

# Where do we go from here for equities?

Market volatility creates opportunities, but selectivity is key

The COVID-19 outbreak has triggered market turbulence in recent months and seen prompt policy actions around the world. But will the pandemic change long-term views and is it an opportunity to make strategic adjustments within strategies? At a recent webinar, Max Anderl, Head of Concentrated Alpha Equity and Nicole Lim, Equity Specialist gave their views on the current bright spots and the areas to watch out for in the months ahead.

## Key Takeaways

- The COVID-19 pandemic has meant that the bull market we have enjoyed over the past decade could finally be coming to an end.
- How and when to navigate the market in the coming months will be crucial, and we will look to continue to implement our buying selectively.
- When comparing an event-driven crisis like COVID-19 with the Great Financial Crisis of 2008/2009, we believe that the swift fiscal and monetary stimulus will be a key differentiator as the economy may be in a better position to recover.
- The shift in consumer preferences will likely come from pent-up demand and record stimulus measures.
- Post-pandemic, deglobalization and greater use of digital options are expected to create new investment risks and opportunities.

The focus around COVID-19 is now largely centered on when businesses will reopen and when governments feel there is a safe enough environment to do so, in the hope that pre-crisis levels of economic activity can resume.

Monetary and fiscal policy has played an enormous role and the response has been faster, and far more comprehensive than during the Great Financial Crisis of 2008/2009.

Stimulus will help support an economic recovery but we believe there will be a permanent shift in consumer preferences amid a combination of pent-up demand and weakened globalization which will change the investment landscape.

We believe that opportunities exist in quality cyclicals, most notably software companies and healthcare equipment providers, while industrials and semi-conductors stocks have some way to go. Timing remains key."

Max Anderl

## What does the Pandemic mean for stock picking?

### Where are we?

- Disease now more understood, recovery a question of time, economic impact uncertain
- Unprecedented low risk free rates, quickest largest stimulus

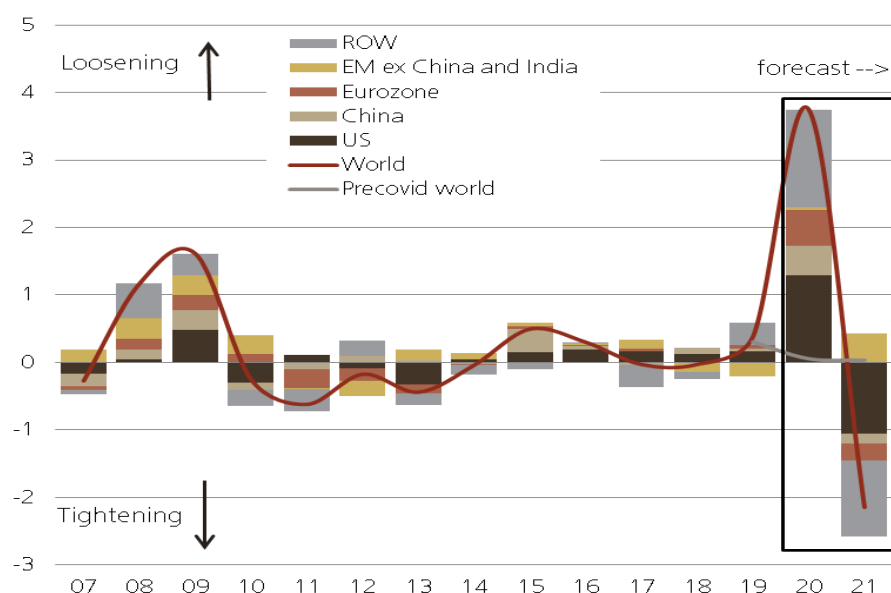
### Side effects

- Liquidity crisis appears solved, bankruptcies and bail-outs likely to follow
- Permanent shifts in consumer preferences
- On the other side of the virus crisis - combination of pent-up demand and record stimulus
- On the other side of the tunnel - heavily indebted governments, weakened globalization, higher inventory

