

Long-term trends

How will they play out in a post COVID-19 world?

Joe Elegante, Senior Portfolio Manager, and Matthew Konosky, Healthcare Portfolio Manager and Senior Investment Analyst, presented at a webinar focused on how COVID-19 is affecting long-term trends across the world. Moderated by Uwe Rohrig, Senior Equity Specialist, here is a summary article of the event.

Key webinar takeaways

- This crisis has created dislocation and disruption, which creates opportunities for active investors;
- Companies that have the ability to benefit from acceleration of long-term secular trends and have flexibility to adapt their business models to changing environments will be winners;
- We may see a rethink of global supply chains and the onshoring of manufacturing in many countries;
- Don't forget about the environment, longer term there is definitely a reason to think the planet can benefit from reduced traffic, reduced pollution, a new focus on health and the creation of more sustainable jobs;
- Development of a COVID-19 vaccine is clearly a key focus; however, there is a much broader effort going on related to medical treatment, testing and monitoring.

Joe Elegante, Senior Portfolio Manager

Defining events of the past, like 9/11 and the World Wars, reshaped societies and governments, and resulted in lasting behavioral changes.

The substantial capital market volatility, unimaginable business interruptions and disruptions caused by these events opens up major investment opportunities. We believe the COVID-19 pandemic will be a defining event that creates similar disruptions. Here are a few examples:

- Unprecedented disruptions to work, education, travel and consumption patterns.
- Global trade is down massively while nationalism is increasing, which may force a rethink of global supply chains and the onshoring of manufacturing in many countries.
- Renewed focus on healthcare issues, as well as diets and obesity, and a shift toward telemedicine.
- We are already seeing rapid adoption of technology and industrial changes. How and where we work and live may be permanently changed for large portions of our society.
- High-rise buildings containing banks of lifts and tightly packed office workspaces, situated in dense city center spaces and supported by public transport, are going to be completely rethought.

COVID-19 pandemic is accelerating long-term secular trends

E-commerce, automation, and the proliferation of artificial intelligence (AI), quantum computing and cloud services were already put in place for remote working and cyber security.

Automation and robotics in the industrial space were already growing, as was production automation, in sectors including auto assembly, protein production, and warehouse fulfillment.

The pandemic has accelerated these trends. This shift is pulling forward around five-to-10 years of investment, depending on the industry. That's because the incremental cost of outages and furloughing employees is too great for companies to bear, and the cost benefit of bringing in enhanced safety measures and employee testing justifies the extra capital spend.

Transportation will also change. Global air travel declined 90% at the worst of the pandemic. After 9/11 it took approximately four years for air traffic to recover.

Now, the need to socially distance will make air travel and other mass transit systems more cumbersome, likely slowing recovery for these sectors. It will also make people reconsider automobiles for marginal trips and certainly for commuting.

The pandemic will accelerate recent progress in autonomous driving, perhaps as an alternative to ridesharing for some. Interestingly, some of the technology powering the space launch at the end of May 2020 will soon be applied in the latest self-driving initiatives.

We are also seeing a change in the perception and value of healthcare, as well as an increased emphasis on health technology.

This is accelerating the notion of countries using healthcare as not only a service, but also a form of economic power, which can be used to gain influence over other countries. Obesity rates are also getting a lot of attention, due to higher morbidity rates in this cohort.

Matt Konosky – Healthcare Portfolio Manager and Sr. Investment Analyst

The healthcare industry has been relatively insulated from the substantial demand shocks we have seen elsewhere in the economy.

Many non-essential medical procedures have been postponed, but we consider this a temporary situation which will have relatively limited long-term impact on the sector.

At the same time, demand has increased in other healthcare categories, including:

- **Biopharma:** A potential source of both a vaccine and therapeutics. Currently, there are over 315 ongoing clinical trials of therapeutics and vaccines;
- **Life sciences:** Diagnostic testing for active infections and antibodies;
- **Healthtech:** Increased investment in respiratory and patient monitoring systems as healthcare authorities around the globe strive to establish surge capacity ahead of a potential second wave in 2H20.

In our view, these tailwinds will likely persist for the next 12–18 months and perhaps much longer, there are a lot of areas in healthcare services that are in dire need of investment and the need for diagnostic testing is not going to go away if infection rates fall.

Vaccines are one part of a broader biotech approach

Efforts to develop a vaccine have captured headlines, raising the biotech industry's public image and moderating the near-term risk of significant drug pricing reform.

But vaccine development is just one part of a much broader industry effort, which includes a wide range of treatments, including antivirals, antibody approaches and immune modulating.

These efforts should put global health systems in a much better position to deal with future outbreaks which we hope will soon result in much lower mortality rates.

A vaccine candidate will probably be available by year-end, but many questions will remain

It is realistic to believe that we will have one or more vaccine candidates available, at least in limited quantities, before year end. It will take a further 18–24 months to manufacture the large number of doses needed.

In the meantime, there are key questions around vaccine development. Of the four or five broad approaches being attempted, we believe the most promising are around two in particular: viral-based approaches and genetic, or RNA, based approaches.

Vaccinating a small group would go a long way to controlling future outbreaks

But vaccination is not an all or nothing proposition.

Even if you were to just vaccinate a small group of high-risk individuals, e.g. healthcare workers and first responders, this could go a long way to controlling community transmission and hopefully avoiding the need for full-scale global lockdowns in any subsequent outbreak.

