

## Long-Term Secular Growth Drivers

### Shifts in Consumer Preferences

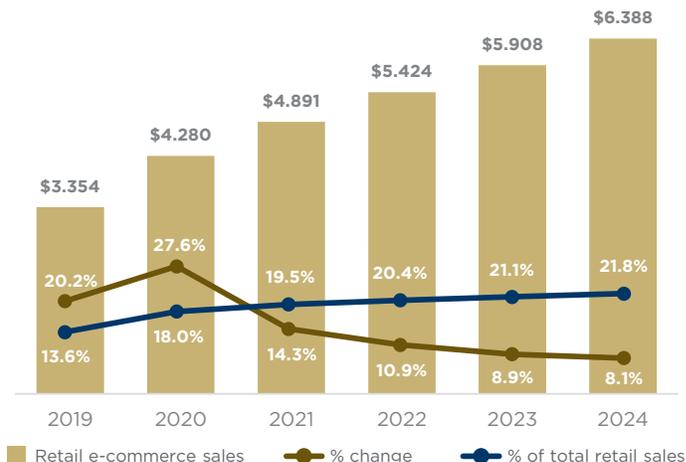
Scout Investments' Small Cap Strategy Team believes that long-term, secular shifts in consumer preferences play a vital role in driving outsized investment returns. These trends develop over time and help us identify opportunities in the markets that others may miss. The ways in which people consume products have experienced myriad changes over the past few decades. Whether it be the rise of online commerce, the pervasiveness of wireless communication, or the genesis of alternative forms of payment, the opportunities (and pitfalls) for consumers are seemingly endless. Add to the mix a pandemic, and these developments will only continue to intensify. In this paper, we will discuss several of the changes in consumer preferences that are most impactful today and how the Scout Small Cap Team seeks to take advantage of these trends in its portfolio.

#### Rise of e-Commerce

Since the mid 1990s, when a small online bookseller in Seattle began its ascent into one of the world's largest companies, ways of shopping and conducting business have evolved significantly. When consumers want to shop for everything from clothing to electronics, groceries, cars, and even insurance, their first stop is often on the internet. During the COVID-19 pandemic in 2020 and 2021, shoppers were able to buy essential supplies from the comfort and safety of their home while e-commerce employees and delivery drivers proved their value as essential workers. A survey conducted by Adobe Analytics found that 9% of U.S. consumers who shopped online in 2021 had never shopped online before March 2020.<sup>1</sup>

Worldwide, the percentage of retail sales conducted via e-commerce is expected to continue its rise to 19.5% in 2021 from just 7.4% in 2015, according to eMarketer. Over that same period, those e-commerce retail sales have grown at an annual rate of 20% to \$4.68 trillion, according to Robert W. Baird research estimates. Much of this is driven by growth in countries outside of the U.S. that have a lot further to go in e-commerce penetration. Adding to that, the rise in shopping via social media platforms with buy buttons and shoppable posts shared by retailers will only continue to drive e-commerce further. Beyond retail, DHL estimates that sales on business-to-business e-commerce sites and marketplaces will grow from \$12.2 trillion in 2019 to \$20.9 trillion by 2027.<sup>2</sup>

**Retail E-Commerce Sales Worldwide, 2019-2024**  
in trillions



Note: includes products or services ordered using the internet, regardless of the method of payment or fulfillment; excludes travel and event tickets, payments such as bill pay, taxes or money transfers, food services and drinking place sales, gambling and other vice goods sales

Source: eMarketer, Dec 2020

#### Wireless Networks and Internet of Things

Wireless communication has been around since the late 1800s. It took another 100 years from its discovery for the technology to expand into broad consumer usage. Initial products included radios, while more recent advancements have evolved into cell phones and the transmission of shorter distance wi-fi as well as Bluetooth. This has increased the need for specialized computer chips that can process and detect wireless transmissions.

The current market for 5G phones is expected to top 500 million units in 2021, capturing 35% of all mobile phone shipments, according to Gartner.<sup>3</sup> Mobile phone semiconductor revenues are estimated to grow 23.3% to \$147 billion this year. Radio Frequency content has increased with each iteration of the mobile phone from \$3 in a 2G phone to \$25 in a 5G model. Ultimately, 5G will provide the platform to expand the internet of things devices (IoT).

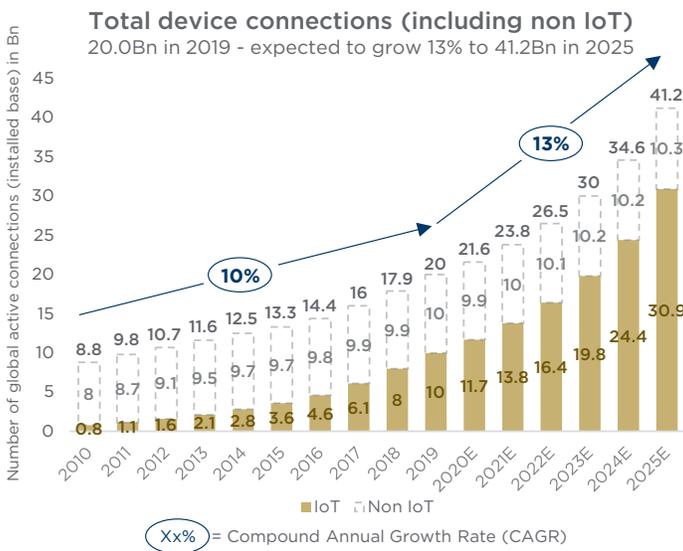
IoT devices contain sensors, processors, software, and connectivity that collect data and deliver actionable information. The semiconductor portion of the IoT device makes up about 10% of the chip industry. Estimates are

