HSBC Global Research

AI – Asia Insights

Recessions don't last forever

- **Judging by history, the US recession will be over before end-08**
- **Asian stocks on average bottom three months earlier**
- **Separately, we look at post-Olympic performance of stocks in host countries: they always go up**

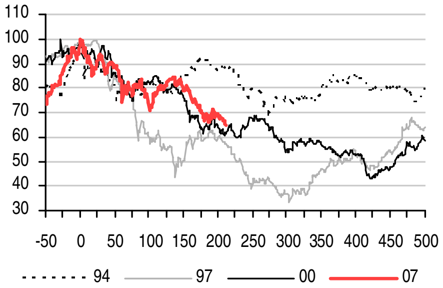
One frustration with being an Asian equity strategist is that, in the end, you are forced to spend a lot of time thinking about the US. Over the past 12 months, that has been particularly the case, with Asian stocks on average showing a 56% correlation with US stocks, and sentiment largely driven by the US sub-prime issue and US economy.

What happens in the US will also be crucial when we start to think about when this bear market could end. Markets have been falling now for 10 months, with Asia ex Japan down by 35% from its peak. Within the next one to two quarters, the bear market will at a point where rebounds usually start (Chart 1). And the key determinant for spotting the bottom will be when the US recession (for that is what we are now clearly in) ends.

A look at US recessions over the last 50 years shows they lasted between six and 16 months (Chart 2). US stocks on average bottomed four months before the trough in the economy (and Asian stocks about a month later than that). We think the start of the recession will be pinned down to November last year – which means that, as long is this is just a normal cyclical recession, the bottom for stocks could come very soon.

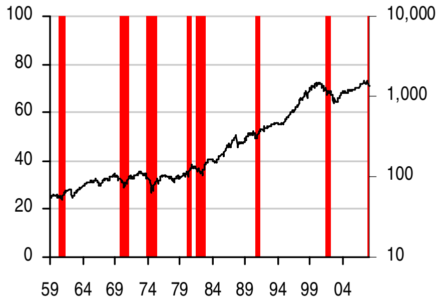
Separately, we looked at stock markets in countries that hold the Olympics. Over the past 25 years, they have almost invariably risen by at least 25% the year after the games. The one exception – Sydney in 2000 – saw the market moving sideways but outperforming global markets by 31%. Good news for China, then.

1. Bear markets in MSCI Asia ex Japan



Source: HSBC, Bloomberg

2. S&P 500 and US recessions



Source: HSBC, Bloomberg, NBER

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HSBC strategy recommendations

Recommended market weights

Market	HSBC recommended weight	Benchmark weight	Weighting	End-08 target	Current index	YTD perf *	12-mth fwd PE	EPS growth forecast 2008
Japan	47.5%	47.2%	NEUTRAL	1,350	1,233	-16%	14.1	-2%
Australia	12.5%	14.9%	UNDER	5,500	4,930	-23%	11.4	9%
China	10.0%	8.3%	OVER	70	57	-34%	11.5	14%
Korea	9.0%	8.1%	OVER	1,850	1,541	-27%	9.9	9%
Taiwan	5.5%	6.4%	UNDER	7,500	7,041	-16%	12.4	-12%
HK	5.0%	5.0%	NEUTRAL	24,000	20,931	-30%	14.3	-26%
India	3.0%	3.6%	UNDER	14,000	14,678	-38%	14.2	19%
Singapore	4.0%	2.7%	OVER	3,300	2,752	-18%	12.5	-2%
Malaysia	2.0%	1.4%	OVER	1,350	1,073	-29%	11.4	-11%
Indonesia	0.5%	0.9%	UNDER	2,200	2,070	-23%	10.0	18%
Thailand	0.0%	0.8%	UNDER	750	690	-22%	9.4	114%
Philippines	0.0%	0.2%	UNDER	#N/A	3,332	-32%	#N/A	#N/A
Pakistan	0.0%	0.1%	UNDER	#N/A	10,526	-31%	#N/A	#N/A
Vietnam	1.0%	0.0%	OFF-BMK	400	508	-45%	13.1	#N/A

