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A FRESH LOOK AT THEMATIC INVESTING

Thematic strategies have had a challenging time in 2022, with many factors combining to unsettle markets. Higher inflation, greater geopolitical risks, and uncertainty about the economic outlook have impacted the valuations of many companies we believe will benefit from key long-term trends. In our view, their prospects are undiminished.

The near-term macroeconomic outlook presents challenges. Europe has already entered recession and the US will likely have its own version of a downturn in the second half of 2023. While growth in China should be positive, it will be historically low.

The market performance of risk assets will likely reflect these developments. But once inflation has moderated, central banks should be able to take their feet off the policy tightening brake, allowing markets to recover. Thus, the current struggles of equities are perhaps better seen as an opportunity to buy into these long-term strategies at far lower prices.

At BNP Paribas Asset Management, thematic investing is about identifying and capturing structural trends in society and the economy. These global megatrends, such as tackling climate change, addressing inequality or enabling the digital & technological transition, often have end-points in the distant future that require a long-term approach to investing.

Investment themes typically span various economic cycles. This is particularly important to remember in times of short-term volatility, such as those we have seen in markets this year.

Thus, true thematic investing is not opportunistic. Many of the themes we look at are multi-generational. They affect not just investors' lives now, but those of their children and grandchildren.



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Companies can act on such themes throughout their growth cycle, from being early-stage adopters to established industry leaders joining in. Start-up companies can be disrupters in their industry, while older and established companies can contribute by adapting to change.

Some of the smaller companies our thematic strategies invest in may not have particularly large revenues (yet), but their growth prospects are often more than promising and involve sizeable addressable markets.

We believe allocations to thematic strategies can play a crucial role in addressing the world's long-term challenges. They often support growth by providing companies with access to capital. And, with a longer-term investment horizon, we see greater scope to focus on a smaller number of potentially exceptional companies with the opportunity to generate excellent growth and ultimately superior returns.

At BNP Paribas Asset Management, we offer investors a range of both active and passively-managed equity, fixed income and multi-asset strategies. We offer thematic investment solutions across two key areas that are strategically positioned to capture the opportunities presented by global megatrends: secular innovation & disruption, and environmental & social sustainability.

SECULAR INNOVATION AND DISRUPTION

This field ranges from innovation in healthcare and consumer goods and services to disruptive technology. Technology is central to many trends: it permeates all aspects of our lives – from software at work to entertainment in our spare time. While the Covid-19 pandemic has accelerated and strengthened this trend, our long-standing focus means we had invested in many companies that operate in these areas already before the pandemic struck.

To zoom in on our disruptive technology theme, there are many sub-themes under this umbrella:

- Cloud computing is experiencing a structural tailwind as it enables digitalisation and the storage of data
- Artificial Intelligence, including machine learning, is helping companies perform data analysis for new products and services
- Cybersecurity is a top spending priority for many companies and the trend is being reinforced by an increasingly strict regulatory environment.

Technology shares experienced a significant correction in 2022. Higher interest rates – raised by central banks to try and control elevated inflation – have impacted many companies, as a high portion of their projected cash flow is typically expected far into the future. Risks such as delays to semiconductor supply have affected a wide range of companies, but particularly technology ones.

Meanwhile, the threat of recession, the removal of pandemic-related fiscal stimulus, and greater geopolitical risk due to the Ukraine war have led to higher volatility for all companies and sectors.

We believe the long-term outlook for disruptive technology is attractive because the digital transformation of all industries still has long way to go, further increasing efficiency, helping to create new products and services, and making companies more competitive.

As long-term high-conviction investors, we look for companies with sustainable business models, strong competitive 'moats', and attractive valuations. Our active approach to stock selection involves identifying and allocating to companies poised to take advantage of emerging themes, while avoiding those that fail to adapt.



ENVIRONMENTAL SUSTAINABILITY

Sustainability is at the heart of everything we do at BNP Paribas Asset Management. We believe it will be an important driver of financial returns over the long term – be it in an inflationary or deflationary environment, or one of high, low or no growth. Significantly, we believe that as investors, we can help shape a better world by investing sustainably.

In addition to our broader sustainability focus, which ensures we rigorously assess the environmental, social, and governance (ESG) practices of the companies we invest in, sustainability thematic strategies focus primarily on companies solving environmental and social challenges.

On the environmental side, these are companies that provide solutions to facilitate the energy transition as well as those that help restore and sustainably manage our ecosystems. However, this also extends to financing the transition to a more sustainable world, for example, through green bonds which are intended to raise funds for climate and environmental projects.

This area benefits from several structural tailwinds, which have recently been reinforced by:

- The rising frequency of extreme weather events such as severe summer droughts in Europe and the US and catastrophic flooding in Pakistan; these have highlighted the impact of climate change
- The passing of the US Inflation Reduction Act; this sets aside USD 369 billion for climate change mitigation and clean energy programmes.

Many countries have targeted net-zero carbon emissions by 2050, in line with the Paris Agreement to limit global warming to 1.5°C degrees above pre-industrial levels. And many companies are underpinning and facilitating national transitions, creating a range of opportunities for investors.



SOCIAL SUSTAINABILITY

Our other key sustainability theme – which can be more challenging for asset managers to address directly – is the increasing importance of social factors. The pandemic and cost-of-living crises have exacerbated inequality and disproportionately affected low-income households.

Our social thematics focus on tackling inequality. This entails considering how companies manage employees and work with customers and suppliers to encourage equality. It extends to the use of 'social bonds' to help finance social housing, education or women entrepreneurs.

Unlike the environmental theme, where clear, quantifiable targets are more widely available, international standards and measures for tackling inequality are less developed. Our work on developing the [SDG Fundamentals with Matter](#) is a step in this direction. Further, the development of the EU's social taxonomy will set forth a framework in Europe for classifying activities and practices which should be considered sustainable from a social perspective, and those which should not.

We manage social thematic investing as a standalone strategy. However, we also consider how well companies – and countries – address social factors including equality, health and safety, diversity and community development as a core part of our ESG scoring framework. We put particular focus on a just transition in the context of our work on climate and the shift towards a net zero economy by 2050.



CONCLUSION

The near-term outlook for markets can arguably be characterised as challenging, clouded by inflation concerns, tough monetary policy action, weakening growth and the risk of flare-ups in geopolitical tensions. However, we see a sound case for looking beyond this and focusing on sources of return that have staying power. We believe there are significant enduring trends that meet this criterion: secular innovation & disruption, and both environmental & social sustainability.

They are benefiting from notable tailwinds including growing investor attention, changes in consumer behaviour, and support from regulators and governments.

Our mission is to deliver sustainable returns for clients. We believe that allocating to the themes of the future is an important component of achieving this – in terms of optimising asset allocation from a risk diversification perspective, as well as through providing capital to the companies that will help the world transition towards a more sustainable, low-carbon and equal future.

To find out more about thematic investing at BNP Paribas Asset Management, visit our website

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VIEWPOINT



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