

## **WAR ROOM**

# **New Economy v Old Economy stocks**

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## OLD ECONOMY Vs NEW ECONOMY

- Old economy companies dominated the economic landscape before the dotcom era of the late 1990s
- An entire industry of new, high-growth companies emerged
- Old economy stocks have sustained business activities through many market cycles.
- Old economy stocks = typically classified in the **value** category - known for relatively low volatility, stable earnings, consistent returns, dividends for income, and steady cash flows. **Crucially, low P/E ratios**

## OLD ECONOMY Vs NEW ECONOMY

- New economy stocks are the companies leading a revolutionary transition to the internet and activities in the cloud
- E.g. FAANGs but there are many more - internet of things, social media, cryptocurrency, cloud storage, e-commerce, streaming, sharing, big data, fintech and artificial intelligence
- New economy stocks provide innovation for the easy and fast exchange of services.
- Compared to old economy stocks, they can have much lower costs of sales and much less need for the physical assets required to manufacture, store, and sell physical goods

## OLD ECONOMY Vs NEW ECONOMY

- Post the dotcom boom (and bust!) new economy companies have achieved much of the success initially envisioned
- Made huge strides with relatively high financial risks to achieve new groundbreaking services centred around the capabilities of the internet and internet technologies
- New economy stocks tend to be high growth. They often exhibit huge growth potential, uncovering new opportunities that can possibly revolutionize the way individuals and businesses interact
- They can often be unprofitable...so P/E ratios don't work. **So, how do we value them?**

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## OLD ECONOMY Vs NEW ECONOMY - **sector/industry performance attribution**

- Focussing on **market levels** misses the underlying shift in value that has occurred **across companies**
- There's been a redistribution of value from **older**, low growth, more capital intensive companies to **younger**, high growth companies
- Reflects not only the unique nature of this crisis, but also a changing business landscape

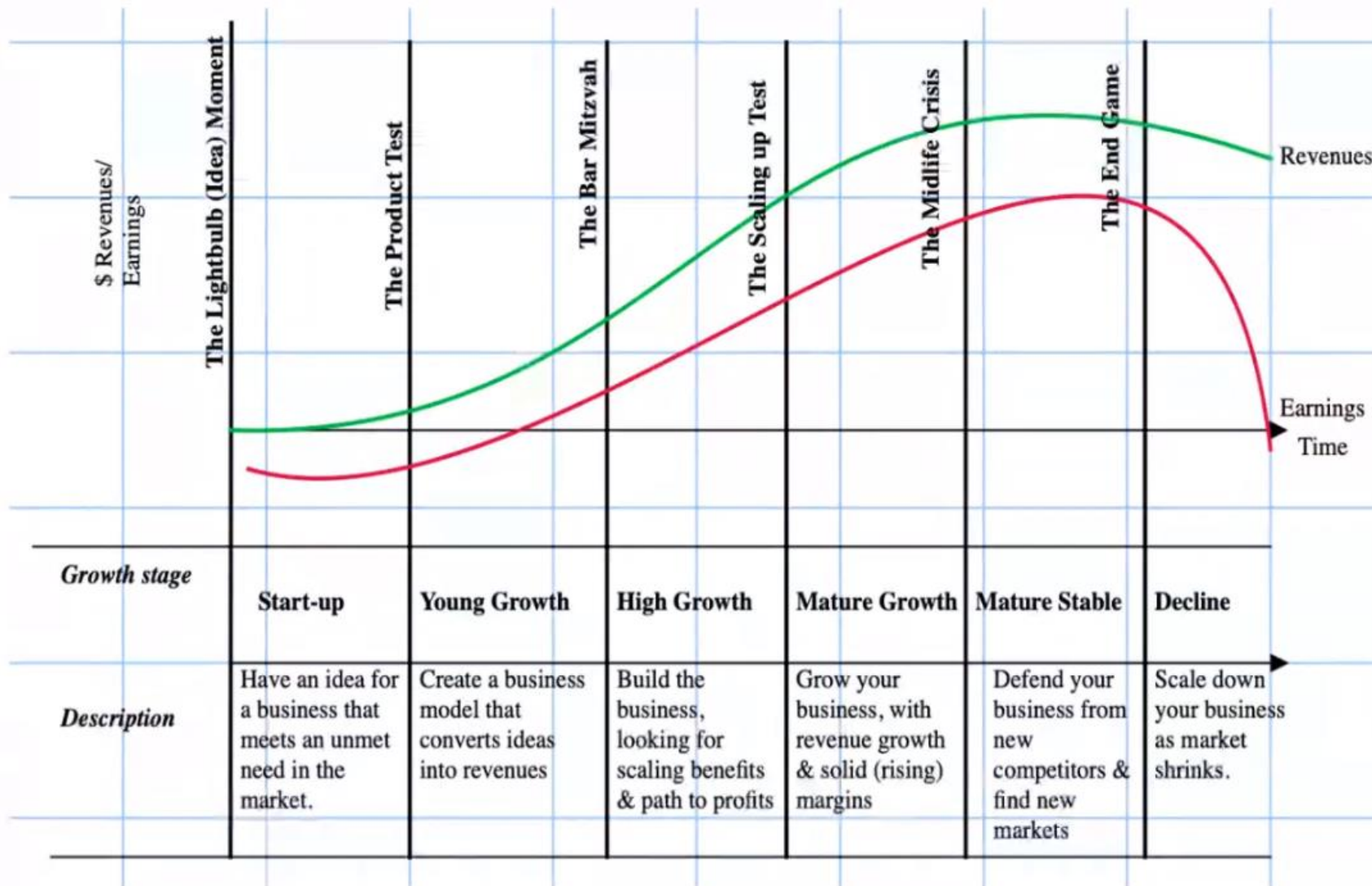
**Worst Performing Industries (2/14 - 6/12)**

