

Mark Noble

Welcome to the latest episode of Generation ETFs. I'm Mark Noble, Executive Vice President of ETF Strategy at Horizons ETFs. The COVID-19 pandemic has led to widespread adoption of so-called thematic ETFs. Now retail investors across North America have really embraced thematic investing in a big way, with the amount of assets under management in these ETFs, now sort of around \$150 billion, which is well, actually, about half the size of the Canadian ETF market, which is at about \$300 billion now.

With us today is Jay Jacobs, Head of Research and Strategy at Global X ETFs. Global X is arguably the most well-known thematic-focused ETF provider globally. They are a sister company of ours in the United States. We were both owned by Mirae Asset Global Investments. But really Global X has been a trailblazer in the development of some of the world's most popular thematic ETF mandates. And a driving force behind this innovation is Jay, who leads the firm's research team, which originates the firm's unique insights in the markets and ETFs. He also guides the planning and development of the firm's strategic direction. Jay is a frequently cited expert in the financial media, including CNBC, Bloomberg and the Wall Street Journal.

So Jay's really here today to discuss why thematic ETFs have become so popular, some of the key advantages versus more traditional index ETFs that investors are, especially in Canada, probably more familiar with as well as, I think which is a lot of people interested in, some key thematic opportunities for the remainder of 2021 and beyond that he and his team are monitoring. Jay, thanks so much for being here today.

Jay Jacobs

No, thanks for having me.

Mark Noble

I think I just want to start a little bit about your background. I mean, how did you become sort of Mr. Thematic ETF guy in the United States? We see you on Bloomberg and I see you on CNBC and you're really the guy that a lot of people talk to about emerging investment in trends and identifying these new trends. How did you get into this sort of, I don't want to call it a niche because it's become so large, but how did you end up in this kind of space being sort of a leading voice in this area?

Jay Jacobs

Sure. Well, I'm an ETF lifer. I've spent my entire career in the ETF space. I started at the New York Stock Exchange. Global X was one of my clients when I was there helping different ETF issuers list on the exchange. And it was just so obvious to me that Global X was ahead of the curve, really identifying these really interesting, unique investment opportunities that other people weren't looking at. And when we go back to the first Global X thematic ETF launching back in 2010, the lithium and battery tech ETF, they were looking at an industry that was really hard to get exposure to back in 2010. If you were buying S&P 500, you were getting 0% exposure to lithium and battery tech. So if you believe that batteries were going to take over the world, either because of the transition to electric vehicles, or the needs to store renewable energy, or simply the increased demand for batteries as we went mobile using smartphones and tablets and laptops, there wasn't a great way to do it until Global X came around with the lithium and battery tech ETF.

So it was very obvious to me that Global X was working on some really interesting products very early on. Even at the time, we didn't even really call it thematic investing yet. We just knew this was an interesting exposure that people wanted. As I joined Global X, and I've now been there for eight years leading the research team, we've really started to formalize an analysis, a rigorous research process around how we find these opportunities, like lithium back in 2010, up to some of the most interesting themes that we see today, where we can analyze what's happening in the world with a consistent framework and determine what is a powerful investible long-term structural theme.

Mark Noble

I didn't realize that lithium ETF was 2010. If I go back to 2010, I'm thinking about like the infancy of Tesla. We're only a couple of years in on iPhones and the batteries. That's amazing that you guys highlighted that earlier.

That kind of dovetails really nicely into my question, which is just if I'm looking at a thematic ETF, how would Global X define that? Because in the ETF space, we tend to get in a lot of kind of semantics around this. But again, as a pioneer in this space, if someone asks you what is a thematic ETF, how would you define that?

Jay Jacobs

Sure. Well, it starts with what is a thematic investment? So a thematic investment is the process of identifying powerful macro level trends that stand to disrupt major parts of the global economy. Now, a thematic ETF has an ETF designed to capture one or several of those themes within the ETF structure.

