

Market Bulletin

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What are the investment implications from the coronavirus outbreak?

The general public, especially in Asia, is understandably anxious about the latest coronavirus outbreak that originated in Wuhan, China. It is also important to consider some of the investment implications from this incident. This is an example of how investment principles are important to keep investors rational and on track to meet their investment objectives. In particular, diversification, both in amongst different asset classes and geography, and focus on the long term, can help investors to build stronger portfolios.

It is worth looking back to the experience of severe acute respiratory syndrome (SARS) outbreak in 2003, even though each outbreak is different. This SARS outbreak, started in November 2002 and subsided in the summer of 2003, infected over 8,000 people around the world with 774 deaths. The chart below compares Asian market performance during the peak of concerns when the number of infection begins to rise, as well as when the outbreak comes under control. There are a number of observations.

- Markets with the greatest number of infections, namely China, Hong Kong and Taiwan, faced more pressure when the outbreak began. By sector, the consumer in both staples and discretionary, were heavily impacted. Financials, which includes insurance and real estate (think shopping malls and retail spaces) were also badly hit. Countries with fewer cases, such as Malaysia and Thailand, experienced more moderate corrections.
- There was also market volatility in markets that were not impacted by SARS, such as India, which only had 3 cases, but its market was down 12.5% during the 'rising concern' period. In contrast, we saw Indonesia and the Philippines gained during this period. Hence, investors should recognize that SARS was only one factor of many that would drive market performance, especially for those countries that were less impacted by the outbreak.
- The market recovery phase started before the number of new infections started to plateau in late May 2003. This is partly due to a greater understanding of the SARS virus and how to prevent infection. Once the outbreak subsided and official warnings were lifted, economic activities were quick to recover back to pre-outbreak level. In China, retail sales, industrial production, fixed asset investment all took a hit in 2Q 2003. Yet, these indicators rebounded swiftly to their pre-SARS growth rate once the outbreak came under control.
- The Chinese stock market did lead the rebound and performance recovery was comprehensive across all sectors, with staples, healthcare and financials leading the way. That said, equity market recovery was strong during this period across Asia, even for economies that were less affected by the SARS outbreak. Again, the underlying economic conditions and global market sentiment were important drivers.

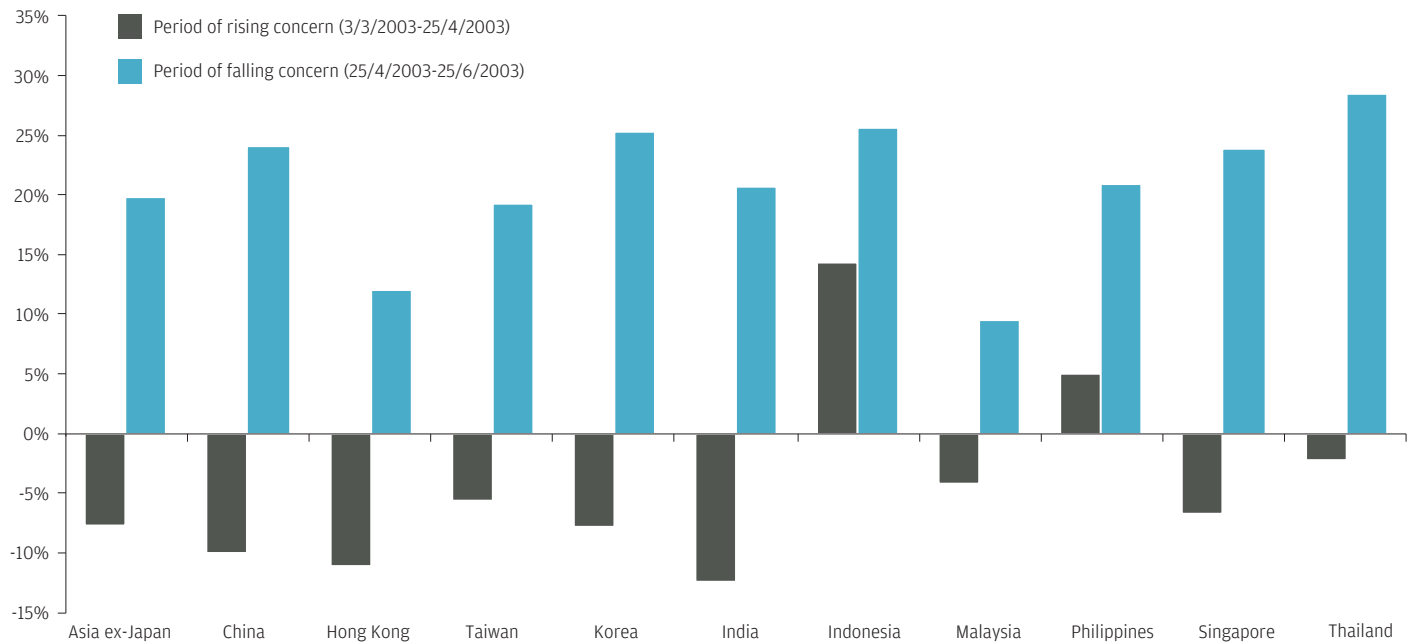
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EXHIBIT 1: EQUITY PERFORMANCE DURING THE SARS OUTBREAK

Index performance in USD terms



Source: FactSet, MSCI, J.P. Morgan Asset Management. Data reflect most recently available as of 28/01/20. Past performance is not a reliable indicator of current and future results.

Where do we go from here?

Unfortunately we are still at an early stage of this outbreak. The number of confirmed cases is likely to rise in the weeks ahead, especially given the Lunar New Year traffic. One question would be the extent and speed of disease spread in other countries. The death rate from the infection is also a consideration. Hence, Hong Kong and China could still come under pressure after returning from Lunar New Year break. It should be noted that many Hong Kong companies with business exposure to domestic retail and tourism have already suffered earnings downgrade on the back of the local political unrest in the past 8 months.

Once the number of new infections start to stabilize and official warnings removed, we should see economic activity go through a prompt rebound in China, and to a lesser extent, in Hong Kong. This would also support market sentiment. Again, it is important to recognize that there are other market drivers at play that would influence the Asian markets. The recovery in the global trade cycle and economic activities could benefit export oriented markets, such as Taiwan, South Korea and Singapore.

Investment implications

We are still at an early stage of this outbreak and hence it is difficult to assess the full impact on the Chinese and Asian economy. We expect economic activities in China and Hong Kong to take a hit in the months ahead. China is extending its Lunar New Year holiday until early February, while advising people to stay home. Naturally, this is going to impact on China and Hong Kong markets, especially the retail sector, the most considering the economic exposure. The spill over economic impact on the rest of the world would depend on whether the spread of virus is contained. Global exporters who are dependent on China's economic rebound, such as those in Europe, is very likely to see a delay in recovery.

Asia investors should diversify their asset allocation at this point, both by asset class and geography. The direct economic and earnings impact from the outbreak on U.S. and European companies are likely to be limited at this stage. Even within Asia, some sectors are likely to see greater resilience on their earnings performance. Asian technology companies with global business exposure is likely to face less volatility in this environment. It is also important to focus on the long term, and the fact that economic activities should bounce back once the outbreak subsides.

Uncertainties from the outbreak are also expected to reinforce the dovish bias for central banks around the world, especially China when it prepares to support the economy once the outbreak is contained. This should provide support to government bonds and selected Asian and Chinese high grade corporate credits.

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