

WISDOMTREE QUARTERLY THEMATIC REVIEW: THEMATICS FOR THE LONG RUN

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The first nine months of 2022 have seen a rapid decrease in thematic assets in Europe, with the total figure now standing at \$259 billion (bn). This represents a decline of \$111 bn from the end of 2021, driven mostly by performance. Amidst a challenging performance environment, total thematic flows were, in contrast, positive with \$11.7 bn of net investments, suggesting a strategic use of thematic funds within portfolios. After a significant correction in the first half of 2022, Q3 started with a period of short-term rebound across various themes, superseded by yet another sell-off from mid-August¹.

Thematic assets invested in exchange-traded funds (ETFs) have shrunk -24.6% year-to-date vs. -30.8% in open-ended funds. However, similar to the first six months of 2022, the performance impact on assets across both wrappers (as of 30 September) was approximately the same, -32% and -33.3%, respectively. Notably, with around 13.6% market share in Europe, ETFs have captured 30% of the year-to-date flows going into thematics.

Some optimism in equity markets that started in mid-June continued into the first half of Q3, amidst expectations of the Fed² pivot. However, the release of the Fed minutes in mid-August, and chairman J. Powell's speech at Jackson Hole, indicated that the Fed maintains its hawkish stance, triggering further sell-off. More growth-oriented thematic strategies that are more sensitive to interest rate hikes first enjoyed a stronger rebound but subsequently wiped their short-term gains and corrected further in line with the broader equity market. Blockchain was the only theme that was positive in the thematic space in Europe in Q3.

In this quarterly thematic review, we will analyse the third quarter, as well as the first nine months of the year, through the lens of performance, flows, and new launches. For all of our calculations, we will use the [WisdomTree Thematic Classification](#) that we have previously introduced in a series of blogs where we discussed [how to classify](#) and [select thematic funds](#).

Winners and losers

As noted in our research paper on [thematic investments](#), themes tend to rotate in flows and performance over time due to their individual narratives. This year, China-centered themes continue to offer a bright example here. After a rough Q1, these themes were most resilient in Q2, amidst certain optimism around the softening of its tech crackdown, easing of lockdown policies, and government's readiness to support the economy. The tide turned again in Q3 with a sharper than expected economic slowdown and themes such as

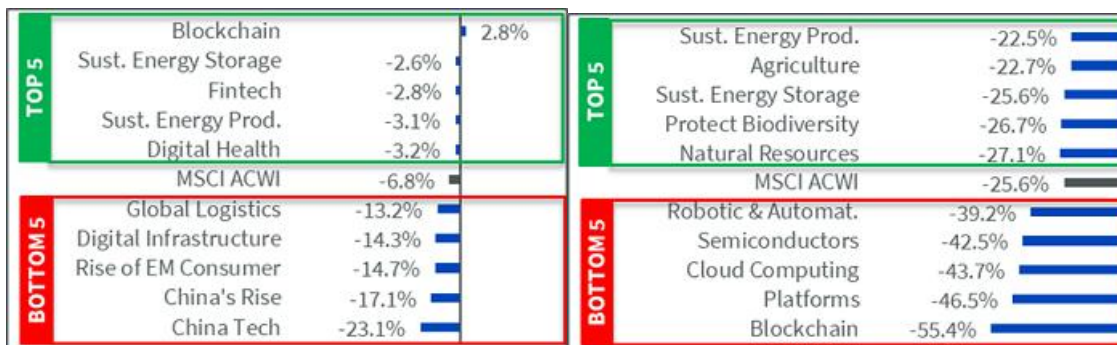
‘China Tech’, ‘China’s Rise’, and ‘Rise of EM Consumer’ posting the worst performance for the quarter.

Many themes have experienced a rebound in the first half of Q3 and a subsequent sell-off in the second half. The MSCI ACWI Index lost 6.82% in Q3 and 25.62% year-to-date. Most of the themes underperformed the benchmark in Q3, while 11 themes beat it. Year-to-date, only ‘Agriculture’ and ‘Sustainable Energy Production’ beat the benchmark, as topics of energy and food security received huge attention amidst the war in Ukraine.

Only two themes beating the benchmark year-to-date highlights the depth of the correction in the thematic space. However, the short-term rebound in the first half of Q3 gives an idea of the rebound potential, once monetary policy stops being the dominating factor driving the markets. Three out of the top 5 best-performing themes in Q3 were classified within the ‘Technological Shifts’ cluster. ‘Blockchain’ and ‘Fintech’ have swapped their places in the bottom 5 in Q2 to the top 5 in Q3 after significant drawdowns that happened in the first six months of the year.