Source: HSBC (Weights relative to MSCI Asia Pacific) *MSCI index in USD terms

Recommended sector weights

Sector	HSBC recommended weight	Benchmark weight	Weighting	Overweights	Underweights
Financials	23.0%	25.8%	UNDER	CH, HK	AU, IN, JP, TW
Industrials	13.5%	15.1%	UNDER	IN, JP, MY	AU, CH, KR, TW
IT	11.0%	13.2%	UNDER	IN	CH, JP, KR, TW
Cons Discretionary	10.5%	11.9%	UNDER	HK, TW	AU, CH, IN, JP, KR
Materials	10.5%	11.8%	UNDER	KR, TW	AU, CH, IN, JP, KR
Energy	5.5%	5.2%	NEUTRAL	CH, TW	
Telecoms	8.5%	5.1%	OVER	ID, IN, KR, JP, SG	HK
Cons Staples	8.0%	5.1%	OVER	AU, CH, HK, KR, MY, TW	
Utilities	3.5%	3.6%	NEUTRAL	AU	HK, IN
Health Care	6.0%	3.2%	OVER	AU, CH, HK, JP, KR	

Source: HSBC (Weights relative to MSCI Asia Pacific)

Top high-conviction buy ideas

Code	Name	Country/ region	Sector	HSBC rating	Upside to target price (%)	Price (local curr)	Market cap (USDm)
1398 HK	IND & COMM BK OF CHINA - H	CH	Financials	Overweight (V)	35.8	5.08 (HKD)	220,310
SCR US	SIMCERE PHARMACEUTICAL	CH	Healthcare	Overweight (V)	43.0	12.50 (USD)	781
8277 HK	WUMART STORES INC-H	CH	Consumer	Overweight (V)	13.7	8.09 (HKD)	1,128
823 HK	LINK REIT	HK	Real Estate	Overweight	21.5	17.70 (HKD)	4,891
19 HK	SWIRE PACIFIC LTD 'A'	HK	Industrials	Overweight	29.9	78.50 (HKD)	9,201
LT IN	LARSEN & TOUBRO LIMITED	IN	Industrials	Overweight (V)	23.5	2,675.10 (INR)	17,932
9433 JP	KDDI CORP	JP	Telecoms	Overweight	37.7	639,000 (JPY)	26,116
000640 KS	DONG-A PHARMACEUTICAL	KR	Healthcare	Overweight	20.3	107,000 (KRW)	1,045
033780 KS	KT&G CORP	KR	Consumer	Overweight	14.6	91,600 (KRW)	12,285
005490 KS	POSCO	KR	Materials	Overweight (V)	44.6	463,500 (KRW)	38,509
1303 TT	NAN YA PLASTICS CORP	TW	Materials	Overweight	97.6	49.60 (TWD)	12,042

Source: HSBC Note: These stocks are chosen by the strategy team from among HSBC analysts' top large-cap Overweights (in terms of upside to target price) with reference to the markets or sectors where the strategy team has an overweight call. A summary of valuation and risks can be found on page 77 of *Pan-Asian Equity Strategy: Headwinds*, pub. 7 Jul 2008.

Top sell ideas

Code	Name	Country/ region	Sector	HSBC rating	Downside to target price (%)	Price (local curr)	Market cap (USDm)
1088 HK	CHINA SHENHUA ENERGY	CH	Materials	Underweight (V)	-23.3	31.95 (HKD)	13,928

Source: HSBC Note: These stocks are chosen by the strategy team from among HSBC analysts' top large cap Underweights (in terms of downside to target price) with reference to the markets or sectors where the strategy team has an underweight call. A summary of valuation and risks can be found on page 77 of *Pan-Asian Equity Strategy: Headwinds*, pub. 7 Jul 2008

HSBC

When will the US recession end?

Forget decoupling, forget structural growth. In retrospect, the last 12 months in Asian equity markets look like a textbook bear market. US growth began slowing from about November last year (we explain below why we reckon this was the date) and stocks both in the US and in Asia peaked a little ahead of that. Yes, there were special factors – the credit crunch, the lag in response to the slowdown from commodity prices and inflation – but so are there in every recession.

If the bear market started in textbook fashion, there is every reason to believe it will end the same way. The key to pinpointing when stocks will bottom, then, is to figure out when the US recession will be over.

We will leave it to our economist colleagues to analyse the fundamental drivers behind the slowdown. What we can say, though, is that the length of US recessions has been fairly regular in recent decades and that this, therefore, gives an useful indication of how long the bear market might last too.

What is a recession anyway?