Industry	No. firms	Change in Market Cap (%)		
		2/14-3/20	3/20-6/12	2/14-6/12
Oil/Gas (Production and Exploration)	482	-54.11%	56.36%	-28.25%
Air Transport	150	-43.63%	27.48%	-28.14%
Aerospace/Defense	209	-44.65%	30.56%	-27.73%
Broadcasting	122	-42.94%	27.45%	-27.28%
Food Wholesalers	118	-46.36%	36.17%	-26.95%
Oil/Gas Distribution	187	-44.83%	33.40%	-26.41%
Reinsurance	33	-45.63%	35.57%	-26.29%
Insurance (General)	194	-39.05%	25.61%	-23.44%
Homebuilding	147	-48.37%	48.38%	-23.39%
Bank (Money Center)	609	-32.08%	12.95%	-23.28%

**Best Performing Industries (2/14 - 6/12)**

Industry	No. firms	Change in Market Cap (%)		
		2/14-3/20	3/20-6/12	2/14-6/12
Software (Internet)	108	-26.54%	65.27%	21.41%
Retail (Online)	251	-18.98%	41.57%	14.70%
Drugs (Biotechnology)	907	-19.46%	36.60%	10.01%
Precious Metals	518	-28.88%	54.60%	9.95%
Healthcare Information and Technology	315	-21.37%	39.81%	9.93%
Software (System & Application)	1068	-25.83%	36.44%	1.20%
Education	187	-21.85%	28.88%	0.72%
Entertainment	516	-24.41%	33.23%	0.71%
Beverage (Alcoholic)	196	-23.74%	31.03%	-0.08%
Software (Entertainment)	236	-27.37%	37.13%	-0.40%

- Double digit **negative** returns over the period Feb 17 to June 12 for sectors like energy, utilities, real estate, industrials and financials
- Worst performing sectors punished for their capital intensity and debt dependence
- Infrastructure and financial service companies among the worst performing sectors
- Health care and technology on the best performing list



