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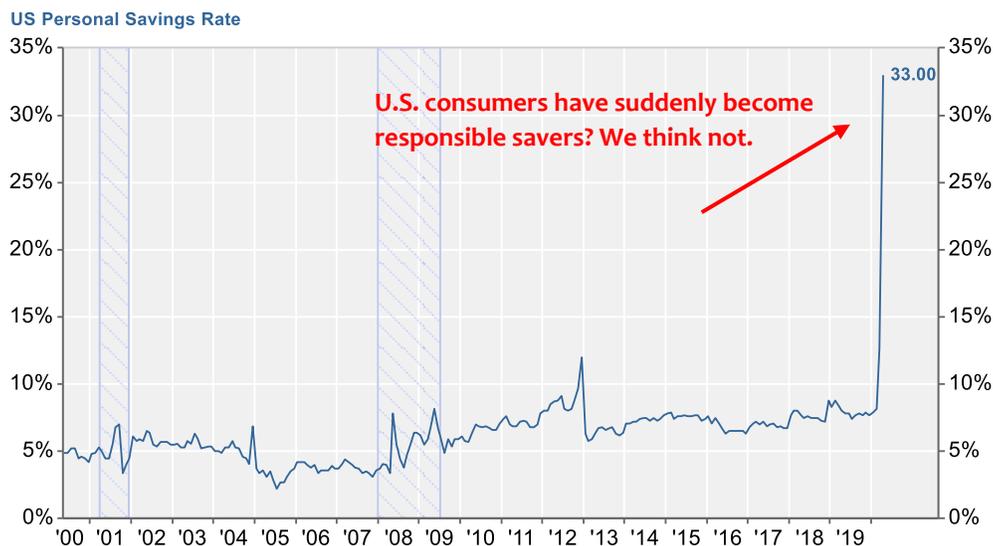
Pet Market Hits All-Time High

Summary: Dire forecasts for the end of the world have not come to pass. Five months into 2020 and the S&P500 has rebounded nearly 40% from lows and is sitting 10% below all-time highs. The resurgence reflects 1) investor anticipation of things getting better at some distant point in the future, 2) the fact that some companies have actually seen business improve during the Crisis, and 3) a broad-based shift in sentiment to optimism from fear. Our outlook has not changed. We remain bullish on the long-term potential for the U.S. economy and for exceptional companies to do well.

Extreme Shifts in Behavior and Economic Data

Some “temporary” effects of the Corona-Crisis have already lasted longer than we anticipated but we expect other secular shifts to be sustained. We try to speak to representatives of at least one company every day and “take the temperature” of what is happening out there. How are people feeling and what are they buying during this bizarre time? Some of the companies we follow closely (grocery and discount retailers, for example) have experienced huge increases in demand while others (dine-in restaurants, movie theaters, beauty salons) have been completely closed. Initially, there was a run on essentials (toilet paper, ramen noodles) as restaurants closed, shelter-in-place orders were received, and end-of-the-world survivalists restocked their backyard bunkers. However, demand quickly shifted, with sales jumping in home-oriented and comfort categories such as exercise equipment, home improvement projects, video streaming services, lululemon leggings, and facial cremes. Other sales spikes are more surprising. For example, adult bicycles have sold out. New pet adoptions are at an all-time high. Besides unusual activity in spending by category, the Crisis has also accelerated secular shifts that were already unfolding, in particular the migration of business to digital and ecommerce channels from terrestrial stores. New adopters (late adopters?) to e-commerce have often been older consumers who needed an extra push to get online. In contrast to the raging trade in puppies, which is going to peter out, the increased use of e-commerce should continue.

Figure 1. The mall is closed. U.S. savings rate rises to highest-ever level.



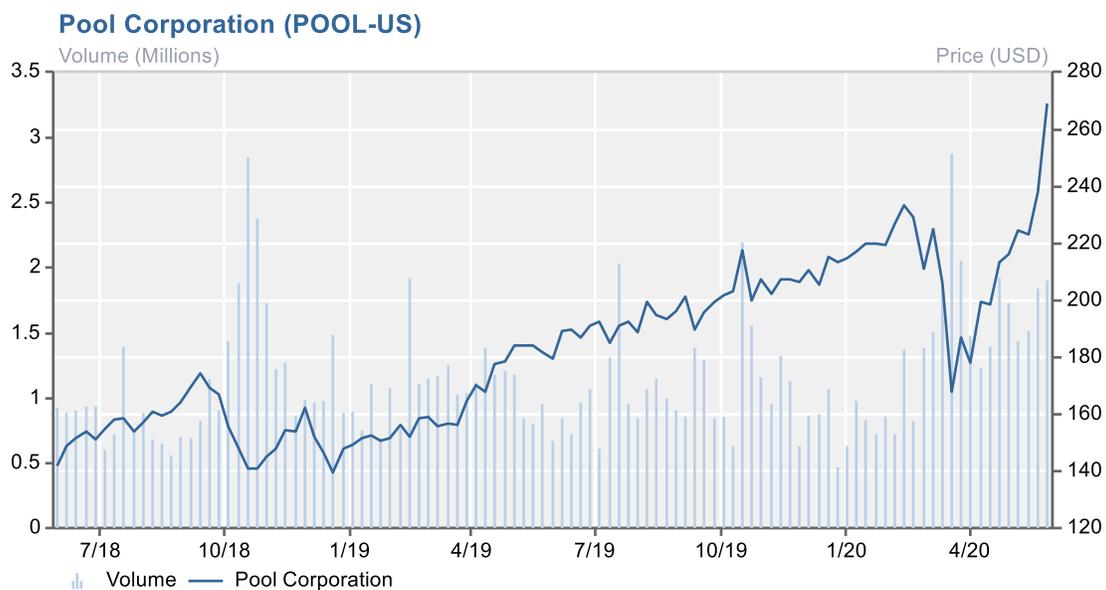
Complicating our efforts to understand and separate out short-term distortions in demand from long-term secular changes spurred by the Crisis has been the influence of the U.S. government raining down cash on consumers. Companies that have commented recently are clearly benefiting from customers coming in to spend their \$1,200 stimulus checks. This too creates unusual and temporary category spikes. Consumers tend to spend one-time windfalls on larger ticket discretionary items. Potentially benefiting from this spending have been categories including consumer electronics (especially televisions, but note that the check is about the price of a new iPhone 11 Pro Max) but also for mattresses, furniture, used cars (the check is used as the deposit), and the latest Brand Jordans.

