
WHY THEMATIC FUND SELECTION IS PARTICULARLY SUSCEPTIBLE TO FEAR OF MISSING OUT (“FOMO”)?

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Thematic investments enable investors to link their vision of the world and its evolution directly to their investments. However, they also create risks for investors. One important area of risk involves evaluation, both in terms of strategy due diligence and ongoing performance monitoring. Without the standard fund selection toolkit, for which benchmarks, peer groups, and track records are paramount, selecting thematic funds may require a completely different framework. Traditional benchmarks and peer groups are rare and hard to come by in the thematic universe.

In this blog, we discuss how the WisdomTree Thematic Classification, which we introduced in a previous [blog](#), can be used to create thematic peer groups. This is exciting because it then allows for the benchmarking of the performance of thematic strategies. We also illustrate the difficulty of fund selection in the Thematic space. The performance dispersion between funds can be quite large between funds inside an investment theme—a fact that many investors may not yet realise. In fact, looking at 14 different investment themes, the difference between the best performing and the worst-performing fund was higher than 5% on average per year for the last 3 years in every single theme.

Using the WisdomTree Thematic Classification to benchmark funds and create peer groups

In the WisdomTree Thematic Classification, ETFs and open-ended funds are organised by themes. This creates a de facto peer-group for each theme:

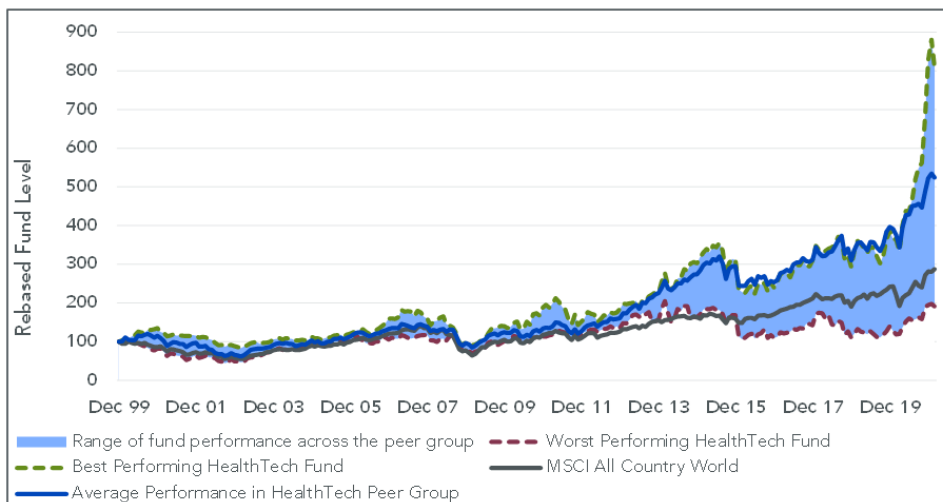
- At any point in time, the peer group comprises all the ETFs and open-ended funds currently classified in a given theme. All those investment vehicles share the same investment objective, which is to benefit to the maximum extent possible from the growth and adoption of the theme.
- Classifying funds into themes makes it possible to benchmark the performance of any fund in the theme. By averaging every month, the returns of all ETFs and open-ended funds classified in a specific theme and with available returns for the month, we can compute the average monthly return for that theme. This average historical performance is not biased towards surviving funds or successful funds as it includes every fund irrespective of its survival or success.

Taking the example of the HealthTech theme, Figure 1 illustrates how the wisdomTree Thematic Classification allows a fair performance comparison between thematic funds.

- The blue envelope in Figure 1 represents the range of performance delivered by all the funds in the HealthTech theme. The dark blue line represents the average performance of investing in all of those funds equal-weighted over time.
- It is clear that HealthTech, in general, has performed very strongly, outperforming the MSCI All Country world by a fair margin. Some strategies in this theme have outperformed the average and have done even better. However, it is also clear that a fair chunk of the strategy in the peer group have fared less well, underperforming the average of the peer group but also the MSCI All Country world.

