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The impact of COVID-19 on capital markets, one year in

Stock market performance reveals the impact of accelerating trends, growing gaps between the winners and the rest, and a flow of value to megaplayers.

by Chris Bradley and Peter Stumpner

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February 19, 2020, marked the stock market peak before the outbreak of the COVID-19 pandemic triggered a freefall in share prices. In the year since, the world has changed, transforming our lives, our economies, and the fortunes of our businesses—an unfolding journey that is reflected in the ups and downs of share prices. The fundamental trends have accelerated, propelling some companies forward at record speed while for others headwinds have turned into hurricanes.

By pooling investors' beliefs about the future, capital markets are powerful indicators of what could lie ahead. And this view puts the new realities we face into stark relief.

For equity investors, the drama of the past year has played out in four distinct acts, reflecting marked shifts in expectations about the pandemic's duration and its impact on consumers and businesses (Exhibit 1). To illustrate this, we have grouped 5,000 of the world's biggest companies into their respective sectors and examined these sectors' average shareholder returns over the course of the year. We have placed one special set of companies, which we have dubbed the "Mega 25" (more on these later), in a "sector" of their own because their exceptional market performance would skew their industry results.

Act 1, spanning roughly the first month of the crisis, saw historically large and rapid declines across all sectors. Recall that early in the pandemic, all news was bad, uncertainty was extraordinary, and the downside seemed unlimited. The tide started to turn after mid-March as governments began responding with record stimulus packages, and by early June some sectors, such as pharmaceuticals and biotechnology, fully regained their market losses. But the recovery was far from even, and many industries—notably aerospace, air and travel, banking, insurance, and oil and gas—remained down significantly from their prepandemic peaks.

Through the middle of the year, this dispersion grew, with the high-performing sectors gaining strongly and widening their lead on the lagging industries. Seven months after markets had bottomed out, almost half the sectors had fully bounced back—although banking remained 19 percent below the pre-COVID-19 high, indicating concerns about the health of the wider economy. Finally, in Act 4, from late October to today, news of imminent vaccines led to the anticipation of recovery, with the worst-hit industries partially regaining their market losses while those that thrived through the pandemic continued to advance strongly. While the average returns rose in each successive act, the spread between the best- and worst-performing sectors also grew, from 27 percentage points in mid-March to 80 percentage points today—the widest in recent history.

This wild roller-coaster ride reflects the vast confusion and radical shifts sparked by an unprecedented crisis. Yet the past year in the capital markets also tells a story of resilience and hope, offering the promise of new growth and vigor on the other side of the long, dark COVID-19 tunnel. In our analysis of the market gyrations, three key themes emerge: a new group of exceptional outperformers is changing the rules of the game; the pandemic has served as an accelerator of existing trends; and companies primed to ride those trends are extending their leads on their peers.

The 'Mega 25' surge ahead

Over the past year, 25 companies have recorded market-capitalization gains that put them in a category of their own. They collectively added \$5.8 trillion in value, with average increases of \$231 billion (Exhibit 2). Given that the overall market rose by \$14 trillion over the past 12 months, these 25 companies represent a whopping 40 percent of the total gains.

Exhibit 1

The stock market went through four acts.