As you alluded to, there's not a ton of consensus over what is a thematic ETF. It's kind of a we know it when we see it kind of approach is generally how the industry has taken on thematic investing. But if you look at Bloomberg, if you look at Morningstar, if you look at ETF.com, all of them generally have some similarities with what they consider thematic ETFs, but there's also very big differences, and you can see that just simply in the number of ETFs they track within the thematic space. Some of them include ESG, some of them include unique structures like MLPs, but we have a very consistent definition which is really looking at those long-term structural disruptive themes. So to us, something like ESG, while an important part of investing, is not a long-term structurally disruptive theme. So we don't include ESG, we don't include MLPs; we're purely looking at those disruptive themes.

Mark Noble

Yeah, I agree completely. ESG's almost like a factor, right? It's a factor on top of whatever kind of exposure you're getting to, then you have an ESG screen. Whereas if I'm trying to determine the difference between a theme and the NASDAQ-100, you've got stocks like Nvidia or Tesla that would be part of a thematic investment, but those are part of a larger theme that's separate from being that broad index strategy.

Jay Jacobs

Absolutely. And I think where people struggle with thematic investing is they want it to really neatly fit these buckets and I think this is a little bit of a result of having sector-based funds for so long is that the global industry classification system, which was co-run by MSCI and S&P, divided up all the companies into these 11 economic sectors, consumer staples, consumer discretionary financials, et cetera, et cetera. And every company is placed into one sector, whether it should be or not is another question, but it gave people this really clean framework for thinking about where things fit, what a company is and what sector it's associated with.

Thematic investing, by its very definition, doesn't care about sectors or geographies. We don't care for robotics companies, an industrials company, a healthcare company, a services robot – It doesn't matter as long as it's leveraging robotics technology and really kind of pushing this theme forward. Similarly, we don't care if it's Japanese or European or American or Canadian, it's irrelevant to us. So it's a very different way of approaching investing that I think a lot of investors have to be kind of untrained in their old habits to accept that a Nvidia can be, at the same time, both an artificial intelligence company and somewhat of a block chain company because it's used in mining, as well as a video games company, because that same GPU has three different use cases that is very powerful in gaming and AI and mining.

Mark Noble

Right. But what's, in your mind, Nvidia again, what's in your mind tipped the scale where instead of investors just buying Nvidia, they're actually now trying to capture these themes? In the last two years, and I've been in the ETF space now for 12 years, I am absolutely astounded. I've never seen an idea take off the way that thematic ETFs have taken off for the last 18 months where, and you guys do a fantastic job at tracking the sales data in the United States, where you've gone from approximately US\$41 billion at the end of Q2 2020 and now you're at roughly US\$150 billion at the same Q2 2021. Like that's astounding to me. And I would love to know your thoughts on what is driving this growth. What's moving people from buying just Nvidia or buying these placeholder stocks to where they're actually moving towards these thematic ETFs?

Jay Jacobs

Absolutely. Well, I think the biggest thing that's happened in the last 18 months, which is very much a function of COVID-19, is the dispersion within sectors.

Mark Noble

Okay.

Jay Jacobs

So, had you simply sector invested during COVID-19, maybe you had an overweight to the technology sector or the communications services sector, and they did well during COVID-19 because technology stocks generally did well with low interest rates and people adopting technology. But, when you looked under the hood at the technology sector, you have companies that basically make printers and make desktop computers, which are completely irrelevant in the COVID-19 economy.

And, at the same time, you have companies that were facilitating cloud computing, that you could communicate with people remotely from the comfort of your home and the safety of your home. Companies that were developing slack communication so that you can communicate with your coworkers; companies that were streaming media to you so you could be entertained on your couch; or companies that were allowing you to play video games so that you had something else to do while you were at home for six months last year. It showed that there was companies that really thrived during this economy, and then other companies that really didn't even within something like the technology sector or within communication services.

So, I think investors really started to recognize that. And the better way to play that was not just buying the broad sector fund that had both those winners and kind of losers or laggards, but by finding the thematic funds that really grouped together those companies across sectors that benefited from these structural trends. So, instead of just trying to buy the tech sector to get exposure in companies that might do well from COVID-19, buying the cloud computing theme, because broadly almost all of those companies benefited from the COVID-19 lockdowns and the shift to a more digital economy.

