

THEMATIC INVESTING WITH ETFs

Megatrends: Own the Future



Audio Script

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Audio Script:

Thank you so much for watching today. In our discussion, we're going to focus on megatrends, the long-term transformational forces that are driving not just the future of our economy but also our society, and we're going to discuss as well how these can play an important role in your portfolio.

So let's talk about some historical examples of structural growth opportunities. The punchline here is they're happening faster and faster. It took 35 years for the telephone to become mainstream. It took 16 years for the personal computer to become mainstream. Only seven years for the web, only four years for Facebook, and actually, in 2020, it took Disney Plus only a few months to reach over 100 million users. The point here is that structural changes are more available to us in truly investable timeframes.

Now let's draw a really important distinction between structural opportunities and cyclical opportunities. Structural opportunities play out over long periods of time-- 5, 10, 15, even 20 years-- and they feel so powerful because they feel almost inevitable. And so think about areas like aging populations, the rise of middle class consumers in emerging markets, the long-term adoption of technological breakthroughs. These feel almost inevitable, and they play out over these long periods of time. But in contrast to that, we have cyclical themes. These are shorter term. They might be driven by interest rates or short-term government policy. The thing about cyclical themes is, they often rise as quickly as they fall, meaning that timing your entry and exit is critical. In contrast, for long-term structural themes, for megatrend themes, timing is significantly less important because your investment horizon is long-term as you capture long-term structural growth.

Now, how exactly do you go about that, as an investor? Well, we see that as something of a Goldilocks problem. And what I mean by that is, when you're looking to invest in structural growth opportunities in megatrends, a single stock approach may be too narrow, a traditional index maybe too broad, but a megatrend targeted strategy, or a megatrend targeted index, could be just right. So let's dig into that a little bit.

I'm guessing that you're probably familiar with this acronym, FAANG, F-A-A-N-G, and that stands for some of the most innovative successful companies of the last 20 years-- Facebook, Amazon, Apple, Netflix, Google. And I think it's also safe to say that these companies rode the last 20 years of megatrend structural changes to become as successful as they have. Facebook: with the rise of social media, Amazon: e-commerce, Apple: the smartphone, Netflix: streaming and Google: search, and really, the internet writ large. And of course, all of us would have loved to have been very early investors in one of these companies, and if you were, congratulations. But, I would submit that picking these companies in their early days is actually really challenging.

And so we're going to play a little game here right now. We call it, can you spot the FAANG? What we're going to actually look at are two pure play e-commerce companies, and how they performed in the late '90s. Let's take a look at this. So we have Company A and Company B. Company A was up a whopping 213% in the late '90s. Company B was up 22%. Pretty different outcomes, and I think it's safe to say that, by the late '90s, the world knew, investors knew that e-commerce was coming. This theme was going to change the world. But these two companies had very different fortunes over the period. Now Company A that did so well was an online seller of toys. Company B, up only 22%, was an online seller of books. And with that, you can probably see where I'm going with this story. So what we actually see here is that these two companies were Amazon and eToys.

So Company A was eToys, an online seller of toys that filed for bankruptcy. Company B, of course, was Amazon, which over the next 20 years, gave investors a 45x return on their investment. Pretty different outcomes. So an investor who identified the theme of e-commerce correctly, may have knocked it out of the park with Amazon, or might have lost it all with eToys. And that's the challenge of single stock picking against these themes.

Now, what about a traditional index? If you diversify, you take less of that single stock risk. The thing here is, you don't want to be too diversified. So let's look at the NASDAQ Composite over the same 20-year period. An investor may have said to him or herself: *you know what? I'm going to invest in technology more broadly to capture this e-commerce opportunity.* Well, over the same 20 years, the NASDAQ Composite saw about a five times return. And hey, it's not bad to quintuple your money, over a 20-year period, but that's a far cry from that 45x return you would have seen with Amazon. And the reason for that is, that tech-focused index isn't targeting a specific theme like e-commerce. It's targeting many themes around technology. And I would submit, e-commerce as a theme actually goes far beyond technology.

So we've talked about these two approaches, selecting single stocks. Risky. It can work out really well if you get Amazon, not so well if you get eToys. We've talked about a traditional index, like the NASDAQ Composite, where you would have done well, but not nearly as well as with Amazon. And again, this is a Goldilocks example, right? So what we think might be just right is the megatrend approach. If you invest in a megatrend index, focused explicitly on e-commerce, in this case, MSCI's e-commerce benchmark, you would have had a 28x return over this period. Not quite what you got with Amazon, but you didn't take the risk of getting an eToys, and you significantly outperformed the NASDAQ or that broad traditional technology index.

And so I think the focus here shouldn't be how do you pick the FAANG. The real question is actually just, how do you spot the trend? And I would argue the trends are often on the tips of our tongues. Are we wondering if self-driving cars are cool? If they're interesting? Are we curious, how they're going to change our commute or our communities? Do you wonder, as I do, whether your children will ever actually drive a car, themselves?

