

Transcript

The Ideas Exchange

Episode 20: How megatrends are shaping our global economy and society

September 2022

[00:00:01] **Rory Cunningham** Welcome to the Ideas Exchange by ASX connecting you with investment experts, market updates and ideas. I'm Rory Cunningham, Senior Manager of Investment Products at ASX and this is our regular podcast covering everything from investment trends through to different ways to invest using a variety of products.

[00:00:20] **Disclaimer** A quick note about this podcast. Information is provided for educational purposes only and is not intended to include or constitute financial product advice. You should obtain independent advice from an Australian financial services licensee before making any investment decisions. Please refer to ASX's full disclaimer with respect to this podcast on the section of the ASX website titled The Ideas Exchange by ASX.

[00:00:46] **Rory Cunningham** Hi and welcome to this month's episode of The Ideas Exchange. I'm your host, Rory Cunningham. I'm very excited about today's discussion because we're going to be talking about megatrends and looking into the future about what is going to shape our lives over the coming years and decades. To take us through this discussion. I'm joined by Tommy Taw, head of Investment Strategy, ETF business, Asia Pacific at BlackRock. Tommy, thanks very much for joining us.

[00:01:10] **Thomas Taw** Hey, Rory. My pleasure. Thanks for having me.

[00:01:12] **Rory Cunningham** So Tommy we might start off if you could explain what's your role at BlackRock and also give our listeners some idea of who BlackRock is.

[00:01:22] **Thomas Taw** Sure. I'll try and keep this short, I guess. So I run the Investment Strategy and Product Solutions Group for the iShares business in Asia Pacific. I don't think that doesn't fit entirely on my name, on my business card. But in terms of in terms of BlackRock and iShares, I mean, BlackRock is the world's biggest asset manager. We've got about \$10 trillion in assets. The ETF, an index investment team which is where I sit in, we are obviously an ETF provider, we've got about \$3 trillion across global developed markets, emerging markets, commodities, real estate investments and of course what we're going to talk about today, thematic and in the region, we currently have ETFs in Australia, Hong Kong, Japan and Singapore. So that's kind of a very in a nutshell stock-pile answer to it but that's who I am and that's who we are.

[00:02:12] **Rory Cunningham** Great. Thanks. Great to have you on the show. So let's jump right into it. Thomas, what are megatrends?

[00:02:19] **Thomas Taw** Great question. Very difficult to define, I think most investors will tell you. But breaking it down. So basically megatrends, we're looking at long-term transformational forces which basically influence the future of our global economy and society. So these are themes that are not really constrained by sectors or geography and are more focused on the companies that are actually going to benefit from structural changes which are created by megatrends. So it's basically the coming together of all these global megatrends, and that's prompting structural shifts in a lot of industries and changing drivers of company earnings and the way we live. And that's kind of what we're looking to invest in as kind of as a kind of a broad top-down theme.

[00:03:01] **Rory Cunningham** One of the things that comes up quite regularly and we see this in our stats is that the use of thematic ETFs, both in Australia and around the world, is increasing year on year at quite a rapid pace. But Thomas, is there actually a difference between a thematic and a megatrend or are they interchangeable?

[00:03:20] **Thomas Taw** They're relatively interchangeable. Interchangeable. So a theme versus a megatrend by our definition. Basically, we use megatrends for sort of the higher level. So I'll probably talk about this in a little bit. But we've identified five major megatrends, which we set as the main categories. And then underneath that, each of the megatrends there are different, different themes. So those would kind of be more classified as thematics so megatrends kind of sitting on top. And the themes are sort of one level down. So I'll give you an example like climate change as a whole, that's a megatrend. If you look at electric vehicles or something like clean energy, those are themes which would actually sit under the megatrend of climate change. So they're relatively interchangeable. But the way that we think about it is megatrend sits on top, and then you've got thematics or themes within those five megatrends.

[00:04:12] **Rory Cunningham** Understood. Thanks for that. So Thomas, your CEO, Larry Fink, has been actually quite outspoken about certain megatrends, and you referred to it earlier that there's a number of megatrends that BlackRock have identified. So what is it that excites you in the investment market in terms of megatrends and what megatrends have you identified?