In the US, the recession is officially dated by the National Bureau of Economic Research (NBER). It defines a recession as "a significant decline in economic activity spread across the economy, lasting more than a few months". This does not necessarily entail two consecutive quarters of negative growth in real GDP (another common definition of recession) although the slowdown should be apparent in the GDP data too. The NBER has been doing this job since 1929 (and has worked out the dates of recessions going back to 1854), so it has long experience of how to do it.

How stocks perform around recessions

The officially dated US recessions are shown in Table 3. Over the past 50 years, there have been seven recessions, lasting between six and 16 months, with an average length of just under 11 months. (Before World War Two, recessions were usually nastier, averaging 18 months in length in 1919-1945, and 22 months in 1854-1919.)

3. US recessions and stock market performance

Recession began	Recession ended	Length of recession (months)	US market bottom vs recession end	Asia market bottom vs recession end
Apr-60	Feb-61	10	-4	
Dec-69	Nov-70	11	-5	-1
Nov-73	Mar-75	16	-3	-3
Jan-80	Jul-80	6	-4	-4
Jul-81	Nov-82	16	-4	0
Jul-90	Mar-91	8	-5	-6
Mar-01	Nov-01	8	+10	-2
	Average	10.9	-4.2	-2.7

Source: HSBC, NBER, Bloomberg

The performance of stock markets is comfortingly predictable. The S&P500 index bottomed between three and five months before the trough in the economy. The only exception was 2001, when the market kept on falling for another 10 months, double-dipping as a result of excessively high valuations, an only anaemic economic recovery, and the Iraq War.

Asia has had some home-grown bear markets – most notably in 1997-8 – but when Asian market declines followed the US, markets in the region bottomed fairly regularly just ahead of the trough for the US economy, on average about three months before.

Watch for the NBER announcement

The NBER takes its time before declaring the start and end of the recession. This is so it can use final revised data, and so it is not fooled into mistaking a short period of economic softness for a recession. In fact, it generally takes so long that the official declaration of the recession is often a good indicator that stocks should rebound.

Table 4 shows the start and end dates of the past four recessions, together with the dates on which the NBER made the announcements. In 2001, the announcement that the recession had begun came two months *after* stocks had bottomed. On average, the NBER recession announcement was a month after the end of the bear market, although there has been quite wide variation.

4. NBER announcements of recessions

Started	Announced	Stock market bottom	Ended	Announced
Jan-80	3-Jun-80	27-Mar-80	Jul-80	8-Jul-81
Jul-81	6-Jan-82	12-Aug-82	Nov-82	8-Jul-83
Jul-90	25-Apr-91	11-Oct-90	Mar-91	22-Dec-92
Mar-01	26-Nov-01	20-Sep-01	Nov-01	17-Jul-03

Source: NBER

But when did this one start?

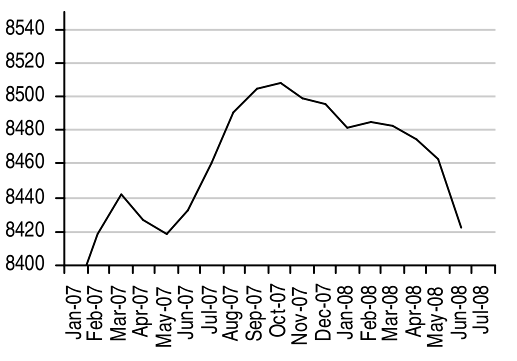
But, even if the length of recessions and the reaction of stocks to them are fairly predictable, we still need to work out when the current recession started.

The NBER decision is somewhat a judgement call, but the institute publishes in detail the factors it looks at to decide on when the recession started. (Those interested will find a full explanation at http://www.nber.org/cycles/recessions.html#faq.) The data it watches most closely are (1) real personal income less transfer payments, (2) employment (using non-farm payroll data), (3) industrial production, and (4) real sales for manufacturing and retail/trading companies.

We have reconstituted the data the NBER used in calling recessions since 1969. Table 5 shows the start-date of the recession, as determined by the NBER, along with the month in which each of the four main indicators peaked. As one might expect, industrial production has the closest coincident relationship with the recession date, with the two labour indicators – employment and personal incomes – tending to lag slightly. The NBER makes it clear that its decisions are not pure science; in retrospect some of the timing-calls seem a little odd. It seems puzzling, for example, that the 2001 recession is deemed not to have started until March 2001 – Q3 2000 would seem more appropriate given the data. If that had been the date, the last recession would have lasted more like 14 months, rather than the eight months the NBER reckons.

