The first 6 months of 2020 have been unprecedented, with global investors facing volatility of epic proportions. The main catalysts rattling markets and investor confidence are not a mystery. Financial markets have struggled to quantify the economic impact of COVID-19, oil prices have collapsed due to a price war and demand shocks, and government bond yields declined to historic lows.
A different world - structural changes from 2020 and beyond

Aside from the markets, the world today is a different place than it was at the start of 2020. While estimating the date that life returns to “normal” is difficult, it is safe to say that society will likely change in many ways permanently once this virus is under control.

As investment professionals, it is vital for us to look past the pain that many are feeling and ignore the constant news stories and social media posts. We remain focused on decisions that will help ensure your investments weather this storm and participate in the forthcoming investment environment that we expect to emerge.

With this top of mind, we believe that quality and secular growth companies will be the winners coming out of the pandemic.

Those with strong balance sheets, robust corporate governance and excellent business models should thrive. However, the pandemic has the potential to structurally change the attractiveness of a variety of industries - both positively and negatively. This article will be the first of two publications the Fundamental Equities Team at TD Asset Management Inc. (“TDAM” or “we”) is creating to discuss some of the main industries we feel will be impacted the most.
Investing in a post-pandemic world

**E-commerce**

With leaving the home not an option for many, e-commerce has gone from a “nice to have” to a utility. Everything from groceries to furniture is suddenly being researched and ordered online thanks to the investments made by technology companies. One of the leaders in the space is Amazon who has faced surging shopping demand from consumers. To keep up, the company hired an additional 175,000 employees, investing in new delivery capacity and prioritizing warehouse space for essentials.

Closer to home, Canadian success story Shopify has been making a great impact as well. A champion of the small-business, Shopify is facing the task of supporting its 1.7 million merchants. In response to the pandemic, the company has offered a 90-day free trial for new sign-ups, introducing curbside pick-up to its physical merchant base, and increasing its funding commitment for Shopify Capital by an additional $200 million to support small businesses. As a testament to just how far e-commerce has come, Shopify reported that its merchants have been able to replace 94% of in-store lost sales through its e-commerce channels.

The longer physical distancing and the state of emergencies go on, the more consumers will likely be ordering online, which in turn could permanently change shopping habits. Will people go back to their old practices, maintain their new ones, or something in between? Physical isolation may become baked into our culture, which will likely bode well for e-commerce and have a negative effect on traditional “brick and mortar” retail.

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**E-Commerce Sales as % of All Retail Sales in the U.S.**


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E-commerce has gone from a “nice to have” to a utility
Remote (work from home) work arrangements

Millions around the world have come to rely on collaboration and video conferencing tools for their day-to-day telecommuting tasks when working from home. Examples of some of the more widely used applications include Zoom (Zoom Communications), Teams (Microsoft), and WebEx (Cisco). Just months ago, many would have dismissed the idea that hundreds and even thousands of employees scattered around the globe could participate in real-time video communication. Yet today, this is a reality, and many are embracing the new normal, finding that these applications have helped maintain productivity.

Against this backdrop there are two critical implications for how we incorporate this new set of facts into our investment framework. First, there have been and will continue to be opportunities to invest in companies that have established leadership positions in the video conferencing space. Beyond that, and potentially even more meaningful given the breadth of application, is the implication on expenses for the companies in which we invest. Many companies are using this as an opportunity to track productivity and reset their cost base, and in some cases, these revised expense assumptions are translating into meaningful revisions in the operating margins of the firms whose stock we own.

Digital payments

This has been one of our team’s dominant investment themes in recent years, and while this trend has been slower than expected to materialize in certain key economies, we believe an acceleration in the adoption of digital payments is imminent. The backdrop for this theme is quite straight-forward - approximately 70% of Americans still use cash on a weekly basis⁴. Furthermore, when Americans do use digital forms of payment like cards, they generally employ antiquated swipe technology vs. modern contactless technology that’s largely adopted in Europe and Canada⁵.

