How the Pandemic has Impacted the Consumer Sector

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The global pandemic has exacerbated the gap between the winners and losers in the Consumer Discretionary sector. It has accelerated the move to online retailing, resulting in more than 14,000 store closures so far in 2020. And as consumers spend more time at home and less time traveling, spending patterns have shifted meaningfully. Companies with strong e-commerce operations selling necessities such as food and household goods have clearly been the beneficiaries, while travel and leisure companies have been some of the hardest hit with revenues down more than 50%.

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Our consumer analyst, David Schiminger, has navigated the Fund's consumer stocks to a 41% return through September 30, 2020 compared to the S&P 500 return of 23%. We sat down with David to learn more about what has been driving the Fund's performance in consumer stocks.

Consumer spending habits have clearly shifted in 2020. How have you positioned the holdings for the new retail landscape?

The pandemic has accelerated the move to online sales from brick-and-mortar retailers. According to the Commerce Department, e-commerce sales rose 44.5% in the second quarter and now make up 16% of all U.S. retail sales. Amazon has clearly dominated the e-commerce space and been the biggest beneficiary of this shift, with revenue growing 33.5% through the first half of 2020. It has been a holding of ours for several years.

The pandemic has also led to changes in spending patterns as consumers have stayed away from apparel retailers and department stores and chosen to visit food retailers and home-improvement stores more frequently. We positioned some of our consumer holdings defensively by adding retailers who offered groceries, home products and furnishings. This year we added Target to our portfolio and increased our position in Walmart. These large chains benefited from government stimulus checks and being able to remain open throughout the crisis while many smaller stores were forced to close. Their prior investments to build e-commerce warehouses, mobile apps, and delivery networks yielded strong returns as online sales surged. We believe the market share gains these companies have made are likely to remain in place long after the pandemic is over.

What other trends are you seeing?

With consumers spending less on travel and dining out, that money is being redistributed to the home. Home sales have been one of the bright spots in the economic recovery driven by low interest rates. We are also seeing migration from big cities to the suburbs as families look for the safety and security of suburban single-family homes. We recently added NVR, one of the largest homebuilders in the U.S., to our Fund. We like its lower-risk homebuilding model and its focus on first-time and move-up buyers, which is well-suited to the current environment.

We have also increased our exposure to companies associated with the home and home-nesting. As everyone is spending more time in their homes, they are finding things about their homes they would like to change leading to more and more home projects. Lowe’s and Home Depot were well positioned to capitalize on this trend. Lowe’s has been a long-term holding of the Fund. In June we added Home Depot. Both reported strong earnings results driven by do-it-yourself projects and we see the long-term trends remaining favorable.

We also added Dick’s Sporting Goods, a leading sporting goods specialty retailer, to our portfolio. We view the company as well positioned to manage through this crisis given it has invested heavily in its digital capabilities and should benefit from athletic trends. Although COVID-19 has impacted organized sports temporarily, it has also driven renewed interest in working out at home. Furthermore, working from home is driving more activewear purchases. Categories like bikes are selling out as people staying at home are looking for alternative activities that embrace social distancing. As consumers allocate less money toward travel and leisure, sporting goods may prove resilient and even accelerate.

What are your thoughts on some of the sectors most impacted by the pandemic such as travel and gaming?

The tourism industry has been one of the most challenged during the pandemic with revenues down 50.0% through the first half of the year. We took advantage of the stock sell-off in this sector to add some high-quality names to the Fund as part of our strategy to balance our holdings with some companies that would benefit from the reopening of the economy.

We added Las Vegas Sands in late March after the stock fell 45% due to casino closures and restrictions. The company has some of the most attractive assets in the best gambling markets in the world. We believe that the company's strong balance sheet and ability to generate significant cash flow will enable it to withstand the current environment.

Hotels were understandably hit hard over concerns about the pandemic. We added Hilton Worldwide Holdings to our portfolio in July. We believe Hilton is well positioned over the long-term with its strong brand, its asset-light model, and its strong liquidity position.

There are still many unknowns impacting consumer stocks, including the duration of the virus and how consumer behavioral changes will impact the recovery. We have taken a barbell approach to our consumer portfolio with a portion in defensive companies, a portion in companies we believe are clear winners in the current environment, and a portion in those companies that we believe will benefit as the economy recovers. We may have been a bit early with some of these investments, but at Adams Funds we take a long-term approach to our portfolio. This enables us to tune out the near-term noise and focus on owning quality companies with strong fundamentals.