



Crisis Playbook (Part III)— The Acceleration of Adoption

Today's environment will act as a powerful catalyst for change.

April 2020

This is the third installment in our “Crisis Playbook” series. We first examined the “fear of loss or regret” in early March, asking which poison investors would choose—avoiding loss or regretting opportunity? Then we explored the concept of “stop getting worse,” laying out signposts for the bottoming of global equity markets. We identified three possible indicators of when and why fear would peak—(1) centralized policy response, (2) progress on testing and treatment, and (3) peaking U.S. infection rates.

Markets have since had a powerful bounce, with U.S. and global growth stocks leading the way, while “value” sectors have been more mixed. Oil- and travel-related equities continue to suffer. Financials have shown signs of life, despite monetary policy stimulus collapsing interest rates.

Looking Beyond the Growth/Value Dynamic

With growth stocks leading both into the crisis and through the market's current recovery, valuation spreads between growth and value have become extended by almost any measure. This has created opportunity within financials, and even commodities, and we have sought to



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capitalize on that. However, calling a broad-based bottom in the value cycle has proven treacherous work over the past decade. We prefer to stick to specific opportunities in stocks we consider on the right side of change with good growth prospects when those stocks happen to live in “value” neighborhoods.

We have long subscribed to the view that “technology is unlocking capacity” across industries and that, when combined with aging demographics, this points to a low-growth, low-inflation, and low interest rate world. Perhaps we have entered a new phase of response to these circumstances, with the coronavirus pandemic forcing many central banks and governments into Modern Monetary Theory, an unexpected nudge to an idea that has been on many policymakers' minds.

“Barriers crumble,
the virus a catalyst,
future pulled
forward.”¹

¹ Haiku—a short form of Japanese poetry in three phrases, typically characterized by three qualities, traditionally including a seasonal word and evoking images of the natural world.

“Facebook total messaging increased by >50% in March, while voice and video calling have more than doubled on Messenger and WhatsApp.

“Total estimated number of minutes streamed to TV is up 85% year over year.

Time will tell if “too much money chasing too few goods” leads to inflation. Over the past decade, there have been few, if any, financial consequences to monetary or fiscal stimulus. Will this time be different? We will be watching closely.

But what of the growth/momentum darlings? Do we risk a reversion in the names that have proved so defensive for the year to date? The short answer is “yes” because when factors become this crowded, short-term reversion is likely. The trickier question is what to do about it.

We have made some adjustments to our strategy to trim extreme momentum, while also leaning into very selective mispriced value opportunities where we see an insight driving positive change. An important lesson we have learned about periods of crisis is that they often create powerful catalysts for change. Crisis breaks down barriers and accelerates the rapid adoption of efficiency. “Necessity is the mother of invention,” and in times of crisis, the adoption of smart technologies and the value of innovation is pulled forward. An early 20th century Bell Telephone advert is reported to have read “people who are quarantined are not isolated if they have Bell Telephone.”

This crisis is no different. We are seeing a powerful acceleration of adoption because of the radical and abrupt changes that physical distancing is bringing to our lives. Communication, entertainment, commerce, health care, and education have suddenly switched to become remote and digital with an order of magnitude we could never have imagined in the short term. Digital is no longer supplemental—it is primary. Barriers to adoption have crumbled through that necessity, and we expect lasting behavioral and attitude changes, including society’s stance on the internet, which has softened during the crisis.

We think that this creates an environment ripe for extreme outcomes. An extreme outcome is the opposite of mediocre. Human beings are comfortable with averages, but extreme outcomes are all around us and often describe the history of significant alpha from an equity-investing perspective.

Extreme outcomes are heavily tied to network effects, where adoption takes on a snowball effect (a global one in this era), and that may lead to natural monopoly characteristics, including scale benefits to profitability and high barriers to entry.

One of the challenges of investing today is that a handful of companies with natural monopoly characteristics represent a huge percentage of global market cap. Identifying these stocks and sticking with them has been crucial to performance. We believe this crisis will compound the advantage of some of these companies and catalyze new winners.

Accelerated Outcomes—Grasping the Rapidly Unfolding Opportunities

We see multiple opportunities to capture the acceleration of extreme outcomes in the market today. The virus and its burden on society are forcing change. E-commerce is an obvious beneficiary. The dominant players in the West are scaling up to meet accelerating demand, while in Latin America and Asia, multi-format players are also seeing accelerating growth as a result of today’s challenging environment.

Second-order beneficiaries include the select software and payment/commerce platforms that are helping to transform. Video streaming services—first dates, birthday drinks, and love lost over video chat. Enough said.

Enterprise systems are accelerating their shift to the cloud as work from home moves beyond the temporary. Many aspects of remote communication

175,000

Number of new employees Amazon is hiring to meet the spike in demand caused by the coronavirus.

are turning out to be more powerful and efficient than in person. One simple example that stands out to us is the acceptance of digital signatures. The health care industry and municipal governments all but refused to accept digital signatures before the virus, but that is changing rapidly.

The hardware and semiconductor infrastructure to support this shift is being challenged. It must be faster, more scalable, and cheaper. We believe only a handful of critical companies can deliver the innovation necessary to enable this. This should create a powerful right side of change benefit for these select companies.

The virus itself is challenging our health care paradigm. The urgency of testing and the development of a vaccine are accelerating the move to mass scale diagnostics to test for the virus and its antibodies. Vaccine investment is creating

demand for single-use bioprocess solutions. We think that changes in health care investment as a result of the coronavirus will be long lasting.

Part of a Journey to a “New Normal”

We respect today’s extended valuation spread between growth/momentum and value. Caution on this dimension is warranted in the short term and we are working hard to manage rotation risks. However, we also believe in the power of change, driven by periods of crisis. New behaviors and models that seem strange today will soon be the norm. As growth investors we need to be vigilant about extreme conditions, but always seek to put our clients on the right side of change.

Crisis often accelerates change. This time is no different.

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