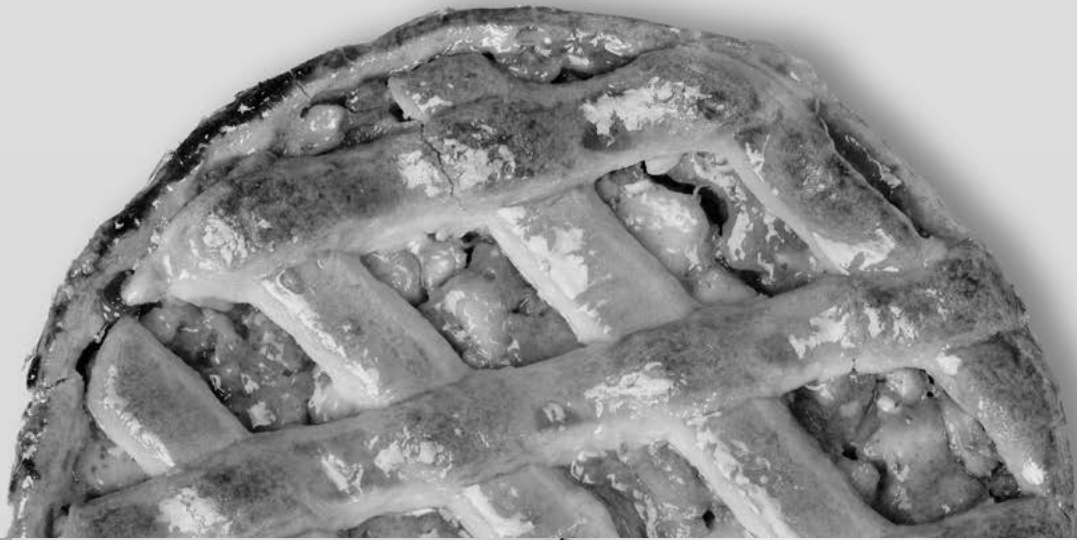
But investors’ patience is not inexhaustive, and their views may differ in other asset classes. One question is whether thematic allocations in fixed-income funds, for example, will be given similarly lengthy periods to produce good results.

Chart 11: Investors take a long-term view of fund performance

Assuming you would consider a third party to invest thematically on your behalf, how long would you give them to produce results?

In %





Real-time technology
is connecting businesses
and consumers to sell
the third of food that goes
to waste worldwide.

Part 3

Risk and reward – overcoming barriers to a thematic shift

Risk management to the fore

The desire to mitigate and manage risk is just as important to the expansion of thematic investment as the search for superior performance. If anything, risk is an even more crucial driver: 56% of respondents believe their thematic approach can help offset other portfolio risk, while 46% believe they will secure diversification benefits (see Chart 12).

In practice, there is nuance. Many investors believe that the themes they are now exposed to will be where future growth is to be found – 51% believe these allocations will deliver superior investment returns – rather than in many of the areas that traditional country or sector funds are weighted towards. In that sense, a move into thematic strategies may be seen to reduce the risk of underperforming because of exposure to assets that are now past their sell by dates. To put that another way, respondents are keen to use thematic funds to reduce their reliance on more conventional approaches to investment.

But investors need to be conscious that an embrace of thematic investment could expose them to other types of risk. In particular, many thematic funds offer relatively concentrated portfolios that could be prone to increased volatility.

“When you have an internal risk-scoring process, a fairly regular developed market global equity fund might score at five or five and a half, while with thematic equity funds, you are looking at more like six to eight,” warns Hawksmoor Investment Management’s James Clark. “They might well be slightly more concentrated.”

This makes sense. A robotics fund, for example, is a narrow bet on a particular technology; an e-commerce vehicle is unlikely to be much broader. Even a more broad-based theme – resource scarcity, for instance – offers exposure to only a relatively limited segment of the market.

