Manole Capital Management
3rd Annual Financial Services Survey June 2020

Introduction:

Manole Capital Management exclusively focuses on the emerging FINTECH industry. Over the last few months, the nine 2020 interns of Manole Capital have conducted our 3rd annual financial services survey. This group is comprised of students from Lehigh University (4), the University of Tampa (3), Indiana University (1) and the University of Florida (1). Like our prior surveys, this research specifically targets the thoughts and insights of America's younger generations and how they view various categories of the financial services industry -banking, brokerage, digital currencies and the payment sector.

Generations:

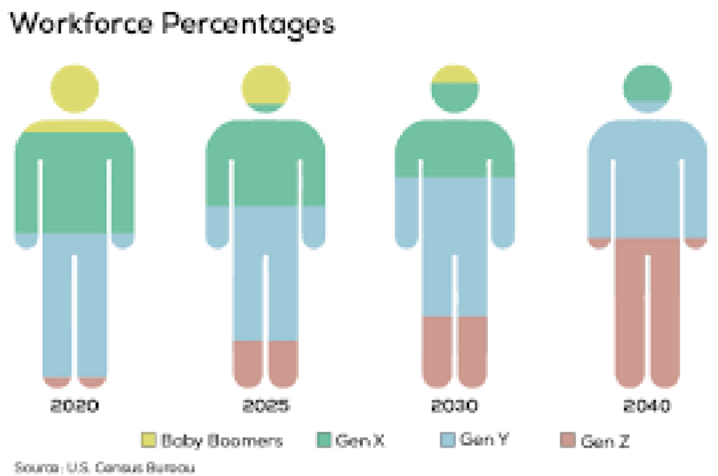
Baby Boomers are often characterized as optimistic, idealistic, self-driven and have shown a tendency to be loyal to one company (average tenure is 15 years). After years of climbing the corporate ladder, many are now interested in retirement and sharing their legacy. The Gen-X and Millennial generations tend to be somewhat skeptical, pessimistic, independent and some focused on having a solid work / life balance. This group is often described as resourceful, as they attempt to build a portable career. The two youngest generations are Millennials and Gen-Z. Early analysis shows that these younger consumers are less concerned about brands, labels or even corporate names. They tend to be quite entrepreneurial, ethnically diverse, socially tolerant and environmentally aware. These two segments were taught at a young age to collaborate and embrace flexibility (at school, at home and at work). They are idealistic and focused on advancement, with fairness.

Our Target Audience:

Once again, we targeted Gen-Z (those born after 1995) and Millennials (born between 1980 to 1994) to better understand America's younger generations. In terms of size, Millennials and Gen-Z are both over 20% of the US population. We feel it is important to understand the perspective of these younger individuals, especially since Millennials have surpassed Baby Boomers, as our largest living adult generation (according to the US Census Bureau).

This younger generation, often called the "Internet Generation", doesn't know what life is like without an iPhone or social connectivity. They seek truth, value individual expression and seem to avoid labels. While most of Gen-Z is still in school, a Fast Company survey estimates that this group will account for 40% of all consumers by the end of this year. How will businesses engage, target and attract this group? The three most influential events of their lives are the September 11th terrorist attacks, the Financial Crisis and now this COVID-19 global pandemic. We are attempting to understand how this audience will bank, conduct its payments and invest going forward. We inquired about four distinct financial services categories and received answers to our series of questions from 247 respondents. Nearly 60% of our responses were female and 40% were male. Those that answered our questions come from 28 different US states and attend 33 different colleges / universities. Our target audience was Gen-Z and we successfully hit that mark, as 95% were between the ages of 18 to 22 years old.

Our Research:



As this chart shows, over the next five to 20 years, the percentage of the US workforce will dramatically shift towards Gen-Z. The questions we asked, as well as the information we received, is summarized below. Where possible, we have attempted to provide our conclusions, takeaways and opinions. While some might be considered controversial, it is simply intended to serve as possible Gen-Z and Millennial perspectives. In addition, since this is our 3rd annual survey, we feel it is interesting to note how certain answers have changed over the last couple of years. Lastly, we have attempted to sprinkle in a few questions pertaining to COVID-19, as this virus was beginning to spread globally, just as our survey had begun.

