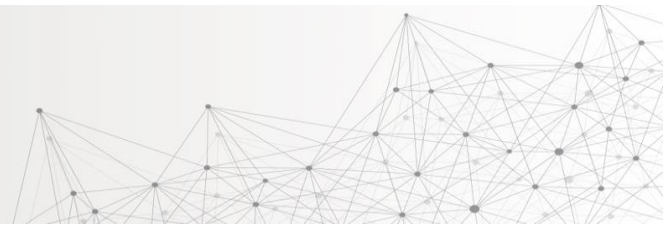


Are Financials the New ‘Must Have’ Specialists?



For many investors, two sectors have dominated headlines (and in many cases, portfolios) over the last decade: Technology and Healthcare. But increasingly, Financials are starting to emerge as an area of keen focus – with many seeing the group as fertile an opportunity set as they have seen in recent years.

WHAT ARE WE TALKING ABOUT WHEN WE TALK ABOUT ‘FINANCIALS’

Banks, yes. Insurance companies, for sure. Exchanges, broker-dealers, specialty finance firms, of course.

But where does the rapidly emerging and innovative Fintech sector fit in? And why **are Financials specialists in some ways better poised to understand the long-term Fintech space than even Tech specialists?**

FINANCIALS: THE RECENT BACKDROP

In the wake of the global financial crisis, broad Financials’ performance has been somewhat muted. The sector has wrestled with numerous factors from persistently low interest rates, a highly regulated environment, thinning margins on the back of declining fees, and a number of other issues have converged to create a somewhat challenging environment.

Despite these challenges, some managers have found success in navigating these waters, and increasingly, we see Financials specialists alongside Healthcare, Tech and Energy specialists.

FINANCIALS SPECIALISTS TAKING THEIR PLACE ALONGSIDE HEALTHCARE, TECH AND ENERGY SPECIALISTS

An overall trend in the alternatives space in recent years has been the acceleration of specialization. While Healthcare and Tech have been more prevalent, and Energy specialists have long held a niche for their sector, we are seeing a growing number of Financial specialists coming to market.

STEADY GROWTH IN FINANCIALS LAUNCHES

Looking across the last few years, **more than half** of the Financial launches that have come to market did so in 2020 or plan to do so in 2021.

This is particularly notable given the unexpected, unprecedented and in many ways challenging environment these two years pose for new managers coming to market.

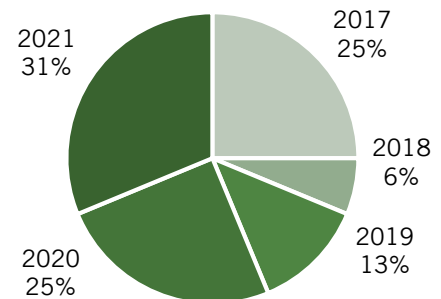
The drivers of this growth are multiple:

- 1) Strong perceived opportunity set – with some viewing the drawdown and muted bounceback in 2020 as offering considerable upside
- 2) Expected growth of traditional financial services industry
- 3) Shifts in regulatory regimes
- 4) Expansion of Fintech

A steady and growing pipeline of new specialists is often taken as an additional sign of health for the industry, but also for investment opportunities in the sector.

