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Rebounding from COVID

Reviewing the Industries Hit the Hardest…. One Year Later…

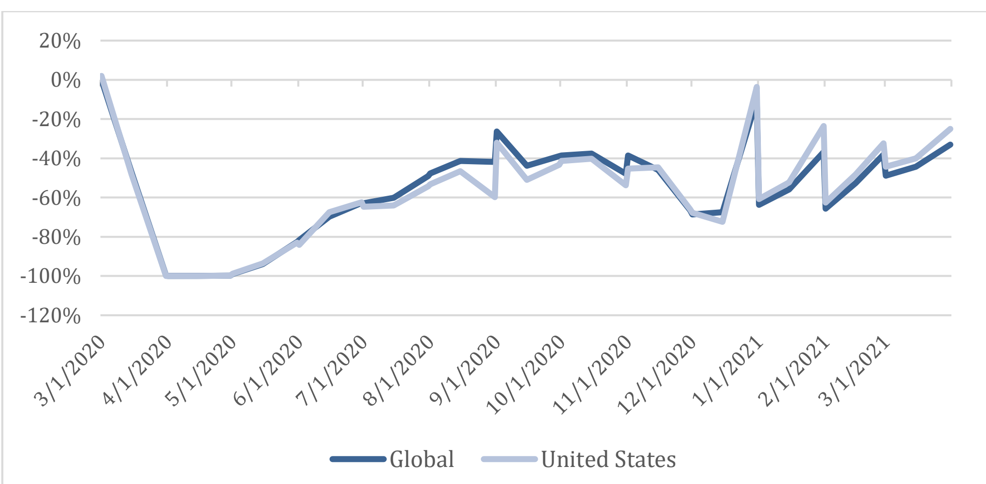
In preparing our investment outlook for 2020, if an analyst were to tell the team that face masks, bathroom tissue and hand sanitizer were to become some of the most valuable commodities, we would have thought they were crazy. Well, here we are in 2021 in which this was the reality we have lived in for over a year as everyone adjusted to work from home arrangements. We have all mastered video-conferencing, become accustomed to hearing dogs bark in the background, and at least once during a call someone uttering the phrase: "I think you're on mute." Not all was out of the ordinary, Tom Brady still won the Super Bowl and retail stock trading continued to boom due to commission-free trading, and more recently, the chance to find the next GameStop stock.

Now that we have made it through a year of the pandemic and the vaccination rollout is progressing, let's reflect on where some of the most impacted industries stand including Retail, Restaurants, Hotels and Airlines.

Retailers that rely more on in-store visits, such as mall-based retailers, were especially hit hard. Neiman Marcus, J. Crew and Brooks Brothers were a few of the notable retailers who were forced to file for bankruptcy as a result of the pandemic. Social distancing and stay-at-home guidelines severely limited instore foot traffic and companies were forced to invest heavily in health and safety measures to protect consumers and employees, all of which contributed to weak profits. At the other end of the spectrum, e-commerce retailers thrived with some reporting sales increases of 75-100% as on-line shopping replaced trips to the store.

Eating behavior was radically altered as a result of the pandemic. Restaurant dining was largely curtailed as governments and communities implemented strict social distancing guidelines. That left consumers a choice between preparing meals at home, food delivery, fast food drive-thru, or outdoor restaurant dining. As the number of people being vaccinated grows and the economy continues to reopen, restaurant capacity continues to come on line reaching 70% by the end of 1Q21. That's an increase of 20% since the start of 2021. One of the potential positive outcomes for the restaurant industry from the pandemic would be the continuation of outdoor dining, allowing restaurants to reach more customers.

