9 THINGS TO WATCH IN THEMATICS IN 2023 (PART 1)

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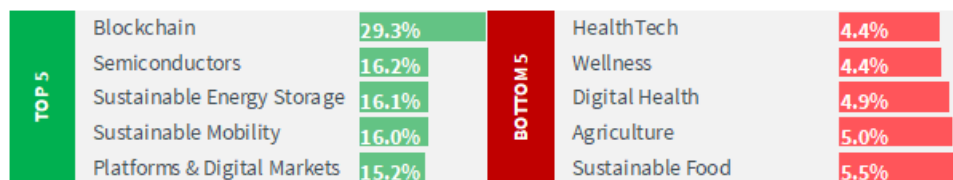27 Feb 2023

2022 didn't offer any respite to financial markets caught up in the maelstrom of macro and geopolitical events. With turbulence in equity markets, and vast underperformance of thematic strategies, developments in the space might not have been high on investors' radar in 2022. However, as investors are starting to look at thematic opportunities with renewed interest, a retrospect of the space in 2022 offers valuable inferences. In part one of this two part blog series, we use our analysis of the thematic landscape in Europe in 2022 to discuss key observations that thematic investors should keep an eye on this year.

1. The depth of thematic drawdowns and the speed of rebounds

2022 has shown the level of risk associated with certain thematic investments. Strategies that were more exposed to longer duration assets (for example: newer public companies, companies with high growth rates and with low or negative earnings) suffered the most amidst ongoing interest rate hikes. The worst-performing themes in the WisdomTree Thematic Classification lost between 40%-60% in 2022.

With the ongoing resilience of the labour market in the United States, the US Federal Reserve (Fed) has more flexibility to keep rates higher for longer. Consequently, investors may keep their risk exposure low despite strong returns of risk assets in January. However, we believe that returns we have witnessed year-to-date in January (Figure 1), and in early February, were indicative of the potential rebound that might happen across a range of thematic strategies when the smoke of monetary tightening and recession fears clears. To put it into perspective, 28 themes out of 37 investable themes in Europe within our classification beat MSCI ACWI in the first month of 2023.

Figure 1: January 2023 performance of the top 5 and the bottom 5 themes

TOP 5			BOTTOM 5		
Blockchain	29.3%		HealthTech	4.4%	
Semiconductors	16.2%		Wellness	4.4%	
Sustainable Energy Storage	16.1%		Digital Health	4.9%	
Sustainable Mobility	16.0%		Agriculture	5.0%	
Platforms & Digital Markets	15.2%		Sustainable Food	5.5%	

Source: WisdomTree, Morningstar, Bloomberg. All data based on WisdomTree's internal classification of thematic funds. Performance is based on monthly returns from Morningstar. Please refer to Footnotes 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 strength of performance rebound across a range of thematic strategies exhibited in
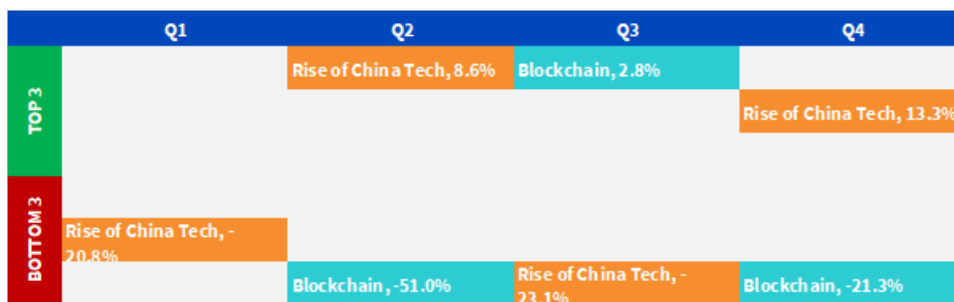
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the pandemic spring of 2020, as well as during recent periods associated with higher expectations of a potential Fed pivot (July – early August 2022 and January 2023), suggests that strong rallies across thematics can happen extremely fast. We certainly cannot predict when and how thematics will rebound in the future but, for long-term investors, we believe it makes sense to evaluate entry opportunities in 2023 ahead of the Fed pivot vs the risks of missing the subsequent rebound.

