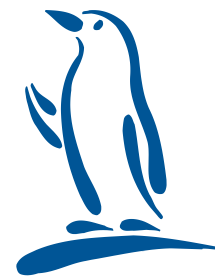


Excess Returns

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Whether one practices “thematic investing” or merely considers themes a potential avenue to new investment ideas, one thing is certain: investors like themes. This issue of *Excess Returns* explores the power of investment themes from a marketing standpoint.

With best wishes,

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Alpha Partners is an investment marketing firm specializing in research and presentation strategy. Our goal is to create alpha (excess returns) by helping investment firms win, keep and diversify assets under management.

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Pigeonhole or Keyhole?

I am a philosophical soul. So every time something weird happens to me, I look for a larger meaning.

A few years back I attended a meeting with a well-known chief investment officer for a large global firm. The goal of the meeting was to discuss examples of the investment process, the better to understand how a potential investment becomes a portfolio holding. The CIO’s examples failed to connect to the investment process stated in the presentation book (a common problem). I sought to get the discussion back on track by starting from the beginning. “What are some of the macroeconomic themes currently expressed in your portfolio?” I asked.

My question offended him. “I won’t tolerate your trying to pigeonhole me,” he responded. The firm’s marketing representative tried to help by observing that specific portfolio investments could not be neatly tied to macroeconomic themes. All of this left me feeling as if I had committed some form of giant gaffe.

“But,” I soldiered on, “the investment process in your presentation book explicitly starts with ‘Step 1: Define Macroeconomic Themes?’” (I also gently suggested that if he was uncomfortable identifying specific themes, perhaps he should revise Step 1 so as not to mention themes.)

“Now there you go again,” he said, “trying to pigeonhole me.”

This level of opposition to the concept of themes and the sheer weirdness of this exchange convinced me that more was afoot here than met the eye.

The Marketing Power of Investment Themes

Talking about the portfolio in terms of themes helps prospective investors understand the investment world from a big picture perspective, viewing the universe of potential investments in terms of how the world is changing for better or worse and how human enterprise is responding to such changes. By “themes” I mean long-term trends such as “Aging Baby Boomers,” “The Battle Against Climate Change” or “Efficiency and Automation.”

I am far more comfortable thinking of my own portfolio in terms of themes than in terms of factor, country and sector exposures. I want to know what those exposures are, sure, but they do not speak to my imagination. Accordingly, I think of a holding in GoPro as expressing a “Weekend Warriors” theme and a holding in Costco as representing “The Rise of the Frugal Consumer.”

Purely from a marketing standpoint, there are several reasons why themes have broad appeal with both individual and institutional investors:

Themes provide context. Investors don’t only want to know about general investment principles or this or that investment. They want a clear, rich, differentiated picture of how their investment manager views the world. Themes satisfy this basic human craving for context.

Themes are active and forward looking. According to [“Thematic Investing: Variations on a Theme”](#) by [Martin Steward](#) of *Investment & Pensions Europe (IPE)*, theme-oriented investment firms such as Newton Investment Management argue that themes by definition focus on change, making a thematic approach “more robust than traditional economic forecasting or quantitative modeling, which are both so vulnerable to the fact that history cannot be used to predict the future.” In an article by its Thinking Ahead Group, [Towers Watson](#) notes that theme-based investing “stands in clear contrast to the more widely used approach of market capitalization investing, where it is implicitly assumed that past winners will continue to win, and therefore deserve more attention and weight in the portfolio.” In a recent [asset.tv](#) video, Tim Hodgson of Towers Watson observes that all investors are thematic, but some choose to be so “explicitly and deliberately” while others are thematic “implicitly and accidentally.” (I think of the many firms that were significantly more exposed to the subprime debacle than they thought because the categories of investment they used masked such exposure in a way that a thematic approach might have uncovered.)

Themes tell a story. The investment markets, notes IPE’s Mr. Steward, ultimately may be less about countries, regions, sectors and market caps than “the overarching narratives that hold all the pieces in place.” Thematic investors build their portfolios to reflect these overarching narratives.

Themes are different. Part of the reason I originally wanted to work in investments was that I saw investing as a discipline requiring broad-based knowledge of how the world works and how the world is changing. In my role today as an investment marketing specialist, I have come to pounce on any information about top-down perspective like a starving dog thrown a scrap of food. I have learned to expect nothing but “bottom up, bottom up, bottom up” and my ears are always alert to anything different. Themes, like some of the world’s greatest investors, are top down (which does not by definition mean a lack of focus on bottom-up decision factors such as balance sheets and business models).

There are many more reasons why investment themes make sense. Why then did this CIO react so negatively to a straightforward question about macroeconomic themes? I still don’t know, really. I do know that so-called “thematic investing” is active, differentiating and forward looking in a way that purely bottom-up approaches cannot emulate. Themes represent a keyhole — a view on how and why the world of investments is changing — not a pigeonhole.

Thematic Investing

In conducting Internet research for this issue, I came up empty when searching for “investment themes” but hit the mother lode with a search for “thematic investing.” For example, I found several investment firms that believe in thematic investing and organize their research efforts around the concept of themes.

While it has many proponents and practitioners, however, thematic investing is controversial for several reasons. Its results are difficult to measure. It is easier to attribute performance to index-defined measures such as factors, countries and sectors. Many professional investors also conflate “themes” with “trends” or “fads.” As one skeptical hedge fund blogger put it, “Themes are all about fads.” And of course some of the best investments will not necessarily fit any one theme. It strikes me, however, that regardless of whether one chooses to be a thematic investor or a classic bottom-up investor, themes are merely another useful tool in the tool kit. The way some write about thematic investing, it reminds me of conventional medical practitioners who completely disavow holistic approaches and vice versa. Why not use all available resources? Some of those who have written about thematic investing also seem to get hung up on whether to start with themes and move to specific investments or vice versa — when obviously the best place to start is wherever one has the good fortune to get a good idea.

The main thing cutting across such theoretical considerations is the simple fact that investors like themes. According to IPE, Russell Investment’s [OpenWorld](#) single-manager platform gives investors access to themes such as climate change, infrastructure or individual emerging markets because Russell could not respond to investor demand for such exposures “with the standard large-cap equity and aggregate bond multi-manager products.”

Investing from the Top Down

In *Investing from the Top Down*, Anthony Crescenzi argues that a macro approach is best suited to the global nature of today's capital markets. Selected chapters explore the role of exchange traded funds in implementing diversified thematic views and specific economic indicators key to understanding global market themes. Mr. Crescenzi's book provides much-needed context to investors regardless of whether their primary orientation is top down or bottom up. By demystifying the process of reading major economic indicators, the book provides useful macroeconomic guideposts suitable for individual and institutional investors.

