



Amid Market Turmoil, We See Opportunity in Industrial Conglomerates, Aerospace & Defense, and Agricultural Firms

The Morningstar US Industrials Index has underperformed the broader U.S. equity market in early 2020 amid investor concerns about trade tensions, COVID-19, and a potential economic downturn (Exhibit 9a).

Given current market conditions, we see many opportunities in the industrials sector, with most stocks in our coverage trading in 4- or 5-star territory (Exhibit 9b). The median stock we cover is priced at a 0.80 price/fair value ratio, and industrial conglomerates, construction, and aerospace and defense are the most undervalued industries.

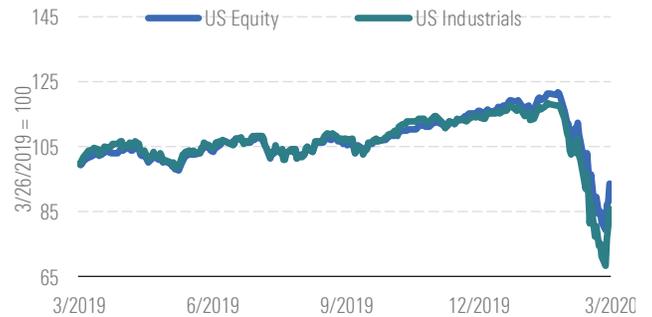
Industrial production appears poised to further contract from the late 2018 peak amid a likely global economic slowdown (Exhibit 9c). While many industrials firms will be adversely affected over the short run, we see many long-term opportunities across the U.S. industrials sector as the virus abates and business conditions normalize.

Industrial conglomerates like General Electric and 3M have substantial healthcare exposure, which tends to be stable compared their more cyclical industrial counterparts, an attractive quality given current market volatility. 3M and Honeywell also have sizable personal protection segments, which will certainly see revenue growth as global demand for facemasks and respirators exceeds supply. 3M already intends to increase production by about 30% over the next 12 months.

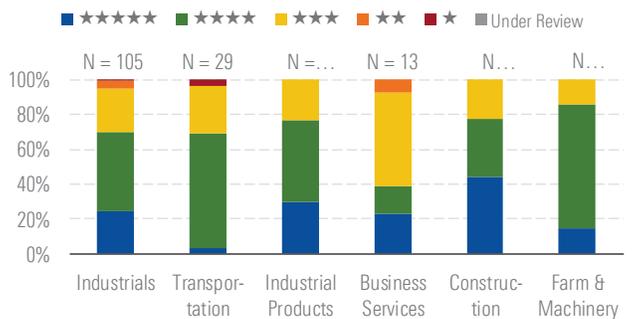
We think defense prime contractors are a smart play for investors concerned with unfavorable cyclical turns for a few reasons. First, defense primes are not exposed to the business cycle, as revenue is largely funded by U.S. and international government spending. Second, increased focus on great-powers competition through the National Defense Strategy indicates that the military will continue prioritizing modernization. Third, customers fund much of the research and development, so defense firms can consistently return substantial free cash flow to shareholders.

In our view, it is hard to see how U.S. agricultural commodity production will be affected by COVID-19. U.S. acres planted remains relatively constant over time as demand for agricultural commodities varies less than discretionary goods (Exhibit 9d). Furthermore, firms like Deere are federally designated critical infrastructure businesses and may continue operations even as the coronavirus pandemic persists.

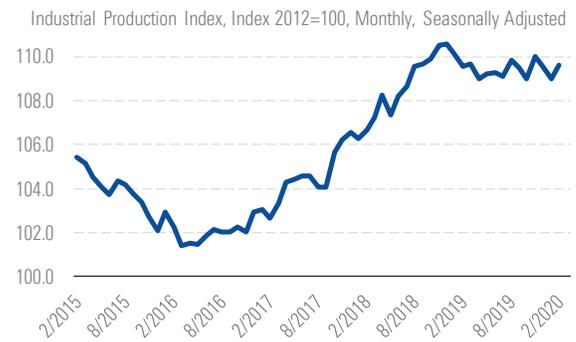
Exhibit 9 Industrial Stocks Undervalued Amid Uncertainty
9a Industrials have underperformed the broader U.S. equity market.



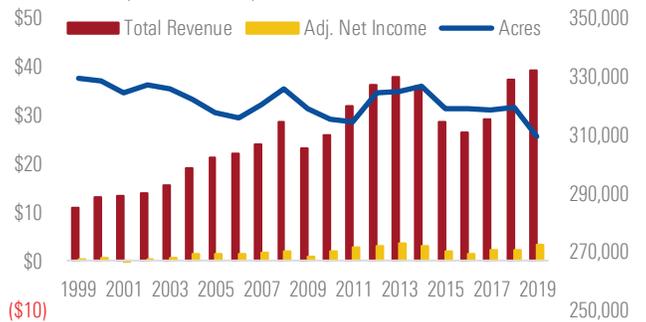
9b Shares undervalued; majority in 4-star or 5-star territory.



9c Industrial production likely to fall amid economic slowdown.



9d U.S. acres planted relatively constant over time.



Source: Morningstar, Federal Reserve Bank of St. Louis, Deere.
Data as of March 26, 2020.

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