DISPELLING A MISCONCEPTION,

SUBSCRIPTION ≠ TECHNOLOGY

Some are born as Tech funds; others are **not** and are falsely considered as such. The Subscription economy strategy falls in the latter category and has been repeatedly mistaken by investors to behave like one. Simply put, this analogy is a statistical misconception, that has resulted through extreme market conditions. A useful way to look at how companies move in relation to one other is through the lens of *correlations*, that have the ability to statistically explain performances within a portfolio – and have historically reflected the relationship between sectors, between stocks and consequently between indices and portfolios. Exogenous events, particularly those unexpected by markets - the unknown unknowns - can push statistics into extreme territory. This was the case of the year 2020.

While we have been claiming since the launch of the strategy that the Subscription Economy is much broader than simply a Tech fund, a look at the correlation of fund performance with the MSCI IT performance would certainly lead to another conclusion. Subscription-based business models can be found in a multitude of industries: tech of course but also consumer discretionary and staples, industrials, healthcare and so on. In fact, more than 75% of the fund1[1] is invested outside of IT. So, why such a high correlation?

We have also been claiming that subscription-based business models are incredibly resilient due to the recurring nature of revenue (see previous papers). It turns out Technology has proved very resilient during the Covid crisis and simply put we think this is the reason why the fund behaved similarly to a tech fund in 2020.

THE CURIOUS CASE OF 2020

Everything was unusual during the year 2020, how it started, how it ended, and everything in between. Over the past year we have had to reconsider how we communicate, work, travel and even how we invest. In 2020 markets have seen one of the sharpest draw downs, followed by one of the swiftest of rebounds, making it only natural to see even the most rational relationships get distorted – a great illustration being correlations.

1 Thematics subscription Economy fund. Source Thematics AM, as of 30/04/2021

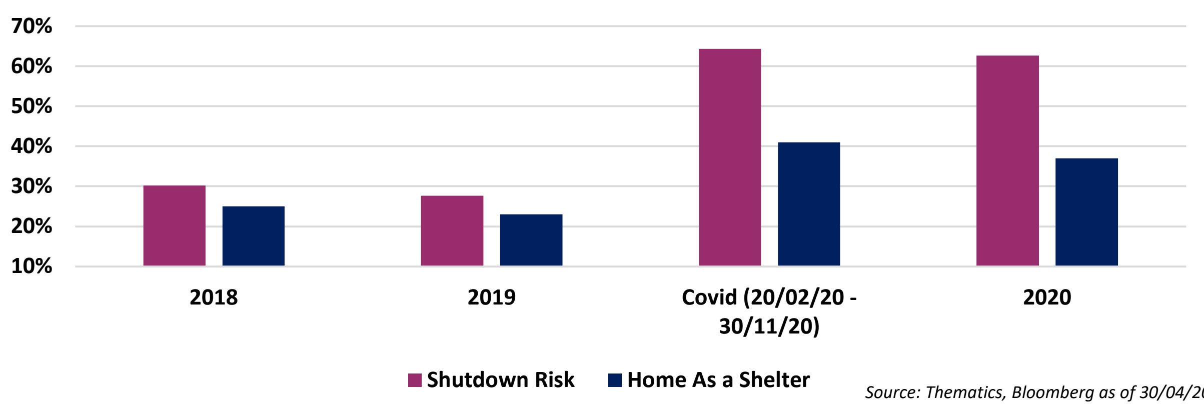
To put things into perspective, let us look at the bigger picture. Very few of us would have expected markets to end the past year at all-time highs and yet it was the case among the world's largest indices.

The main driving force behind this unimaginable record are baskets, constituted of generally unrelated, hardly associable stocks that not only resisted the impact of lockdowns on markets, but effortlessly ensured capital gains for their holders. Those stocks ranged from grocery delivery to cloud solutions as well as at home fitness companies. While sharing no common driver or catalyst during normal times, all of them continued to tick higher during the pandemic as people rushed to adapt to this new, hopefully temporary norm, called "home as a shelter".

