Are Thematic Equity Products on the Cusp of Tech Disruption?

The magnitude of SpaceX's IPO raised questions about the relevance, the construction, and the mechanics of index funds. Within a few days, hundreds of millions of people suddenly had exposure to a rocket company, whether they wanted it or not. Most of them did not even know it happened. Their index fund had quietly reshuffled, as index funds do, making the rocket company a new line item in their retirement portfolio.

The question is not whether buying SpaceX at IPO is a good or a bad investment; it might very well be a great one. The question is around the entire premise of passive indexing: that investors don't need to have opinions and could simply buy "the market" through an index governed by a committee following the historically predetermined rules. SpaceX's investment case is unique for multiple reasons. First, it carried the largest IPO valuation by far at around $1.75T, implying a valuation roughly 95x revenue. Second, SpaceX fast-tracked its entry into the Nasdaq-100, FTSE Russell, and MSCI indices, which is historically unprecedented.[1] As such, about 30% of SpaceX's free float will be passively owned within just 15 days of trading; under the old rules, that figure would have been roughly 4%.[2] No company has ever had multiple major index providers rewrite their seasoning rules to accommodate a single IPO. SpaceX's precedent paves the way for Anthropic and OpenAI to enter everyday retirement accounts. Most people assume the indices governing trillions in passive capital are rigorously objective, but indices like the S&P 500 are ultimately curated by a small committee at a private company that meets behind closed doors, and exercises exceptions to its rules, meaning a handful of individuals act as gatekeepers to the largest pool of automatic capital allocation.

We believe that with the emergence of fee-free trading and direct indexing, the mechanics and committee-led structure behind incumbent indices are becoming obsolete as investors now have the ability and the option to personalize indices to their preferences, at low cost, and select whether or not they want to invest in SpaceX within their broad market exposures.

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Why ETFs Initially Succeeded, and Where They Are Facing Disruption Now

When the first ETF launched in 1993, it stripped away the accumulated inefficiencies of the mutual fund wrapper, offering investors passive exposure at a fraction of the cost with intraday liquidity and tax efficiency that the mutual fund structure simply could not match. ETFs rapidly became popular; global ETF assets under management have grown from roughly $1.3T in 2010 to $22.1T today.[3] US-listed ETFs hold ~67% of global ETF AUM with $14.9T in assets and $11.9T in equities alone.[3] While the US equity mutual funds market size remains larger at $16.5T as of Q1 2026[4], a significant share of the US ETF market growth came at the expense of mutual funds, with US equity ETFs taking in $3.6T of net inflows since 2010, compared to the $3.8T net outflows in US equity mutual funds.[3]

When we look at disruption, ETFs based on indices, what are called broad-based ETFs, remain the dominant category of the US ETF market at $5.2T[3], and are difficult to replicate in any practical sense, even with direct indexing. The liquidity is deep, the rebalancing infrastructure is vast, the regulatory familiarity is entrenched, and the sheer scale of the wrapper creates efficiencies that no individual investor can match by buying the underlying constituents. If investors want exposure to "the US large-cap equity market," SPY (Standard & Poor's Depository Receipts S&P 500 ETF Trust)[5] and VOO (Vanguard S&P 500 ETF)[6] at ~3 to ~9 basis points of fees remain remarkably good products. As the market got larger and ETF indices commoditized, the broad-based equity indices faced fee pressures with average fees decreasing from 21 basis points in 2017 to 14 basis points in 2025, increasing the stickiness of the products.[7]

We believe that the disruption lies at the other end of the spectrum with what we call thematic ETFs. The sector ETF, the style ETF, the “clean energy transition” or “high growth mid-cap” charge hefty fees for the privilege of following a custom rules-based methodology. Combined, these US thematic ETFs now represent $4.1T in assets, growing at 18% per annum since 2018.[3] These funds charge anywhere from 40 to 75[8] basis points depending on the industry, and the logic behind them can now be replicated at near-zero marginal cost by direct indexing platforms. The compounding cost is not trivial. On $100,000 compounded at 7% gross over 30 years, a 40 basis point annual fee costs roughly $81,000 in foregone growth; at 75 basis points, that figure rises to approximately $145,000. That is the price for the convenience of having someone define the rules of investors’ portfolios. And it used to be a price worth paying, because replicating those rules was

operationally complex, time-consuming, and inaccessible to most investors. These constraints are evaporating with AI, and with them, so is the defensibility of the thematic ETF. This defensibility used to rest on three pillars, and technology is collapsing all of them.

The first was the cost and complexity of replication. Building a rules-based portfolio that tracked a specific theme, like AI semiconductors or space companies, required data feeds, rebalancing infrastructure, fractional share capability, and ongoing maintenance. This was expensive enough that paying up to 75 basis points felt reasonable. Today, direct trading and indexing platforms handle all of this programmatically. AI can add and delete names in a rules-based manner based on personal preferences and set auto-rebalance on a continuous basis.

The second was brand trust and regulatory familiarity. Investors knew what a "Nasdaq Biotechnology ETF" was. They trusted the methodology committee. They understood the wrapper. But this pillar erodes when AI agents can evaluate and compose methodologies dynamically. You do not need to trust a committee when you can define your own criteria in natural language and have a platform execute it. "Give me US-listed companies with more than $1B in revenue and more than 20% of sales from AI infrastructure" is a portfolio instruction and can be a better expression of what the investor actually wants.