And not only are these themes relatable and all around us. I would argue they're intuitive. Will there be more self-driving cars on the road 10 years from now than there are today? That seems like a pretty likely bet to make. Now, of course, we have to go deeper still in really understanding long-term themes. And so BlackRock has put an incredible amount of work into laying out these five megatrends: our super highways into the future. And this is really the best thinking across our firm, around the world, and from investors of all shapes and sizes. And so let's click through what these five are.

The first would be technological breakthroughs: long-term adoptions of new technology, like cybersecurity or artificial intelligence. The second would be demographics: changes driven by aging populations and impacting breakthroughs in areas like genomics and immunology. Third, we have rapid urbanization: the rise of cities in emerging markets and their revitalization in developed markets that many investors are looking to access through infrastructure. Fourth, climate change: shifts in preferences on the parts of consumers, corporations, and governments towards a cleaner, greener tomorrow, playing out through investments in areas like electric vehicles and clean energy. And last, but certainly not least, emerging global wealth: the rise of the middle-class consumer in emerging markets, especially in places that investors are looking to, like China and India. So these are our five megatrends, and we're going to take a quick tour through them now.

We'll start with everyone's favorite, technological breakthrough. But actually, as we do that, I'd like to ask you a question. Two questions, actually. So the first question is this: would you rather sacrifice for one week your smartphone or dessert? The second question is: would you rather sacrifice for one week your smartphone or alcohol? Your glass of wine at dinner or your beer at the ball game.

Think about the answer for yourself, and at the same time, we'll take a look at the national results. So, drumroll please, 50% of Americans are willing to give up dessert for their smartphone, and a whopping almost 75% are willing to give up alcohol in favor of their smartphone. Now, 20 years ago, these numbers would have been completely shocking. Even 10 years ago, they probably would have been surprising. But here and now, it's probably not that surprising at all. The smartphone has become an incredibly important part of our lives, and in really a short period of time, compared to things like sweets and alcohol that have been things humans have liked for hundreds, if not thousands of years. And of course, when we say that we don't want to give up our smartphone, it's not because we're enamored of this piece of glass and metal and plastic. What we're really saying is, in this day and age, we're not willing to be disconnected from the world.

And so, fundamental to this trend of technological breakthroughs is this idea of connectivity. You know, at the start of this year, there were about 35 billion internet-connected devices in the world, but by 2025, in less than five years, that will have more than doubled, to 75 billion devices. And over the course of 2020, with what we faced down during the pandemic, connectivity became that much more important. In fact, you probably tried, as I did, a range of new technologies, from telemedicine to tele-education to working from home. So connectivity is more important than ever and accelerating faster and faster, leading to opportunities in areas like artificial intelligence. It's really important, as we think about it, also in areas like cybersecurity because the more connected we are, the more challenges we may face. And that brings us to our first MegaRule.

So as we go through this section, in addition to touring the megatrends, we're going to tour three MegaRules by which BlackRock and iShares build our megatrend ETFs. The first of those rules is to weight for tomorrow. Not W-A-I-T. Quite the opposite, actually. We want to be thinking about the companies that have the potential to be the leaders of tomorrow. And let's take a look at that historically. Back in 2000, you can see who the top five firms were in the S&P 500-- Microsoft, GE, Cisco, Walmart, and Intel. Fast forward 20 years and the list looks fairly different. Microsoft stays at the top, but Apple, Amazon, Facebook, these are new companies that rode megatrends to prominence and weren't at the top or anywhere near it back in 2000. And what's interesting is, if you look at those companies in 2000, like GE, like Cisco, like Intel, these are companies that were innovators, right? They had written megatrends to their own prominence, but they didn't make it or remain in the top of the league tables when it came to 2020. And of course, all of this begs the question, who's going to be up top there in 2040? Now, by virtue of these companies being at the top of the S&P 500, they're already likely a large part of your portfolio. So, when we build you megatrend ETFs, we focus on the small and the mid-cap innovators that have the potential to be the mega-cap leaders-- to be the folks on the league table in 2040-- to be the players of tomorrow that you want to own today.

So our second megatrend is demographics and social change. And I referenced this earlier. Two of the areas of massive medical breakthrough that we're seeing are genomics and immunology, and part of that is driven by aging populations-- the fact that, in the next decade, there will be more grandparents than grandchildren in the United States for the first time in our history. That leads to more health care spending. That leads to more spending on medical breakthroughs and in these two areas in particular.

So genomics is really mapping human DNA and sometimes manipulating DNA and RNA. And in fact, while it cost \$2.7 billion to sequence a human genome in 2003, it cost less than \$1,000 today. That's enabling personalized medicine. It's also enabled us, again in 2020, facing the coronavirus, to come up with a completely and radically new form of vaccination, the RNA vaccine, that many of us may have received. And that vaccine is a groundbreaking form of genomics never before used in history. And that has the potential to be applied to any number of diseases that might threaten us in the future. Genomics remains an area of huge breakthrough, as does immunology, where we stimulate or destimulate the body's immune system to fight disease, particularly in areas of cancer treatments, where we're already seeing extended lives, boosting lung, renal, brain, and skin cancer survival rates.

