

Mega Trends Everywhere

How to harness the potential of structural growth

The Covid-19 pandemic has wreaked havoc across many sectors, but it has also led to an acceleration in long-term mega trends, linked to technological, demographic and environmental change.

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From an investment perspective, mega trend investing offers a few clear advantages:

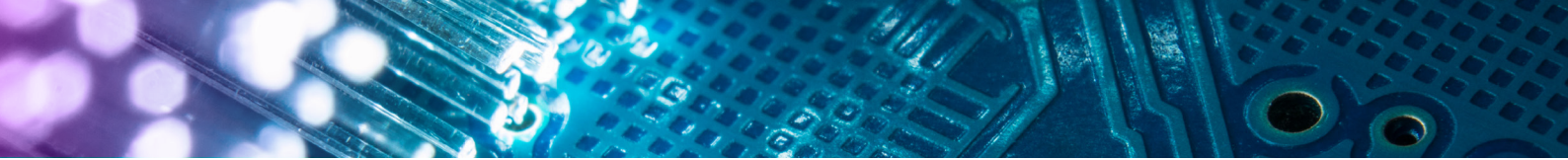
- The investment universe is clearly defined and the factor exposure is purer
- It can help improve Sharpe ratios and overall diversification
- Different themes or trends can offer different investment characteristics

It's no wonder then that investors are putting their money where their mouth is with flows into thematic funds seeing year-on-year growth of 58% between 2019 and 2020.

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Pandemic accelerates shifts towards mega trends

The Covid-19 pandemic has wreaked havoc across many sectors, but it has also led to an acceleration in long-term mega trends, linked to technological, demographic or environmental change. Indeed, appetite for mega trends, whether innovation or resources, has only grown. As a result of the pandemic, we are all communicating, working and consuming more online and investors are looking to have exposure to the real economy and the more digital world we now live in. Resource scarcity, innovation and demographics are all long-term considerations for investors.

The focus on renewable energy from the incoming Biden administration as well as the European Union is likely to increase demand for these sectors as well. Indeed, the EU has agreed on a 7-year budget which includes multitudes of green initiatives and President Biden is planning

on a massive infrastructure package that will also focus on renewables.

From an investor perspective, demand for ESG has risen and is only set to increase further. Regulatory moves in Europe will push for further ESG and across the asset management industry, responsible investing is gathering steam. Investor appetite is also growing in Asia and China is looking to improve its record of accomplishment in climate. The US remains a laggard, but 2020 has accelerated the move in that direction.

Moreover, ESG-related strategies proved defensive in the market turmoil of March 2020, showing that ESG was not just a smart investment choice over the longer term on a risk-adjusted basis, but also resilient through short-term bouts of volatility¹. Investors no longer need to choose between performance and ethical investing. As a result, ESG has become a must-have rather than a nice-to-have.

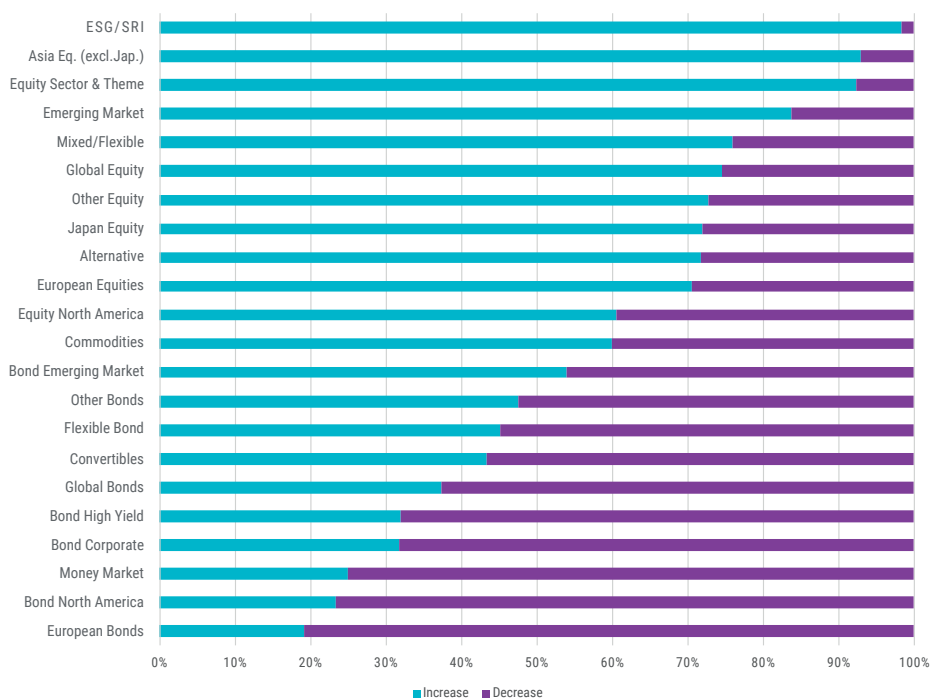


Esty Dwek
Head of Global Market Strategy
Natixis Investment Managers Solutions

“As a result of the pandemic, we are all communicating, working and consuming more online and investors are looking to have exposure to the real economy and the more digital world we now live in.”