[00:04:32] **Thomas Taw** Yes. So I couldn't pick a favourite. Maybe I can do that by the end of it, I think probably the one that's getting the most traction at the moment is probably the first one. So I'll go through them very quickly. So the first one is around climate change and resource scarcity. So this megatrend is becoming increasingly important, as I think everyone knows, and the listeners will know as we see countries making these net zero pledges. Right. So the demand for a clean future. This will continue to grow and the investment opportunity here is including the themes of clean energy, electric vehicles and clean water. So I think that's the one that's probably got the most traction and is most exciting at the moment given what's happening globally with government regulations. The second one is around demographic and social change. So, you know, as we look at structural trends like longer lifespans, modern lifestyles, changing medicine, consumer habits, changes in global demographics, these are things that will bring significant challenges, but also opportunities for societies and businesses. So the related themes here are things like aging population, health care innovations. And so that's the second theme. The third one is, you know, we're not only seeing demographic shifts, but also changing economic power as a result of this. Right. Particularly in developing countries like China, which are increasingly dominating the world in terms of GDP growth and wealth. In the last 20 years, markets like China have benefited from globalisation and manufacturing shifts to Asia. You know, we've had obviously more geopolitical tensions over the last couple of years, but the third one is really around demographic shifts, which is kind of classified into emerging

markets. The fourth one is around urbanisation or rapid urbanisation, which I guess is somewhat related to the second theme, but sorry, the third theme. So there's a rising need for infrastructure. And this calls for new funding resources as global populations continue to grow again, particularly in some of these developing economies. And so you see some countries starting to build smart cities, which are leveraging technology and sustainability to improve efficiency and quality of life. So that's you know, a theme there would be around smart cities. And then the final one is, is around technological breakthroughs. So, you know, as we see new technologies at the center of resolving and accelerating the four above megatrends. So you've got themes like robotics. I think most listeners would have heard of that before. Artificial, intelligence, cybersecurity. These have been very popular amongst investors in recent years as technologies continue to advance. So, you know, amongst those five, I would say the first one, climate change and resource scarcity. That's the one that probably has the most traction. I think probably one that's probably known to most investors is around the last one, the technological breakthrough, I think most investors have heard about robotics, artificial intelligence, etc... So that's also quite an exciting area of megatrends.

[00:07:25] **Rory Cunningham** Yeah. Thank you for taking us through that. There's definitely a lot in there. All really big topics on their own, aren't they?

[00:07:34] **Thomas Taw** Yeah, it's it is difficult to sort of break it into five classifications, but that's the way that we look at it. You know, I think other providers, other asset managers might classify things quite differently, but for us that's sort of the best way to actually structurally divide the major megatrends that we're seeing at the moment.

[00:07:51] **Rory Cunningham** And so how do you go about identifying the changes that will really hold, you know, for example, digitisation versus, say, pipe dreams, such as, for example, flying cars. So obviously, there's a lot of research for a firm of your size that that sits behind the things that you have identified. So can you walk through the process for us and maybe the process to identify a particular megatrend and maybe use a megatrend as an example?

[00:08:19] **Thomas Taw** Sure. Yeah. I mean, I haven't seen a flying car ETF yet, you know, maybe at some point, I'll talk to maybe Elon Musk about that one. But, you know, as I as I sort of pointed out earlier, you know, megatrends, when we look at them, the first the first adjective, first word that comes to mind is long term, right? The second one is transformational. And again, these are these are subjective, but generally that's driven by consumers and that influences the future of the global economy and society. So the first point is really that, you know, investing in these themes can provide unconstrained and also diversified returns, of course, and those would be well placed outperform global equity markets again over the longer term. So it's about it's about trends. It's about change. Investment trends are not megatrends. Investment trends are more based on signals. So, you know, investment trends, megatrends not the same thing. Megatrends are more structural trends. As I mentioned earlier, changes in society, changes in consumer demand, that kind of thing. So what do we look for in a theme? So there are sort of three key forces when we and tailwinds which we look at and which will actually power these longer term secular shifts and make them hold in the long run. You know, for example, if we're looking to launch a product and not looking at, as you mentioned, pipe dreams, the first one is regulatory. That's a big thing, particularly for net zero at the moment. The second is societal. The third one is economic. So if I give you an example, let's just go back to electric vehicles. You have a regulatory force that comes into play, change in emission standards that can drive a theme like electric vehicles. On the societal side, a

societal force such as increased consumer preference for electric vehicles like we're seeing right now can incentivise companies to ramp up that EV production and scale back on combustion engine production. Again, we're seeing that at the moment. And the final thing, economic forces. So within that, you've got the declining cost of batteries, you have these scale of efficiencies, these can make electric vehicles cheaper to produce and then become more affordable. And that basically increases demand. So the three things and they kind of go in chronological order, you have or tend to go in chronological order, regulatory force and then you have a societal force and then you have an economic force.

[00:10:42] **Rory Cunningham** So we continue with the electric vehicle example. Does Tesla come out, as you know, a company that aligns with this megatrend or are there certain parts of a value chain that might be of interest or surprise to our listeners that come out align to that particular trend?