Our third megatrend is rapid urbanization. Again, the rise of cities in emerging markets and their revitalization in developed markets. And the numbers here are fairly staggering. The World Bank estimates \$100 trillion of spending on infrastructure over the next 20 years. And in just the next 10 years, you can see where a lot of that's coming from. Cities like Delhi and Dhaka will add 9 million citizens each. Shanghai will add seven. Cairo will add five. I could go on. Emerging markets are growing their cities rapidly and creating infrastructure booms at the same time, but the infrastructure opportunity is also in developed markets where, in the West, in Europe, in the United States, as well as in Japan, infrastructure is in need of repair and revitalization. And in fact, again, this has been accelerated, given what we've seen over 2020 and into 2021, as governments around the world look to get their economies back on track by spending significantly on infrastructure to help make that a reality. Take Joe Biden's Build Back Better program, significantly driving infrastructure investments, for example, in the United States.

Our fourth megatrend is climate change and resource scarcity. You know, 80% of US consumers are actually willing to pay a premium today for an electric vehicle. Many corporations around the world are establishing

net zero targets for when they will no longer contribute pollution to the environment. And governments are setting more and more stringent standards around all of this. We see trillions of dollars of spending coming on clean energy, electric vehicles, and the like, to meet these goals of consumers, corporations, and governments. And again, spending to get economies back on track in 2021, isn't just focused on traditional infrastructure, like roads and bridges and tunnels. It's also focused on renewable infrastructure, which is a huge part of many of these government programs.

And that takes us to MegaRule number two, and this is about connecting the value chain. So if you want to invest in one of these clean energy themes, for example, say electric vehicles or self-driving cars, you can't just think about one company, say Tesla. That's usually what comes to mind first around electric vehicles. There's a range of companies that are playing in that space.

But not just car companies. Think about Valeo that builds the software and sensors to help self-driving cars navigate, Infineon that puts the batteries in an E-V, Albemarle that puts the materials into those batteries, and ABB that builds the electric vehicle charging infrastructure. So when we build our megatrend ETFs, we don't just pick one company or even one industry. We look at a whole value chain or ecosystem of opportunity.

We come to our last megatrend here, emerging global wealth. And I find these to be some of the most powerful stats of this presentation. China mints two billionaires on average every week. One to two billion people enter the global middle class every year and will over the next decade. 90% of those are from Asia, specifically emerging markets. And 44 people escape extreme poverty in India every single minute of every single day. And this rise in wealth in emerging market countries is supercharging a whole range of megatrends, as well as the global economy more broadly.

And that's what really informs our third MegaRule, this idea of thinking beyond borders. You know, in the United States, a lot of the success we've seen in companies in the stock market has been driven by the rise of various online technologies, but if you look at the United States, 300 million of us are already online. There's only about 35 million who are not yet online. We're pretty fully penetrated.

Compare that to China. Almost 800 million people already online, but more staggering, over 600 million people yet to get online. Combine that with a country like India, we're talking about one to two billion people who have never tweeted, never streamed, never liked, never made a mobile payment. And think about the opportunity that presents for growth, similar to growth we've seen in the US over the last decade or so, first taking hold across over a billion people in just these two countries alone.

And so that's why when we build these megatrend ETFs. We have to think beyond borders. We have to think globally about these opportunities, because at the end of the day, it's all about owning the future. And that's what iShares Megatrend ETFs seek to deliver. So across the five megatrends we've talked about, you see a range of tickers and themes to help you access megatrends in your portfolio. These range from I-H-A-K, our cybersecurity ETF, I-R-B-O to capture robotics and artificial intelligence, I-D-N-A to capture those breakthroughs in genomics and immunology. I-F-R-A, one of our most popular ETFs capturing the US infrastructure boom being driven in this post-pandemic world and by government spending. I-C-L-N, and I-D-R-V, capturing the boom in global clean energy and electric vehicles, respectively. And then of course, C-N-Y-A, capturing access to mainland China consumers and their rising incomes. But if you want to keep it simple, there's one ticker, iShares' X-T, our exponential technologies ETF, that can give you access to all five of these megatrends right in your portfolio.

So we covered our MegaRules: to weight for tomorrow, to connect the value chain, and to think beyond borders. That's how we build these ETFs to help you capture long-term megatrend outperformance. And as we close, I would just encourage you to put your money where your mind is. The world is going to be different after Covid-19, and now is an opportunity not just to rebalance or even reinvest portfolios but to reimagine them for that future. That's what iShares Megatrend ETFs are designed to do.

Thank you so much for joining us today. We've built megatrend ETFs to help you access the future, and we hope in this conversation, we've provided a little bit of education as well about what that future might hold.

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