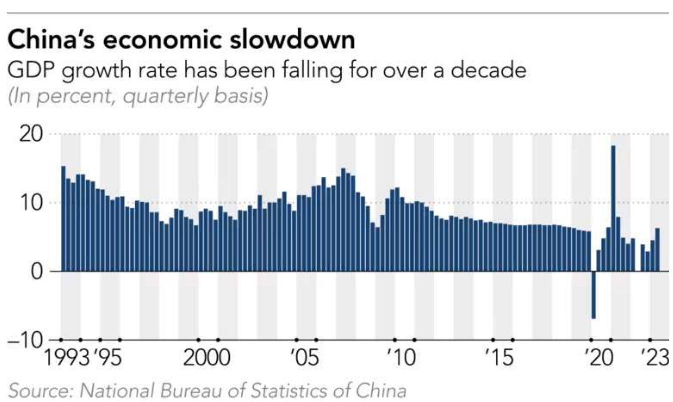
Monthly Commentary 4th of September 2023

Major equity market indices took a breather in August. The S&P 500 and Nikkei 225 were among the indices that fared better than the rest of the world with drops of 1.77% and 1.33% respectively. European and UK equity indices had worse declines with the MSCI Euro and the FTSE 100 down 3.35% and 3.38% respectively. Emerging Markets also finished lower for the month (-4.88%), dragged down mostly by China. China's mainland equity index Hang Seng was down 8% for the month. Surging bond yields in most developed countries fueled by signs of stronger than expected growth have caused bond prices to drop in August. US Treasuries and UK Gilts were down 0.6% while Eurozone Treasuries were up by 0.3%. In the commodity space crude oil edged higher (+2.24%) amid a drop in US stockpiles and positive demand. Gold and silver were down 1.27% and 1.10% respectively. The dollar (DXY Index) gained traction in August gaining 1.78% while Bitcoin continued its negative trend dropping another 10%.

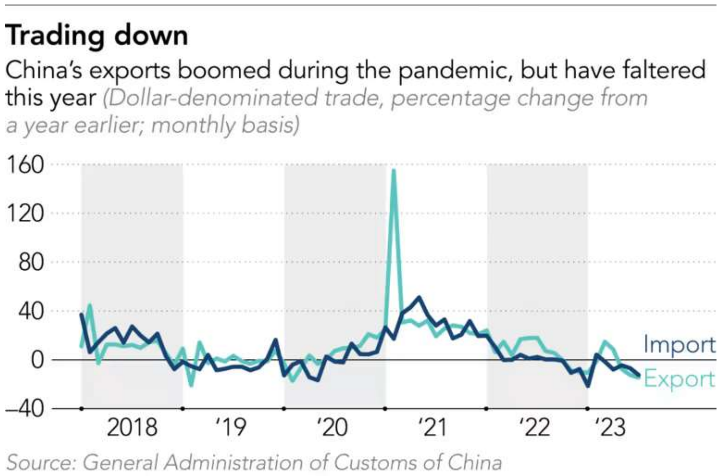
China's Crisis in Charts

Many of our investors have expressed concerns about China's economic woes and for good reasons. The period of economic and political opening that transformed China over the past 50 years appears to be over. Most economists believe that China is entering an era of much slower growth, made worse by unfavorable demographics, a deepening debt, reduced willingness to spend, deflation and a widening divide with the U.S., which is jeopardizing foreign investment and trade. Rather than just a period of economic weakness, this could be the dimming of a long era.

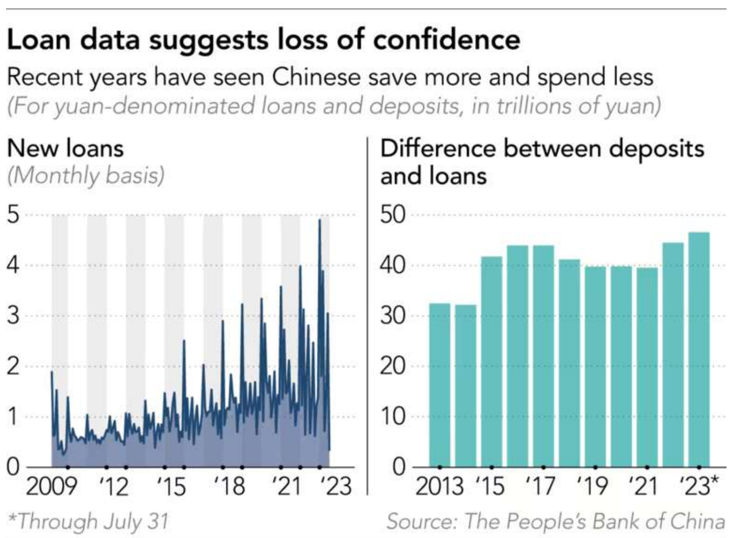
- **GDP Growth:** China's GDP is expected to grow at 4.5% in 2024 and to remain below 5% for a prolonged period of time.



- **Trade:** China's exports and imports are on a declining trend from 2020. Weaker economic growth overseas has also reduced foreign demand for Chinese goods, while geopolitical tensions between China and the US have taken a further toll on trade.