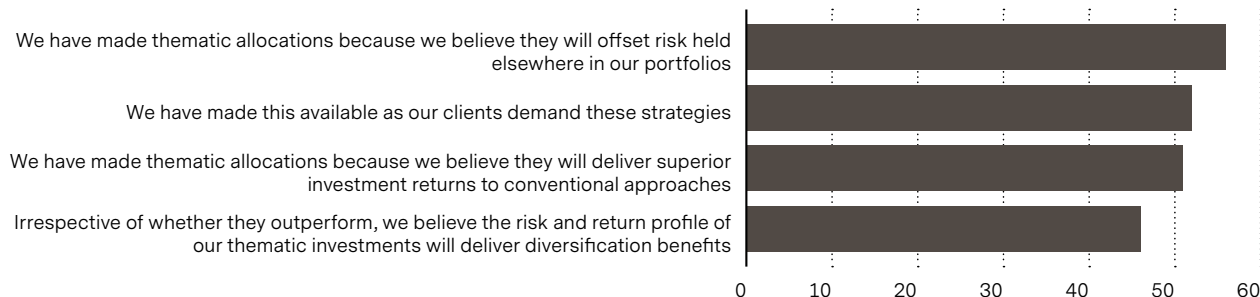
There is also the question of where the market opportunity takes fund managers. “Thematic investments tend to be in emerging markets, particularly if the market is in a bullish phase,” says MLP Banking’s Jakob Trefz. “Some customers might not be willing to take those kinds of risks.”

These are real and pressing concerns, says BancoPosta-Fondi’s Fabio Catalano, which call for careful fund selection and an approach that incorporates active funds. “We create baskets [of thematic funds],” he says. “We do not give customers the opportunity to buy just one theme, because I think it is pretty difficult to really understand. Instead, you have at least five different approaches. If you have a passive instrument in, say, technology, you have a concentrated portfolio.”

Chart 12: Investors believe that thematic investments can help them to manage risk

Which of the following statements is true of your thematic investment choices?

In%



Source: Vontobel Thematic Investing survey 2021

“We do need tools to understand risk, because there are potential traps in thematic investments.”

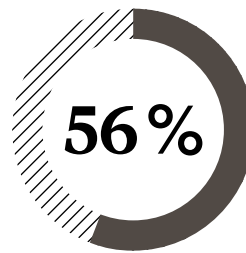
Werner Leithenmüller, 3 Banken-Generali Investment

The evidence of this research is that risk is a top concern as respondents shift into thematic funds. They are aware that portfolio concentration can expose investors to levels of volatility that they are not comfortable with.

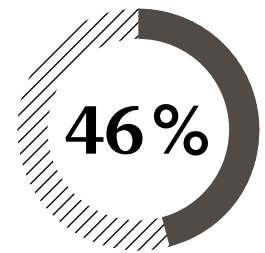
So, risk management is a central plank in most respondents’ approach to thematic investment: just 9% have not set risk budgets for their thematic portfolios (see Chart 13). Among those that do have these budgets, the appetite for risk is conservative, with most respondents only prepared to accept fluctuations of returns of up to 20%.

“We do need tools to understand risk, because there are potential traps in thematic investments,” says Werner Leithenmüller of 3 Banken-Generali Investment. “This is why we see investors stepping back to their benchmarks when they perceive that risk in the market is rising.”

Risk management is a crucial driver of the shift to thematic strategies



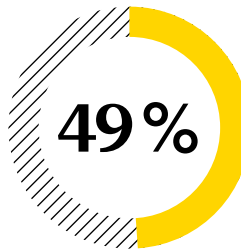
believe their thematic approach can help offset portfolio risk



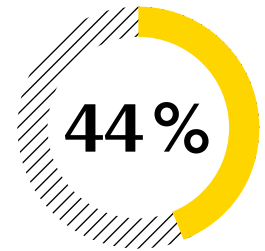
believe they will secure diversification benefits



And as volatility leads to uncertainty ...



believe that the current uncertainty makes this the wrong time to significantly shift asset allocation

