Philequity Corner (February 3, 2020)
By Wilson Sy

Three black swans

The rapid spread of the Wuhan coronavirus has sparked fears of a global epidemic and has triggered sharp drops in stock markets all over the world. Last Friday, the Dow plunged 600 points and the PSE Index fell 2.6% while other markets posted substantial losses. Investors are bracing for the worst as China's stock market is set to re-open today after being closed for a week for the lunar holidays.

Black swans sink Philippine stocks

Aside from the Wuhan coronavirus, the Philippine stock market is reeling from two other black swans. A black swan is a totally unexpected negative event which has immense consequences. This was described in a book by Naseem Taleb. In an older article, we explained that the US subprime mortgage crisis is an example of a black swan event (see *Black Swans and Minsky Moments*, September 29, 2008). Below, we enumerate the three black swans which caused the PSEi to drop 12.4% from its recent peak in November.

1. **Regulatory risk on water utilities.** Water utility stocks and their parent companies dropped precipitously when the government initiated a review of water contracts. Three affected companies are index stocks (Ayala Corp, DMCI Holdings, Inc, and Metro Pacific Investments Corp) and their sharp declines have weighed on the PSEi's performance.
2. **Eruption of Taal volcano.** The sudden eruption of Taal resulted in the evacuation of thousands in nearby provinces. The dense population in Cavite and Batangas, as well as the proximity of the volcano to Metro Manila, have raised concerns on the potential damage of a hazardous explosion. This is a risk for property companies in the PSEi which have major developments in the area.
3. **Spread of Wuhan coronavirus.** The Philippine stock market fell in tandem with global indices as the Wuhan coronavirus reached many other countries. The PSEi dropped by another 3.5% in the last two days after the Philippines confirmed its first case of the Wuhan coronavirus.

The 2019 nCov and the 2003 SARS

The alarming spread of the 2019 novel coronavirus or nCov brings back memories of the 2003 SARS scare. SARS, which stands for severe acute respiratory syndrome, is another type of coronavirus which came from civet cats. SARS was a lethal disease with a mortality rate of 9.6%. Globally, there were 8,096 reported cases and 774 casualties. Out of this, 5,327 patients and 349 deaths came from China. Back then, China was not as developed as it is now, and outbound travel was still limited. Hence, the cases of SARS were mostly confined in China and Hong Kong.

More contagious but less deadly than SARS

The Wuhan coronavirus is suspected to come from civets, snakes, or bats. Unlike SARS which has an incubation of four to six days, the 2019 nCov has an incubation period of up to fourteen days and can be spread asymptomatically. This means that undetected patients may be unwittingly spreading the disease even if they do not exhibit the symptoms yet. Though the 2019 nCov has a lower mortality rate, it is more contagious than SARS and it spreads at a much faster rate. As of this writing, the number of nCov cases in China has exceeded 11,000 with 259 deaths.

Coronavirus stokes fears of economic slowdown

Aside from triggering sharp drops in the stock market, the spread of the coronavirus will also hamper the real economy. Economists estimate that the coronavirus may drag China's 1Q20 GDP growth to 4.5%, substantially lower than the government's target of 6%. The lockdown of many provinces coincided with Chinese New Year celebrations, thus stifling the seasonal boost in inbound tourism and domestic consumption. In addition, many countries have imposed travel bans on China. This has raised fears of a deeper slowdown of the Chinese economy, the second largest in the world and the biggest contributor to global economic growth.

Stock market and the 2003 SARS scare

Global markets sank when the SARS scare happened in 2003. The S&P 500 fell 12.5% but bottomed within two months after the first reported SARS case. The Hang Seng Index dropped 12.8% and bottomed three months after. The PSE Index sank 6.7% at that time.

Performance of selected indices after initial report of SARS

	1m	3m	6m	12m
S&P 500	-5.9%	-1.1%	8.5%	27.3%
Hang Seng	-3.2%	-10.3%	5.8%	44.0%
PSEi	-4.8%	5.5%	22.0%	46.3%

Source: Bloomberg

As we show in the table above, the drops caused by SARS were sharp but markets eventually recovered. Stock indices were able to recoup their losses within six months and rallied strongly twelve months after the first confirmed SARS incident.

Markets can recover over time

The Philippine stock market has fallen substantially because of three black swans. The PSEi has plunged 12.4% since the emergence of black swan events and is 7.9% lower since the first case of the Wuhan coronavirus was reported on December 31, 2019. Despite this drop, it is still unclear how long the decline will last and how deep it can go. Our wish is that the three black swans will abate or disappear. We hope that the government and water utilities can reach an amicable and mutually-beneficial agreement. We pray that Taal stabilizes and the threat of eruption eventually dissipates. We continue to monitor developments regarding the Wuhan coronavirus and hope that the disease will be contained thru efforts of governments and medical authorities. Based on the SARS experience, we believe that markets will recover in the medium to long-term despite the sharp drops that an epidemic may cause.

Podcast briefing on February 8

We will be holding a podcast on February 8, 2020, 9:30 am. This will take the place of our semi-annual investor briefing which we postponed due to concerns over the spread of the coronavirus. Follow our Facebook page - https://www.facebook.com/Philequity/ for details regarding the podcast.

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