



Harnessing investment tailwinds

Thematic investing is all about tapping into powerful structural trends that shape markets. But simply identifying a compelling theme is not enough. A lot more work and experience is needed to go into making successful thematic investment decisions.

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The world has experienced unprecedented geopolitical, technological, environmental and economic change in recent years.

These rapid upheavals are set to continue, with further tectonic shifts forecast as digitisation becomes universal, and environmental threats, societal anxieties and regulation gain ever greater prominence.

Few areas in global financial markets have had greater focus in investment thinking in recent years than global thematic funds as key structural changes and their impacts over the next three to 10 years are analysed.

Almost 600 thematic funds were launched globally in 2021 alone, with funds of this type now boasting US\$806 billion in assets under management at the end of 2021.¹

Designed originally and primarily for investors wanting an alternative to benchmark-centric funds, thematic funds are now appealing to investors who look at big structural changes as profit opportunities.

What to look for when considering a thematic fund

Despite their popularity, not all thematic funds have strong investment models or represent sound investment opportunities.

Strong thematic funds are committed to doing much more than simply identifying a popular narrative, such as climate change or artificial intelligence, and then investing statically.

The best thematic funds are dynamic and flexible enough to evolve as the world does and as critical criteria shifts and transforms.

Companies, markets and competition are always evolving. The best thematic funds need to have proprietary themes based on observations of how companies at the frontline invest their capital for the long term, so as to maintain structural winners rather than chasing hot money.

Sound thematic funds should try to access multiple sources of returns from structural change without permanently embedding any reliance on a particular geography, sector or style.

They should offer diversification across different fundamental thematic ideas, adopting a global, cross-sector approach. They should be fad-averse, avoiding any gimmicky trends and overnight success stories.



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Instead, they should be based on solid, strategic research from multiple sources that highlight long-term structural trends, change and transformation. And it's very important to recognise that even good themes play out over time.

A disciplined thematic approach should insist that themes evolve, to reflect the reality that the world changes over time, or even face retirement. Indeed, a key benefit of a multi-theme portfolio is that there is healthy competition for capital across themes.

Discipline and rigour is essential

Zurich Investments has partnered with the thematic team at Lazard Asset Management for over 2 decades, to offer investors the Zurich Investments Global Thematic Share Fund and, more recently, Zurich Investments Global Thematic Focus Fund. Lazard's investment approach brings deep experience and has been honed over time.

Thematic funds need to show discipline and rigour in their processes and be committed to robust implementation. Investors can realise the significant benefits of thematic investing only if a strategy is implemented properly.

All of these characteristics underpin Zurich Investments global thematic framework, a proprietary tool sitting at the heart of the thematic investment strategy.

This global framework is primarily an aggregation of key data and insights from more than 4000 company interactions each year, which grounds the framework in real-world experience.

It helps narrow the focus to key structural and secular changes that are likely to be enduring as they are under-pinned by the very enablers of those structural changes, the companies themselves through their deployment of capital.

Importantly, it also outlines the interactions, debates and policy responses between our four identified key areas of structural change – technology, geopolitics, monetary policy and sustainability.

This framework is the basis for our proprietary themes. Each theme must capture at least one of these key structural drivers, preferably more to have as many tailwinds as possible.



And what to look out for when choosing a thematic fund

Over the years, the thematic team at Lazard have identified many key implementation errors in the pursuit of thematic investing. Unfortunately, we see these errors playing out across the industry to this day, with potentially negative consequences for unwitting investors.

Seven key issues to be wary of:

1. Tall and (un)true tales²

Thematic strategies can be vulnerable to building themes around slick but ultimately empty marketing narratives.

2. Dodgy forecasting

Predicting the future is a fraught task. Forecasting, particularly long-term predictions, are at best imprecise and at worst dangerous.

Investors should ask managers where their ideas come from and prioritise research and fact-based sources. To source most of our ideas, we have interactions with companies that are allocating the capital that will drive structural change.

3. The wide-angle lens

Generic, broadly defined investment propositions can have an immediate marketing impact but leave lasting damage to portfolios. Themes that are designed too broadly in scope may not target the actual opportunity. Instead, themes should be as precise as possible. We develop our own proprietary themes to isolate specific structural changes that will generate returns.

4. First impressions

Stocks that appear at first look to be valid candidates for a theme may actually have little potential or relevance. Managers should look beyond the obvious and crosscheck for risk and valuation.

5. One-trick ponies

A thematic strategy should access multiple sources of return from structural change without a reliance on any particular geography, sector or style. The portfolio should be diverse across different fundamental thematic ideas.

6. Sustainability fails

Managers tend to make three mistakes when claiming to incorporate sustainability into their investment processes: failing to do so, pretending to do so, and doing it badly. We place equal weight on the traditional analysis of fundamentals and on sustainability-related external costs.

7. The inexperienced

Genuine thematic experience is scarce. Time spent in the market, and even covering specific geographies and industries, may not provide enough learning opportunities to fully understand thematic investing. We feel it's vital that thematic investment team members have had specific training and experience in analysing many structural changes.

¹ Global Thematic Funds Landscape report, dated March 2022. Morningstar, <https://www.morningstar.com/lp/global-thematic-fund-landscape>

² The Seven Sins of Thematic Investment by Lazard Asset Management dated 7 September 2021. Insights from our Partners: The Seven Sins of Thematic Investing | Zurich Australia



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