

LO Funds

Global FinTech

Newsletter

Thematic Equities • Equities

31 July 2024

PERFORMANCE COMMENTS

In July, LO Funds–Global FinTech was up strongly and delivered one of its best monthly relative performances since the inception of the Fund. A long-awaited rotation away from the handful of stocks that have driven global markets for so long towards the laggards is finally underway. The immediate trigger was a subdued inflation print in the US, fuelling expectations of a September rate cut, which were confirmed by comments from Federal Reserve Chair Jerome Powell at the end of the month. In a market predominantly driven by passive flows and retail investors, what started small soon gathered momentum in the small- and mid-cap space. This was perhaps best illustrated by the double-digit outperformance of the Russell 2000 Index (+10.2%) relative to the Magnificent 7 (-0.6%) in July. The FinTech theme was also back in favour, with a strong start to the second-quarter earnings season. The combination of the rotation away from mega caps, the total capitulation of long-only sponsorship and solid earnings were the perfect ingredients for a solid outperformance by the Fund. Though this broadening trend is still young and will likely encounter days of reversal – as we witnessed on the last day of the month, with another surge of AI-driven capex enthusiasm for the Magnificent 7 – we feel encouraged by the trend change. As long as our portfolio companies continue to deliver earnings growth, momentum and flows will ultimately find their way and correct the massive undervaluation.

During the month, both sector and market cap allocation effects were positive as Financials strongly outperformed and mega caps, particularly Information Technology, lagged. The selection effect was very positive across all sectors and market caps. Encouragingly, the Fund gave a best-in-class performance relative to peers with a first-quartile result despite its conservative risk profile. This was helped by a contrarian positioning away from mega-cap momentum and into mid- and large-cap quality names with a strong value bias. The stocks that contributed most to the Fund's relative performance in July were TransUnion (+21%), Pathward Financial (+20%) and Virtu Financial (+24%). Flow

Traders (-17%), Block (-7%) and Hong Kong Exchanges (-9%) detracted most from relative performance. The portfolio's current positioning comprises 42% Established FinTech, 39% Enabling Technology and 19% Upcoming FinTech.

MARKET REVIEW

With the exception of Japan, where the BoJ raised interest rates, bond yields across the world dropped significantly in July, with the US 10-year bond yield ending the month at 4.05%. The Bloomberg Commodity index dropped another 4.5% during the month, driven by Energy, Metals and Agriculture. Gold was the exception, rising 4.7% with increasing concerns about the state of US finances. Gold was flat for the month and oil was up. The VIX spiked from 13 to 16 with an intra-month high of 19.

THEMATIC INSIGHTS

FinTech stocks provide natural hedges against rising inflation and a potential economic slowdown. Physical payment companies (payment processors and merchant acquirers that focus on physical stores as opposed to e-commerce) tend to benefit most from this natural hedge. Fundamentals for payment companies have been strong and the outlook remains positive. We do see a slowdown on the software side, which is why we have repositioned the portfolio away from the more expensive software names and towards the cheaper, quality payment companies. We also believe high-quality companies will benefit more than their loss-making hyper-growth peers, as long as access to credit is declining and borrowing costs are rising. This is because quality companies can fund growth from their profits and cash reserves. Management can also make a substantial difference, and most high-quality companies have a team that has gone through several economic cycles and can navigate most market conditions.

C-suite level discussions are focused on digital strategy, which has

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moved from “nice to have” to “must have” to remain competitive and meet the needs of all stakeholders. Shareholder rewards have gone to digital leaders: clients expect services to be able to continue in the event of another lockdown, and staff expect the right tools to perform their jobs in a work-from-home environment.

PORTFOLIO ACTIVITY

In July, we sold Envestnet after a takeout offer from a consortium led by Bain Capital. Since its addition to the portfolio in December last year, the position had delivered a 50% return. Furthermore, we took profit in FIS, Fiserv and Pathward Financial during the month. We used the proceeds to add to attractively valued laggards with improving momentum, like MSCI, TransUnion and EPAM. Our trading remains low, with an average holding period of more than five years.