On the other hand, another basket constituted of stocks with little common drivers and virtually no apparent connection spearheaded the downfall, seeing their value rapidly reduced to fractions of what they used to be. These stocks were the biggest culprits behind the impressive selloff of March before fueling an impressive market rally in November. This "Shutdown Risk" basket was comprised of companies ranging from Mining companies to Banks as well as Hotels, Restaurants and Automotive companies.

In 2020 markets weren't defined by traditional segments, there was little talk of growth, value, defensive, cyclicals or yield plays. 2020 was the year when unthinkable ties were born, where new

Average Correlation between basket constituents



Source: Thematics, Bloomberg as of 30/04/2021

correlations were defined. It may already be in the past, but the last 12 months was the era of the Home as a Shelter stocks vs Shutdown Risk stocks.

(Calculation methodology : Average of the Correlation between every stock of each basket – Correlations are calculated with daily performances over each year). Baskest are Goldman Sachs Baskets : However we removed every company that wasn't listed as of 31/12/2017-The eligibility of stocks for each basket : Home as Shelter : Every company that either saw its userbase, or engagement, or sales grow substantially during the pandemic - Shutdown Risk : Companies that saw their operation greatly affected by the pandemic either due to lockdowns or due to other sanitary reasons – 20/2/2021 to30/11/2021 because the drawdown started on 20/2 and the last positive vaccine trial data was published on the week of the 30th of nov.)

PUTTING ALL THE EGGS IN THE SAME BASKET

A closer look at the previously mentioned baskets could help gain further insight into these observations. Singling out a few stocks from each basket, could also help shed further light on this unpredictable situation.

With regards to the home as a shelter basket we can take a closer look at the ties between three stocks:

- Adobe[2] : One the of the leading SaaS companies in the world. A pioneer in the subscription-based model offering the likes of Photoshop, Acrobat reader, Lightroom as part of its services
- Costco[2]: A club warehouse where memberships are mandatory. The company has a small e-commerce division but discount warehouses remain its core business selling everything from food, clothes, gas to travel packages
- Activision Blizzard[2]: The biggest game developer in the world with franchises such as Call of Duty, World of Warcraft and the infamous mobile game Candy Crush

These three companies clearly do not operate the same businesses, and none are in the same sector. The first company is a professional tool for digital workers as well as an invaluable tool for enterprises, the second is a consumer staples company and the third is a digital entertainment company on PC, Console and Mobile devices. Adobe depends on small and medium size business' budgets and their respective capacity to generate sufficient revenues to increase the time and amount spent on the various platforms, Costco has a steady growth profile, that relies on the vital nature of demand for its product whereas Activision Blizzard is a purely discretionary consumption business that relies on hit games and engagement to strive.

Needless to say, the array of drivers is certainly broad for these examples, however, all three had curiously similar performance during the period spanning from the first lockdown until the first successful vaccine trials[3].

2 Source : Company info, Bloomberg, Thematics AM

3 Source : Bloomberg, Thematics AM

Belonging to the same basket created ephemeral ties between them, and rightly so, providing the ability for their holders to comfortably outperform the market. Those ties can clearly be observed by the significant increase in their cross correlations.

Annual Daily Price Return Correlation

	2018	2019	2020
Adobe x Acitivison Blizzard	**61.0%**	**40.0%**	**73.0%**
Costco x Adobe	**52.0%**	**39.0%**	**67.0%**
Costco x Activision Blizzard	**33.4%**	**34.7%**	**61.8%**

Source: Thematics, Bloomberg as of 30/04/2021

The same could be said about the big losers of the pandemic, those that saw their business model fall out of favor whether it was on the back of lockdowns, restricted activity or simply lack of appetite for their services. Unfortunately for their holders, those companies fall into the other bucket, the Shutdown Risk bucket. A deeper dive also helps better understand their individual and collective behavior:

