CFA SINGAPORE INSIGHTS

By Pranay Gupta

Virus, oil and a slowing global economy: Time to buy or take cover?

If you buy stocks directly, buy the blue chips, not the speculative stocks. And if you invest in funds, make sure you invest with a large multi-philosophy asset manager

IT WAS just two months ago that the main issues on the table for investors were the future of the US-China trade dispute, a slowing Chinese economy and the Brexit fuddle. Bulls were pointing to the positive sounds coming from an interim trade deal, and bears were touting the impact the trade dispute was having in slowing down the global economy. At best the pendulum was balanced.

How things have changed practically overnight. But is this a time to buy or sell?

Let us break down what has happened in the last few weeks.

Corona-panic

I have had the somewhat dubious privilege of seeing first-hand what happened in Hong Kong with Sars, and the reaction to the coronavirus in Hong Kong, Singapore and now the US. Hong Kong, with its experience of Sars, was immediately on alert – literally everyone was wearing masks and all offices, buildings, shops and schools had switched to battle stations. Virus contained – limited panic.

Singapore was somewhat apathetic at first, but this rapidly changed to a cohesive plan when required – panic avoided.

Europe and the United States were unprepared. They had almost two months of advance warning, but despite that, the attitude of "it can't happen to us" is now creating real problems. Result – panic, not just for healthcare, but for people, businesses, companies and the economy. And the worst may be yet to come. As corona cases skyrocket in New Rochelle (north of New York city) and Lombardy (northern Italy), what has happened in markets this week is sheer panic. If this was the sole factor, this would be probably the best time to buy risk assets, as was seen when Sars happened in Asia.

Corona-impact

Panic aside, it is clear that the shutdown will have a severe impact on corporate performance in the first quarter of 2020 and perhaps the second quarter – for hotels, airlines, consumer discretionary companies and others. But this is a supply-side shock.

Demand has not vanished, it has been postponed till the virus is contained. And if history is of any guide, all of that demand will return with a vengeance when rational thinking prevails. Short term, the impact will be felt most by fundamentally weak or indebted companies. The strong companies and blue chips will not only survive, but will emerge stronger. But the markets have been nonchalant in making this distinction. Blue-chip stocks have become much cheaper than they were a few months ago.

if the virus spread continues to worsen, there will be sustained policy support for markets, and if the virus is contained, as is probably more than likely, then the world and markets will return to sanity. Another reason to buy. PHOTO: AFP

Policy response

The knee-jerk reaction of policy-makers (particularly in the US where the country was unprepared for the shock) has been to provide support, much like they did when the global financial crisis happened in 2007 (and we know what happened to markets after QE) – not only monetary, but potentially also fiscal. Cynically this basically means that if the virus spread continue to worsen, there will be sustained policy support for markets, and if the virus is contained, as is probably more than likely, then the world and markets will return to sanity. Another reason to buy.

Oil's well that ends well

And then came the Saudi-Russia oil dispute, and oil prices crashed by 30 per cent in a day. Good or bad? Well, save the energy companies and the indebted companies surviving by issuing high yield debt, it is good for everyone else. So why are we so worried? Any budding inflationary pressures will be contained and it will be positive for consumer spending and the global economy. When Opec+ resolves its dispute to reduce oil production, oil prices may revert and we lose this benefit. And if the dispute continues for a few weeks, it will drive the weaker shale producers out of the market and reduce production automatically and have a similar effect. But while the dispute stays unresolved, it is beneficial, with or without the coronavirus.

It's the economy, stupid!

At the end of the day, unless you are a diehard pessimist on the human condition, the coronavirus is a fleeting event. Once the panic is contained, economies will revert not only to their long-term trajectories, but perhaps a better one than before as policy is more supportive and demand is resurgent. And markets follow economies, though they are swayed by fads. So while the environment can be disconcerting, it's probably the best time in a while that we have had to buy risk assets.

No pain, no gain

Having said that, be clear that the ride will be bumpy while investors coalesce around this view, and it is not clear that we have seen any kind of bottom yet to the markets. Much will depend on how long it will take to contain the virus in Europe and the US. Decisive action on tackling the virus, as was done in China, but implemented in a democracy will be critical. As we all know, you will never be able to time the bottom of a market, but it's safe to say that it's time to make your buy list.

If you buy stocks directly, buy the blue chips, not the speculative stocks. And if you invest in funds, make sure you invest with a large multi-philosophy asset manager. As the Franklin/Legg Mason merger reinforced, commercial pressures will force mid-sized asset managers (with less than US$1 trillion assets under management), particularly those with a single traditional fundamental investment philosophy, to reorganise or merge, which is often detrimental for fund investors. Large managers who have the resources, and are able to provide not only traditional active, but passive, quantitative and alternative strategies with equal ease, are better-placed to weather the economic turbulence which is under way.

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