Fiscal and monetary stimulus to support markets

March 2020

FULLERTON FUND MANAGEMENT

Executive summary

- The COVID-19 virus is expected to have a significant impact on economic activity in the short term.
- We also expect large fiscal and monetary stimulus from countries across Asia, especially China, which should support markets.
- We have reduced exposure to vulnerable sectors but would use market corrections to build positions in long term structural growth stocks.

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After a rather buoyant start to the year markets have been hit by what can be classified as a "black swan event". The outbreak of the COVID-19 virus has dented the positive market sentiment which was pervasive during the first few weeks of the year. Asian markets are likely to remain volatile until the outbreak is decidedly brought under control.

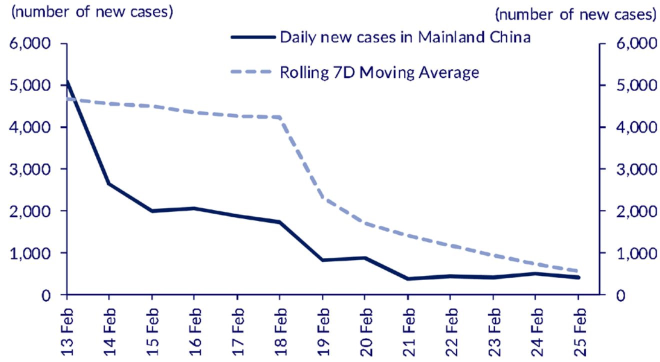
In the longer term, we believe that this incident is likely to be transitory and will not have any major structural impact on the region. Thus, any significant market correction may prove to be a potential buying opportunity.

Containment efforts taking effect in China, but risk of global pandemic remains

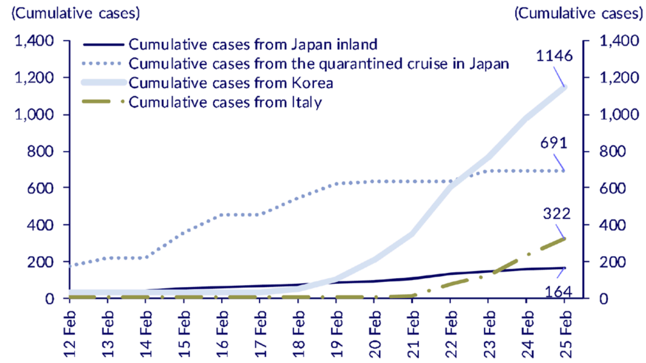
The rather contagious nature of the virus (reproduction rate or RO estimated to be anywhere between 1.5 to 3.5) coupled with the fact that China is far more inter-connected both domestically as well as globally than before has translated to the rapid spread of the virus. However, on the positive side, the fatality rate (around 3% based on reported statistics) is also much lower versus SARS (around 10%). Thus, it appears at this stage that the COVID-19 virus is far more infectious but has a lower fatality rate than SARS.

The unprecedented aggressive stance taken by China to contain the spread of the virus has started to show results, and official data now points toward a sharp deceleration in rate of growth of new infections. Furthermore, the number of infections in China (outside of Hubei) is somewhat limited. That said, the virus seems to be spreading at high rate outside China. Countries such as Korea, Italy, Iran are showing a sharp increase in the number of cases, and around 40 countries have reported cases of COVID-19. This indicates that the risk of this outbreak developing into a global pandemic is still high. It is worth highlighting that even after three months of the outbreak, there is still a high degree of uncertainty regarding some of the key characteristics of COVID-19 such as reproduction rate (R0), forms of transmission, fatality rate as well as the incubation period.