OUTLOOK

The FinTech sector benefits from strong secular growth trends, such as the move away from physical cash, the digitalisation of financial services and the rising role of cybersecurity. The pandemic accelerated these trends through both push and pull forces – businesses have started to invest more in digital infrastructure so they can remain open during any future lockdowns, and consumers are demanding digital services for reasons of health, user experience or convenience.

Our investment process aims to select the highest-quality companies that can benefit from these trends to build a well-diversified portfolio. We believe the most important factors to watch are company-specific fundamentals such as revenue and earnings growth, return on equity (ROE), cash flow return on investment (CFROI) and balance sheet conditions. We also monitor macroeconomic factors such as interest rates, inflation and growth. We diversify between Financial and Technology companies, aiming to create a stable, disciplined portfolio that can weather a multitude of market conditions. Within our FinTech mandate, our portfolio management style is best described as “quality growth at a reasonable price”.

Certain segments of the FinTech market are extremely interesting from a valuation perspective. Payments, for example, is a segment that has been sold by many generalists and is only held by a handful of specialist long-only funds. Despite the extremely good fundamentals, active managers and passives all accumulate positions around the Magnificent 7 stocks. As a result, the quality growth at a reasonable price strategy proliferates, particularly in the payments sub-sector where growth (both earnings and topline) is higher than the market; quality is extremely high (this segment produces the top 10% of CFROIs globally) and valuations show a discount to the market.

Sincerely,

LO Funds–FinTech investment team

PERFORMANCE

31.07.2024	INCEPTION	AUM	MONTH-TO-DATE	YEAR-TO-DATE	INCEPTION-TO-DATE	2023	2022	2021
LO Funds – Global FinTech PA	6 April 2020	USD 81 mn	6.12%	0.60%	32.96%	15.29%	-28.90%	9.97%
LO Funds – Global FinTech NA			6.20%	1.11%	37.92%	16.27%	-28.29%	10.91%
Benchmark [3]			1.61%	13.10%	94.89%	22.20%	-18.36%	18.54%

Past performance is not a guarantee of future results. Performance is presented net of fees.

[1] Dividend accumulated private client share, net performance in USD.

[2] Dividend accumulated institutional client share, net performance in USD.

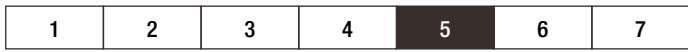
[3] MSCI All Countries World USD ND

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The following risks may be materially relevant but may not always be adequately captured by the synthetic risk indicator and may cause additional loss:

Concentration risk: To the extent that the fund's investments are concentrated in a particular country, market, industry, sector or asset class, the fund may be susceptible to loss due to adverse occurrences affecting that country, market, industry, sector or asset class.

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Active management risk: Active management relies on anticipating various market developments and/or security selection. There is a risk at any given time that the fund may not be invested in the highest-performing markets or securities. The fund's net asset value may also decline.

Before taking any investment decision, please read the latest version of the prospectus, the articles of incorporation, the Key Information Documents (KIDs) and the latest annual report and semi-annual report. Please pay attention to the Appendix B "Risk Factors Annex" of the prospectus.

Incorporation of extra-financial risks into the investment decision process may result in underweighting of profitable investments from the sub-fund's investment universe and may also lead the management of the sub-fund to underweight investments that will continue to perform. Sustainability risks may lead to a significant deterioration in the financial profile, profitability or reputation of an underlying investment and may therefore have a significant impact on its market price or liquidity.

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Finland: Finanssivalvonta (Fiva) - Financial Supervisory Authority (FIN-FSA), Snellmaninkatu 6, P.O. Box 103, FI - 00101 Helsinki, Finland; Website: <http://www.finanssivalvonta.fi>.

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