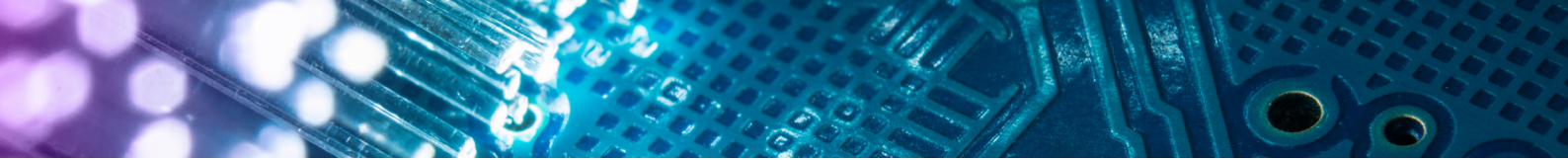
Future asset allocation changes favour Thematic Equity & ESG Funds

Expected net changes in asset allocations



1. Source: <https://www.morningstar.co.uk/uk/news/203214/do-sustainable-funds-beat-their-rivals.aspx>

Source: Broadridge Fund Buyer Focus as at end December 2020 based on 804 interviews with European Fund Buyers and Sellers



Put your money where your mouth is

Flows into thematic funds have seen year-on-year growth of 44% and 58% over the last few years, despite being in a universe that has seen outflows from actively managed funds.

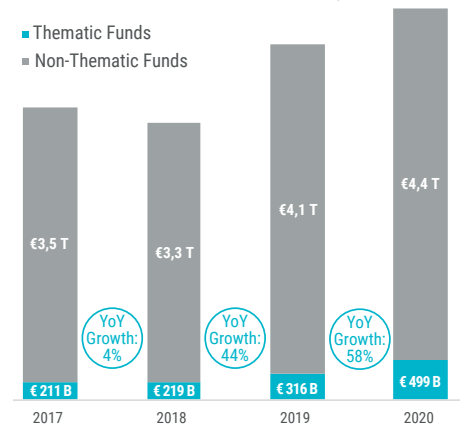
Flows into ESG strategies have seen similar growth patterns, but the pre-existing asset base was already much larger, with inflows nearly reaching 1 trillion US dollars in actively managed ESG funds.

Translated into portfolios, we have seen a steady increase in allocations to thematic funds over 2020. Taking French portfolios as an example (confirmed by anecdotal evidence elsewhere), thematic funds (silver economy², green cities, safety &

AI, water etc) are now seen as part of a full-fledged long-term allocation that can decouple from short-term market trends. This has only been further supported by the resistance of these strategies during last year's shock and their stronger rebound. (Note that the mechanical price effect explains part of the rise of these funds in the typical portfolio allocations). One consideration is that there is still a fine line between 'sector funds' and 'thematic funds'. For example, financial advisors often use technology funds to build 'future-proof' allocations, but we believe the universe is much broader than one sector. As for ESG strategies, they confirm their prime position in portfolios, becoming the new norm.

Investors are walking the talk

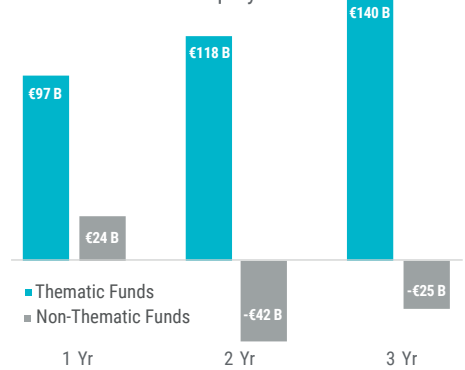
Growth in total net assets of equity funds



Source: Morningstar Direct as end of December 2020. Total net assets of all equity funds classified in EAA (Europe, Asia, Africa) with proportion of Total Net Assets in Thematic Equity Funds Highlighted.

Thematic flows buck the trend

Net sales of active equity funds



Source: Morningstar Direct as end of December 2020. Total net assets of all equity funds classified in EAA (Europe, Asia, Africa) with proportion of Total Net Assets in Thematic Equity Funds Highlighted.

