

## Develop an Affinity with Thematic Investing

Thematic investing involves building portfolios in order to capitalize on secular trends. Rather than investing in a single sector, such as financials, thematic investing offers focused exposure to a strategic opportunity that can cut across several different sectors.

For example, the current Tech adoption boom has benefitted companies not just in the Information Technology sector (like Apple or Microsoft), but also Communication Services (like Netflix, Google and Facebook) and Consumer Discretionary (like Amazon).

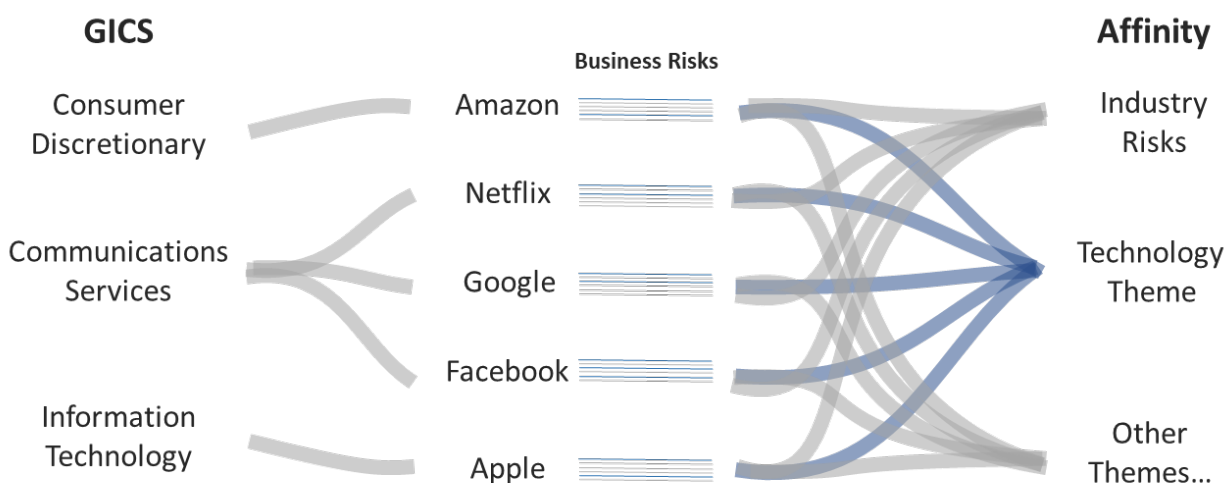
By splitting companies into their component business risks, stocks that have affinities to (or relationships with) a particular theme can be identified. Syntax® Affinity™ is an online portfolio analysis suite which can be used to quantify exposures to economic sectors and secular themes by breaking down each company into its associated business risks. This enables a portfolio to be viewed through multiple lenses. For example, using the Affinity lens, the FAANG portfolio in Figure 1 clearly aligns with technology risk.

af·fin·i·ty

A similarity of characteristics suggesting a relationship

Source: OxfordLanguages

Figure 1. Characterizing the FAANG companies: GICS versus Affinity



Source: Syntax

## Affinity Uses Product Level Classifications

Affinity addresses a shortcoming with industry classification systems such as GICS (Global Industry Classification Standard) that are used to construct many thematic index products. GICS designates a single industry code to each company, even though the company may have a wide array of products and be exposed to many different business risks.

Unlike GICS, Affinity uses a Functional Information System (FIS™), a standardized method for classifying companies. In Affinity, each product line is tagged with a standardized set of detailed codes relating to its product type, supply chain and customer groups. For example, Amazon (AMZN) is broken down into Amazon.com, Amazon Marketplace and Amazon Web Services and each of these products is classified separately (Figure 2). It is clear from the tags that all three of Amazon’s largest product lines have technology related business risks.

Indeed, the three most correlated stocks with Amazon in the S&P 500 are Microsoft, Google and Adobe, so it has tended to trade more like a technology than a consumer company. Classifying Amazon as just a Consumer Discretionary stock is potentially dangerous as investors with AMZN in their portfolios may be far more exposed to Technology business risks than they think.

