ROBECO
The Investment Engineers

NEW WORLD FINANCIALS

Brave new financial world

- Aging finance fundamentals remain robust amid strong 2024 performance
- Emerging finance looking for 'revenge' growth in 2025
- Digital finance enjoying powerful momentum

Our three key trends are all primed for growth in 2025 as the financial sector continues an epochal change process driven by technological advances, geopolitics and demographics.

A banner year for financials

At the start of 2024 only few strategists and market pundits foresaw the strength of equity markets in general, and financials stocks in particular. The MSCI AC World rallied 17.5% in USD in 2024, while the MSCI AC World Financials gained a stunning 24.3%. For non-USD investors returns were even higher due to the distinct strength of the USD. The year 2024 was characterized by US equity market 'exceptionalism', with few other markets even close. Equity returns were boosted by rate cuts in the US and Europe as inflation moderated, resilient macro data, the AI theme, and ongoing China stimulus. Nevertheless, the rally was narrow with only 29% of stocks outperforming the global index, and only eight stocks contributing half the return of the global index.

Bond yields could be peaking

As always, we note that equity markets continue to be highly correlated with the direction of global liquidity indicators. The course of action in (real) interest rates, credit spreads and global central bank policies will continue to set the tone, especially for financials. A key issue facing investors at the start of 2025 is the self-evident contradictory nature of incoming US President Trump's policy agenda and how those contradictions are going to be resolved. One risk for US equities is that at some point they will not be able to ignore rising bond yields, which are sending strong signals worldwide that we are entering a new inflationary regime. The Covid pandemic, the subsequent massive government stimulus, and rising geopolitical risks have reset the global economy with higher structural inflation. This aligns with our consistent view over the past few years that the days of zero interest rates policies are behind us, and that new reality is positive for nearly all financials. At the same time, surging bond yields and inflation expectations will – in our view – enforce fiscal discipline across the globe and moderate the extreme elements of any tariff plan. While we do not exclude the possibility of continuously high US bond yields

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From left to right: Patrick Lemmens Portfolio Manager, Michiel van Voorst Portfolio Manager, Koos Burema Portfolio Manager, Mariia Semikhatova Equity Analyst

and USD strength, we think we may be closer to peak than is currently priced-in, and investors need to be careful to avoid managing portfolios by looking through the rear-view mirror. We prefer to focus on the structural growth trends that drive our stocks, as they tend to show far more consistency and longevity than the typically reactive Wall Street consensus. We will follow the fundamental value drivers of our companies: earnings and book value growth. So, with that in mind, we will discuss the driving forces within our three trend buckets, aging finance, emerging finance and digital finance.

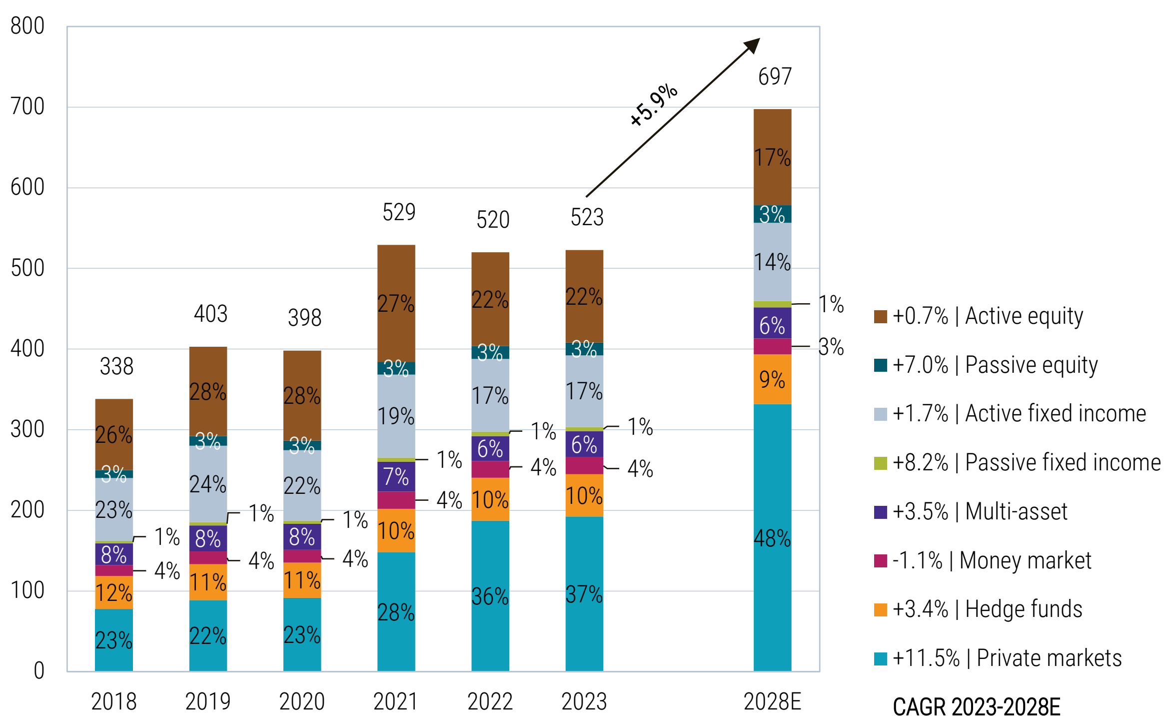
Fundamentals for aging finance remain robust amid strong 2024 performance