- Planet Fitness[4]: The biggest low-cost Gym operator in the US operating mainly through a franchise model with around 1500 clubs across the country
- HealthEquity[4]: A HealthCare platform that enables employees to make health related spending and saving decisions. Services include price comparison, bill payments and tax saving accounts
- Auto Trader[4] : The UK based online vehicle market place that enables users to buy used and new cars, trucks and vans

Much like the previous names that were singled out, there are little similarities between those three companies, neither on the operating side nor on the driver side. The first is a fitness company, the second is a bridge between a financial and health care company and the third is a digital car seller. The only, rather unfortunate, tie they share was the heavy toll the pandemic took on their businesses. Planet fitness rides the wellness wave spearheaded by Millennials, Gen Z and social media, HealthEquity strives on the much needed optimization of health care spending and saving hence is interest rates sensitive, and Auto Trader is your typical next door car dealer, but online.

4 Company info, Bloomberg, Thematics AM

As it was the case for the first group, those companies have very little in common, are fueled by different dynamics and possess different drivers. And yet they ended the period in the red as their prices behaved in a similar fashion[5]. The reason behind that was quite simple, either those companies could not operate, as was the case for Planet Fitness, or were under stress due to swift changes in consumer behavior. Indeed, in the case of Auto Trader people weren't ready to plan the purchase of a car during uncertain times. As for Health Equity, dropping interest rates coupled with a lack of non COVID related health spending came to a halt.

Annual Daily Price Return Correlation

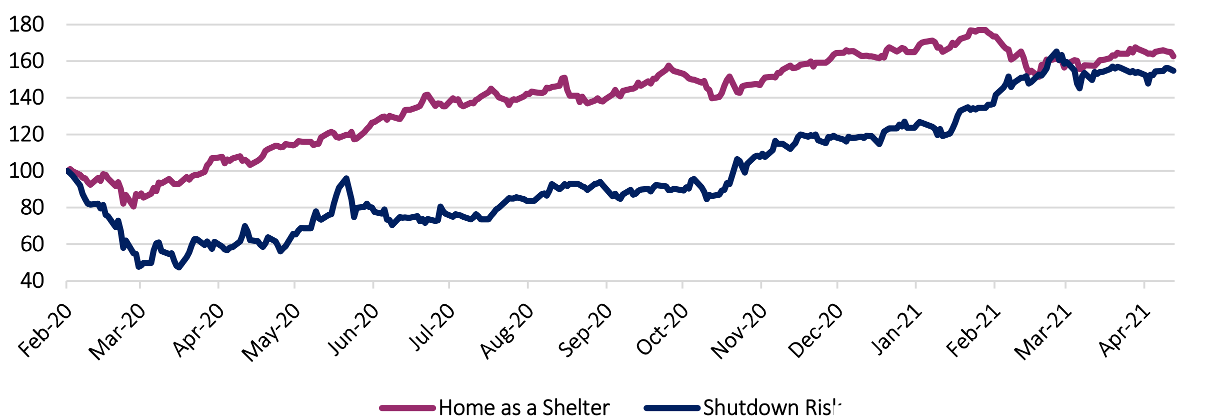
	2018	2019	2020
Auto Trader x Planet Fitness	**12.0%**	**3.0%**	**48.0%**
HealthEquity x Planet Fitness	**43.0%**	**21.0%**	**66.0%**
HealthEquity x Auto Trader	**8.0%**	**13.0%**	**38.0%**

Source: Thematics, Bloomberg as of 30/04/2021

NEW YEAR, NEW BEGGININGS?

As the year ended the decoupling between pandemic winners and losers continued but this time in reverse. To a point where the big gap witnessed throughout the crisis closed in its entirety leaving investors wondering what now ?

