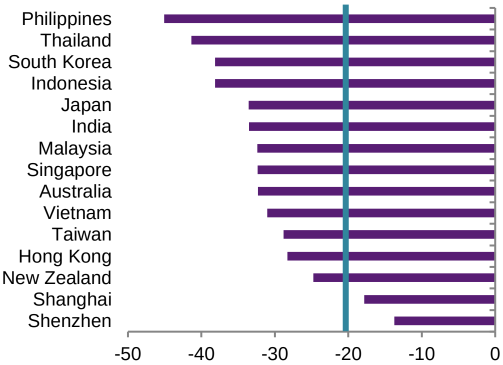
ASIA HOT TOPICS

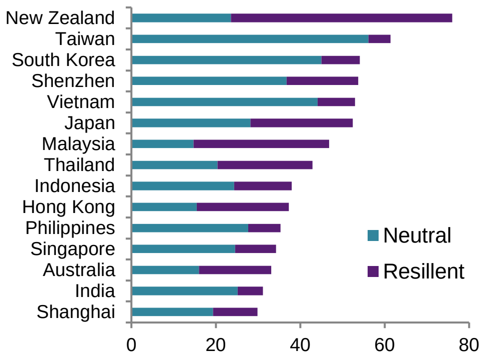
20 March 2020

Perfromace of Asia Equity Indicies from Peak (%)



N.B Data as of 20 Mar 2020. Calculated from the peak per index.
Source: Natixis, Bloonberg

Share of Neutral and Resillent Sector (%)



Source: Natixis, Bloonberg

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WHY SOME STOCK MARKETS CAN DEFY GRAVITY LONGER THAN OTHERS?

Asian equities are in the sea of red. Thrashed by one fear after another, most markets have either entered the bear market or are getting close to the line. A widely spreading coronavirus pandemic, an unsolved oil dilemma and lower interest rates are intensifying fear not only for recession but even depression. Still, differences exist with mainland China, New Zealand Hong Kong and Taiwan in defying the gravity.

Under the current trilemma (coronavirus pandemic, weak oil and ultra-low rates), the sectors facing the biggest headwinds are energy, financials, consumer discretionary, industrial and materials. Instead, consumer staple, real estate and information technology should be less affected given the inelasticity on essential sales and the medium-term market outlook on 5G related demand. Health care, utilities and communication services are more resilient.

Among Asian markets, Taiwan and New Zealand are less negatively affected by the coronavirus directly due to sound and proactive policies and low exposure to oil in benchmark indices. The other reason is the sectoral composition of the indices. Although the recent turbulence has dragged performance, information technology has proven to be relatively stable in this round of market rout and constitutes 51% of market capitalization in Taiwan. New Zealand's index is dominated by resilient sectors, such as communication services, health care and utilities, and to a lesser extent consumer staples. The limited exposure to financials also imply New Zealand is less sensitive to ultra-low rates.

In addition, equities in mainland China seems to be somewhat insulated from the world. Beyond the positive official news on the control of coronavirus spread, recent data is disappointing so it is hard to understand the reason for such resilience. While health care and information technology have supported Shenzhen, the reasons behind the performance of Shanghai is unclear. Hong Kong has also benefited due to its stronger correlation with Chinese equities as a whole.

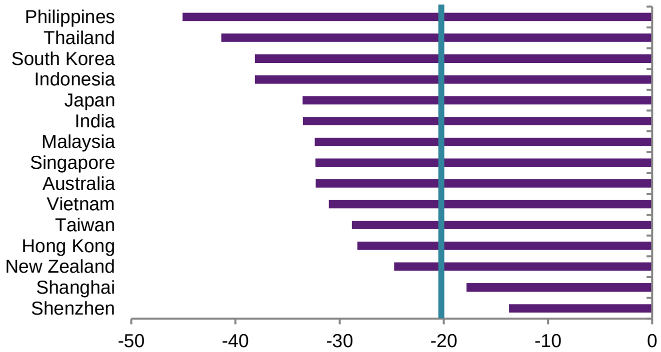
The rest of Asia have all turned into bears. Thailand is the worst given its exposure in oil and tourism. While Australia and Indonesia are also affected by energy, the impact is amplified through financials and materials. Singapore is impacted negatively with large share in financials under a low rate environment The sectoral composition and the nature of being oil importers show Japan and Korea could have performed better but limited by the large domestic virus outbreak, which also mean the tide may revert if the pandemic is further controlled.

All in all, different sectoral compositions of Asian equity indices do offer some guidance to the future evolution for investors, especially when the “risk on, risk off” behavior changes in response to evolving uncertainties.

