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How will a Covid vaccine change markets?

Pfizer's announcement of the success of its SARS Covid-19 vaccine trial was – pardon the pun – a shot in the arm for markets. It was also a reminder of distortions in positioning and sentiment. The moves on the day highlighted the opportunities to buy companies that have seen demand collapse but which have the potential to return to pre-crisis levels should social distancing end.

For months we have been debating internally the speed at which the world might normalise. Interestingly, the debate has been not *whether* it will but *when*. Humanity will surely not be forced ad infinitum to fear a virus statistically no more virulent than historical epidemics – particularly at a time when technology provides the tools and understanding to defeat it. Both politically and economically, governments cannot afford to lock their populations up forever.

Vaccine optimism

Yet this in itself is no reason to be unswervingly positive on equities in the medium term. Amid higher unemployment, weakened demand and shifts in consumer habits and business practices, any discerning investor must reflect carefully on the lasting impact of the pandemic.

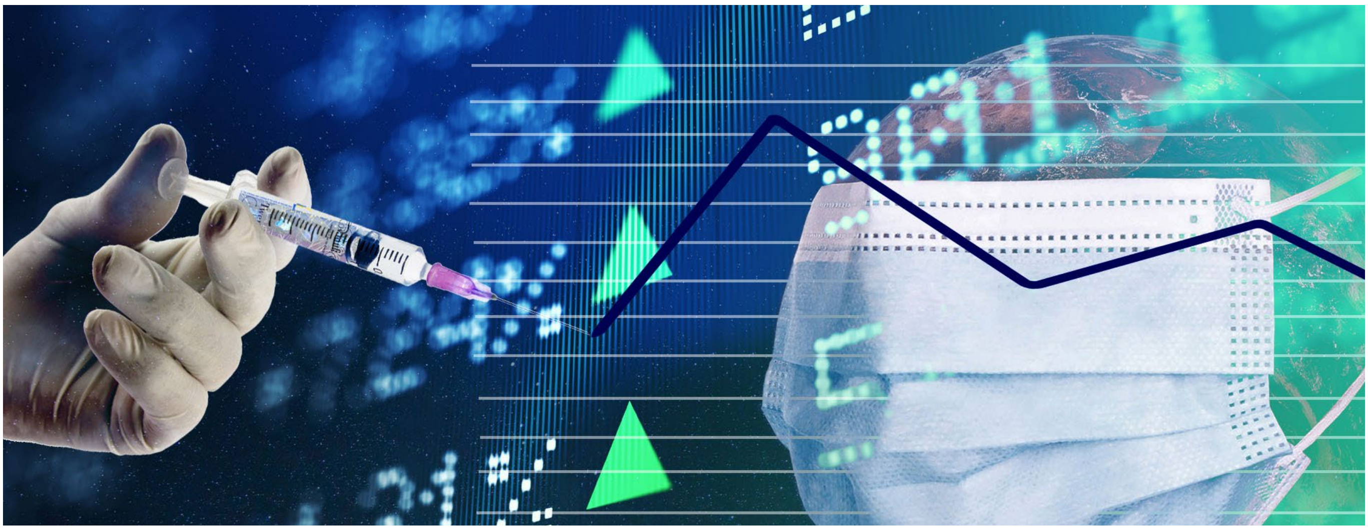
Central banks and governments have done much to prevent the truly disastrous economic fallout that could have occurred. The former have pushed interest rates to near zero and stepped in to provide liquidity to debtors, while the latter have responded through stimulus packages and furlough schemes – preventing the spiralling impacts of a traditional recession in which falling confidence drives lower demand and reduced capital investment. At least for consumers who have managed to keep their jobs, household balance sheets are in fairly good shape and debt servicing costs are low. There is scope for accelerated spending once lockdowns ease.

So which companies should we own in the face of a potentially complex new normal? This question requires nuanced consideration.

Winners, losers and potential turnarounds

Stay-at-home policies have clearly favoured some business models more than others. The move towards a more digital lifestyle – shopping, communicating, working – has exacerbated the valuation extremes that already existed in the market. Many growth companies benefiting from visible and understandable secular trends have gone from strength to strength. What remains to be seen is the degree to which people revert to old habits.

On the flip side, many cheaper and more structurally impaired industries have continued to fall. Some were already trading at historically low valuations prior to Covid-19, having been impacted by growing investor aversion to carbon-intensive industries. Look at the collapse in demand for oil. Look at the dire struggles of companies dependent on the movement of people.



Our portfolios are built on three broad characteristics, the first of which is digital enablement. We hold a group of companies closely associated with innovations such as digital payments, data aggregation and software platforms. These businesses, which are central to the acceleration of "digital life" in home and business settings alike, have performed well during the year. We see no reason why trends will revert when normalisation occurs.

Second, we continue to hold highly profitable consumer-facing businesses, most of which have been adept at adapting to the shift from out-of-home to in-home consumer demand during the crisis. Where this has been harder to achieve we have added to our exposure, knowing that demand will return when activity normalises.

Finally, we hold companies that sit at the heart of the transition to a more sustainable future. Policymakers around the globe – from Europe to China and now potentially the US – are putting the green agenda at the centre of their post-pandemic fiscal thinking at a time when consumer preference is clearly encouraging change.

Thinking in terms of "when", not "if"

What was apparent at the point of the vaccine announcement is how entrenched the Covid-induced status quo is, as represented by company valuations. Lockdown losers shot up as investors rotated away from stay-at-home winners. In recent months we have added to the high-quality companies we own that have seen demand evaporate as people have remained at home.

Spirits group Diageo, exhibition business Relx and US broadband provider Comcast – which also has a large interest in film and theme parks – are just a few examples of businesses that have suffered during the pandemic.

In each case we have kept faith. The percentage gains seen in these companies upon Pfizer's news provided some vindication to this strategy.

As well as adding exposure to the businesses we already own, we have been exploring areas of the market where we see opportunity in normalisation. We do not just want to ascertain whether the positive dynamics that companies enjoyed prior to Covid still exist. We want to establish that these businesses are likely to emerge from a period of mandated demand destruction stronger than before.

Take, for example, Compass Group, which provides catering services in business, entertainment, healthcare and education settings. Although it has been significantly impacted by work-from-home policies and the closing of schools and stadiums, it has bolstered its balance sheet and aligned its costs with the new environment while investing in novel services and platforms that should make the firm more relevant when activity returns. It could be argued that only a small proportion of its revenues could be permanently impacted by a step change in working-from-home practices. We believe this is more than discounted by the current share price. The new world of on-site catering services is likely to be more complex in the post-Covid era, providing Compass with the opportunity to benefit as the trend to outsource this essential but non-core service is likely to accelerate.

There are likely to be many similar stories in the coming months. The trick, as ever, will lie in identifying them. We do not yet know whether Pfizer's vaccine is the cure the world is looking for, but we do know that the light at the end of the tunnel is getting closer and brighter. It is a question of when, not if – and this inevitability must shape our investment thinking.