

## Alley Company Quarterly Letter Silver Lining

July 15, 2020

As we have learned over the past several months, the challenges presented by a global pandemic are numerous. Along with hundreds of thousands of tragic health outcomes, COVID-19 has also disrupted nearly all aspects of everyday life. The ability to congregate, travel, work, attend school, etc. have all been impacted and our previous “normals” are unlikely to be obtainable until widespread vaccination or natural herd immunity occurs.

Moments of significant disruption and crisis, however, also create opportunities for advancement. If there is a silver lining to this pandemic, it is that individuals and businesses are adapting and developing creative solutions that will likely have a lasting impact well into the future.

In a matter of just a few months, some prominent trends and data points have emerged:

- Zoom, WebEx, and other providers of online collaboration tools have become an efficient alternative to conducting in-person meetings.
- Telemedicine has become an increasingly viable option in which to effectively engage with your doctor and the health care system.
- Google Classroom active users have doubled to more than 100 million, enabling students and teachers to productively engage in remote learning.
- The use of digital wallets and contactless card payments are accelerating, providing safe and effective forms of electronic payment.
- And not surprisingly, internet traffic has increased between 50 and 70 percent in developed nations over the past several months.

Net, the speed at which the world is embracing technology and digital solutions of late is noteworthy. An article by McKinsey Consulting commented, “we have vaulted five years forward in consumer and business digital adoption in a matter of around eight weeks.”<sup>1</sup> Indeed, necessity is the mother of invention, and this is especially true during a pandemic.

As with past technological change, the implications of such events are distinctly positive for economic productivity. Research from Booz & Company indicates that an increase in digitization of ten percent within an economy results in a 0.50 to 0.62 percent gain in per capita

gross domestic product (GDP). Importantly, a ten percent increase in digitization also reduces a country's unemployment rate by 0.84 percent.<sup>2</sup> And while these statistics are encouraging, perhaps the largest benefit is in improved living standards. For example, twenty years ago, we just started using hand-held devices primarily for phone calls. Today we use our smartphones to order retail goods, send and receive digital payments, read the news, take pictures, stream media content, and this only covers a portion of the functionality of modern smartphones.

Technological advancement, though, does not happen without collateral damage. Those who are on the wrong side of the digital divide will be more apt to struggle. The past several months have been especially challenging for companies that lack the financial wherewithal or management acumen to make the necessary investments to reach their customers in this digital age. Case in point is that e-commerce spending is actually expected to *grow* by 18 percent in 2020, while traditional brick-and-mortar retail will *decrease* by 14 percent.<sup>3</sup> There is no doubt that this shift has been exacerbated by COVID-19, nonetheless it underscores the notion that a business that is embracing digital change is well positioned for the future.

From an investment perspective, businesses across the economic landscape are tapping the power of digital and stand ready to reap future rewards for their shareholders as a result. Whether it be the quick service restaurant that is moving their clientele towards mobile ordering, or the industrial company whose products are tethered to the internet for real-time analysis, or the medical device company whose implanted devices can now be monitored remotely, the opportunities are numerous. Going digital can mean lower long-term costs, increased brand loyalty, and in some instances, accelerating revenues. At Alley Company, our mission is to understand these trends and seek out high-quality companies with market power that are benefiting and growing stronger as a result.

As with any economic recession, businesses are presently tightening their belts and in this case have been forced to do so given the temporary shutdown of the U.S. economy in March and April. Corporate America should benefit from increased operating leverage during the ensuing economic recovery as higher revenues spread over a lower cost structure result in improving profit margins. Couple this with an acceleration towards a digital economy that we have witnessed over the past few months and it is possible that we emerge on the other side of the storm, a more efficient, productive, and digitally advanced economy.

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<sup>1</sup> McKinsey Consulting, "The Covid-19 recovery will be digital: A plan for the first 90 days", 05/14/2020.

<sup>2</sup> Booz & Company, "Digitization and Prosperity", 8/28/2012.

<sup>3</sup> E-marketer, "US Ecommerce 2020: Coronavirus Boosts Ecommerce Forecast and Will Accelerate Channel-Shift", 06/08/2020.