

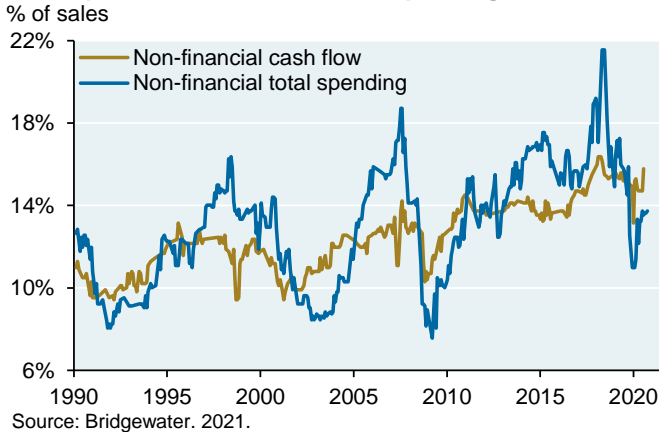


**Topics: An investor’s look at the China recovery, the Sinopharm vaccine and scientific methods**

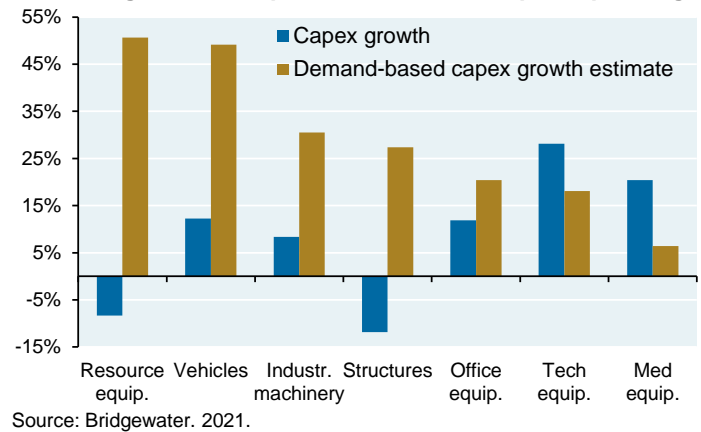
The US recovery is in good shape heading into summer, world trade is growing strongly again and US airline spending is only 20% below normal levels<sup>1</sup>. One of the best determinants of the business cycle is the ability of companies to sustain investment spending with cash flow. Whenever the latter (gold) is higher than the former (blue), it’s a good sign. As shown on the right, a lot of sectors are facing “catch-up” conditions that will require plenty of hiring and capital spending. The inflationary consequences are the risk here, which I wrote about in detail last time. Bottom line: rising inflation will likely cap US equity returns at the pace of earnings growth as P/E multiples decline. The degree to which expiring unemployment benefits boost the US labor supply will be one of the most important trends in the second half of the year; I believe they will. The next EoTM will be our biennial Private Equity review of performance, leverage and other trends.

As the “China Century” hits year 20, China now commands a 30% share of major world power GDP. This level was last seen in the mid-1800’s, after which a war with Great Britain over its refusal to cease opium exports into China led to a collapse in the Qing Dynasty and subsequent occupation of China by foreign powers. **The rest of this note looks at the latest issues facing investors in China, and concludes with comments on the Sinopharm vaccine and the importance of scientific methods.**

**US corporate cash flow exceeds spending**



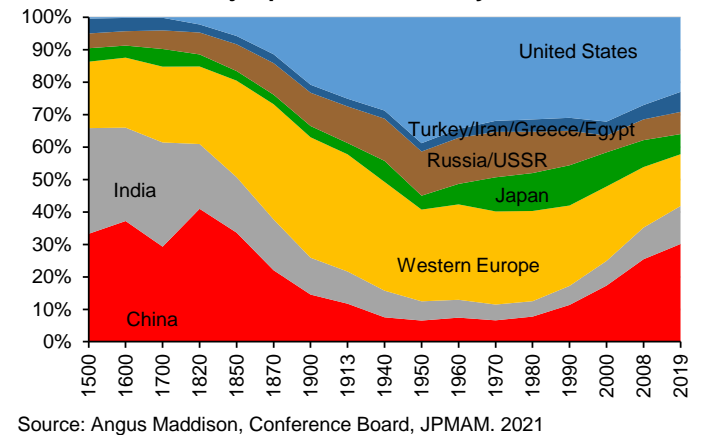
**US leading indicators point to a lot more capital spending**