Mark Noble

But I mean this is where, and I agree with you completely, Jay, but I want to be a bit of devil's advocate here, where I'll have an investor just say, "Why in the world though would I go and buy this diversified bucket of stocks when I could get most of that thematic exposure by buying some of the leaders in these themes? So, I'm curious why an ETF versus just holding a couple leading stock names? Like if I'm going to do electric vehicles, why wouldn't I just hold... Albemarle is a big battery lithium component company and hold Tesla where I'm going to get majority of that? Why would I hold the ETFs?"

Jay Jacobs

Yeah, absolutely. I mean, I think a lot of people can probably go one, two, maybe three companies deep.

Mark Noble

Yeah. Right.

Jay Jacobs

What's the leading company in e-commerce. Okay. Fine, Amazon. Fine, Shopify. Okay. What's next.

Mark Noble

Yeah.

Jay Jacobs

And it's fine that people can get exposure to really concentrated bets within those themes. But the reality is there's a much deeper ecosystem behind each of these themes. The average number of companies in our thematic ETFs has around 40 or 50 names.

Mark Noble

Okay.

Jay Jacobs

Most of our themes, with the exception of two of them, are global in nature. So, not only would you need to be able to identify dozens of themes on your own through your own research to get that diversified exposure to the theme, but also you would need the global trading capabilities to get exposure to all those different names around the world. So, the bar is pretty high for someone to want to do that themselves.

Also, I think what people don't maybe necessarily appreciate is there is a lot of turmoil and turnover within these themes themselves, that a company that maybe leaps to the forefront early on in the themes trajectory may not be the ultimate winner. Think back to the early days of the internet. It seems like Webvan and Pets.com were these really pioneering companies and had these huge valuations, but then completely died and now have been replaced by the next generation.

Mark Noble

I'm waiting for my Blackberry to come back in favor. Right? So, right? As a Canadian-

Jay Jacobs

All of us are waiting for that too, Mark.

Mark Noble

Yeah. Well, a great point. Right? I mean, Blackberry was 30% of our market up here and clearly was ahead of the curve on the mobile phone market. And where is it today? It's mainly a software company for that. But what are the main thematic ideas? Like, can you kind of classify where investors have really gravitated towards in the last year? Are there some really big themes that people have started to follow in your mind, in the space?

Jay Jacobs

Absolutely. I would make a distinction because there was very much a COVID-19 investing flavor where a lot of people were looking at things like cloud computing stocks, and e-commerce, and video games, and e-sports. That was very much kind of the at home trade. The biggest differentiator since then, of course we've seen the reopening, but actually where we've seen a lot of the thematic flows are kind of the Biden trade. With Biden elected and coming in with some pretty aggressive policies to change the U.S. economy, people are really looking at thematic ETFs for ways to play that.

So, the first and foremost biggest one we've seen, from a flows perspective, is looking at U.S. infrastructure development. This is a theme that we've had our eye on for almost five years now, dating back to the Trump/Clinton election in 2016, because it was very clear that Republicans and Democrats don't agree on pretty much anything in the United States these days. But the one area that they agree is that our infrastructure is terrible and anyone just has to fly into JFK into New York to agree with that as well. And, when you look at the stats behind it, you see trillions of dollars of under investment in our infrastructure, truly just letting these roads, these highways, these airports, these ports depreciate and physically deteriorate for decades without the appropriate amount of money to keep them running.

Mark Noble

Right.

Jay Jacobs

So, this is an area that is so painfully obvious to citizens, to politicians, to business leaders, it just takes that catalyst to get it going. And right now we see that in the American Jobs Plan from President Biden and actually a pretty decent shot here for Republicans and Democrats working on kind of a skinny version of that bill later this year. So, that's the first theme that we've seen just a lot of interest in since the Biden election.

I would say stemming from that is other themes that stand to benefit from his policies. So, in the environmental side, clean tech, lithium and battery technology, electric vehicles, all benefiting from Biden's kind of expanded vision of infrastructure, which would include electrification of transportation as well as reaching net neutral carbon emissions by 2050.