‘Sustainable Energy Storage’ and ‘Sustainable Energy Production’ were the only green themes in the top 5 best performers in Q3. Both themes are linked to the energy transition megatrend and, alongside ‘Agriculture’, were the top performing themes year-to-date.

Figure 1. Q3 (left) and year-to-date (right) performance of the top 5 and the bottom 5 themes vs MSCI ACWI



Source: WisdomTree, Morningstar, Bloomberg.

All data as of 30 September 2022 and based on WisdomTree's internal classification of thematic funds.

Performance is based on monthly returns from Morningstar.

Please refer to Footnote 1 for the details around the calculation of performance for a given theme.

Historical performance is not an indication of future performance, and any investments may go down in value.

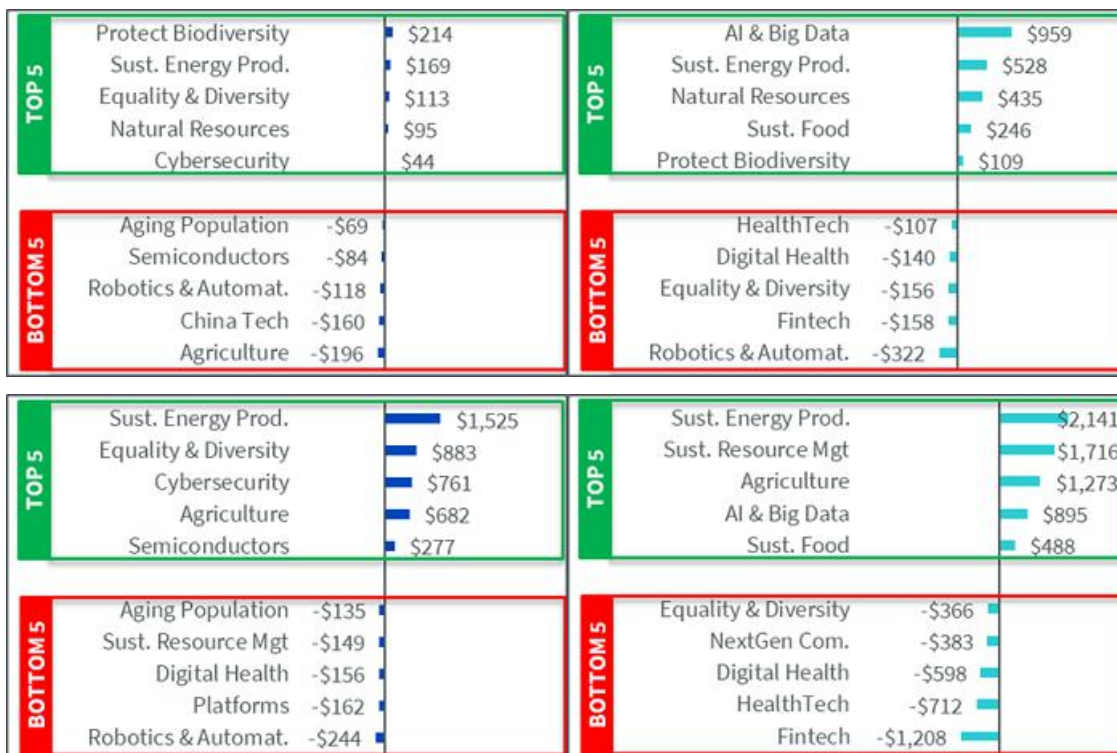
The year-to-date performance figures show that the largest correction in the thematic space happened across the tech-focused themes, with the ‘Blockchain’ theme being the worst performer and losing 55.4% as of 30 September 2022. Two themes following ‘Blockchain’, ‘Platforms’ and ‘Cloud Computing’ were the key beneficiaries of the digital transition fuelled by the global pandemic. This year, many cloud computing companies have experienced a significant correction from their previous peaks resulting in some historically low valuation multiples. The ‘Semiconductors’ theme, due to its cyclical nature, is suffering both from supply chain disruptions and demand slowdown in the space, putting future revenue streams and margins in the industry into question.

