

Why Thematic Investing, and why now?





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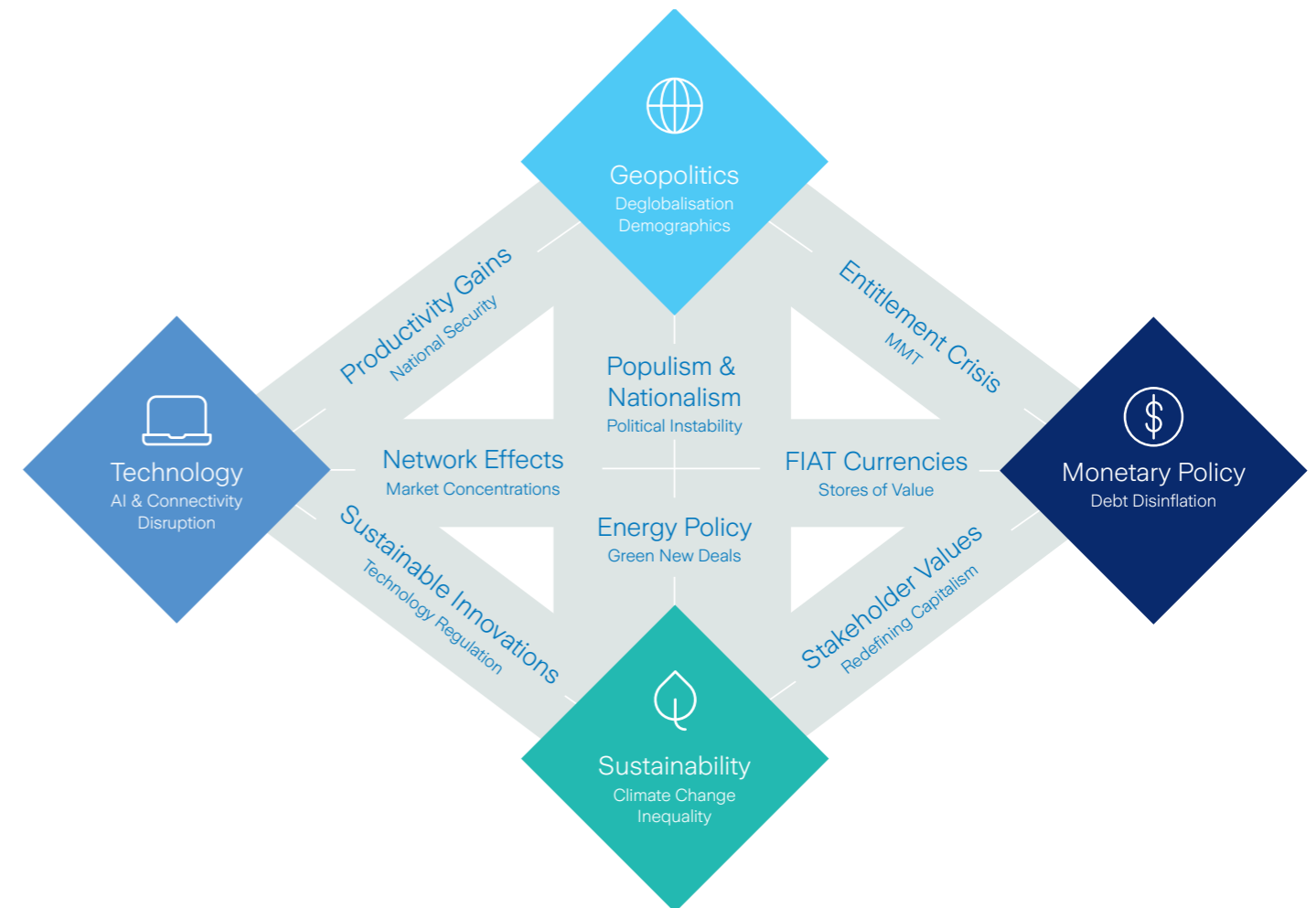
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1. A time of seismic change

Profound transformations are taking place in the global economy as digitization becomes universal and environmental threats, societal anxieties, and regulation gain ever greater prominence. Investors are therefore beginning to focus on the risks these transformations pose to business as usual, as well as the coming response of policymakers.

Embedded within these shifts, our partners, Lazard Asset Management believe that there are generational opportunities for investors willing to take a differentiated approach. The team represent what they believe are the key structural changes of the next decade in their Global Thematic Framework (Exhibit 1).

Exhibit 1 – Global Thematic Framework



For illustrative purposes only.
Source: Lazard

2. Investing for the next decade

The Lazard team believe that structural change is the major driver of investment returns over the long term. They aim to identify the key shifts in business models, industries, economies, and markets, and from these insights they create multiple themes, which they believe offer asymmetric investment opportunities in the investor's favour.