**World trade volume**



**GDP shares of major powers since the year 1500**



<sup>1</sup> I am not flying just yet but have interacted with flying objects. I hired a wildlife drone photographer to capture some amazing footage of my fishing adventure with a swarm of spawning fish:

[https://www.instagram.com/tv/CPd7vFQHEMm/?utm\\_medium=copy\\_link](https://www.instagram.com/tv/CPd7vFQHEMm/?utm_medium=copy_link)

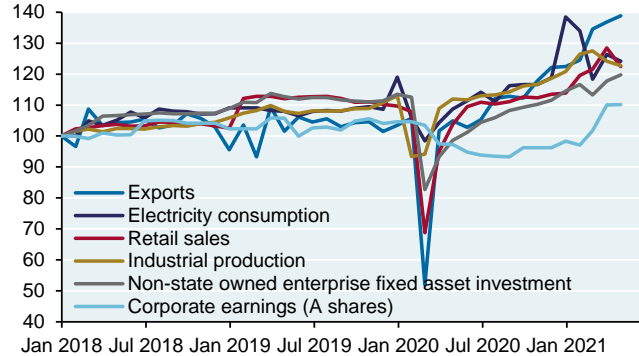


### China's recovery in full swing

China's recovery is in full swing and for the time being is growing at a faster pace than before COVID. China's exports are booming and as shown on the right, China actually *grew* its share of global exports despite ongoing trade conflicts with the US. The damage that COVID inflicted on some of China's trade competitors may be the primary explanation for China's growing share. While COVID may end up as merely a footnote in the history of 21<sup>st</sup> century China, it may impose a much more lasting and damaging legacy elsewhere.

#### China economy monitor

Index, 100 = Jan 2018



Source: China National Bureau of Statistics, General Administration of Customs, MSCI, JPMAM. April 2021.

#### China's share of global exports

%, seasonally adjusted

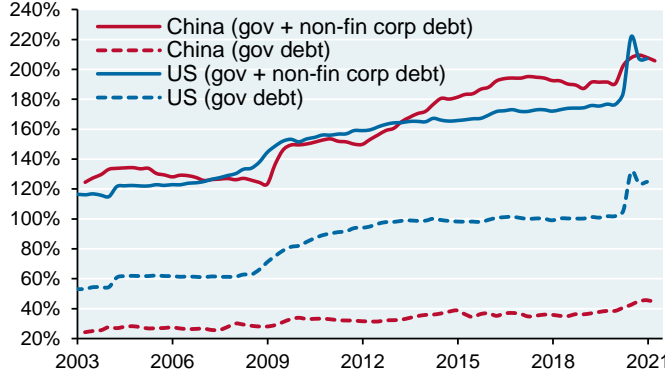


Source: Haver, IMF, JPMAM. February 2021.

**Looking forward, China has a smaller COVID hangover regarding government finances and macroeconomic stability.** Its government debt is in a completely different zip code than the US. The complicated part is China's implicit debt guarantee for some state owned enterprises, many of which are large borrowers. We don't have a good read on how large this is, so we look at trends on overall government plus non-financial corporate debt; note how this measure is not that different than in the US. But again, this overstates the size of China's federal government risk regarding state owned enterprises. Another important comparison is the "Net International Investment Position", which measures each country's stock of foreign assets less foreign claims on that country's assets. China is still a net creditor nation, in contrast to the US.

