REPORT
20 FEBRUARY 2020

ASIA MACRO STRATEGY

Is a COVID-19 Containment-Induced Recovery Realistic?

For Professional Investors only in Hong Kong and Accredited Investors (in respect of accounts opted-in to be treated as Accredited Investors) and Institutional Investors only in Singapore

With uncertainty still lingering around the COVID-19 outbreak, we recommend a defensive strategy at current valuations and consider a severe economic decline but a well-priced V-shaped rebound in the markets.

Severe economic decline will be reflected in data releases ahead. This will also be reflected in corporate revenues / earnings along the supply-chain. Apple's latest revenue warning due to COVID-19-induced production delay is a case in point. The macro environment is overall less supportive than previous outbreak episodes – China's daily coal consumption is down 50-60% on the year, while domestic travel has come to a halt.

We prefer thematic or single stock ideas – laggards with good fundamentals to capture policy stimulus (real estate, financials, materials) and virus-induced long-term growth sectors (healthcare, online tech/entertainment, cloud computing/storage, insurance)

We have seen US dollar credits pricing recovery similar to equities. China high-yield will be supported by increasingly favourable housing measures and overall tight market supply.

V-shaped rebound well anticipated

The MSCI Asia (ex. Japan) index has rebounded from the trough and is now merely 3% down from 17 January peak. The regional index fell about 8% from peak to trough (17 January to 3 February), but has regained some 5% since the recent low.

Markets that received a big hit such as China A- and H-shares and the Hang Seng Index (HSI) have regained 2/3 of the initial losses. By sector, the expected outperformers – information technology, communication services and health care – have largely recovered more than initial correction and continued to perform strongly. Even the sectors, which have been highly impacted – such as Macau gaming, real estate, industrials, consumer discretionary – have recovered about half of their initial decline.

Market resilience

A series of China's policy stimulus – corporate tax cuts, fee reductions, liquidity injections, interest rate cuts, the delay of tax/fee payments plus forbearance measures – have helped boost market sentiment.

Beijing's policy response has been swift but still measured. In our view, there is risk of the market over-pricing continued policy boldness ahead.

Other outbreaks such as SARS (2003), Swine flu (2009), Ebola (2014) and MERS (2015) have all resulted in significant market rebounds after initial declines, have been swiftly and efficiently priced in this COVID-19 crisis. However, we think that current rebound appears too early and optimistic about the upside.

During SARS, the market rebounded when the infection rate reached a decisive peak. But with COVID-19, the key focus is whether the spread from Hubei to the rest of China has been contained effectively.

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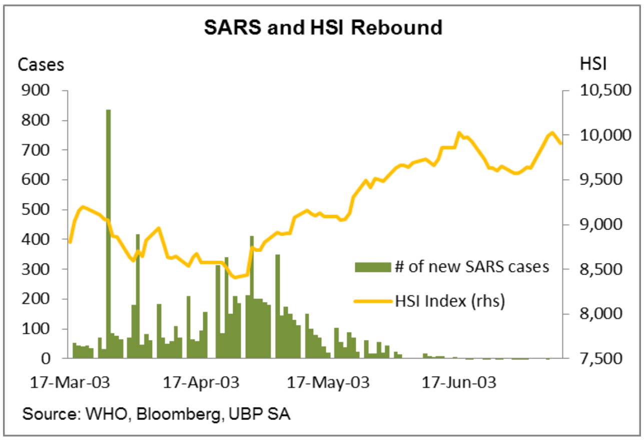
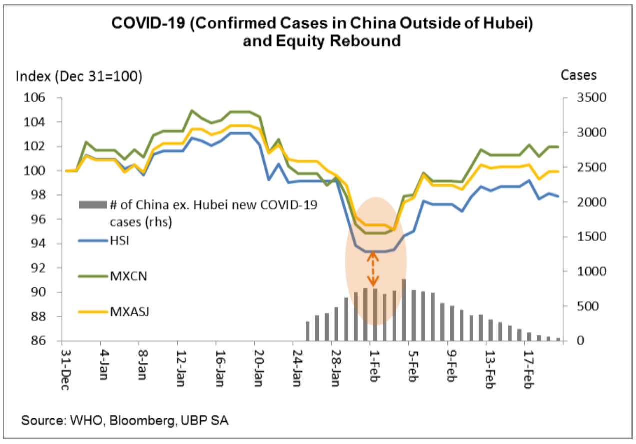
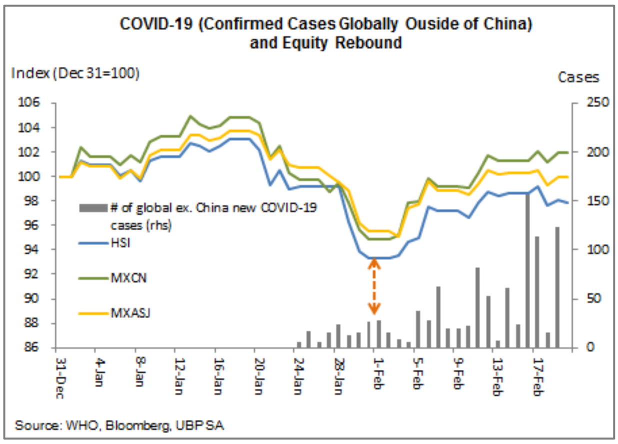