The Gap is Closed – Performance since 20/02/20 – Until 30/4/21 (USD)



Source: Thematics, Bloomberg as of 30/04/2021

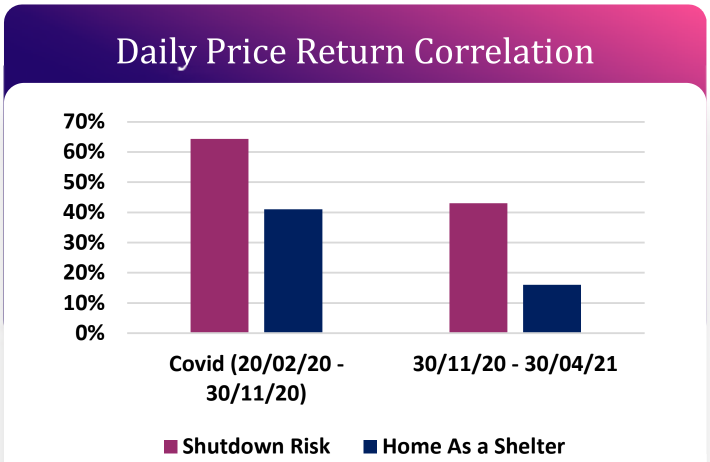
5 Source : Bloomberg, Thematics AM

One thing is sure, companies are slowly but surely being looked at through a different scope. Investors are getting back to fundamentals rather than simply categorizing companies as being lockdown or re-opening plays. A Tech stock rebecame a Tech stock and isn't correlated any longer with a Grocery Delivery stock or with a Home Fitness company. With that in mind, the ephemerous correlation driven by the pandemic started fading.

The "illusion" where all outperformers during the pandemic were Technology companies and oppositely all the underperformers since the Vaccine breakthrough were Technology companies seems to be behind us. However, we are yet to witness these changes in the way investors perceive portfolios.

SUBSCRIPTIONS TO WEATHER ALL STORMS?

While a strategy focusing on the Subscription Economy had a relatively comfortable year 2020 – ending the year up +49.14% (For the I USD share class), it wasn't spared from the volatility and sharp rotations witnessed over the first quarter of 2021[6]. And naturally, was a victim of the Technology fund analogy for all reasons mentioned above.



Source: Thematics, Bloomberg as of 30/04/2021

In reality, Technology doesn't exceed 25% of the holdings in the strategy, this is just a slight overweight in comparison to global equity market indices[7]. Technology is a big enabler of subscriptions and plays a big role in adapting an offering to ever-changing consumer demand. That being said the strategy is no way Technology oriented and does not intend to be. The pandemic driven rotations have led to this false conclusion: this is simply the 'long term' dressing up in 'short term' clothes.

What might have slowed the progress of the strategy in 2021, is ironically the high resiliency of businesses that rely on subscription. A recurring revenue model, by definition, is not cyclical, and hence was tactically out of favor in 2021 with investors choosing recovering, cyclical companies at the

6 Source : Bloomberg, Thematics AM

7 Source : Thematics AM

expense of quality. The growth rebound in 2021 is certainly less steep if you have seen decelerating growth in 2020 rather than outright revenue decline.

In our opinion, this fall in the pecking order should be short lived, as noise stemming from inflation expectations, stimulus package talks, lockdowns, chip shortages among others should slowly fade with investors discerning winners from losers based on the following : Business Models, Fundamentals, MOAT, Execution, Return on Investment, Balance Sheet health to name a few. As soon as the market prices more normalized growth rates, we are convinced it will prove more favorable for subscription-based companies.

Subscriptions add one more, core advantage to companies: Visibility. Having a resilient business coupled with high visibility is the key anchor of the theme and paves the way to capture long term value across a wide array of industries. As a result, the Subscription Economy strategy embodies a well diversified, lowly cyclical portfolio that invests in the winners of tomorrow. Subscriptions are in no way solely Tech oriented, in 2020 they just happened to be in the right place at the right time, and we believe this is where they will be over the years to come.

Written in May 2021

Past performance is not a guarantee of future results.
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