GLOBAL ECONOMY AND FINANCIAL MARKETS SHORT COMMENTARY

<u>Market Commentary – 2023.08.25</u>

Comments on market specifics:

- From March to July, US equities have recorded 5 straight monthly gains. The rally was initiated by frenzy around generative artificial intelligence and the mega-cap tech stocks (so-called FANG+ stocks) served as locomotives leading the charge higher *(see Chart 1 below)*.
- Since July, the rally has taken a pause as investors tried to figure out whether the strong rally so far this year is able to extend further. This is particularly so with the US Fed appeared sticking to it hawkish tilt to lift interest rates further up in order to tame inflation pressure.
- At the same time, more and more investors are upgrading their views on the US economy as economic data seem to paint a much more constructive picture than previously anticipated. This is reflective in the performance of sector ETFs whereby the more economically sensitive sectors have generally outperformed year-to-date *(see Chart 2 below)*.
- While the lethargic state of China’s property market has been known for some time, matters have taken a turn for worse in recent months with two of the nation’s largest property developers, namely China Evergrande Group and Country Garden Holdings, raising business viability concerns.

Comments on notable macro developments:

- Economic-related:
  - The US economy continued surprised on the upside, with GDP growth for Q2 much stronger than expected. The annualized rate of economic growth was initially reported at 2.4% but was later revised down to 2.1%, yet still considerably higher than the 1.4% pace expected.
  - Perhaps the most distinctive feature of US’s economy is the health of labor market, with national unemployment rate near half-century low of 3.5%. Low unemployment coupled with real wage gain have enabled American households to maintain moderate consumption growth that contribute to the lion’s share of US economic growth.
  - At the same time, inflation pressure has been receding gradually and persistently. While consumer prices are still expanding much faster than the long-term target of 2% set by the US Federal Reserve, things are progressing in the right direction that should enable the Fed to maintain a pause on its rate hike cycle.

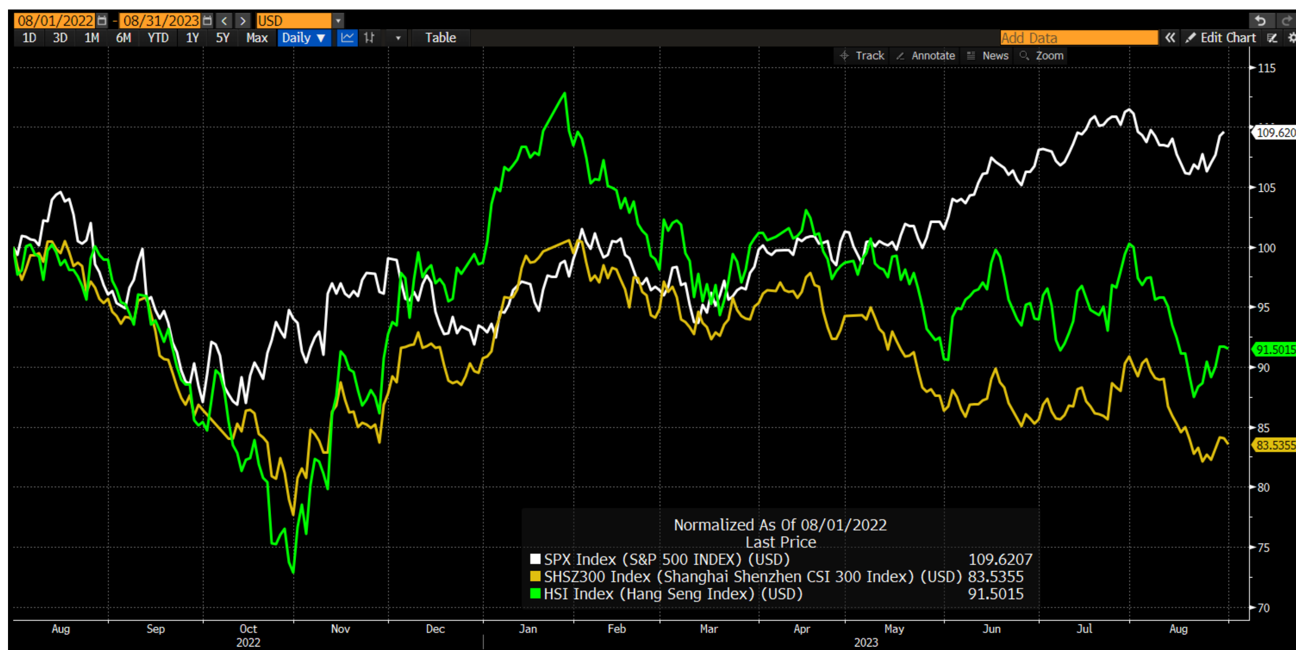
- For China’s economy, things are considerably more challenging as various measures of economic activities all pointing to slower growth ahead. Retail sales, industrial productions and fixed asset investment are all stuck in downward trends. Exports and imports have been in negative year-on-year growth as overseas buyers look for alternative suppliers to reduce their dependency on China given the sensitive US-China geopolitical development.
- As for the wider Asian region, there are signs that manufacturing activities are bottoming with the year-long inventory adjustment especially in the semi-conductor industry nearing the end.
- Global tourism sees continued rebound, with tourist arrivals in popular destinations such as Japan and South Korea recovering to around 90 percent of levels at end-2017. The situation should improve further as China’s Cultural and Tourism Board approved reopening of group tours to most destinations in early-August.
- However, some of the more optimistic projections on tourism spending might need to be tapered as the weakening China economy appears to be curtailing the willingness to spend among Chinese tourists. Based on data on domestic tourism, tourist counts have more than fully recovered to pre-COVID levels during major holidays though average spending per tourist is only 85 percent compare to previous peaks.

- Political-related:
  - There appear signs that the US is switching to a less confrontational tactic in its relationship with China. On the back of the visit by US Secretary of State Anthony Blinken in June, Finance Secretary Janet Yellen also visited China in July and held meetings with key Chinese economic officials and currently Commerce Secretary Gina Raimondo is in Beijing. The series of visits may path the ground for US President Joe Biden to meet Chinese leader Xi Jinping at the Group 20 summit in India in September. If all goes well, the two leaders might also be meeting in San Francisco at a later date towards year end.
  - Despite the softer stance, there is no question the US-China relationship is shifting to a more rivalry one with the US side setting new limits on investment and exports of sensitive technology to China.
  - With the US and EU counterparts working to “de-risk” their reliance on China, India is working overtime to win over new investments from major multinational corporations. The emergence of India being a new manufacturing hub and major supplier should help to keep the entire Asia region maintaining its importance in the global picture.

Chart 1 – Comparison of major US equity benchmarks since the beginning of this year. The mega-cap tech index known as FANG+ is the clear winner, followed by the tech-heavy Nasdaq Composite Index. On the other hand, the Dow Jones Industrial Average Index, which is considered a proxy for more traditional sectors, is the clear laggard. Still, all US equity benchmarks have posted solid gains so far in 2023.

Chart 2 – Comparison of major sector ETFs year-to-date shows the top 5 performing sectors to be Global Technology, Communication Services, Consumer Discretionary, Industrials and Materials. The only major sector ETF that has recorded a decline is Utillities, which is considered to be a defensive play.

Chart 3 – Comparison of S&P500 Index, CSI300 Index and Hang Seng Index since last-August shows that the US market is the clear winner over the past year. Both China-A shares and Hong Kong market have suffered negative return with the former being the clear laggard in this group.



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