ESG: from nice-to-have to must-have

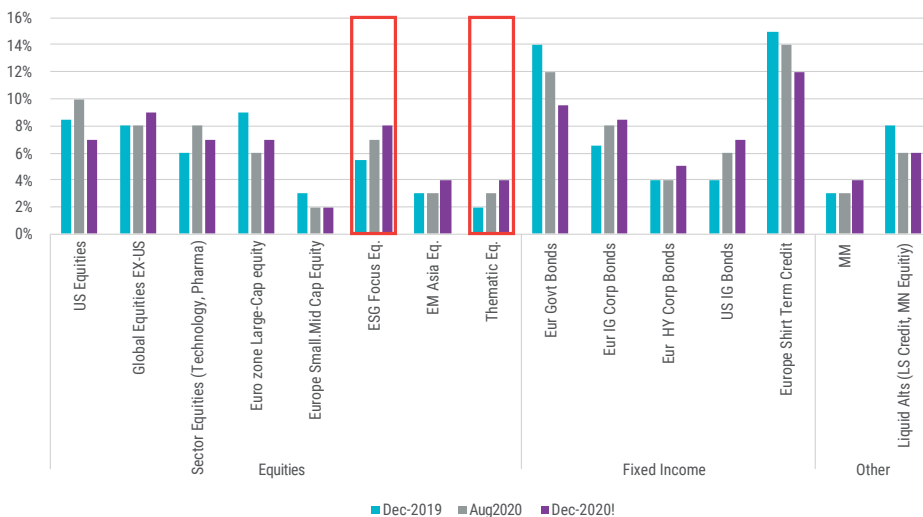
Growth in total net assets of equity funds



Source: Morningstar Direct as end of December 2020. All Allocation, Equity and Fixed-Income funds classified in EAA (Europe, Asia, Africa) Categories. Funds flagged as Sustainable Investment – Overall considered to be ESG

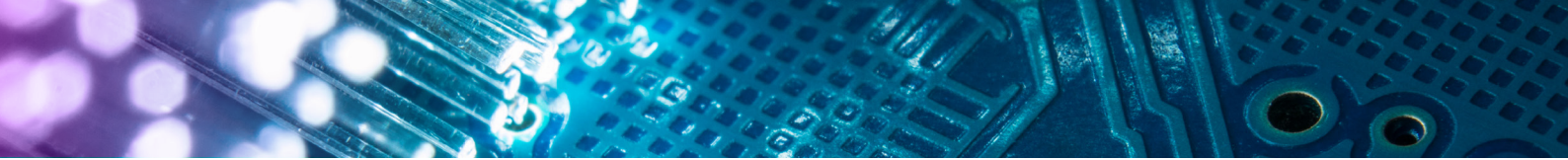
Allocations to Thematic Equity Funds increased in 2020

Composition of typical European balanced portfolio over 2020



Source: Natixis Investment Managers Solutions as at end of December 2020. Historical analysis of European wholesale portfolios.

2. Silver economy is the system of production, distribution and consumption of goods and services aimed at using the purchasing potential of older and ageing people and satisfying their consumption, living and health needs.



Thematic strategies complement portfolios

When breaking down a number of mega trends to see their impact on portfolios, it is clear that they can help improve Sharpe ratios and overall portfolio diversification.



Julien Dauchez
Head of Portfolio Consultants,
Natixis Investment Managers Solutions

Mega trend exposure can help improve portfolio diversification

Average correlation of mega trends with MSCI World

	Environmental Challenges	Technological Breakthrough	Demographics & Social Change	Growing Urbanisation	Shifting Economic Power	MSCI World NR USD
Environmental Challenges		0.88	0.9	0.75	0.85	0.91
Technological Breakthrough	0.88		0.91	0.89	0.93	0.92
Demographics & Social Change	0.9	0.91		0.85	0.88	0.95
Growing Urbanisation	0.75	0.89	0.85		0.82	0.87
Shifting Economic Power	0.85	0.93	0.88	0.82		0.88
MSCI World NR USD	0.91	0.92	0.95	0.87	0.88	