Flows indicative of strategic use

Flow dynamics in the first half of 2022 have pointed to a relative resilience in ETFs compared to open-ended funds. However, in Q3, open-ended funds gathered the bulk of flows with \$1.1 bn, while flows into ETFs have turned slightly negative. July was the best month of the quarter, with \$1.5 bn in open-ended funds and \$0.2 bn in ETFs. Year-to-date flows into ETFs comprised 9.8% of their assets under management (AUM) (as of 30 September) and 3.7% for open-ended funds. Overall, ETFs have gathered 42% of assets raised by open-ended funds in the first nine months of the year, despite ETF's total thematic assets being more than six times smaller.

In Q3 and year-to-date, flows have gravitated towards green themes, with 'Sustainable Energy Production', 'Protect Biodiversity', 'Sustainable Resource Management', and 'Sustainable Food' attracting a significant proportion of flows. 'AI and Big Data' led the flows in Q3 and was the only tech-focused theme in the top 5. However, year-to-date, the only tech-focused theme in the top 5 flows was 'Cybersecurity', with close to \$0.9 bn allocations. The theme has also received elevated attention in light of the war in Ukraine. It represents that the technology spending segment is poised to better withstand any spending cuts due to its critical function for almost any business. The 'Equality and Diversity' theme was the only theme that, in both Q3 and year-to-date, showed a diametrically opposite sentiment in ETFs and open-ended funds.

Figure 2. Q3 (top) and year-to-date (bottom) flows in Europe of the top 5 and the bottom 5 themes - ETFs (dark blue) vs open-ended (OE) funds (teal)



Source: WisdomTree, Morningstar, Bloomberg. All data as of 30 September 2022.
 Data based on WisdomTree's internal classification of thematic funds.

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Year-to-date, 'Sustainable Energy Production' keeps its title as the theme raising the most flows across both wrappers. 'Agriculture' is the second best theme by flows across both wrappers, coinciding with the ranking of both themes by performance year-to-date.

The 'Environmental Pressures' cluster, where the themes sit, was also the top asset gatherer year-to-date, continuing the trend established last year. The cluster accounted for 71% of flows within ETFs and 118% of flows within open-ended funds.

In turn, \$3.3 bn and \$0.4 bn outflows from 'Technological Shifts' and 'Demographic and Social Shifts' clusters in open-ended funds are contrasted by net positive flows of \$139 m and \$844 m in ETFs, respectively. The three themes that have seen the largest outflows year-to-date are from the 'Technological Shifts' cluster - 'Fintech', 'Digital Health', and 'Robotics and Automation'.

Regardless of global rotation out of growth strategies, and only two themes beating MSCI ACWI, we see positive flows across 22 of 37 themes, indicative of strategic thematic allocations in light of entry opportunities presented by the current correction.

Launches point to long-term growth

Year-to-date launches in open-ended funds are showing signs of deceleration amidst a huge flow slowdown. However, the picture is quite different for ETFs, where launches have already outpaced the 2021 figure of 44 funds by 12 new strategies³. September was the strongest month in the space, with 28 new launches. This indicates that, regardless of significant drawdowns across many themes year-to-date, asset managers haven't paused their efforts to add new thematic funds, suggesting they believe in the long-term growth of the space.

Looking at the top 10 themes by year-to-date launches, we can note two trends. Asset managers introduce themes where they see future growth potential and add new launches where they see strong momentum in terms of flows. 'Metaverse' is an example of the first trend and a new theme that has been added by asset managers in Europe, with ten funds launched year-to-date. 'Blockchain' is another example where asset managers grew the space with five new launches, bringing the total funds offered in Europe to 13.

Themes from the 'Environmental Pressures' cluster can support both trends, as the cluster was the leader in gathering assets in the last two years and encompasses a range of themes linked to the fight against climate change. For example, 'Sustainable Energy Production' and 'Sustainable Resource Management' themes, even being the most saturated in the space by the number of funds offered, have seen 13 and 9 new funds added so far this year, respectively.

We will continue to closely watch the space in Q4 2022 and we will summarise our findings in the next WisdomTree Quarterly Thematic Review. Stay tuned.

Sources

¹ Source: WisdomTree, Morningstar, Bloomberg. All data as of 30 September 2022 and based on WisdomTree's internal classification of thematic funds.

² Federal Reserve

³ Source: WisdomTree, Morningstar, Bloomberg. All data as of 30 September 2022 and based on WisdomTree's internal classification of thematic funds.

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