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SGA: Weathering the Storm, Assessing the Opportunities

As coronavirus fears rattle global markets, concern continues to grow as the virus has crossed borders, transitioning from an issue that was largely impacting China to one which is now increasingly affecting other countries around the world, including South Korea, Italy, Iran, and, to a lesser degree, a number of other nations. While this situation remains highly fluid with intense news flow, global equity markets have declined, reflecting the higher degree of uncertainty over the economic impact it may have on businesses.

At SGA, we remain focused on identifying the sustainable growth businesses we think can weather the difficulties associated with the current storm and come out the other side able to continue to generate attractive revenue and earnings growth on a long-term basis. Our Investment Committee is taking an “all hands on deck” approach to assess the impact of the coronavirus on companies that are on our Qualified Company List. Subsequently, we have continued to evaluate the likely effect it will have on these businesses as they begin to provide updated guidance on their sales for 2020. All of our analysts are involved in this process to ensure that the evaluations benefit from the broad perspectives that our team encapsulates.

While we are deeply saddened by the human cost being inflicted by the virus—and we fully acknowledge the difficulty in predicting its course moving forward—we continue to look at this issue through the lens of our disciplined investment process. Our process emphasizes key business quality characteristics which tend to enable companies to generate more predictable growth over time, as well as leverages our long-term investment horizon which allows us to look beyond short-term impacts and focus on the economic value over time.

In past decades, there have been serious viral outbreaks—bird flu, swine flu, MERS, and SARS, to name a few—and these played out over a relatively limited time period. Whether that will be the case with the coronavirus, we cannot say. Although governments worldwide are taking unprecedented steps to limit its spread, their ability to contain it is being questioned by the markets as investors have begun to discount the impact of the virus on global economic growth and corporate profits. Interestingly, 2020 EPS growth expectations for the MSCI All Country World Index remain higher than we would expect for the broad market at 8.4%, while 2020 EPS growth expectations for the Russell 1000 Growth® Index are at 12.3%. In both cases, we were surprised by the magnitude of the increase in expectations that took place at year-end for 2020 revenue and earnings growth relative to 2019. Given the slowing effect the virus will undoubtedly have on economic growth, we would expect these figures to decline from their already optimistic levels.

After evaluating the businesses in our portfolios, we have reduced growth expectations for the remainder of 2020 and do not expect a sharp V-shaped recovery in economic growth in 2021. We believe the eventual rebound will be more muted with some demand simply lost. We expect there will be some companies which will be less affected by the virus than others given their products, markets, supply, and manufacturing arrangements. As investors who emphasize buying repeatable and sustainable revenue and earnings growth rates at attractive valuations, and leveraging our 3-5 year investment horizon, we look at the current weakness in the market as an opportunity to selectively refill and increase positions in current holdings, as well as to take advantage of attractive valuations to establish new positions in select great growth businesses that may have previously been overvalued based on our analysis. In all of this, it is important to emphasize that each of our decisions is based solely on our expectations for individual businesses and not on any thematic or macro oriented bet on the ramifications of the coronavirus situation. Accordingly, we have not made major shifts in sector or industry exposures, rather changes made have been opportunistic and focused at the individual stock level.

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