

Thinking Thematically

After a difficult two-year stretch, thematic ETFs return to inflows



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Overview

- Last year saw stronger flows in thematic ETFs after a weak showing in 2022 and 2023
- Next Gen themes remain dominant, garnering 94% of 2024 flows
- Among those themes, “Digital Future” dominated, with sub-themes including artificial intelligence and robotics

How we think about thematics

To better understand the thematic universe, we maintain internal tags on more than 600 funds by their thematic style and the specific themes they target. We'll use those distinctions below to explore what trends we're seeing lately.

One of the first lenses we use to divide the thematic universe is between what we call “Next Gen” themes and more traditional “Thematic Industries.” Thematic investing is ultimately about investor choice, going beneath and between traditional sectors to target a more specific global or macro trend that interests the end investors. On the Next Gen side, you have familiar futuristic spaces like Robotics, artificial intelligence (AI), Sustainability and more. On the Thematic Industry side, you have investments options in areas like defense, banking, or packaging. We think this distinction is useful, because while most thematic fund providers focus only on Next Gen technologies, investors could also care deeply about issues like rising geopolitical tensions or how a rise in e-commerce during the pandemic might change the demand for cardboard boxes.

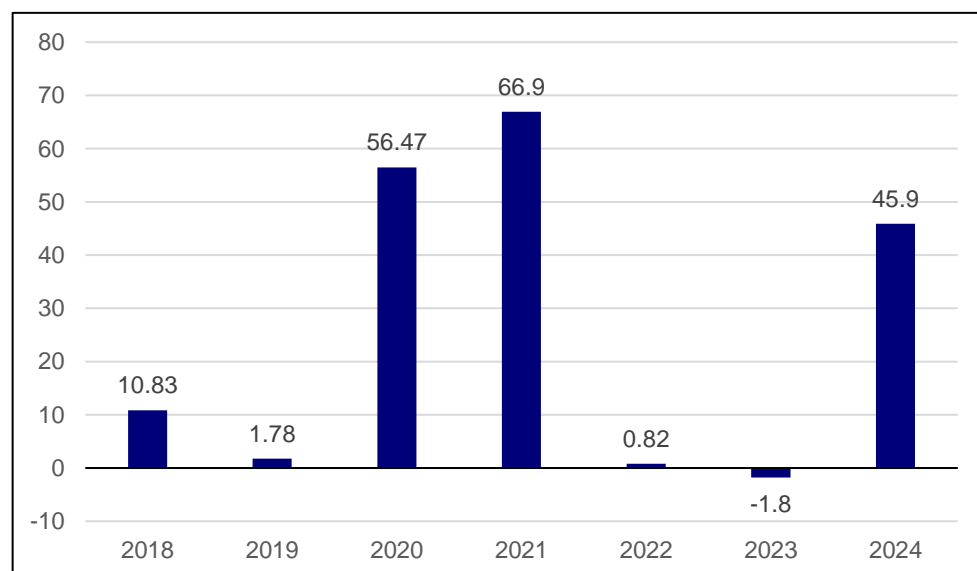
Flows from the past year and quarter¹

After two difficult years, the thematic ETF industry saw a return to inflows last year with \$45.9B of flow. Much of this came in the 4th quarter, with \$22.8B, a little under half of the full year number. Next Gen themes – and their focus on growth/technology – remained the preference for investors, garnering 94% of YTD flows. However, thematic industry ETFs saw a 4th quarter comeback, taking 25% of Q4 flows.

The top-flowing theme was one we call “Digital Future,” which includes technologies like artificial intelligence (AI) and robotics. With the market focus on Nvidia and the potential for AI technologies since the launch of Chat-GPT, this comes as no surprise. However, we also saw flows into MLPs, nuclear energy, and banking. Increasing market breadth post election could have contributed to stronger flows for thematic industries.

Outflowing themes included broad innovation-focused funds, biotechnology, and healthcare. Biotechnology continues to struggle in the wake of the post-COVID boom, as declining usage of vaccines dents previous winners.

Thematic ETF Annual Flows – US\$ Billions¹



1. Bloomberg L.P. as of December 31, 2024. Theme type determined by our internal tagged thematic fund list not available to the public

Notable launches¹

Last year was a decent one for thematic ETF launches, seeing 66 new funds come to market. However, this is still below the 89 new funds launched in 2023 and 71 in 2022 – though both those years saw weaker flows. January was the strongest month with 13 launches, followed by September with 10.

Highlighting the market focus on AI, the Digital Future theme took 36% of new launches. While Sustainable ETFs were not a focus for flows, they did manage to see some launches with 8 new funds coming to market. Another notable theme was defense, which saw 4 new funds launched.

A theme we're thinking about this quarter

Defense was a topic we touched on frequently last year, and it seems to be no less relevant moving into 2025. One key question mark for the industry is Trump's return to the White House. While defense budgets have historically grown under both Republican and Democratic administrations, Trump's interest in ending support for Ukraine could alter spending needs.²

However, there remains no lack of conflict worldwide, and geopolitical struggle looks set to continue. At the top of President Trump's agenda is competition with China. Just before New Year's, the US Treasury Department even announced the discovery of a massive Chinese hack of their network.³ Meanwhile, the defense industry continues to seek modernization, including in the realms of space, drone warfare, and cybersecurity.

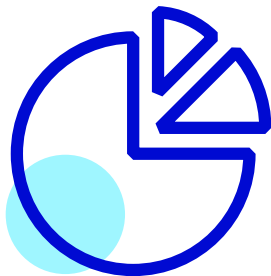
From an economic standpoint, however, defense companies tend to operate on long-term government contracts, which could support such companies regardless of any macro uncertainty stemming from Trump's planned tariffs. At the same time, Trump's planned tax cuts could potentially benefit corporations of all kinds, including defense names.



Conclusion

With improved market conditions during 2024, we also saw an improvement in flows into the thematic ETF space. While the market remains focused on AI and Next Gen themes, Q4 did seem to mark a turning point for thematic industry ETFs. With 66 new launches in 2024, the industry also seems poised to continue offering thematic options to investors. We don't know what 2025 will bring, but we look forward to navigating thematic markets with you!

Thematic Investing with Invesco



- One of the largest thematic providers with 5.34% market share (higher than 3.0% ETF share ex-QQQ)
- 37 thematic investments
- \$22B of assets and more than 15 years in the space
- Balance between Next-Gen themes and Thematic Industries (21/16)

Bloomberg L.P. as of 12/31/2024

2. Macrotrends, December 2024

3. Reuters, December 2024

Investment Risks

Thematic investing involves the risk that a given theme is out of favor, or that the industries chosen to capitalize on that theme underperform the market.

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