



## Thematic ETFs – the active advantage

### Why an active investment approach may be best for thematic ETFs

Thematic ETFs have become very popular in recent years. The explosion in demand is partly due to the rapidly increasing popularity of ESG (environment, social and governance) investing, but it has also been driven by interest in other key themes, such as disruptive technology and healthcare. According to Trackinsight's 2023 ETF survey, more than 40% of respondents are anticipating an increase in their thematic allocation over the next few years. Globally thematic ETFs now account for over USD 81.5 billion in assets under management, with roughly one half of the assets from the UCITS space (Source: Simfund, 31 March 2023).

Much of this rise in demand for thematic ETFs has been met by passive strategies, which track benchmarks that are specially constructed to give a broad exposure to a particular theme. However, active strategies are now becoming increasingly popular, as investors come to recognise the particular advantages that active stock selection can bring to the thematic ETF space.

### Active thematic ETFs are more flexible

Whether investors choose passive or active thematic funds, it is crucial to understand the methodology used to construct the thematic ETF.

As befits their passive heritage, many thematic ETFs attempt to track specialist thematic indices. These indices are compiled using rules-based stock selection which aims to create some kind of economic linkage to the theme that investors want to gain exposure to. For example, the popular S&P Global Clean Energy and MSCI ACWI IMI New Energy indices provide exposure to the energy transition theme by selecting the companies with the largest overlap with the selected theme. The inclusion criteria are prescriptive, with potential constituents drawn mainly from companies that derive a particular amount of their revenues.

Because they are constructed based on prescriptive rules, thematic indices tend to focus on what are often referred to as pure-play stocks—these are companies

whose activities predominantly lie within the scope of a particular theme. The result can be a narrow focus on just a small number of stocks. For example, in a clean energy index, only companies heavily involved in the generation of renewable energy may be included. They may exclude more diversified companies that also have a key role to play in the energy transition theme, such as companies providing software and infrastructure to enhance the electric grid or companies enabling electrification such as EV charging.

Thematic indices are also often weighted by market cap, or by a simple equal-weighting construction. Given the growing number of thematic ETFs and the relatively small number of pure-play stocks, these benchmarks can mean that many funds end up chasing the same stocks and investing in highly crowded positions. The table displays the heavy concentration that some leading thematic index providers have in their top ten holdings. This high concentration increases investment risk and fails to deliver

### Active ETFs show less concentration than thematic benchmarks

Benchmark	MSCI ACWI	S&P Global Clean Energy	S&P Global Water	MSCI ACWI IMI New Energy ESG Filtered	MSCI ACWI IMI Water ESG Filtered	JPM Climate Change Solutions ETF*
Constituents	2,884	100	44	93	37	55
% Assets in Top 10 Holdings	15.95%	48.5%	53.2%	40.3%	60.5%	37.4%

Index provider website; as of 28 April 2023, J.P. Morgan Asset Management as of 16 May 2023.

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the diversification benefits that investors may expect.

Compared to tracking a thematic benchmark, an active approach has much more embedded flexibility in the construction of the ETF portfolio. Active thematic ETFs often have a much broader investment universe, like the MSCI All Country World Index, which can give access to the full opportunity set of a theme, beyond the narrow focus of thematic benchmarks. Active portfolio managers can also implement investment ideas without being limited by index providers to stock selection and rebalancing rhythms. This flexibility can be particularly important if there is negative news flow around a company. By contrast, passive ETFs usually rebalance only every three months and so cannot adapt to changing market conditions as quickly.

### An integrated thematic view

Another advantage to active thematic managers is their ability to take a much more granular approach to portfolio construction and give more weight to companies that they believe can provide the most impactful and effective exposure to the selected theme, from across the market rather than limited to certain sectors or types of stock.

Gaining exposure to some of the largest structural themes, such as climate change for example, does not – in our view – require a targeted approach. The climate challenge is so huge that it touches almost all areas of the global economy. Greenhouse gases come from a wide variety of areas – energy in industry, buildings, transportation, and agriculture – with investable opportunities existing across the broad spectrum. If an investor wanted to get full exposure to the climate change investment theme, several different passive ETFs would have to be selected, e.g. Clean Energy, Water or Sustainable Food, putting the burden on theme selection and monitoring on the end client.

An active investor can apply a much broader approach to the theme and select companies from different sectors as long as these companies have a significant overlap with the selected theme. They can also position the portfolio towards different sub-themes and companies depending on the current market dynamics. However, given the breadth of the investment universe, it is important to select an active manager that has access to a network of global research analysts and the capabilities to support deep thematic research across markets and sectors.

At J.P. Morgan Asset Management, our active thematic ETFs use our proprietary Artificial Intelligence natural language processing tool Themebot. Themebot helps our portfolio managers cover more than 13,000 companies globally, at speed, generating a manageable list of opportunities from

which to start.

Companies are rated for their exposure to the theme by both textual relevance and revenue. The use of this technology helps identify stocks that fit a particular theme, which may not have been initially covered by our analyst team, and also cover the breadth of a global opportunity set using one consistent framework.

Once a stock has been identified by Themebot, our analysts conduct fundamental research and management meetings to gain a fuller picture, only investing in our highest conviction investment ideas.

### An active approach to climate solutions

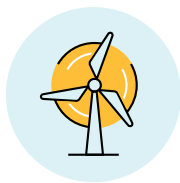
According to the 2023 Trackinsight Global ETF survey 81% of investors are already investing or interested to start investing in thematic ETFs targeting environmental changes.

**JPM Climate Change Solutions UCITS ETF (T3MP)\*** is an active ETF that combines artificial and human Intelligence to target the optimal thematic exposure to climate change solutions across a broad range of sub themes: Renewables & Electrification, Sustainable Food & Water, Sustainable Construction, Sustainable Transport, and Recycling & Re-Use. Each of these areas has a role to play in addressing climate change, and each draws on stocks from across the markets.

T3MP\* is categorised as Article 9 under SFDR, typically holds between 50 and 120 stocks. Its comparative benchmark is the MSCI All Country World Index to ensure we can access the full opportunity set and are not limited by index providers stock selection. TER is 0.55% which is very competitively priced for a thematic ETFs.

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Climate change as an investment theme is related to many industry sectors



### Renewables & Electrification

Companies developing clean energy such as wind, solar, or hydro across the full production chain, and enabling electrification across the economy.



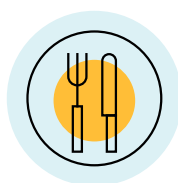
### Sustainable Construction

Companies developing less carbon-intensive forms of construction, including energy efficiency of buildings and cement & steel production.



### Sustainable transportation

Companies investing in sustainable forms of transportation across automobiles, trains, and planes.



### Sustainable Food & Water

Companies investing in less carbon-intensive forms of agriculture, sustainable food, or clean water infrastructure.



### Recycling & Re-use

Companies developing technologies to reduce waste, including equipment and materials recycling, which can conserve resources and reduce GHG emissions.

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