LOMBARD ODIER
INVESTMENT MANAGERS

LO Funds
Global FinTech
Newsletter

Thematic Equities • Equities

31 October 2024

PERFORMANCE COMMENTS

During October, the Fund was able to continue its strong absolute and relative performance. The two driving forces were similar to those we described for the previous month: China and the broadening of the market. Our Chinese stocks continued to perform well, especially in mainland China, where we own a well-diversified set of companies ranging from (Financial) software providers to payment companies. The re-opening of the Chinese market after Golden Week did cause some profit taking in our Hong Kong listed names. Those are still up considerably year-to-date but gave back some of that performance during the month. In our portfolio construction process, we anticipate these rotations by taking profit on strongly performing stocks and thereby locking in our gains. Although the broadening of the market seemed to press the pause button during the last couple of weeks, it was back with a vengeance on the last trading day of the month. We clearly saw the pullback in Mag7 names, though we do not own any of these as they are not pure-play FinTech, hence the relative performance contribution was significantly positive.

Earnings season is in full swing. About half of our portfolio holdings reported during October. The fundamentals look good, with about 6% revenue growth and close to 10% earnings growth for the quarter. Reactions to earnings updates were not always in line with those fundamentals, though. MSCI, for example, had good numbers but turned negative during the trading day. Similarly, PayPal is executing well on its strategy of focusing the business on profitability and divesting non-core areas, but the market disagreed for now, and the stock suffered from profit-taking. Our fundamental reasons for owning these stocks did not change, hence we kept our positioning. On the bright side, companies like Flow Traders, Tradeweb and Virtu, which all reported great numbers, saw a positive market response (albeit less enthusiastic than the negatives). We will give a full update on earnings in our next monthly newsletter once all companies have reported. As we have seen over many years of investing in FinTech, high-single-digit topline growth with 12-15% earnings growth is to be expected in the long run. The portfolio has been tracking those numbers very well, despite the market not always rewarding these quality compounders accordingly. That just means we have some catching up to do in terms of returns, which bodes well for the years ahead.

During the month, both sector allocation and stock selection contributed positively to portfolio returns. Especially within Financials, our allocation to the payment sector (which is now part of the financials industry) as well as our stock-picking within payments, were strong contributors. Upcoming FinTech performed best (+2.0%), followed by Enabling Technology (+1.4%) and Established FinTech (-0.8%). The stocks that contributed most to the Fund's relative performance in October were Yusys Technologies (+60%), Lakala Payment (+26%) and Block (+7.8%). The detractors for the month were Wex (-17.8%), Lufax (-23.2%) and Yeahka (-20.4%). The portfolio's current positioning comprises 44% Established FinTech, 38% Enabling Technology and 18% Upcoming FinTech.

MARKET REVIEW

In October, the day of central bank rate cuts saw an opposite reaction in 10-year bond yields, which rose from about 3.8% to 4.3%. Similar moves happened in Europe. Everyone is on the edge of their seats to see the outcome of the US elections at the beginning of November. This will certainly lead to some heightened volatility, but directionally, anything could happen. The Bloomberg Commodity index was down 2.3% during the month, with falling oil prices the biggest drag. The VIX increased from 16 at the end of September to 22.5. This is, to some extent, a reflection of the pre-election nervousness.

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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 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

We sold our remaining position in Worldline last month, having been mistaken in our thesis that new management would turn performance around. It seems more like a kitchen-sinking exercise at the moment, and we do not feel comfortable owning the stock during that process. We re-allocated the proceeds over the rest of the portfolio. We bought no new positions last month.

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

30.09.2024	INCEPTION	AUM	MONTH-TO-DATE	YEAR-TO-DATE	INCEPTION-TO-DATE	2023	2022	2021
LO Funds – Global FinTech PA	6 April 2020	USD 78 mn	2.59%	6.69%	41.00%	15.29%	-28.90%	9.97%
LO Funds – Global FinTech NA			2.67%	7.37%	46.47%	16.27%	-28.29%	10.91%
Benchmark [3]			2.32%	18.66%	104.48%	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

RISK AND REWARD PROFILE

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Lower Risk — Higher Risk

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.
Emerging market risk: Significant investment in emerging markets may expose to difficulties when buying and selling investments. Emerging markets are also more likely to experience political uncertainty and investments held in these countries may not have the same protection as those held in more developed countries.
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.

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