In a nutshell, the opportunity is significant, and given that cash remains a possible means for COVID-19 to spread, it is our expectation that the pandemic has increased the slope of the digital payments adoption curve in the short run. Our portfolios are positioned with the aim to take advantage of that trend.

### Top App Store Downloads

- Zoom
- TikTok
- Google Meet
- Microsoft Teams
- Netflix
- Instagram
- YouTube
- Tax Report
- Facebook
- Google Classroom

Leisure and entertainment

The pandemic not only impacts physical health, but it also has mental health consequences. Anxiety and stress have been elevated in many households across the world. To that end, leisure and entertainment may be more important than ever as we all try to keep a semblance of sanity and balance in our daily lives. However, with many traditional forms of entertainment, like movie theatres and concert halls now off-limits, the entertainment landscape has shifted dramatically.

One obvious beneficiary of the trends has been video streaming platforms like Netflix, Amazon Prime Video and Disney+, where streaming has shot up exponentially during the pandemic, as people were confined to their homes with few options for entertainment. Another form of digital entertainment that has become invaluable to millions of people during the pandemic is video games. More and more people are increasingly turning to consoles from Sony, Microsoft, and Nintendo and publishers of popular video game titles from Electronic Arts, Activision and Ubisoft to pass the time.

Consumers aren’t just playing more video games. Video game environments are increasingly merging with real world entertainment.

Deprived of opportunities to attend live concerts, 28 million fans attended a live Travis Scott concert staged entirely within the top-selling Fortnite game⁴.

The big debate right now is what comes next. Are these shifts in how we spend our leisure time permanent, or will we revert back to our old ways? Our view is that the answer is somewhere in between. While live sports and concerts will always be an integral part of the human experience and technology is not yet available to displace them, we believe consumers will be slightly more discerning when allocating a portion of their discretionary income to sub-par entertainment experiences.

Believe it or not, when taken collectively, individual decisions to avoid spending $100 per ticket on a second-rate concert and instead stay home to bake bread or garden, will result in broad changes in the revenue profile of several companies within the public equity domain. This is having implications on how we invest here at TDAM.

Finding alternative ways to be entertained due to COVID-19

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Telemedicine

Amongst the biggest beneficiaries coming out of the pandemic, will likely be the increased utilization of telemedicine in delivering healthcare. Prior to the pandemic, telemedicine, despite tremendous growth in recent years, was still a fairly niche service, with approximately 30 million out of 900 million U.S. doctor consultations in 2019 taking place via telemedicine.⁵

The chart below helps illustrate the growing popularity of virtual medicine. Teledoc Health, a leading telemedicine provider in the U.S., has shown strong growth leading up to the pandemic. Keep in mind, these numbers don’t even include the surge of usage reported throughout the industry as the pandemic took hold and people were largely confined to their homes.

The pandemic has served as a catalyst for the accelerated use of telemedicine. While demand will likely decline in the immediate aftermath of COVID-19, many patients will remain as stay-at-home orders get lifted and thanks to the seamless 24/7 experience of modern video-based telemedicine, versus the traditional method of visiting a doctor. This pandemic has served to “prove out” the efficacy of an alternative health care delivery model, which in turn has provided our team with confidence that certain portfolio holdings are positioned very well going forward.

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**Utilization**

Investing in a post-pandemic world

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**Annual Telemedicine Visits at Teladoc Health**

**Vaccines**

The outbreak of COVID-19 has been a humble reminder of the power of infectious diseases, while also highlighting just how important vaccines have been in controlling the scourge of many infectious diseases of old, like Smallpox and Polio. There are two key vaccine trends to watch for in the months and years ahead:

First, in the more immediate future, the overwhelming focus in the biopharma industry will be developing a vaccine to tackle COVID-19. As of May 22, 2020, there are 124 vaccines currently in development, of which 10 of them are already in clinical trials⁶. In addition to more traditional Inactivated Viral, and Recombinant Vaccines, we are also seeing COVID-19 fast track a new generation of vaccine technologies such as mRNA and DNA Plasmid technology.