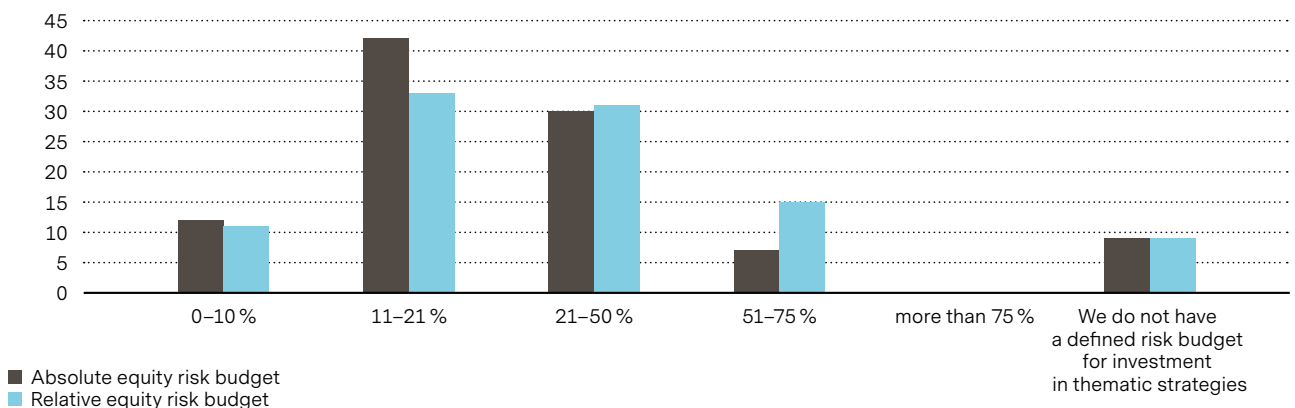


warn that some themes have been undermined by the pandemic

Chart 13: Investors focus on keeping volatility in check

What is your available risk budget for thematic strategies, expressed as a fluctuation of returns in absolute terms and relative to an index?

In %



There is a measurement problem

Another barrier to further take-up of thematic investment is the potential difficulty of holding fund managers to account. If managers are no longer selecting portfolios from within a set country or sector, then country or sector indices provide a less meaningful readout on how well they are performing.

The question of how to measure and report on performance is a key challenge for advocates of thematic investment approaches — there is no clear consensus on which benchmarks are most appropriate. Almost half of respondents (47%) are comparing their thematic funds’ performance with standard market cap indices, while 27% are using more specialist benchmarks (see Chart 14). A smaller number of respondents have chosen to develop their own benchmarks.

Interestingly, the views of respondents favoring active and passive approaches to thematic exposure vary little here, even though passive investment depends on being able to track an index. Some 18% of proponents of active management have developed their own benchmarks to track performance, against only 13% of those taking a passive approach. But very similar numbers on each side have chosen to depend on traditional market cap or specialist external benchmarks to measure performance.

“When looking for funds, an understanding of the vehicle profile is crucial.”

Paolo Patelli, Crossinvest SA

It will be vital to look through the benchmark to the fund’s underlying profile and constituents, says Crossinvest’s Paolo Patelli. “We need to pay attention to the composition of the vehicles,” he says. “When looking for companies, it is important to consider their sustainability profile, governance structure, resource efficiency and culture, as well as financial criteria. When looking for funds, an understanding of the vehicle profile is also crucial.”

Alongside the question of benchmarking, whereby 56% of respondents are worried about how to hold managers to account, there are other challenges. For example, 50% of respondents say that thematic investment may be more volatile (which is significant given the findings on risk above), and 48% worry about practicalities such as identifying genuinely long-term themes (see Chart 15).

Chart 14: Investors may struggle to hold fund managers to account

What approach does your organisation take to performance measurement when it comes to thematic portfolios?

In %



Source: Vontobel Thematic Investing survey 2021

What do these challenges mean for the future of thematic investing?

The good news for supporters of this approach to investment is that more than twice as many respondents agree that thematic strategies will deliver higher long-term returns as disagree.

But 42% believe the case for thematic investment has yet to be clearly proven – a view held by significant minorities in every country in the research and by every type of organization. Even among relatively heavy adopters of thematic styles, with more than 40% of AuM allocated thematically, 46% say that the jury is still out on the long-term merits of thematic approaches.