#### General government and non-financial corporate debt

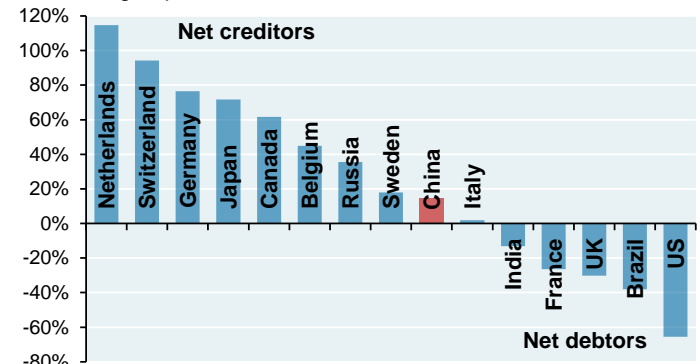
% of GDP



Source: Wind, CNBS, Federal Reserve. Q1 2021.

#### Net international investment position

% of trailing 4-quarter GDP



Source: BEA, central banks and government agencies, JPMAM. Q4 2020.

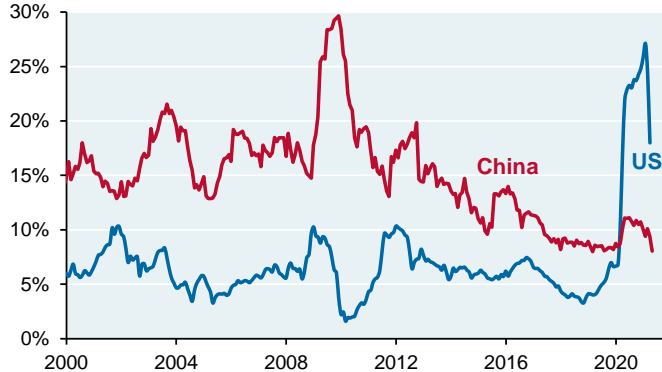


**The bigger difference vs the US: the change in central bank policy and fiscal stimulus**

The US had to resort to desperate monetary and fiscal measures to sustain growth while China has no such COVID albatross to deal with. Another example of COVID as a footnote for China and an entire chapter for the US in future economic history textbooks on the 21<sup>st</sup> century.

**Money printing**

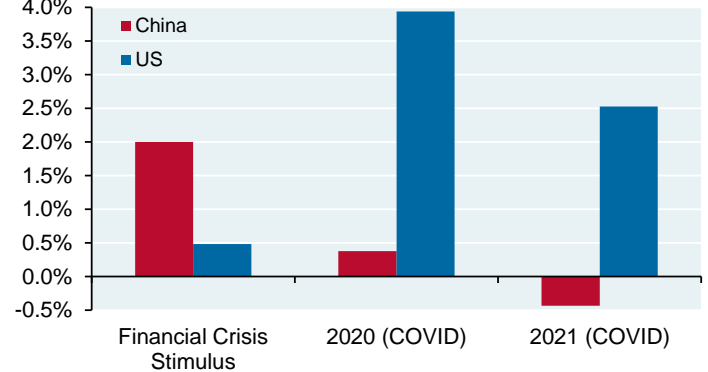
Annual growth rate of M2 money supply



Source: Bloomberg, St Louis Fed, Gavekal, JPMAM. April 2021.

**Fiscal stimulus impact on growth**

% GDP growth

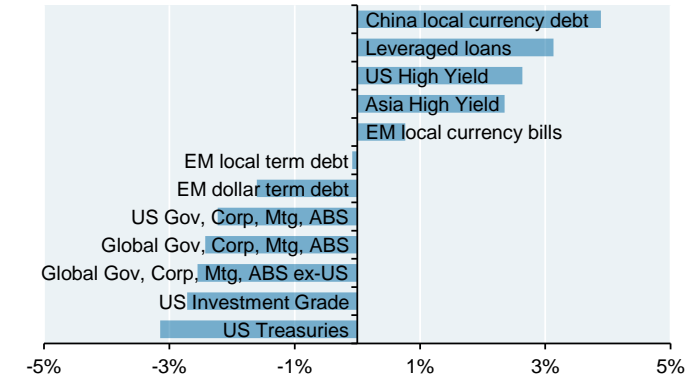


Source: Bridgewater. May 2021.