The comparison in Figure 1 shows the large dispersion in the historical performance of the different funds aiming to benefit from the development of HealthTech over the long term. This highlights the risks associated with selecting thematic funds and the importance of picking a robust strategy that would translate into successful performance over the long term.

Figure 1: Performance dispersion in the HealthTech Peer Group



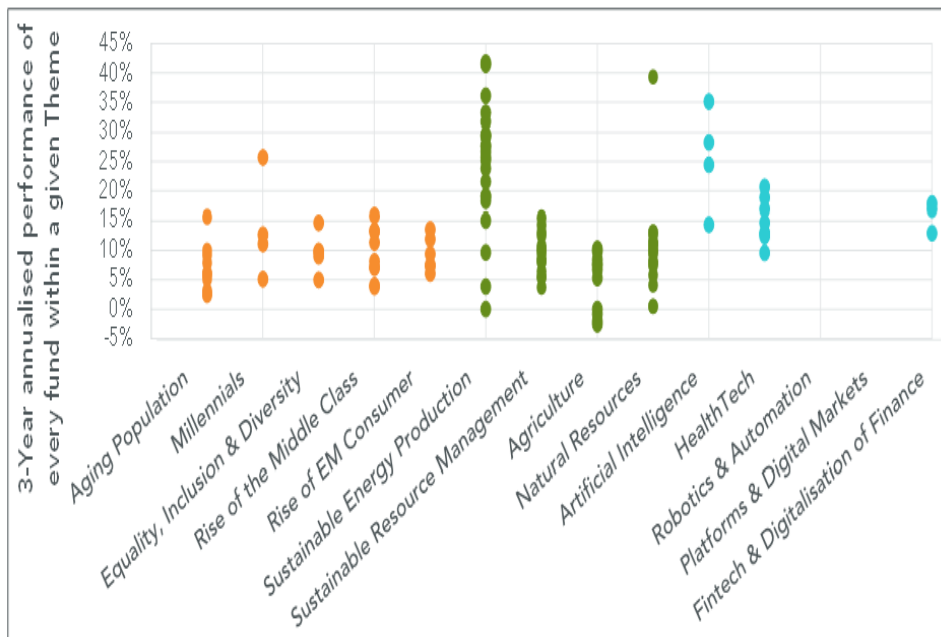
Source: WisdomTree, Morningstar, Bloomberg. From 31st December 1999 to 28th February 2021. Returns are calculated in U.S. dollars on a monthly basis. Only funds live at the time of computation of the graph and launched before December 2017 are considered.

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

Strategies harnessing the same theme deliver very different results

In Figure 2, we extend the analysis to multiple investment Themes in our classification. This analysis shows the last 3-year performance of every Europe-domiciled ETF and open-ended fund for a set of investment themes. In each of the 14 themes below, the difference between the best performing and the worst-performing fund is higher than 5% on average per year. In Sustainable Energy Production, the difference is 41.7% every year for three years. The opportunity cost in picking the wrong thematic fund even within a well-defined theme like Artificial Intelligence (A.I.) or HealthTech can therefore be very high.

Figure 2: 3-Year Performance Dispersion of the Europe-domiciled ETFs and open-ended funds across selected investment themes



Source: WisdomTree, Morningstar, Bloomberg. From 28th February 2018 to 28th February 2021. Returns are calculated in U.S. dollars on a monthly basis. Only funds live for the whole 3-year 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 dispersion is why developing a new toolkit to select funds in the Thematic space is key, especially when the standard toolkit for fund selection amongst these specific types of strategies does not exist.

At WisdomTree, we believe that it is possible to achieve success in selecting thematic funds with the appropriate framework. Our next blog will present a holistic framework to approach fund selection in the thematic space. Our goal will be to provide clear steps for understanding which strategy might best represent an investor’s conviction in a theme and its underlying story.

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