

Ignites

Thematic Assets Have Surged – And Are Here to Stay

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Assets in thematic strategies have ballooned in the past three years. Though they face headwinds amid market volatility, demand will likely stay strong, a new report says.

Assets in thematic strategies have surged over the past three years, driven by the growth in environmental, social and governance-themed strategies, a report shows.

Thematic funds domiciled in the U.K. and U.S. collectively attracted over \$1 billion in net flows during the first half of 2022, according to Indefi. Nearly half of those sales went to ESG strategies, said Jenny Holmgren, an engagement manager at Indefi and author of the report.

But such sales represent just a drop in the bucket, she noted. Since 2019, all active thematic equity funds, globally, gathered \$193 billion in net inflows.

Thematic mutual funds and ETFs had \$115 billion in assets as of Nov. 30, according to separate data from Morningstar Direct. The largest themes identified by Morningstar are energy transitions and resource management, and each category had \$16.9 billion in assets in them as of last month.

Even separately managed account offerings, “driven by tax-harvesting and tax strategies previously, are now integrating ESG preference,” said Richard Bruyère, managing partner at Indefi.

Though thematic strategies may face headwinds due to market volatility, demand for such products will likely continue into 2023, Indefi’s report says.

The most successful thematic products will be those with diverse client bases, as well as those that can effectively manage risk, according to the report, which is based on public information as well as discussions with institutional investors, distributors and Indefi clients.

Young thematic products are also lapping up a large chunk of sales, the report says. More than half of thematic inflows come from products with track records of less than three years.

However, this may be due to the fact that the volume of thematic products has surged, Morningstar’s data indicates.

A record 589 thematic mutual funds and ETFs debuted globally in 2021, according to Morningstar, more than double the previous record of 271 launches, set in 2020.

On average, thematic funds have a longer life span than their equity counterparts, according to a September report from Morningstar. Some 90.6% of global thematic funds and ETFs that debuted before June 2019 were still on the market as of midyear 2022, compared to 85.5% of non-thematic global equity funds.

But some of the more recent themes have not yet proven that they will withstand the test of time, Indefi’s Holmgren said, pointing to products like metaverse funds and funds that chase growth as a primary strategy, noting, “It’s highly volatile between categories.”

There are at least 35 metaverse vehicles on the U.S. market, according to Morningstar data cited in a recent Financial Times report, the most of a “sub theme” tracked by the researcher. The oldest metaverse ETF is the Roundhill Ball Metaverse ETF, which was born in June 2021 and now has \$400 million in assets.

“In 2022, a whole range of metaverse funds had been launched,” Holmgren said. “But those flows are not as sticky as other funds. You could see some trends where it’s easy come and easy go.”

Other popular ETF tech themes are the internet, blockchain, cloud computing and cybersecurity, according to the Morningstar data cited in the FT’s report.

In fact, cybersecurity-themed mutual funds and ETFs were the best performers during the five-year period ended July 31, according to Morningstar. Such funds returned an average of 67.8% during that period, or 60.3 percentage points above the Morningstar Global Markets Index.

Though some niche trends may be doing well now, funds tend to be safer for investors if they track broader themes, said Darek Wojnar, the head of funds and managed account solutions at Northern Trust.

Northern Trust’s \$2.4 billion FlexShares Stoxx Global Broad Infrastructure ETF, for example, invests in stocks that generate at least half of their revenue from industries including energy, communications and utilities, fund filings show. The fund had more than 200 holdings as of September, a fact sheet says.

For FlexShares, funds that focus on themes like infrastructure and natural resources “were very attractive for flows over the course of several years, and they happen to be the largest, which speaks to particularly thoughtful consideration of inclusion of a variety of assets,” Wojnar said.