INTRODUCTION

KEEPING AN EYE ON THE FUTURE

Investors looking to benefit from global developments can access an expanding range of themes, in either multi- or single-themed approaches. But both are a long-term investment, writes Elisa Trovato

Thematic funds aim at selecting companies, typically across a variety of sectors, which benefit from global themes expected to have a long-term growth potential. They are increasingly considered a valid alternative to a geographic or industry approach, and most suitable to today's integrated global economy.

The remarkable product development activity in this space is further broadening the range of themes in which it is now possible to invest.

One of the latest innovations comes from Natixis Asset Management, with the launch of its Globalisation Winners fund last September. "We believe that emerging markets will enjoy a higher growth rate than the developed countries over the next 10 years," says Dominique Sabassier, chief investment officer at the French firm. The fund invests in "companies that are most able to capture this long-term trend," he says, within the sectors most impacted by globalisation. The stocks are mainly European, in order to limit the risk of investing directly in emerging countries.

Some other global themes have already had a very long shelf life. The food theme, which is incorporated in Natixis' 20-year old Actions Agro Alimentaire fund, responds to the major demographic, social and technical challenges in the food and consumer space. These include demographic explosion and growth of middle classes in developing markets, ageing population in developed countries, as well as improved product quality standards. "This is a defensive investment theme," claims Mr Sabassier "and it is historically less sensitive to market cycles than traditional equity funds, as the idea behind it is that everybody needs to eat."

But increasingly, multi-thematic funds, as opposed to single thematic funds, are considered the way forward.

"To me, a successful thematic fund is a multi-themed fund," says Guy Monson, managing partner at Sarasin and Partners, and pioneer of multi-thematic investments in London back in 1996. "It is the interrelationships between the themes, rather than the individual themes that interests me."

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Sarasin's blended thematic fund EquiSar, managed by Mr Monson, currently invests in five core themes. "Whenever we introduce a new theme, we review the correlation of the thematic universe with the existing themes we hold in the fund," he explains.

New themes are typically triggered by a development in the wider economy. The strong get stronger theme, which is now part of the fund, was originated by the sudden rationing of capital due to the credit crisis.

"I believe that the strong get stronger theme, which looks for companies that, either by luck of good judgement, at the end of the credit crisis are liquid and autonomous, will do exceptionally well," says Mr Monson. "Abnormal balance sheet strength is going to become a multi-year contributor in stock price outperformance."

Another theme Mr Monson is keen on is that of intellectual property. "The strong research and developments driven, patent driven and intellectually property rich companies will outperform, as the R&D budgets at many weaker competitors will come under pressure, there will be a quest for efficiency, and a drive to save resources and costs," he says.

FIRST OUT OF THE BLOCKS

Oliver Kratz, manager of the Global Thematic fund at DWS in New York, stresses the importance of identifying a theme when it is still in its bud, and starting investing in it before anybody else. "There are some monumental shifts taking place in some industries, countries and sectors, and once they happen and once everybody knows about them, it is typically too late to invest in them," says Mr Kratz.

Ten to 12 themes constitute the investment base of what Mr Kratz believes to be one of the oldest thematic funds around. "All our themes or sub-strategies share one common phenomenon: they identify a sequence of events, which could be micro-economic or macro-economic or structural, that are going to happen for sure over a period of three to five years."

The latest new entry in DWS' fund is personalised medicine, which has its foundations in a deeper understanding of the DNA of the human beings and aims at developing more fine-tuned, customised treatments.

The social impact that personalised medicine will have on the world population is going to be as big as the internet, believes Mr Kratz. It is still at the data collection stage, "in 1995 in internet terms," but there is no doubt it will positively grow, he says. "The fact that people will explore personalised cancer treatment options when they are available is something nobody will argue on."

Thematic investing is indeed very much associated to the study of future challenges that the world face.

"There is a whole host of environmental and social challenges," says Tim Dieppe, director of SRI (socially responsible investing) at Henderson Global Investors. "Companies, within specific industries, that provide solutions in a sustainable and economic manner to these kind of challenges are well placed to outperform the market over time," he says, explaining the firm's Industries of the Future fund. The fund invests in ten themes, five of which are sustainability or environmental themes and five social themes.

"One of the benefits of having a multi-thematic approach is that themes are not correlated with each other and therefore genuinely add diversity to the fund," he says. "If you had only environmental themes, you would be a lot more trapped into high volatility and growth companies and you would have struggled a lot in the last year, whereas if you just had social themes you would struggle to do well when the market is doing well."

Thematic investing is in some way an evolution of SRI,

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says Mr Dieppe. SRI was originally about excluding investing in companies that are considered to have a bad social effect such as arm, tobacco or alcohol. It then evolved to investing in best in class firms that embrace a good environment, governance and social policy (ESG).