Aging finance refers to the growing need and demand for wealth management products and solutions. Research has shown that rising global life expectancy coupled with falling birth rates is increasingly straining public pension systems. We have hence seen a shifting of the retirement burden from the state or corporation to the individual. As a result, a large portion of the world's population faces a huge challenge: ensuring a desirable and dignified lifestyle post-retirement.

This challenge didn't suddenly arise; the pressure has been building for decades. The wealth, asset management, and insurance industries have responded by developing a range of innovative products and services that improve people's ability to tackle their savings, investing, and protection needs. Still, there is a huge savings gap, which also represents a strong growth opportunity, especially for private markets assets. We see additional opportunities as a growing number of people are acquiring wealth at a younger age as they either inherit that wealth (growing intergenerational wealth transfer) or capitalize that wealth as they sell businesses as M&A and IPO markets come back to life.

From 2023 to 2028 the entirety of asset management revenue growth is set to be driven by alternatives (private markets), which are expected to grow at a 11.5% CAGR and approach almost half (48%) of total revenues by 2028 (see **Figure 1**). Public markets revenues are expected to grow at an annualized rate of only 1.8%. We focus our investments on the high growth segments of the asset management industry.

Figure 1 – Global asset management revenues (USD bln) split and growth rates (CAGR 2023-2028E)



Source: Oliver Wyman, Morningstar, Mercer, company reporting, Morgan Stanley, Robeco, October 2024. The graph originates from a recent study, published by Morgan Stanley and Oliver Wyman, titled 'Retiring in the Age of Aging'.

M&A will be a tailwind

Encouragingly, despite strong performance in 2024 there remain clear pockets of undervaluation, even as certain segments, such as alternative asset managers, retail brokers, and investment banks, have experienced a valuation re-rating. Across our portfolio and potential investments, we anticipate continued earnings growth in the high teens for most holdings. That said, growth in investment banks and retail brokers is likely to remain volatile, reflecting the inherent cyclicality of capital markets.

> *“ The M&A pipeline positions markets for at least two more favorable years*

Looking ahead, we see the pipeline for M&A deals and IPOs as a significant tailwind, positioning markets for at least two more favorable years. Several factors contribute to this outlook. First, the dearth of IPOs and large-scale M&A activity in recent years – stemming from the Covid aftermath, lower valuations, and tighter regulatory conditions – has left significant pent-up demand. While we don’t foresee regulatory easing in Europe, the US is benefiting from a markedly pro-business climate, which augurs well for deal-making. This trend stands to benefit not only investment banks and boutiques but also alternative asset managers, which must deliver realizations from their pipelines to secure fresh capital. Firms like KKR and Apollo Global Management are particularly well-positioned, thanks to their sizable investment banking operations, which offer an additional avenue for growth.