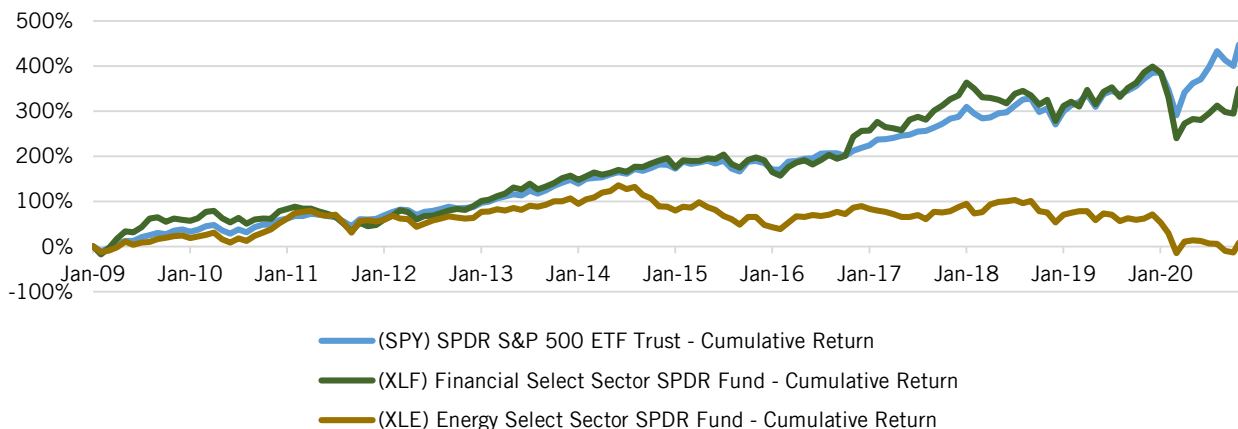
It sends a strong market signal that there is enough of a perceived opportunity set, that managers are still willing to take the risk, launching their own firms in uncertain times.

Financials-Focused New Launches
2017 - Present



Source: Jefferies Prime Services

S&P 500 (SPY) vs. Financials (XLF) vs. Energy (XLE)
Jan 2009 - Present



Fintech Broadens the Industry and Drives Innovation Across Sector Verticals



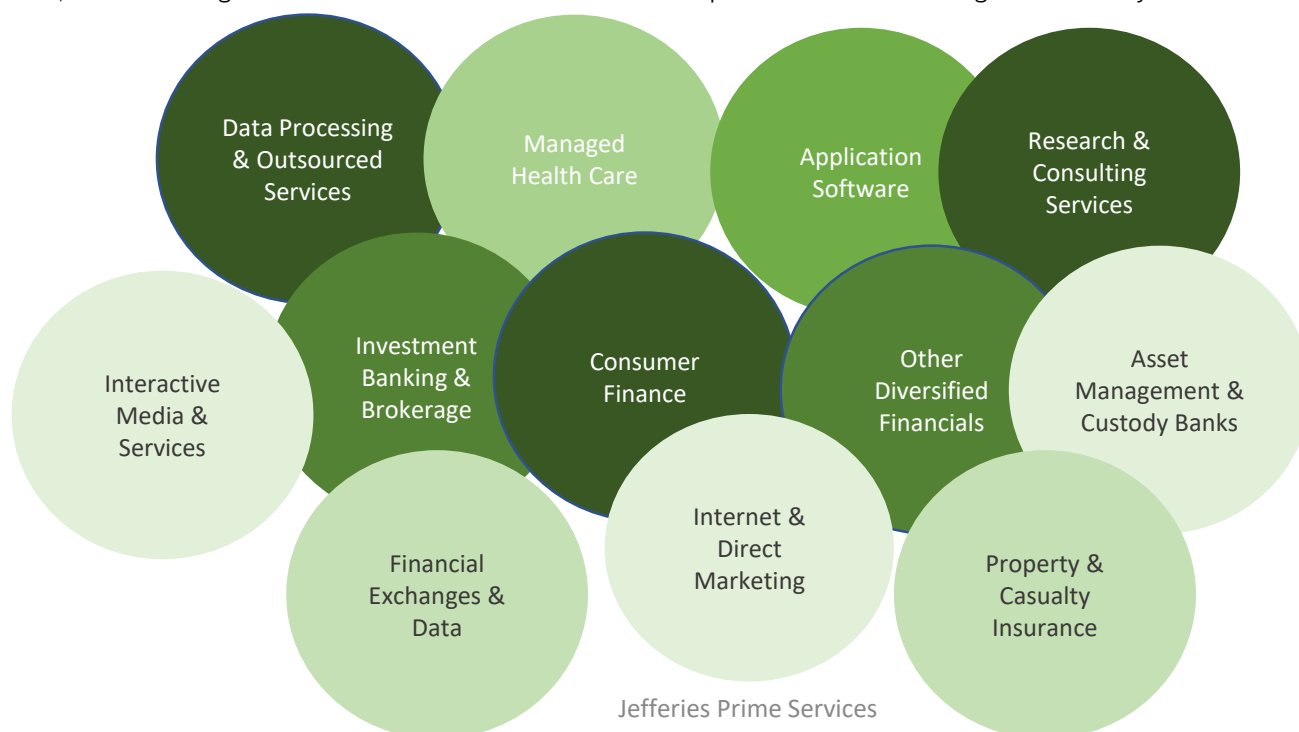
HOW BIG IS THE SANDBOX: Like many sectors, Financials is an evolving industry and a diverse ecosystem of companies that are regulated by different regulatory regimes. And **like all sectors, technology is helping upend long held assumptions and driving new efficiencies.**

