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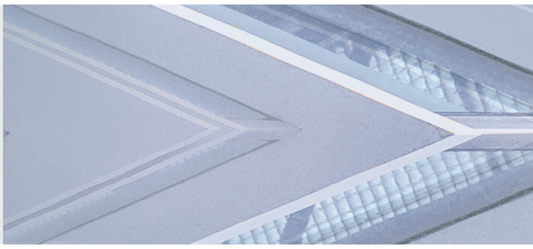

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Investing in global equities with a thematic lens

Some markets are growing faster than the broader global economy due to a range of long-term, secular growth drivers.

Key Takeaways:

- Thematic equity investing focuses on markets that are growing faster than the broader global economy due to a range of long-term, secular growth drivers.
- It seeks out businesses that will be at the forefront of long-term growth themes – Safety, Water, and Artificial Intelligence (AI) and Robotics – and that are likely to benefit from the 'primary forces' of global disruption.
- Investors gaining exposure to global equities using a thematic lens can invest in companies delivering superior sustainable growth, for longer than the market gives them credit for, and can therefore capture a "duration premium"

Increased urbanisation. An ageing and shrinking workforce. Adapting to climate change. These are just some of the long-term structural shifts we see today and that we will increasingly need to face tomorrow.

Thematic investing focuses on markets that are growing faster than the broader global economy due to a range of long-term, secular growth drivers – economic contributors that remain consistent over time rather than based on seasonal or cyclical trends. It seeks out businesses that will be at the forefront of long-term themes and identifies those best positioned to benefit from the 'primary forces' believed to be the root causes of global disruption – demographics, innovation, globalization and resource scarcity. The long-term themes currently include Safety, Water, and Artificial Intelligence (AI) and Robotics.

In this Q&A, Simon Gottelier, Karen Kharmandarian and Frederic Dupraz from Thematics Asset Management, an affiliate of Natixis Investment Managers, explain how thematic equity is an attractive and differentiated investment opportunity that buys into the innovation shaping the future.

Simon Gottelier
Client Portfolio Manager
Thematics Asset Management

Karen Kharmandarian
Client Portfolio Manager
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Frederic Dupraz
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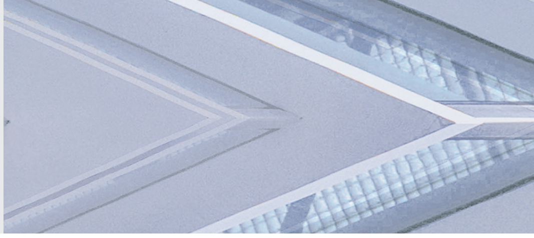
How do you work together as portfolio managers across different themes?

Simon Gottelier: Arnaud Bisschop and I manage the Water strategy. We are an experienced, complete and settled team.



We then have Karen Kharmandarian who is our CIO and who co-manages the AI& Robotics strategy together with our digital and tech expert, Nolan, Hoffmeyer. As for Frédéric Dupraz, he co-manages our Safety strategy with Matthieu Rolin. So, we currently have six focused portfolio managers as well as Mohammed Amor, who is the company's CEO.

At the heart of everything we do is the identification of long-term themes, underpinned by secular growth drivers that create the potential for thematic equity strategies. The difference between a sector strategy and a thematic equity strategy is an investible universe that offers diversification, balance and the ability to be exposed to both economically sensitive businesses and defensive businesses.

By reputation in the market, Arnaud and I manage strategies with a profile that people tend to associate with being relatively defensive, or as we like to call it, 'sleep-at-night money'. And we have plenty of defensive opportunities to act as a 'counter-weight' when there's a market drawdown. But we also aim to find and exploit opportunities in some of the more cyclical companies in our value chain to capture market upside.

What makes AI & Robotics a particularly attractive investment theme?

Karen Kharmandarian: Well, the first thing is that it's an appealing and accessible subject, which is part of our collective unconscious – everyone's watched sci-fi movies or read books about robots taking over the world. So there's plenty of curiosity about the theme and what it is all about.

Second, you have large data sets available thanks to ever-increasing connected devices, and the 'Moore's Law-powered' computing power that is necessary to deal with these data sets. In terms of AI techniques, especially deep learning systems, you can uncover the insights based on the data.

There's also the fact that costs are coming down quite significantly for these technologies. And when you have this combination of technological advancements and costs coming down, you are at an inflection point – especially when this relates to a general-purpose technology that's applicable to many different industries and sectors.

In terms of how it has evolved, you've seen more technologies being embedded into these robotic devices, be they sensors, machine vision systems, natural language understanding or generation, and contextual awareness systems, to name but a few.

So, from basic mechatronic devices used for performing the very repetitive tasks on mass- manufacturing floors – what we call the four Ds: dull, demanding, dirty and dangerous – robots have suddenly become smaller, smarter, safer and cheaper. Moreover, they have made leaps forward in terms of versatility, adaptability, flexibility, user-friendliness and mobility, allowing them to become ubiquitous.

What's driving the need for investing in Safety?

Frédéric Dupraz: Well, safety is a primary human need. In psychology and motivational theory, safety forms one of Maslow's hierarchy of needs. This includes factors such as security, as well as law and order.

