
CYBERSECURITY: A CRITICAL STOCK PICKING THEME IN AN INCREASINGLY DIGITAL WORLD

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In today's interconnected digital landscape, we believe cybersecurity has emerged as a crucial investment theme that demands attention from savvy investors. The recent global IT outage linked to CrowdStrike, a major player in the cybersecurity industry, serves as a stark reminder of both the importance and the challenges faced by this sector. While such incidents may cause short-term disruptions, they ultimately underscore the growing need for robust cybersecurity solutions, potentially fueling long-term growth in this theme.

The CrowdStrike Incident: A Wake-Up Call

On July 19, 2024, a widespread IT outage affected numerous businesses worldwide, including banks, airlines and media outlets. This disruption was reportedly linked to CrowdStrike's Falcon sensor, a key component of their cybersecurity suite. The incident led to grounded flights, disrupted financial services and even impacted emergency services in some regions.¹

While such events can temporarily shake confidence in cybersecurity providers, they also highlight the critical role these companies play in maintaining the smooth operation of our digital infrastructure. The far-reaching impact of this outage demonstrates just how deeply integrated cybersecurity solutions have become in our daily lives and business operations.

Why we Believe Cybersecurity Remains a Compelling Investment Theme

Despite short-term setbacks, several factors continue to make cybersecurity an attractive theme for stock pickers:

- **Escalating Cyber Threats:** The frequency and sophistication of cyberattacks continue to rise. By 2025, cybercrime is projected to cost the world \$10.5 trillion annually, nearly 10% of global GDP.²
- **Growing Market:** The cybersecurity market is expanding rapidly. Gartner estimates that global cybersecurity spending could increase by 14% year over year in 2024, reaching approximately \$215 billion.³
- **Technological Advancements:** The emergence of new technologies like AI, cloud computing and Internet of Things (IoT) creates new security challenges, driving demand for innovative cybersecurity solutions.
- **Regulatory Pressures:** Increasing data protection regulations worldwide are forcing companies to invest more in cybersecurity measures.
- **Remote Work Trend:** The sustained shift toward remote and hybrid work models has expanded the attack surface, necessitating more comprehensive security solutions.

- **Generative AI's Impact:** The rise of generative AI technology significantly influences the cybersecurity landscape. While it can aid attackers and improve the sophistication of threats, it also aids in developing advanced defense mechanisms, such as data analysis for identifying vulnerabilities and automating repetitive tasks.

Conclusion

While incidents like the recent CrowdStrike-related outage may cause short-term volatility, they ultimately reinforce the critical need for robust cybersecurity solutions. As our world becomes increasingly digital, the importance of cybersecurity will only grow. For investors, this presents a compelling long-term opportunity to capitalize on a theme that is not just a trend, but a fundamental necessity in our modern, interconnected world.

It is interesting to remember:

- SolarWinds faced a devastating supply chain attack in 2020, and it was particularly pernicious in the sense that the vulnerability was exploited in the users of SolarWinds' products—not simply the company itself. As of July 22, 2024, SolarWinds is still publicly traded and has a market capitalization of nearly \$2.0 billion.⁴ The flow of news and headlines in 2020 and 2021 were so negative that I'll admit I was surprised the company is 1) still trading and 2) has a market capitalization above \$1 billion. In its most recent investor presentation, the company reported growth in annual recurring revenue of 36%.⁵
- In the second half of 2023, Okta suffered a data breach where hackers stole data from all customer support users.⁶ As Okta's business is securing digital identity, this is not a great headline. In 2022, there was a breach where some Okta customers were impacted by a breach from LAPSUS\$, a hacking organization.⁷ If we look at Okta's market capitalization as of July 22, 2024, we see a figure of nearly \$16.0 billion.⁸ In the most recent quarter, subscription revenue at Okta grew 20%.⁹

I mention these two companies simply because it is important to keep perspective. We never know the future, but we do know that if we look at history, there are examples of companies that have been hacked in significant ways—making global news—they have come out the other side. For those that can keep a longer-term perspective, sometimes these kinds of events signal interesting points of entry for investors, particularly those investors who have been concerned about valuations in the past.

