



Mitch on the Markets

Portfolio Manager Investing Insights

WEEKLY CLIENT COMMENTARY

April 30, 2020

The One Thing Covid-19 Cannot Restrict: Innovation

During World War II, the US economy adapted into what was termed an “Arsenal of Democracy,” mobilizing industry to turn car factories into assembly lines for Liberator bombers and shipyards into production facilities for Liberty freight ships. The US economy – and all of the great innovators and leaders within it – evolved to meet the needs of the time, producing ammunition, uniforms, bombers, and tanks.

Today, we are seeing innovation and mobilization of a different kind, for a different type of fight. Corporations big and small across America are shifting production to make personal protective equipment (PPE), ventilators, sanitizer, treatments, tests, and perhaps most importantly, to develop a vaccine.¹ It may not be perfect and it may not be seamless, but the country is aggressively using the engines of private enterprise and innovation to respond to this crisis – and it’s making a big difference.

Economic headlines tend to overwhelmingly focus on what is being lost – jobs, GDP growth, corporate profits, etc. This is fair reporting, as the short-term economic pain is acute and affecting millions of American lives during this period. But

focusing overwhelmingly on near-term, weak economic data often clouds our ability to acknowledge what is actually working – the very engines that make the economy resilient over the long term.

Here are a few examples. The hardware store chain, True Value Co., turned one of its cleaning products and paint factories in Illinois into a production facility for jugs of FDA-approved hand sanitizer. Over a 2 ½ week period in early April, Ford Motor Company produced 2.4 million protective face shields for medical personnel, and it only took the company’s engineers and suppliers three days to figure out how to source and use the raw material to do so.

General Motors linked up with a company called Ventec Life Systems to make ventilators. Apple Inc. and Google are working simultaneously to develop software that will help users trace contact with people infected with the virus. A few developers in the Midwest developed an online form – powered by an algorithm – that allows hospitals and other medical facilities to “match” with factories that can produce needed materials. More than 200 experimental drug treatments are

being tested and developed around the world. The list goes on.²

Companies that cannot alter their businesses to support the fight against Covid are not necessarily sitting idle, either. Many executives are actively using the pandemic to rethink and retool their businesses to make them stronger, leaner, more digital, more prepared, or some combination of all of these things. During the 2007-2009 recession, for example, General Motors used the crisis as an opportunity to shut down brands that had been underperforming and probably needed to be shelved anyway: Pontiac, Saab, Saturn, and Hummer. The company also closed about a quarter of its plants and around 40% of its dealerships³ – a painful correction that ultimately made the company leaner and better suited to compete in the rapidly-evolving auto industry.

Similarly, many US companies today can use this opportunity to reassess ‘nonessential initiatives,’ target strategic acquisitions of struggling companies that can add value to the revenue profile, and take bigger steps to digitize business operations (move more quickly to cloud, increase remote work capabilities, etc.). From an earnings standpoint, corporations are also in a situation where “uncertainty” reigns supreme, meaning that analyst expectations are generally as low as they can go (if they exist at all). This environment gives companies the ability to maneuver within the crisis – in some cases making significant changes – without excessive scrutiny from investors. The end result often ends up being a corporation under-promising or hedging greatly in their guidance, which generally tends to increase the possibility that the company can surprise to the upside sooner than later – the desired outcome.

Bottom Line for Investors

Economic, geopolitical, and health crises throughout human history have often spurred a flurry of innovation, production, and growth. The Spanish flu pandemic in 1918 and 1919 – which killed some 50 million people worldwide – eventually gave way to the “Roaring Twenties,” one of the most productive economic periods the country has ever experienced.⁴ World War II brought women into the workforce and turned

factories in the US into wartime production facilities, assembling all of the materials needed to win the war. There are countless other examples.

These crises are never welcomed ones, and they often lead to devastating, tragic losses. But we must also remember that crises are inevitable – they are part of the human story and always will be. Believing that innovation, ingenuity, adaptation, and growth is *a bigger* part of the human story, however, is what I see as the ideal mindset – especially for long-term investors.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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¹ The Wall Street Journal, April 16, 2020. <https://www.wsj.com/articles/american-companies-innovate-to-fight-the-coronavirus-in-echo-of-world-war-ii-11587045652>

² The Wall Street Journal, April 16, 2020. <https://www.wsj.com/articles/american-companies-innovate-to-fight-the-coronavirus-in-echo-of-world-war-ii-11587045652>

³ Bloomberg, April 26, 2020. <https://www.bloomberg.com/news/articles/2020-04-26/smart-ceos-are-playing-dumb-in-the-age-of-coronavirus>

⁴ NPR, April 2, 2020. <https://www.npr.org/2020/04/02/826358104/the-1918-flu-pandemic-was-brutal-killing-as-many-as-100-million-people-worldwide>

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