The four key data items to decide on the start date of the current recession are shown in Charts 6-9.

6. US personal income (USDbn)



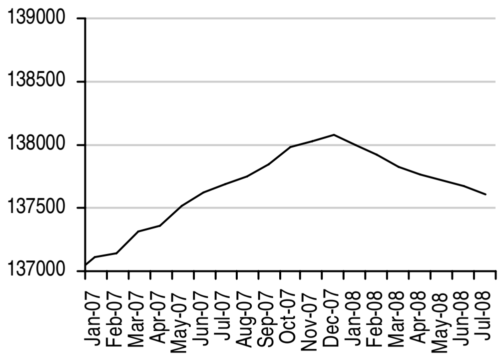
Source: BEA

5. How NBER worked out previously recessions

Recession started	Peak in: IP	Employment	Corp sales	Pers income	Average	Lead/lag: IP	Employment	Corp sales	Pers income	Average
Dec-69	Oct-69	Mar-70	Oct-69	Aug-70	Mar-70	2	-3	2	-8	-3
Nov-73	Nov-73	Jul-74	Nov-73	Nov-73	Nov-73	0	-8	0	0	0
Jan-80	Jan-80	Mar-80	Mar-79	Dec-79	Dec-79	0	-2	10	1	1
Jul-81	Jul-81	Jul-81	Jan-81	Aug-81	Jul-81	0	0	6	-1	-1
Jul-90	Sep-90	Jun-90	Aug-90	Jul-90	Aug-90	-2	1	-1	0	-1
Mar-01	Jun-00	Feb-01	Sep-00	Nov-00	Aug-00	9	1	6	4	7
	Jan-08	Dec-07	Oct-07	Oct-07	**Nov-07**					
				Average		1	-2	4	-1	**Nov-07**

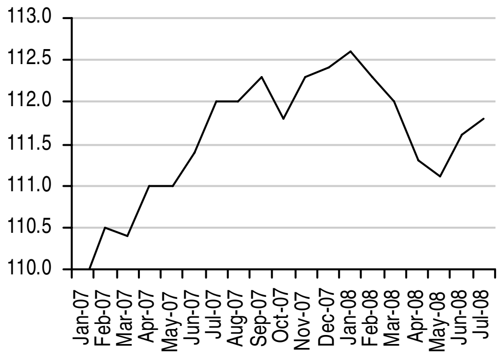
Source: HSBC, NBER, BEA, Consensus Board, Bloomberg

7. Employment (Non-farm payrolls, '000s)



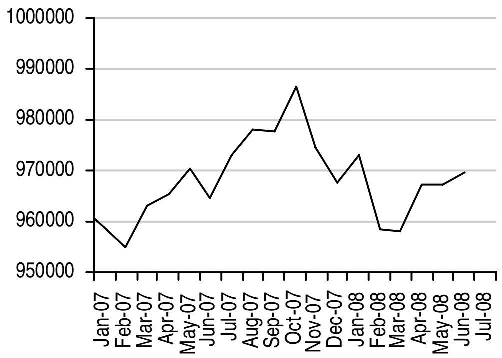
Source: Bloomberg

8. US industrial production



Source: Bloomberg

9. Corporate sales (1996 USDm)



Source: Conference Board

All of them show very clear signs of slowdown from Q4 last year – although both IP and sales have actually rebounded a little over the past three months. The peak for the four indexes was between October 2007 and January 2008.

We tried to replicate the NBER's previous decisions in two ways: (1) taking the average of the peak months for the four data series to be the start of the recession, and (2) weighting each dataset by how it had led or lagged previous economic peaks. Both methods point to November 2007 as the start of the latest recession.

Conclusion: the end is near

If the historical pattern holds, the recession which began in November 2007 should end between May 2008 and May 2009 (i.e. six to 16 months later). Even under the most pessimistic outcome, Asian stocks should bottom between November 2008 and May next year (i.e. zero to six months earlier). The average case (a recession of 11months, with Asian stocks bottoming three months before the trough) would place the rebound in stocks in almost exactly now.

