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Post-corona:
a fresh look

April 2020

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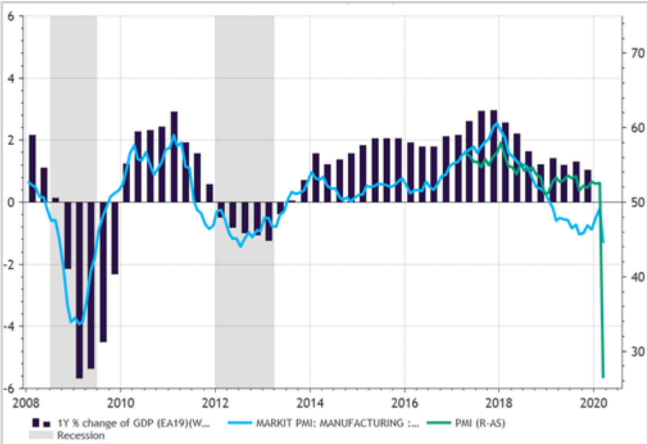
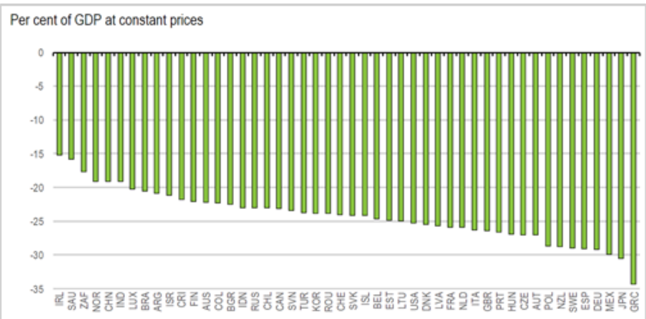
Between 15 February and 15 March, we saw a record decline in stock indices of around 35% across the world, followed by a recovery of up to half of losses until the time of writing (mid April). Volatility remains high due to measures taken across the world to slow down the spread of the coronavirus. The uncertainty about when and how economies will open again, and what the long-term consequences will be in terms of growth and unemployment has investors in their grip. Opinions differ about how long the measures should last (and how quickly economic growth can recover afterwards) after an expected record decline in global gross domestic product (GDP) in the second quarter of 2020.

PMI for production and service industry Eurozone



Source: Refinitiv Datastream, 20 April 2020

The potential initial impact on activity of partial or complete shutdowns on activity in selected advanced and emerging market economies



Note: See notes to Figure 1. The sectoral data are on an ISIC rev. 4 basis in all countries apart from Korea, New Zealand and Brazil, where national data are used. The calculations are based on an assumption of an economy-wide shut down, rather than a shutdown confined to particular regions only. Source: OECD Annual National Accounts; OECD Trade in Value-Added database; Statistics Korea; Statistics New Zealand; Brazilian Institute of Geography and Statistics; and OECD calculations.

Some sectors, like the audio-visual sector, data centres and other digital services, as well as essential food producers, food distributors and even do-it-yourself outlets and the construction sector, are not being affected by the coronavirus measures as much as others. As is generally the case, individual stock selections can make all the difference for investors. We take a closer look at the various sectors.

WINNERS

We can see that there is still relatively strong demand for shares in independent clean energy producers (so-called Independent Power Producers, IPPs) such as Brookfield, Enclavis, Scatec, Atlantica, Falck, Albioma, Nextera and Solaria. Knowing that energy will always be an essential necessity of life and that these IPPs will continue to generate turnover thanks to longer-term purchasing contracts or even long-term feed-in tariffs. Therefore as a certain minimum level of turnover will always be maintained, renewable energy producers seem to be a relatively safe haven. Due to growing volumes, IPPs are becoming an asset class in their own right, and because of their decentralised nature, the correlation between prices in this sector and the oil sector is weakening. Another interesting niche that is emerging right now is the digital healthcare sector. This sector includes companies like Teledoc in the United States (which focuses on medical telephone/video diagnoses and treatments), and Ping An Health and Technology in Hong Kong (operating in the healthcare software sector, including online medical consultations). Neither of these companies is profitable as it stands now, but the prevailing circumstances may accelerate demand for their services and products, now and in the future.