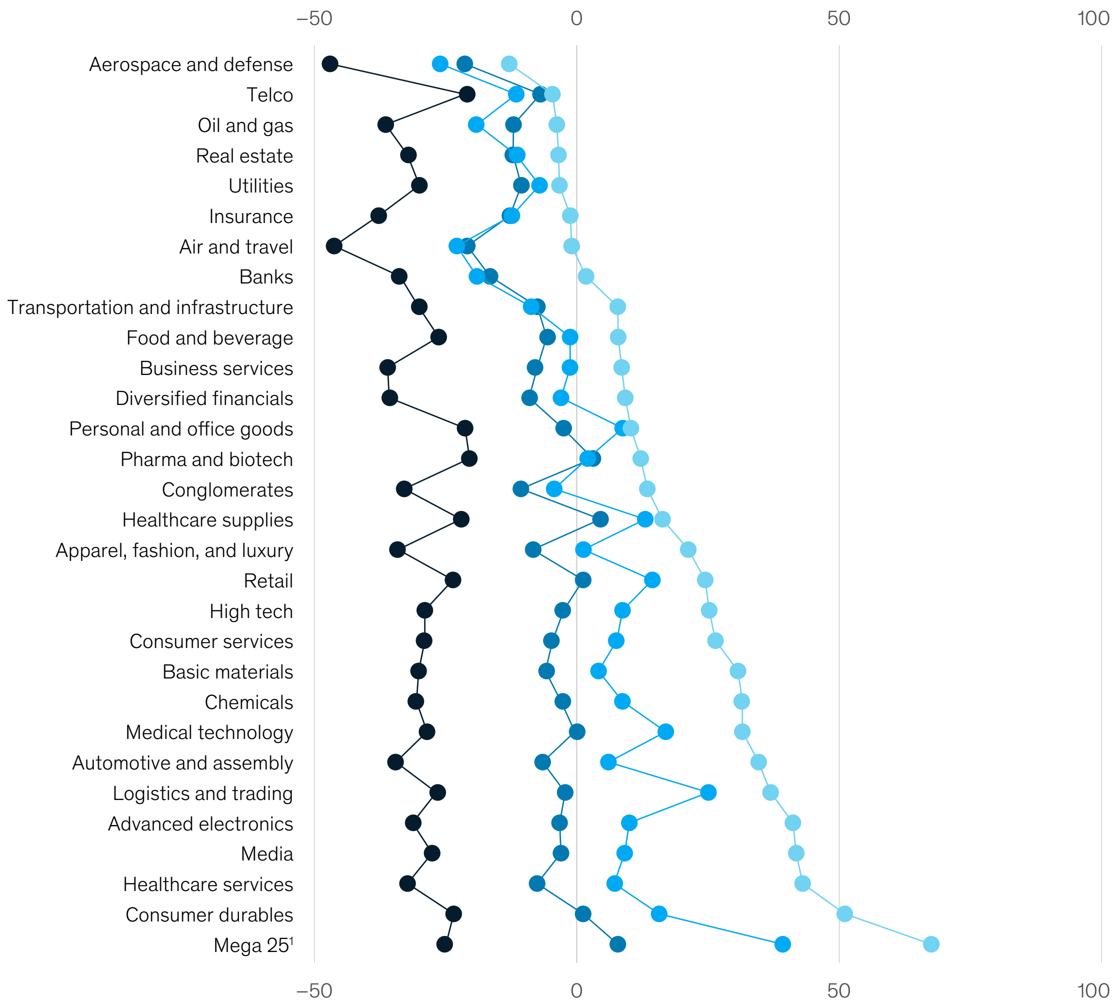
Weighted average shareholder returns by industry since February 19, 2020, %