### Equity investment implications

- Absolute return proposal: quality yield stocks in defensive sectors – however the most attractive entry point has now passed
- Quality cyclicals: profitable, valuation support
  - Semiconductor equipment, software, biggest cloud players, healthcare equipment, industrials
  - Working and added to on weakness
- Value ideas: operational or financial gearing, avoid both, as they may be the last leg to recover
- Avoid: deep value with weak balance sheet and structural problems, non profitable speculative business models, most affected industries

### Change in cyclically-adjusted primary fiscal balance (% of global GDP)



Source: UBS Investment Bank. Data as of April 30, 2020

With banks in a better position than in 2008/2009, we are still expecting to see some restructuring but the safety nets in place as a result of fiscal stimulus should certainly be beneficial. Companies that have performed well, for example some of the tech names, have continued to do so through the current extreme environment.

But we believe value stocks remain cheap and valuation spreads remain wide. Therefore, we remain selective in this area, either buying operationally geared companies or financially geared companies and avoiding those industries that we think may take longer to recover.

## Q&A:

- 1** What opportunities has the virus created and how are you positioned to capture them?

We believe that companies that are well positioned for the stay-at-home trend and the shift to online, including Cloud, will benefit the most. However, the market has already priced this so many of these pure play stocks are now trading at all-time highs. Therefore, while these stocks may look attractive from a risk/reward perspective, they may not necessarily present a good entry point from an investment perspective. We believe there are more interesting opportunities in areas that may be less obvious beneficiaries coming out of this crisis and where there is concrete pent-up demand. Across our strategies, we are buying into these types of areas where the stocks could see a recovery.
- 2** What are the bright spots for Europe?

Europe has long been a large underweight consensus position so there is a lot of catch-up potential here. Valuations are also a bright spot and Europe is trading at a discount compared to other markets even after adjusting for the different sector weights.

Valuations for some large caps and some industrials, for example, stand out to us. We have added to these areas in our European and global portfolios as we view this as an opportunity to take part in the recovery and in this valuation anomaly.

European companies have historically been among the largest dividend payers but now we are seeing delays and cancellation in payment of dividends following regulatory pressure during the current crisis. Healthcare is an area we still like as we believe the dividend is safe and interesting versus fixed income.

- 3 Where in healthcare do you see potential opportunities amid the pandemic?
- There are some companies leading the way in testing while others in trying to find a vaccine. Therefore we continue to favor the sector as we believe it is reasonably valued and has strong earnings that have largely been undisturbed by this virus. That said, it is unlikely we will be adding much further to this area as they were relatively more attractive some weeks ago and we began to see some pharmaceuticals companies sell down. With valuations now back to levels where they started, the price gap has closed and we will be looking at other interesting opportunities, such as in the industrials sector, to add to at this stage across our strategies.
- 4 The pandemic is seeing the acceleration of digital transformation of economies which will results in a skew in terms of your holdings. How will you manage this risk?
- Winners in digital transformation – online, cloud and healthcare equipment companies – are the same winners as before the crisis. We are well aware of the upside and downside risk through our investment philosophy and believe that these names still present the best risk/reward in the medium term. We are overweight to some of these names particularly the large caps because we feel that they don't have the same exuberance we see in the smaller cap pure plays which are more expensive now than they were before the crisis. The larger caps are in line or cheaper as they haven't been hyped up that much. They are also the ones that have the profits and earnings power. Smaller companies are less profitable and it is unclear if they will ever reach profitability. We are tilted towards larger good risk/reward opportunities in the digital world.
- 5 Are you concerned about overcrowded trades?
- Crowding can be an issue if markets change but it won't always tell you very much about future performance, as the consensus is not always right. Therefore we remain in the larger caps as we believe they tend to suffer less in sell offs which do come from time to time. It is a risk if there are dramatic changes but there has been progress in digitalization in terms of cashless payments and it is unlikely this will change when the crisis is over.
- 6 What are your thoughts on how EU leaders will support member states during the crisis?
- These discussions are very difficult and are less of a focus area for us because we know that support is coming from the single states. For example Germany is doing a lot to support its own economy along with other countries with good fiscal support at the state level. Europe as a whole is a very international economy so in the event of a global recovery Europe should be in a position to gain regardless of headlines such as this.

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