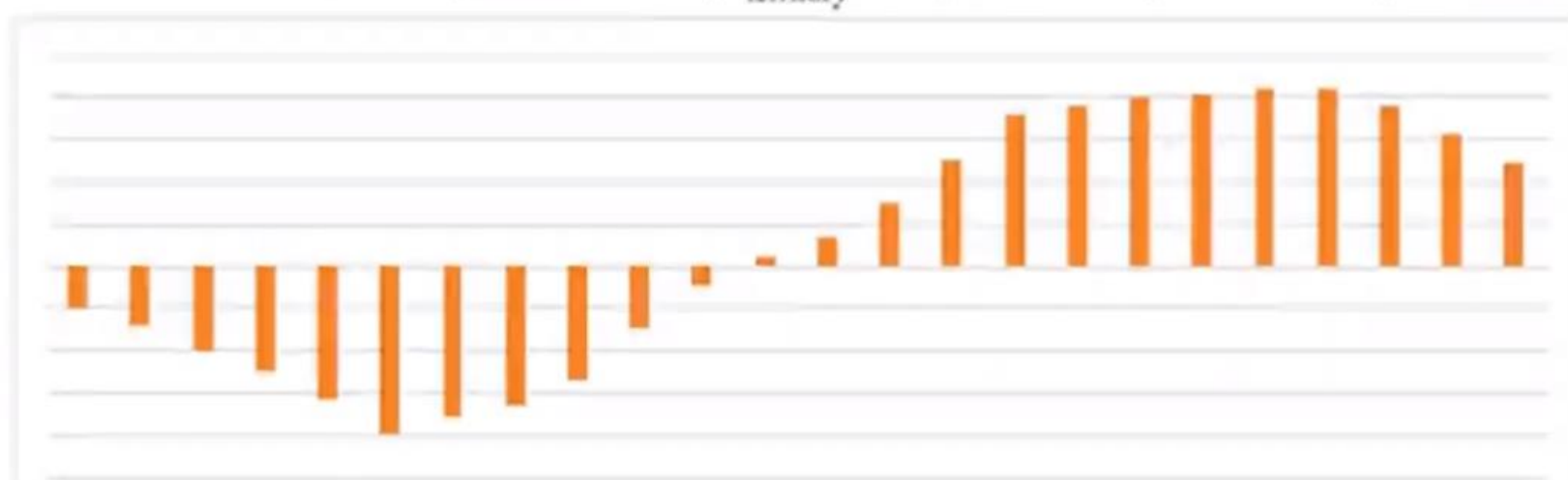
## CORPORATE LIFE CYCLE

- Companies go through a life cycle from start up to young growth to peaking as successful growth companies, before becoming mature and then declining
- Free cash flows i.e. cash flows left over after taxes and reinvestment, vary as companies move through the life cycle
- Generally negative cash flows (cash burn) are a feature of young companies
- Cash build ups as companies grow and mature. E.g. AAPL
- Declining companies tend to return cash as they shrink

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<i>Growth stage</i>	Stage 1 Start-up	Stage 2 Young Growth	Stage 3: High Growth	Stage 4 Mature Growth	Stage 5 Mature Stable	Stage 6 Decline
<i>Operating Profits</i>	Large operating losses	Operating losses narrow	Operating profits turn positive	Operating profits grow quickly	Operating profits level off	Operating profits decline
<i>Reinvestment</i>	Very high	High	Remain large, but scale down as percent of firm	Decrease	Scale down further	Divestment
<i>Free Cash Flow to Firm</i>	Negative	Negative	Cross over to positive territory	Positive & growing	Positive & stable	Positive & dropping



## CORPORATE LIFE CYCLE

- Young companies derive their value from **growth** assets i.e. the value of investments they are expected to make **in the future**
- As companies age value that is attributable to **assets in place** increases. Mature firms derive most/all of their value from **existing** investments
- Young companies lack the earnings and cash flows to service debt so are more dependent on equity to fund their businesses than mature firms

## PERFORMANCE DIFFERENTIALS

- The COVID-induced crisis has had a much greater **negative** impact on **older**, more mature companies than on younger, high growth ones
- Divergence in the market treatment between young and older companies during this crisis explains why **value** has **underperformed** growth
- **Value** investing strategies focus on more **mature** companies
- **Growth** investing is more focused on **younger** companies

## CONCLUSIONS:

1. Higher risk, high growth, greater volatility, higher returns tend to come from the new economy stocks which are high P/E or high multiples of sales
2. Value strategies gravitate around low P/E, low growth, old economy stocks
3. There is a place for both in a diversified portfolio
4. Stay in motion and look for trading opportunities in both categories