And then, kind of finally, I would say the last leg of that is cannabis. In the United States, investors are increasingly bullish on cannabis. We've seen a couple of states so far this year legalize cannabis sales, New York being the big one, Connecticut following up behind that. Basically a lot of states in the U.S. are broken, need new forms of revenue.

Mark Noble

Right.

Jay Jacobs

So, what seemed to be kind of a hairy topic for these states maybe as recent as five years ago is now pretty easily getting approved at the state legislature levels.

Mark Noble

Yeah. I mean, if Colorado can raise a billion and a half dollars, then Texas and Florida are like, "Okay, maybe we should take a serious look at more further liberalization," so.

Jay Jacobs

Absolutely. And, if you ask individuals, "Would you rather have your income taxes increased or have cannabis legalized?" Most people would say, "Keep my income taxes the same. Thank you very much."

Mark Noble

In terms of creating a thematic ETF though, one thing we do notice is that they are a little bit more expensive, like we charge more for thematic ETFs. How do you rationalize that cost? I mean, obviously there's margins there, we're in a profit business and we're trying to generate returns for our unit holders, but there's more to a thematic ETF than what would go into like the S&P 500 or a sector ETF, which necessitates that cost. Right?

Jay Jacobs

Absolutely. There's two things that really factor into that. One is the expected scale of these ETFs. If you're launching the S&P 500 in the U.S. and expect it to be \$100 billion fund, you can get away with charging a few basis points and still reach profitability there.

The second and probably more important part though, with thematic investing is the amount of research and analysis and production work that goes into the fund. People don't always see this on the other side, but we're spending about six months, at least, developing a new theme from the ground up, because there's no S&P 500 of AgTech and food innovation, which we just launched last week.

We start with literally a blank word document and a blank Excel document and build from there. We start writing a methodology for what we think the theme should look like, we define the theme, we look at the different sub-segments of what the theme should include, we start analyzing investability, what potential companies would be, what the sector and geographic exposures unintentionally look like from that perspective. We look at the private space and look at what the IPO pipeline could look like in the next several years to understand what the evolution of this theme might look like. We read tons of research about the theme and its total addressable market and the state of that technology, all of these different factors, and it takes time, it takes work, it takes expertise. When you're buying a thematic ETF, which has a higher expense ratio, a lot of that is baked into that research work that the ETF issuer is doing in preparation of bringing that theme out.

The last thing I would point out is just, with thematic investing, this is not going to be 50% of someone's portfolio, like a U.S. core allocation might be. Often, we see in a growth-oriented portfolio a thematic sleeve might be anywhere from five to 15%, so when you multiply that weighting by a higher expense ratio, which call it 50 to 70 basis points, yes, they're higher fees, but they're contribution to the overall cost of the portfolio are not huge contributors.

Mark Noble

I think another thing, too, is a lot of these themes are global. Right? Especially here in Canada, for example. The ability to trade Asian equities is not as simple as trading large-cap U.S. equities, and the ability to find those companies as well. Right? You guys have done a great job with that with a lot of your strategies. LIT is a perfect example where you have a number of Chinese lithium producers. How do you even find those to begin with? And then sourcing and creating liquidity. That's not as easy as running NASDAQ-100 or the S&P 500.

Jay Jacobs

That's a great point. Yeah, absolutely. In the case of lithium, we felt we had to have Chinese companies. We had to have Chinese A-share companies, which are extremely difficult for people to access. But when you look at the state of the lithium market and the battery market, some of the biggest companies in the world are in China, so if we want to do justice to this theme, we have to get that exposure even if it is more challenging than just buying U.S. equities.

Mark Noble

Right. Let's move on to probably the part people want to hear about. I'm interested just, Jay, your opinion on what are some maybe two or three themes that you're really keeping your eye on? They can come from left field. I just want to hear where... You guys have been so foundational in looking ahead with the themes that you've picked, PAVE, your infrastructure ETF, is a perfect example, one of the best-selling ETFs this year in the world. Lithium, obviously back in 2010. What's the next great big themes, theme or themes, over the next 18 months to two years in your mind?