China's official numbers show a persistent decline of confirmed cases outside of Hubei province from a peak of 888 on 4 February to a mere 42 on 20 February. This has convinced the market that the virus is being contained.

The key risks in this are, whether the numbers are precise, and whether there will be second wave of the virus spreading as workers start to return to their factories.



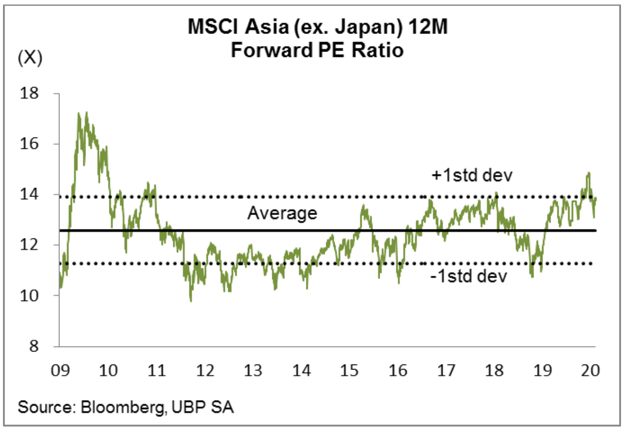
More importantly, equity prices has bottomed out even though global infected cases continued to rise, but rebounded on containment as reported in China outside of Hubei. This is despite the fact that the global spread (outside of China) has increased persistently even though the absolute numbers of infected cases (123 on 19 February) remain small and are largely ignored.

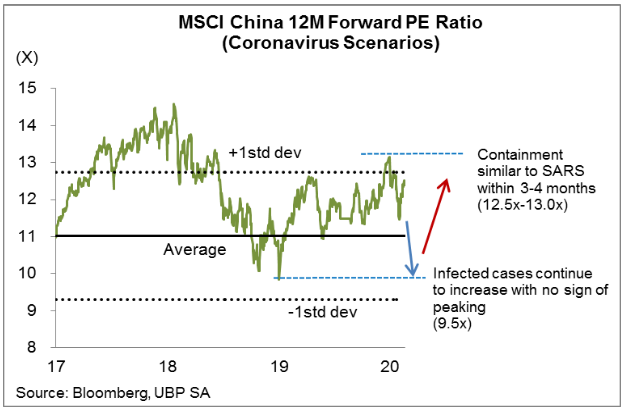


Investors also seem less worried about the virus' fundamental impact given its relatively low mortality rates (0.7%-2.5% vs. SARS's overall 10%) and improving recovery rates (21%- 22% both globally and in China).

Market valuations

However, equity market valuations are not too attractive at current levels. Forward price-earnings (P/E) multiples of MSCI Asia (ex. Japan) is currently trading at 13.9x (vs. 12.6x 10Y-mean), MSCI China at 12.5x (vs. 11.0x), CSI300 at 12x (vs. 11.8x) and HSI at 10.4x (vs. 11.4x). We see limited upside from current levels but won't exclude some overshooting in the near term.





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