

## The Rise of Thematic ETFs

**Liz Bowyer:** Hi Jessica.

Jessica Binder Graham: Hey Liz.

**Liz Bowyer:** So, you and your team in Goldman Sachs Research recently put out a report on the growth of the US ETF market over the last decade. Talk a little bit about that growth and some of the drivers behind it.

**Jessica Binder Graham:** Yeah, so, Liz, the last ten years really have been nothing short of exceptional. Total assets have surged over five times to 5 trillion dollars of AUM. And really show no signs of slowing down. And I think in some ways part of this growth has just been that it's democratized access for certain investors into asset classes that they may not have been able to readily get into in the past.

And we look at it, broad based equity is still by far and away the lion's share of assets, just about 50 percent. Although, this has been shrinking as areas like style factor, as well as fixed income have been taking some share. And those areas are where we see some of the most significant product innovation. So, its new fun launches have helped kind of gain some of those assets. ESG is another area where we see a lot of growth, with sustained inflows. And this is very much a global phenomenon.

**Liz Bowyer:** So, within that broad context, one area of rapid growth that we've seen over the past year has been in thematic ETFs. Talk about thematics and why we're seeing such investor interest there.

**Jessica Binder Graham:** Absolutely. So, one of the key pitches for these products is that they cut across traditional sector definitions where they focus on just a subset of a sector to better capture whatever that target of exposure is that they're after. If you drill down, the large [UNINTEL] areas right now are in innovation, renewable energy, internet. There's a lot of buzzwords in there. And I think it's no coincidence that many of these funds took off at the same time that we saw dramatic pick up in retail investing in the US, as it is catering to those retail investors. And I think a lot of people look at these as a way to gain exposure to very long-term disruptive areas with the added benefit of dispersification [PH] across stock, and in some cases, geography.

**Liz Bowyer:** So, let talk about active versus passive investing. Most ETFs are passive. But within thematic there are a number of active funds. How do you think about the role of active investing within the context of ETFs?

**Jessica Binder Graham:** You're exactly right, Liz. Thematics actually account for the vast majority of actively managed AUM within the broader equity ETF space. And active in this context relates to funds that make active decisions on their portfolio holdings. But they do offer full transparency by disclosing their holdings and position sizes daily. It's really interesting. I think in some ways the interest stems from the benefits of the ETF wrapper. But also, that these funds can be faster moving when it comes to investing in new companies, as well as be thoughtful around their position size and liquidity, and use flows, whether it be inflows or outflows to help make adjustments to that portfolio.

That's a little different from what you see in the traditional passive vehicle where the ETF is tied to an index methodology that they need to follow.

**Liz Bowyer:** And just given this growth in the thematic ETF space, what does that mean for investors at the single stock level?

**Jessica Binder Graham:** Yeah, so, we do get a lot of questions on this in terms of what, quote/unquote, "impact" inflows in trading may have on stocks. Particularly given that many of these thematic funds are not market cap weighted. And in some ways, this is a very similar dynamic to style factor funds. And we can see that despite a relatively small overall asset base, thematic ETFs are larger owners in some stocks already. And as a result, we do think it is useful for fundamental investors to be aware of these dynamics.

While I think some like to point to flows potentially driving price action, it is worth keeping in mind why there are big flows, as ETFs are unlikely to be the sole market participants driving this price action. And even though I made the point that ETFs can be large owners of some of these stocks, our data actually suggests that they often are a much smaller fraction of overall trading volumes.

**Liz Bowyer:** So, finally Jessica, we've been talking about ETFs in the US. But how do you think some of these trends might

play out from a global perspective?

**Jessica Binder Graham:** Yeah. So, while the US still represents the lion's share of overall assets, we are seeing signs of nascent growth in Europe with assets recently surpassing the 25 billion dollar mark, which is a sixth of the size of the US. That said, the focus of funds is a little bit different. Clean energy is the biggest. Which does dovetail with some of the secular shifts towards ESG that we're seeing in the region. There are also funds focused on cyber security and automation.

But with all of that said, I mean, given the robust pace of new launches and inflows both in the US and Europe, this suggests this is an area that we're going to be continuing watching for some time.

**Liz Bowyer:** Thanks Jessica.

Jessica Binder Graham: Thanks Liz.

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