Jay Jacobs

It's a great question and it's a challenging question. I don't have kids, but I imagine it's like asking someone to pick their favorite.

Mark Noble

Yes. Of course.

Jay Jacobs

For certain themes, and I love all of them to death. One of my favorites for so long has been PAVE, U.S. infrastructure development. It's something that I so genuinely knew was going to happen, and even when the markets were sometimes discounting the chances of a bill being passed, I just knew it was a great tool to get exposure to this theme, and that patience has paid off.

I guess looking down the road, what's the next exciting one that people haven't really talked about? We just launched it last week, AgTech and food innovation. The reason why I like this theme is that it's benefiting from all of the major drivers that tend to drive thematic performance. The first is technology. Is there technology pushing this theme forward? In short, yes. You have hydroponics, you have indoor farming, you have biotechnology that's making seeds more disease-resistant that need less water, that result in higher yields. You have cloud computing and artificial intelligence being used in fields to reduce the amount of labor inputs and to increase crop yields. You have drones being used to analyze fields from the air. You have all the different forms of technology being put into AgTech right now.

On top of that, you have demographic trends. Demographic trends are really powerful in themselves; you have growing populations. Probably more importantly, you have a rising middle class in the emerging markets. These are people that are going to consume more, that are going to want higher-end food categories like dairy and meats that are going to be propelling more demand going forward.

Then finally, the third leg of the stool is the environmental component, that it requires greater efforts given that we have climate change today. Greater efforts to grow in a sustainable manner, whether you can transition from meat and dairy products to alternatives, whether you can be more efficient with your water use so that if there are water challenges going forward, that it doesn't affect crop yields as much. So, when you combine technology with demographics with the physical environment, you're hitting on all three major categories of thematic disruption. I think that just positions AgTech to be an extremely powerful theme over the next several years.

Mark Noble

What would be some key holdings there? This is fascinating to me. I always find agricultural technology fascinating as well because you're talking about a 25,000 year old problem. Right? How do we grow more and do so efficiently so we don't starve, and now dealing with a population of eight billion people to manage that efficiently? What are some of the leaders that would be in that portfolio?

Jay Jacobs

I'll kind of barbell that answer because there's some really new, innovative companies and there are companies that have been around for a long time that are innovative in their own right, but people don't really think about them that way. On the more young, hip companies, you can look at Oatly, you can look at Beyond Meat. These are companies developing alternative sustainable foods. So, instead of depending on the dairy industry or depending on the meat industry, to give people dairy and meat, can you do plant-based versions that require less water, that have less carbon emissions, that maybe ultimately become healthier for you or less expensive and all those benefits as you see more adoption? Those are two examples on the food innovation side.

Maybe a little bit more of an old school company that people might not think of as being super innovative but is, is John Deere, the tractor company. They are at CES every single year, the Consumer Electronics Show. They have my favorite booth every single year because they bring in one of these tractors, these state of the art tractors that does all the farming these days. It is a unbelievable piece of equipment. It truly looks like it's in the same class as a private jet in terms of how sophisticated it is, how many buttons it has, how much technology is packed into the cockpit of this tractor. It is absolutely fascinating. Everything they're developing from basically being able to scan a field, understand the crop yields within those fields, understand where to precision spray pesticides, precision spray water to reduce the costs and the inputs, to be able to upload all of that to the cloud and use artificial intelligence to help farmers understand when to farm and when to harvest, all of those things, it's truly a remarkable piece of technology, not to mention that these tractors now completely drive themselves through artificial intelligence as well. It is absolutely cutting-edge and a very, very cool thing to see.

Mark Noble

Farming at night, too, right? We don't even think about something like that, but the fact that you can actually have farming continuing 24/7, it's incredible. Another key theme, obviously that we're both aligned with and you guys have launched recently, a hydrogen ETF. In the U.S., it's HYDR. Canada, we have a hydrogen ETF HYDR. You have L-I-T, LIT, and we have HLIT up here in Canada. You can tell, we may be related company-wise, but in terms of your thoughts on the alternative energy space because this is something that Canadian investors seem to be having a lot more interest in. What's your view on these sectors? Is there compelling reasons to still consider some of these alternative energy sectors long-term?

