"Deferred Growth" Companies Pose Intriguing Opportunities

Some strong firms may benefit from a delayed surge in demand.

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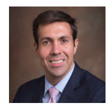
KEY INSIGHTS

- We believe investors should cast a wide net in the search for secular growth opportunities.
- Health care firms involved in diagnostics and bioprocessing have stayed largely out of the spotlight but should play a crucial role in fighting the coronavirus.
- Cord cutting may in fact benefit cable companies able to reposition themselves as broadband streaming hubs.



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One important focus of our teams is finding secular growers—companies that are leveraging technology either to take share away from others or to create entirely new markets, making them less reliant on a healthy economy. We often refer to these firms as being "on the right side of change" as they disrupt industries across the globe.

While many of the most prominent secular growth companies have benefited from stay-at-home orders in the wake of the pandemic, other disruptors have seen their growth interrupted. We believe this is one reason investors should cast a wider net in looking for growth opportunities. Our portfolios include firms across a range of sectors, many of which are less well known than the internet platforms that have led the market's advance in recent months. We believe that many of these "deferred growth" companies should perform well when vaccines or effective treatments for COVID-19 emerge and global economies more fully reopen.

Health Care Innovators Outside the Spotlight

While the search for treatments and vaccines is compelling, we've typically avoided the pharmaceutical sector, and for a number of reasons. In general, top-line growth is relatively muted, and the level of innovation required to replace legacy blockbuster drugs is daunting. We're also skeptical that many of these companies will be able to significantly monetize the COVID-19 vaccine, at least initially.

We think a more interesting area within health care is the life science tools and services industry, which is seeing just as much innovation but is subject to less regulatory risk in the form of drug pricing controls. Two areas of particular focus are diagnostics and bioprocessing.

Molecular tests to detect current infections of COVID-19 and serology

Biologic drugs based on proteins secreted from living cells may soon represent over 50% of the drugs in development.

tests for antibodies are likely to be in high demand for longer than most expect—for example, doctors and nurses are expected to be tested two or three times a week. An example of a company in this market is DiaSorin, an Italian specialty diagnostic concern that has developed a test for antibodies to spike proteins, the mechanism that the coronavirus deploys to hijack cells. DiaSorin's test is likely to be especially valuable in analyzing the many vaccines under development that mimic spike proteins to provoke an antibody response.[1]

Biologic drugs based on proteins secreted from living cells may soon represent over 50% of the drugs in development. Unlike traditional small molecule drugs, which are made by chemical synthesis, biologic drugs are essentially proteins that are secreted from living cells and require a more complicated manufacturing process. Up until recently, biologics have been made in large, expensive tanks that need to be cleaned after each use, a process that can cost hundreds of thousands of dollars. German company Sartorius is pioneering the use of disposable containers—which can be compared with highly sophisticated trash bags—to replace those tanks, reducing both contamination risk and capital expenditures.

A New Appreciation for the Broadband Pipeline

Some of the companies that have benefited directly from consumers' need and desire to stay at home during the pandemic are seeing changes in their business models that may benefit them even after the crisis is over. The need for a fast internet connection for families to share as they try to work, study, and entertain themselves at home has highlighted the importance of the broadband pipeline, which should help cable firms take share from digital subscriber line (DSL) providers, while charging existing customers more for upgraded connection speeds. With many customers hesitant to bring installers inside their homes for an upgrade, cable companies are also seeing ballooning demand for self-install kits—a durable shift that saves significant money for providers and results in less customer churn.

Netflix has been a beneficiary of the stay-at-home rules, and many speculate that the switch to streaming services from traditional television has been accelerated by the pandemic. Cord cutting may also benefit well-positioned cable providers. Firms that are able to provide broadband access may see improved margins as their customers dispense with linear television bundles in favor of streaming services. Netflix, Hulu, ESPN, and other services may pay firms such as Charter Communications a "finder's fee" for bringing in new subscribers, reversing the stream of payments to acquire content. Charter and others are developing their own Roku-like operating systems in order to become households' centralized hub for streaming subscriptions.

Opportunities in Companies Largely Untouched by the Crisis

We are keeping an eye out for opportunities presented by the ongoing rollout of 5G cellular networks, which has carried on despite the pandemic. Among the primary beneficiaries of the 5G buildout are likely to be the leading cell tower operators. T-Mobile and Dish, in particular, have spent heavily on new spectrum for 5G, and they should be active buyers of tower capacity in order to leverage their investment. Tower companies should also benefit from tight zoning restrictions that keep a lid on competition as well as the low interest rate environment.

The rollout of 5G should also drive a significant upcycle in the smartphone

[1] Specific companies mentioned here and subsequently are examples of important economic and market trends being accentuated by the pandemic. These are provided for informational purposes only and are not recommendations to buy or sell any security.

supply chain through the end of next year. The new wireless standard will require significant changes to the internal structure of smartphones to allow for more components and better heat dissipation. Apple is investing heavily in factory automation to be able to churn out 5G-capable iPhones, which could benefit a number of its suppliers.

Markets are likely to remain turbulent in the months ahead, but we are mindful that sell-offs can provide an opportunity to upgrade our portfolios by bringing down valuations in what we believe are the most attractive companies. We are also aware that downturns offer a chance for "do-overs" on companies whose growth potential we had underestimated.

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