On Instagram, "influencers" can make millions of dollars for their social influence and popularity. Long before this term became popular, the world has attempted to understand and interpret the thoughts of our younger generations. Young people play a critical role in society, as they create and help shape our future. Older generations may believe these differences are unconventional and progressive, but we believe that understanding different perspectives is critical in adapting to change. We hope you find our research insightful into America's younger generations. We have identified a series of quotes, which has helped to shape our research. We hope you embrace this adaptability and flexibility, as you read our note.

Albert Einstein	*"The measure of intelligence is the ability to change."*
George Bernard Shaw	*"Those who cannot change their minds cannot change anything."*
Edwards Deming	*"It is not necessary to change. Survival is not mandatory."*
Richard Branson	*"Every success story is a tale of constant adaption, revision and change."*
Martha Stewart	*"The more you adapt, the more interesting you are."*

Introduction:

From our experience, when we chat about investing, most of our Gen-Z friends simply shy away. Many of our friends say "that sounds like a good thing" or "I should probably be doing that", but there's a clear lack of experience and knowledge, regarding investing. When it comes to saving money and investing, many of us tend to simply fall short. Either we have not been taught rational investments strategies from our parents or at school.

Gen Z's are just beginning to enter the work force, and many are facing challenging and ballooning student debt burdens. While the number of college graduates entering the "real world" is growing, many are saddled with six figures worth of student loan debt. So even if Gen Z wants to save money and potentially invest in the stock market, their available cash (after student debt) is somewhat limited.

Many Millennials, some of whom experienced the devastation of the Financial Crisis, are cautious about the stock market. Gen Z's were essentially too young to have experienced the direct impact and pain of the Financial

Crisis. We hope that this survey will provide some valuable information and insights into what the growing Gen-Z generation things about investing and the brokerage community.

FINTECH & The Brokerage Industry:

At Manole Capital, we define FINTECH as "anything utilizing technology to improve an established process." Most investors would not consider the brokerage business as being terribly "fintechy", but let's take a step back and look at how investing has dramatically changed over the last several decades. Through the 1980's, most investors needed to speak with a broker, in order to purchase a stock. The commissions were very high and then the broker would speak with their trading desk and then trading floor to execute a trade through a specialist. Starting with Charles Schwab in the 1980's and 1990's, trading began to move off the phone and online and over one's smartphone. Clearly, the brokerage business and investing has truly begun "to utilize technology to improve an established process", right? For us, we are somewhat contrarian in considering the brokerage business a main example of FINTECH.

The FINTECH ecosystem is quite dynamic and certain brokerage players have become extremely aggressive. Newer FINTECH companies are leveraging data and information, exercising an entrepreneurial mindset, and utilizing technological benefits. Newer, nimbler companies, that rely on algorithms, specialized software and technology can succeed. Ultimately, there is no escaping the advancement of certain FINTECH benefits. Whether it is artificial intelligence or other technological advances, the brokerage business is rapidly changing.

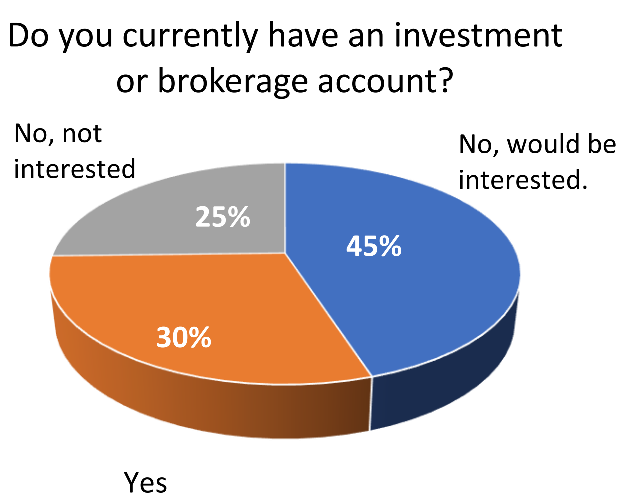
In this note, we will be commenting on the results from our "Brokerage/Investment Accounts" section of the survey. Specifically, we address which brokerage brands are succeeding in the market, as well as what characteristics are attracting Gen-Z investors. We have a quick discussion concerning Robinhood, which is quickly becoming a FINTECH and brokerage leader. Lastly, we examine automated brokerage platforms (i.e. robo-advisors) and ask our respondents a series of questions regarding usage, habits and brokerage preferences.

