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Accelerating Secular Shifts Are Reshaping Industries

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The COVID-19 pandemic is disrupting the lives of people around the globe and changing consumer behavior in real time. While the long-lasting impacts of this pandemic are yet to be seen, we believe the virus is rapidly accelerating several big-picture secular shifts within certain industries that have been developing for years.

The Rise of E-Commerce and Digital Payments

The demise of traditional retail has long been predicted. As the COVID-19 crisis unfolds, more consumers are now shopping online, primarily due to the shutdown of nonessential brick-and-mortar stores amid government shelter-in-place policies and fears surrounding the spread of the COVID-19 virus. The easing of shutdown orders is unlikely to curtail this shift, which we now expect to occur at a faster rate than we were previously anticipating.

We believe the increased adoption of e-commerce will continue as the convenience and comfort of online shopping will likely result in a permanent shift in consumer behavior. Additionally, some smaller retailers may not survive the extended shutdown, resulting in fewer traditional shopping options, and many consumers may remain reluctant to return to physical stores due to fears of contracting the COVID-19 virus.

Some traditional retailers operate through multiple distribution channels, including both e-commerce and brick-and-mortar stores, allowing them to benefit from the accelerated shift to e-commerce. However, as more consumers shop online, in-store sales are likely to remain muted, putting pressure on the margins of many traditional retailers that operate brick-and-mortar stores throughout the country.

We expect select leading traditional retailers with loyal customer bases and large existing e-commerce operations to successfully navigate the shift. As expected, major online retailers, as well as companies that provide e-commerce infrastructure to other companies, are positioned to tremendously benefit from this shift.

Similarly, the use of cash as a payment method has been declining for decades amid the popularity of credit cards and digital payments. Currently in the United States, more than half of the transaction volumes are completed using credit cards.

Globally, however, that percentage is lower as the use of cash is much more prevalent. We see that poised to change, as concerns about contracting COVID-19 are likely to prevent people from carrying and handling cash and the growing popularity of e-commerce will likely spur the increasing use of digital payment methods.

The Shift Away From Linear Television

The use of linear television has been on the decline as video-on-demand (VOD) services and digital media are gaining popularity. The COVID-19 crisis is likely to accelerate this shift as shelter-in-place orders have kept people indoors with fewer entertainment options.

New content production and sports programming, which we view to be the primary advantage of subscribing to linear television, have also been put on hold as a result of COVID-19. We believe these factors will accelerate the shift toward VOD services as consumers may begin to realize the cost savings associated with these types of services, particularly in the absence of sports programming and advertisement interruptions that come with traditional programming.

Additionally, as linear television continues to lose viewers, we expect advertising dollars to shift toward various online and digital channels, furthering the demise of linear television. Roughly 20% of the U.S. population has already cut the cord, and we believe another 20% will follow suit over the next few years.

The Rapid Transition to the Cloud

Corporations have traditionally run their own data centers and invested in the necessary employees and equipment to do so. However, over the past few years, more companies have shifted to using enterprise cloud computing services for at least a portion of their software and processing needs.

The strategic benefits of cloud computing are plentiful—enhanced data security and optimization, scalability, reduced capital expenditure and operating costs, and improved mobility, which has quickly become a critical factor in the wake of the COVID-19 pandemic.

Efforts to contain COVID-19 have forced many companies to transition their employees to a work-from-home environment, which has prompted those that do not have the data center infrastructure necessary to support such a transition to outsource these needs. Companies that provide cloud computing and migration services have become instrumental in allowing businesses to transition to the cloud quickly and seamlessly.

We believe this experience is likely to force companies to acknowledge the importance and benefits of using the cloud and reevaluate their technology infrastructure.

It is estimated that about 15% of corporate processing needs, otherwise known as workloads, currently occur in the public cloud. While we expected that number to grow to more than 50% over the next few years, the pandemic has rapidly accelerated this transition over the past couple of months. As this trend continues to accelerate, well-established, dominant players in the enterprise cloud computing space are poised to benefit as they are able to provide the ample security, vast reach, significant cost savings, and required infrastructure.

An Increasingly Remote Workforce

Working from home is not a fad, in our view. As we previously mentioned, the COVID-19 crisis has forced many companies to transition their employees to a work-from-home environment. As a result of this, we believe corporations have discovered that employees who work from home can be just as effective and productive as they would be in the office, if not more so.

From a technology standpoint, previous obstacles that may have prevented companies from allowing employees to work from home will likely no longer be an issue as enterprise cloud computing services have enabled a smooth and seamless transition to a remote work environment.

We believe remote work is here to stay in some form or another, even after shelter-in-place orders have been lifted.

Companies are likely to be cautious in bringing employees back to traditional offices, at least until there is a solution to the COVID-19 dilemma, for fear employees could contract the virus during commutes or in crowded offices. Staggered schedules that reduce office density—where groups of employees alternate which days they work from home—will likely become common. Additionally, cost savings associated with a reduced need for office space will likely further motivate employers to shift to an increasingly remote work environment.

Supply Chain Diversification

We believe some companies had already started to rethink their supply chains and manufacturing sources heading into the COVID-19 crisis.

As the U.S.-China trade war intensified, companies began restructuring their supply chains to rely on multiple sources, including shifting a portion of manufacturing to other regions, rather than relying on a single source such as China. We believe this trend will accelerate, as the COVID-19 pandemic has highlighted the risks associated with the absence of a diversified supply chain.

This risk has been especially evident in healthcare. There have been shortages of critical personal protective equipment, a significant amount of which is manufactured in China, along with many basic pharmaceutical drugs. In an effort to be more prepared for future crises, we believe the U.S. federal government is likely to encourage U.S. healthcare companies to shift at least a portion of their manufacturing back home and to help set up a more robust U.S. medical testing infrastructure.

Implications on Our Investment Process and Philosophy

Identifying these accelerating secular shifts within industries is a key part of our investment process and philosophy. We focus on identifying what we call structurally advantaged companies—growing companies in growing industries whose long-term growth potential is underappreciated by the market.

We look for healthy industries with strong secular growth drivers whose profits are expected to grow at least as fast as the overall economy over a three- to five-year horizon. We then aim to invest in large-cap companies within those industries that we believe are taking share of the industry profit pool.

We find that companies in healthy industries that are taking share of the industry profit pool typically achieve faster profit growth than the overall market and tend to be better performers over the long term.

Our differentiated large-cap portfolio's focus on growing companies and industries has been key in our ability to deliver compelling investment outcomes over the years. These accelerating shifts reinforce many of our past investment decisions and increase our confidence that the trends we had identified are in place and will only get stronger over the next several years.

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