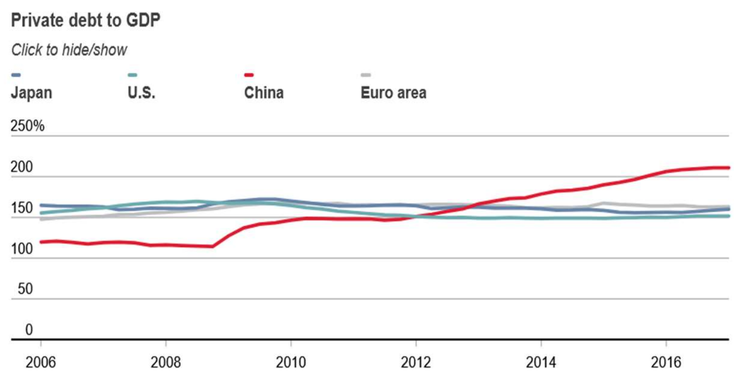


- **Loans/Savings:** Chinese have started to borrow less and save more and the gap between the two is increasing. One of the main reasons is deflation (as next chart shows) which causes households and corporations to wait on new investments until prices stabilize.



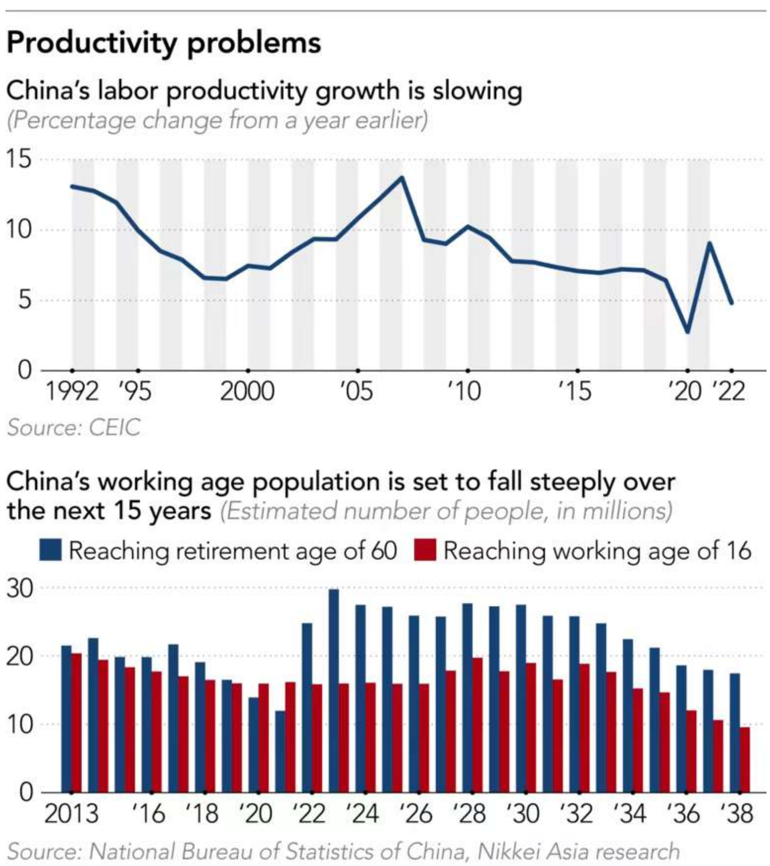
- **CPI Data:** The buildup of deflationary pressures in China in recent months has raised concerns over the risk of economic stagnation. Deflation leads to lower consumer spending and that results in lower production by companies, which then leads to layoffs and salary reductions.

- **Debt:** Total debt, including that held by various levels of government and state-owned companies, climbed to nearly 300% of China's GDP as of 2022, surpassing U.S. levels and up from less than 200% in 2012. However, when government debt is removed from the comparison, you see a very different picture. China's corporate and household debt has risen sharply, and this is where most worries are focused.



Source: Reuters

- **Labor Force:** China's demographic shifts are changing. If there are fewer people working, and they are less and less productive, it is hard to see how China can continue to grow over the long term.



The news about China is worrisome and the question to most investors is what would be the impact to other major economies? In a note published Thursday, Wells Fargo simulated a “hard landing” scenario for China in which output over the next three years would be 12.5 percent smaller than previous growth rates would achieve — similar to the impact of a slump from 1989 to 1991. Even under those conditions, the U.S. would shave only 0.1 percent off its inflation-adjusted growth in 2024, and 0.2 percent in 2025. Results on Eurozone and Japan are listed below. You can view the full article at https://wellsfargo.bluematrix.com/links2/html/7f6b0b35-1562-46c9-b9b0-b51822dd59a0

Effects on the Major Economies

	GDP Growth			CPI Inflation		
	2024	2025	2026	2024	2025	2026
United States	-0.1%	-0.2%	0.0%	-0.2%	-0.7%	-0.2%
Eurozone	-0.3%	-0.3%	0.0%	-0.2%	-0.6%	-0.3%
Japan	-0.3%	-0.4%	0.1%	-0.2%	-0.7%	-0.5%

Source: Oxford Economics and Wells Fargo Economics

Overall, the implications for the United States are probably minor, given China’s limited role as a customer for American goods and the minor connections between the countries’ financial systems.

As Elgin we do not have any direct exposure to China. Our only exposure is through Emerging Market Funds which account for roughly 1.5% of our total assets under management out of which only 30% is invested China.

The Elgin Analysts Team