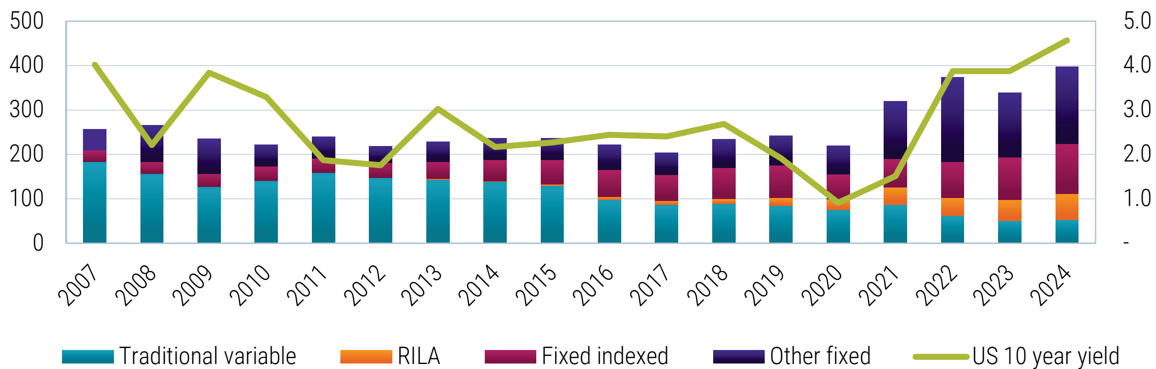
Alternative asset managers are well-positioned to deliver robust growth in fee-related earnings over the next five years. Combined with an improving exit environment, this momentum is expected to facilitate new asset under management gathering, further justifying premium valuations compared to traditional asset managers. Blackrock’s recent acquisition of HPS Investment Partners has reinforced the valuation framework for the sector, with higher multiples warranted for the top ten players. Even as interest in sustainable investments wanes in the US, leading alternative asset managers view sustainability as a critical long-term growth driver. Firms such as Brookfield, KKR, and Macquarie Group are at the forefront of this strategic shift, leveraging their expertise to capitalize on the global energy transition trend.

Life insurers on the comeback trail in 2025

After a year of lackluster returns in 2024, life insurers are poised for much-improved performance. A notable trend driving this resurgence is the growing involvement of alternative asset managers, which have been acquiring assets and liabilities from life insurers or forming strategic partnerships with them. This reflects rising demand for annuity-style returns in retirement alongside better yields from non-equity investments. As markets grow more comfortable with the implications of the new accounting standard IFRS 17, we anticipate a significant rerating of life insurers, particularly in Europe, as well as undervalued peers in the US. This rerating will be fueled by marked improvements in cash generation, enabling increased buybacks, dividends, and robust new business growth.

New business growth looks especially promising in Asia, where life insurers have been deeply discounted due to concerns surrounding China. However, Europe and the US also present strong growth opportunities, driven by rising demand for pre-retirement savings, post-retirement annuity income, and generational wealth transfer solutions. These trends underscore the need for tailored investment strategies and comprehensive financial planning services. Importantly, the impact of new business growth will extend beyond immediate market sentiment. Over the next three years, earnings are expected to benefit positively as revenues from newly sold life insurance products are realized incrementally over their lifecycle. Figure 2 below highlights the strong correlation between annuity sales and the 10-year US Treasury yield. Beyond this relationship, global aging and intergenerational wealth transfers have significantly boosted growth in annuity sales. This trend is not confined to the US; it is a global phenomenon. The most attractive investment opportunities are found in regions with mature markets and robust demand, including the US, Canada, Europe (particularly the UK, Netherlands, and Nordics), and Asia, with Japan standing out as a key growth driver.

Figure 2 – US rates and US annuity sales (USD bln)



Source: LIMRA Secure Retirement Institute, Jefferies, Bloomberg, Robeco.