The team believe their forward-facing themes are a more robust starting point for portfolio construction than benchmark weights based around geography, sector, or style.

The portfolio managers have also observed that the majority of market participants are heavily focused on the short term. The structural changes which represent the foundation of their themes play out over a longer time horizon of 3 to 10 years and can drive significant changes in global profit pools and valuations.

Despite the longer forecast horizon, the fundamental grounding of these themes gives the team high conviction. They therefore consider their long-term time horizon a key investment advantage.

3. Differentiated, proprietary themes sourced directly from companies

Lazard's thematic insights are grounded in real-world experience. The primary source of their thematic insights are the companies themselves.

The team meet with a large number of company management teams each year, who offer direct data points about structural changes within their industries, economies, and markets. As the companies will be key enablers of these structural changes, this approach gives the portfolio managers high conviction in their view of the future.

Abstract and undifferentiated top-down concepts like "digitization" or "health" may make for appealing narratives. More often than not, however, they fail to capture in any meaningful way the real competitive landscape, pricing dynamics, or regulatory environment, let alone anticipate how stakeholders will participate in economic gain or absorb reputational risk.

Lazard are wary of these thematic narrative fallacies and have a differentiated approach to theme design to ensure there is potential for a genuine return opportunity, not just a nice story. They develop all of their themes using bottom-up, intensive fundamental research of these companies, representing a key differentiator between Lazard's approach and those of their peers.

“A long-term time horizon is a key investment advantage.”



4. Constantly evolving themes

In contrast to many other thematic products, Lazard's themes evolve over time. The portfolio team's understanding of the next 3 to 10 years is an ongoing process based on their thematic insights.

Often change is incremental, in which case they will maintain the theme, adjusting and optimizing the underlying thematic criteria and holdings to reflect their latest insights. This may or may not involve renaming the theme to best express the investment asymmetry.

This evolving, multi-theme approach, while a little more complicated to explain than static approaches, best represents the reality that the world changes over time and we must stay ahead of these changes rather than assume comfortable constants.

5. Implementation drives returns

The Lazard team have found that effective theme implementation requires a detailed and in-depth understanding of a theme's implications and potential, as well as intensive research into the idiosyncratic qualities of the stocks that express it. They believe that this is preferable to easily quantifiable "thematic purity" metrics, which tend to invite false precision and provide insufficient criteria for stock selection.

They research each stock in detail to ensure thematic fit, using five key criteria for stock inclusion (Exhibit 2) and seeking clarity through both valuation and scenario analysis. They believe that the most important insight from their long experience is that no matter how interesting a theme may be, in order to produce returns implementation is everything.

Exhibit 2 – Five Criteria for Stock Implementation

Key points

✓ Each theme is typically populated with 8–10 stocks, typically equally weighted

✓ The team have 5 criteria for stock inclusion in the portfolio:

Thematic Fit

The structural drivers of the stock should be aligned with our structural insights.

Idiosyncratic

Stock specific factors should either be positive or neutral.

Valuations

Using the relevant tools, express a view differentiated from the market price based on our longer-term thematic insights.

Sustainability

Every stock is subject to our full Sustainability Framework.

Diversification

Where possible, we seek diversifying expressions of the thematic idea via different industries and end-markets.

✓ The stocks within a theme change over time based on valuation, thematic fit, fundamental stock view or as the portfolio manager's find better ideas.

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6. True sustainability integration

Sustainability analysis is fundamental to the strategy. Each stage of the investment process fully integrates traditional environmental, social and governance (ESG) and broader sustainability considerations.

