Industry Perspectives - Q2 2020

The Return to a "New Normal" —
Reopening of the Economy Amidst the Coronavirus

Overview

During the onset of the COVID-19 pandemic, the U.S. unemployment rate spiked from 4% to 15%, but has since fallen to 11% as businesses reopen.

The world's central banks are committing stimulus funds that far exceed what was done during the financial crisis of 2008/2009.

As the daily case count of the COVID-19 virus in the U.S. has shifted back into its growth phase, many regions are re-instituting lockdown measures in response.

Weighing all the outstanding risks, with valuation trading near all-time highs, leads us to be cautious with our near term outlook.

These are certainly challenging times in which we live. Over the many decades we have been serving shareholders, it feels like we have seen everything. There have been wars, oil price spikes and crashes, mild recessions, deep recessions, computer-driven bear markets, and tech and real estate bubbles, but we have survived all these events, coming out better than the decline.

Given the significant amount of uncertainty that has kept the market pundits worried over the course of the past decade, such as Brexit, the Trump Presidency, healthcare reform, North Korea, Russia-gate, and trade wars, it took a virus to bring the global economy to its knees and end the historic bull market. Such is the case with a "black swan" event, where an unpredicted crisis comes out of nowhere. The swiftness of economic devastation, not to minimize lives lost to COVID-19, has been extensive. In the U.S. over 38 million workers lost their jobs because of the forced lockdown of businesses and stay at home edicts implemented by cities and states. The unemployment rate spiked from under 4% to near 15% in a matter of months, but has recently fallen to 11% as businesses reopen.

In response, the avalanche of grants, loans, and government stimulus provided to businesses and individuals, as well as massive bond purchases by the Federal Reserve, has been unprecedented. The world's central banks are committing stimulus funds that far exceeds, by multiple times, what was done during the financial crisis of 2008/2009.

The tug of war between investors that foresee a v-shaped recovery and those that expect a slow and drawn out recession, produces the extreme volatility exhibited in the stock market. As cities and states began reopening, the market rallied. However, a myriad of potential negatives exist including a sustained spike in coronavirus cases and hospitalizations, higher federal and state taxes needed to pay for debt accumulation, a fading of optimism for a coronavirus vaccine, uncertainty surrounding the Presidential election, and a potential "new normal" of lackluster spending by consumers.

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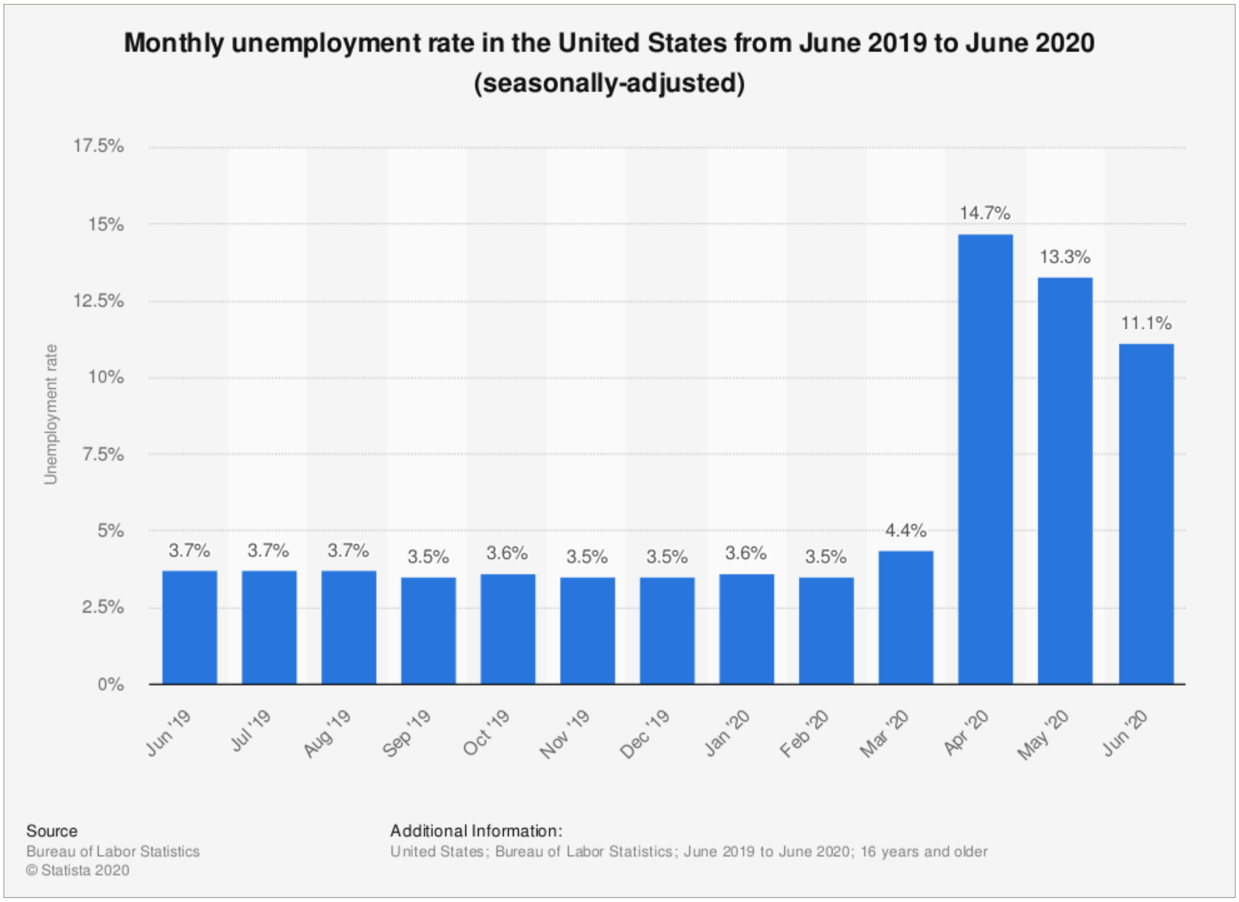