Emerging finance looking for 'revenge' growth in 2025

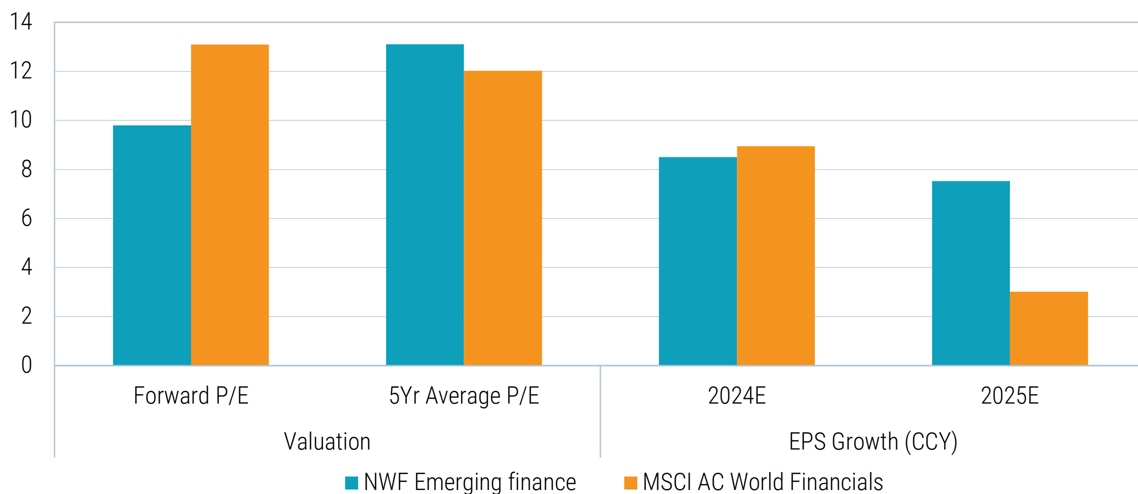
The emerging finance trend focuses on the growth of the global middle class, especially in emerging markets, where financial penetration is still low. In developed markets we search for financials that can grow by providing basic financial services in an innovative way or with limited competition. The notion that a growing middle class and rising incomes are driving superior financial services growth in emerging markets is as relevant as ever. We invest in countries where the macro set-up gels with financial system fundamentals. We prefer systems with low credit penetration (private credit/GDP), healthy levels of GDP per capita growth and excess system liquidity. The marginal propensity to save and invest tends to increase as GDP per capita goes up, as certain sections of economy with higher income (typically above USD 10,000/year) get in a position to save money. This ability to save leads to better credit availability, as financial institutions re-cycle these savings with a multiplier.

> *" Material progress on disinflation supports emerging market central bank easing*

Emerging market economic growth has been resilient in 2024 with material progress on disinflation supporting emerging market central bank easing. However, relative equity market performance in 2024 was a different story. Over the course of the year concerns over China's growth, elevated US yields and renewed tariff tensions weighed on emerging market equities. There were significant idiosyncratic risks as well, as half of the world's population went to the polls in 2024, including India, Indonesia and Mexico. Policy uncertainty and implications for emerging market central banks' capacity to lower rates is likely to continue weighing on emerging markets into 2025. Whereas uncertainty remains high, we note that tariff tensions may be a negotiation tactic rather than a full-scale trade war considering potential impact on US inflation. Moreover, many emerging markets have proven to be resilient to significant shocks (Covid pandemic, Russia-Ukraine war, China's slowdown) in recent years partly owing to better macro policy management reflected in the contained current account deficits. Finally, emerging market FX is already meaningfully cheaper today than at the outbreak of Trump's first trade war in 2018 and emerging market assets are attractively valued relative to global peers and history.

Our emerging finance exposure trades on a forward consensus PE of 9.8 times or at a 30% discount to MSCI AC World Financials as shown in Figure 3. We concede the valuation alone has not been a sufficient catalyst and rather presents a longer-term potential. In the near-term we expect our emerging finance performance to be supported by earnings growth which in turn is driven by credit expansion broadly sustaining current momentum, growth in fee income on the back of healthy real GDP growth and robust asset quality.

Figure 3 – Emerging finance – P/E valuation and earnings growth



Source: Bloomberg, Robeco.

While 2024 was a disappointment for markets in Indonesia, Mexico and Brazil, we believe the fundamentals of financial systems in these countries remain strong. We prefer companies with robust and sustainable profitability and an ability and willingness to increase shareholder returns. In Indonesia the combination of weaker top line growth amid tighter liquidity and asset quality concerns led to material sector de-rating in 2024. For example, Bank Rakyat faced challenges in its micro lending in 2023 driven by the impacts of high food inflation and weak government spending. To address these issues, the lender slowed its micro lending and focused on collections and improving asset quality which showed signs of stabilization in Q3 2024. In 2025 the segment should be supported by minimum wage growth of 6.5% and state support programs. Bank Rakyat is expected to deliver solid earnings growth in 2025 at a ROE of 20% and an 8% dividend yield.

