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Date: December 19, 2022
Topic: Insights

GLOBAL X ETFs INVESTMENT STRATEGY

# Investment Strategy Monthly Insights, December 2022

After a bumpy year for the markets, 2022 finishes with reduced geopolitical risks, a weaker U.S. dollar, and lower commodity prices. In 2023, investors are looking at a different macroeconomic landscape, highlighted by lower but longer central bank rate hike trajectories, a lower U.S. dollar, and a slowdown in global growth, except in China, where a rebound in possible. This month, we review the major trends in thematics this year and investigate investment opportunities for next year as markets possibly regain some normalcy.

## 2022 Thematic ETF Market Recap: Climate Flows Pick Up

The broadest layer in Global X's thematic classification system, Categories, includes three fundamental drivers of disruption: exponential advancements in technology (Disruptive Technology), changing consumer habits and demographics (People & Demographics), and the evolving physical landscape (Physical Environment).

Through November 30, 2022, there were 126 thematic UCITS ETFs totaling about US$33bn in assets under management (AUM), down 19% from US$41bn in December 2021. AUM for themes in the Physical Environment category increased 32%, followed by a 31% decrease in Disruptive Technology and a 52% decrease in People & Demographics.[1]

Net inflows to UCITS Thematic ETFs totaled US$1.23bn, while net outflows from the U.S. Thematic ETF's totaled US$3.83bn. The top two mega themes in terms of global net inflows in 2022 were Climate Change-related themes (US$977mn) and Big Data (US$278mn).[2]

Climate Change (US$1.53bn), Big Data (US$714mn), and Infrastructure Development (US$87mn) dominated net inflows into thematic UCITS ETFs this year. Health (US$327mn), Robotics (US$291mn), and New Consumer (US$201mn) recorded the largest net outflows. In contrast, the largest net outflows from thematic ETF in the U.S. were from Robotics (US$1bn), Mobility (US$791m), and Climate Change (US$556m), while Disruptive Materials thematic ETF had the lowest net outflows (US$60mn).[3]

### Growth Stocks Struggle

2022 was a year marked by rapidly rising inflation across all regions due to the steep recovery from the COVID-19 pandemic and the high commodity prices that resulted from Russia's invasion of Ukraine. Led by the Federal Reserve, central banks globally responded to inflation with aggressive rate hikes, which in turn challenged rate-sensitive growth stocks for most of the year. The largest net outflows came from tech-heavy themes, led by Robotics & Automation with US$1.23bn, followed by Autonomous & Electric Vehicles (US$643mn) and Healthcare Innovation (US$630mn).[4]

This trend did not apply to Cybersecurity, which had strong net inflows of US$1.67bn, both in UCITS and U.S. thematic ETFs. The need for data and critical infrastructure protection increased in 2022 as global risks of cyberattacks increased amid the Russia-Ukraine conflict.[5]

### Climate-Related Themes Surge

The energy crisis in Europe that followed the cut in Russian gas supplies via Nord Stream 1 led to a strong shift in sentiment towards Climate Change themes as an economic and security priority for the region. The

push for energy independence resulted in tremendous interest from investors in Europe, as reflected by strong net inflows into Cleantech and Renewable Energy Producers (US$1.17bn).[6]

Unprecedented global commitments to decarbonization was another significant energy development in 2022. In May, the European Union launched the RePowerEU program, which includes a €300bn investment package to streamline and accelerate the renewable transition and further invest in cleantech.[7] In August, the U.S. announced a US$370bn investment package as part of the Inflation Reduction Act (IRA) and additional incentives in the form of investment tax credits for renewable project developers.[8] During the annual COP27 meeting in November, developed countries committed to fulfilling their pledge of providing about US$100bn annually to help developing nations finance their clean energy transition, starting in 2023.[9]

## 2023 Investment Outlook: Markets Can Embrace a Return to Economics

After a year of significantly elevated geopolitical risks, 2023 may bring a return to more normal markets driven by economics rather than by geopolitics. Global inflation is likely to decline sharply amid lower base effects due to declining oil and commodity prices alongside the slowing global economy. As a result, we expect a gradual rotation back to growth stocks, supported by slower policy tightening in developed markets; large public spending on infrastructure, tech, and clean energy; attractive valuations in certain areas of tech; and a weaker U.S. dollar.

Given expectations of slower global growth and inflation in 2023, investors could consider a more nuanced approach towards equities, such as covered call strategies, which benefit from slowly rising or rangebound trading markets. The potential income collected from covered call writing could be particularly attractive to add on dividend yields amid higher interest rates.