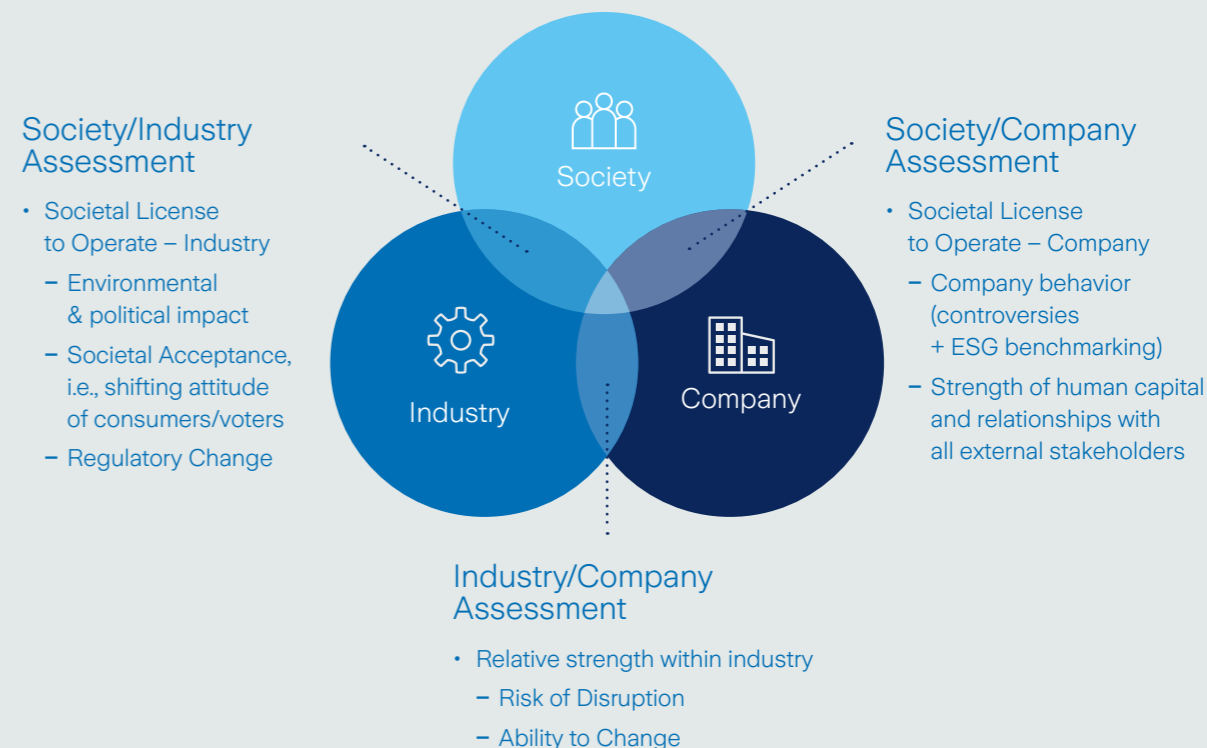
As long-term investors Lazard believe it is critical to understand the evolving societal and policy landscape and the associated opportunities and risks. They believe that traditional investment analysis tends to underestimate the risks faced by some companies today.

At theme level, the team believe that sustainability analysis offers an opportunity to enhance return and mitigate risk through identification of long-term societal change. This incorporates consideration of the direction of future policy via frameworks such as the United Nations Sustainable Development Goals (UN SDGs) and global Climate Change policy.

At the stock level, all stocks are subject to analysis under our Sustainability Framework (Exhibit 3), which integrates multiple aspects of business risk, including formal ESG inputs.

This framework offers a consistent way to evaluate sustainability and has the potential to generate positive, differentiated long-term returns for the portfolio.

Exhibit 3 – Sustainability Framework



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“Sustainability analysis offers an opportunity to enhance return and mitigate risk through identification of long-term societal change.

7. Risk mitigation through diversification

In contrast to single-theme strategies, the portfolio is expressed through multiple themes and multiple stocks per theme. This enables diversification between themes and across time horizons. Diversification is an important tool for risk mitigation.

