[021]2030 5888 [021]2030 5999
58 Floor, New Bund Center, NO.555 West Haiyang Road/588 Dongyu Road, Pudong New Area, Shanghai
上海市浦东新区海阳西路 555 号/东育路 588 号前滩中心第 58 层，邮编：200126

Rosefinch Weekly

Lessons From the Previous Two Oil Crises

Global markets took big hits on the back of the Russo-Ukraine conflict and its impacts. NASDAQ is now in bear market, CSI300 and HSI's Price to Book ratio is now below 2008's low with PE ratio nearly there. Russian Ruble has made repeated new historical lows as it lost over half of its value against USD. Commodities rallied across the board, with oil leading the way with increase of over 30% YTD and a high of around $130 per barrel.

Looking back to the two previous oil crises in the 1970's - 1973 oil crisis and the 1979 energy crisis - the major energy, industrial metals, and precious metals had noticeable increases that caused sustained inflation amongst the major market economies. The pricing pressure quickly passed from PPI to CPI. In the 1972 to 1982 period, the US CPI increased an annualized 8.7%, while the British, French, Korean CPIs all had increases over 10%. During these two oil crises, oil prices increased by multiples which caused widespread interruptions to global economic order and contributed to severe recessions among major Western economies. **But the oil crisis was not the fundamental reason for the global inflation in the 1970's.**

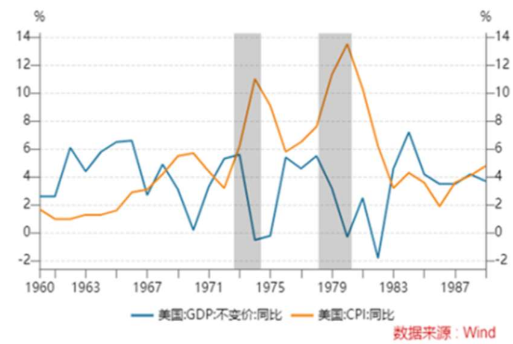
In the 1960's, US had embarked on massive fiscal stimulus and defense spending spree, while labor productivity stagnated, supply exceeded demand, and vicious cycle of higher wages and higher prices appeared. The last straw was the oil crisis which worsened the inflation dynamics and damaged economic growth.

朱雀基金
Rosefinch Fund
T [021]2030 5888 F [021]2030 5999
A 58 Floor, New Bund Center, NO.555 West Haiyang Road/588 Dongyu Road, Pudong New Area, Shanghai
上海市浦东新区海阳西路 555 号/东育路 588 号前滩中心第 58 层，邮编：200126

图 1：美国部门生产力和成本指数走势

资料来源：wind

图 2：美国 GDP 和 CPI 走势



资料来源：wind

Source: Wind. Left chart is US productivity; right chart is US GDP (blue) and CPI (orange).

During the 1973 Oil Crisis (Oct 1973 to Oct 1974), the capital market capitulated with S&P 500 dropping over -44%. But in the 9 months BEFORE the crisis erupted, US had already experienced economic slowdown, inflation upturn, FED hike, and stock corrections. So the oil crisis was not the cause of the US stock market drop, but a magnifier.

During the 1979 Energy Crisis (1979-1980), the stock behaved very differently. The economy went through stagflation. But as Paul Volcker came onboard at end of 1979, he embarked on aggressive policy to control inflation and take back FED's monetary independence. This gave market hope of FED taming the inflation beast, thus led to +41% increase in S&P over the two-year period.

The main reason for the energy price rallies in 1970s was the imbalance between supply and demand. The supply shocks from the two oil crises were the accelerants. In fact, global markets often experience supply shocks in major commodities, but mostly they have only short-term inflationary impacts. After the 1980s, there were several instances of oil supply tightening due to geopolitical factors, but they never led to the wide-spread inflationary impacts like the 1970s.

Currently there's no major "stagnation" risk in the US. The FED has learned lessons from the 1970s and is proactive in stabilizing inflation expectations and communicating the "dot plot". By hiking rates quickly to reduce overall demand, it may lead to short-term negativity but will decrease uncontrolled long-term stagflation.

The inflation risk comes mainly from the vicious cycle of higher-wage-higher-cost, and not from energy prices. Compared to the 1970s, US is better positioned in energy supply: US is already a net exporter of oil & gas. US also has more flexibility in oil supply too: aside from pushing OPEC for production increases, resolving Iran and Venezuela sanctions can offset drop in Russian oil exports. Europe, on the other hand, lacks such maneuvering room. Europe is highly dependent on energy

[021]2030 5888 [021]2030 5999
58 Floor, New Bund Center, NO.555 West Haiyang Road/588 Dongyu Road, Pudong New Area, Shanghai
上海市浦东新区海阳西路 555 号/东育路 588 号前滩中心第 58 层，邮编：200126

imports, especially from Russia. The sharp energy shock puts it in greater stagflation risk than US. Recently as US stock retraced, the UST 2y-10y spread tightened to 30bp and showed some market concern on stagflation risk. We may see US stock market taking further hits on monetary tightening with potential US yield curve inversion. But this is more likely the result of stagflation expectation and not the cause. The market will continue pricing in tail risk of stagflation. The key to changing the expectation is the timing of taming the inflationary pressure.

For China, the Russo-Ukraine conflict has limited direct impact on its energy supply. If anything, Russia may increase its energy export to China. There may be more inflationary risk from higher global commodity prices, which drags down China's recovery as the production costs increase. Overall, the imported inflationary pressure in China is much less than Europe or US. Domestically, such pressure is also less than 3Q21's energy quota shocks. From energy perspective, China's energy production relies more on coal than on oil. Even though global coal price has higher positive correlation with crude oil price, China's coal supply is 90% from domestic sources. With domestic policy guidance leaning towards long-term supply contracts and emphasis on stable growth, the domestic coal sector will remain steady.

From industrial goods perspective, some commodities that are heavily imported with global pricing, such as non-ferrous metal and some agricultural commodities, will see more pressure on the mid-stream manufacturers. On the other hand, if Europe or US enter into stagflation environment, the drop in overall demand will impact China's exports. Even though China is pushing for stable growth this year, significant external risks remain. **Overall, we see the stagflation risk impacting Europe the most, followed by US, and then to China.**

In the short-term, both global and domestic stock markets are in over-sold territory, with ample release of risk expectations. In the medium to long-term, we are carefully analyzing companies within our core capabilities. Our focus is to concentrate on enterprises who are leaders in their respective eco-systems or potential future stars with extraordinary innovative capabilities. **We endeavor to utilize the short-term market uncertainty to position our investors for long-term profitability.**