Needless to say, shares in food companies that provide for the primary necessities of life, remain relatively good safe havens. The ‘beta’ of these shares remains low. Unilever and Ahold Delhaize are examples of companies offering relatively good protection, even in times of looming inflation and extreme quantitative easing (the Fed, the European Central Bank and other central banks are pumping even more liquidity into the global economy than they did in 2008/2009). Both companies have beaten the YTD indices in Europe. Nevertheless, in the food services (Sligro) and beverage sectors (Heineken), the drop in demand from the catering industry will only be partly offset by home consumption.

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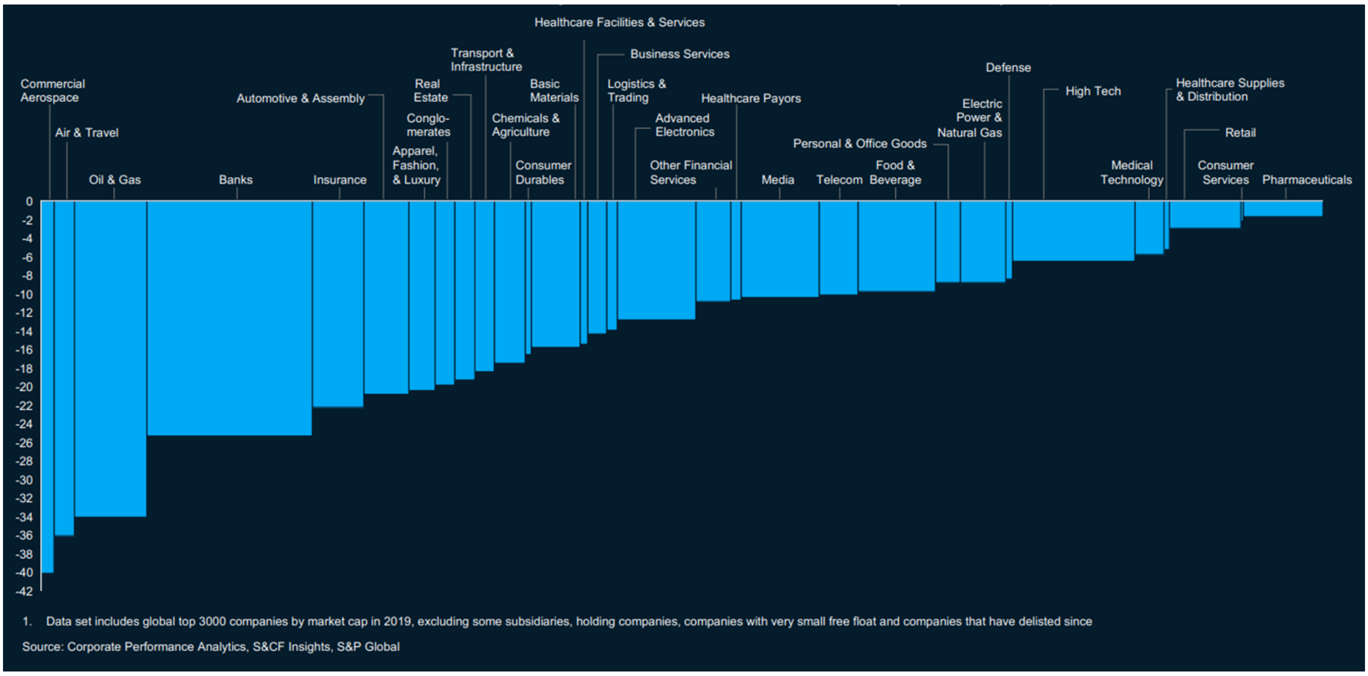
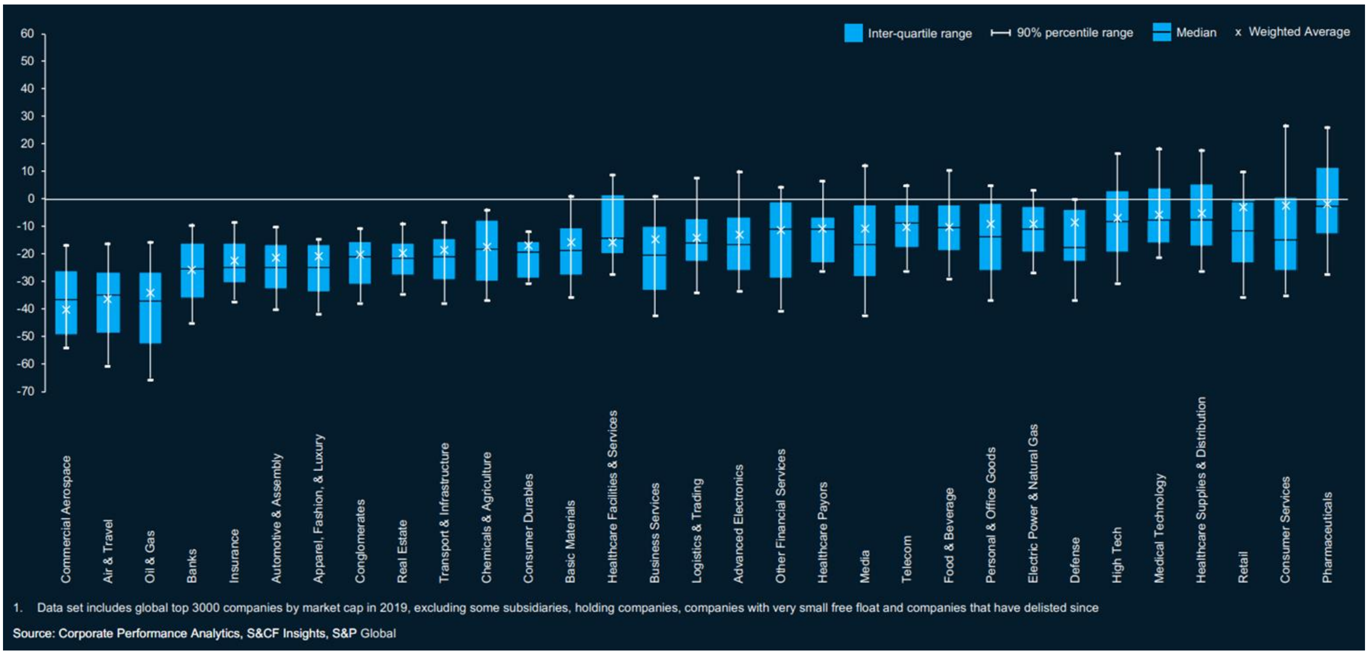
Weighted average YTD local currency total shareholder returns by industry (%)[1]

