FRANKLIN TEMPLETON

May 31, 2021

Pent-Up Consumer Demand Fuels US Market Recovery

As the US recovery gains momentum, Franklin Equity Group's Grant Bowers explains why pent-up consumer demand should present a fertile environment for stocks and highlights some opportunities he sees in the US equity market.

The US recovery is gaining momentum as the country reopens parts of its economy—boosted by government stimulus and vaccine rollouts. Reopening is ultimately leading to better-than-expected earnings growth across the broader equity market. First-quarter company earnings in the S&P 500 Index recently surpassed estimates by 22.5% in aggregate, as 86% of the 95% of companies which have already reported (as of 21 May 2021) topped projections.1

While we believe much of the positive news over the last six months is priced in, we still think upside can be found in companies with attractive long-term earnings growth. As the economy continues to recover, not every company will see the same level of appreciation, resulting in a fragmented equity market of winners and losers. Recently we have seen some shifts in market leadership toward value-oriented and cyclical names, as we near the end of the pandemic and growth and inflation rates are rising. We believe this near-term volatility is creating opportunities in a number of areas which we previously thought were fully valued, but are now trading at more compelling valuations.

Worst May Be Over for Epicenter Stocks

The impact of the global pandemic opened up new opportunities for equity investors. Last year, we saw COVID-19 accelerate and support the growing trends of e-commerce and online learning and entertainment. Many technology names benefitted from the global pandemic and we expect they continue to do so. On the other hand, we are seeing an upturn in what we call "epicenter stocks"—companies which underperformed dramatically as the pandemic forced changes in our work, travel and social behaviors. Epicenter stock prices have recovered to some extent in recent months, but we still see opportunity for improving growth in the consumer space as pandemic restrictions are lifted, benefitting restaurants, travel and consumer-oriented technology companies.

Some of this growth will be driven by pent-up consumer demand, coupled with high savings rates. We think pent up consumer demand is going to be a huge growth driver—as of March 2021, the US personal saving rate stood at 27.6%, a huge increase from 8.3% in March of last year.2 Consumers simply haven't been spending any money. We expect consumers to seek out products offered by the retail sector as well as activities and experiences. We would also expect many digital behaviors pursued during the pandemic—like remote work or a hybrid office/home model— to continue long after the economy fully reopens.

Fintech trends were already accelerating prior to the pandemic. A combination of cashless payment systems, mobile banking and challenger banks—smaller banks set up to compete with larger, traditional banks—had already widened access to basic financial services and products. While companies in the fintech sector were not immune to the effects of COVID-19, we believe the contactless habits spurred by the global pandemic are likely to continue. We've also seen an increase in the popularity of mobile remittance apps and platforms. Families working overseas continued to send money back home electronically, even as traditional brick-and-mortar remittance locations were closed due to lockdown measures. Small and mid-sized businesses have also invested in software tools which allow for more efficient management of back-office billing and payments transactions; we expect these tools to stay in place going forward and can continue to gain share as business growth improves post-pandemic.

Health care, for obvious reasons, will also likely take a front and center role in our economy for many years to come. Consumers want better health care, treatment and access, and technological advances can facilitate that. Telemedicine is just one example; digital access allows consumers to connect with their treatment providers for routine questions, creating more efficiencies and productivity by reducing time spent going to the doctor's office for an in-person appointment. Advances in gene sequencing is another example; with the significant decline in the cost of mapping the human genome, we anticipate faster time to market for vaccines, as well as higher efficiencies in the research and development process for various patient populations.

A Trend Reversal to Define 2021?
While growth stocks outperformed over much of the last decade, value names have certainly outperformed over the last six months. As interest rates started rising and US gross domestic product (GDP) growth accelerated from 4.3% to 6.4% over the first quarter of 2021, we saw higher returns in cyclically oriented areas of the market as energy and other commodity prices increased substantially, driving oil and gas and metals and mining stock prices higher.3 Bank stocks rose in large part on rising interest rates and many industrial stocks in areas like airlines, railroads, and machinery improved as demand started to increase.

This type of performance is to be expected in an economic recovery phase, which we are clearly in at the moment. As long-term investors, however, we look through these cycles and argue that growth is better positioned than value. Supply constraints, rising costs, challenges passing rising costs through to customers, likely contributes to margin compression and less earnings visibility in many of the more cyclical parts of the market in coming quarters. Our preference is to own companies with better pricing power prospects, benefiting from secular growth trends and a higher degree of earnings predictability. While rotations in market leadership are healthy, we remain convicted in our growth positioning as we seek to identify companies that we believe can be the future leaders within the US economy and the overall market.

FRANKLIN TEMPLETON

Franklin Templeton Investments (Asia) Limited
富蘭克林鄧普頓投資（亞洲）有限公司
17/F Chater House, 8 Connaught Road Central, Hong Kong
Tel: (852) 2805 0111 Fax: (852) 2519 9482
www.franklintempleton.com.hk/institutional