The Financials Sector According to GICS¹

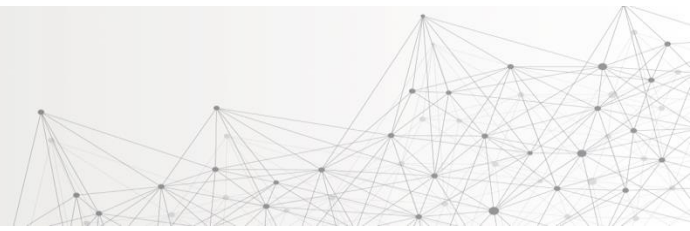
| Industries | Sub-Industries | FINTECH |
|--|--|---------|
| Banks | Diversified & regional banks. | |
| Thrifts & Mortgage Finance | Financial institutions providing mortgage and mortgage related services. | |
| Diversified Financial Services | Multi-sector holdings and specialized finance. | |
| Consumer Finance | Providers of personal credit, credit cards, lease financing, travel-related money services and pawn shops. | |
| Capital Markets | Asset management & custody, investment banking & brokerage, financial exchanges & data. | |
| Mortgage Real Estate Investment Trusts (REITs) | Companies/Trusts that service, originate, purchase and/or securitize residential and/or commercial mortgage loans. | |
| Insurance | Insurance brokers providing life & health, property & casualty, multi-line, and reinsurance. | |

As Technology continues to shape **all** industries, Financials have not been left behind. The convergence of Financials and Technology is creating new opportunities, disrupting long held practices and building innovative business lines.

In fact, two of the larger Fintech ETFs (ARKF and FINX) hold companies from the following GICS Industry classifications:

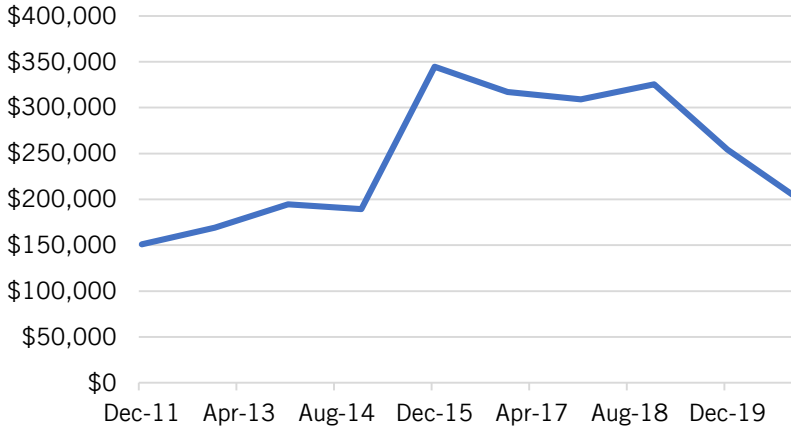


Is There Upside for a New Decade of Dealmaking?

