

## Understanding the Lessons from COVID-19

REFLECTIONS AND OUTLOOK FROM OUR GLOBAL EQUITY CIO

Psychologists often talk about five stages of grief. Similarly, we have witnessed five distinct reactions to the pandemic in asset classes, stocks, and sectors since February. To keep our message simple, we have described these stages sequentially, but we know, that like grief, reality is more complex and that these stages may overlap and repeat themselves.

While the path to a resolution of COVID-19 is unpredictable, we think understanding these stages could help investors with time horizons greater than five years navigate the unique opportunities and challenges that such a pandemic presents. Below, for each stage we attempt to identify the key drivers, what investments may be optimal, and our current fundamental view.



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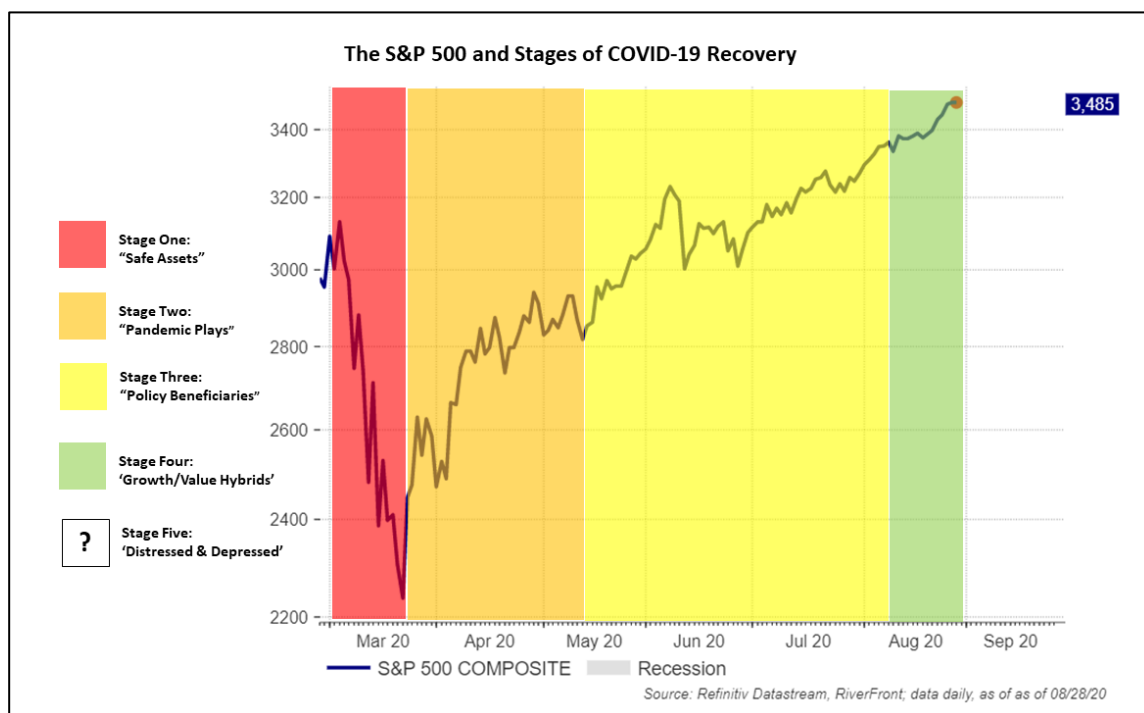
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- We believe there will be five distinct stages to the pandemic in stocks and sectors.
- We think understanding the characteristics of each stage can help investors navigate opportunities and challenges.
- We believe we are currently in Stage Four, which benefits companies that combine long-term growth characteristics with value attributes.



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### STAGES ONE THROUGH THREE: WHERE WE'VE BEEN AND WHAT WE'VE LEARNED

#### Stage One: 'Safe Assets' the Only Game in Town

- **Time Period:** February- late March 2020
- **What Worked:** 'Safe Assets' or 'Governmental Debt'. When a dramatic and unexpected event occurs in the economy, there are very few places to hide. In our experience, the only broad capital appreciation potential available in this type of

environment is government debt. Cash can help, but only by not falling in value. Defensive equities behaved better than the market, but still dropped in value.

- **RiverFront's View: Safe assets are overvalued;** Due to their very low yields, we use government bonds primarily as a volatility buffer and, along with cash, temporarily to reduce risk.

