Matthews Asia

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Matthews Asia Perspective

Current Conditions Call for a Long-Term Focus

It is impossible *not* to talk about the coronavirus. It starts, of course, with recognizing the severity of the outbreak and the need for empathy as the human toll continues to rise. There also are the usual media and political accusations against China: that the numbers could be false and China may be hiding the truth. And it is not easy to convince people that the Chinese government actually has been quite transparent. But in our view the difference between reality and media headlines is always great when it comes to China; right now is no exception. So let us run through what seem to me to be some basic facts.

First, we have past incidences of similar virus outbreaks to consider: SARS (severe acute respiratory syndrome), MERS (Middle East respiratory syndrome), bird flu and swine flu. The coronavirus is most often compared with SARS. Our analysis suggests that the effect of SARS on markets was limited. Global markets were already falling long before the SARS outbreak and it is difficult to attribute how much of the fall was due to SARS and how much was just the momentum of previous price declines. Second, that the reaction by Chinese authorities has been swifter and more disciplined than during SARS. Also, the Chinese health care system has improved in the nearly 20 years since SARS. Third, that lives are being lost to the disease but no more perhaps—and potentially many fewer—than in past outbreaks. Some estimates of the deaths attributable to the swine flu pandemic of 2009-2010 were over 280,000 worldwide.

Some companies are seeing sales and profits hit because they have had to close down retail stores, or temporarily halt manufacturing operations. These factors are going to hit quarterly and full-year profits. In some cases, an entire year's worth of profits may be wiped out. These developments are starting to be absorbed by investors, however, and so we believe the market ought to be able to look through short-term numbers and focus on the long term.

After all, valuations in Asian markets appear reasonable. While Asia is not at rock-bottom valuations in price-to-earnings (P/E) terms, it is in price-to-book (P/B) terms. In our view, this apparent contradiction is due to the fact that policymakers in Asia have been happy to allow wages to take a greater share of the economy. The effect of this is to reduce earnings—but investors seem to focus only on the current earnings numbers and make the P/E ratio look higher than it otherwise would be. Given that across much of the rest of the world, governments have been squeezing wages to create higher profit margins for corporations, the relative P/E ratios in Asia may actually be cheaper than what is reflected in the market.

Sentiment also is undeniably weak. Weak sentiment due to prolonged earnings stagnation was worsened by fears of a U.S.–China trade war, which was exacerbated by the Hong Kong protests and then by the coronavirus. Price declines are inevitable for some stocks. Current conditions seem rather pessimistic and we believe that is normally a good time for the long-term investor to buy.

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