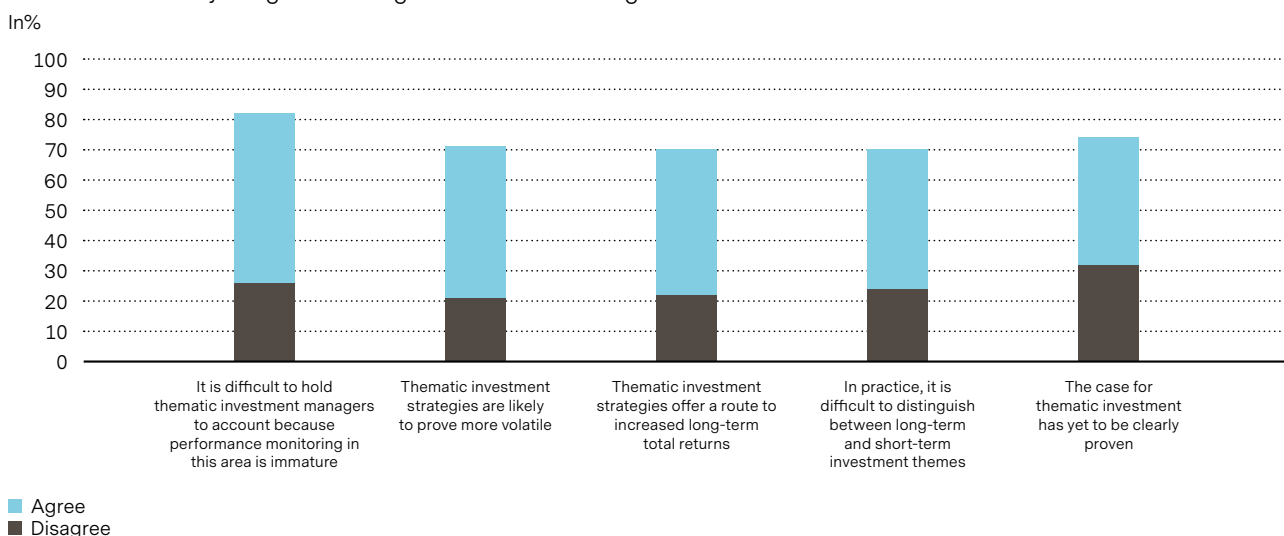
This anxiety could reflect the beginnings of a backlash against the increase in interest in thematic funds and a nervousness that they are over-hyped. Respondents understandably want to see how performance develops over time, particularly where thematic fund exposures are relatively new to them.

The key, suggests Werner Leithenmüller of 3 Banken-Generali Investment, may be recognize that the thematic approach has a longer history than is often acknowledged. “Looking back 10 to 15 years, I see this as an extension of the debate we had about adding ‘satellite’ investments to your core holdings,” he says. “We have been interested in adding pure plays in particular areas to more diversified core holdings for some time.”

Importantly, 48% of respondents believe thematic investment strategies offer a route to increased long-term total returns, against only 22% who disagree with this view. Still, as investors and intermediaries move into uncharted waters, there is a sense of caution and a need for careful risk management.

Chart 15: Investors are positive about future prospects, but have some concerns

To what extent do you agree or disagree with the following statements about thematic investment?



Conclusion

This research finds that for both institutional investors and intermediaries the question is not whether to invest in thematic strategies, but how to do so effectively.

Many are determined to raise their exposures to thematic funds, often taking the view that Covid-19 has strengthened the case for such investments. And they are embracing a broader range of themes, convinced that the structural drivers underpinning them will drive growth.

The challenge now is to execute on their ambitions and manage risk effectively. Respondents are looking for support and guidance on:

How to allocate assets across themes.

Thematic fund managers offer a broad and growing range of ideas and strategies, particularly in areas such as sustainability and technology. But investors may struggle to choose between so many different options and build portfolios that blend different ideas.

How to select managers and hold them to account.

While investors are prepared to be patient with investments that may play out over an extended period, there is little consensus about how to benchmark performance. And with growing numbers of funds – both active and passive – appealing to investors keen to take a thematic approach, fund selection is becoming more challenging.