While the risk of research and development failure is high for any one given vaccine, the sheer number of vaccines under development suggests that it is not a question of if, but simply a matter of when we get the first COVID-19 vaccine. While there is a very real possibility we will get the first vaccine approval by year-end, supplies will be limited at first and reserved for frontline workers and high-risk individuals. That said, by the end of 2021, we estimate that the industry may have over +4 billion vaccines available -albeit contingent on the success of clinical trials⁷.

Secondly, looking beyond COVID-19, the pandemic is likely to be an accelerant driving further innovation in new vaccine technologies. It is likely new technologies like mRNA, DNA plasmid, and viral vector vaccines get further refined, opening up the opportunity to vaccinate viruses that have been hard to target to date (including RSV, CMV, EBV and Zika). Moreover, beyond infectious diseases, companies like Moderna and BioNTech are also looking to leverage this technology to make new tools to tackle cancer, where there remains significant unmet need that dwarfs COVID-19.

**Industrial and General Automation**

As human-to-human contact is recognized as the number one vector for the spread of COVID-19, automation will play an increasingly important role in many areas of our lives. For example, Selective Compliance Assembly Robot Arm robots (SCARA) are already one of the fastest growing areas in robotics.

Due to concerns over COVID-19 contamination, their role in repeatable tasks requiring high speed and high accuracy could increase. Another area of accelerating growth may be in collaborative robots or “cobots”. These machines are designed to work alongside humans. One can imagine a cobot on the front lines of a pandemic checking temperature and administering tests in order to protect the health of the medical professional. This is simply an example of another emerging trend that will likely impact the cost base and margin profile of a large group of companies over the next several years.
Impact on the bottom line

Depending on how long it is before the economy fully reopens, there will be implications for corporate earnings, which will affect investment decisions for years to come.

Early on in the pandemic, it became evident that many corporations were ill-equipped for this business continuity event and as a result it has become quite clear that technology expenses will likely move higher in both the near and medium term. That said, we are less interested in the 3-6 month trend in margins, and instead, spend the majority of our time investigating the structural impact on business models and profitability over a 1, 3, and 5 year time period.

Over that horizon, we see meaningful shifts in spending across three major categories – real estate, human capital, and technology. As a team, we are focused on identifying companies that have the flexibility and enterprise to optimize that spend and structurally improve productivity for years to come. Indeed, companies that are successful in this endeavor will be rewarded by the market over the long run.

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Positioning ahead of the curve

At TD Asset Management Inc. (TDAM), we actively review the risks of every holding in our investment portfolios, and given the unprecedented market conditions, we are evaluating not only the prevailing risks, but where we expect the future opportunities to be. There is no question that many companies and economies will experience negative impacts from the locked-down world of restricted travel, school closures, temporary shuttering of businesses, and cancelled mass gatherings.

Though we cannot predict the exact timing of an economic rebound, we strive to ensure that our investment portfolios are weighted to industries and companies that are strategically positioned to capitalize on the potential reversal of current trends. Our equity investment process focuses on identifying companies that have healthy balance sheets and a demonstrable ability to generate strong and growing free cash flows. We expect these companies to be industry leaders who are resilient in the face of uncertainty and can help minimize portfolio risk.

At TDAM, our Fundamental Equity investment professionals are focused on these as well as a plethora of other second order effects due to the pandemic, and how they could impact each holding on a company by company basis. We believe that active management will play an important role in helping to protect client portfolios through this volatile period and also in finding opportunities when the global economy begins to recover.

In part two of this series, we will not only shed light on more of the industries we see will benefit moving forward, but also explore some of the sectors that will be challenged as we look into the future.
Invest


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