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INVESTMENT OUTLOOK

May 2020

"Life After Covid 19"

Finally, Western economies are beginning to reopen and by mid/end May, we expect to be (almost) back to normal. It is not yet clear what the new "normal" will be. We can, however, begin to draw some tentative conclusions as to how life will be when the lockdown ends. China, and some European countries, are now beginning to open up their economies again, but consumers are wary and cautious about spending, except for essential supplies, and cautious about travel, and being in public places. Masks will become as ubiquitous in Europe and the USA as they are in Asia.

So our first conclusion is that economies will continue to be fragile, and there will be caution, both in stock markets, which are currently diverging on the upside from the real economy, and in consumer spending. The reason markets are so strong is probably the extraordinary government support that has been rolled out, both in the US and Europe, to bolster incomes and employment.

The "Virtual World," which we wrote about last month, is more than ever a key theme for us as investors; and we are looking for long-term opportunities in:

(1) E-commerce (Amazon, Alibaba, etc.).

(2) On-line learning (TAL, New Oriental)

(3) Tele-medicine (Teladoc, Ping An Good Doctor)

(4) Video games (Tencent, Activision Blizzard, Bilibili, Netease)

(5) Communications (Zoom, Netflix, Disney, even Verizon).

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Consumer habits may well have changed permanently as the ease of on-line ordering and communications has greatly improved. The focus of buyers is on essential supplies, i.e., toilet paper, hand sanitizer, Clorox bleach, food, and medicine supplies, not on luxury goods or new clothing. This is the first impression of our observers in China, as China reopens.

Secondly, World Trade will suffer. Exports and imports have been badly damaged in China and other Asian exporters, as well as Europe and the Americas. Both shipping and aviation have been shut down for 6 weeks now, and will take some time to recover. There is a growing backlash in western countries at their dependence on China, especially for pharmaceutical supplies such as antibiotics and Ibuprofen, (a nonsteroidal anti-inflammatory), as well as masks, gowns, gloves, and other key medical products.

US-China relations will be negatively affected. There is no question that there is some anger at China about how they have handled the virus, their reporting of cases and, indeed, the actual origin of the Covid 19 in Wuhan. China has unsuccessfully tried to counter this negative commentary by putting out its own propaganda; but expelling US journalists will not help their case, nor the recent arrests of leading democracy activists in Hong Kong on April 18th. The global economy is likely to go into a period of low growth for up to 12 months, and the very negative price action of oil, industrial metals, and some food prices is indicating this clearly. The only commodities which have shown positive trends are orange juice (for vitamin C), coffee, and gold. With the introduction of Modern Monetary Theory, we continue to believe that gold and silver will steadily appreciate and reach new high prices.

Our reports from Asia are fairly negative. China's GDP in the 1st quarter 2020, shrank 6.8% - the worst figure since 1976. The Chinese Communist Party has tried to maintain at least 6% positive growth for many years now to enable employment for the growing young population to be provided. This could cause social unrest. Exports fell 17% in January and

February, and 6.6% in March, but are likely to continue to decline as US, Europe, and SE Asia have been locked down for a month. Domestic retail sales fell 16.2% in March. China is likely to come out with a stimulus package in the next few weeks. On the positive side, healthcare, on-line services, mobile gaming, data centers, and PCs have done well. Total mobile internet time spent rose 24%; entertainment time, 31%; mobile game time grew 65%; and Tencent's mobile games market share grew to 83%. We have a number of names ready to buy in China, including GDS in the cloud space; Silergy (Taiwan technology); and in the medical field, AK Medical and Innovent Biologics.

Hong Kong has seen a further contraction in its property market, with rents falling 15% from their peak last summer. Retail sales were down 44% in February, visitor arrivals were down 96%, and luxury sales were down almost 80%. More than 1,000 restaurants in Hong Kong have closed down, and hotel occupancy is at 22%. The government is offering some small relief, but nothing like in the West. Unemployment has risen to 6.1% from 3% a year ago; and Hong Kong is experiencing a second wave of cases, as foreigners and locals returning from Europe have infected others.

India introduced a complete lockdown across that vast nation of 1.4 billion on March 24th, when there were only 520 confirmed cases. This has, generally, prevented a more rapid spread; although, as of April 29th, the number of cases was only 30,000. It is, after all, a tropical country with a young population. In general, rural India has been spared the virus. The lockdown period has been extended to the 3rd of May, and the economy is probably going to contract by 2% in the 2nd quarter; but it is expected to recover later this year with 1.9% growth in 2020 and 4.7% in 2021. India is relatively insulated from global supply chains, with exports to GDP under 10%, so the health of the domestic economy will be the key. It is, as elsewhere, very difficult to forecast corporate earnings, which may be marginally positive; but foreign investors have sold US$6.6 billion worth of Indian shares year-to-date, and the Indian Rupee has fallen 6.5% against the US dollar, in line with other

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Asian currencies. However, the fall in the oil price is a boon for India, which imports 85% of its requirements, and the Indian market is now on its lowest price earnings, and price to book, since 2009. We remain positive about the Indian market. On SE Asia, we are somewhat more cautious, as the lockdown in Singapore remains very strict (and there has been a “second wave” of over 10,000 cases), and Indonesia and Philippines, with their large urban populations, are prone to a rapid spread of infection. One nation that has been relatively spared is Vietnam, but their dependence on exports and the illiquidity of the share market, will weigh on performance.

We are living in an extremely interconnected world and the leading edge of Asian economies such as Japan, Taiwan, Korea, and China, is bound to affect what happens in Europe and the USA. There is some good news in Taiwan and South Korea which, like Israel, were also on permanent defense alert, and therefore reacted quickly to the threat of the virus. But the big open economies like the United States have been terribly defenseless and easily infected and it is difficult for free western democracies to lock down all their citizens, as the Chinese did. We can only hope that medical breakthroughs (antivirals and vaccines) will provide some confidence and a positive way out of this pandemic within the next 9-12 months. Oxford University is today reported to have a vaccine ready and being tested, possibly available in the autumn.

At the time of writing, both European nations and US states (especially in the South and Midwest) are gradually reopening. The stock market scents this opportunity; and after 3 months of economic depression, the recovery may be “U” not “V” shaped, but it is coming.

R. Lloyd George

Hong Kong

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