

Capstone Project Public Summary

Author Name: Harshita Saxena

Project Name: Thematic Funds – Competitive Landscaping

Faculty Supervisor: Peter Szilagyi

Project Sponsor: BlackRock, Hungary

Project Overview and Objective

This project aims to create a standardized and a detailed compilation of competitor analysis of thematic funds focusing on the 5 key themes of the decade: FinTech, Future of Transport, Next Generation Technology, Nutrition and Sustainable Energy.

Competitive landscaping is an extremely important activity for thematic funds since they are currently not benchmarked to any indices. Until now, no indices have been created specific to a theme although MSCI is in the process of releasing an index focussed on companies rated on the basis of Environmental, Social, Governance (ESG) factors. Hence, in order to gauge the market standing and positioning of a thematic fund it is imperative to assess it against the performance and characteristics of other funds. These comparator funds follow a common philosophy of investing and for the purpose of this project, have been selected based on MorningStar peer groups.

Business Background

BlackRock's Thematic Platform is a combination of active and index equity funds investing across sectors and geographies in companies set to benefit from global, structural changes driven by Megatrends which are set to drive outperformance versus global equities over the long term. These funds invest across sectors having a common thread of idea which makes them more diversified than sectoral funds. The objective of investment in such funds is to get high returns from sectors having a strong growth potential due to boom in the industry.

BlackRock launched its own thematic fund range recently over the past 5 years. The 5 megatrends driving the next decade as identified by BlackRock are: technological breakthrough, demographics and social change, rapid urbanization, climate change and resource scarcity, and emerging global wealth. The impact of these trends will be on how we live, spend money, and government policies. Some of the transformations that maybe seen in the future are: the number of internet connected devices¹ will grow by ~25% growth from 2017 to 2030, longer lifespans and modern lifestyles² will modify consumer medicine intake, 2/3rd population³ will reside in cities by 2050, 50% world's energy⁴ is predicted to come from solar and wind by 2050 and lastly, emerging markets are predicted to represent 6 out of the 7 largest economies⁵.

Considering how the current year has been affected by various macro-economic factors, a sketch of bad events is expected to deeply impact many years to come. These factors range from the heightened political tensions between Iran and the US, the Australian wildfires, to the ongoing coronavirus pandemic. 2020 is just the beginning, as they say, and these events have largely transformed consumer habits as we will observe in the top five themes I picked for the purpose of this analysis.

Research Framework and Data Resources

For this project, my main data resource is MorningStar. Microsoft Excel is the tool I use to present the data in an efficient manner. Furthermore, I divided the building of this project into 4 phases:

- Phase 1: Identifying relevant characteristics and performance metrics
- Phase 2: Extracting data from Morningstar
- Phase 3: Formatting the one-page brief and linking to database in MS Excel
- Phase 4: Analyzing the performance of the funds

Summary of Results

Sustainable energy

The BGF Sustainable Energy Fund aims to invest in companies that are both leading and benefitting from the energy transition to a lower carbon economy. It is expected that future trends suggest a hedge against climate change for which investing in Sustainable Energy would be a positive move. In 2013, the UN Intergovernmental Panel on Climate Change (IPCC) concluded climate change is real and human activities are the main cause. Investing in this trend will reap benefits to the energy transitioned world with a lower carbon level. This will be observed in two ways: increasing energy efficiency and upgrading to sustainable energy sources. The three key drivers of this theme are Regulation, Economics and Society. From 1997, there has been a 95% increase (from 60 laws) in the number of climate laws globally. Currently, 187 countries have ratified the Paris Climate Agreement, and the costs of renewable electricity have also pushed down and are

more parallel to the current source of energy. Lastly, the society as a whole is constantly striving to reduce global carbon emissions and is showing its concerns through organized protests.