The WisdomTree Cybersecurity Fund (WCBR) Helps Capture the Theme Effectively

The [WisdomTree Cybersecurity Fund \(WCBR\)](#) is designed to track, before fees and expenses, the total return performance of the [WisdomTree Team8 Cybersecurity Index](#). In discussing the strategy, we tend to highlight the following:

- **Expert Partnership in Cybersecurity:** The strategy leverages our expert partner, Team8, to measure the exposure of cybersecurity companies and their products and services to key developing themes. This approach ensures a comprehensive evaluation of the companies' alignment with critical industry trends, enhancing the Fund's ability to capitalize on emerging opportunities within the cybersecurity theme. Industry professionals at Team8 have worked in the Israeli Defence Force's Unit 8200 and the National Security Agency (NSA) in the U.S., to name a few.

- **Systematic Approach Highlighting Growth and Exposure:** The strategy benefits from the discipline of a systematic approach combined with active expert selection. Modified equal-weighting and semi-annual rebalancing help mitigate over-valuation risk. Only companies with high exposure to at least one defined cyber theme and meeting the revenue compound annual growth rate (CAGR) requirement are included in the portfolio. The weighting tilts the portfolio toward companies with the broadest high exposure to the themes and the fastest revenue growth within the theme.
- **Low Overlaps with Tech Benchmarks:** The strategy’s low overlaps with major tech benchmarks like the [NASDAQ 100 Index](#), as of June 2024, provides investors with unique exposure. This differentiation allows access to opportunities beyond traditional tech indexes, focusing on innovative and emerging segments. By avoiding heavy concentration in well-known tech giants, the strategy offers a balanced approach, aligning with forward-looking investment trends.

Bottom Line Picture as We Enter the Second Half of 2024

When I have spoken to investors in 2024, for the most part, they have been unhappy with the cybersecurity theme. In fact, wisdomTree tracks the thematic universe of U.S. ETFs, and we find that, out of roughly 45 distinct thematic topics into which we group hundreds of ETFs, cybersecurity was the second-worst in terms of outflows, seeing investors remove about \$1.1 billion during the first six months of 2024.¹⁰

We understand that performance of cybersecurity strategies has lagged that of the larger market capitalization technology firms capturing the lion’s share of headlines, but to be the topic with the second-most outflows across all U.S. thematic topics is quite a statement. Even outside of the CrowdStrike incident, it’s possible that sentiment is too bearish for the reality. It’s difficult for us to rationalize the excitement about Nvidia and AI and not think about all the new cybersecurity tools that will ultimately be required.

In setting up for the second half of 2024, we wanted to try to put things into a better context.

First, we must always show the standardized performance as of the most recent quarter-end. In this analysis, we compare [WCBR](#) to two growth-oriented performance benchmarks. We look at the [Russell MidCap Growth Index](#) because we wanted to show a measure of the performance that was growth-oriented but did not include Nvidia, Microsoft, Alphabet, Amazon, Meta Platforms, Tesla or Apple—the so-called Mag 7. We then also showed the Russell 1000 Growth Index that does include these large companies.

In figure 1, one of the starkest comparisons occurs when looking at [WCBR](#) (either NAV or market price) on a year-to-date basis compared to a one-year basis. We will remind people just how strong the [WCBR](#) performance was in the second half of 2023 even if it has been very weak in 2024 so far.