2. Themes exhibit rotation over time

In our [Thematics Universe Paper](#) published in April 2021 we have shown that themes tend to rotate in performance over time vs broad equity benchmarks. This observation has also been highlighted numerous times in our quarterly blogs. In 2022, 'Blockchain' and 'Rise of China Tech' offered a bright example, as shown in Figure 2. A disastrous performance of -51% for the 'Blockchain' theme in Q2 2022 was followed by a rebound in Q3, when 'Blockchain' was the only theme to post a positive return of 2.8%. Meanwhile, the 'Rise of China Tech' theme was on the opposite end of the spectrum, swapping the top place by performance in Q2 with the bottom place in Q3. In Q4 2022, both themes have rotated again ending up on the opposite ends of the performance spectrum.

In our view, the rotation of themes offers not only short-term tactical opportunities but also entry opportunities for long-term investments in thematic strategies. With a strong start to the year across a range of thematic strategies, the 'Blockchain' theme yet again topped the performance table in January, posting a 29.3% return for the month.

Figure 2. Quarterly performance of 'Blockchain' and 'Rise of China Tech' in 2022

Source: WisdomTree, Morningstar, Bloomberg. All data based on WisdomTree's internal classification of thematic funds. Performance is based on monthly returns from Morningstar. Please refer to Footnotes for the details around the calculation of performance for a given theme.

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3. Dispersion of returns across themes

Exchange-traded funds (ETFs) and open-ended funds in Europe currently represent 37 themes in the WisdomTree Thematic Classification, and the list is only growing. While we cannot tell which themes will outperform in the long term, we can tell that, even in the short term, themes exhibit significant dispersion. In 2022, the return differential between the best and worst performing theme was almost 55%. Figure 3 shows the dispersion between the best and worst theme by performance in the last 5 years. The lowest differential was observed in 2019 at around 35%, and the highest differential was in 2020 at around 108%.

In our view, dispersion of returns across themes not only shows the potential of

thematic strategies for tactical plays, but also the diversification potential of thematics in a broad multi-thematic portfolio that can even become the new reinvented core. We have discussed this unconventional long-term approach alongside the other two in our Thematics Universe Paper.

Figure 3. Best and worst performing themes in the WisdomTree Thematic Classification in 2018-2022

	2018	2019	2020	2021	2022
Best	Cybersecurity, 10.0%	Fintech & Digitalisation of Finance, 39.7%	Sustainable Energy Storage, 116.4%	Semiconductors, 44.3%	Agriculture, -10.2%
Worst	Sustainable Mobility, -27.5%	Sustainable Energy Storage, 4.7%	Agriculture, 8.4%	Education, -30.3%	Blockchain, -64.9%

Source: WisdomTree, Morningstar, Bloomberg. Calculations are based on WisdomTree's internal classification of thematic funds. Performance is based on monthly returns from Morningstar. Please refer to Footnotes for the details around the calculation of performance for a given theme.

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4. Dispersion of returns within themes

In our European thematic update, we feature a chart that plots dispersion between returns of the funds across each theme in our classification. Over the last few years, we noted that dispersion tends to be rather large within themes as well. In Figure 4, the average return differential between the best and worst performing funds within each theme in 2022 was around 26.6%, with the lowest differential of 0.07% in 'Semiconductors' and the highest differential of 76% in 'Sustainable Energy Production'. The magnitude of dispersion highlights a variety of ways in which thematic strategies can capture a given theme.

As there is no such thing as a beta exposure when it comes to thematics, any allocation to thematics is in the realm of active investing. At WisdomTree, we believe that the best way to approach thematic investing is to select funds driven by subject matter expertise. Expert knowledge informing the formation of a thematic portfolio can offer an efficient way to get a comprehensive exposure to a theme tilted to pure-play opportunities. In our view, expertise and purity are two ingredients that allow a thematic strategy to stay focused on the theme and benefit the most from the theme's wider adoption, as rapid new developments are happening in the space and new companies come to market.