But I honestly wasn't aware of the potential of a 'safety' product until about ten years ago. It's only since we've seen rapidly advancing technological change that I think it's becoming vitally important. You only need to consider how safety features that are practically invisible secure our everyday activities, whether you think of travel, online shopping, energy production or social networking. These intangible resources underpin the framework of human safety in our world today.

This is why safety is a top priority for individuals, company managers, heads of financial institutions and government leaders. And I think it will continue to be driven by urbanization, increasing regulatory oversight, innovation and globalization, because risks today don't respect borders and can appear anywhere in the world in real-time.

Take the automotive industry: the safety content in a modern car has more than doubled in recent years and is likely to double again in the coming years with advancements in safety and driver assistance technologies. And security content is increasing across other verticals.

I'm primarily concerned with physical security – the real world. But I also cover cybersecurity and payment services. This is a broad remit across tech, digital and the real world.

What's the main advantage with Water as a thematic opportunity?

Simon Gottelier: A key reason why water is such a great investment opportunity is that it has perhaps the longest-term secular growth drivers underpinning it. Each of them is, by its very nature, fifty to a hundred-year narratives.

One of our biggest opportunities is based around changing demographics in emerging economies. Somewhere in the region of 350 million people in China are expected to move from rural to urban areas in the next 30 years. That clearly places a huge amount of strain on existing infrastructure and drives the need, at the government level, to invest in new infrastructure. In the US, on the other hand, there's something like a trillion dollars of refurbishment spending required in water infrastructure.

The whole water opportunity is driven essentially by imbalances in supply and demand, so governments are spending more money on the oversight of water quality – whether that's for drinking water utilities or industrial water. And that also tends to be mandated spend, very predictable. Furthermore, there is a 100% correlation between water availability and a country's ability to grow its GDP. Without water, there can be no economic activity – none whatsoever.

Moreover, governments and the private sector are also waking up to the fact that there is a need to invest to mitigate against the effects of climate change. When you witness the clear and obvious changes in global weather patterns that we are experiencing today, it is clear that the water is falling where it didn't fall previously, and droughts are becoming longer and more severe. There's simply more intense rainfall in different areas relative to previous decades – devastating floods caused by the recent cyclone in Mozambique, as well as the recent floods in Nebraska, and the five-year drought suffered by California.

Naturally, this puts pressure on governments, the agricultural sector and the private sector to invest to mitigate against the negative and sometimes devastating impacts of these changing weather patterns.

It appears that 'thematic' has replaced 'ESG' as the investing buzzword for 2019. How difficult is it to differentiate in such a competitive environment?

Frédéric Dupraz: First, I think thematic investing is quite easy to explain because it's about things that everyone knows well. This incorporates longer-term themes that have already become part of our lives. ESG is also a way to think long-term. I know it's really hyped as a phrase, but with ESG you are investing in companies that will be here for the longer-term, so we integrate ESG into our process in a serious and considered way.

For us, thematic investing is not only about managing portfolios, it's about finding good companies and good ideas to invest in. I think we're adding value because we differentiate between the companies that benefit from short-term hype - those concepts that won't endure in the future - and we invest instead in companies that benefit from long-term secular growth drivers.

We have a unique selling point in that, as a team, we've been doing this for, on average, more than 10 years. We know the industry as well as anyone, so we know how to invest in this complicated space. We know the investment landscape inside-out, and there is a mutual respect among the members of the investment team regarding their convictions and what they know.

Do you have specific investor audiences in mind when it comes to investing into global equities using the thematic lens?

Karen Kharmandarian: Over the past few years, we've seen institutional investors becoming increasingly interested in investing into global equites using the thematic lens. My feeling on this is that they have acknowledged that when they were buying a US equity fund, for example, it was very difficult to understand exactly what they were buying, and what end market risk they were gaining exposure to. Was it US companies exposed to the US market or US listed companies offering exposure and associated risks to many more regions? End markets and revenue generation become so diversified that it is unclear what exactly one invests in using a regional approach.

The same applies with a sector fund, for instance, as these classifications are fairly arbitrary. Not so long ago, Alphabet/Google was in the consumer discretionary category, but it could just as easily have been categorised as an IT, industrial or communication services company.

So institutional investors have started to realise, if we're not really grasping the reality of our investments using the traditional classifications, then maybe using the value chain of a theme helps us to have a better understanding of the drivers of this theme and what we're investing in.

These used to be very niche investments for them, even five years ago. We'd meet with them and they would say they were convinced by thematic investing but couldn't figure out where to position us in terms of portfolio allocation.

They started to make satellite allocations to thematics and, for many, it has now moved to the core part of their portfolio, sometimes becoming central in their global equity allocation.

Insurance companies, too, are clearly looking for secular growth and compounders that can provide attractive returns over the long term. They also have this willingness to protect the downside. And in this respect, thematics provides some safety – it gives them exposure to global equities supported by secular growth tailwinds. From an asset liability-management perspective, the long-term horizon of our investments matches nicely with that of their liabilities.

Insurers are also quite familiar with a specific form of duration risk that thematic investing looks to capture. The compounders we invest in tend to sustain superior growth and profitability longer than the market gives them credit for.

The market tends to price a reversal to the mean too rapidly, presuming market forces will play out, ignoring the secular forces supporting their operations. It therefore misprices these stocks, due to this shorter investment horizon. With our unique standpoint, we try to capture this duration premium.

This Q&A is based on individual manager interviews that took place between April and June 2019

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