**The stronger fiscal condition of China’s government and its lower level of financial repression were reasons why we recommended Chinese fixed income in our 2021 Eye on the Market Outlook.** As shown below, local currency debt in China has been one of the better performing fixed income markets so far this year.

**YTD total returns for major fixed income markets**

Percent, US\$



Source: Bloomberg. June 8, 2021. ABS = asset-backed securities



**One day, the US-Emerging Market equity overweight vs Europe and Japan will fail. Today is not that day.**

Readers of the *Eye on the Market* are aware that I have been writing about the benefits of a regional equity overweight to the US and Emerging Markets (and an underweight to Europe and Japan) for a long, long time. Every year, a few intrepid souls in the industry position against this, usually to their own detriment.

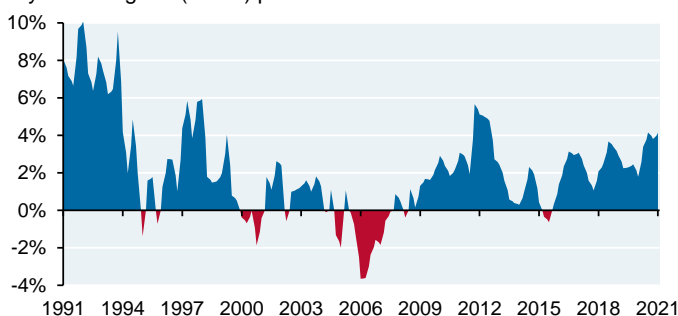
**The US-EM barbell is flat this year.** This *could* have been a year when the barbell didn't work since Europe is outperforming the US by 2.2%, reversing a tiny portion of Europe's 160% underperformance vs the US from 2012 to 2020. However, one key macroeconomic principle behind the barbell has been that during a global industrial production and trade recovery, while Europe could outperform the US, the gains in global economic activity would cause EM to outperform Japan. That's what has happened so far this year, despite the comparatively weak EM manufacturing and consumer recovery illustrated below.

| YTD barbell outperformance |      | Region | Weight | Delta | Rev weight | US\$ return | LOC return |
|----------------------------|------|--------|--------|-------|------------|-------------|------------|
| US\$ barbell               | 0.0% | US     | 61%    | 10%   | 71%        | 13.2%       | 13.2%      |
|                            |      | EM     | 13%    | 5%    | 18%        | 7.3%        | 7.3%       |
|                            |      | EUR    | 18%    | -10%  | 8%         | 15.4%       | 14.9%      |
|                            |      | JPN    | 7%     | -5%   | 2%         | 3.6%        | 9.8%       |

Source: Bloomberg. June 8, 2021. LOC refers to local currency return.

**Overweight US & EM, underweight Europe & Japan**

3-year rolling out (under) performance vs MSCI All World Index



Source: Bloomberg, JPMAM. Q1 2021. All equity portfolio, rebalanced quarterly. 10% OW to US, 10% UW to Europe, 5% OW to EM, 5% UW to Japan. Assumes no currency hedging.

**Manufacturing output**

50+ = expansion, seasonally adjusted



Source: JP Morgan Economic Research. May 31, 2021.

**Global manufacturing expectations**

Standard deviation from 2013-2019 average



Source: JP Morgan Economic Research. May 31, 2021.

**Consumer confidence**

Standard deviation from 2010-2019 average



Source: JP Morgan Economic Research. May 31, 2021.