[00:11:03] **Thomas Taw** Yes. I mean, if you're looking at something like electric vehicles, you know, you would expect Tesla to be a relatively big portion of that index. I mean, of course, it depends on the index provider. But, you know, within these within electric vehicles, as I mentioned, you have not only the car, the actual in-car producer, but you have things like the battery producers. You know, you have you have other electronic vehicle producers. And then once you get to this sort of scale of efficiency, you know, you might see traditional car companies, Ford, for example, coming in and actually increasing EV production as well. So it might start with one company. Tesla is a great example of that. But as you get these economies of scale and then you get the societal forces that obviously creates demand, then you start to see some of the more traditional companies that have strong balance sheets and are able to actually invest in that space. And then eventually, once they become or have divisions that are electronic vehicles, then they would be considered for that index.

[00:12:02] **Rory Cunningham** Understood. I suppose one of the biggest challenges for investors, if they're looking at this space, trying to pick a winner themselves, is how do they pick a winner that's going to stick around versus what's going to fall by the wayside from a BlackRock perspective, how do you think about that problem in terms of constructing portfolios to enable investors to get access to, I suppose, a diversified portfolio of stocks? Or said another way, what investment principles do you try to adhere to at BlackRock?

[00:12:32] **Thomas Taw** So investing into megatrends, you know, certainly not easy. You know, the space is quite new by definition. So you know, what we kind of see is on one end, some investors try and try and invest in the space by by picking individual stocks. Again if we use the example of Tesla for electric vehicles, with that performance can be quite volatile. You know, when you have a new burgeoning industry, you might have limited research for investors to look into as it's as it's sort of a new theme. Banks might not have analysts on the specific companies that are that are coming through. On the other hand, at the other end of the spectrum, you might have some investors that look for exposure in specific themes, like, for example, clean energy from traditional market or sector funds. So, you know, for example, if you're looking at oil and gas and some companies within there might be might be moving towards clean energy, but these funds are usually a little bit too broad to actually encapture those things. So this is where thematic ETFs come in because they're kind of in between those two. So our thematic ETFs are basically trying to provide targeted access to specific themes that are across sectors and geography. So they give more of a holistic view, but also much more diversified exposure, so less volatility. So there's a couple of things, three main things to bear in mind when investing into megatrends in

light of what I just mentioned, the first one is around long-term view. I keep mentioning that, but the core of investing into megatrends is you're looking to capture long-term growth of secular trends. These trends can take several years to realise you're getting in at a very early stage. It's also important for investors to maintain a longer-term view on that. I think trading in and out of thematic investments is not a great way to go about it. This way you can sort of pass short-term volatility, be patient in order to realize the full potential of these investments. The second one is around being diversified. You know, as I mentioned earlier, concentrated exposure can be quite risky. Broad strategies might not provide you what you're actually looking for, and you're looking out for strategies with good diversification in terms of number of holdings. So again, you don't want to be too concentrated. Market cap, so, you know, you don't want to be in the companies that are still very, very early stage or post IPO and have very small market cap and then geographies and sectors. So diversification, final thing is around investing early. So one of the biggest mistakes we've seen in the past is that investors tend to underestimate disruptions when they start to take place. So when the theme takes off, it might be a little bit too late to invest. So take time to understand your theme of interest. Take a look. See if there are any relevant driving forces, you know, whether you know, whether you're interested in those driving forces. The three elements I mentioned earlier, regulatory, societal and economic forces. And that's really going to drive the longer-term theme.

[00:15:26] **Rory Cunningham** We just by way of background, ASX runs investor education programs, one of which is called ASX Investor Day and we're actually going around the country in May, so earlier this year and one of the things that came up about megatrends or thematic investing, a regular question from investors was do you think that there's been too much money has piled into chasing these trends? And do we think that rising interest rates will see a re-rating of some of the stocks in those areas. Do you have any views, comments in relation to that?

[00:16:03] **Thomas Taw** Yes, I mean, let me answer the second one first. I think we've already been seeing that, right. I mean, if you look at, for example, clean energy, I mean, clean energy in 2020 and 2021 was really the one theme in terms of megatrends that was getting the most traction. We saw a huge amount of inflows going into that space and as rates have picked up over the last over the last year, particularly over the last eight months, you've seen a derating of a lot of those stocks. So, I mean, clearly thematics, you're looking at the long term again, but, you know, they're not immune to market forces, right? They're not immune to interest rates and growth and other economic indicators. So, you know, when it comes to investing in thematic funds, you do need to be careful when you're when you're picking those funds. So again, you're looking for well-diversified true thematic strategies, longer-term trends on the three forces I mentioned, rising rates. You know, yes. As I mentioned, have had some impact today on growth exposures. Generally thematics, you know, there is a correlation with growth, right, because you're investing into the future. But not all thematic funds are growth style, you know, clean energy. It tends to be a little bit more exposed to utility sector, for example. That's something that's not very well known, has been performing a little bit better over the last couple of months and taking a portfolio approach helps as well. So there are funds that invest in multiple themes which can complement each other in terms of risk characteristics. So the risk management approach, that's what really helps us navigate various market environments. But as I said, you know, this is not a space which is completely immune to the shorter-term macro picture.