**In Affinity, a company’s product lines are tagged with detailed codes relating to the product type, supply chain and customer groups**

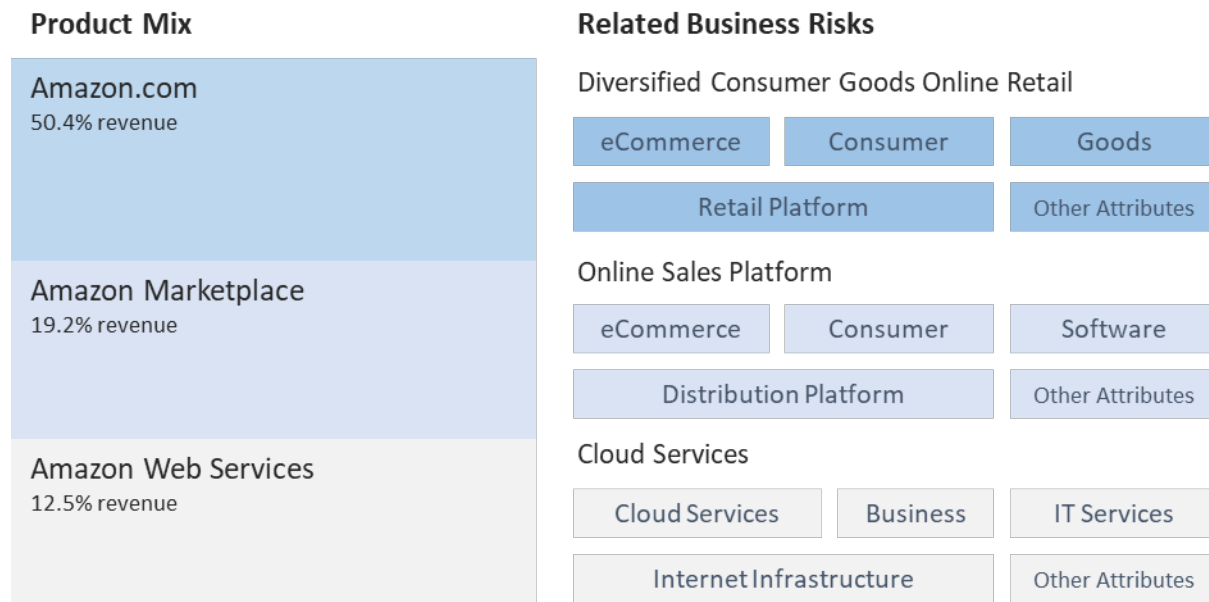
### Correlation with Amazon

GICS Sector*	0.36
Microsoft	0.64
Google	0.61
Adobe	0.61

\* Equal Weight S&P 500 Consumer Discretionary Sector.

Correlation calculated from weekly returns over the 5 years ending 9.25.20.

Figure 2. Classifying Amazon’s Business Risks using FIS



Source: Syntax, Amazon.com 2019 Form 10-K Annual Report.

## Affinity Can Uncover Latent Thematic Exposure

Classifying the attributes of a company using FIS tags allows Affinity to query an investment universe, such as the S&P 500 or MSCI EAFE and determine which companies have exposure to the specified theme.

For example, to acquire a broad-based technology exposure, one could screen stocks that directly produce software or hardware products or have a product which is used in IT. The user can keep adding rules to narrow or broaden the scope of the query (Figure 3).

Figure 3. Affinity uses the FIS Query Language

### Technology Query Definition

Company product is Software or  
 Company product is Information equipment or  
 Company product is used in IT or  
 Company utilizes Proprietary information platform in its product or  
 ...other clauses

Source: Syntax.

The above query found 95 US large-cap companies with Technology related business risks across six different GICS Sectors. It also excluded many non-tech companies in the S&P 500 Communications Services sector, which includes media companies like Fox, Viacom, and Disney that have a low correlation to technology stocks and have underperformed the index over the past five years. The average media stock went down 3.7% over the past year, whereas the rest of the Communications Services sector went up 13.7%.