"Thematic investing seems to us to be a logical extension of how SRI has developed," says Mr Dieppe. "The idea is now that we positively want to invest in the industries where we see the growth potential, because we are thinking long term and we are thinking about mega trends in the world."

SCARCITY AND MONOPOLY

An important consideration to make when identifying new themes is whether there is a scarcity of goods or skills and whether the firms within the theme benefit from being in a monopoly situation, according to Denis Schmidli, product manager for thematic funds at Pictet Funds in Geneva.

"A telling story is the water theme," says Mr Schmidli. Pictet's water fund, with €2bn of assets under management, is the biggest of the eight thematic funds that the Swiss firm offers to its clients. Water is a scarce commodity, it cannot be replaced by anything else but the need for it will increase exponentially, as the world population is forecast to reach 9bn by 2050. Outdated or non-existant infrastructure provide a huge challenge.

"The water business is very complex, capital intensive and barriers to entry are relatively high," he explains. With governments increasingly seeking to outsource water services, supply companies effectively operate as monopolists, as they are typically awarded a contract for 20-50 years. Producers of infrastructure such as pump producers, system engineers, environmental service consultants and water distributors are all part of the theme, and all have a "unique selling proposition" to offer, he says.

That there is a clear trend towards multi-thematic funds is shown also by the launch last November of Pictet's Global Mega Trend Selection fund. The fund invests, on an equally-weighted basis, in all the eight thematic funds which are offered individually already, and it is re-balanced monthly.

"The idea behind this fund is that each of the eight themes – be they premium brands, biotech, water or digital communications, timber fund or security investing, or generic drugs or clean energy - has its right to exist and has a long term growth," he says.

"Whenever we launch a new thematic product we will add it to the global megatrend selection and similarly, whenever we decide to liquidate or close a fund, we will remove if from the list," says Mr Schmidli.

"IT IS BETTER TO GIVE THE FUND A CLEAR PROFILE SO THAT INVESTORS KNOW WHAT THEY ARE BUYING"
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CORE VERSUS SATELLITE INVESTMENTS

A multi-thematic product having a neutral stance on the themes relieves the investor from the pressure of deciding on which theme to bet. While thematic funds are for private investors who have a strong conviction about a topic, but also attract professional investors, the global megatrend selection fund has clearly a private client orientation, says Mr Schmidli.

In the Swiss private banking arena, the trend is, increasingly, for wealth managers to make active bets mainly in the area of thematic equity funds. These are generally employed in the satellite part of a portfolio, while the core is allocated to passive investments such as exchange traded funds (ETFs).

But in truth, whether thematic funds are core or satellite depends on the investment approach employed.

"I strongly suggest that a well managed global equity portfolio run on a thematic basis should be formally core and not satellite," says Mr Monson at Sarasin. He recommends that his EquiSar multi-themed fund, which he describes as "a large cap, low risk global equity solution," may be effectively utilised for fifty to 100 per cent of investors' global equity exposure.

Stephan Meier, head of asset management at Clariden Leu believes that for some broad thematic funds - for example the Infrastructure fund or the Climate Leaders funds that the Swiss private banks offers - it does make sense to invest in single themes. "It is better to give the fund a clear profile so that investors know what they are buying. Otherwise, if you combine different themes, you would lose a bit of focus."

But the actual blending of thematic and sector funds, perhaps sourced from different providers, can indeed prove to be a valid solution for building an investor's equity portfolio. "It is much easier for a private investor to relate to themes or sectors, and to understand what they are buying rather than investing into a region or country," he says.

"However, it is important to understand what sectors are actually included in a thematic fund. For example if you are buying into infrastructure, you must be aware that a huge part of your money is invested into utilities, so you don't necessarily need to hold a utility sector fund in your portfolio," explains Mr Meier.

In general, thematic equity investments cannot be really considered defensive, he says. "In our infrastructure or climate leaders funds there is a large content of emerging economy investments, of tech companies and more growth and more beta type of investments."

Although huge investments planned by governments in areas such infrastructure or climate change, as part of the large stimulus packages, may have stimulated investors' interest in these themes, the general fear of moving back into equities still prevails, reckons Mr Meier. "People can see that all this money is really going to be spent, but at the same time there is still caution and investors are really not ready to step back into equities."

Any theme must be researched in-depth before launching any product, says Mr Sabassier at Natixis AM, voicing a common remark from thematic fund providers. "Launching a thematic fund, only to close it after two or three years, would just kill the firm's reputation," he explains, emphasising the importance of not caving in to marketing pressures. "You have to be very sure of the very long-term prospects of the theme."