The third was the liquidity premium of established ETFs. This was never strong for niche products. A thematic ETF with $200M in AUM does not trade like SPY. The bid-ask spread is wider, the market depth is thinner, and the creation-redemption mechanism is less efficient. Direct indexing sidesteps this entirely as its execution cost is based on the underlying securities, not on the ETF wrapper.

For broad-based indices, all three pillars still hold to varying degrees. But for the long tail of thematic products, the moat has drained.

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Direct Indexing: What It Is, How It Works, and Who It Is For

We believe that direct indexing is the successor, and it is important to understand what it actually offers rather than treating it as a buzzword.

Platforms like Tilt charge no management fees, which is disruptive alone, but the product is also structurally superior in several ways:

- Personalization: investors define exactly their desired exposures and exclusions
- Tax optimization: direct ownership of individual securities enables continuous tax-loss harvesting at the individual position level
- Improved cost structure on execution: investors' bid-ask spread is based on the underlying securities, not on the ETF itself, so they avoid the wrapper-level spread premium that exists on thinner products
- AI-enabled portfolio management: AI now drives continuous auto-rebalancing by automatically adding and removing assets according to custom rules

These platforms go further than simple replication. They allow individual investors and portfolio managers to make granular bets on sectors that others could not or did not have the desire to make before. The barrier to expressing a specific thematic view has collapsed. Natural language portfolio construction makes this accessible to anyone, not just quants. The shift is from subscribing to someone else's index methodology to defining your own exposure. If investors want SpaceX, they can buy it.

The question for incumbents is whether they can adapt to a world where methodologies are consumed as infrastructure rather than licensed as intellectual property.

We believe that the thematic ETF distributors, the robo-advisors, and digital discount trading platforms will be the primary drivers of adoption. They are already competing on fees and personalization, and direct indexing is the natural next step in their value proposition as they look to offer more customized solutions and push costs even lower for their clients.

The enabling infrastructure is also there now, with companies like Alpaca providing the API-first trading infrastructure that allows brokerages and platforms to offer fractional share trading and custom portfolio construction programmatically. Companies like Seeds are providing financial

advisors with the tools to offer direct-indexed portfolios and allow advisors to build portfolios tailored to their clients. Direct indexing platforms operate at the infrastructure layer, handling continuous rebalancing and methodology management.

It is also worth thinking about who actually uses ETFs today, and what they really want.

There are active investors, who are already trading individual names, options, and thematic positions. They were never truly ETF customers. What has changed is that technology now lets them take far more granular positions than a sector ETF ever could, with targeted investments on a set of specific companies or themes, expressed precisely rather than through a blunt wrapper.

There are the "I want market exposure" investors, who are the core ETF buyers. They wanted exposure to a market or a theme, but lacked the tools to be specific. That constraint is gone. You can now say "index me to AI hardware" or "give me GPU exposure excluding NVIDIA" rather than buying a broad tech ETF and hoping it approximates what you had in mind.

And there are the "help me manage my money" investors, who rely on a wealth advisor. These advisors of the future will make their investment offerings feel personal and provide a personalized investment portfolio of individual securities tailored to individual clients' preferences.

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Who will be the winners and losers in the shift to direct indexing?

Consumers win. Lower fees, better tax efficiency, full personalization. The end investor captures the value that used to sit with ETF manufacturers.

Distribution and brokerage platforms win, including robo-advisors and discount trading platforms. They capture a share of the fee streams that currently flow to ETF manufacturers. Direct indexing shifts the economics from the product manufacturer to the distribution layer. If you are the platform through which investors express their preferences, you have pricing power. If you are the wrapper around someone else's methodology, you do not.

Infrastructure providers win. The companies building the plumbing – rebalancing engines, trading APIs, methodology management tools – are the picks and shovels of this transition.

Sector-specific and thematic ETF manufacturers lose. Their product is a rules-based methodology wrapped in a fund structure. When the methodology can be replicated for free, and the wrapper is no longer necessary, the margin disappears. This does not happen overnight, but the direction is unambiguous.

Niche index licensors lose. Their licensing revenue from thematic ETF issuers erodes as direct indexing platforms reconstruct equivalent methodologies without a license. The business model depended on the contract between the methodology provider and the fund issuer, and that contract is becoming optional.

Large-cap broad-based index providers survive. It will remain hard to replicate the cost efficiency of VOO or SPY versus buying the constituents individually. The liquidity, the rebalancing scale, and the operational simplicity of a single-line position in a broad index are real advantages that direct indexing does not yet match.

ETFs served their purpose for a generation. They democratized market access, drove fees down, and made it possible for any investor to get diversified exposure to virtually any market segment with a single trade. That mattered, and we should not minimize it.

The next frontier is building on ETFs' success, but direct indexing platforms are breaking the cost model and enabling deeper personalization in a way that will completely disrupt the thematic ETF market. We believe the economics are moving from the thematic ETF manufacturers to the distribution platforms and the infrastructure providers. The world is moving to direct indexing, whether incumbents like it or not. The only question is how fast.

Sources:

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