Jay Jacobs

Absolutely. I mean, it's still very early stages in alternative energy. I would say that hydrogen is where lithium was 10 years ago.

Mark Noble

Okay, interesting.

Jay Jacobs

Even starting to see very broad adoption. We've seen electric vehicles breach the 3% level of total car sales. You're starting to see just the ramp up in the amount of electric vehicles being purchased. You see the big car companies committing to bringing out more models like Volkswagen with the ID.4, with Volvo and BMW and Mercedes all committing to several models on the electric battery side. So hydrogen, take a step back 10 years ago with lithium: it's a proven way of storing power; it's an efficient way of storing power, relatively speaking; and it has certain advantages to it that people can't ignore. One is it's really light. It's lighter than air. That's very important when you're looking at something like heavy transportation, like trucking, or ships or trains, where the weight of what you're transporting is a huge factor in the equation. If you can reduce-- if you're not spending all that weight on a battery, but can spend it on cargo, it's much more efficient way to ship things.

On top of that, it's very quick to refuel. You can just pop in a new capsule, you don't have to wait for something to charge, and it's a way to store renewable power pretty effectively. If you have excess solar or excess wind energy being produced, rather than just having that energy be wasted, you can be using that to separate hydrogen from H₂O, and that can ultimately become that gas battery that you can use however you want; it has a lot of advantages to it. The biggest problem right now is simply infrastructure and cost. Right now, hydrogen is still relatively expensive. It will get a lot cheaper once we have more excess renewable energy production. The more solar and more wind we have, the cheaper hydrogen will become because it'll just be naturally created as you have excess energy there.

Then the infrastructure part. There's not a lot of places to refuel hydrogen vehicle days. There's only a handful around the world. In the United States, I think all of them are just in California right now, so good luck leaving the state. That makes it a little bit difficult to see more hydrogen fuel cell cars being adopted right now, but that doesn't mean the technology isn't very promising and will continue to be adopted over the next several years. I think it's really exciting. I think we'll certainly see some ups and downs as this technology progresses, but if it follows the trajectory of lithium, I think we'll be in for a pretty exciting transition here.

Mark Noble

I mean, the thing about that as well is you've got a clean burning fuel. Your excess is water. As we've seen with, I believe it's Biden over the last two weeks, highlight that by 2030, he wants 80% of energy production in the United States to be renewable. You're really limited in your sources of that. You're basically looking at uranium, maybe nuclear, but who knows by definition? And hydrogen and battery power, and solar and wind as you highlighted, which are more conducive, I guess, to hydrogen production as well.

Jay Jacobs

I think the other component of it is that energy production is obviously not the only polluter in our economy right now. Transportation itself is a big source of pollution. If you can convert trucks and cars to electric, and those electric vehicles or those hydrogen vehicles are run through clean fuels, you can reduce more carbon that way. A lot of emissions come from agriculture. If you can move to the Beyond Meats and the Oatlys of the world, you can reduce carbon emissions that way. A lot of emissions come from buildings themselves. A lot of buildings still burn heating oil and natural gas to heat themselves. If you can electrify that with heat pumps, you can remove a lot of carbon from the atmosphere as well.

Then finally, you just have industrial emissions. A lot of factories that are producing carbon emissions at the source. That is probably a bigger opportunity for carbon capture, capturing carbon at the source rather than pumping it into the atmosphere. This is an interesting technology into itself. There's several areas of the economy where you need to see those dramatic changes take place to really be able to reach carbon neutrality.

Mark Noble

So we have them all covered with your thematic suite, right? If I look at it, right, they're all highlighting this disruptive trend of making the world smarter, faster and ideally better. This has been great. Thank you so much, Jay, for taking the time. Really love having you on. Hopefully we'll do it again soon. Hope we can chat about some of these calls and see what kind of themes are capturing the imagination of investors over the latter half of 2021. Thanks again, Jay, for being with us.

Jay Jacobs

Absolutely. Thanks, Mark.



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