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Think Different. Think Small.

JOHCM Emerging Markets Small Mid Cap Strategy

Back to Work, Not Back to Normal

Stephen Lew
Fund Manager

As of February 17th, 2020, the coronavirus ("COVID-19") has infected 72,436 individuals and killed 1,898 people in China alone[1]. In an effort to contain its spread, the Chinese Government has taken the unprecedented step of shutting down major modes of transportation in and out of Wuhan City in Hubei Province, the epicenter of the outbreak, as well as other major cities. Travel restrictions within China and disruptions to international shipping and air travel persist, and manufacturers have little clarity on when things might get back to normal. Consequently, while the human dimension comes first in this tragedy, the negative economic consequences are expected to be significant. In a recent survey of manufacturing companies conducted by the American Chamber of Commerce in Shanghai last week, 87% of companies responding believed that the coronavirus will have a direct impact on 2020 revenues; 24% expected revenues to fall by 16% or more[2]. On the back of meaningfully diminished economic activities, domestic Chinese GDP growth for full year 2020 is expected to suffer[3].

While the negative economic impact from COVID-19 may ultimately be transitory, the larger question that remains unanswered is when the factories in China can return to pre-COVID-19 production capacity. The return of migrant workers to their workplaces is being impeded by the travel restrictions and quarantine requirements imposed by local governments across the country. Current daily train passenger volume has been tracking below one million passengers versus 20 million passengers over the same period last year; daily coal consumption by the top six power plants is tracking below 400,000 tones as opposed to over 600,000 tones over the same period last year[4]. Based on the above and other anecdotes, it would suggest that 1Q20 reporting period is going to be a difficult one for not just Mainland China-based companies but also companies which have significant exposure to the domestic Chinese economy, such as companies based in Taiwan, Hong Kong, and South Korea.

There are two important signposts in determining whether we have reached an inflection point in this struggle against COVID-19: indications of infection containment and full resumption in factory activities. On the infection containment front, it is critical to see a leveling off of infection rate in Hubei Province, the epicenter of the outbreak, and a decline in the rest of China. That would be a positive indication of the beginning of a successful containment of COVID-19 within the epicenter itself. In the area of resumption of factories activities, access to on the ground surveys can provide high frequency data on where we are in the recovery cycle. Incidentally, the latest high frequency data from February 18th are indicating that the majority of companies surveyed in China are expected to resume operations by February 24th[5]. Indeed, as the English theologian and historian Thomas Fuller pronounced many centuries ago, "It is said that the darkest hour of the night comes just before the dawn."

[1] National Health Commission of the People's Republic of China, February 17th, 2020
[2] AmCham Shanghai Coronavirus Impact Member Survey, February 7th, 2020
[3] "2019-nCoV outbreak series #3: Cutting growth target to below 6%?", China Economic Watch, BofA Global Research, February 7th, 2020
[4] CLSA: Covid-19 update, February 17th, 2020
[5] CRR Data Flash, China Reality Research, February 18th, 2020

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