COVID-19: The Best Companies Will Likely Come Out Stronger

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The spread of COVID-19 globally has driven significant market volatility and a downturn not seen since the Global Financial Crisis—or the 1930s by some measures. With the quarter behind us, how did our global equity portfolios hold up?

A Challenging Quarter

Governments' unprecedented levels of monetary and fiscal stimulus helped ease the equity drawdown somewhat at the end of March, but global equities still finished the first quarter down more than 22%. During this downturn, our global equity portfolios defended value fairly well as markets rewarded quality and its defensive nature.

In a time when the near-term economic growth outlook is so uncertain, the market was looking for reassurances of corporate sales and profit growth.

During the recent drawdown, areas of perceived structural growth have significantly outperformed more traditional industries, such as energy and industrials. This occurred regardless of the perceived valuation advantage of those older-economy industries. Our portfolios generally consist of companies that fit the former profile, given our strong preference for companies that demonstrate structural growth advantages.

That said, not all of our long-term secular growth plays have benefited in the current market environment. The travel and leisure ecosystem, a focused overweight for many of our portfolios, has been a detractor to performance.

A Focus on Quality

With equities in bear market territory across many developed and emerging markets, we expect that our emphasis on owning quality companies will continue to help protect on the downside.

Consistent with this approach, we remain focused on assessing the probability of long-term corporate performance as a key driver of investment returns.

We have been diligently speaking with as many of our companies as we can to gauge their preparedness and ability to navigate through this crisis. During the month of March alone, we had more than 125 corporate touchpoints.

We believe that, as in all crises, the best will not only survive but will actually come out stronger with improved competitive positioning and growth potential.

From a regional perspective, we find many of these long-term resilient growth opportunities in China and the United States. We expect economic growth will resume first in China, and across Asia, so a tilt in that direction would make sense.

Assessing Opportunities

As for our positioning, we are being deliberate with the actions that we take in response to the pandemic. We are evaluating opportunities across all regions and sectors by comparing current valuations levels to our expected long-term growth and intrinsic value forecasts.

We are assessing opportunities to buy great companies that are now selling below their intrinsic value. As we move through this economic shock, we will be looking to purchase quality cyclicals where we find that the risk/reward is favorable and balance sheets are strong. The recovery phase may favor overly penalized areas such as the energy sector, airlines, and financials.

To mitigate risk, we are reevaluating the quality of the companies in our portfolio one by one. Many are being stress-tested for the first time in years. We recognize that the previous steady (albeit low) growth environment may have flattered some companies, making good companies look like great ones. We also expect that companies with more fragile balance sheets are going to be challenged.

Our Outlook

Our outlook rests on the nature of the virus's progression and the resulting economic impact. We expect this to be a very deep recession with unprecedented policy response. We currently see a very steep recovery in the latter part of this year, though we expect a full recovery taking 8 to 10 quarters.

During this period, uncertainty will remain high, with a great deal of disparity around potential economic outcomes.

I have been inspired, though not surprised, by the energy and commitment of our team members in this very challenging time. We have been engaged not just in triage for the current crisis but also for deeper reflective work concerning the drivers of long-term structural growth.

Lastly, we see COVID-19 accelerating many of the shifts we are seeing in long-term structural growth trends, especially around themes such as distributed technology, mobility, 5G telecom, e-commerce, online education, and telemedicine.

We will keep you updated as our outlook evolves.

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