REUTERS

FEBRUARY 4, 2020

RPT-UPDATE 2-Hedge funds hold their nerve on China, seek opportunities

By Samuel Shen and Ira Iosebashvili

SHANGHAI/NEW YORK, Feb 4 (Reuters) - Hedge funds are holding their nerve on China's ability to rebound quickly from a coronavirus outbreak that has rattled global markets, but many are also adding caveats as they try to predict the potential economic fallout.

Mainland China stocks tumbled on Monday, when Shanghai and Shenzhen markets opened after an extended Lunar New Year break, wiping out nearly $700 billion in market capitalisation.

But the broad blue-chip CSI 300, which fell almost 8% on Monday, rose 2.5% on Tuesday. European and U.S. markets followed later in the day: the S&P 500 benchmark U.S. index was up more than 1% in early trading.

"In a crisis, everyone feels the sky is falling. But the sky does not fall in the end," said Gu Weiyong, chief investment officer at Shanghai-based hedge fund manager Ucom Investment Co.

He favoured the battered stocks of airport operators such as Shanghai Airport, betting on an economic recovery.

Shares in Shanghai Airport, down 19% so far this year as of Monday's close, gained 8% on Tuesday.

Oil prices, often a barometer of investor confidence in the global economy, eased off 13-month lows hit on Monday, with benchmark Brent crude gaining 0.7% to $54.83 a barrel.

"The market seems to have reacted quite reasonably," said Switzerland-based David Nietlispach, portfolio manager for Pala Asset Management. He added it was a "wait and see" moment for Chinese stocks, as the government continued to battle the epidemic and assess economic damage.

George Schultze, founder of Schultze Asset Management in New York, said he saw some opportunity in metallurgical coal producers, where he has added to positions.

"Most of these companies have already restructured their debt several years ago, so they are operating with an excessive amount of liquidity," said Schultze. "Eventually the crisis will subside and people will travel more and build things again and you'll see a rebound in demand for steel. It is a value play."

Schultze also said that companies in the travel industry and their suppliers, if they are over-leveraged, may be good short sell candidates.

HEDGES, VOLATILITY BETS

Stock market volatility – a favoured play for many hedge funds - has risen sharply in recent days. On Monday, the VIX index measuring U.S. market volatility reached its highest in more than three months.

Christopher Stanton, chief investment officer at Sunrise Capital Partners LLC, bought stocks shortly after trading opened Monday morning. “Am I happy about it? No. Because everything in my body tells me this is not over yet,” he said.

His fund, which uses computer-driven strategies to time short-term market swings, reduced its position in stocks later Monday and purchased derivatives that would rise in value if volatility increased.

The epidemic has claimed more than 420 lives in mainland China but has spread to several countries.

Yuan Yuwei, who manages a global macro fund from China’s eastern city of Hangzhou, said property, retail, luxury goods, travel and leisure sectors were most vulnerable to an epidemic.

He shorted several stocks ahead of China’s Lunar New Year holiday, including Yum China Holdings Inc and Starbucks Corp, while betting on some potential gainers such as Chinese online video platform Bilibili Inc.

“In such a crisis, if you’re cool-headed, there are plenty of opportunities to jump into a trend,” he said.

Yang Xiaofan, a Japan-based hedge fund manager, was more pessimistic, and was shorting copper, whose price typically tracks global growth, while buying silver as a less crowded safe-haven trade than gold.

“The new virus itself is not that horrible but the supply chain disruptions and factory closures caused by city lock-ins and holiday extensions would deal a real blow to the economy in the near term,” he said.

UBS O’Connor, the Swiss bank’s hedge fund unit, is selling some of its positions in mainland China equities and using options in the Hong Kong markets to manage its net exposure to China, said chief investment officer, Kevin Russell. The fund’s long-term view on China remains bullish, though.

For now, it appears the virus is “likely a very short-term blip,” Russell said.

However, “if we start to see things not stabilizing – factory closings or store closings extending past another week to 10 days – then we and others will be acting more aggressively.” (Reporting by Sam Shen in Shanghai, Ira Iosebashvili in New York and Marc Jones in London; Additional reporting by April Joyner and Megan Davies in New York; Writing by Jennifer Hughes; Editing by Jacqueline Wong, Bernadette Baum and Richard Chang)