Question #1: Brokerage Account

To begin our brokerage survey, we asked our respondents if they currently have an investment account. If the respondent did not, we also asked if they would be interested in creating one.

30% of respondents currently have an investment or brokerage account, while 45% of respondents did not but were interested in opening one. The remaining 25% is comprised of respondents who currently do not have an account and are also not interested in opening one.

Over the last 3 years, we have inquired with our Gen-Z survey this same question. In 2019, 58% of our Gen-Z survey had brokerage accounts while only 17% had accounts in 2018.



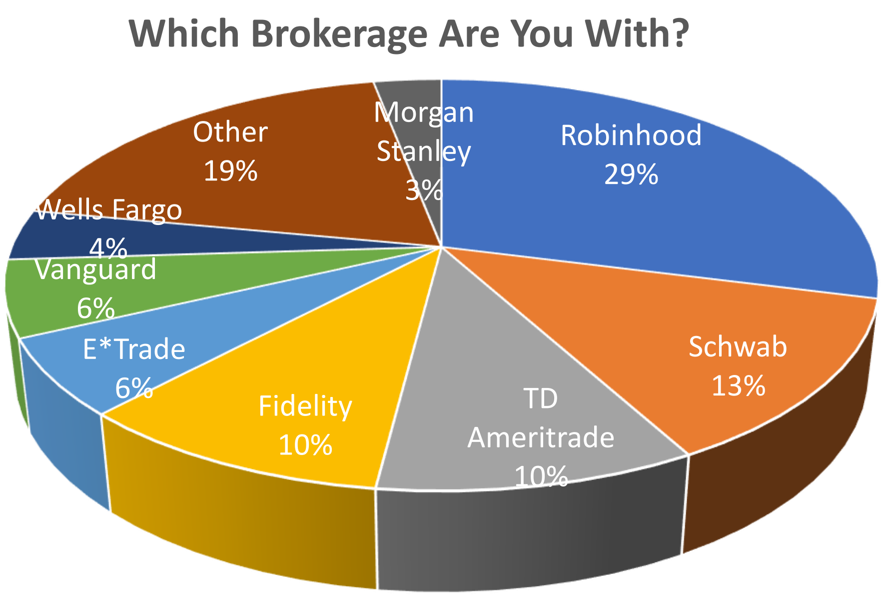
Our Research / Conclusions:

We would have thought that the likelihood of having a brokerage account would mimic the overall stock market, but there does not seem to be a clear correlation. The S&P 500 was down (4%) in 2018, but Gen-Z accounts climbed from 17% to 58%. Then, in 2019, the S&P 500 rose an impressive 31%, but Gen-Z brokerage accounts fell from 58% to 30%. We have to believe that COVID-19 and the global pandemic had some impact on the decline in Gen-Z's desire to have a brokerage account. With the stock market being very volatile in 2020, we are curious to see how Gen-Z brokerage trends develop.

This takeaway and outlook should be promising for brokerages, with 30% of our Gen-Z participants currently having an investment or brokerage account. In addition, another 45% of our survey is interested in opening an account. We believe this bodes well for future growth of accounts at brokerage firms. As our Gen-Z cohorts enter the workforce, we expect an increase in opening of brokerage accounts, as well as an increase in overall investing in the stock market. While today's volatile and uncertain conditions might cause some to shy away from investing, we believe the best long-term option for growing one's wealth remains the equity market.

Question #2: Brokerage Firms:

For those with brokerage accounts, we wanted to know which firms dominated the interest and attention of Gen-Z. We asked our respondents to indicate with whom they have accounts with.