Act 1: Decline across sectors *(Mar 23, 2020)*

Act 2: Differentiation of sectors *(Jun 9, 2020)*

Act 3: Amplification of difference *(Oct 23, 2020)*

Act 4: Anticipated recovery *(Feb 19, 2021)*

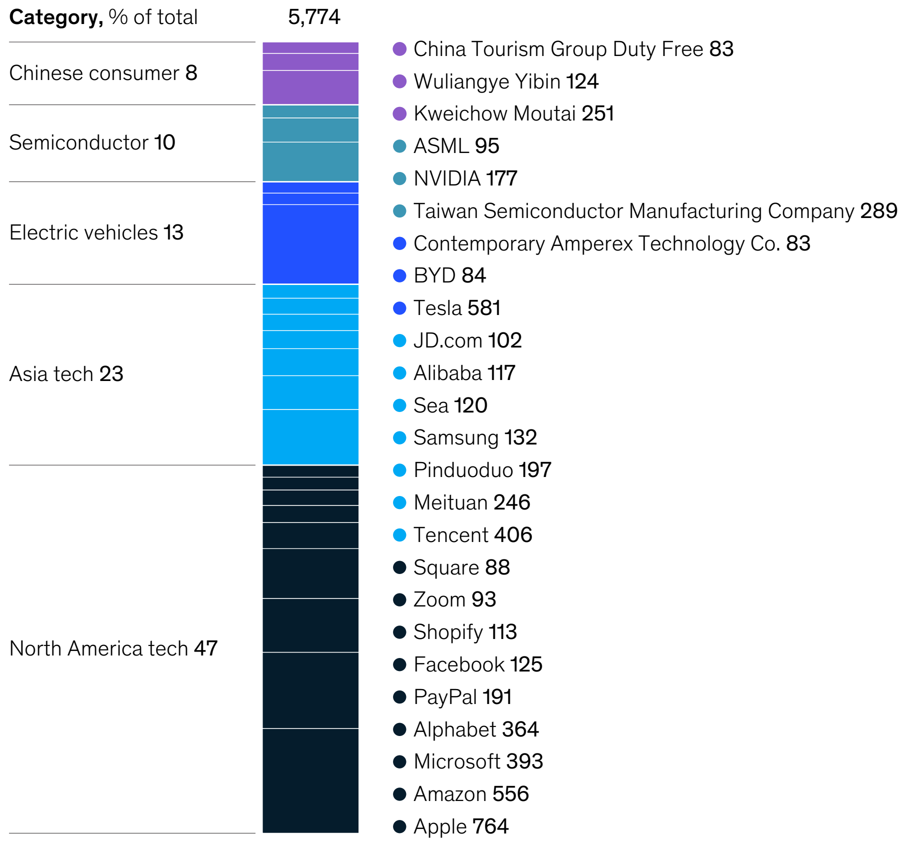


[1]A group of 25 companies with market-capitalization gains that place them in their own category.
Source: Corporate Performance Analytics; S&P Global

Exhibit 2

The ‘Mega 25’ are a sector of their own, with exceptional market performance.

Market cap change since Feb 19, 2020, peak for Mega 25 companies,[1] $ billion[2]



[1]Figures may not sum to total, because of rounding.
[2]At constant, average exchange rates.
Source: Corporate Performance Analytics; S&P Global

Notice that 22 of the Mega 25 fall into four sector categories: North American technology, Chinese and Asian technology, electric vehicles, and semiconductors. The remaining three companies benefited from China’s strong consumer demand. Drilling down, we can see the specific trends in play too: three companies on the list—Square, Shopify, and PayPal—are revolutionizing the once bank-dominated world of payments as commerce fully digitizes.

The majority of these companies had mega-capitalizations before the crisis, but 11 started with market values below $100 billion. Many of these found themselves at the epicenter of the forces at play. Consider Zoom, a company whose name has become a verb for many of us, which added $93 billion to its market value over the past year.

Just beyond the Mega 25, an additional 28 companies gained more than $50 billion of market capitalization. Many of these are in the same four sectors as the top 22, alongside companies directly benefiting from pandemic-related demand such as those involved in COVID-19 treatments and testing, digital entertainment, and e-commerce. Collectively, these 28 runners-up increased their value by $1.8 trillion, representing 12 percent of the total gains made by the 5,000 companies in our sample. Added together, the total set of 53 companies covers more than half of the market gain.

Acceleration of trends

A look at the trends driving the economy today shows a pattern of great acceleration: few new trends emerged over the past year and even fewer reversed direction, but many of those present before the pandemic have experienced dramatic surges. Online shopping, remote education, telemedicine, and even geopolitical tensions are not new, but the COVID-19 crisis has intensified these forces like an earthquake releasing pent-up energy.

