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ATLANTIC CAPITAL MARKETS

Recession Beating Stocks

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Introduction

There is a lot of talk circulating about the impending recession we are heading for (if not already in) with analysts openly discussing anything from a long lingering recession to a short- term sharp dip and bounce back, but one thing all analysts agree on is it is coming and the depth and extent are not yet truly measurable. The Bank of England has warned that the UK economy is heading towards its sharpest recession on record, saying the Coronavirus impact would see the economy shrink 14% this year, and that is based on the lockdown being relaxed in June.

The latest Monetary Policy Report has showed the UK economy plunging into its first recession in more than a decade. The economy has shrunk by 3% in the first quarter of 2020, followed by a jaw dropping 25% decline in the three months to June. This would push the UK into a technical recession, defined as two consecutive quarters of economic decline.

So, what is a recession and is this one different?

A recession is a significant decline in economic activity that lasts for months or even years. Experts declare a recession when a nation's economy experiences negative gross domestic product (GDP), rising levels of unemployment, falling retail sales, and contracting measures of income and manufacturing for an extended period. Recessions are considered an unavoidable part of the business cycle, or the regular flow of expansion and contraction that occurs in a nation's economy. The most popular and widely used measure is two consecutive quarters of declining GDP.

A healthy economy expands over time, so two quarters in a row of contracting output suggests there are serious underlying problems. However this time is very different, it has been triggered by one key factor.... **A sudden economic shock**, rather than the mixture of various catalysts such as, excessive debt, asset bubbles, too much inflation or deflation, and the time we spend in this recession will ultimately be dictated by how long and how deep the economic impact lasts.

Key Considerations for buying to beat the recession

Before we look at what we should be buying in a recession, let's just look at what we shouldn't be buying....

Knowing what **not** to buy is as equally important as knowing what to buy, the companies and assets with the biggest risk during a recession are those that are highly leveraged, cyclical, or speculative. You would be wise to avoid highly leveraged companies that have huge debt loads on their balance sheet. These companies often suffer under the burden of higher than average interest payments that lead to an unsustainable debt to equity ratios. While these companies are struggling to make their debt payments, they are also faced with a decrease in revenue brought about by the recession.

Cyclical stocks are also often tied to employment and consumer confidence, which are battered in a recession. Cyclical stocks tend to do well during boom times when consumers have more discretionary income to spend on non-essential or luxury items such as companies that manufacture high-end cars, luxury goods, furniture, travel, restaurants, and leisure services or clothing. When the economy falters, consumers typically cut back their spending on these discretionary expenses, because of this, cyclical stocks in these industries tend to suffer, making them less attractive investments for investors during a recession.

- A better recession strategy is to invest in well-managed companies that have strong balance sheets, low debt and good cash flow.
- Counter-cyclical stocks do well in a recession and experience price appreciation despite the prevailing economic headwinds.
- Some industries are considered more recession-resistant than others, such as utilities, consumer staples, and discount retailers.

Consider this:- is it an essential industry?

Essential industries tend to perform better in a recession and could perform even better if they are also considered an essential industry during the current public health emergency.

- Healthcare
- Food
- Consumer staples
- Basic transport

These are the sectors that tend to weather the storm far better and should form the basis of what you are looking at.

Stocks primed to flourish in a recession

RDSB

Royal Dutch Shell PLC or as its more commonly known “Shell”, is an Anglo-Dutch oil and gas company headquartered in the Netherlands and incorporated in the UK. Shell is vertically integrated and is active in every area of the oil and gas industry, including exploration and production, refining, transport, distribution and marketing, petrochemicals, power generation and trading. It also has renewable energy activities, including biofuels, wind, energy-kite systems and hydrogen. Shell has operations in over 70 countries, produces around 3.7 Mn barrels of oil equivalent per day and has 44,000 service stations worldwide.

Royal Dutch Shell has seen its share price fall by around 40% since the start of 2020. The stock has taken a beating thanks to collapsing oil prices and the pandemic. However, Shell is well positioned to withstand a prolonged negative impact on business. This is primarily thanks to its huge cash reserves and healthy liquidity. Once the world economy starts to recover, demand for oil should also start to recover. That is of course if Russia and the Saudi’s maintain a peaceful alliance.

Tesco

Food retailers are essential, which holds Tesco in good stead during a health emergency and in the resulting recession. Tesco’s have maintained a strong position in the current environment with margins hitting target, deals with Booker and Carrefour creating significant cost saving opportunities and restructuring the poorer, profit diluting business in Poland. Tesco’s P/E ratio also highlights value in the stock. The food retailer’s dominant market position and healthy margins are also impressive and gives the business the strongest growth potential. This can be seen in its expanding online services and acquisition of the wholesale operator Booker. A dividend yield of 4% further sweetens the deal.

Tesco also said that it plans to use the proceeds from the sale to reduce the amount of debt on its balance sheet through a £2.5 billion pension contribution, eliminating the fund's deficit and 'significantly' reducing the prospect of making further such payments in the future.

AstraZeneca

AstraZeneca is a British-Swedish multinational pharmaceutical and biopharmaceutical company with its global headquarters in Cambridge, England. Its R&D is concentrated in Cambridge, Gaithersburg, Maryland, and Mölndal in Sweden. AstraZeneca has a portfolio of products for major disease areas including cancer, cardiovascular, gastrointestinal, infection, neuroscience, respiratory and inflammation.

The company was founded in 1999 through the merger of the Swedish Astra AB and the British Zeneca Group. Since the merger it has been among the world's largest pharmaceutical companies and has made numerous corporate acquisitions, including Cambridge Antibody Technology (in 2006), MedImmune (in 2007), Spirogen (in 2013) and Definiens (by MedImmune in 2014).The wide diversity of products and persistent need for their products.

Astra are also at the forefront of leading the charge to find a vaccine for Coronavirus. Astra provide consistent dividends no matter the economic climate. At AstraZeneca, rapid sales growth from newly developed drugs caused full-year revenues and operating profit to rise by 13% in 2019.

Scottish and Southern Energy

In the Utility sector SSE has always been a popular income stock. SSE plc is an energy company headquartered in Perth, Scotland with operations in the United Kingdom and Ireland.

As a generator of renewable electricity in the UK and Ireland, it develops, owns and operates low-carbon infrastructure to support the zero-carbon transition. This includes onshore and offshore wind, hydro power, electricity transmission and distribution grids, gas and energy from waste, alongside providing energy products and services for businesses. It is UK-listed. As a real Living Wage and Fair Tax Mark accredited company, it employs 12,000 people across the UK and Ireland. Since the election and the end of the fear of labour nationalisation utilities are looking attractively priced with an appealing dividend yield. In a year when so many companies have cut their dividends the stocks that will beat the recession are those strong enough to maintain and even increase dividends. This was confirmed by SSE at the end of March when the firm said that it intended to maintain the dividend at 80p.

SSE's role as the UK's largest renewable generator may have also provided some protection against lower electricity demand during lockdown. This is because renewable power gets sold into the grid before fossil fuel power.

About Atlantic Capital Markets

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