**Past performance is no guarantee of future results. It is not possible to invest directly in an index.**

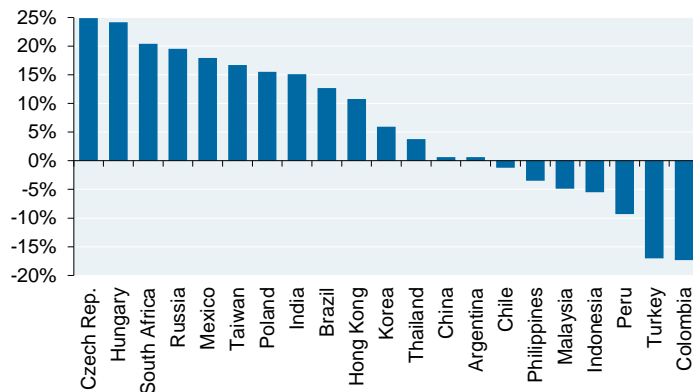


**Note that the outperformance of Emerging Markets vs Japan this year was not helped by China, at least not according to the way that MSCI defines “China” in its Emerging Markets Index.** As shown in the first chart, the MSCI China Index is flat this year with gains coming from an assortment of other countries instead. [As an aside, this year is another example of why I tell people not to try and pick countries in Emerging Markets, since the gains often come from places you would least expect: I doubt that Russia, South Africa or India would have been on anyone’s recommended list a few months ago].

**While the MSCI China Index is flat this year, other Chinese equity investments have performed better.** MSCI China is a diverse basket of large and mid-cap stocks. It includes H shares (Chinese-incorporated companies listed in Hong Kong), B shares (Chinese companies listing in US\$ on Shenzhen and Shanghai exchanges), red chips (Chinese companies with substantial Chinese gov’t ownership listing in Hong Kong), P chips (Chinese companies incorporated outside China and listing in Hong Kong) and foreign listings (American Depository Receipts). As per the second chart, many of these MSCI subcomponents and other Chinese equity indexes performed better this year than the MSCI China Index. The CSI 300 measures the largest 300 stocks on Shanghai and Shenzhen exchanges, and the HS China Enterprises are Hong Kong listed companies focused on China.

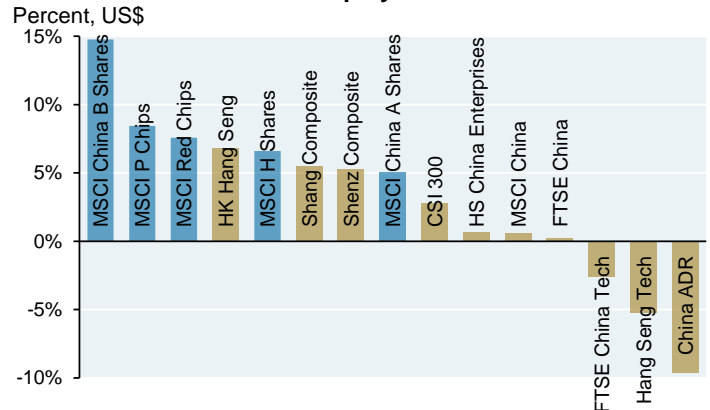
**What has been negatively affecting the MSCI China Index this year?** The third chart shows the 15 largest stocks that make up 50% of this index by market cap. Alibaba, Baidu, interactive shopping and e-commerce stocks, a mobile phone software company and a Chinese electric vehicle company have generated YTD declines. From a sector perspective, losses on China tech and consumer discretionary stocks have offset gains elsewhere.

**YTD Emerging Markets equity total return in US\$**



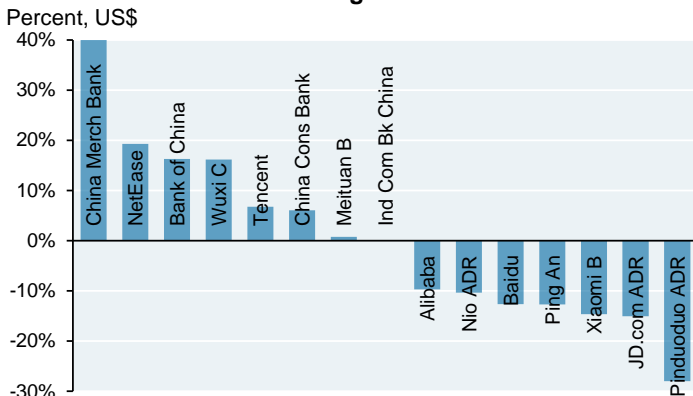
Source: Bloomberg. June 8, 2021.