This acceleration is reflected in the market value that various sectors have generated. The big winners during the pandemic had already been riding these waves to the head of the pack. Exhibit 3 compares sector returns in the previous five-year period to those of the past year. Consider the Mega 25 group in the top-right quadrant—these companies were significantly outperforming the market even before the pandemic's economic shock. Among sectors, advanced electronics, high tech, and medical technology were likewise already in the lead when the COVID-19 crisis gave them an additional jolt. On the other hand, banks' weak market performance has been exacerbated by the pandemic, as has been the case with telecommunications and energy industries. The travel sector and its related aerospace suppliers are the one exception, affected by the near cessation of international travel that is a novel (and possibly temporary) outcome of this crisis.

The pattern of winning sectors extending their leads and laggards dropping further behind also plays out at the company level. While the median price-to-earnings (PE) ratio stayed nearly flat over the past year, at around 15 times, organizations in the top decile of performance, which already boasted a high average PE of 25 times, expanded their ratios to 40 times. Meanwhile, those in the bottom decile whose PE ratios averaged 13 times before the pandemic saw them decline slightly to 12, showing yet again the impact of the great COVID-19 accelerator.

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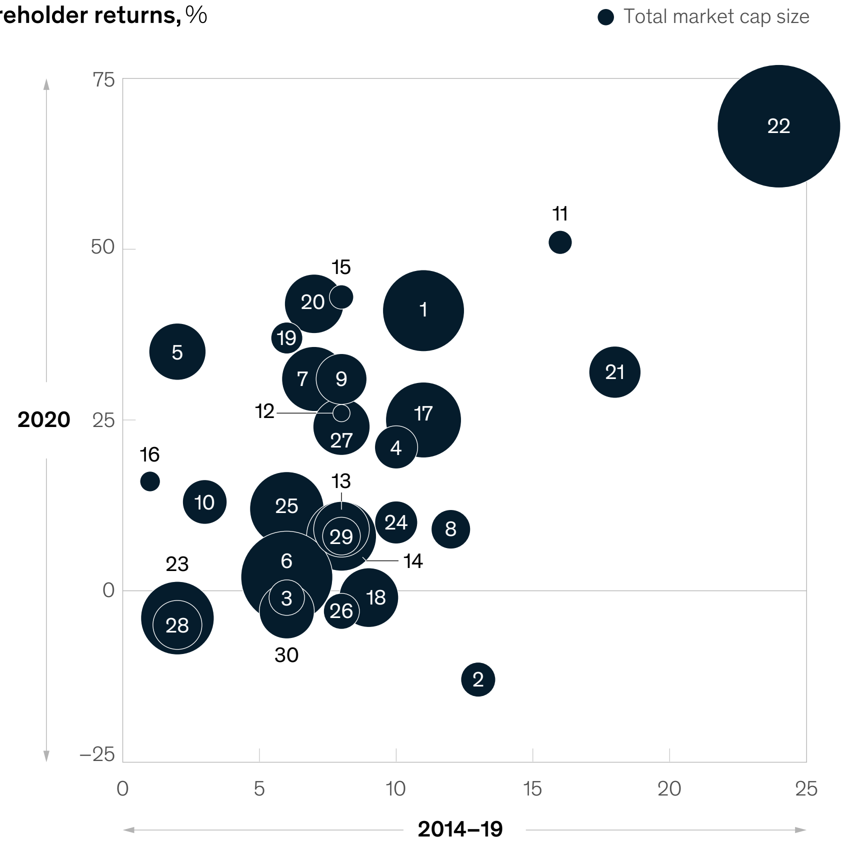
Exhibit 3

Big winners in the stock market were already riding a wave of acceleration before the pandemic.

