

TRENDMACRO LIVE!

On Bad News About Avian Flu

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Donald Luskin

A fresh news cycle concerning avian influenza is beginning, with evidence of human-to-human transmission within a family in Indonesia. The World Health Organization has only said so far that "human-to-human transmission cannot be ruled out." WHO also reports that gene sequencing of samples from the Indonesia case shows no genetic reassortment or evidence of significant mutations. So there is no direct reason to believe that the virus has mutated into a more transmissible strain. That said, the Indonesia case casts doubt on dozens of earlier cases in which the victims had no known contact with infected birds, and yet in which human-to-human transmission had nevertheless been assumed away.

This news should significantly change the tone for stocks in the avian influenza thematic sector. They have fallen sharply since the last peak of frenzied publicity interest in late March, with year-to-date gains in our Avian Flu Index eroding from 44% to only 10% (see ["Quick Takes"](#) March 29, 2006). Since then human infections and deaths have spread to two additional nations, and the cumulative death toll has risen by twenty. Yet there has been a general sense of reassurance that a worst-case pandemic can be prevented, as the wildfire spread of infections in human and poultry populations in Europe and Africa seems to have been effectively controlled by concerted public health measures. Most reassuring, there has been evidence that the highly pathogenic strain of the virus is not now being carried by migratory birds heading north from Africa to Europe (see ["On Good News About Avian Flu"](#) May 11, 2006). But now the "media narrative" of reassurance is set to change.

BOTTOM LINE: The news about human-to-human transmission in Indonesia should reignite awareness that avian influenza remains a volatile risk, and reignite interest in the stocks of companies working on vaccines, treatments and diagnostics. Stocks in this thematic sector can be thought of not as stocks, but as call options -- the value of which is sensitive to implied volatility driven by the risk of worst-case outcomes. The Indonesia news should be enough to break the complacent "media narrative" that has prevailed over the last several weeks, and build a floor under that implied volatility -- and under stock prices in the thematic sector. These stocks are now ripe for reaccumulation as options on the risk that migratory birds are actually still carrying the highly pathogenic strain of the virus, and will bring it through Siberia and into the United States via Alaska by year-end. An outbreak in human or poultry populations on United States soil would put these stocks well in-the-money. There was a poultry outbreak in Siberia last week, which received very little media attention while the "media narrative" was still being dominated by messages of reassurance. **TM**

Update to strategic view

AVIAN FLU STOCKS: After more than a month of declining media interest, a fresh news cycle is beginning with evidence of human-to-human transmission in Indonesia. With many stocks in this thematic sector having been sold down to levels not seen for six months, they are ripe for reaccumulation as options on the risk that migratory birds will bring the infection to US shores by year-end. .