From the competitive analysis, looking at the performance metrics for time frames ranging from 1 month to 5 years, RobecoSAM Smart Energy has outperformed its competitors the most frequently. Launched in 2014, the success of this fund can be attributed to allocating 42% of its funds into its top 10 performers. Most sustainable energy funds are invested into the IT sector majorly, followed by utilities and healthcare. The BGF Sustainable Energy Fund on the other hand has an added exposure to materials while iShares has its majority in utilities. Like most funds, the top performing fund is concentrated in the USA invested into Mid-Cap companies. However, BlackRock's BGF fund focuses on Greater Europe into Large Cap companies which maybe a reason for its divergence from being a top performer.

Nutrition

A long-term structural shift is being observed globally which is necessary for the transition into a more sustainable world. As the world becomes more populated, prosperous and demanding on the world's resources, the pressures of climate change and resource scarcity rises. The three major sustainable nutrition trends in focus are: bringing healthy and sustainable eating choices to the masses, delivering efficiencies across global food supply chains, and enabling a less resource-intensive farm. Societal and consumer pull factors are driving changes in nutrition. For example, meat substitute sales have grown four-fold in the European market over the last 4 years. Tech is revolutionizing the global food industry in many ways. For instance, tech has made high-quality food delivery more affordable. For context, the food delivery mobile app market is expected to be valued at \$16.6bn in 2023, compared to \$4.0bn in 2017. Governments are supporting healthier eating, driving change across the food industry. A case in point for this is the UK- here, 50% of all drinks sold had their sugar content reduced ahead of the implementation of a new sugar levy.

The BGF Nutrition Fund has outperformed its competitors many times over in the range of 1 month to 5 years returns. It is also the only fund with positive net inflows for 1 year and YTD as well. On the other hand, iShares Agribusiness ETF has underperformed consistently and, also has the lowest expense ratio. In terms of sector attribution, all the funds have invested nearly 50% of its funds into Consumer Staples, about 30% to Materials. What stands out is the ~10% allocation to Consumer Discretionary by the BlackRock Global Nutrition Fund- perhaps the key to outperformance. Overall, the US is the focus region for investment across all funds and are investing into Large Cap companies. The fund, which sits on the BlackRock Sustainable Investing platform, has >60% of its holdings which contribute to four of the United Nations Sustainable Development Goals (SDGs 2,3,12 and 13). ESG considerations are also an integral part of the investment process.

FinTech

The FinTech theme emphasizes on investing in companies benefitting from the growth associated with digital finance and customer behavioural changes in the financial industry as it is expected to reap benefits in the future. The regulatory force comes in the form of digital payments providing a much clearer and accountable record of sales for tax purposes compared to cash. This can also reduce fraud and save time and resources from an administration standpoint. Societal forces can be witnessed in the form of consumers demanding more digitalized financial services. By 2022, it's estimated that over 1 trillion digital payment transactions will take place, up significantly from 539 billion in 2017. Lastly, an important economic driver is that 23% of earnings from the MSCI World Index derive from the Financials Sector, providing a large market for disruption from tech-driven companies and new entrants through IPOs.

While AXA Framlington FinTech Fund has consistently outperformed its competitors in the past, BlackRock's BGF FinTech fund is one of the few funds with net positive inflows. Launched in 2018, the BGF FinTech fund focusses on investing its majority of funds in IT, followed by Financials. AXA further expands its exposure to Industrials, Telecom and Consumer Discretionary too. Once again, like other thematic funds, investment is directed mostly into USA in Large Cap companies although BGF Fintech focusses on mid cap primarily.

Future of Transport

The Future of Transport theme revolves around investing in beneficiaries of transport becoming more electric, more autonomous and more connected. Governments are helping drive the transition towards electric vehicles (EVs) e.g. China offers subsidies for longer-range EVs and Europe is introducing new emissions targets for OEMs from 2021 EVs are no longer seen as a compromise by consumers. Meanwhile, society wants the benefit of lower pollution that comes with EVs. For reference, pollution in 97% of cities in low and middle income countries currently exceeds WHO air quality guidelines. Economically, the cost of EVs

is on course to fall below that of the equivalent ICE vehicle within 5 years. Battery costs are the main driver of EVs currently being more expensive, but the cost of batteries has fallen by ~80% since 2010.