“ Emerging finance remains a structural growth segment of our portfolio

In Mexico growth expectations have been weakening from domestic (constitutional reform) and foreign policies (US tariffs). Valuations now looks very cheap and the decoupling from earnings momentum is large. The case for nearshoring remains strong with Mexican wages still at least 20% cheaper than those of China and half those of the US. The growth outlook for the banking sector is supported by very-low financial inclusion and the need for industry financing to meet increasing demand. Banorte’s ROE is resilient and its diversified loan book should help maintain low delinquencies and cost of risk. Banorte is expected to deliver robust earnings growth and to continue returning capital to shareholders through dividends and buybacks.

In Brazil concerns about fiscal risks have been the most significant headwind for the market this year. The outlook for 2025 is not an easy one given the tightening cycle and unresolved fiscal issues but the level of rates priced in looks too pessimistic. The market is pricing a ~16% peak interest rate (or ~12% above inflation). Whereas historically higher rates correlated with a credit cycle, Itau has managed its risk appetite throughout the credit cycle and de-risked its retail portfolio. Itau is expected to maintain strong profitability (23% ROE) and deliver solid earnings growth. In addition, Itau has room to increase payout in 2025 given its strong capital position and management signaled extraordinary dividend payments over the next two years.

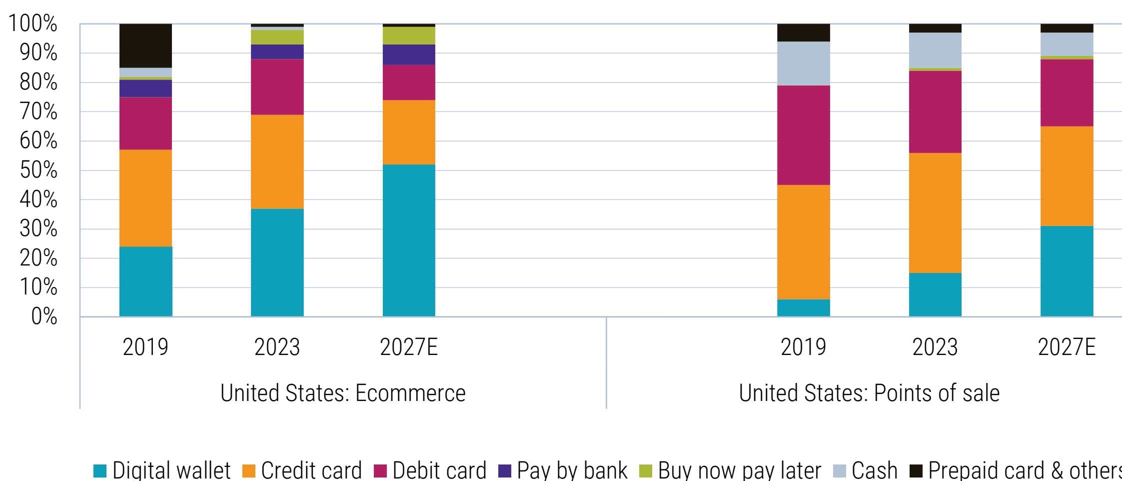
In sum, sentiment for emerging finance will in the short run be driven by the trajectory of US rates and USD, but over the medium term this remains a structural growth segment of our portfolio, where we observe healthy book value growth in up and down cycles, which will ultimately drive stock returns of our holdings.

Digital Finance's powerful momentum

With the Magnificent Seven grabbing headlines, the outperformance of fintech companies has flown under the radar in 2024. As we look ahead to 2025, the fintech sector continues to demonstrate robust growth and innovation, driven by several key trends and developments. By focusing on key trends such as alternative payment methods, increased capital market activity, and AI adoption, we can identify and capitalize on the most promising opportunities within the fintech landscape. At the start of 2025, we have seen plenty of changes in underlying fintech trends but long-term growth prospects remain robust. We have three trends to watch in order to identify and capitalize on the most promising opportunities within the fintech landscape.