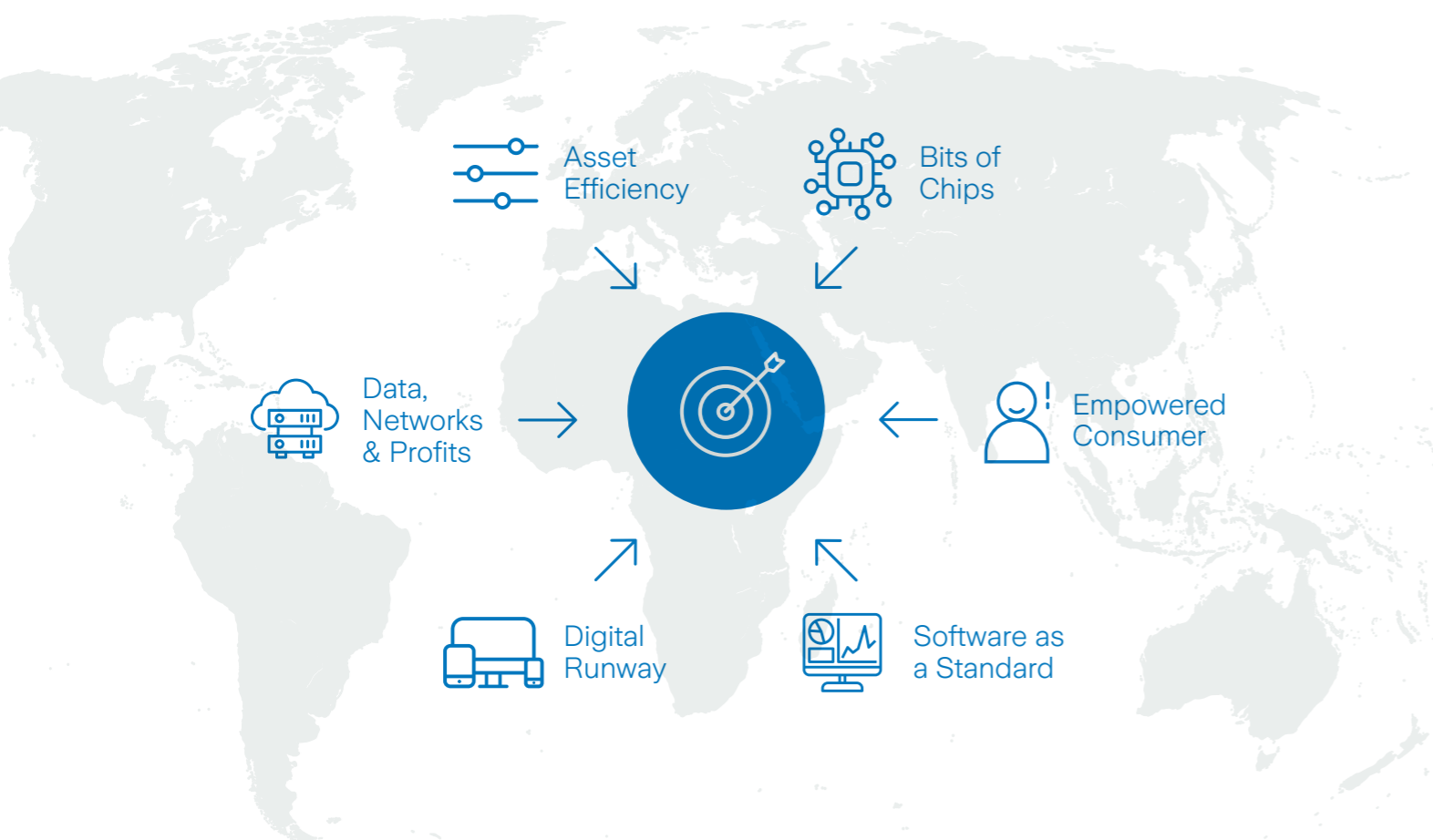
The team’s portfolio construction also enables them to capture returns from volatility through rebalancing of theme and stock weights (to an equal weighting for each theme and stock). We believe the combination of this thematic approach with the sustainability framework helps to significantly reduce portfolio risk, without compromising returns.

8. Two strategies, one unconstrained approach

The diversified strategy, the Global Thematic Share Fund, combines return opportunities with risk mitigation to target strong risk-adjusted returns. Invested across 8-12 themes, the portfolio typically holds between 80-120 stocks.

The concentrated strategy, the Global Thematic Focus Fund, identifies what the team believe are the highest return opportunities of the next decade. Focused on just 3-6 themes (Exhibit 4), the portfolio holds between 35 and 55 stocks. Both strategies represent a high conviction, best-ideas portfolio which, unconstrained by geography, sector or style, will add a differentiated return stream to most asset allocations.

Exhibit 4 – Zurich Investments Global Thematic Focus Fund - Current Themes



For illustrative purposes only.
Source: Lazard

9. Pioneers in thematic investing

Lazard's thematic investment team has spent nearly two decades identifying structural and secular changes in the global economy and investing in companies that stand to benefit from those trends. The original diversified Lazard Global Thematic strategy launched back in October 2003 was one of the world's first thematic investment strategies. Zurich Investments partnered with Lazard in November 2003 to bring the strategy to Australian advisers and investors. The more concentrated, returns-seeking Lazard Global Thematic Equity Focus strategy was launched in June 2018. Zurich Investments launched the Focus Fund in Australia in late 2020.

The thematic investment team leverages Lazard's global investment resources of 300 people, including global sector specialists, while maintaining complete control over theme design and final stock selection.

The team likewise benefits from an absence of administrative or sector responsibilities alongside our roles as portfolio managers—their sole responsibility is to run the Lazard Global Thematic strategies.

Zurich Investments believe that the team's vast experience in cross-sector and cross-theme research and portfolio construction is a significant advantage. We value our long-term client relationships. The conviction they have in the strategy is evidenced by investing their own money within the strategy, alongside that of their clients.

10. The portfolio of the future

Lazard's Global Thematic strategies combine an innovative approach with a time-tested process. They believe the future will look very different from today and construct their portfolios accordingly.

The world is undergoing a sea change—straining under the stresses of globalisation and demographics, inequality and environmental challenges, as well as the disruptive impact of technology.

Their themes look to benefit from the opportunities provided by these structural shifts. The combination of broad thematic insights supported by intensive fundamental analysis sets Lazard's Global Thematic strategies apart.



To learn more about the Zurich Investments Global Thematic strategies and how you and your clients can invest, speak with your Zurich representative today or go to: zurich.com.au/globalthematic

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