

PALOS

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Weekly Commentary

Issue No. 23 | MAY 25, 2020

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With stores shuttered, where will discretionary spending go?

The world we live in has undergone drastic change. No one is travelling or dining out. Malls are empty and gasoline prices have plummeted. While consumer behaviour has undergone a massive shift away from the norm, there's something that should not be overlooked. Many consumers are discovering that their savings rates have seen a significant boost as a result of a void in discretionary spending options.

Without a doubt, COVID-19 has changed the way we live. It has not only changed how and where we work, it has drastically altered how we spend our free time - and our money. As we know from past recessions, one of the first sectors to feel the economic impact is discretionary spending. However, what's different this time around is that while many businesses are suffering, and their mere existence remains in question, others are thriving.

It's clear by now that travel related industries (airlines, hotels, resorts), entertainment (theatres, casual dining, casinos) and discretionary spending (spas, gyms, salons) have taken a huge hit and it's reasonable to assume that it may take years for these businesses to recover. Mall-based stores that rely on foot traffic are facing similar challenges and many are unlikely to survive. What these businesses have in common is that the services they provide are targeted at consumers who are fulfilling their emotional needs for an 'experience' rather than fulfillment of a basic need.

It is important to recognize that consumer demand for entertainment and stimulation has not disappeared - it has been displaced. Social distancing has forced a shift to 'stay at home' entertainment and it is likely that this trend will persist well beyond the pandemic. For example, we are seeing a significant increase in demand for home entertainment (gaming), social media and streaming, spending on home improvement (nesting), and an appetite for recreational products that by their nature, allow for the desire to be entertained while maintaining social distancing. What fits this bill? Motorcycles, camping equipment, boats, and bicycles. A recent article in the 'La Presse' newspaper referred to a story that bicycle inventories are selling out (see link below).

By Charles Marleau, CIM

BRP Inc. (TSX: DOO), also known as Bombardier Recreational Products, is a Canadian company that manufactures and retails a strong line of recreational products that includes watercraft, snowmobiles, all terrain vehicles, and motorcycles. Benoit Poirier, consumer goods analyst from Desjardins Capital Markets, has published a note that a recent survey with BRP dealers has revealed surprisingly strong demand for their products. The company, which markets their products globally and has a market cap of just under \$4 billion CAD, has seen significant upgrades from analysts at TD, RBC and Desjardins. Currently, seven analysts rate DOO a 'Buy' and six have the stock at 'Hold' (source: Bloomberg).

I am confident that the recreational vehicle industry is well positioned to thrive as consumers seek alternatives that are well-suited for maintaining social distancing and vacationing 'closer to home'. BRP should be a clear winner as consumers look for new ways to conquer 'cabin fever'.

<https://www.lapresse.ca/covid-19/202005/19/01-5274227-achat-dun-velo-depechez-vous.php>

Disclaimer: Palos Funds are shareholders of DOO.

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$6.79	-17.50%
Palos Equity Income Fund - RRSP	PAL101	\$4.84	-14.81%
Palos Merchant Fund L.P. (Dec 31, 2019) ²	PAL500	\$1.71	20.15%
Palos WP Growth Fund - RRSP	PAL210	\$6.49	-15.20%
Palos-Mitchell Alpha Fund ³	PAL300	\$7.40	-28.67%
S&P TSX Composite (Total Return with dividends reinvested)			-11.43%
S&P 500 (Total Return with dividends reinvested)			-7.78%
S&P TSX Venture (Total Return with dividends reinvested)			-6.91%
Chart 2: Market Data ¹			Value
US Government 10-Year			0.66%
Canadian Government 10-Year			0.51%
Crude Oil Spot			US \$33.25
Gold Spot			US \$1,735.50
US Gov't10-Year/Moody BAA Corp. Spread			319 bps
USD/CAD Exchange Rate Spot			US \$0.7145

¹ Period ending May 22, 2020. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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