Dominoes of the bear market

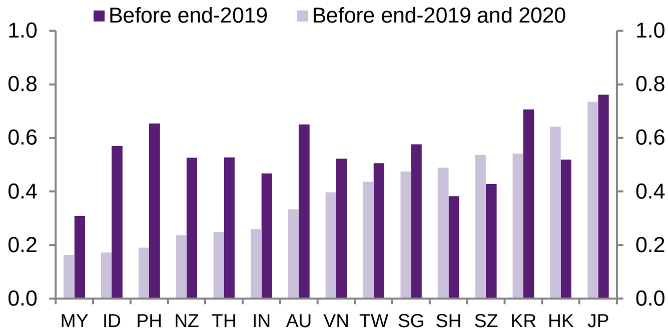
Asian equities are in the sea of red. Thrashed by one fear after another, most markets have either entered the bear market or are getting close to the line. A widely spreading coronavirus pandemic, an unsolved oil dilemma and lower interest rates across the board are intensifying fear not only for recession but even depression. Still, differences exist in mainland China, New Zealand, Hong Kong and Taiwan in defying the gravity (**Chart 1**).

Chart 1
Perfromace of Asia Equity Indicies from Peak (%)



N.B Data as of 20 Mar 2020. Calculated from the peak per index.
Source: Natixis, Bloonberg

Chart 2
Volatility: Beta



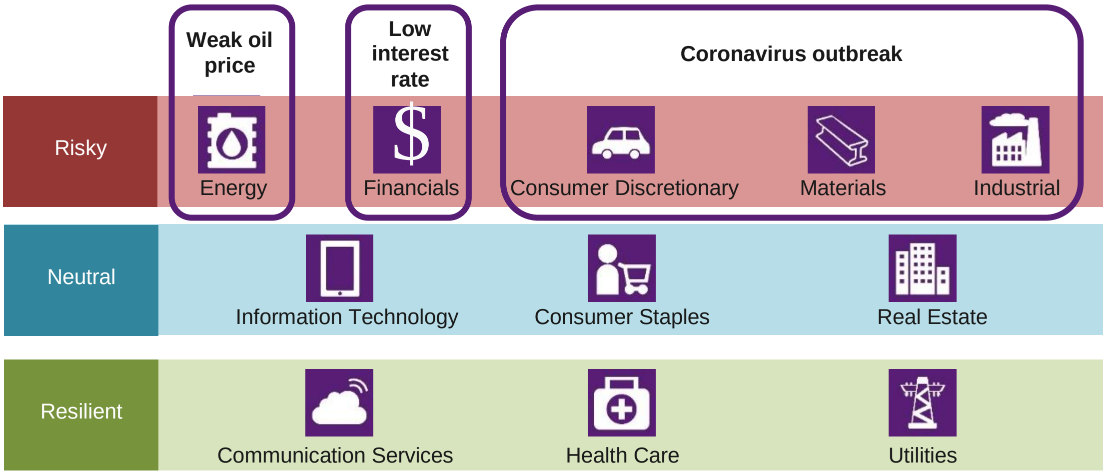
N.B Data as of 20 Mar 2020.
Source: Natixis, Bloonberg

Communication services, health care and utilities should be more resilient

First and foremost, the world is embracing another coronavirus outbreak but on a global scale. Although no market can hide from the global selloff, Asian economies with higher infections tend to perform worse for reasons ranging from weaker consumption and services to disruption in manufacturing production. The uncertainties in being in a dark tunnel but not able to see the light have pushed markets historically with low volatility towards high fluctuations (**Chart 2**).

We classify various sectors into three types: risky, neutral and resilient (**Chart 3**). The trilemma in coronavirus, oil and interest rates are going to hurt some sectors more than the others. Neutral sectors mean the condition is generally stable under large shocks but do not come without risks. Good sectors are relatively shielded from uncertainties.

Chart 3
Sectoral impact by the trilemma: Coronavirus, oil and interest rates



Source: Natixis

Under the current trilemma, sectors facing the highest risks are **energy, financials, consumer discretionary, industrial and material**. Already hit by the coronavirus on lower demand, energy is further exposed to geopolitical dilemma in oil prices with no clear solution in the short run. The headwind will be more challenging for financials due to lower interest rate and potentially worsening asset quality. As for the coronavirus related sectors, demand on consumer discretionary has shrunk not only in luxury goods and hospitality but also on automobile both in demand and supply. With tougher restriction in passenger movement and lower demand in capital goods, industrial is taking the burnt ranging from aviation to machineries. As such, materials will suffer further with lower demand dragged by weaker global growth.

Although the global condition looks challenging, **consumer staple, real estate and information technology** are relatively stable given the inelasticity on demand and the market outlook on future growth. The impact on basic goods are generally neutral but the present globalization in larger cross-border trade and supply chain integration will mean consumer staple may not be an oasis as nice as the past. Unless there is a contagion effect towards financial system, real estate should be relatively shielded given the lower interest rate environment. For the specific case of China, the high return has attracted capital, but risks remain on liquidity. As for information technology, the current uncertainties have brought short term volatility but do not seem to alter the market perception on the medium term outlook on 5G related manufacturers and service providers, such as semiconductor, cloud services etc.

Amid the negative shocks, **health care, utilities and communication services** will be more resilient. Against the background of escalating coronavirus outbreak, health care is a clear shelter from the turmoil. Although weaker production is posed to reduce demand on electricity, Asian utilities are supported by basic demand and good corporate health. Although disruption may still exist for communication services, the basic demand should remain solid.