Total shareholder returns, %



1 Advanced electronics
2 Aerospace and defense
3 Air and travel
4 Apparel, fashion, and luxury
5 Automotive and assembly
6 Banks
7 Basic materials
8 Business services
9 Chemicals
10 Conglomerates
11 Consumer durables
12 Consumer services
13 Diversified financials
14 Food and beverage
15 Healthcare services
16 Healthcare supplies
17 High tech
18 Insurance
19 Logistics and trading
20 Media
21 Medical technology
22 Mega 25
23 Oil and gas
24 Personal and office goods
25 Pharma and biotech
26 Real estate
27 Retail
28 Telco
29 Transport and infrastructure
30 Utilities

Source: Corporate Performance Analytics; S&P Global

Amplification of the corporate performance gap

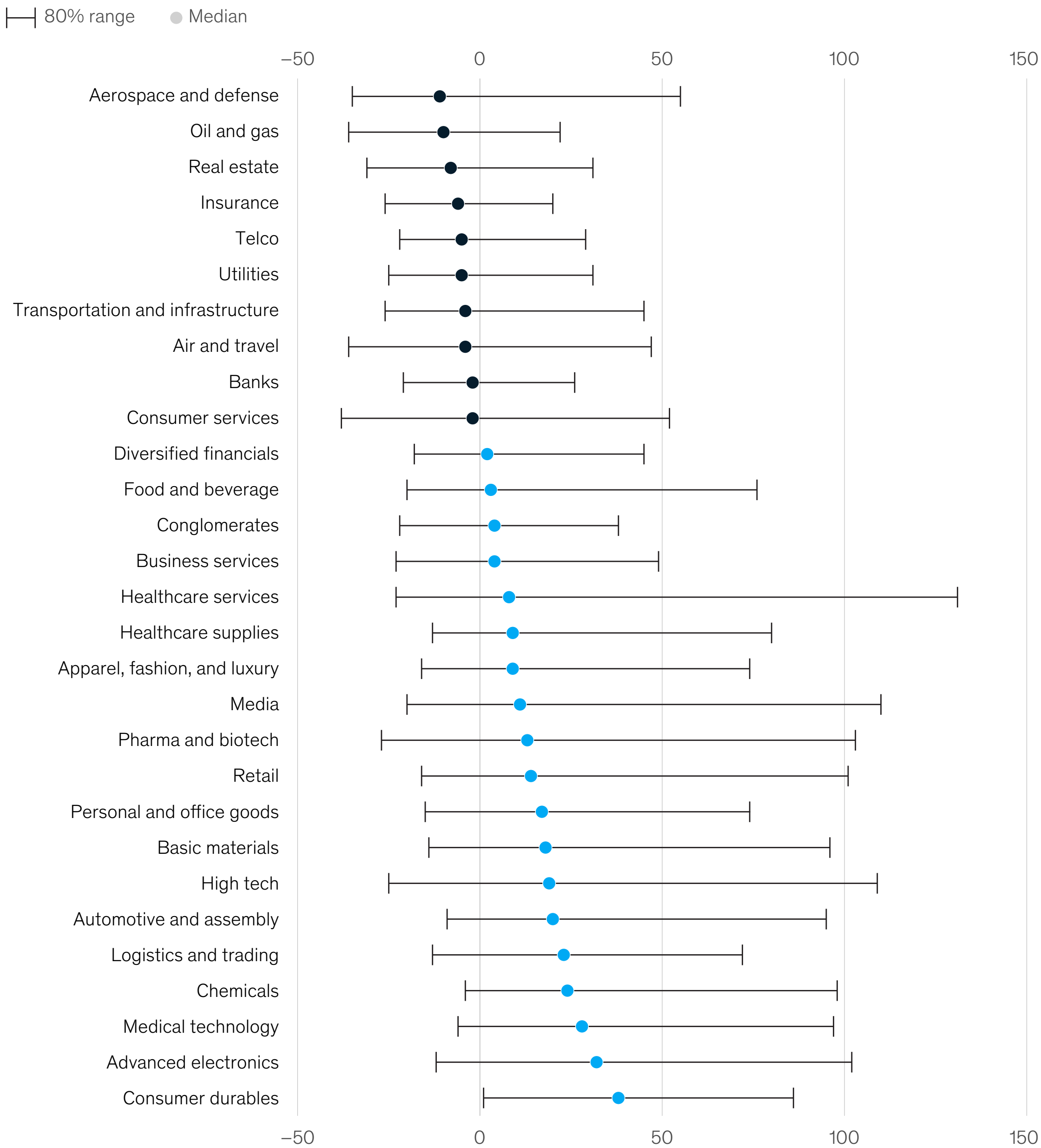
The same forces widening the gap between sectors are also amplifying differences within sectors, mostly because the winners are pulling ahead. In every single sector, including those facing significant industry headwinds, some companies increased their market value during the course of the crisis (Exhibit 4).