Width of bars is starting market cap in $



Source: Mckinsey & Company, 13 April 2020 (https://www.mckinsey.com/business-functions/risk/our-insights/covid-19-implications-for-business).

Distribution of YTD total shareholder returns by industry percent[1]



Source: Mckinsey & Company, 13 April 2020 (https://www.mckinsey.com/business-functions/risk/our-insights/covid-19-implications-for-business).

LOSERS

The international aviation, hotel and hospitality sectors, and related niches of the real estate industry, are facing tough times ahead. Some countries that opened up after extended periods of social distancing, like Singapore and South Korea, have indicated that they are also taking future temporary and regional 'intelligent lockdowns' into account.

It is likely that the catering and travel industry will not experience a V-shaped recovery. This will be a major additional challenge for those countries that depend on tourism, like Spain and Italy, which have already lagged behind in terms of reforms and sovereign debt reduction. The expectation is also that many companies will try to prop up their balance sheets in the near future by issuing new shares or cheap debt securities.

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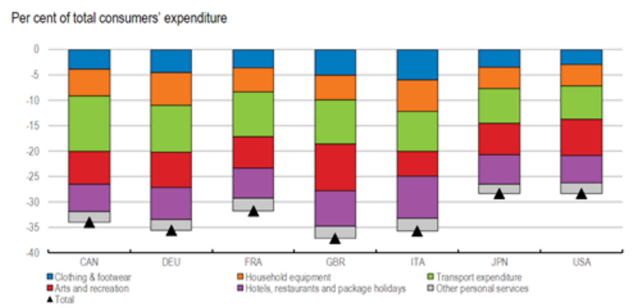
HORIZON

The big question is whether the indices have hit rock bottom. As previously noted, much will depend on the duration and scope of the measures taken against the coronavirus, and the extent to which governments dare to open the economy in an effort to save (some of the) jobs. GDP growth recovery and the associated consumer spending (65 to 70% of GDP) depend on it.