We also have to highlight that expertise in the context of thematics is not directed at outperforming peer strategies in every state of the market. We link the notion of expertise closely to the notion of purity and, in 2022, we saw more pure-play stocks across various themes being hurt much more in the global value rotation. But, in the long term, we believe more pure-play companies stand to benefit the most from wider adoption of the theme, and subject matter experts are better positioned to identify any compelling opportunities in the space as the theme evolves.

Figure 4. Return differential between the best and worst performing funds in Europe within each theme in 2022
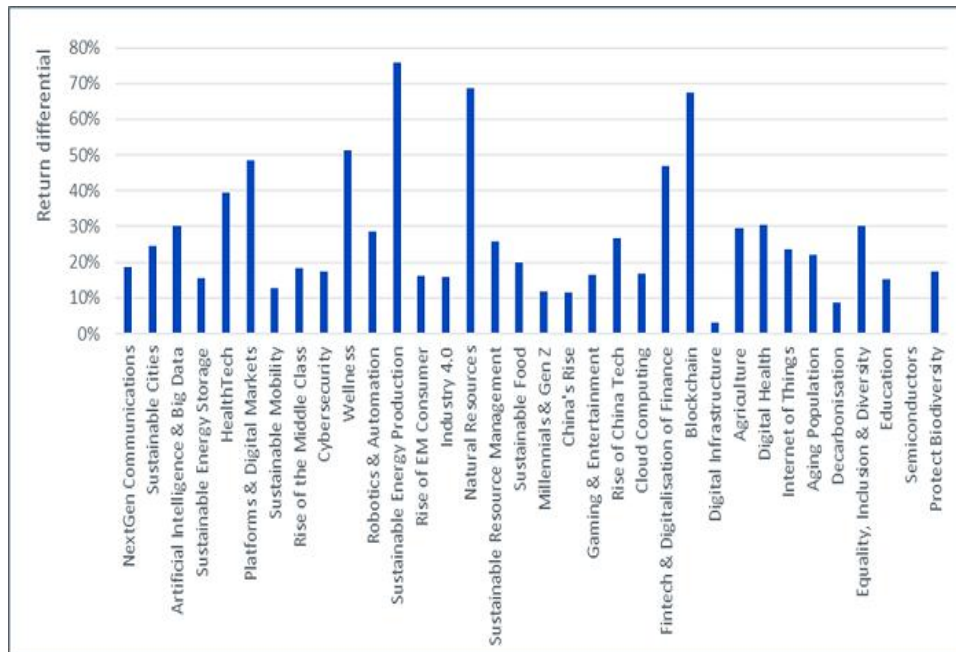
Source: WisdomTree, Morningstar, Bloomberg. Calculations are based on WisdomTree's internal classification of thematic funds. Performance is based on monthly returns from Morningstar.

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Our further observations will be summarised in the second part of this two-part blog series, where we will look at the trends in the thematic space from the perspective of flows and fund launches. We believe both data points serve as a barometer of investor sentiment around thematic strategies that can be incorporated in thematic investment decisions. Stay tuned.

Footnotes:

1. All figures are based on the WisdomTree's internal classification of thematic funds and WisdomTree's calculations using the underlying data from Morningstar and Bloomberg.

2. **Performance of a theme.** For any given theme, we consider each month all the ETFs and open-ended funds classified in that specific theme that have published a monthly return for that month in Morningstar. We then calculate the average of all those monthly returns to compute the average monthly return for that theme. So, the monthly return for January 2020 for the theme may include 19 funds, while the February 2020 return may comprise 21 funds (if two funds classified in that theme have been launched in the meantime). By collating monthly returns for the theme, we get the theme's average historical performance. Therefore, the theme's average historical performance incorporates every ETF, and open-ended fund focused on this theme. The theme's average historical performance is not biased towards surviving funds or successful funds. Every fund alive in a given month is included irrespective of its future survival or success. Investments that try to focus on multiple themes and, therefore, classified either at Cluster or Sub-Cluster Level are not included.

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