How to manage risk and volatility.

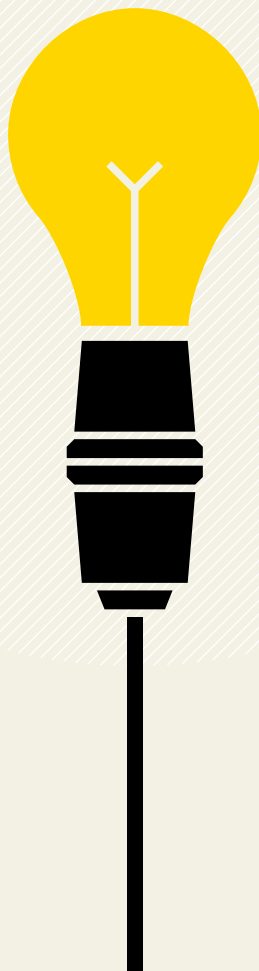
The desire not to miss out on performance in fast-moving areas of the marketplace is a driver of demand for thematic funds, but investors worry about portfolio concentration. Diversification is a central challenge to address as investors pursue a more thematic approach.

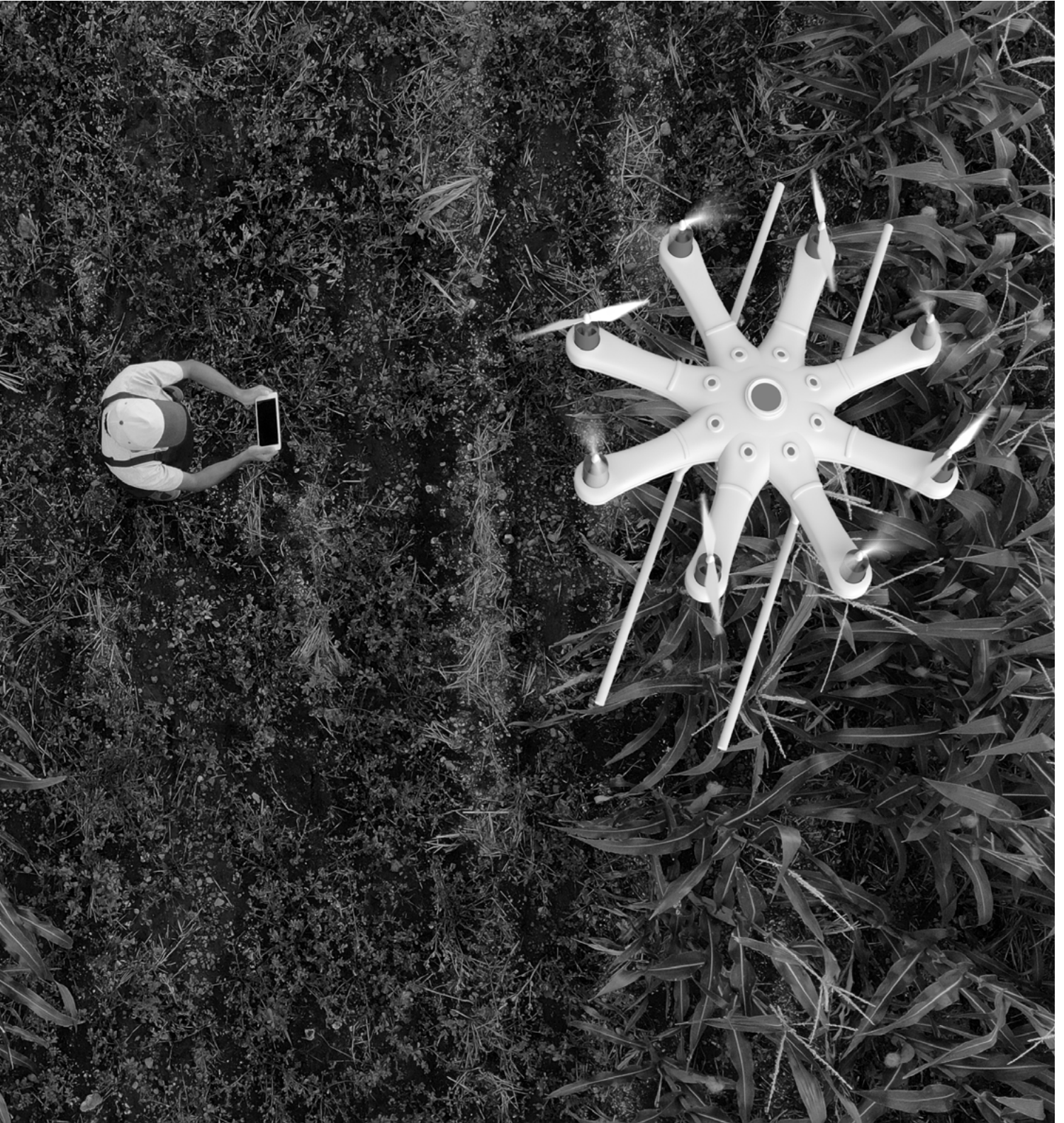
When to move on from particular themes.

