

Weekly Market Insights

January 20, 2021

A market pause, no economic surprises and Asia

Equity Markets

U.S. equity markets closed this past week with minor losses. There are many reasons this may have occurred. As we, and almost everyone else, have said, the market will tend to follow the course of the pandemic. Last week was not a positive one with both the levels of infection and the death toll rising. This was accompanied by talk of slow vaccine distribution. Furthermore, this unfortunate news was coming out at the opening of earnings season. Investors would be hard pressed to be aggressive buyers with COVID-19 cases on the rise, but in the face of corporate earnings releases, it would take a lot of courage to be outright buyers. Investors will continue to watch the progress or regress of the pandemic as they analyze earnings reports and what they hear from corporate management teams. The DJIA closed down 0.91%, the S&P 500 closed down 1.48% and the NASDAQ closed down 1.54%.

The Global Economy

The global economy, other than China, appears dependent on the pandemic. The U.S., of course, has the added tension of President Biden's inauguration. Two questions must be on the minds of investors—will anything untoward occur at the event, and what will the new president's policies be? Changes large and small are occurring around the globe. There is no easy way to analyze where all the moving pieces will fall. One thing appears quite clear; no one nation can stand completely on its own.

Asia

For as long as anyone can remember, globalization has been moving forward, often in fits and starts but forward nonetheless. It has been progressing at a rapid pace since the end of World War II when a liberal global trading regime was encouraged. However, the term "global" may have been a stretch, as it was dominated by the U.S. and Western Europe. It got a significant boost

about 40 years ago when Deng Xiaoping started his now famous, "Reform and Opening" policy. Bringing China into the WTO¹ just moved globalization ahead more rapidly, and China grew to be one of the top three trading nations. Trade expanded and all economies benefited. Then Xi Jinping became the leader, his stature almost equaling Mao in power. China after Xi has become a much-changed country, both in its view of capitalism and China's rightful place in the world, particularly in Asia.

Xi has thrown both the world trading system and Asian autonomy into confusion. This has led many to argue, "Globalism is dead!" Globalism, as we have often written, doesn't die. It changes, it adapts, and countries successfully adapt with it or fall back.

We concentrate on China when writing about Asia because it is clearly the elephant in the room. China's dramatic growth has gotten much deserved praise, but, in our view, many analysts have gone too far in projecting future growth. Much of the reported growth has been from State Owned Enterprises (SOE). These range from companies to entire industries. The problem is that SOEs are very inefficient. They are riddled with non-performing loans and over production. This cannot go on if China is to achieve its potential. China drew millions of poor laborers from the countryside into factories. These workers were highly inefficient due to lack of education and low labor to capital ratios. Now China is facing a western problem—a declining population. This started with Chairman Mao's one family, one child policy. Labor costs must go up, and this will continue to pressure profitability, particularly for SOEs.

In an effort to become the dominant leader of Asia, China has entered some ill-advised lending and construction projects known as "Belt and Road" initiatives. These projects were created in an effort to ingratiate other countries and make them dependent upon China. It is not working out as planned.

¹World Trade Organization

Weekly Market Insights (cont'd)

None of this means China will not keep growing and remain a force to be reckoned with, but growth will likely slow to a far more sustainable rate. Things to watch—how much more government takes control of industry, does the SOE system not just remain but become more dominant and, perhaps, more important, does Xi's apparent crackdown on highly successful enterprises continue or accelerate discouraging new advances?

In the international arena, investors must, of course, see how the western community of trading nations continues to respond to China.

One interesting change may very well be that China becomes a far more important trading partner, not because of its exports, but because of its growing consumer base.

The second largest country next to China, India, also has the fastest growing population. While it is a country of enormous potential, India has not demonstrated the ability to convert potential into reality. India has consistently disappointed analysts; for years, they expected economic growth to take off. It has a large and growing population, a fine educational system in many regions, and abundant natural resources. What is

holding India back? A number of things. Education is not evenly distributed, grinding poverty exists alongside of great wealth, there are fractious relations between groups and religions, and there is an almost unworkable bureaucracy. Also, India is constantly at odds with its neighbors China and Pakistan.

Japan is, of course, a large economically developed country. For decades, it has been a dominant figure in international trade. It now appears as though its economy has stalled. Japan is the flower child of a country with a shrinking population. It is a unique country with an aversion to opening itself to immigration.

The two other dominant economically advanced countries are Taiwan and South Korea, both of which, under great pressure, have been extremely successful.

There are many smaller countries thriving in Asia. Examples include Vietnam, Singapore, and Malaysia. All are doing well and as supply chains expand and diversify, these smaller countries should benefit.

We left out one country that exists between the east and west. That country is Russia, which stands somewhere in Eurasia. We will visit this topic another time.

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