The combination of stimulus check spending, enhanced unemployment distributions of \$600 per week, and the fact that many usual avenues for spending are just not available, has led the few businesses that *are* open to report that conditions are actually good despite 36 million people filing for unemployment over the past eight weeks. This is probably an illusion. Something else to consider, the U.S. savings rate (see figure 1 above) jumped to 33% for the most recent period. This number might be eventually revised lower, but directionally it makes sense to us, as people isolating at home and surrounded by closed shops *couldn't spend money*. It could also reflect stimulus checks arriving in checking accounts. This will not continue. Net, there will be a near-term reversal of many of the trends we've just mentioned as consumers leave home, stores, restaurants and industries (e.g. travel) reopen. Further, the sugar-rush from stimulus checks will wear off and enhanced unemployment will not continue.

How We are Managing Client Money: Pool Corp (POOL)

We are not selling strong performers. We wrote about Pool Corp. not that long ago, back in January. ([You can read that write-up here.](#)) We're not going to revisit the story in detail except to say that the company supplies equipment and products for installing and maintaining mostly residential swimming pools. This has been a category that has benefited from the Crisis as consumers stuck at home have redirected their vacation spending towards improving the shelter.

Figure 2. Dive right in. POOL shares are up 27% YTD and 50% over the past 12-months.



Source: FactSet Prices

We do not expect this spike in activity to continue for reasons we outlined above, although we do think the business could benefit from a secular shift to focus on the home. Regardless, we're highlighting POOL again not because we want to call out the shares at this price but rather to make a point about stock selection and investment time horizon and to explain why we're not selling at an all-time high. We are managing our investments for the *very long term*, which affords us the ability to hold onto names that might be temporarily overvalued on near-term numbers. There are three principles behind this approach. First, we avoid paying taxes (which would be due if we sold) allowing our gains to compound. Second, we are not compelled or tempted to replace the stocks of outstanding companies that have performed well with those of businesses that may be struggling or just mediocre. Third, we gain the *advantage of duration*. Wall Street and the financial industry in general are organized around short-term (typically 12-month cycle) outlooks and performance. This is how everyone is judged, professionals are paid and marketing materials are created. Accordingly, by thinking further than this arbitrary 12-month cycle can permit us to base our investment case on future earnings and cash flow that are beyond the focus of Wall Street and the industry.

Not traveling, and the scene in France: Over here in Paris we have been out of full-on lockdown-mode for a few weeks but the exciting news is that the outdoor seating of restaurants (referred to in French as les terrasses) are reopening starting Tuesday this week. This is very much needed, at least by me. It's simply not Paris without the cafes. Where else can you sit for hours with a tiny espresso and the waiter won't even look at you?

Recent mentions in the press. We were quoted in a [Wall Street Journal article about the fraud of Chinese coffee company Luckin Coffee \(LK\)](#) where \$12 Billion of market value has evaporated. You can also read our comments on the impact of unemployment rates on discount [retailers Dollar General \(DG\) and Dollar Tree \(DLTR\) in a marketwatch.com](#) write up. We were quoted on trends in rural vs. urban spending in this [marketwatch.com article on retailer Tractor Supply \(TSCO\)](#).

Do you already have enough ETFs and mutual funds? If you are looking for a more concentrated, thoughtful portfolio constructed by a manager who does his own work and is available to answer your questions, please get in touch. To get these newsletters directly in your inbox or to read our past newsletters please visit our website [by clicking this link](#) .

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Mr. Zolidis started his career in finance in 1996 following degree studies in Philosophy at Kenyon College and the University of Oxford. He has followed U.S. consumer companies as a senior analyst since 1999, mostly on the sell-side, writing research for institutional investor clients. He also managed money in a buy-side role at a long-short equity fund over 2013-2014. He was named in the Wall Street Journal's Best on the Street list in 2005. Mr. Zolidis founded Quo Vadis Capital, Inc., a Registered Investment Advisor (RIA) and research consultancy, in 2017 and works from New York and Paris, France.

Relief. Our cat, moustache (that’s pronounced frenchy-style, MOO-stash, not American-ee Must-ash) upon learning that we were not participating in the pet adoption craze.



Ring-a-round the rosy. Pocket full of posies. Ashes! Ashes! We all fall down!

Perhaps a childhood rhyme originating from the Black Plague. Will kids in the future sing about Corona-virus?

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The analyst who is the author of this report has a long position in shares of Pool Corp. (POOL). Quo Vadis prohibits analysts from trading in a way that is inconsistent with opinions expressed in reports [subject to exceptions for unanticipated significant changes in the personal financial circumstances of the analyst].

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