The clean, yet broad-based technology exposure delivered stronger performance over the past five years than the average stock in the GICS Information Technology or Communication Services sectors (Figure 4).

Figure 4. Performance of Technology Thematic stocks versus GICS sectors

	#	Average Stock Performance		
		1 year	3 years	5 years
<b>Affinity Technology theme</b>	<b>95</b>	<b>21.0</b>	<b>18.7</b>	<b>21.7</b>
Information Technology	72	19.0	14.0	15.5
Communication Services	26	6.3	6.9	10.0
<b>Info. Tech &amp; Comm Svcs.</b>	<b>98</b>	<b>15.6</b>	<b>12.1</b>	<b>14.1</b>

Source: Syntax. Average total return of the current constituents of each index. Priced at 9.21.2020 (annualized).

**The flexible query language allows Affinity to capture exposure to a wide range of different themes**

**The broad, yet focused technology exposure delivered stronger returns than the GICS IT and Communications sectors**

Investors looking to make a play on technology would do well to discern the different business risks of each individual stock to determine whether they will benefit as the technology theme plays out, rather than just buying the entire Information Technology and Communications Services sectors. Affinity data is designed to help them do precisely this.

Themes are not always positive for companies. Amazon's innovation has been a headwind for brick and mortar retailers. Affinity can easily be used to identify companies outside of the Consumer sectors with significant exposure to that theme, perhaps to be excluded from a portfolio or even shorted.

Figure 5. Brick & Mortar query

### **Brick & Mortar Query Definition**

Company is in S&P 500 ex Consumer universe where  
 Company product is sold in Brick & Mortar Retail or  
 Company utilizes Brick & Mortar Retail to sell its product

As was the case with the Technology thematic, the companies exposed to the Brick & Mortar theme can be found in many different sectors. The majority are in the Consumer Staples or Consumer Discretionary sectors, but we also see Mall Operators in Real Estate, Point of Sales Terminals in IT and sector specific retail companies, such as CVS in Health Care. Outside of the traditional consumer universe, Affinity suggests five companies have significant Brick & Mortar exposure in the S&P 500 (Figure 6).

Figure 6. Results of Brick & Mortar exposure query

		<b>Average Stock Performance (ann.)</b>		
	<b>Sector</b>	<b>1 year</b>	<b>3 years</b>	<b>5 years</b>
Federal Realty Investment Trust	Real Estate	-43.8	-13.3	-8.6
Regency Centers Corp.	Real Estate	-42.9	-12.4	-6.1
Simon Property Group Inc.	Real Estate	-57.1	-22.9	-15.4
Realty Income Corp	Real Estate	-19.5	5.6	9.5
<b>Average Performance</b>		<b>-40.8</b>	<b>-10.7</b>	<b>-5.1</b>
Real Estate Sector (Equal weight)		-17.0	1.0	4.0
<b>CVS Health Corp</b>	Health Care	<b>-7.1</b>	<b>-8.3</b>	<b>-7.9</b>
Health Care Sector (Equal weight)		15.2	9.8	10.2

Source: Syntax. Average total return, priced at 9.21.2020 (annualized).

The headwind that the Brick and Mortar retail exposed Real Estate companies have faced since the online shopping trend has driven consumers away from shopping malls can be seen in their performance over the past five years. The four REITs in Figure 6 went down 5.1% in the last five years on an annualized basis, whereas the average REIT rose 4.0%. CVS also underperformed its sector, losing 7.9% (annualized).

### **Develop an Affinity with Thematic Investing**

Affinity can identify dozens of thematic exposures, including Technology, Tourism, Retail, ESG, Infrastructure, Commodities and many more. Each theme includes granular sub-themes, like Agriculture or Fossil Fuels.

With hundreds of product categories and myriad business functions, the thematic possibilities permutations are endless. If a theme can be described, it can be built in Affinity, and investors can focus exposure to their desired investment theme.

## Important Disclaimers

Past performance is no guarantee of future results. Performance of the Affinity Technology thematic and Brick & Mortar Real Estate companies index is hypothetical and has been calculated by Syntax, LLC. Charts and graphs are provided for illustrative purposes only.

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