THE Wealth REPORT

Throughout history, certain events have irrevocably changed the world — the Industrial Revolution, the invention of radio, television and the internet. This time around, it may be the pandemic. Stock markets tanked, employment plummeted, economies receded and health care systems were tested to the brink.

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INVESTING IN THE MIDST OF A PANDEMIC

Overview

The global COVID-19 outbreak pretty much put the world on its ear. Many countries are still reeling from its impact six months after the first reported cases in China. And yet, despite an initial drop in the investment markets, some sectors and asset classes have remained strong.

A common assumption is that stock market prices reflect the overall health of the economy, which is still in decline. So, what do these misaligned market signals mean?

The S&P 500 quickly rallied by more than 25% from its precipitous drop in March. While some analysts claimed early on that the market was priced for a quick recovery of the virus, a quick recovery did not materialize. And yet, the S&P 500 and the Nasdaq continued to persist with relatively stable performance. In recent months, analysts have recognized that market rallies are more likely the result of two factors:

- The Federal Reserve's lightning-quick moves for more generous liquidity via monetary policy.
- The U.S. federal government's record-setting stimulus packages providing aid to households and small businesses.

It's important to note, too, that leaders worldwide responded in kind, with more than $10 trillion in global fiscal and monetary stimulus issued by the end of April. Those moves injected a lot of money into the economy, which has helped fuel investment markets.[1]

Is the Market Rally Sustainable?

The rush to reopen economies had little to do with whether the virus was contained. Even before the pandemic, the U.S. deficit was in bad shape. The debt-to-GDP ratio was at approximately 80% — two times greater than the historical average. When you add in the recent stimulus packages, the federal budget deficit is anticipated to reach $3.7 trillion this year, three times higher than last year. That number doesn't include any further stimulus that may be issued this summer and/or in the fall.[2]

The economic goal is twofold. By relaxing shelter-in-place rules and allowing businesses to reopen, more people can get back to work in order to bolster income tax revenues rather than siphon from them. Moreover, reopening helps generate business growth and consumerism and sustain high share prices.

Despite the push to get people back to work, earnings expectations for companies are dropping. This makes sense. Even with companies running at full tilt, it's unrealistic to expect them to deliver the outstanding growth they achieved over the past eight years. And while most investors aren't completely exiting the market, we are seeing a flight to the perceived safety of well-established growth stocks.

Some market analysts are predicting that a return to "normal" post-pandemic society — when professional baseball teams return to playing at stadiums filled to capacity — will not occur until spring 2021.

The Old Normal

Under the "old normal" scenario, a quick recovery would have seen outperformance by stocks that typically do well coming out of a recession, such as value stocks, small caps and cyclicals. That's not the case here.

If it does take a year for the economy to get fully back up to speed, how much growth can investors expect while companies are running at 20%, 30% or 50% below capacity? It is unlikely that the government will continue fueling the economy with liquidity. It is more likely that we are in for a long-haul recovery, with many household budgets and investor portfolios feeling the hurt. The most recent expectations are for -4% global GDP in 2020.[3]

Flight To Safety

In the short term, old-normal tactics may be a viable respite for mature investors concerned about preserving principal. Market analysts at T. Rowe Price emphasize quality and yield, given today's uncertain economic outlook and the unknown level of containment for COVID-19. Recommendations include a preference for:[4]

- Higher-quality large cap stocks over small caps
- U.S. over international allocations
- Pandemic-friendly sectors such as communication services, technology and health care
- Short-duration fixed-income vehicles

The New Normal

Despite the economic woes experienced since the new millennium, today's global economy has not been tested by a massive health crisis to the scale of this one. We now better understand the economic connectivity among international communities and how one country's problem is, in many ways, every country's problem.

Moving forward, the "new normal" may be characterized by a shift in the way businesses are run — and what and how consumers buy.

Shifting Business Patterns

To keep the capitalist engine running during lockdown, businesses, schools and government entities quickly moved to remote operations, with millions of Americans quite suddenly working from home. While this was previously a slow-moving trend, much of the U.S. has now developed the infrastructure to make it happen. In many ways, this flexible and scalable capability will help define the short- and medium-term success of both large and small businesses. Those that see overhead cost-reduction opportunities may decide to implement this labor model, at least to some degree, as a longer-term, fundamental change.

In addition to beefing up cloud computing capabilities so that employees can work from home, the business world is exploring new trends such as Infrastructure as a Service (IaaS), Platform as a Service (PaaS) and Software as a Service (SaaS).[5]

We also may see faster and increased investment in robotic automation and artificial intelligence (AI) on factory floors, throughout the supply chain and for low-touch customer service call centers. After all, fewer people involved in day-to-day production activities means that manufacturers are less vulnerable to a widespread health crisis. Furthermore, the use of these advanced technologies allows factories to scale production in response to rising and falling demand.[6]

Pandemic Business Lessons:

- Shift from cash to digital payments
- Enable workers to utilize their own computers – a business technology trend known as bring your own device (BYOD)
- Product/service versatility – the ability to quickly switch gears and ramp up manufacturing capability for on-demand goods, such as personal protective equipment (PPE) and ventilators

Shifting Consumer Patterns

Companies aren't the only ones adapting the way they operate. Being stuck at home for a month or more with new challenges such as child care, home-schooling and working from home have forced many households to rethink their space, routines, resources and time management skills. As if we were not already a nation dependent on technology, the pandemic rather drove that need home.