China's confirmed daily new Covid-19 cases



Cumulative number of cases in key countries outside China

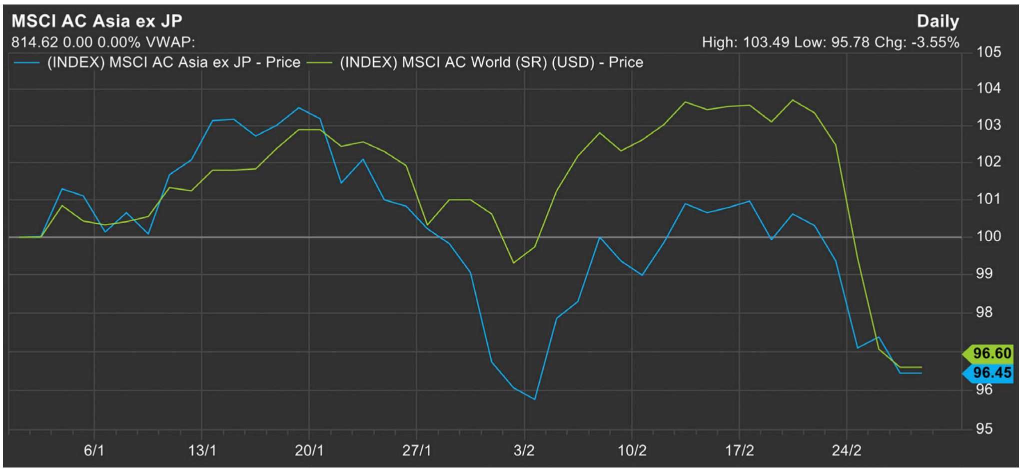


Source: CLSA, 25 Feb 2020

Markets are likely to remain volatile

Global equity markets have seen a sharp increase in volatility over the past month due to the uncertainty surrounding both the time taken to bring the virus under control as well as the associated economic impact. While markets in Asia initially sold off after the news of the outbreak, they did recover quickly as China took action to bring the virus under control. However, as the virus started to spread globally, it triggered another round of sell off in global markets. As of now, we believe that the situation in China seems to be improving but the incidence rate outside of China may continue to accelerate in the near future.

Performance of MSCI Asia ex Japan and MSCI AC World Index



Source: Factset, as of 28 February 2020

Markets are expecting fiscal and monetary easing to offset the economic impact

While the economic impact in the short term may be quite severe with most high frequency indicators pointing towards sharp slowdown in China, as well as broadly across Asia, most economic as well as earnings forecasts are factoring in only a marginal impact on full year 2020 growth. Furthermore, equity markets in Asia and globally are only down marginally. This clearly indicates that market participants still expect a rather swift recovery in economic activity i.e. markets are currently factoring a scenario where infections slow down materially by the end of the first quarter of 2020.

Additionally, recent measures announced by China, as well as other countries in the region, indicate that significant monetary and fiscal stimulus is likely in the near term. Fiscal stimulus could help sustain valuations. However, if the virus is not brought under control over the next quarter, it could create downside risk for both earnings as well as valuations.

Travel, entertainment take a hit; opportunities in communications services and online gaming

Travel, entertainment and retail are the most obviously affected sectors as people stay indoors and avoid crowded places. Thus, consumption should be significantly impacted since the outbreak coincided with the peak holiday season in China.

Furthermore, consumption today is a far bigger part of the Chinese economy than during the SARS episode, and therefore the overall impact to GDP growth may be quite significant. We think the drag on GDP growth in the first quarter of 2020 could potentially be over 100bps, with a strong potential recovery in the second half of the year. The Chinese government is likely to resort to significant fiscal stimulus to offset some of the drag which could involve a mix of easier financial conditions, tax breaks and infrastructure spending.

Broadly, we think the rest of Asia is also likely to see some negative impact but to a smaller degree. Stocks and sectors across Asia which depend on tourism are however more vulnerable.

On the other end of the spectrum, communication services especially online gaming companies, could see increased spending as consumer's entertainment wallet is likely to shift further towards online service providers.

Summary of measures announced by China to support the market

Date	Institution	Measures
1-Feb	PBoC MoF CBIRC CSRC SAFE	Joint Statement: (1) US$174bn open market operations; (2) To issue USD 43.4 billion special relending funds; (3) Lower interest rate to support firms; (4)facilitate companies' use of foreign exchange to ensure smooth goods imports; (5) postpone personal loan repayment; and (6) provide credit support to small and micro-companies and manufacturing producers
2-Feb	PBoC	Cut 7D and 14D reverse repo rates by 10bps to support the economy
	CSRC	Exempt initial listing fees and annual listing fees for listed companies registered in Hubei Province in 2020
		Allow companies to defer financial disclosure
3-Feb	CSRC	Issue guidance to brokers to suspend the margin short selling from Feb 3
		Suspend futures night trading at commodity exchanges
	PBoC	Conduct RMB 1.2tn OMO, net adding RMB150bn to the banking system
	PBoC	Net inject RMB400bn through reverse repo agreements
4-Feb	MoF	Subsidize 50% of actual interest payments for impacted companies on their special purpose re-lending, making actual financing cost fell below 1.6%
7-Feb	MoF	Fully refund VAT to epidemic control product suppliers
		Remove the RMB5mn limit of equipment purchased to be deducted before income tax
		Reduce VAT and income tax to industries affected by the epidemic, such as transportation, retail, hotel and tourism
8-Feb	MoF	Held joint conference with PBoC, NDRC, NAO and MIIT
		A total of RMB71.9bn was allocated to control epidemic by 8-Feb, with actual expenditure of RMB31.6bn
		Fiscal and tax support policies
10-Feb	Hubei gov.	Exempt 3-month rent of state-owned assets for medium small, and micro enterprises
11-Feb	MoF	Issue RMB800bn local government debt ahead of plan
	PBoC	Net drain RMB280bn from market liquidity

Source: Goldman Sachs Investment Research

We are closely monitoring the severity of the outbreak. We have calibrated our portfolios accordingly, including trimming our positions in the more vulnerable sectors mentioned above. Conversely, we are cognizant that this issue is likely to be transitory, and we will seek to take advantage of corrections to build positions in long-term structural growth stocks.