BGF Future of Transport is the largest fund by AUM size amongst its top 4 chosen competitors. Accompanied by iShares Electric Driving & Vehicle, this fund is among the few to have positive net inflows. NB Next Generation Technology is among one of the top performers looking at 1 month to 1-year returns. Although all funds have had negative returns lately, April 2020 has brought some recovery in the form of positive returns for the funds. Set up as soon as in 2018-19, these funds are relatively new in the market. These funds are focused in the IT sector, followed by Industrials and Consumer Discretionary. On the contrary iShares Electric Driving & Vehicles has focussed its investments in the Consumer Discretionary sector, followed by IT and industrials. In terms of Regional Exposure, the US is home to most of these investments and there seems to be an equal weightage to Mid Cap and Large Cap companies. While the top performing fund has a mere AUM of ~32m USD, the BGF Future of Transport has the largest AUM till date standing at ~245m USD.

Next Generation Technology

The Next Generation Technology theme is suggestive of investing in emerging technology companies that aim to overtake larger technology incumbents by launching new ideas, solutions and fresh thinking to the problems of tomorrow. It is believed that with the increase of cybersecurity breaches, governments are encouraging the private sector to increase IT defence spend. It's projected that \$1 trillion will be spent globally on digital security through 2021. Globally, consumers are demanding innovations in technology. In 2011, just 35% of US households owned a smartphone, today, just 8 years later, that level is >80%. By the year 2022, IT spending is expected to grow to \$4.3 trillion, which is equal to the world's 3rd largest GDP- a 23% increase from 2018.

The BGF Next Generation Technology Fund at BlackRock has been a constant outperformer of its competitors with an all-time high of ~20% return over a period of 1 year. It is a relatively small fund in terms of size of the AUM, standing at 490mn USD, about 8% of the size of the largest fund-Pictet Robotics Fund's AUM standing at 5,500 mn USD. The BGF Fund has invested vastly into the IT sector like other funds and is overweight (compared to other funds) in the Consumer Discretionary sector- perhaps the reason of its outperformance. Other sectors of interest in small portions for all funds are diversified telecom sector, healthcare and industrials. The US remains the key focus area for the Next Generation themed funds with a focus on Mid Cap funds. iShares Automation & Robotics ETF is the only fund that gives an equal weightage to small and mid-cap companies.

Areas of Further Research

Analyzing the 5 themes against the backdrop of the megatrends as identified by the BlackRock Investment Institute give an investor key insight into the forthcoming patterns of investing based on regulatory, societal and economics shifts in the world. This Capstone Project was focused on creating a consolidated database of its competitors and linking it to an external data source- MorningStar. This objective was successfully achieved. However, the challenge of having insufficient data will be countered in the future as the funds are at a relatively new stage currently. Future scope of this project lies in two areas: first, creating automated links connected to Morningstar such that opening the file will provide updated numbers instead of copying MorningStar data outputs; second, expanding this format for funds of other departments/ teams.

Learning Outcomes

The output of this project is a bunch of consolidated tables of comparative analysis for each theme. This gives the viewer not just the latest values for performance, characteristics, holdings, asset allocation, sector allocation, regional exposure and market capitalization but also a visual comparison (due to conditional formatting) of all the funds. The viewer, in this case typically being a portfolio manager may reap the benefit of getting a concise outlook on the updated value for funds in order to prepare for client meetings, key presentations, sales meetings and stock selections. It enables the portfolio management team to keep tabs on their competitors. They can gain insights on performance, flows and positioning of the funds.

Personally, I have been able to put my excel skills to practical use and simultaneously gain in depth knowledge of the most relevant upcoming trends of the next decade. I would like to thank BlackRock for providing me the opportunity to not only identify but also fill the gap and smoothening out the functioning of daily tasks in the team. I am grateful to the Finance department at the Central European University for equipping me with the right tools to successfully carry out the project up to the client's expectations.

