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MARKETS

China Plays Are Left Behind as U.S. Stocks Charge to New Highs

S&P 500 keeps rising, but U.S.-listed Chinese companies and American firms with heavy exposure to China haven't gotten the same bump

By Steven Russolillo

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U.S. stocks have hit repeated highs this year, but many China-related trades still lag behind the broader market.

Hopes that the coronavirus outbreak will be contained—and faith that central banks in China and the U.S. will step in, if needed, to support the economy—have helped rejuvenate the stock market. The S&P 500 set its 12th record close of the year Friday, extending its gain to 4.6%.

But shares of Chinese companies listed in the U.S. and many American companies with heavy sales exposure to China haven't gotten the same bump. Apple Inc. also warned on Monday that it won't meet its revenue projections for the current quarter, saying the coronavirus outbreak had limited iPhone production and curtailed demand for its products in China. The Greater China region, which includes Hong Kong and Taiwan, accounts for almost a fifth of Apple's total revenue.

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Nearly two-thirds of the U.S.-listed Chinese companies with market values of at least $1 billion are down for the year, according to data provider FactSet. For instance, coffee company Luckin Coffee Inc., known as the Chinese challenger to Starbucks Corp., and electric-car maker NIO Inc., considered the Chinese version of Tesla Inc., wiped earlier gains of nearly 30% and are in the red, as the coronavirus outbreak intensified.

China's benchmark Shanghai Composite Index has risen 8.7% since bottoming on Feb. 3, recovering its post-Lunar New Year losses. It is still down 2.2% for the year through Monday.

Luckin Coffee of China has shares listed on the Nasdaq Stock Market.

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Similarly, a basket of U.S. stocks with heavy revenue exposure to China has also struggled, falling by about 5.4% this year, according to an index compiled by Goldman Sachs Group Inc. Among the 68 companies in that basket are manufacturer 3M Co., casino company Las Vegas Sands Corp. and restaurant operator Yum China Holdings Inc.

The underperformance comes as the death toll from the outbreak reached more than 1,800 globally as of Monday, while the number of confirmed cases in mainland China rose to more than 72,000.

"I think it's a rational pullback," said Michael Farr, president of portfolio-management firm Farr, Miller & Washington, which has $1.9 billion in assets under management. "You're seeing how commerce is becoming stalled in China and how people are cocooning because of this epidemic."

He said he is considering buying shares of Yum China, which runs more than 9,000 KFCs, Pizza Huts and other outlets as China's largest restaurant company. The company said earlier this month that it was forced to close more than 30% of its locations because of the coronavirus. The stock is down 6.6% for the year.

Similarly, Starbucks said last month that it temporarily closed more than half its stores in China. Mr. Farr, a Starbucks shareholder, said he expects the stock could take an additional hit. Shares are up 1.6% in 2020.

"These stocks should go down, but they are going to be buying opportunities at some point," he said.

Wall Street economists expect the virus to hurt the Chinese economy in the first quarter and weigh on the rest of the world, including the U.S. JPMorgan Chase & Co. economists recently cut their estimate for first-quarter global growth in half to a 1.3% annualized rate but predict a strong rebound later in the year.

U.S. hotel and casino operators with properties in China have also been hit hard. Wynn Resorts Ltd. said last week that the closure of its casino in the semiautonomous city of Macau would cost it $2.6 million a day, largely to pay employee salaries.

Macau has been a cash cow for the Las Vegas giants and other casino players for almost two decades, generating more than five times the revenue of Las Vegas in 2018. Wynn shares have dropped 13% since mid-January.

The declines have also prompted increased activity from short sellers looking to profit from continued drops. Short sellers borrow shares and sell them with the hope of profiting by buying the shares back at a lower price later and pocketing the difference.

Ihor Dusaniwsky, head of research at S3 Partners, a financial analytics firm, said he has seen a significant increase in activity from investors betting against many of the U.S.-listed Chinese travel and consumption companies.

Among this group, Mr. Dusaniwsky said he has seen the largest increase of shares shorted in Chinese travel agent Trip.com Group Ltd. Its stock has fallen 14% since mid-January.

Similarly, short interest has surged in Luckin, the Chinese coffee company, which has also been the target of an anonymous report questioning its business model, management and financial results. On Feb. 3, Luckin said the report, which was circulated online by short seller Muddy Waters, was malicious and all of its claims were either false, misleading or irrelevant.

Mr. Dusaniwsky said one reason Trip, Luckin and other U.S.-listed Chinese companies have become popular targets for short sellers is the difficulty in shorting shares in China itself. That leaves these companies as “the main vehicle to accumulate short exposure to the Chinese market,” he said.

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