Investors also worry about when to take profits from some of the themes that they have already backed. There is anxiety that in certain cases, the best of the growth may now be behind them.

How to choose the right funds to secure thematic exposure.

Thematic investment now looks set to continue growing. But helping investors to resolve these concerns is key if fund providers and other advocates of a more thematic approach to asset allocation are to rise to this challenge.





About the research

In February till April 2021, Vontobel and Longitude, a Financial Times company, surveyed 300 institutional investors and intermediaries across 14 countries.

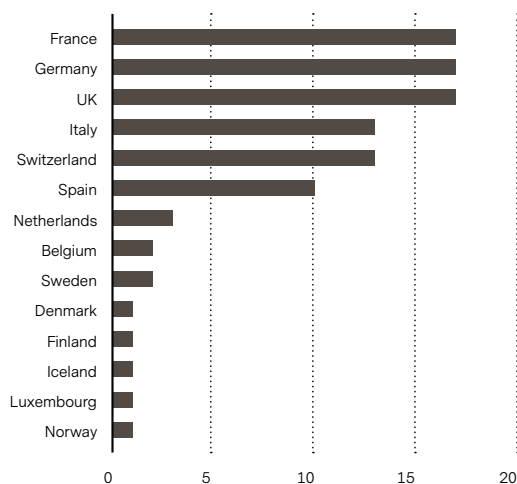
This study also draws on a number of interviews with experts in asset allocation and thematic investment. In particular, we would like to thank the following contributors:

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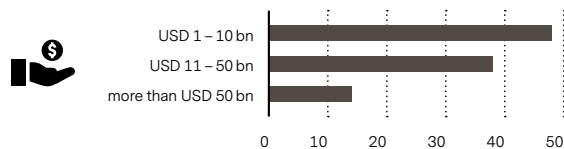
Countries

In %



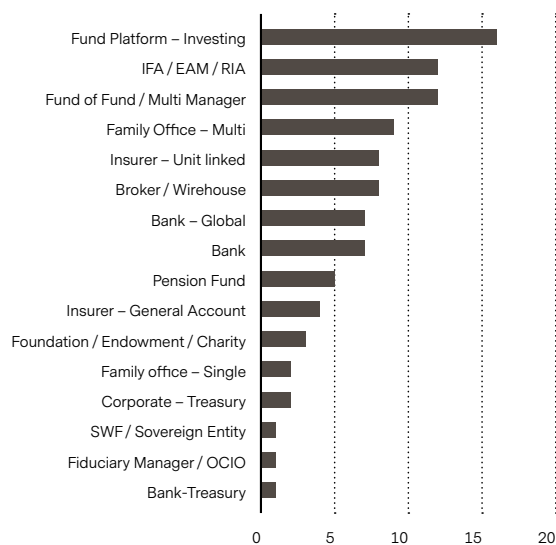
Assets under Management

In %



Organisation type

In %



Sources: Vontobel original research, February till April 2021, based on survey of 300 respondents in EMEA and CH

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