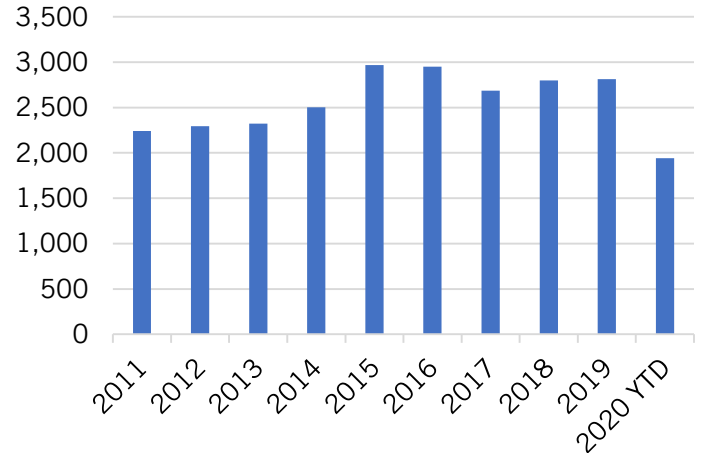


Financials Sector Deal Flow Over the Last Decade

Total Value of Annual Financials Sector M&A Transactions (mm)
Jan 2011 - Present

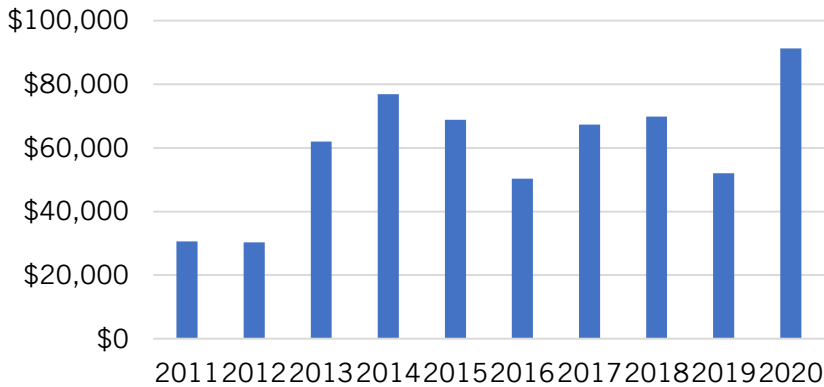


of Financials M&A Transactions
Jan 2011 - Present



IPOs

Gross Proceeds from Financials IPOs (mm)
Jan 2011 - Present



2020 has witnessed a rebound in Financials IPO proceeds. Numerous headlines have pointed to the decline in overall deal making in the Financials sector, but with a number of high profile transactions YTD, some are questioning whether there will be more to come.

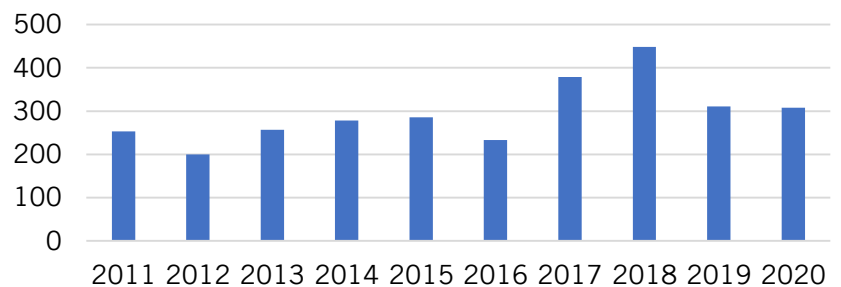
Is Fintech Poised to Create the “FAANG” of Financials?...and Other Considerations

Playing the Cyclical: Even after post vaccine news rally, many feel banks have yet to truly play “catch up” from an earlier decline. Are allocators thinking that banks are cyclical, and we may be primed for a rebound?

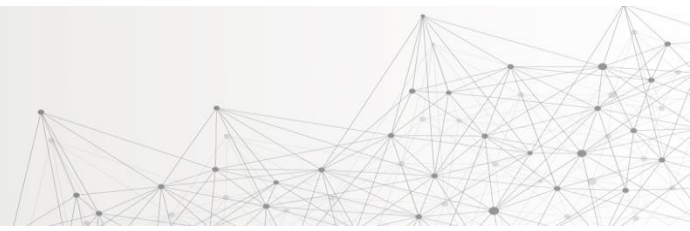
It's All About Timing: Are Financials a way to play another dimension of a reopening economy? Or, by contrast, target vulnerable shorts they believe will underperform over the medium term?

