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KEY POINTS

- Thematic investing is an alpha enhancer and an alternative to traditional strategies
- There must be an inevitable structural shift within a theme
- Thematic investing has become more institutionalised

CONFERENCE SUMMARY

THEMATIC INVESTING: GROWTH IN A LOW-GROWTH WORLD

We argue that thematic investing is different from linear investment programs that are primarily history-dependant. Its focus is on applying first principles to evaluate what should be the future profitability or future growth profile of a company; it has little to do with what the company has done in the past. Because of this, Neuberger Berman's 47-strong thematic investing team is organised differently than many of our other teams: almost all are from operational rather than finance backgrounds, and we believe this experience helps us to understand thematic change from the inside out.

Why thematic investing?

Hari argued that thematic investing is an alpha enhancer. It provides an alternative to traditional strategies because it focuses on ecosystems undergoing disruptive change. Moreover, thematic investing looks to transcend economic cycles by investing in areas where there are inevitable structural shifts.

The alpha comes from understanding those changes, which helps to identify companies with attractive long-term growth prospects related to those changes. We aim to capture the alpha before it is well recognised by the market, and this means investing in areas where there is some opacity and confusion.

Hari further explained that we want to express thematic investment ideas in a way that is both benchmark and factor-agnostic, in order to preserve and enhance the diversification benefits of the approach.

Filtering out fads and building confidence in the stability of themes

To help prevent falling prey to fads, themes are not "greenlighted" until we are confident that they are inevitable but also adaptable, Hari explained. Typically, we construct a universe of about 300 companies, and every six months the purity of each theme is examined as well as how it relates to each specific company in the universe. From that analysis, a portfolio is created of about 40 companies by looking for the best risk-reward potential in that universe.

But we also ask ourselves how we will create enough flexibility in these themes in order to navigate cycles. For example, in our 5G Connectivity strategy, we invest in three categories: network infrastructure, Internet-of-Things devices, and applications and services. Each area has different business models that allow us to align ourselves with different environments. During 2020 we could be flexible, increasing our exposure to companies that had made the push to digitisation, which benefited from the coronavirus pandemic, and decreasing exposure to network infrastructure, where near-term upside potential was more limited. The market environment caused dislocations within the theme, but the design of the strategy allowed us to identify, adapt to and take advantage of them.

Thematic investing and environmental, social and governance (ESG) criteria

Hari explained that each company has a proprietary ESG rating, based on material ESG factors, and that helps us to understand their ability to think long-term. We create an industrial agenda for companies with poor ESG scores to follow that should lead to mitigation of any issues and drive change where we believe there is alpha to be had and multiples can expand. This has been validated from work we have done in the past. We also do ad hoc work at the strategy level: for example, in 2020, we examined modern slavery across our holdings and shared this information with our companies and our institutional investors.

Thematic investing is here to stay

Over the last two years, we have seen thematic investing develop into a genuinely institutionalized approach. Hari acknowledged that investing in change comes with risk—particularly the risk of getting sucked in by bubbles or fads or blown off course by short-term market stresses—but that an important aspect of the institutionalisation of thematic investing has been greater emphasis on the purity of the chosen themes and a clear approach to adaptability and navigating change.

Market Risk: The risk of a change in the value of a position as a result of underlying market factors, including among other things, the overall performance of companies and the market perception of the global economy.

Emerging Markets Risk: Emerging markets are likely to bear higher risk due to a possible lack of adequate financial, legal, social, political and economic structures, protection and stability as well as uncertain tax positions which may lead to lower liquidity.

Liquidity Risk: The risk that the fund may be unable to sell an investment readily at its fair market value. In extreme market conditions this can affect the fund's ability to meet redemption requests upon demand.

Smaller Companies Risk: The fund may invest in small capitalisation companies. Such investments involve greater risk than is customarily associated with larger, more established companies due to the greater business risks of small size, limited markets and financial resources, narrow product lines and a frequent lack of depth of management.

Concentration Risk: The fund's investments may be concentrated in a small number of investments and its performance may therefore be more variable than the performance of a more diversified fund.

Counterparty Risk: The risk that a counterparty will not fulfil its payment obligation for a trade, contract or other transaction on the due date.

Operational Risk: The risk of direct or indirect loss resulting from inadequate or failed processes, people and systems, including those relating to the safekeeping of assets or from external events.

Currency Risk: Investors who subscribe in a currency other than the base currency of the fund are exposed to currency risk. Fluctuations in exchange rates may affect the return on investment. Where past performance is shown it is based on the share class to which this factsheet relates. If the currency of this share class is different from your local currency, then you should be aware that due to exchange rate fluctuations the performance shown may increase or decrease if converted into your local currency.

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