[00:17:37] **Rory Cunningham** Changing attack slightly. I just wanted to ask a question about ESG. So again, your CEO as well as BlackRock have been thought leaders in terms

of how funds should approach thinking about ESG and their responsibilities there. How does BlackRock think about ESG in the context of megatrends? And also, is there an ESG overlay that applies across your megatrend portfolios?

[00:18:05] **Thomas Taw** Sure. Yeah, very good questions. So as you mentioned, BlackRock, very committed to ESG. It's been a huge focus of the firm, one of our major pillars, I guess if I define ESG just by using the acronym Environmental Social Governance, if I kind of break those down and look at and look at in the context of megatrends, so the environment part. So this is relating to climate change, energy transition. You know, this is especially critical to future economy and society. So there's clearly some overlay there with some of the megatrends the megatrends that I mentioned earlier. So we see more and more countries are making net zero pledges. Policymakers around the world are issuing new policies to reduce carbon footprints. Recently, we've had the Inflation Reduction Act in the U.S. That's \$370 billion of energy related spending focusing on clean energy, electric vehicles. And so you can see that there's clearly there's clearly a relation here. There's not always a massive overlay, but generally across environmental, social and governance. If you go back to the three main forces I mentioned earlier, there's clearly there's clearly quite, quite a strong correlation in terms of regulatory, societal changes, etc... So, you know, we think energy transition is a long-term structural trend. The companies in the value chain in this area are going to benefit as more, more and more money go into this area. So ESG is a very big thing. It will continue to be a very big thing. And to answer your question very simply, there is there generally does tend to be some strong correlation between ESG and megatrends in terms of the overlay across the whole portfolio. So, you know, you are seeing more and more investors starting to incorporate ESG into portfolios, you know, both for their own interests in ESG, but also because of regulatory reasons. That's been one of the big drivers, particularly in places like Europe and Australia, I'm led to believe. So there are a few ways that investors can look at this from a whole portfolio perspective. The first one is investing into ESG as a core. So you replace your traditional regional market indexes with ESG versions of those. You know, for example, you replace your S&P 500 index with an ESG version of S&P 500. The second thing from a portfolio perspective is investing into ESG as a satellite investment. So you know, for example, if you believe a certain ESG theme like clean energy, for example, you then allocate a portion of your portfolio into the theme. But that's more for an alpha generation. So there's a core way of looking at it. You're shifting your core portfolio into an ESG version. And then there's the satellite approach where you're using funds to complement your core portfolio for alpha generation.

[00:20:50] **Rory Cunningham** Fantastic. Two questions for you Thomas in terms of learning more. One, do you have a favourite book or commentator that you follow about megatrends?

[00:20:58] **Thomas Taw** I think this is a good segway to plug the business. I don't actually have a favourite commentator, but I would say that we do have dedicated research analysts in megatrends, not only globally but also in the region. So I tend to just kind of copy their homework. So I guess for investors they're interested in learning more, you know, just I would just reach out to you your ishows representative and they can they can probably point you in the right direction in terms of thematic research. And sorry what was the second question?

[00:21:32] **Rory Cunningham** You've made my job very efficient.

[00:21:33] **Thomas Taw** I got carried away with plugging the business.

[00:21:35] **Rory Cunningham** You've made my job very efficient because I was going to ask about your website resources. So you've already done that for me, so thank you, but I will double down on that. I've been on the BlackRock byshares website recently looking at your content about megatrends and I must say it is very good. So I encourage investors to go there if their keen to learn more. But Thomas, you've been you've been great with your time. Thank you so much for taking us through those megatrends. And I really, really appreciate you coming on to the show.

[00:22:04] **Thomas Taw** My absolute pleasure. Thanks for having me.

[00:22:06] **Rory Cunningham** Thank you for listening to the discussion with Thomas from BlackRock. I hope you got a lot out of that and came away learning a little bit more about megatrends. Two things in particular that stood out to me were, one, to take a long-term view when thinking about how we invest in megatrends, and also two, think about how we can achieve diversification across various megatrends. I look forward to you joining us again on the Ideas Exchange podcast.

[00:22:35] **CTA** Visit the ASX website - [ASX.com.au](https://www.asx.com.au) and register for the ASX small and mid-cap event providing investors with a unique opportunity to hear from emerging leaders.