WELLINGTON MANAGEMENT®

May 2021

Bruce Glazer
Portfolio Manager and Global Industry Analyst

Michael O'Brien, CFA
Investment Specialist

Fintech innovation: A pure play on enduring disruption

KEY POINTS

We believe:

- Now is a historically attractive time to invest in the ever-evolving fintech industry.
- A pure-play approach is the best way to produce additive returns over time.
- Our team of seasoned specialists has the experience and expertise to identify the companies driving the next generation of financial services.

TECHNOLOGY'S DISRUPTION OF FINANCIAL SERVICES CONTINUES TO THRIVE IN THE WAKE OF COVID-19. We believe the pandemic has accelerated many of the driving forces behind our most compelling fintech themes. This crisis has forced consumers to embrace digital technology in order to adjust to the "new normal," driving the adoption of mobile wallets, branchless banking, and "do-it-yourself" financial services. Financial institutions with more modern technology have been able to respond better to an increasingly digital customer and a more remote workforce. In addition, we think recent market movements have provided historically attractive entry points for many fintech opportunities.

The shift to digital is still in its early stages, with developments in areas such as data analytics, artificial intelligence (AI), cloud computing, and machine learning just beginning to transform the sector. While industries like e-commerce and music changed rapidly and had only a few winners, we believe fintech will evolve differently. The industry's greater complexity, regulatory influence, and geographical diversity drive our expectation of multiple leaders emerging gradually over a longer time horizon. We estimate that companies with a combined market capitalization of US$9 trillion in the banking sector and US$17 trillion in broader financial services are set to be disrupted.[1] In our view, fintech innovation and the resulting disruption present a vast multi-decade opportunity.

In this paper, we explore why fintech merits a pure-play approach, discuss the importance of an investment team with deep industry expertise in both financial services and technology, and highlight the long-term nature of this disruption.

A pure-play approach to fintech

Despite the scale of the universe, many available fintech approaches invest in companies that do not have financial technology as the core of their business.

[1]Wellington Management estimates, May 2021.

Public versus private fintech

We believe the opportunity set in public markets has reached critical mass, becoming more broad-based across regions. In our view, public fintech provides significantly greater transparency and liquidity relative to private fintech. We have uncovered what we believe to be quality public fintech companies with sustainable competitive advantages and durable business models growing at attractive rates around the world. Moreover, the IPO pipeline for fintech companies is robust, so our investable universe is constantly expanding.

About the authors

As a global industry analyst (GIA), **Bruce** conducts fundamental research on the financial technology sector, focusing on the payments and IT services industries. In addition to stand-alone fintech strategy, Bruce manages subportfolios in our analyst-managed research products, which combine the expertise of our GIAs across industries.

As an investment specialist in the Investment Product and Fund Strategies Group, **Mike** works closely with investors to help ensure the integrity of their investment approaches by providing oversight of portfolio positioning, performance, and risk exposures. He meets regularly with the investment teams, contributes to developing new client solutions, and manages business issues such as capacity, fees, and guidelines.

In our view, this secular growth story — with a universe of over 500 companies — is best accessed through a pure-play strategy, which offers more direct exposure to the disruption. Our approach to fintech focuses on companies where at least 80% of revenues are driven by financial technology sources. With such a large investable public market, we believe investors do not need to stray from the core of the opportunity. In fact, our team has identified a universe of approximately 200 companies that pass our percentage-of-revenue threshold.

The areas of the fintech market driving our interest in a pure-play approach are payments, the digitization of financial services, and technology infrastructure (see **Figure 1**). In payments, 60% of total consumer payments globally are still cash-based, leaving huge potential for further digitization. Similarly, in the digitization of financial services, roughly 1.5 billion adults worldwide do not yet have access to a bank account, and the digitization of financial services is just beginning to address the insurance and capital markets. Financial technology infrastructure offers the longest runway for growth, as most banks' IT systems were built in the 1980s and are ripe for improvements and upgrades. This space has also reached an inflection point as banks turn from defensive regulatory spending to offensive investment in growth.

Figure 1

Key fintech investment opportunities[2]

Payments	The digitization of financial services	Financial technology infrastructure
Cash-to-card shift	Enhancing customer experiences	Cloud
Software-enabled payments	Vertical-specific software providers	Trading platforms
Omni-channel	Industry platforms	Data providers
B2B payments	Online brokerage platforms	Artificial intelligence
E-commerce		Process-reengineering software
		Modernizing core systems

Investment examples

Fuel card company

We believe what is thought to be a sleepy fuel company in reality has distinct assets in the travel and health care corporate payment verticals, which are both experiencing long-term secular growth. It also benefits from efforts by fleet operators to control costs and the move to electronic payments.

Online wealth management platform

In our view, this LATAM-based online brokerage provider is making it easier, less expensive, and more efficient for its customers to invest their savings. This company is rapidly disrupting legacy banks that have long stifled innovation, due to earlier technology advantages.

