

## THEMATIC INVESTING: A TRANSFORMING WORLD

### Our view

**Global transformation:** Cyclical and secular trends continue to transform the world at a fast pace. Signs of these trends can be seen in the following: 50% of all government bonds in the world currently yield 1% or less; in the next 20 years, one in three UK jobs are expected to be replaced by computers or robots; there are an estimated 122,000 cyber-attacks per week; 47 countries are officially classified as water stressed; and over half of Europe's population is expected to be aged 50 or older within 10 years.

**Five key themes.** Five key investing themes have emerged in response to these trends. They are:

- People – for the allocation of scarce human resources
- Innovation – for the disruptive role of technology
- Markets – for the allocation of scarce financial capital
- Government – for the role of public policy
- Earth – for the allocation of scarce natural resources

**The BofAML case for thematic investing:** In an environment with lower expected returns, investors can position their portfolios by concentrating in assets related to long-term themes in a transforming world. The annualized price return from global thematic investing in the past three years is 32%, versus a 15% return from global equities over the same period. Theme investing should continue to outperform in the brave, new, post-QE world.

### Key calls: Seven Actionable Investment Themes for 2015

**Financial Repression (Markets):** Global central bank assets, including FX reserves, now total \$22.6 trillion, a sum larger than the combined GDP of the U.S. and Japan. Eighty-three percent of the world's equity market cap is currently supported by zero interest rate policies; and 50% of all government bonds in the world currently yield 1% or less. Currently, 1.4 billion people are experiencing negative real interest rates (Chart 5). Low rates mean low returns and enhance the appeal of theme investing.

**Longevity (People):** All aspects of society and the economy need to be viewed through the lens of the aging population and the societal transformation associated it. Companies most likely to benefit from increased longevity are pharma and healthcare, senior living, insurers, drug stores and death care.

**Robotics (Innovation):** Robot installations are estimated to increase by 12% each year, in 2014 and 2015, driven by corporate focus on cost competitiveness, outsourcing of engineering functions,

increasing quality requirements and rising wage inflation across emerging markets. Companies expected to benefit from robotics include industrial automation and robots, robotic surgery, control systems and equipment, and industrial PCs/smart planet.

**Cybersecurity (Innovation):** Cyber-crime costs the global economy an estimated \$0.5 trillion annually, and the average successful cyber-attack cost \$12.7 million per US company this year. Expect more companies to significantly increase their investments in cybersecurity. The companies most likely to benefit from this are those that provide or support - content security, network security, data protection, hardware based on software blades, identification and analysis of machine-generated big data.

**Internet of Things (Innovation):** The adoption of the Internet of Things (IoT), including devices and hardware with sensors, smart nodes and other connectivity, should reach a tipping point in 2015. BofAML estimates the market size for software will be \$36 billion by 2017, representing incremental new revenue opportunities in areas such as big data, analytics, data and application integration, the sales cloud, marketing cloud and end-to-end vertical solution providers.

**Solar & Wind (Earth):** Demand for solar power is growing, though overall penetration remains low, and both pricing and costs continue to fall steeply. The total addressable solar market could exceed \$25 billion of U.S. electrical sales by 2016, according to the BofAML Alternative Energy research team.

Ninety percent of global power generation is water intensive; given global scarcity of water, solar-and wind-generated power should continue to rise. Companies with thematic clean tech exposure that should benefit include those financing, installing and servicing solar power arrays, solar project developers, and wind and solar power generators.

**Water (Earth):** By 2030, it is estimated that half the people on the planet will be living in conditions of water stress. The necessary focus on water treatment, management, infrastructure and supply could lead to a water market worth over \$1 trillion by 2020. Companies with water exposure that should benefit include China water treatment, “more crop per drop” actors, water meters and medical waste treatment.