Technology enables both efficiency and convenience, whether shopping online, ordering food and groceries for curbside pickup, or conferencing with teachers and co-workers for school and work. While online platforms such as Amazon and Alibaba continued profits and were even able to hire workers when everyone else was laying off, other retailers such as grocery stores and restaurants quickly developed logistics to accommodate online ordering, delivery service and social distancing shopping guidelines.

While some households may have rekindled the joy of board games, a vast majority sank down the rabbit hole of streaming video and social media. Streaming giants such as Netflix, Prime Video, Hulu and Disney+ prospered while new players such as Quibi, Peacock and HBO Max are coming online daily in an effort to meet consumer appetite for content.

Travel restrictions have made distance communications even more necessary and valued. New social networking services like TikTok and Zoom joined perennial favorites such as Facebook, Facebook Messenger, Instagram and WhatsApp.[7]

Shifting Societal Patterns

In addition to today's global economy and real-time communications, we share another global commonality: the environment. While the need for regulatory environmental protections has been debated for the past two decades, the coronavirus outbreak has brought this discussion to the forefront for both health and economic reasons.

Air pollution has steadily grown since the Industrial Revolution, to the point where scientists say it is responsible for up to 7 million deaths a year via respiratory diseases. One could argue that COVID-19 may not have had such an enormous pandemic effect had it not been for decades of global pollution that weakened human bodies and made them more susceptible to deteriorated lung conditions.

As the world rebuilds its economy, many economic, government and business leaders are calling for a reset on fossil fuel investment. A pivot to renewable energy not only helps address long-term global health issues but provides a way for companies to store energy through solar panels and battery packs, making it available, efficient and affordable during times of crisis — economic, weather-related or for a scaled-down, remote labor force.

Early in the 21st century, renewable energy solutions were expensive and competitive only when backed by government subsidies. Today, however, that situation has reversed. Oil companies receive ample government subsidies to help keep their businesses afloat while many renewable energy solutions are cheaper than oil, gas or coal. Investments in newly installed renewables delivered returns of 800% in 2019 and accounted for nearly three-fourths of new energy sources. Countries around the world are making significant investments in renewable energy. For example, Australia plans to base 90% of its energy supply on solar and wind by 2040 — without charging consumers for installation. Low-cost universal access means that overhead expenses for Aussie companies may be lower and could lead to higher profit margins — putting other countries at a competitive disadvantage.[8]

Researchers say that, while costly at the outset, shifting the world's energy map to more sustainable solutions will be cheaper in the long run when accounting for climate disasters caused by fires, hurricanes, floods, etc.

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When you factor in potential health benefits, with a reduced cost for treating air pollution-related diseases, transitioning to a greener future helps both commerce and society as a whole.

"A post-pandemic economic reconstruction based on restructuring the energy map makes sense." [9]

Final Thoughts

Market drops are not fun. Investors worry about whether they should exit positions, when to do so, when to get back in and if they'll meet their financial goals. However, market timing is not a reliable strategy. Investors are as apt to lose money before they have a chance to sell as they are to miss out on market gains while still sitting on the sidelines.

The short-term outlook is rocky and uncertain. Long term, investors may want to consider a variety of sectors that are poised to take advantage of growing trends in technology, health care, consumer retail and entertainment, based on survival tactics of the past few months. And regardless of where you stand on the climate debate, it never hurts to diversify so that industries that experience declines can be offset by others that rise, particularly in the energy sector.

Ultimately, the takeaway is that the investor post-pandemic approach shouldn't be much different than the pre-pandemic approach. It's all about assessing your own personal needs and goals. From this point on, consider your current age, the timeline for when you'll need to tap your investments and how much risk you're willing to take.

If you're interested in some of the long-term growth sectors and industries discussed in this report, consult with your financial advisor for help vetting options appropriate for your portfolio.

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[3] Sébastien Page. T. Rowe Price. May 13, 2020. "The Market Is Pricing in a Long Recovery." https://www.troweprice.com/personal-investing/resources/insights/the-market-is-pricing-in-a-long-recovery.html. Accessed June 22, 2020.
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[6] Mohit Joshi. World Economic Forum. April 20, 2020. “Who will be the winners in a post-pandemic economy?” https://www.weforum.org/agenda/2020/04/post-pandemic-economy-favour-fastest-movers/. Accessed June 22, 2020.
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[9] Ibid.