SOURCE > Financial Standard
DATE > Wednesday, 19 February 2020
PAGE > Online

The sick short: Banking big on the coronavirus

BY ALLY SELBY | WEDNESDAY, 19 FEB 2020 12:30PM

With the coronavirus, now dubbed COVID-19, impacting not only many lives, but now also the bottom line of some of the world's biggest companies, investors are chasing shorting opportunities to bank big on the pandemic.

According to the World Health Organisation, 1873 people have died from the COVID-19 virus, with only three of these deaths outside of China. More than 73,332 people have been infected by the virus globally.

As the saying goes, in every problem there is opportunity.

IG market analyst Kyle Rodda told *Financial Standard* that he had seen an increase in short interest in China-focused companies.

"This virus and the way it has affected China and China's economy has disrupted the whole notion that emerging markets and the global markets would be in a better place in 2020, so traders have had to re-evaluate where they see global growth going in the year ahead," he said.

"In Australia, we are seeing a lot of short interest in stocks tied to the Chinese consumer, so the popular ones are your Bubs, your Blackmores, and your A2 Milks, that tend to be fairly sensitive to what's going on in China.

"Anything that is really tied back to the movement in people; travel companies, airlines, are probably the most conspicuous areas of the market.

"In terms of impact on share prices and profit outlooks - traders assume there will be some tough times ahead for these firms."

Marcus Today chief operating officer Chris Conway said investors can benefit from the spreading COVID-19 virus.

"Events like these always create opportunities," he said.

"Buying stocks like CSL and other big pharma companies is one way to play it. Shorting travel and tourism stocks is another way."

It comes as Apple announced it would not meet its quarterly revenue forecast of net sales between US$63-67 billion (announced less than a month ago) in the second fiscal quarter due to constraints on iPhone supplies globally and lower Chinese demand from the coronavirus pandemic.

Shares fell 2.6% on the downgrade, wiping US$34 billion from Apple's market value.

"Our quarterly guidance issued on January 28, 2020 reflected the best information available at the time as well as our best estimates about the pace of return to work following the end of the extended Chinese New Year holiday on February 10," Apple said.

"We do not expect to meet the revenue guidance we provided for the March quarter."

Apple pointed to a slowdown at manufacturing sites for the downgrade, leading to iPhone supply shortages globally, which in turn, "will temporarily affect revenues worldwide".

Demand in China too, has been impacted by the spreading coronavirus, with all Apple stores in China closed, and only some partnering stores "operating at reduced hours" with "very low customer traffic".

Burman Invest chief investment officer Julia Lee said the latest news out of Apple was not surprising.

"The downgrade was not surprising, and many other companies are likely to follow suit," she said.

She pointed to the impact on disruption in the supply chain; given that China is the manufacturing capital of the world, and decreased Chinese consumer demand, as key reasons that other large companies are likely to also downgrade their targets.

Shaw and Partners senior investment adviser Adam Dawes told *Financial Standard* the market was expecting the downgrade.

"The market was expecting this as the supply chain from China has been severely interrupted," he said.

"When the largest company in the world says it will slow because of China it's only a matter of time for the rest to follow.

"What investors, with good reason, choose to believe is that the authorities, in China and all over the world, will respond with more liquidity; it is taken as a given. So I think the market is ignoring the main issue; that we will have a slowdown, but when, is the question."

Conway argues the Apple downgrade brought home the impact coronavirus could have on some of the world's biggest companies.

"Markets have been impacted negatively, but perhaps not as negatively as they should have," he said.

"For the most part, US markets have ignored the virus because it is not really a US problem. The Apple downgrade overnight brought it home, in a major way, to the US. Their tech monolith, the shining beacon of growth, is taking a hit."

He believes investors would have bet on an Apple downgrade.

"It's fairly well known that the gears of business in China have slowed, in some cases grinding to a halt, and that supply chains around the globe are being affected," Conway said.

"Given the amount of parts Apple sources from suppliers in China, it's not a stretch to think that they would have been affected."

Dawes said Shaw and Partners had been playing ASX-listed Aeris Environmental to benefit from the pandemic, and recommended investors short anything China-facing.

He pointed to the consumer discretionary sector (Treasury Wine Estates in particular), the materials sector (BHP, Rio Tinto and Fortescue Metals Group), and oil (Woodside Petroleum) as being shorting opportunities.

In comparison, Conway has been recommending small-cap buying opportunities to benefit from the virus.

He names these as Zoono Group, Micro-X, Biotron and Holista Colltech.

"We have held an overweight position in CSL and we have advised clients to avoid travel stocks and those with significant exposure to China, names like A2 Milk, Treasury Wine Estates and Blackmores," Conway said.

Rodda said many of his clients had banked big on oil.

"Clients got quite lucky on oil," he said.

"When we had tensions between the US and Iran, there was a big spike in oil prices and many of our clients tried to countertrade to that; short selling oil at $77 bucks a barrel, and managed to ride that wave lower, quite fortunately."

Lee herself made some big bets on spreading coronavirus fears.

"There's a saying in the market that it's ok to sell as long as you sell early," she said.

"Very early on, I sold energy and commodity based companies as China is the largest consumer of commodities in the world.

"I also avoided travel companies, tourism-reliant companies and companies that relied heavily on Chinese demand. On the flipside, my gold investments have been doing well."

Rodda said that investors can find opportunities during times of widespread fear.

"Whenever we're fearful, potential opportunities can emerge; it depends on your risk appetite and the fear that you have about how things are going to evolve in the future," he said.

"So right here, right now, cyclical stocks in the market are underperforming; those tied to commodity prices and the Chinese growth complex.

"But at the same time, we are not at economic Armageddon yet, so there is still rational behind looking for opportunities in the stock market given the volatility that has been thrown up by the coronavirus."