### Precious Metals Poised to Shine

Commodity assets—particularly precious metals—appear attractive in this environment as investors look to mitigate currency risks in their portfolios. The weakening U.S. dollar and a global macroeconomic slowdown mean precious metals are likely to outperform other major assets in the near term. The gold-to-silver ratio dropped from 95 in September to 79 as of December 6th which means that it takes 79 ounces of silver to buy 1 ounce of gold, well above its long-term average of 68.[10] Based on historical trends, should precious metals enter a bull market, this ratio could tighten significantly with silver prices rising more than gold.

Silver, like gold, has a negative 0.50 correlation with the U.S. dollar, which means that it offers currency hedging characteristics. Silver is almost two beta gold while having a 0.8 correlation to gold, so silver is a cost-saving, alternative currency hedging strategy to gold. Silver miners offer similar characteristics because they have a 0.8 correlation to silver and a negative 0.53 correlation with the U.S. Dollar Index (DXY). Silver has greater industrial exposure than gold, though the U.S. dollar and real interest rates drive performance for both metals.[11]

In addition, silver is a key input in photovoltaic (PV) cells and could benefit from structural tailwinds as solar plays major roles in Europe's clean energy transition and in the Inflation Reduction Act. These factors could at least partly offset the upcoming slowdown in industrial production, in our view.

### Chinese Equities Gather Support

A weaker U.S. dollar coupled with easing COVID restrictions, a real estate rescue plan, and expectations for easier policy from the People's Bank of China helped attractively valued Chinese equities to rebound in toward the end of 2022. More broadly, the rebound improved investors' sentiment on emerging markets (EM). China and the U.S. resuming dialogue following a meeting between President Biden and President Xi at the G20 summit also supported improved sentiment.

Sectors that are likely to outperform over the next year include Tech, Industrials amid higher defense spending, and Consumer Discretionary, led by automobiles and electric vehicles and e-commerce. Also, China's reopening combined with large public investments in the clean energy transition in the U.S. (Inflation Reduction Act) and Europe (RepowerEU) could further support demand for commodities such as uranium, lithium, cobalt, and nickel despite slowing global growth. We expect these commodities to be largely immune from cyclical headwinds next year.

## Clean Energy Movement Spreads

Clean energy transition themes are likely to continue to garner investors' interest in 2023 as Europe works towards energy independence. When looking to capture the decarbonization trend, we identify three important considerations. First, it is key to evaluate investments' exposure throughout the clean transition value chain. The value chain includes disruptive materials (copper, lithium, zinc, among others) and specific commodities (uranium, silver) required to produce cleantech. The value chain also includes the technology to produce (solar panels), distribute (smart grids), and store renewable energy (lithium battery technology), and the renewable energy producers able to produce alternative energy.

Second, the investment horizons for cleantech investments differ greatly. Solar and wind are currently the most mature cleantech markets with minimal production costs, rapid deployment, and flexibility in their installations. Nuclear power has the potential to grow rapidly in the medium term, driven by the development of small module reactors. These reactors are more flexible and quicker to install than traditional reactors, requiring approximatively three years instead of seven to become fully operational. Hydrogen is still in the innovator phase and has a longer investment profile.

Third, investments in these alternative energy sources can be complementary. Solar and wind are variable energy sources that require expensive storage and local capabilities. Nuclear and hydrogen can replace oil in the long term, given nuclear's immense power generation capabilities and hydrogen's fuel cell adaptability to decarbonize sectors such as transportation, building and manufacturing.

Footnotes

1 Bloomberg Data as of and retrieved on 30 December 2022 from Global X Bloomberg Terminal.

2 Ibid.

3 Ibid.

4 Ibid.

5 Ibid

6 Ibid.

7 REPowerEU: affordable, secure and sustainable. European Comission. Website. https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal/repowereu-affordable-secure-and-sustainable-energy-europe_en

8 Pearson K. and Such M. (2022, September 23) Inflation Reduction Act and renewable energy development: its advantages and limitations https://www.reuters.com/legal/legalindustry/inflation-reduction-act-renewable-energy-development-its-advantages-limitations-2022-09-23/

9 Magdy M. and Lacqua F. (2022, October 26) COP27 Host is hopeful geopolitics won't derail climate pledges. https://www.bloomberg.com/news/articles/2022-10-26/cop27-host-is-hopeful-geopolitics-won-t-derail-climate-pledges?sref=11FjdUrF

10 Bloomberg Data as of and retrieved on 15 December 2022 from Global X Bloomberg Terminal.

11 Ibid.

Investing involves risk, including the possible loss of principal. Narrowly focused investments may be subject to higher volatility.

Index returns are for illustrative purposes only and do not represent actual fund performance. Indices are unmanaged and do not include the effect of fees, expenses or sales charges. One cannot invest directly in an index. Past performance does not guarantee future results.

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