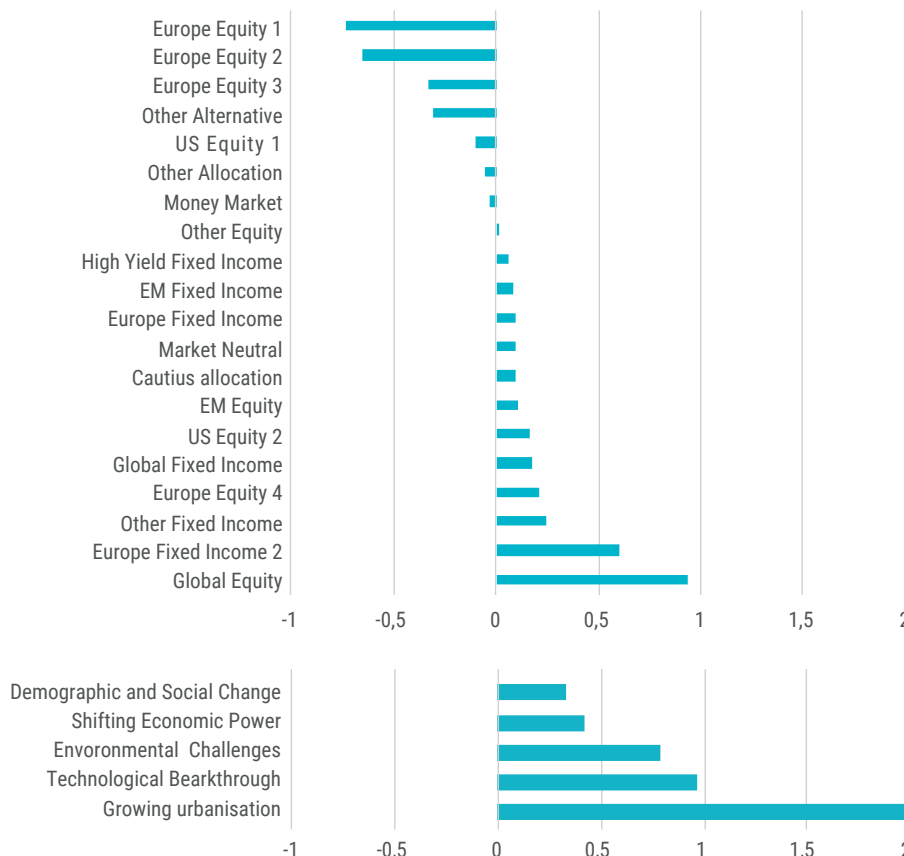
Very High Correlation (>=90)
High Correlation between .70 & .90
Moderate Correlation between .50 & .70

“We have seen a steady increase in allocations to thematic funds over 2020. Thematic funds are now seen as part of a fully-fledged long-term allocation that can help decouple portfolios from short-term market trends.”

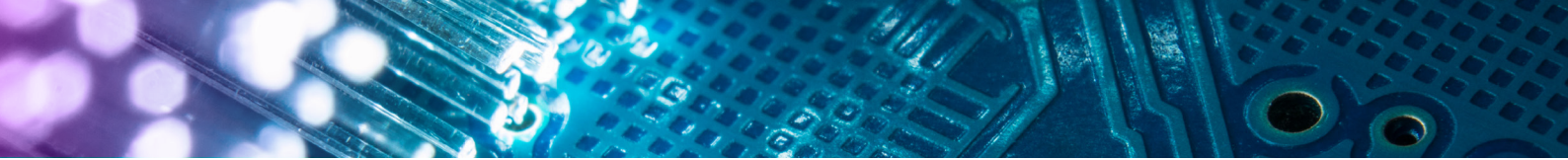
Source: Natixis Investment Managers Solutions as at end of January 2021. Average correlation between end of February 2018 and end of January 2021. The mega trends shown are proxies selected by Natixis Investment Managers Solutions. A correlation below 1 indicates that the respective mega trend may improve portfolio diversification with respect to a global equities as indicated by the MSCI World NR USD.

Mega trend Sharpe Ratios compare favourably with other portfolio allocations

Marginal Sharpe Ratio of typical moderate portfolio and mega trend exposure



Source: Natixis Investment Managers Solutions as at end of January 2021. Average correlation between end of February 2018 and end of January 2021. The mega trends shown are proxies selected by Natixis Investment Managers Solutions.



Dial up or down the cyclicality

From an investment perspective, mega trend investing offers a few clear advantages. First, the investment universe is clearly defined and the factor exposure is purer. Investors find that they can easily relate to the underlying themes and understand their structural growth story, in addition to investing in an innovation cycle. Another advantage of mega trends is the scarcity of supply: a lot of money behind a small number of opportunities and/or a limited addressable investment universe, which can further amplify the relative outperformance of these strategies.

In addition, in an environment where interest rates continue to be lower for longer, investing in secular growth trends offer some reassurance of sustainable growth. This also suggests that the timing matters less, since thematic and environmental considerations are multi-year drivers.

Finally, different themes have different characteristics. Within mega trend investing, investors can “dial up (or down)” cyclicality. For example, automation and robotics might prove more cyclically tilted, while environmental considerations will prove more defensive and “cycle proof”.

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