For example, while the restaurant industry has struggled mightily during the pandemic, Domino's Pizza delivered total returns to shareholders (TRS) of 26 percent, thanks to its technologically advanced business model and its ability to quickly ramp up delivery. Likewise, Peloton, maker of internet-enabled exercise bikes, saw its shares' value increase more than fivefold even as most traditional gyms have struggled under lockdowns. And while it

Exhibit 4

Shareholder returns varied significantly within each industry.

Distribution of total shareholder returns since Feb 19, 2020, by industry, %



Source: Corporate Performance Analytics; S&P Global may not be surprising that many online-first retailers did very well over the past year, some traditionally brick-and-mortar operators such as Target (TRS of 64 percent) managed to adapt and outperform even as the pandemic hammered the retail sector.

In many cases, the strengths enabling some companies to surpass their sector peers—tech-forward and asset-light business models propelled by tailwinds of growing demand—became even more important during the crisis. The demand tailwinds were often directly driven by policy responses to the pandemic, such as lockdowns that changed consumer behavior. But, as the presence of electric-car makers among the Mega 25 demonstrates, the momentum is broader than that. The rapidly increasing importance of sustainability can also be seen in the many renewable-energy companies delivering strong returns while the utilities and oil-and-gas sectors declined in value overall.

The year of the pivot

The stock market performance over the past year sends clear signals about where business leaders should focus their energies in the coming months.

Reimagine the world(s) on the other side of the tunnel. Business leaders need a vision for the post-COVID-19 future, building out various scenarios to account for the continuing uncertainty. How will the accelerated trends, along with the ongoing demand aftershocks, change your industry? If your sector has been troubled for a long time, it may be time to consider changing industries—or leading fundamental change within your industry. If you are among the outperformers, what do you need to do to deliver on the promise inherent in your market valuation? It's time to bring disruption from the edge of your thinking into the center.

Be ready to coexist with megaplayers. Every company in every industry needs to understand the potential impact on its business of the Mega 25 and other performance outliers. Many of these companies are platform and ecosystem leaders that, at their current valuations, have unrivalled access to capital and few limits to their strategic options. If they opt to move into your sector, how will you respond?

Seize the moment to pivot. In contrast to the radical forces buffeting valuations, for most companies, 2020 was a year of "strategy lockdown." Deal volumes fell to record lows. Capital expenditures are down 15 percent (when the Mega 25 and financials are excluded). However, that lull is over. We know from analyses of previous crises that the momentum with which a company emerges from a downturn determines its course for years: those that come out strong keep outperforming while the latecomers continue to lag. That makes 2021 a year of outsize significance for your strategy—an opportunity to get a jump on competitors slower off the starting blocks.

The past year in the capital markets has underscored the growing pace of change. This suggests a short window of time to prepare your company for disruption, potentially requiring you to pick up the pace on any planned strategic transformation. The growing divergence between individual companies, meanwhile, highlights the reality that, while every crisis produces winners and losers, economic shocks also create opportunities for those that act boldly to surge ahead.

Chris Bradley is a senior partner in McKinsey's Sydney office, and **Peter Stumpner** is an associate partner in the New York office.

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