Dispersion Is the Great Alpha Generator

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When we listen to the TV or read on the internet about the economy, it is almost always in aggregate terms. Here are some recent headlines:

America's Awful Economy In The First Quarter Was Even Worse Than We Thought (CNN)

For Economy, Worst of Coronavirus Shutdowns May Be Over (Wall Street Journal)

Good Economic News is Coming and That's Bad (Bloomberg)

But the economy isn't one entity moving in one direction at any given time. It comprises many different businesses in various industries that are experiencing divergent trends. In other words, it has winners and losers.

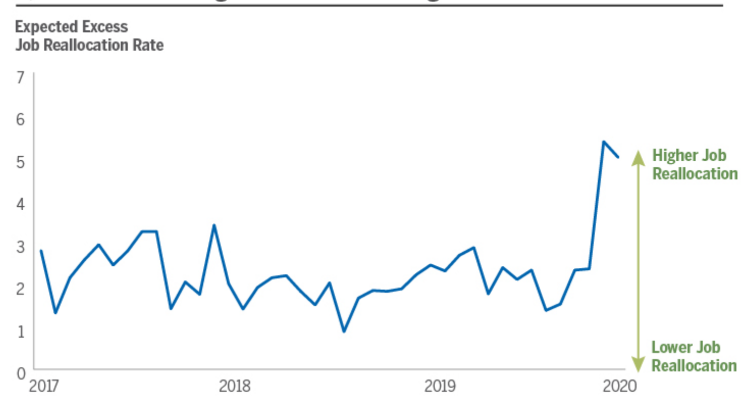
Can there really be winners in a catastrophic environment like the coronavirus pandemic with soaring unemployment and precipitously declining spending? Yes, there are companies bursting at the seams with growth, companies that cannot hire fast enough and cannot keep up with their orders.

Hiring Amidst Mass Layoffs?

Everyone knows the economic picture has been atrocious this year with over 20 million jobs lost, according to the Bureau of Labor Statistics.[i] But just as the aggregate economy sheds jobs, some companies are hiring. Over 2 million jobs have been lost in the retail industry but WalMart plans to hire 150,000 individuals, Amazon 100,000, and Lowe's 30,000.[ii] The transportation industry lost nearly a million jobs but Instacart plans to hire several hundred thousand employees.[iii] This is part of the reallocation of resources in the economy as e-commerce and big box retail share gains accelerate. However, research suggests that the biggest driver of dispersion is not industry exposure but idiosyncratic or firm-specific factors. For example, in the restaurant industry hundreds of thousands of restaurants are under financial duress while stronger restaurants, like Wingstop, have been able to achieve double-digit same-store sales growth during the pandemic.

There is a way to quantify the changing fortunes and churn within the economy—the so-called job reallocation rate measures the shifting employment opportunities across firms.[iv] The statistic looks at the sum of expected job gains at companies that expect to hire plus job losses at companies that expect to fire, relative to aggregate employment. The higher the number is, the more reallocation of human resources exists. In the current economic environment, the job reallocation rate is the highest it has been in years as the dynamic U.S. economy shifts jobs to those sectors and companies benefitting from demand trends, and takes jobs away from business models that may be failing (see figure 1).

Figure 1: **Jobs Are Being Reallocated at a Higher Rate**



Source: Survey of Business Uncertainty conducted by the Federal Reserve Bank of Atlanta, Stanford University, and the University of Chicago Booth School of Business

Winners in a Losing Environment

We believe employment reallocation is an important metric for the economy, but investors are typically concerned with sales and profits. It turns out that the sales reallocation rate is even more elevated than the job reallocation rate (see figure 2). According to May 2020 data from the Survey of Business Uncertainty, sales are being reallocated at a rate of more than five times the years.

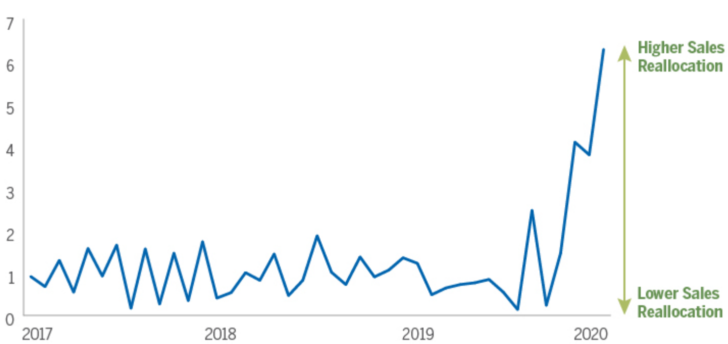
This dispersion is something we have observed. Cloud-native cybersecurity companies like Crowdstrike, e-commerce software providers like Shopify, and digital transformation enablers like Salesforce.com have been able to grow their sales at strong double-digit rates while other technology companies like Oracle or IBM have reported flattish or down revenue growth rates. Even within an industry like multiline retail where store closures are exploding and businesses are fighting for their lives, some companies with strong value propositions, such as Ollie's Bargain Outlet, are growing their sales through this environment.

Dispersion and Alpha

In our view and as I have written in a previous blog post, outperformance is a result of two things: skill and opportunity. While most investors focus on skill, we believe that opportunity, or the amount of dispersion of results, is just as important. If you have a fishing competition in a small pond, it may be hard to tell a very experienced fisherman from a novice. But move the competition to the ocean where big schools of fish reside in challenging conditions and the dispersion between the fishermen in terms of size of the catch is likely to be much larger. In that larger range of outcomes in the ocean, the skilled fisherman is likely to outperform by much more than in the small pond, which has less opportunity for differentiation.

We believe the current rapidly changing economic environment is akin to fishing in the ocean; skilled investors may be able to differentiate themselves because of the divergent trends in the economy and the increasing advantages that innovative companies have in the marketplace. In our view, this increasing dispersion is a perfect backdrop to generate alpha.

Figure 2: **Sales Dispersion Has Jumped**



Source: Survey of Business Uncertainty conducted by the Federal Reserve Bank of Atlanta, Stanford University, and the University of Chicago Booth School of Business

i. Bureau of Labor Statistics.
ii. Challenger, Gray & Christmas, Inc.
iii. Ibid.
iv. For a more complete discussion of the reallocation rate please see the wonderful paper "COVID-19 Is Also a Reallocation Shock," by Jose Maria Barrero, Nick Bloom, and Steven J. Davis, May 2020.

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The following positions represented the noted percentages of assets managed by Fred Alger Management, LLC as of March 31, 2020: Walmart 0.1%; Amazon 5.7%; Lowes 0.7%; Wingstop 0.5%; Crowdstrike 0.5%; Shopify 0.3%; Salesforce.com 2.3%; Oracle 0.0%; IBM 0.0%; Ollie's Bargain Outlet 0.2%; Instacart 0.0%.