The most popular brokerage was Robinhood with 29% market share, followed closely by Charles Schwab at 13%, Fidelity and TD Ameritrade with 10% of the our survey's total

These results were similar to last year's results, with the biggest change impacting Acorns. In 2019, Acorns comprised 12% of our Gen-Z brokerage accounts market share, but received no votes this year. Another change from 2019 was an improvement in Schwab's market share. Schwab more than doubled from 5% to 13%. With Schwab and TD Ameritrade merging, the combined firm is quickly gaining on Gen-Z's leader – Robinhood. Speaking of Robinhood, they increased their 26% market share from 2019.

Our Research / Conclusions:

The Gen Z generation is generally new to investing and many are scared away from large brokerage houses and their intimidating trading platforms. We believe that Gen-Z is looking for simplicity, ease-of-use and mobile access. In our opinion, this is why Robinhood continues to be the Gen-Z market share leader.

Back in 2018, Robinhood was fairly new to the scene, but it still received 22% of our Gen-Z survey. Over the last few years, Robinhood has only increased its market share and presence. If traditional and large brokerage firms want to appeal to Gen Z, they must have a strong digital presence and attract investors without the help of an advisor. Initially, it appears that Gen-Z does not seem interested in working with an advisor (i.e. an actual human being).

Robinhood:

For those of you who are not familiar with Robinhood, we thought it would be helpful to provide some color, especially around their unique business model.

Robinhood was founded in April of 2013 and was widely known as the only zero commission platform. In May of 2020, Robinhood closed a $280 million Series F round that put an implied valuation of the company at $8.3 billion.

Young investors, primarily in the Gen-Z and Millennial demographic, were looking for a low-cost and user-friendly brokerage firm. Enter Robinhood!

Robinhood's mobile based platform is easy-to-use and it provides decent execution capabilities. With their competition charging anywhere from $5 to $10 per trade, Robinhood stood out in a crowded environment. In addition to no fees, we think Robinhood's "no manual needed" motto perfectly fit with what Gen Z was looking for.

Even today, as others have switched to free trading, investors on Robinhood's platform still get the lowest trading costs (when you consider options are free too). While trades are "free", we still struggle with Robinhood's commitment to "best execution". Robinhood uses third-party brokers to assist with order flow. Instead of charging clients a trading fee, Robinhood earns revenue by keeping any volume-based rebates from brokers, exchanges or specialists. Let's walk through a quick example, OK?

If an individual is purchasing 100 shares of XYZ stock, at $6.00/share, he/she is investing $600. If that individual could have purchased XYZ for $5.85/share, instead of $6.00/share, he/she would have only spent $585. On Robinhood, this "free" trade might have really cost that investor $15. On Schwab, TD Ameritrade or Fidelity, that trade would have also been free of commissions, but we believe execution would have been closer to $5.85 than $6.00 per share. These dominant online brokers must report (to regulators) these best execution capabilities. We have yet to see this same press release from Robinhood. Also, we wonder if Gen-Z investors understands the concept of "best execution", as opposed to just fast or mobile execution?

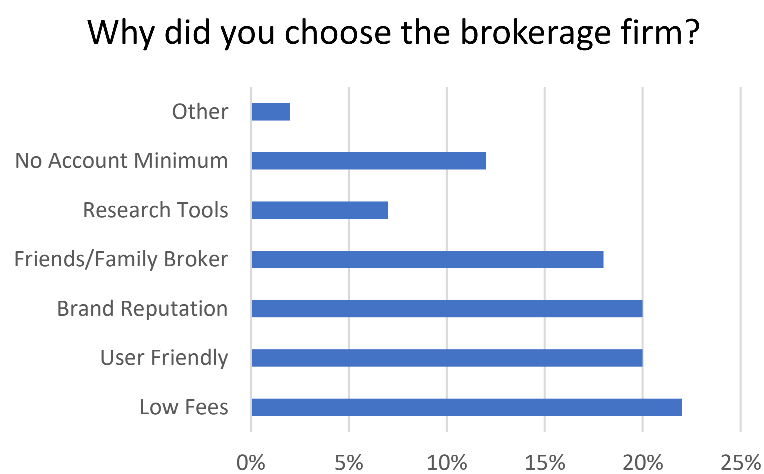
Another key factor to consider, between this upstart and their competitors, is reliability. During the peak of COVID-19 volatility, in February and March, Robinhood's platform crashed multiple times. Its investors were unable to trade, which likely caused millions of dollars of potential losses. These growing pains were reminiscent of the late 1990's and early 2000's problems experienced by Schwab, Fidelity, TD Ameritrade and E*Trade. Back in the day, those firms would compensate upset investors with dozens of free trades. Now that all trading is free, there is really nothing Robinhood could provide to these customers to offset the outage troubles.

