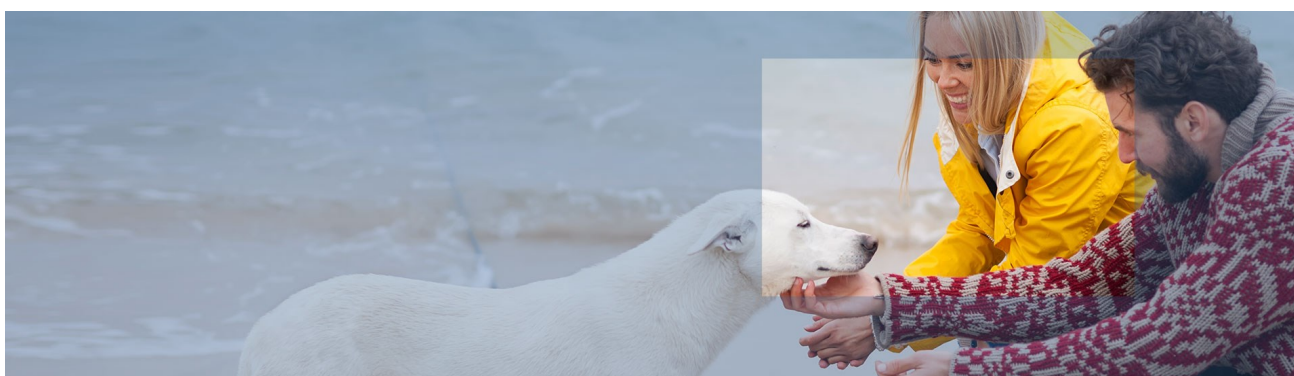


Active is: Telling a story

Winning hearts and minds with thematic investing

01/05/2019 

Summary

Thematic investing is gaining popularity as investors look to invest in a way that aligns with their interests and values. Without typically being restricted to a certain sector, region, market cap size or any benchmark, these strategies offer an attractive opportunity for active asset managers to show what they can deliver.

Key takeaways

- Thematic strategies usually focus on a secular growth trend, driven by structural shifts in technology, demographics or regulation
- Thematic strategies are not usually restricted to a benchmark or index and as a result, tend to be fundamentally active
- Despite the lack of benchmark, asset managers aim to select themes that will outperform the broader market
- Investors may be attracted to thematic products due to an emotional involvement with the theme

Everyone loves a good story. While most asset managers have historically centred their investments around specific asset classes or geographic regions, today more investors are looking for a more emotional attachment with their portfolios – and thematic strategies that reflect a compelling narrative can help meet this demand.

Such strategies tend to focus on a growth trend – political, social or environmental – and often align with the personal values of investors. They are typically driven by one or more of three triggers:

- 1 Technological innovation or disruption
- 2 Shifts in demographics or consumer preference
- 3 Regulatory intervention

One of the key ways thematic investments are different from traditional investment strategies is that they can invest with fewer constraints and are generally not tied to a benchmark index. Rather, they are intrinsically actively managed and can embrace any asset class or region, as long as the investment derives a direct benefit from an underlying trend.

Traditional strategies, on the other hand, are frequently defined by a particular kind of investment in a certain sector, or geographic area – classifications that typically date from an earlier era, before the development of smartphones, solar power and other global disruptive technologies that cross sector classifications

and regions.

Being unconstrained does not mean a lack of focus on performance, however: asset managers build these strategies around themes that they identify as having potential to outperform the broader market. This helps them create strategies that resonate with investors who expect an intuitive and transparent investment case, along with an emotional attachment to their investments – while also aiming to meet their expectations for performance.

Defining thematic strategies

At Allianz Global Investors, we employ investment professionals dedicated to fundamental analysis, working across all sectors and regions to deliver the insight that underpins our active-management approach. We also meet with companies and collaborate across our investment platform to identify the underlying global trends with potential to develop into full-blown themes.

For a trend to merit consideration as a thematic strategy, it needs to meet two key criteria:

- 1 It must represent a structural shift, typically triggered by technological, demographic or regulatory changes
- 2 We must see evidence of broader investment opportunities directly related to that shift

If those requirements are met, we will look at firms relevant to that investment theme. Then, if we find the theme investable, we consider building a strategy around it or incorporate the theme into a broader strategy. Here are a few of the global trends that we believe can be important thematic strategies.

1. Artificial intelligence (AI)

Fueled by the conviction that AI will be a key driver of innovation and disruption for years to come, we seek to identify opportunities related to AI and related technologies such as machine learning. The potential universe includes companies developing AI and Big Data technology as well as the infrastructure that is essential to the future growth of AI – such as electronic components, semiconductors and infrastructure software.

We also don't focus only on "tech" firms. From farming to pharmaceuticals, we look for a diverse range of companies that are benefiting from – and driving the development of – AI.

2. Water Scarcity

ESG (environmental, social and governance) factors are an area of growing investor interest, and they hold big potential for thematic strategies.

Water is one such example. Population growth and improved living standards, particularly in emerging markets, have made water an increasingly scarce but essential commodity. The world needs technological advances and water infrastructure upgrades to ensure its availability, and we see opportunities in such companies, technology and infrastructure projects that aim to improve access to this valuable resource.

3. Pet and animal wellbeing

Themes based on consumer trends are also popular, such as companies whose core markets relate to pets. The pet-related market is vast, spanning financials (pet insurance), consumer staples (food and household products), healthcare (pharmaceuticals), and consumer discretionary (online and retail).

Global cultural shifts are likely to see spending in these areas grow further, with 41% of millennials (those born between 1981 and 1996) saying that "money is no object" when it comes to their pets. Increasing pet ownership is also one of the key features of China's ongoing demographic and cultural shift.

As a result, annual revenue from the global pet industry is forecast to grow from USD132 billion in 2016 to USD203 billion in 2025, creating what we believe are significant opportunities for investors.

4. Topical or "narrow" trends

In the world of thematic investing, shorter-term topics can emerge within larger themes, but while they may offer valuable opportunities, they might not offer enough opportunities, or be too short in nature. At AllianzGI, we see room for strategies that focus on selecting multiple themes and which can rotate from older to newer themes as global trends evolve.

Delivering on investor values

We live in a world where investment opportunities are being recast by demographic changes, environmental concerns and technology-driven disruption. Investors are eager to be on the right side of these trends and back the winners while avoiding the losers. These significant global changes can create opportunities for investment – and thematic strategies can help investors access them in a way that brings investors closer to causes they feel passionate about.

Many investors are more likely to relate to a strategy focusing on, say, cyber-security or space exploration than, for example, a corporate bond fund. While the novelty associated with thematic strategies might suggest they're best received by end-level retail investors, they are actually proving to be popular with institutional investors – professionals who recognise that the issues at the heart of thematic strategies can drive social shifts that generate sustainable investment opportunities.

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Summary

Disruption is impacting all industries as societal shifts drive innovation. We believe active managers are best equipped to help clients navigate this changing landscape, but to do so, it is imperative that they stay ahead of disruptive trends in all sectors.

Key takeaways

- Disruption is not restricted to tech firms and is affecting all industries
- Companies are broadening their remit and embracing areas outside their recognised sectors
- Societal evolution focused around the younger generation's shifting expectations is driving disruption
- Innovative thinking is required to protect firms from evolving digital threats

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