Q&A

1 Where do you see the highest levels of digitization, and which subsectors hold the most promise?

Joe Elegante (JE):

We see high levels in many industries, like teleconferencing, e-commerce, and digital banking.

Global quarantine has highlighted the need for high quality telecoms infrastructure, delivering more bandwidth as the media industry continues to push streaming services.

We are going to need additional, sophisticated video surveillance to complement contact tracing, and not just at the doctor's office but also in manufacturing and service-oriented businesses.

We think this will become the cost of doing business for many industries including airlines, hotels and other leisure sectors that will see it as a key differentiator for their customers.

Digital payment technologies have seen high growth in recent years but are still in the early stages of becoming truly mainstream. But we are seeing people who wouldn't ordinarily use digital payments being forced to adopt it. The same is true for telemedicine. People have become forced adopters of this new technology during the COVID-19 pandemic, and this subsector has seen rapid growth recently.

Additionally, working remotely may become the new normal for workers and companies all over the world. Some companies have gone from having 10%–20% of employees working remotely to 95%+ in a short space of time. From an IT perspective this is a huge challenge to maintain such a wide supporting tech network; as such, companies will need an upgraded digital foundation for their new business operations.

2 What other changes in behavior aren't seeing so much attention?

JE

Some of the spending data we track show a change in behavior away from traditional entertainment activities towards more solitary activities, like golf and boating.

China and increasingly India are pushing to establish energy independence. The fastest way to do that is through a much larger role for renewable energy, and we have seen massive increases in investment in renewable energy technology, which has pushed prices for solar and wind energy down markedly.

As other countries strive to reinvigorate their infrastructure, spending on renewables is going to be a key component of their fiscal spending. Research from Spain, Germany and Italy shows that air pollution has been one of the key contributors to COVID-19 deaths, and this is resurfacing the discussion that the climate crisis is also a public health crisis.

The Energy Information Administration (EIA) estimates that Co2 emissions in the US will fall by around 7.5% this year, and we could see as much as a 5% drop globally this year. We have seen residents in countries from India to Brazil express shock at the unusually clean air in cities which had previously been asphyxiated by smog. They would like to keep it this way.

Just last week, the European Commission proposed a EUR 750bn recovery fund with a 'green deal' at its core, which will guide investments in Europe's recovery toward a cleaner renewable energy mix. The details of the plan are still being formulated but key priorities include:

- Renewable energy projects focused on offshore energy production;
- One million charging points for electric vehicles;
- More sustainable transport infrastructure;

3 How many companies are working on a vaccine?

Matt Konosky (MK)

There are well over 100 vaccines either being developed or on the drawing board. There are about a dozen in clinical testing, and there are about five or six where we are expecting meaningful clinical data by the end of this year.

From an investment perspective what I think is interesting is that there a lot of unique delivery platforms that are using coronavirus as the testing point for new technologies, similar to what we saw with Ebola and some of the earlier infections.

This could be an interesting story from a long-term investment perspective for start-up biotech companies that would have had challenges breaking into more established vaccine markets.

Vaccines are a very important piece of this but they are not the only approach, we are seeing a lot of antibodies which can provide short-term immunity to the virus, and these might be easier to scale up than vaccines themselves.

We are also seeing a lot of therapeutics in the pipeline too, and these could be important for potential growth for biotech start-ups.

- 4 Is there a danger scenario from accelerated Co2 reduction on the economy?
- JE**
Our efforts to reduce emissions have broadly failed globally, we are still not in line to meet the goals of the Paris Climate agreement, so I haven't seen signs to support that hypothesis.
- 5 Clean energy is growing globally, but what's your view on the use of nuclear power as a future energy source and which countries are leading with new nuclear power technology?
- JE**
Nuclear power generation is always controversial to discuss. If you look at data for low-carbon energy production, nuclear power generation is the second largest source, representing around 25%-30% of power generation broadly.
I do think that some of the recent disasters have sparked a global effort to move away from nuclear power toward solar and wind energy sources, particularly as the cost curves for these renewable sources have come down dramatically.
- 6 Companies benefiting from the shift to working from home have rallied substantially, is there a danger that these companies are now overbought?
- JE**
As a whole, many of these companies have performed in price terms but from a fundamental point of view some of the current valuations are not supported by fundamentals.
There are others, particularly some of the larger names in the e-commerce space, that are growing market share, have good cash flow generation, and show solid fundamentals where we still see room for growth.
- 7 Have COVID-19 restrictions affected your access to companies?
- JE**
It makes things more challenging, but the tech we are using is to some extent making us more efficient. I have recently attended many virtual conferences and one-on-ones with CEOs of companies in our coverage. We still have fantastic access to talk to companies and suppliers and do our research.
- MK**
What's been most challenging is the reduction in biopharm industry conferences, which are a good source of intelligence and networking opportunities.
- 8 When things turn more 'normal' what do you think will be the most profound changes brought about by COVID-19?
- MK**
We really don't know what the second wave will look like later in the year, or whether we have to deal with COVID-19 and a stronger than average flu season. If we do see a second wave, many of the changes brought about by COVID-19, like working-from home, social distancing, will become much more permanent features of our everyday lives.
- JE**
We have been through these types of things before and successfully adapted. If we think about some of the experiments going on, like installing UV lights in subways and spraying disinfectant in planes, these

will become part of everyday life.

In sum, I don't think we should underestimate our abilities as a society to both adapt and innovate. We are already seeing marked changes in everyday behavior which will be long-lasting and, from an investment point of view, that will create many interesting opportunities.

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