Despite the terrible press associated with an inability to handle the market's volatility, Robinhood has not missed a beat (in terms of new account growth). Late last year, Robinhood eclipsed the 10 million account mark, making it roughly the same size as E*Trade. To put that account base into perspective, Robinhood had 1 million accounts in 2016 and grew to 6 million accounts by October of 2018.

During a recent TV interview on CNBC, one of Robinhood's founders, Vlad Tenev, said that it brought onboard a record number of new accounts in 2020, over 3 million. Also, Robinhood has stated that over 50% of its new accounts state that this is their first brokerage account. Clearly, Robinhood's user friendly platform is resonating with Gen-Z.

Question #3: Characteristics

To better understand what is important to Gen-Z, we wanted to ask why they chose their specific brokerage platform. Specifically, we inquired what characteristics helped influence their decision.



Interestingly, low fees was the single most important choice for where Gen-Z chose to open a brokerage account. 22% made their decision on low fees, despite the fact that essentially all brokers are offering free trades. 20% were looking for a user friendly interface, which we believe includes mobile based trading. Another 20% made their decision based upon brand reputation and 18% chose to do business with a broker that a family member or friend recommended.

Speaking of research, this was the largest change from the 2019 survey. Last year, users placed excellent research tools near the top of their deciding factors, at 16%. We were disappointed that very few of our current survey viewed research as terribly important, only 7%. So much for getting our friends to read this research note.

<u>Our Research / Conclusions:</u>

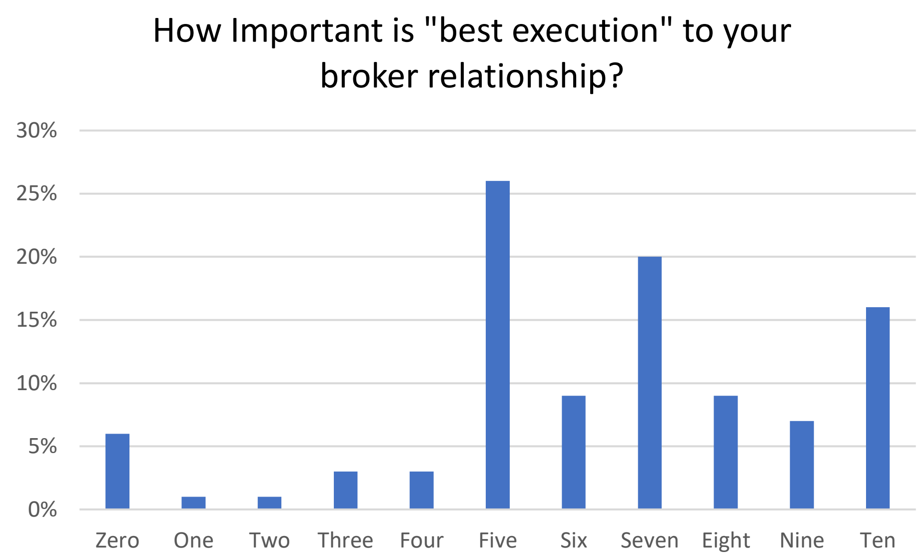
It appears that pricing continues to be an important factor for Gen-Z, when choosing a brokerage house. This is somewhat surprising since essentially all retail brokers moved to free trading in late 2019. Is Gen-Z unaware that all firms are offering low cost trading? Once Schwab, TD Ameritrade and Fidelity went to free trading, one would have assumed that it would have received the vast majority of new Gen-Z accounts, right? These traditional brokerages offer human assistance, hundreds of branch locations, tons of research and excellent and reliable brands.