#### Stage Two: 'Pandemic Plays' Win as the Economy Finds a Floor

- **Time Period: Began March 23<sup>rd</sup> low**
- **What Worked: 'Pandemic Plays'.** It is very rare for a major industry to benefit so immediately and obviously from a recession, but this time it happened. Technology and 'online' stocks entered the pandemic with strong growth and we believe their potential appears to have accelerated throughout the crisis. Outside of technology and certain health care beneficiaries, other industries benefitted from the subsequent quarantine and work-from-home environment like consumer staples, home improvement, and online retail.
- **RiverFront's View: Favor sustained earnings beneficiaries.** Some of the 'pandemic plays' like software, health care, and home improvement have additional upside, in our view, as their earnings have the potential for sustained strength. On the other hand, we believe that many of the consumer staples companies benefitted from a one-time restocking boost that is unlikely to be repeated, and could underperform as investors rotate into cheaper ways to play a burgeoning economic rebound.

#### Stage Three: 'Policy Beneficiaries' Respond to Policy Support

- **Time Period: Began around mid-May**
- **What Worked: Policy Beneficiaries.** In addition to Stage 2 beneficiaries, some consumer, industrial, and material companies benefitted when it became clear that policymakers would use significant amounts of monetary and fiscal stimulus to help stem the pandemic's economic impact. Sentiment around these industries was boosted by government paycheck protection program (PPP) loans, unprecedented unemployment benefits, trillions of dollars of Federal Reserve support, and low interest rates.
- **RiverFront's View: Still favorable on home improvement and global logistics stocks.** In our view, loose fiscal and monetary policy is likely to persist, which should continue to help keep the consumer spending. We also think these companies have defensive qualities making them less vulnerable to broad market declines if COVID-19 cases spike again.

### **WHERE WE MAY BE HEADED...STAGES FOUR AND FIVE**

#### Stage Four: 'Growth/Value Hybrids' Start to Emerge as Earnings Outlook Improves

- **Time Period: Happening right now**
- **What May Work: 'Growth/Value' Hybrids.** These are companies that combine long-term growth characteristics with value attributes. These firms tend to have shares which we believe are attractively valued such that any recovery in earnings should be rewarded by investors, even if business does not fully return to normal in the near-term.
- **RiverFront's View: Keep building our watchlist, focusing first on certain areas of financials and industrials.** We believe companies in this group represent a healthy mix of traditional growth companies that we believe have been cheapened by pandemic, and traditional value sectors that are now trading at multiples that are too attractive to ignore. We think this group includes credit card issuers and aerospace companies but think that individual security selection will be critical in sorting out companies that can recover from those permanently impaired by COVID-19.

## Stage Five: “Distressed and Depressed” Stocks Could Benefit from a Full Economic Recovery

- **Time Period: Hasn’t really started yet...**
- **What May Work: Deep Value** companies, i.e. ‘Distressed and Depressed’ firms. These include highly cyclical, distressed groups like retail/apparel, office/mall REITs, airlines, hospitality, and hotels.
- **RiverFront’s View: Be Careful and Patient...Avoid Potential ‘Value Traps’.** One of the realities of big events like a pandemic, is that they can permanently change behavior. Companies that were already struggling with changing consumer habits, like apparel, might only return as a shadow of their prior selves. We think that cyclical companies, along with value stocks in general, will recover before a full recovery is evident in the economic data, but also that many ‘value traps’ will not survive at all. This suggests to us that there may be many false starts before this group can form a solid relative uptrend, and that intense fundamental research is necessary to separate the eventual survivors from the doomed. Tread carefully here.

### **CONCLUSION: BE FLEXIBLE WITH SECURITY SELECTION AS WE MOVE BETWEEN STAGES**

We don't believe that the pandemic has fundamentally changed the rules of investing, but we do believe it will delay interest rate normalization and create opportunities that active managers can take advantage of. Our continuing philosophy is to remain overweight stocks, especially our preferred themes described in the 5 stages above, knowing we must, as always, be flexible.

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*In a rising interest rate environment, the value of fixed-income securities generally declines.*

*When referring to being “overweight” or “underweight” relative to a market or asset class, RiverFront is referring to our current portfolios’ weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios. For more information on our other portfolios, please visit [www.RiverFrontiq.com](http://www.RiverFrontiq.com) or contact your Financial Advisor.*

*Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.*

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