While the healthcare system is important to society, consumer spending is a critical engine of the global economy, providing more than two-thirds of U.S. Gross Domestic Product (GDP). Small businesses account for approximately half of U.S. employment, and it will take time to fully recover.

Significant industry changes are occurring and some businesses might be permanently displaced. Even with massive help from the government, it is uncertain if many small businesses will survive. However, this will cause many new entrepreneurs to start businesses, thinking this crisis is an opportunity.

While ecommerce has been taking market share from brick-and-mortar retail for years, the closing of "nonessential" businesses, which are primarily consumer discretionary retail stores, solidifies the major online retailers as the go-to source for shoppers. Video calls have become the new normal, and bandwidth demand will continue to increase, as a growing acceptance of remote working may become a reality. More regulations to keep employees safe in the workplace will be enacted at a time when companies seek to lower infrastructure costs. We are also anticipating that sporting events will come back soon, as most sports junkies, desperate for fresh content, like seeing history being made rather than reliving it in reruns. And the list of changes goes on...

Though there are so many uncertainties flowing through the market, these are truly exciting times to be an investor. At the Buffalo Funds our core strategies are based upon identifying long-term trends that provide the "hunting areas" for companies that are the beneficiaries of those trends. We do this so our investments have a potential long-term tailwind pushing their business strategy regardless of the current economic conditions. For us, long-term trends are decades or more.

The changes adopted over the past several months, since "social distancing" has become the norm throughout the world, are hopefully a once-in-a-lifetime event. New "normal" social behaviors, that otherwise would have taken a generation to adopt, are being widely accepted overnight. It will take more time to determine if this is indeed the "new normal" or not, but regardless, when one's life or loved one's life is in peril, inconveniences are more readily adopted.

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As the daily case count of the COVID-19 virus in the U.S. has shifted back into its growth phase, following the reopening of the economy, many regions are re-instituting lockdown measures in response. This could disrupt what has been an improving outlook for consumer sentiment, consumer spending, and unemployment.

However, weighing these outstanding risks, with valuation trading near all-time highs, leads us to be cautious with our near term outlook. The broader risk / reward setup seems challenged without more clarity on the trajectory of the virus or a medical breakthrough on the vaccine or treatment front.

At the Buffalo Funds we will continue to be selective in our portfolio holdings and own stocks with great long-term outlooks that can manage through this current environment. As we learn more about the COVID-19 virus and how to treat, prevent, and attack it, society will return to normal. Black swan events come and go, but human ingenuity prevails long-term.

Interested in more info?

For questions or to speak with a relationship manager about adding any of the 10 Buffalo Funds to your portfolio, contact:

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