CIO's View: October 2021

China Slowdown, US Correction, Germany's Election and Japan's New Prime Minister

By Khun Supakorn Tulyathan, CFA Chief Investment Officer and Khun Krittiya Siriwal

October 4, 2021

Several events have led to increasing market volatilities over the past months, leading to deterioration of market sentiment and market corrections. Notable events warranting focus are;

1) China Evergrande debt situation
2) Power shortage situation in China
3) Possibility of faster Fed funds rate hike
4) US debt ceiling impasse in the Congress
5) Election results in Germany and
6) Change of prime minister in Japan

China Evergrande is the most indebted property developer in the world. Its liability amounts to over USD300bn in total. The company has missed interest payments on some of its outstanding bonds. Currently, market is awaiting news on how the Chinese authority plans to handle the situation with Evergrande. Putting things into context, all of China's property developer loans only account for 8% of total Chinese banking loans; while Evergrande's bank borrowings only account for 0.2% of total banking loans. Thus, we believe that the situation of Evergrande will not become systemic that the Chinese authority cannot handle. However, we expect property investment in China to slowdown in the period ahead, as developer companies comply with China's "Three Red Lines" policy to bring down leverage within the property development sector. This will have long term negative implication for China's GDP in the few years ahead.

Meanwhile, there is a coinciding situation regarding power shortages in China, as a result of coal supply shortage and surging prices in China, as well as China's effort to limit carbon emissions according to its 14th Five Year Plan that have resulted in abrupt suspension in production, particularly in energy-intensive industries. This situation will complicate China's short-term GDP growth until there is an intervention by the government to resolve the issue. However, combining the situation with that of slowing property sector activities, which amounts to 15% of GDP, there is probably downside surprises for China's economy in the years ahead; as well as some downside for Asian trading partners also from the international trade linkages as China is the trading destination for some Asian countries. In the meantime, we recommend staying neutral for China at the moment, as the country's equity markets have corrected by near 20% for the onshore market, and near 30% for the HK-listed market. China's authority may step in to support the economy next. Interested clients can inquire about our **Principal China Equity Fund (PRINCIPAL CHEQ)** and **Principal Asia Pacific Dynamic Income Equity Fund (PRINCIPAL APDI)** through our investment representative.

On the other side of the world, equity markets in the US are going through a period of correction, with the Dow, S&P 500, Nasdaq and Russell 1000 down by about 5-6% during September. Precipitating the market short-term declines are issues tied to disagreement on the Democrat-supported large spending bills and the debt ceiling limit, which the Republicans decline to support. Most recently, President Biden has indicated that he may concede to lowering price tag on the USD3.5tn social spending bill to appease the moderate faction within the party who opposes the legislation.

Meanwhile, Treasury Secretary Janet Yellen has warned that the US Treasury department would run out of cash on October 18, 2021, if the ceiling is not raised or suspended. While this is certainly a risk issue that will need to be closely watched during October, we believe that the equity market has priced in this negative development. Putting things into context, we believe that this correction will not turn into a bear market decline amid an expanding US economy that has just come out of a recession in 2020. Over the past three months, we had been expecting a 5-6% correction to happen, and we believe that this is a good opportunity to add US equity to the portfolio through our **Principal US Equity Fund (PRINCIPAL USEQ).**

Source: https://www.bbc.com/thai/international-58703170

Over in Europe, it is still unclear who will be able to form government as Germany's next Chancellor after Angela Merkel, who is continuing to govern as caretaker for the moment. Election results show the center-left Social Democratic Party (SPD) winning a slim majority of 25.7% against 24.1% for the bloc consisting of Ms. Merkel's conservative Christian Democratic Union (CDU) and Christian Social Union (CSU). Either the SPD or the CDU/CSU bloc could form a coalition government depending on the resulting negotiation with the smaller voted parties - the Free Democrats (FDP) and the Greens.

Currently, the market is leaning against a coalition led by the SPD, which should be positive for growth outlook for the European economies in the period ahead. We recommend interested clients to look at our **Principal European Equity Fund (PRINCIPAL EUEQ)** and **Principal German Equity Fund (PRINCIPAL GEQ).**

On the contrary, the political situation has been a bit more certain in Japan, as Mr. Fumio Kishida, a former foreign minister who will become the next prime minister of Japan after winning an internal party's vote to choose a new leader, following PM Suga's decision not to seek re-election in the Liberal Democratic Party (LDP) leadership contest. The result should be positive for the equity market in Japan due to policy continuity. After the resulting formation of the new cabinet and the Lower House election in November,

Source: https://mgronline.com/around/detail/9640000098378

we expect more details on additional fiscal spending to move ahead in after that, and possibly approved by December, with expectation that the package will be around JPY30tn or 5.5% of Japan's GDP, which should be supportive of Japan's recovery. In the near term, Japan is coming out of the state of emergency that was declared in April and repeated extended. The easing of emergency requirements should also be positive for economic activities. We recommend our **Principal Japanese Equity Fund (PRINCIPAL JEQ)** for interested clients.

CIO's View: October 2021

China Slowdown, US Correction, Germany's Election and Japan's New Prime Minister

By Khun Supakorn Tulyathan, CFA Chief Investment Officer and Khun Krittiya Siriwal

October 4, 2021

Fund	Fund Information
Principal China Equity Fund (PRINCIPAL CHEQ)	https://www.principal.th/en/principal/CHEQ-A
Principal Asia Pacific Dynamic Income Equity Fund (PRINCIPAL APDI)	https://www.principal.th/en/principal/APDI
Principal US Equity Fund (PRINCIPAL USEQ)	https://www.principal.th/en/principal/USEQ-A
Principal European Equity Fund (PRINCIPAL EUEQ)	https://www.principal.th/en/principal/EUEQ
Principal German Equity Fund (PRINCIPAL GEQ)	https://www.principal.th/en/principal/GEQ
Principal Japanese Equity Fund (PRINCIPAL JEQ)	https://www.principal.th/en/principal/JEQ

- Investors should understand product characteristics (mutual funds), conditions of return and risk before making an investment decision.
- PRINCIPAL CHEQ master fund has highly concentrated investment in China. So, investors have to diversify investment for their portfolios.
- PRINCIPAL APDI master fund has highly concentrated investment in Hongkong. So, investors have to diversify investment for their portfolios.
- PRINCIPAL USEQ master fund has highly concentrated investment in US. So, investors have to diversify investment for their portfolios.
- PRINCIPAL GEQ master fund has highly concentrated investment in Germany. So, investors have to diversify investment for their portfolios.
- PRINCIPAL JEQ master fund has highly concentrated investment in Japan. So, investors have to diversify investment for their portfolios.
- The fund and/or the master fund may invest in derivatives for hedging purpose depends on Fund Manager decision, investors may receive gains or losses from the foreign exchange or may receive the money less than the initial investment