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# ECONOTE No 89: Existentialist puzzles: Coronavirus, Equities, Brexit and the Environment 4/2/2020

| Summary | Investment Conclusions |
|---|---|
| The world seems to float in an existential vacuum of directionless. The coronavirus epidemic is now the key focus while few days ago Trump's impeachment had stolen the limelight from the Israel-Palestine non-peace plan, with all the while the Brits sleepwalking out of history and into splendid isolation with the exit from the EU. The US-China trade war feels like history, while the grim environmental news, especially from Oz, came and went with Davos. What is going on? Multilateralism comes at a price, and that price is the fragmentation of foci and of attention. Global it ain't no more. Hence the random bits of the puzzle. | The virus capped the strong performance of US equities and the Fed will stay supportive, as will BoE and the ECB. The SARS epidemic in 2003 had a near zilch macro effect on Hong Kong, but then history does not repeat itself if combined with political riots and a nastier virus. The proxy beneficiary of this, when the epidemic blows away, could be Oz, while Chinese and HK equities, plus airlines will be too obvious as a recommendation as a rebound play! FT100 shorts in six months time could benefit under the harsh light of the UK-EU trade negotiations. Elsewhere ESG and TCFD rule! Read on! |

## In sickness and in health

In Fig 1 ( red lines ) we show the the impact on HK's GDP growth of the SARS epidemic in 2003, the Occupy Central in 2014 and , finally now, the 2019 Extradition crisis plus the coronavirus epidemic. The **SARS** epidemic lasted from March to June 2013 and had a sharp and short- lived impact.The GDP growth rate yoy% moved as follows: 4Q.02 4.1%, 1Q.03 3.9% , 2Q.03 -0.6%, 3Q.03 4.0%, 4Q.03 4.7% . The recovery was quite sharp.The current epidemic has not yet lasted long enough for its impact to be measured, but as Fig. 1 shows , Hong Kong's GDP had been decelerating since the start of 2018 before the riots, which having started in June 2019, begun impacting growth since then.Hence it is will be quite difficult to disentangle the effects of the political uncertainty, from those of the epidemic and from the pre-existing cyclical deceleration.The economic impact of the virus on **China** will be part of a separate report, but its effect can not be long-lasting.As for the **stock markets,** for the G3 markets shown in Fig. 2, the trends are not clear.The S&P is now reaching overbought levels with the index above the 50 moving average(MA).The Nikkei is oversold as is the EU and both trending near their 50MA. In **Asia** virtually every market is negative YTD and, clearly, tourism -dependent economies such as Thailand, Indonesia and the Philippines will feel the impact.We can only repeat here that "recovery" plays are too obvious to be of value and hence our choices for "proxy" equivalents.The USD stays strong as G2 central banks hold steady and Asians,such Thailand and the Philippines cut rates and the PBOC eases further.

**Fig 1: Hong Kong GDP growth 2002-2019**


Source Bloomberg

## Brexit and Enviroment

The key pro-Brexit argument was that taking control would unleash UK's potential in the global markets.That will assume very significant structural changes because if UK's trade will not be dominated by exports to EU ( 45% of total), then these exports would need to fight for space in a highly fragmented world of markets.If the final Brexit deal leaves UK-EU export trade virtually unchanged, why the bother ? The answer is the ability to strike UK bilateral deals, which immediately signifies that the UK-EU deal could and will not leave things unchanged.Assuming that the UK-EU deal is struck in 2020, then all the other bilateral deals, especially with large economies such as Japan,China,Canada etc will take, on average, perhaps 3 years of negotiations, if they take place at all.So it will be 2024 onwards that the "unleashing" will take place.As explained, this will necessitate structural changes.People touting "Singapore on Thames" for the post-Brexit UK, or even just London, are utterly ignorant of the development of Singapore's labor market, trade policies, educational system and monetary- fiscal-tax policies, which made Singapore possible. Structural changes are long term processes, can be extremely painful and can be fiercely resisted, as India has amply demonstrated. Setting a new production facility takes 3 to 5 years of planning and implementation and assumes that the project will be successful. For avid Brexiters the expected benefits will take a minimum of 10 years to start materializing, assuming that they do, and these benefits may well have a "Jane Fonda" tag of "no pain no gain" thus turning them for some in the labor force to pure pain only. To belabor the point, a lot of voters for Brexit may not be alive when the benefits arrive, and lucky not to be alive if the benefits are accompanied by pains. As for the **Environment,** corporates are now faced with a flood of **ESG** and **TCFD r**ankings (see Fact Box) with mutual and hedge funds, as well as pensions managers piling on the agony by demanding clear information and action or else threatening to sell the shares involved.

**FACTBOX: A flood of Acronymics**

**ESG** (Environmental, Social and Governance), **TCFD** (Task Force on Climate Related Financial Disclosures). ESG refers to specific actions taken by corporates, and shown clearly in their reports, on the impact of their activities on the environment and society as well as the way that corporate governance guides these actions. These three areas are then quantitatively indexed and investors are supposed to use them in their responsible decisions. Ditto for TCFD, except here the emphasis is on the preparedness of corporates on the way that environmental risks could impact their balance sheets and capital bases.

Fig.2: S&P (red), Nikkei (yel) and EU (blu) plus metrics,2015-2020


Source: Bloomberg

## Conclusions: Hazy images and unclear horizons

The coronavirus epidemic will continue to dominate sentiment, notwithstanding that the major blows are being delivered to China , and also as collateral damage to Hong Kong, where the epidemic has virtually halted the political protests.The Chinese government has plenty of fiscal leeway to continue boosting spending, as does the Hong Kong government with accumulated fiscal reserves of USD 155 bl.Hence the global impact of the epidemic will derive from whatever disruption to trade is generated by China ( NB in the middle of all this China just cut tariffs on USD 75 bl of US imports).Unless the epidemic becomes truly global, its impact will center on China and partially on Hong Kong whose economy had been deceleating since early 2018.Hardly optimistic conclusions, but neither apocalyptic.Hence our attention to the periphery rather than the centre for investment proposals.A full report on China and the rest of Asia will follow.

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