Figure 1: Standardized Performance

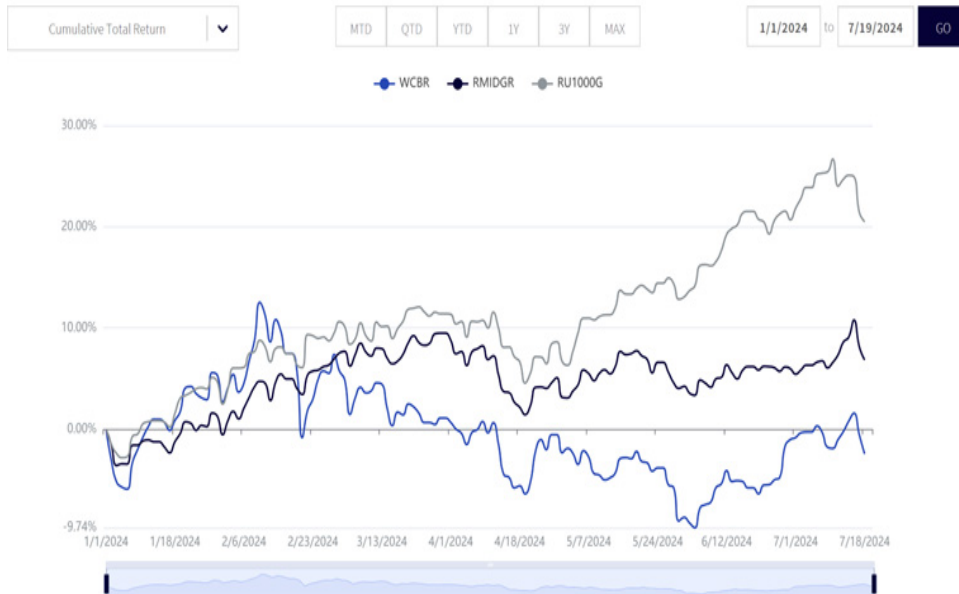
Fund/Index Name	Fund Ticker Symbol	Fund Inception Date	Fund Expense Ratio	YTD	1-Year	3-Year	5-Year	10-Year	Since Fund Inception
WisdomTree Cybersecurity Fund (NAV)	WCBR	Jan 28, 2021	0.45%	-1.03%	29.72%	1.06%	N/A	N/A	1.24%
WisdomTree Cybersecurity Fund (MP)	WCBR	Jan 28, 2021	0.45%	-1.14%	29.29%	0.94%	N/A	N/A	1.21%
Russell MidCap Growth Index				5.98%	15.05%	-0.08%	9.93%	10.51%	N/A
Russell 1000 Growth Index				20.70%	33.48%	11.28%	19.34%	16.33%	N/A

Source: wisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, as

of 6/30/24. NAV denotes total return performance at net asset value. MP denotes market price performance. Past performance is not indicative of future results. Investment return and principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance and to download the Fund prospectus, click [here](#).

Investor sentiment toward cybersecurity does tend to take the current year into account, so we see how [WCBR](#) has underperformed both the [Russell MidCap Growth Index \(RMIDGR\)](#) and the [Russell 1000 Growth Index \(RU1000G\)](#) in figure 2.

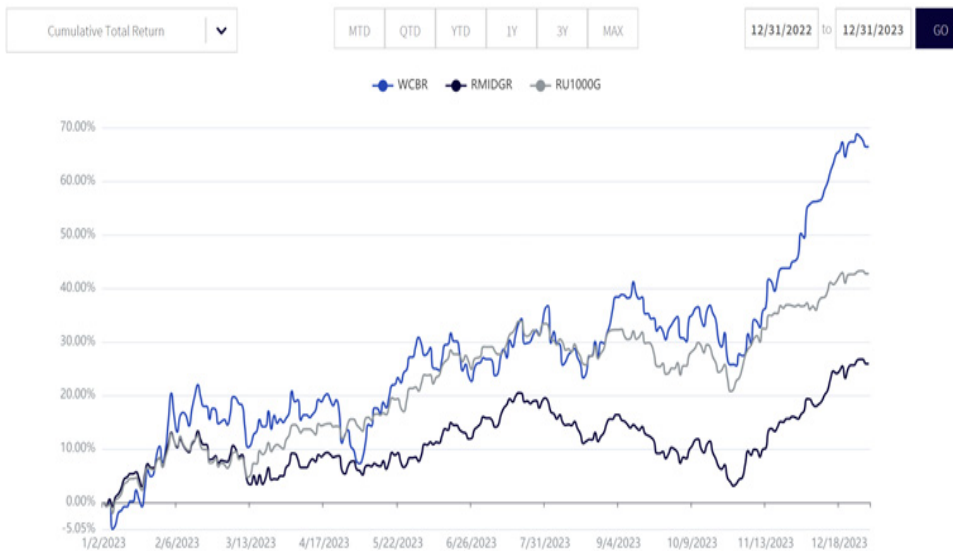
Figure 2: Year-to-Date Performance in 2024



Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, as of 7/19/24. WCBR represents NAV. NAV denotes total return performance at net asset value. MP denotes market price performance. Past performance is not indicative of future results. Investment return and principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance and to download the Fund prospectus, click [here](#).