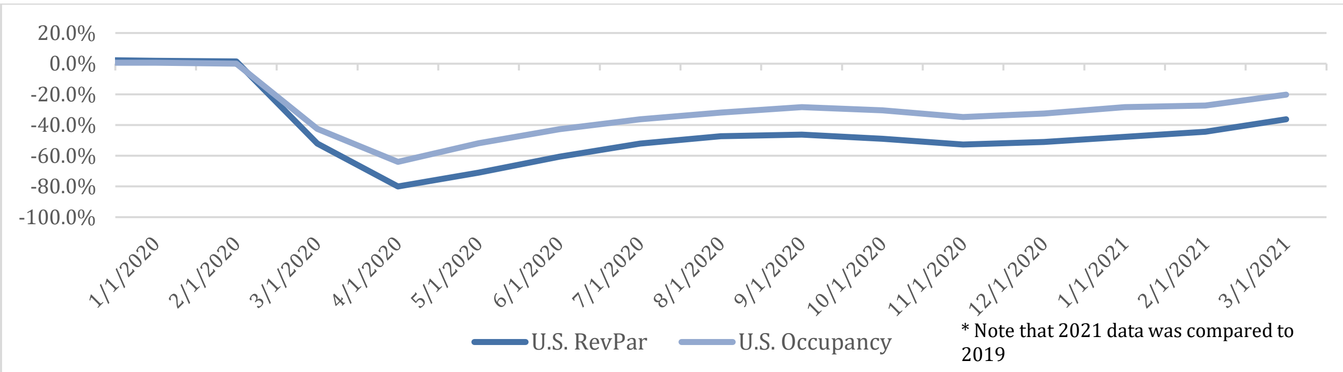
Exhibit 1: Using OpenTable data, following stay-at-home mandates at the onset of the pandemic in March 2020, restaurants' occupancy has been rebounding as the economy continues to reopen.



Source: OpenTable Data, Opus Investment Management

Global business and leisure travel were significantly curtailed as travel bans and lockdown measures were implemented. U.S. hotel occupancy rates hit their lows in mid-April falling to less than 25% and U.S. revenue per available room (RevPAR) was down over 80%. The airlines were severely impacted too. Daily flight departures in the U.S. plunged by 75% at the end of April, with the number one focus for airlines being liquidity management and reducing daily cash burn. As the economic recovery continues to strengthen, travel-related sectors have started to rebound. At the end of 1Q21, U.S. hotel occupancy was 55% (vs. 25% April 2020), U.S. RevPAR was down 35% (vs. down 80% April 2020) and U.S. flight departures were down 25% (vs. down 75% April 2020). The majority of leisure travel is expected to recover to 2019 levels, but the lingering question is how much of business travel will return as companies adopt more work-from-home arrangements and are realizing the benefits of reduced travel expenses.

Exhibit 2: The below chart depicts the YoY change for lodging RevPar and occupancy in the U.S.



Source: STR, Inc., J.P. Morgan, Opus Investment Management

At Opus, we have taken a conservative investment strategy approach to how we have positioned our portfolio to the sectors discussed above. For retail, we have favored higher quality companies with over 80% of the retailers we own rated Investment Grade, with limited exposure to mall-based retailers. Many of the retailers that we own were considered to provide “essential products and services” allowing them to remain fully operational throughout the pandemic, while others were quick to adapt and ramp up their e-commerce efforts. Restaurant exposure is limited to quick service restaurants, which have remained resilient and took the necessary steps to mostly remain open with those having a drive-thru setup at a distinct advantage. And finally, we continue to hold smaller positions in the airline and lodging sectors. Our airline exposure is positioned in the companies with the strongest balance sheets and favorably in their capital structures. Our stratgey in the lodging space has been to hold Investment Grade rated companies that have the balance sheet strength and sufficient scale and diversity in their operations to bridge them through the downturn.

The pandemic caused severe disruptions to the way we once lived and to numerous industries. While nobody knows exactly what the world will look like after COVID, we can at least expect that life will not return to prior status-quo. Adaptations such as the migration towards more sales completed through e-commerce, outdoor dining, remote work and lessened business travel are only some of the changes that we should expect under the “new normal.”