**YTD total return for China equity indices**



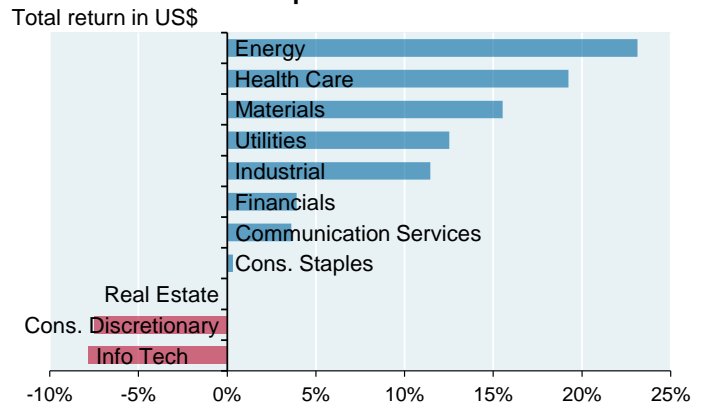
Source: Bloomberg. 6/7/2021. Blue: MSCI subcomponent. Gold: index.

**YTD total return for fifteen largest MSCI China stocks**



Source: Bloomberg. June 8, 2021.

**MSCI China YTD sector performance**



Source: Bloomberg. June 7, 2021.

Past performance is no guarantee of future results. It is not possible to invest directly in an index.

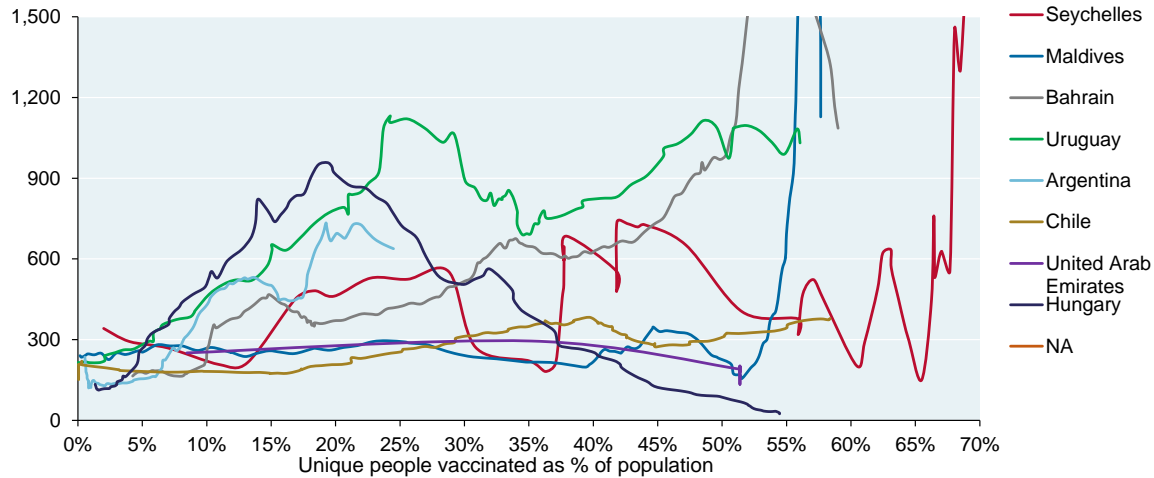


**On vaccine efficacy and Sinopharm**

Most countries have approved multiple vaccines, so it’s not easy to figure out actual field efficacy for individual vaccines (as opposed to clinical trial results). That said, there are a few countries we can identify that have been moderately or highly reliant on the Sinopharm vaccine, where vaccination levels are high, and where infection levels are still high as well. To be clear, there are 45 countries that approved Sinopharm (including China), and an advisory group to the WHO reported a “high level of confidence” that it prevents Covid in adults. However, the WHO cited a “low level” of confidence for people over 60 since Sinopharm enrolled few adults above 60 in its trials. **In any case, note the stark difference in infection levels between Sinopharm countries in the first chart, and countries using genetic RNA and vector vaccines in the second chart.**