But, the tough performance of 2024, in our opinion, is at least partly due to the strong performance of 2023. To understand why we say that, look at the roughly 40% rally upward in [WCBR](#) from roughly October 31, 2023, to December 31, 2023. This was a strong two-month period, characterized by expectations of falling interest rates in early 2024. This expectation did not manifest itself in actual policy decisions in early 2024—particularly at the U.S. Federal Reserve—so we view a lot of the lackluster 2024 performance of [WCBR](#) as a bit of a correction in this misplaced expectation.

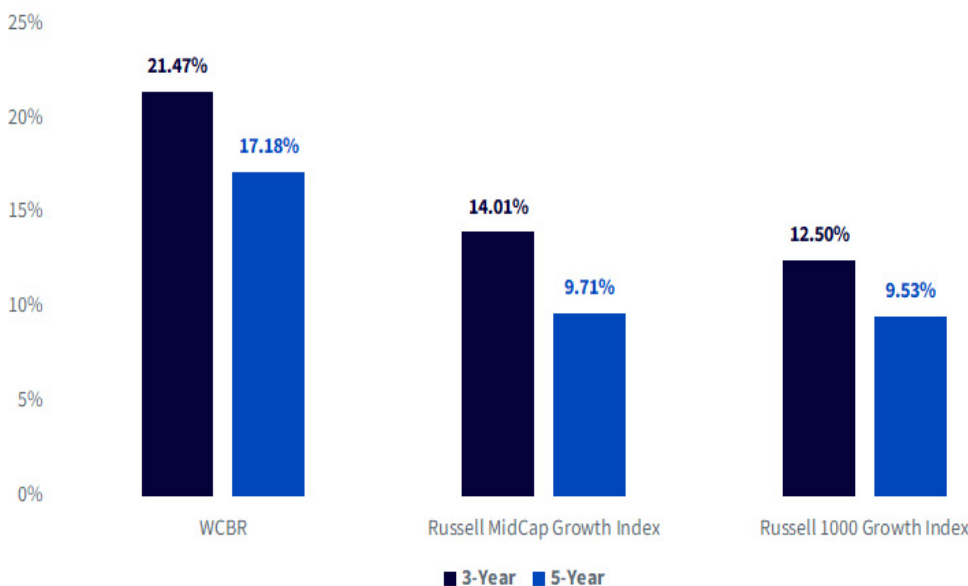
Figure 3: Remembering 2023’s Experience



Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, as of 12/31/23. WCBR represents NAV. NAV denotes total return performance at net asset value. MP denotes market price performance. Past performance is not indicative of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance and to download the Fund prospectus, click [here](#).

In our opinion, thematic funds are about growth, in that there needs to be a reasonable expectation that the growth within a theme has a reasonable expectation of being above that of the growth of the broad market. In figure 4, we ignored the most recent year and focused on three- and five-year periods, also looking at the median as opposed to the average or weighted average to be less influenced by outliers. We see that [WCBR's](#) sales growth does look compelling relative to both the Russell MidCap Growth and Russell 1000 Growth indexes. This is something we will always monitor, as there are never any guarantees of future growth.

Figure 4: Median Sales Growth over 3-Year and 5-Year Periods



the Fund's prospectus for specific details regarding the Fund's risk profile.

For the top 10 holdings of WCBR please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/megatrends/wcbr>

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

Nasdaq 100 Index: Includes 100 of the largest domestic and international non-financial companies listed on The Nasdaq Stock Market based on market capitalization. The Index reflects companies across major industry groups including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology. It does not contain securities of financial companies, including investment companies.

Russell Midcap Growth Index: Measures the performance of the mid-cap growth segment of the U.S. equity universe. It includes those Russell Midcap Index companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Growth Index: A measure of the large-cap growth segment of the U.S. equity universe, selecting from the Russell 1000 Index.