MFS Insights

Potential Opportunities in the U.S. Growth Asset Class

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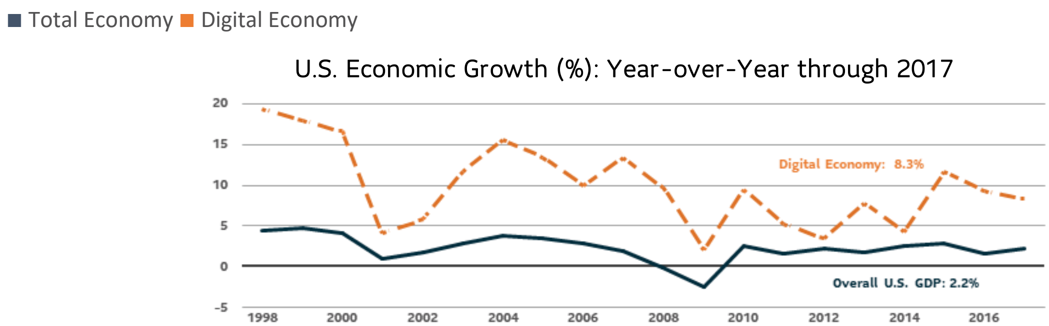
As we look to navigate the current market environment and weigh potential opportunities against risks, we continue to receive questions about market leadership. Investors are particularly interested in our thoughts on the U.S. growth asset class, given its strong performance.

Given the unprecedented global pandemic, are there opportunities for active managers to express a different view on earnings and free cash flow? We believe the answer is an unequivocal yes. Knowing that over time earnings drive stock prices, we keep asking which companies may be stronger and larger in the coming years and which may be weaker? The winners ultimately may determine market leadership, and it is about earnings, not styles, regions, factors, or anything else.

In this context, COVID-19 has significantly affected our daily lives, both personally and professionally. Prior to the pandemic, the digital economy was growing faster than overall U.S. GDP (Exhibit 1). ECommerce was taking share from brick and mortar retail, more applications were moving to the Cloud and remote workflows were increasing. This crisis has significantly shortened the time frame around these dynamics. In our view, what was expected to play out over a decade might be accelerated in the next several years.

Exhibit 1: The digital economy has been growing faster than overall U.S. GDP



Source: Cornerstone Macro, "Tech Will Drive the Investment-Led Recovery," published May 2020. Digital Economy consists of the Internet and related information and communication technologies.

To survive a potentially challenging economic environment in the near term, we believe companies may need to consider investing in technology. For example, in a COVID-19 world, retailers that do not have an online presence may go out of business in a year. In 2019, we witnessed the second-largest number of retail store closures in the US, just below the 20-plus year high of 2017 and well above closures during the global financial crisis (Exhibit 2). The coronavirus pandemic may speed up store closures even more, and we shudder to think what 2020 may look like.

Exhibit 2: COVID-19 may speed up store closures

Source: Credit Suisse, "U.S. Economy Notes: Strong consumer spending is not enough for struggling brick-and-mortar retailers." December 2, 2019.

Remote working is another example of impending technology spending. In a post-COVID-19 world, many employees may continue to work remotely. This too may require significant capex spending on technology, whether wanted or unwanted.

To prevent other pandemics, governments around the world may spend more in the coming years, including on vaccines, testing equipment, delivery mechanisms and hospitals. Moreover, genome sequencing, or the process of determining the DNA sequence of an organism's genome at a single point in time, may alter how drugs are made in the future, creating a potential opportunity.

Looking forward, the entire health care ecosystem may be poised for change. Seeking to identify the winners and trying to avoid the losers of this change through analysis and forming a differentiated earnings outlook are two of the keys that we believe are needed in striving for success (Exhibit 3).

Exhibit 3: The U.S. health care ecosystem

Patients			
Payers	Providers	Pharma	Politics
• Medicare • Commercial • Employers • Medicaid • PBMs	• Pharmacies • Hospitals • Associations • Medical Professionals • Home Care • Extended Care	• Generics • Med devices • Large pharma • Biotech	• Policy • Regulators • Organized groups • Politicians

To sum up, investors may want to consider what drives stock prices over time: earnings. What can a company earn? How much can it grow earnings? How long can it grow them? And what is the value of that earnings growth? At MFS, our growth equity team has approached company analysis by asking and answering these questions repeatedly for nearly two decades now.

If you are looking to understand what may drive market leadership, we suggest simply following the earnings growth. It may lead you back to U.S. growth stocks.

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