Table 1: Asia Pacific Equity Indices

	Performance from Peak		Average New Case per Million People	Beta (Present)	Change in Beta	Sectors			Dividend Yield (%)	P/E Ratio (Present)	Change in P/E Ratio
	Local Currency	USD				Risky	Neutral	Resilient			
PH	-45	-52	1.0	0.7	0.5	65	28	8	2.8	10	-8
TH	-41	-51	0.4	0.5	0.3	55	20	23	4.1	13	-7
KR	-38	-46	19.9	0.7	0.2	46	45	9	3.0	15	-7
ID	-38	-55	0.4	0.6	0.4	62	24	14	3.5	13	-9
AU	-34	-46	2.7	0.7	0.3	67	16	17	5.7	15	-7
IN	-34	-43	0.1	0.5	0.2	69	25	6	2.0	17	-9
MY	-32	-39	4.6	0.3	0.1	56	15	32	4.4	15	-6
SG	-32	-39	13.1	0.6	0.1	66	25	10	5.6	9	-5
JP	-32	-33	7.0	0.8	0.0	48	28	24	2.7	15	-7
VN	-31	-37	0.3	0.5	0.1	47	44	9	2.4	11	-6
TW	-29	-31	0.3	0.5	0.1	39	56	5	5.0	15	-5
HK	-28	-29	4.3	0.5	-0.1	63	15	22	4.6	9	-2
NZ	-25	-35	0.2	0.5	0.3	24	24	52	3.9	20	-6
SH	-18	-25	0.1	0.4	-0.1	70	19	10	2.8	13	-2
SZ	-14	-17	0.1	0.4	-0.1	46	37	17	2.1	35	-5

N.B. Performance peak estimated as 52 weeks high. Average new cases per million people calculated from the past 7 days. Change in beta is the different between historical beta before end 2019 and values extended to now. Change in P/E ratio is the difference between the P/E at peak and now. Data as of 20 Mar 2020.
Source: Natixis

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Taiwan and New Zealand buffered by sectoral composition

Among Asian markets, Taiwan and New Zealand are less negatively affected by the coronavirus directly due to sound and proactive policies and low exposure to oil in benchmark indices (**Table 1**). The other reason is the sectoral composition. Although the recent turbulence has dragged performance, information technology was relatively stable in this round of market rout and constitutes 51% of market capitalization in Taiwan (**Table 2**). New Zealand's index is dominated by resilient sectors, such as communication services, health care and utilities, and to a lesser extent consumer staples. The low exposure to financials imply New Zealand is less sensitive to ultra-low rates.

Table 2: Asia Pacific Equity Indices Sector Composition

	Risky					Neutral			Resilient		
	Oil	Low rate	Virus								
	Energy	Financials	Consumer Discretionary	Materials	Industrials	IT	Consumer Staples	Real Estate	Communication	Health Care	Utilities
PH	1	20	4	0	40	0	6	22	4	0	4
TH	13	16	7	8	11	1	11	8	8	5	9
KR	1	15	4	13	13	34	2	9	2	5	2
ID	5	35	7	10	4	0	19	5	10	2	1
AU	5	31	7	17	8	2	6	8	4	12	2
IN	14	42	5	5	3	13	12	0	3	2	1
MY	3	36	5	6	7	0	15	0	13	6	13
SG	3	42	6	0	14	0	6	19	9	0	1
JP	0	2	20	6	19	17	9	2	10	14	0
VN	3	29	3	4	9	1	15	27	0	1	8
TW	2	15	7	10	5	51	3	1	5	1	0
HK	5	48	5	0	5	2	3	11	15	2	5
NZ	2	2	3	4	14	1	12	10	10	25	17
SH	7	33	7	9	15	7	9	4	2	5	4
SZ	1	6	11	11	17	23	9	4	4	11	2

Source: Natixis

Mainland China and Hong Kong are also less affected

Equities in mainland China seems to be rather insulated from the world. Beyond the positive official news on the control of coronavirus spread, recent data has been disappointing so it is hard to understand the reason for such resilience. While health care and information technology have supported Shenzhen, the reasons behind the performance of Shanghai is unclear. However, foreign investors have accelerated the selloff as illustrated by the Southbound Stock Connect but the low share of foreign ownership means the shock is limited. Hong Kong has also benefited due to its stronger correlation with Chinese equities as a whole.

Bears crawling around Asia

The rest of Asia have all turned into bears. Thailand is the worst performer given its large exposure in oil. While Australia and Indonesia are also affected by energy, the impact is amplified through financials and materials. Singapore is impacted negatively with large share in financials under a low rate environment. The sectoral composition shows Japan and Korea could have performed but the larger coronavirus transmission is threatening growth.

What may not be reflected is risky sectors form a lion share in some markets with potential future pressure from uncertainties. Challenges on containing coronavirus spread remain in China when production resumes and as a global pandemic. The pushback of mobile shipment may also eventually revert the sentiment in information technology. Risks are clearly still on the downside unless there is a breakthrough in coronavirus containment. Lower global rates may help on liquidity but cannot serve as a vaccine for coronavirus.

All in all, different sectoral compositions of Asian equity indices do offer some guidance as to the future evolution for investors, especially when the "risk on, risk off" behavior changes in response to evolving uncertainties.

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