Fintech As the New FAANG: Many voice this thematic view on the coming decade. Tech has disrupted other industries at a faster clip than Financials, leaving many to wonder – is this the decade where tech breakthroughs will create massive value?

of Financials IPOs
Jan 2011 - Present

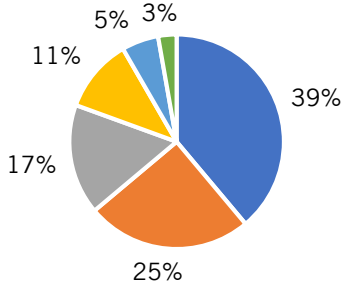


Interest in Financials is Growing... Will Allocations Follow?



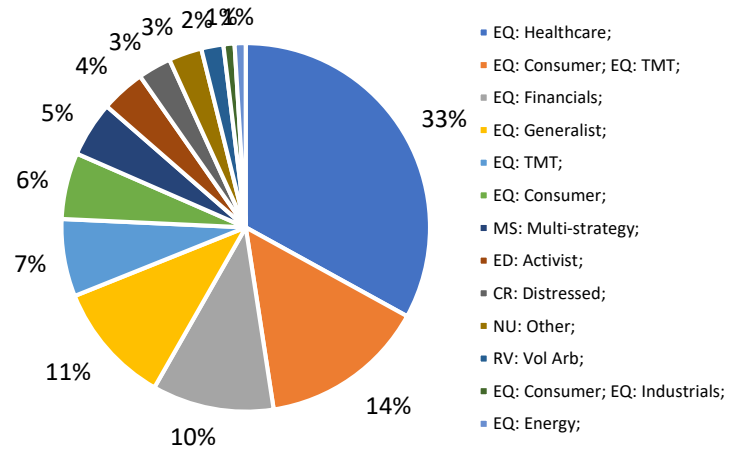
Bridging the Gap between Investor Demand and New Launch Activity in Financials

Financials Investor Mandates
Net Exposure Preferences
July 2019 - Present



- Low Net / Market Neutral (+/-30%)
- Long Biased (70% to 100%)
- Short Only (always < 0%)
- Variable Net (30% to 70%)
- Long Only (always > 100%)
- Agnostic

Allocations made via JEF Intro by Strategy
Q4 2016 - Present



Source: Jefferies Capital Intelligence

Source: Jefferies Capital Intelligence

Current allocator appetite for Financials specialists varies, but largely falls into one of two categories: i) Low Net/Market Neutral or ii) Long Biased or Long Only, with these drawing about one third of open interest. Low Net/Market Neutral is slightly more in demand, but Long Biased or Long Only are only a few points behind.

Variable Net accounts for about one-quarter of open mandates.

There has been a growing focus for some allocators in adding Financials specialists to round out their portfolio of other specialists – namely Healthcare and Tech – as it is increasingly clear that Financials investing benefits from the same deep industry expertise, regulatory understanding and the ability to navigate complex balance sheets, as other research intensive sectors do.

LOOKING AHEAD: THE COMING DECADE FOR FINANCIALS

We believe the landscape of Financials focused funds will continue to grow – and in some cases, materially accelerate – as the opportunity set expands, Fintech firms continue to find their footing, and the landscape favors those who have deep and robust expertise of regulatory understanding and what shifts in any of those regimes may have on the financial services or fintech landscape.

Jefferies Capital Intelligence Team covers nearly 1,000 alternatives allocators globally, and is focused on data and analytics around the specialization of the hedge fund community. We anticipate the trend of specialization, that accelerated in recent years, will only continue, as a new generation of managers emerges and launches niche or highly focused strategies to capitalize on new and evolving opportunity sets.

Footnotes

- 1 Global Industry Classification Standard. 2018. Available At:
https://www.spglobal.com/marketintelligence/en/documents/112727-gics-mapbook_2018_v3_letter_digitalspreads.pdf

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