Software company

Most technology used by insurance companies is decades old and needs to be replaced. We believe this software platform company for property and casualty insurers is utilizing data/analytics/AI functionality that will make it increasingly valuable to customers as insurance companies catch up on digital transformation.

The opportunities and investment examples presented are for illustrative purposes only and are not to be viewed as investment recommendations. It should not be assumed that an investment in the opportunities or examples presented has been or would be profitable.

[2]Figure 1 terms: **Omni-channel** – Combining offline/traditional retail experiences with online/e-commerce

FIGURE 2

Digitization

Digitization in finance will probably take longer to play out because:

- Consumer behavior is harder to change.
- The strength and value of incumbency is unlike other sectors.
- The embedded infrastructure is critical in nature.
- Regulatory oversight results in a slower pace of change.

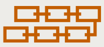
FIGURE 3

Long-tailed secular growth areas

We believe fintech investments should focus on long-tailed secular growth areas, such as:


Artificial intelligence


Machine learning

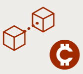

E-commerce


Internet of Things


Mobile wallets


The cloud


Digital payments


Blockchain technology and cryptocurrencies

Deep resources in financial services and technology

The complexity and depth of the fintech ecosystem demands a breadth of investor specializations. In creating our approach to fintech, we brought together industry experts from our global finance and global technology teams — who have fintech experience dating back to the inception of the industry — and combined them with the broad research resources of Wellington Management. Together, these investors have thousands of financial and technology company meetings each year, developing proprietary research independent from the sell side. We believe the key to success amid this disruption is deep collaboration to fully leverage both the capabilities and access to company managements of multiple research teams.

In our view, as the fintech industry continues its disruption, the opportunity set requires both research experience and long-term company relationships cutting across industries, regions, and market caps, including late-stage pre-IPO and other private investments. Our ability to collaborate with our private market colleagues provides critical insight into the durability of public market fintech companies. We estimate that our analysts and investors have more meetings with both public and private fintech companies than any other financial institution.

Additional portfolio management team members

Jennifer Nettesheim Berg, CFA
Global Industry Analyst

Matt Lipton, CFA
Equity Research Analyst

Scott Kennedy, CFA
Global Industry Analyst

Matt Ross, CFA
Global Industry Analyst

A multi-decade disruption

The enduring nature of the fintech story is, in our view, best served by an approach with a similarly long-term perspective. We think the pace of disruption will be moderated by the inertia created by the distinct characteristics of the financial services industry shown in **FIGURE 2**. In spite of this, many approaches to fintech have high turnover. Instead of continually chasing the companies in the latest headlines and news reports, our team aims to identify the public market disrupters, enablers, and incumbents who we believe are positioned to win in this space over the long term. Our approach has lower turnover (approximately 20% – 30% annually) and a long-term mindset focused on key secular themes (**FIGURE 3**). We believe this approach has the potential to better capitalize on the sector's multi-decade growth and, thus, compound returns over time.

Investing in innovation

In our view, a pure-play, public market fintech approach is a compelling way to access this industry's innovation and the valuable disruption it creates. We believe fintech's complexity further warrants an investment team with specialization stretching across the subsectors of financial services and technology — importantly, with deep collaboration across those research resources. Finally, though it may have been accelerated by the current environment, the evolution of this industry is likely to be gradual but enduring. We therefore think the secular growth themes driving the fintech revolution merit a long-term approach.

RISKS

Common stock – Common stock is subject to many factors, including economic conditions, government regulations, market sentiment, local and international political events, and environmental and technological issues as well as the profitability and viability of the individual company. Equity prices may decline as a result of adverse changes in these factors, and there is no assurance that a portfolio manager will be able to predict these changes. Some equity markets are more volatile than others and may present higher risks of loss. Common stock represents an equity or ownership interest in an issuer.

Concentration – Concentration risk is the risk of amplified losses that may occur from having a large percentage of your investments in a particular security, issuer, industry, or country. The investments may move in the same direction in reaction to the conditions of the industries, sectors, countries, and regions of investment, and a single security or issuer could have a significant impact on the portfolio's risk and returns.

Currency – Active investments in currencies are subject to the risk that the value of a particular currency will change in relation to one or more other currencies. Active currency risk may be taken on an absolute or a benchmark-relative basis. Currency markets can be volatile, and may fluctuate over short periods of time.

Emerging markets – Investments in emerging and frontier countries may present risks such as changes in currency exchange rates; less liquid markets and less available information; less government supervision of exchanges, brokers, and issuers; increased social, economic, and political uncertainty; and greater price volatility. These risks are likely to be greater relative to developed markets.

Small- and mid-cap companies – The share prices of small- and mid-cap companies may exhibit greater volatility than the share prices of large-cap companies. In addition, shares of small- and mid-cap companies are often less liquid than large-cap companies.

www.wellington.com