**Infections vs vaccinations: Sinopharm**

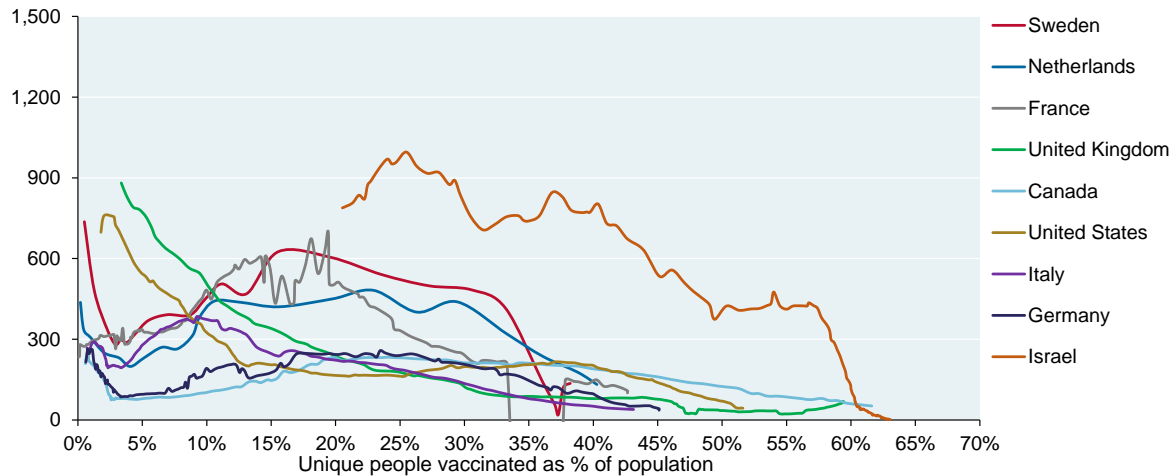
New daily infections per mm, 7 day avg



Source: OWID, JPMAM. June 6, 2021.

**Infections vs vaccinations: Moderna/Pfizer/AstraZeneca**

New daily infections per mm, 7 day avg



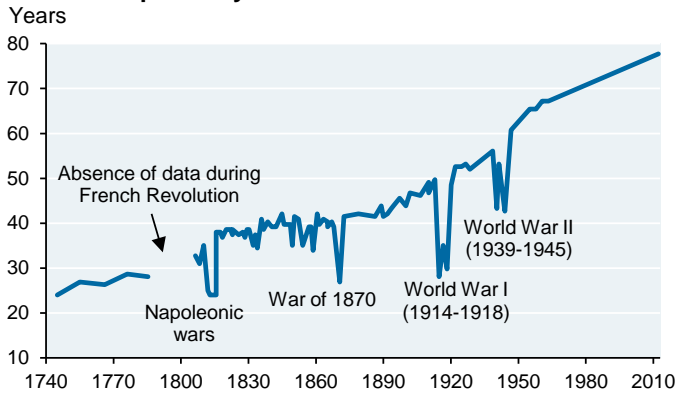
Source: OWID, JPMAM. June 6, 2021.