From our perspective, there must be another factor (besides cost) driving Gen-Z to Robinhood. We believe that Robinhood has the easiest mobile platform and feel it is dominating Gen-Z investors because how user-friendly its interface is.

Question #4: Execution:

Not one single participant mentioned "best execution" as the reason for selecting their brokerage firm. In our opinion, this is arguably the most important characteristic for active traders.

We wanted to see if our respondents understood the importance of "best execution". We asked them to rank its importance from 0 to 10, with 0 being no importance and 10 being critically important.



We considered any votes in the 6 to 10 range as "important" for our investors. 60% of our respondents' value best execution when placing a trade.

<u>Our Research / Conclusions:</u>

We highly doubt Gen-Z fully appreciates the concept of "best execution". As trading volumes skyrocket, in an environment of free trading, this should be very important for active traders. One would hope that all brokerage firms provide great execution, but we do <u>not</u> believe all shops are equal.

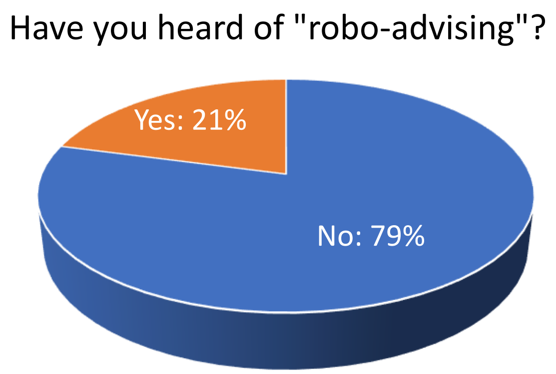
Robo-Advising:

By using advanced computer technologies, databases, and algorithms, FINTECH companies can use artificial intelligence to efficiently meet the demands of investment customers. The brokerage industry has recognized this opportunity and has created "robo-advising" firms. The primary difference is to interact with clients via digital interfaces, as opposed to humans. Robo-advising platforms are a fairly new brokerage solution that uses AI (artificial intelligence) to automate the trading process. In addition, the goal is to remove the human element and any human emotion from the investing equation.

Our next question attempted to address "robo-advising", which is latest trend impacting the brokerage business.

Question #5: Robo-Advising:

It is evident that this "robo-advising" trend is growing. We want to know if Gen-Z was aware of this movement. Also, we were wondering if Gen-Z would be willing to start their investment career via automated processes, as opposed to human interactions.



Less than a quarter, only 21% of our Gen-Z survey, knew anything about "robo-advising". Clearly, the existence of online financial advisors such as Wealthfront or Betterment will need to do a better job of marketing and advertising their services. There appears to be much less market knowledge, at least on college campuses, about this new trend.

We then asked, if they would be comfortable receiving investment advice without a human relationship. 44% of our survey said they would be comfortable receiving investment advice strictly from a "robo-advisor". Interesting!

Our Research / Conclusions:

This is the second year we asked our respondents about "robo-investing" and "robo-advising". We think it will be interesting to watch how this movement evolves. Since Gen-Z loves automation and technology, will it be comfortable getting all of its investment advice through technological methods?

In our opinion, "robo" investing will continue to grow, at the expense of traditional brokerages. Will traditional shops trim their headcount to save on costs? Will they develop better automation to attract younger generations? As Gen-Z ages and begins to seek more advanced knowledge, will it seek the "hand holding" of human relationships and advice of a broker? Only time will tell…

Conclusion:

Over the last year or so, there has been considerable consolidation in the brokerage business. Schwab acquired TD Ameritrade and Morgan Stanley acquired E*Trade. We anticipate the bigger brands will continue to dominate this industry, but they must adapt. Robinhood has developed a strong following among Gen-Z due to its easy to use interface and mobile trading platform. From our perspective, investing is a marathon, not a sprint.

"Thank you" for your interest in the second of a four-part research series on Gen-Z and their opinions on the financial services industry. Please be on the lookout for our payment and banking notes soon.

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