The potential initial impact of partial or complete shutdowns on private consumption in the G7 economies



Note: The spending data are based on a COICOP classification in all countries. The categories included are clothing and footwear (COICOP 3); furnishings and household equipment (5); vehicle purchases (7.1); operation of private vehicles (7.2); transport services (7.3); recreation and culture excluding package holidays (9.1-9.5); package holidays (9.6); hotels and restaurants (11); and personal care services (12.1). All expenditure on clothing and footwear, furnishings and household equipment, vehicle purchases, package holidays and personal care services is assumed to stop completely; spending on recreation and culture, and hotels and restaurants is assumed to decline by three-quarters; and spending on transport services and the operation of private vehicles to decline by one-half. The calculations are based on an assumption of an economy-wide reduction in spending, rather than a reduction confined to particular regions.

Source: OECD Annual National Accounts; Statistics Bureau, Japan; and OECD calculations, 14 April 2020

With time, economies will learn to adapt, to become more flexible and better able to deal with fast and temporary lockdowns. Moreover, a treatment for the virus may come on the market sooner than expected, followed by a vaccine. Yet, many analysts have already revised profit forecasts for companies downwards.

Based on possible negative profit adjustments in the future and the recent recovery in share prices (one hears the term 'bear-market rally' a lot these days), shares are no longer that cheap. In February 2009, too, shares started a long rally from that point forth, even though there was still no sign of real economic recovery from the crisis. Depending on when measures against corona can be lifted, an economic recovery is in sight. It may be far into 2021 or 2022, or perhaps earlier. The liquidity that central banks and governments have injected into the market – already more than in 2008/2009 – will help to absorb the downward pressure. Thanks to asset inflation and a lack of return in fixed-income securities, shares may still be the most attractive asset class in the medium term.

POST-CORONA: THE 1.5 METER-ECONOMY

Without a doubt, the ICT sector – in the shape of digitisation, the internet (of things), data centres, cloud services, cabling and software services – will remain a crucial sector in many respects. In times of ongoing social distancing, digital measurability in several areas and connecting people and institutions may be essential for many parts of society. Examples of this are teleworking, home schooling, home diagnostics, online shopping, online fitness, etc. The online connectivity trend that we are witnessing thanks to far-reaching and accelerating innovation may continue, even more so after this corona pandemic. Google, Microsoft and Amazon are shares that stand out in that regard. That said, also smaller, innovative companies may emerge in this field.

In the not too distant future, topics such as health consciousness and sustainability, but also local and short(er) supply chains will play an even more important role than before. The coronavirus has not only brought to light the interdependence of countries and people, but also our reliance on our health. It is therefore to be expected that trends in exercising (having a healthy diet, eating organic and naturally produced food, as well as buying locally made products) will grow in strength when it comes to food consumption and lifestyle. Shorter supply chains across the sectors, both through local production and consumption (for instance spending holidays locally), will not only follow in the wake of the coronavirus, but will also be prompted by the climate targets that have been set. Shorter chains mean lower CO_2 emissions and thus more sustainable production, fresher products (food) and not to forget: less strategic dependence (for instance when it comes to energy). In that light, the expectation is that the IPPs mentioned previously will continue to perform relatively well.

An interesting item for consideration is shares in the construction industry. For the time being, construction is generally continuing, and has not been overly affected by social distancing. That said, given the declining GDP coupled with the growth of online services, this sector will not be immune to a recession (especially when it comes to offices and retail outlets). On the other hand, people will be investing more in the comfort of their own homes because they will be more and more dependent on their home environment if lockdowns become more frequent while we wait for enough vaccine to become available. Investment in sustainability often goes hand in hand with home renovations and this often leads to energy savings. Keep an eye on Kingspan (insulation) and Nibe Industrier (heat pumps) shares for the longer term.

All things considered, social distancing is expected to benefit the ICT sector, and decentralised and green energy generation. There will also be opportunities in health-related sectors and the (local) food and services sectors, smart logistics solutions, home improvements and home entertainment.

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CONTACT

Marketing & Communications

+31-20-543 6777

marcom@actiam.nl

www.actiam.com

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