Of course, history is never a perfect guide. This recession could prove somewhat more intractable than recent ones. The credit crunch does seem likely to have further repercussions. We also worry that market participants have yet to capitulate: analysts' earnings forecasts are too high, and fund managers haven't moved into cash as much as they usually do in bear markets. There is likely to be a slowdown in US consumption and rebuilding of household balance-sheets before the recession has completely worked its way through. Given the structural distortions in the global economy, a period of sub-par economic growth and poor market returns – and even a double dip – are possible.

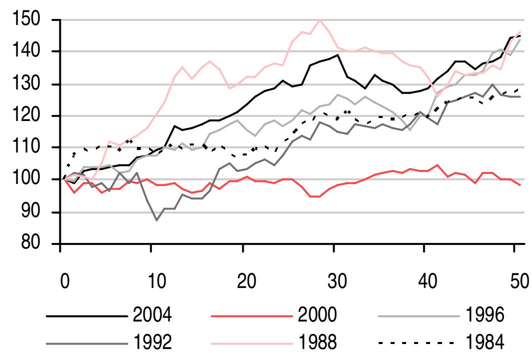
But the data is clear: unless this is a very unusual recession and bear market, stocks probably will not fall for much longer.

Once the Olympics are over

With the fun of the Olympics almost over and China's domestic stock market already down 60% from its high, are investors faced with a post-Olympic economic hangover and further market falls?

Not if history is any guide. The post-Olympic performance of stock markets in countries that hosted the games is consistently good. Over the past 25 years, with only one exception, markets rose by at least 25% in the 52 weeks after the Olympics began (Chart 10). In the year after the Athens games in August 2004, for example, the Greek stock market rose by 45%, outperforming global equities by 20%. Perhaps Seoul in 1988 is the nearest equivalent to Beijing 2008 in terms of being a country's coming-out party. Well, the Korean stock market rose 43% over the next 12 months, outperforming the world by 21%.

10. Host country stock market in year after Olympics (weeks)

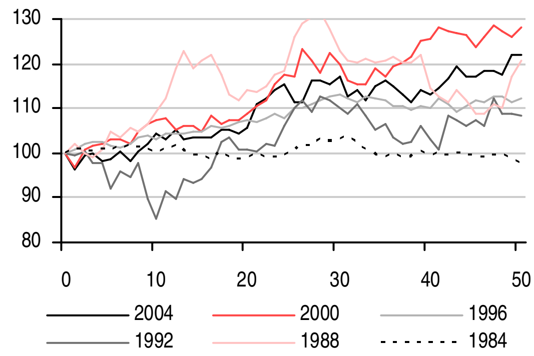


Source: HSBC, Bloomberg, Datastream (Opening date of Olympics=100)

Even the exception – Sydney in 2000 – is explainable. Global stock markets crashed in the year after those games, but the Australian market performed creditably by moving sideways. Relative to global equities, that represented an outperformance of 31%.

Indeed, as Chart 11 shows, not only did markets do well in *absolute* terms after the Olympics, on almost all occasions they outperformed *relatively* too, in most cases by at least 10%. The only exception here was Los Angeles in 1988, where the 27% rise in US stocks in the year after the games was only roughly in line with the rest of the world – but was not exactly bad.

11. Performance relative to global stocks



Source: HSBC, Bloomberg, Datastream (Opening date of Olympics=100)

If we go back further in history, there have been some post-Olympics market falls. The German market performed disastrously after the 1972 Munich Olympics, for example, falling by 22% and underperforming the world by 20%. But those Olympics were a tragic failure after a terrorist attack on the Israeli team, and the world was entering a nasty recession caused by the first oil shock.

Provided, then, that this year's Olympics end smoothly and that the world avoids an economic meltdown next year, there seems a good probability that Chinese stocks will recover over the next 12 months.

Disclosure appendix

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CHINA SHENHUA ENERGY	1088.HK	24.35	20-Aug-2008	4
ICBC ASIA	0349.HK	17.50	20-Aug-2008	2, 6, 7
LARSEN & TOUBRO	LART.BO	2715.15	20-Aug-2008	2, 5, 6, 7
POSCO	005490.KS	468500.00	20-Aug-2008	2, 6, 7
SIMCERE PHARMACEUTICAL GR	SCR.N	12.84	21-Aug-2008	6, 7
SWIRE PACIFIC	0019.HK	78.20	20-Aug-2008	2, 4, 6, 7, 11
THE LINK REIT	0823.HK	17.90	20-Aug-2008	5

Source: HSBC

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