<sup>1</sup>Source: [https://business.adobe.com/content/dam/dx/us/en/resources/reports/adobe-digital-economic-index-april-2021/Digital\\_Economy\\_Index\\_April\\_2021.pdf](https://business.adobe.com/content/dam/dx/us/en/resources/reports/adobe-digital-economic-index-april-2021/Digital_Economy_Index_April_2021.pdf)

<sup>2</sup>Source: <https://www.dpdhl.com/content/dam/dpdhl/en/media-center/media-relations/documents/2021/dhl-b2b-guide.pdf>

<sup>3</sup>Source: <https://www.gartner.com/en/newsroom/press-releases/2021-02-03-gartner-says-worldwide-smartphone-sales-to-grow-11-percent-in-2021>

that there are over 10 billion active IoT devices in 2021, which is expected to surpass 25 billion units by 2030. For the past three years, wireless communications and IoT are the leading semiconductor applications, according to a survey done by the KPMG Semiconductor Industry Group in early 2021. Markets are in all industries including consumer, industrial, energy, and healthcare. Within industrial companies, unplanned downtime can be nine times more expensive than scheduled maintenance, helping drive more IoT implementations. Products include home security, elderly care monitoring, industrial equipment sensors, and luggage tag tracking to name a few. It is estimated that globally \$15 trillion will be spent on IoT devices during the six year period 2019-25.



Note: Non IoT (Internet of Things) includes all mobile phones, tablets, PCs, laptops, and fixed line phones. IoT includes all consumer devices and B2B connected devices.

Sources: IoT Analytics - Cellular IoT & LPWA Connectivity Market Tracker 2010-2025. Data as of November 2020.

## Alternative Forms of Payment

When new graduates sit at their desk for the first time as employees, they may be surprised to be using a phone attached to a cord on a regular basis. They may also have to deal with the fact that many of the invoices they send or receive at work are paid using another unfamiliar technology ... the paper check. While the trend towards electronic and card payments is well entrenched in consumer applications, the transition many consumers went through a decade ago is just becoming the reality for many businesses. According the Federal Reserve, cash and checks continue to lose share of consumer payments in favor of credit and debit based payments.<sup>4</sup> As more transactions move online or in app, many of these transactions are becoming completely digital. Today cash

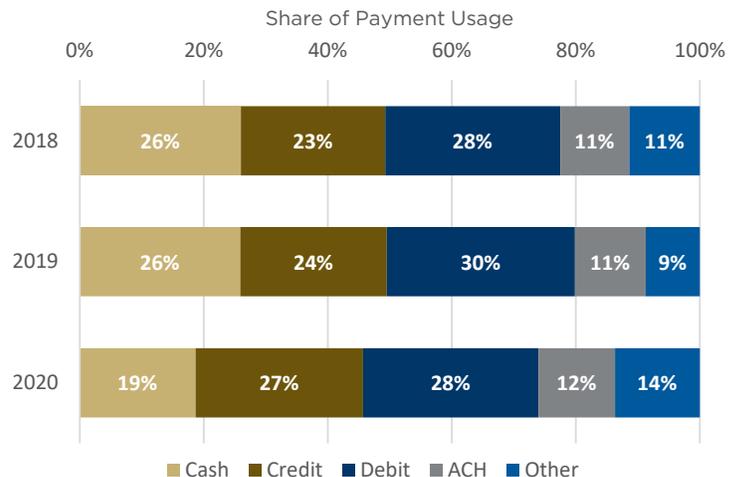
is predominantly used for small-dollar transactions, while checks continue to hold 33% share of transactions over \$100, with the middle ground now dominated by card-based payments. The COVID-19 pandemic drove a material increase in online transactions as well as an increased use of contactless payment technologies, especially for small-dollar transactions where cash is still important. Consumers are also using more account-to-account payment technologies that allow them to send and receive payments from other people. We believe many of these changes will be fairly durable as the economy re-opens.

In business transactions, the story is at a much earlier stage. There are a number of factors that have kept more business transactions via check, including high interchange fees charged by card providers, which matter more for larger transactions, and paper-based receivable and payable processes.

Today we are seeing a number of companies focused on facilitating electronic payments for business and government. These solutions sometimes bundle software that makes portions of the accounts payable or receivable process run more smoothly, possibly with some degree of automation and integration with payment solutions. Other solutions may help businesses address customers in a more modern and digital way, easing interactions with the business.

As companies continue to progress to more digital and software-based methods of serving customers, we expect that the integration of payments will become more standard. The opportunity to facilitate more modern payment methods appears to have a long way to go and is a theme in which we continue to look to invest.

## Consumer Payment Methods Over Time



Sources: Federal Reserve Bank of San Francisco, Diary of Consumer Payment Choice May 2021

<sup>4</sup> Source: <https://www.frbsf.org/cash/publications/fed-notes/2019/june/2019-findings-from-the-diary-of-consumer-payment-choice/#:~:text=Debit%20cards%20were%20the%20most,percentage%20point%20increase%20from%202017&text=In%2Dperson%20payments%20accounted,percent%20of%20in%2Dperson%20payments>

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