Firstly, as depicted in **Figure 4**, the rise in **alternative payment methods** is self-evident. Digital wallets like PayPal, Apple Pay, Venmo, CashApp, and Shop Pay continue to grow transaction volumes. In the US, digital wallets accounted for 37% of total ecommerce transaction value and 15% of point-of-sale transaction value in 2023. The appeal lies in increased user convenience and reduced fraud risks, driving the shift away from manual card entries, card-on-file, and cash. Apple Pay is gaining ground both online and in-store and Bernstein estimates that it held approximately 5% of the US ecommerce checkout share and represented 3.2% of in-store retail spending in the US in 2023 (according to the US Census Bureau).

Figure 4 – Alternative payment methods are gaining share both online and offline in the US



Source: Worldpay, Robeco, June 2024.

Buy-now-pay-later providers like Afterpay, Affirm and Klarna represented 5% of ecommerce payments and just 1% of offline payments in 2023, but are gaining traction. Affirm grew its total platform portfolio 35% year-over-year to USD 11.8 billion at the end of September 2024. As a reference, card behemoth Capital One grew its gross loan book by 2% to USD 320 billion in that same period. Anecdotally, we have seen pay-by-bank payment options being promoted by merchants in recent months. It is a trend to watch as these volumes do not go over the card networks. However, both the Real Time Payments network and FedNow still show limited volumes but the rails are in place nowadays. We estimate roughly 300 million transactions for a combined value of around USD 300 billion for these networks in 2024 while, according to the US Federal Reserve, cards were used 162 billion times for an value of over USD 10 trillion in 2022 already.

Secondly, **capital market activity** is picking up. We expect a resurgence in private fintech funding and a wave of initial public offerings (IPOs) in 2025. Notable companies like Klarna and Chime Financial have already submitted confidential filings for IPOs, signaling a strong pipeline of fintech companies ready to go public. This renewed interest in capital markets is likely to provide significant growth opportunities for fintech companies and investors alike.

Since the US election, excitement in M&A teams is at fever pitch on anticipation of a much more permissive regulatory regime under Trump 2.0, with the financial sector in general and fintech in particular likely to be in focus for dealmakers. The interest in fintech IPOs is clearly on the rise with financial management companies Klarna and Chime Financial announcing it intends to launch an IPO on the Nasdaq with Klarna's anticipated valuation between USD 15-20 billion.[1] Chime was last valued at USD 25 billion when it raised USD 1 billion in 2021.[2] The success of those IPOs will be a good gauge of how the market views this segment and Stripe, Circle or Revolut could follow suit.

Thirdly, one of the most transformative trends we are watching in 2025 is the adoption of AI agents. AI agents are capable of autonomously performing tasks on behalf of a user, and can enhance efficiency, reduce costs, and improve customer experiences by automating complex tasks. In a digital finance world, that means thousands of white-collar jobs at financial institutions are in line to be augmented by AI. Goldman Sachs CEO David Solomon for example stated that drafting an S1 for an IPO, which used to take a six-person team two weeks, can now be 95% completed by AI in minutes.[3] We firmly believe that most incumbents will be slow to respond to these platform shifts and that digitally native or 'tech-first' companies are much better placed to adjust and benefit from the wave of incoming AI solutions. Having said that, as Enterprise GenAI adoption is still in early innings, we have to have an open mind when it comes to picking winners and losers.

Where we sit today, we see several of our holdings well placed to benefit from the AI revolution. Companies like nCino, Epam and Endava, which offer advanced financial infrastructure solutions, could benefit from this trend as AI agents integrate well within existing workflows. For example, compliance agents could help investigating customers flagged for manual review and approve or decline their onboarding. Same holds for transaction monitoring or sanctions alerts. Data & Analytics behemoths like S&P Global have been plugging copilots to its customers to support with credit analysis, portfolio reporting and banking workflows. Credit agents can collect and interpret financial documents, handle transcripts, and manage legacy systems like a credit analyst. As the blockchain offers instant settlement, digital assets companies like Coinbase will likely see far more blockchain transactions between two AI agents. The first transaction was AI agents exchanging a piece of text for a micropayment.

[1] Klarna's Seb Siemiatkowski — from burger flipping to billionaire club – Financial Times, 15 November 2024
[2] Fintech Startup Chime Submits Confidential Filing for IPO, Bloomberg, 18 December 2024
[3] Goldman Sachs chief David Solomon questions start-ups' need to list – Financial Times, 16 January 2025

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