**On the benefit of scientific methods**

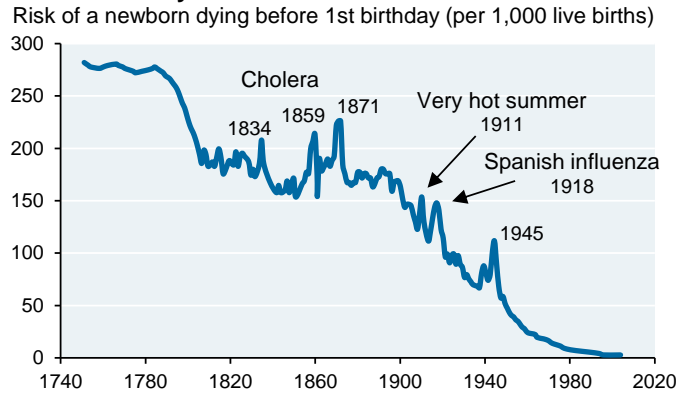
There are other COVID issues being investigated and reported on right now, and which are widely discussed in the global press. I will not discuss them here at this time. What I can share with you is this: I'm hopeful that scientific methods which have led to substantial gains in quality of life around the world prevail, and that the world can refocus its energies on jointly confronting the challenges that define the 21<sup>st</sup> century. Scientific methods have resulted in enormous gains in life expectancy and declines in infant mortality, illustrated below using examples from France since 1740. The other exhibits show the rich history of discovery and innovation in China even before the Enlightenment, and the explosive pace of innovation in Europe once the Enlightenment began in the 1700's<sup>2</sup>. **Examining and re-examining hypotheses without undue influence of politics or emotion has been the foundation of human achievement.** A world without it would be a very dark place.

**Male life expectancy in France since 1740**



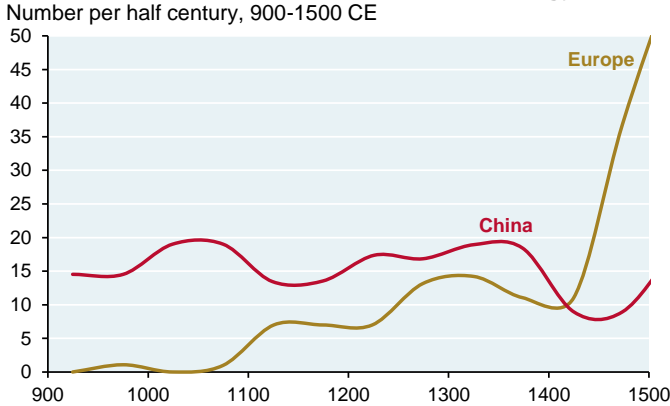
Source: French Institute for Demographic Studies (INED). 2018.

**Infant mortality in France since 1740**



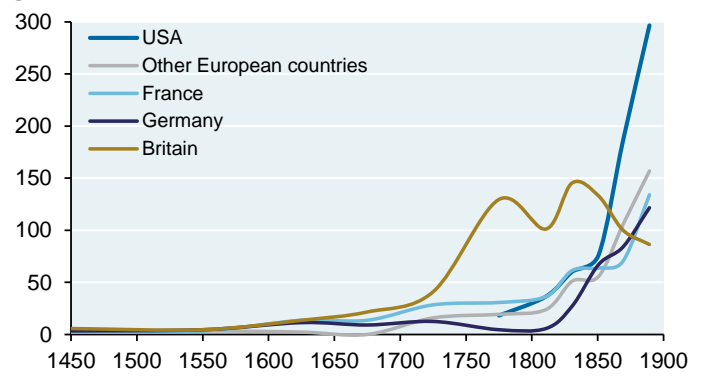
Source: French Institute for Demographic Studies (INED). 2017.

**Number of innovations in science and technology**



Source: Hellemans and Bunch, Goldstone. 2017.

**Dynamics of technological inventions: technological growth rate, number of major inventions, 1450-1900 CE**



Source: Korotayev and Grinin. 2017.

<sup>2</sup> "Technological Competition after the Twelfth Century: A Quantitative Analysis", Leonid Grinin and Andrey Korotayev, Globalistics and Globalization Studies, 2017

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