

State Of the Markets: Best Long And Short Strategies 2023Q4

September 2023

State Of the Markets: Best Long And Short Strategies 2023Q4

Historical Performance of Recommended Trades

Positions	Number Trades	October 3, 2023		
		Initial Investment (MM)	Current Investment (MM)	Net Total Return
Open	4	20	34	71%
Closed	115	575	1610	180%
Total	119	595	1645	176%

Current Recommended Trades And Recent Closed Trades

Status	SOM Strategy	Trade	Initial Position			Pricing Date		10/3/23	
			Date	MM/Share	Price	Date	Price	Invest (MM)	Total Ret
New	China Baby Bust, Property Bust And Delfation	Buy 1-yr 5% OTM CNY Put/USD Calls	8/24/23	500	1.00	10/3/23	1.00	5.0	0%
New	Equity Rally Is Overdone	Buy 6-month 5% OTM S&P Puts	6/5/23	500	100.00	10/3/23	60.00	3.00	-40%
Restruck	The Fed Does Not Blink	Buy 6-mon Forward Start ATM Pay Fixed For 1-years Swap	9/12/23	2000	0.00	10/3/23	0.23	9.6	92%
Restruck	Corporate Credit Opportunities in An Inflationary World	Buy European And HY Debt	1/1/23	200	100.00	10/3/23	100.80	21.7	333%
Restruck	The Fed Does Not Blink	Buy 1-yr Forward Start ATM Pay Fixed For 1-years Swap	6/29/23	2000	0.00	9/12/23	0.44	13.8	176%
Restruck	Regional Bank Sell-off Overdone	Buy Regional Bank Equites Vs Large Banks or S&P	6/5/23	100	100.00	1/3/00	113.00	18.0	260%
Restruck	The Fed Does Not Blink	Buy 1-yr Forward Start ATM Pay Fixed For 1-years Swap	6/5/23	2000	0.00	6/29/23	0.63	17.6	252%
New	Regional Bank Sell-off Overdone	Buy Regional Bank Equites Vs Large Banks or S&P	5/15/23	100	100.00	6/5/23	109.00	14.0	180%
Old	Normalization of European Yields	Buy Italian Banks Vs Other European Banks or Broad European Index	3/17/23	100	100.00	6/5/23	110.50	15.5	210%
Restruck	The Fed Does Not Blink	Buy 1-yr Forward Start ATM Pay Fixed For 1-years Swap	3/17/23	2000	0.00	6/5/23	0.67	18.4	268%

State Of the Markets: Best Long And Short Strategies 2023Q4
Higher For Longer--Consumer Spending Is Strengthening As Are Inflationary Pressures

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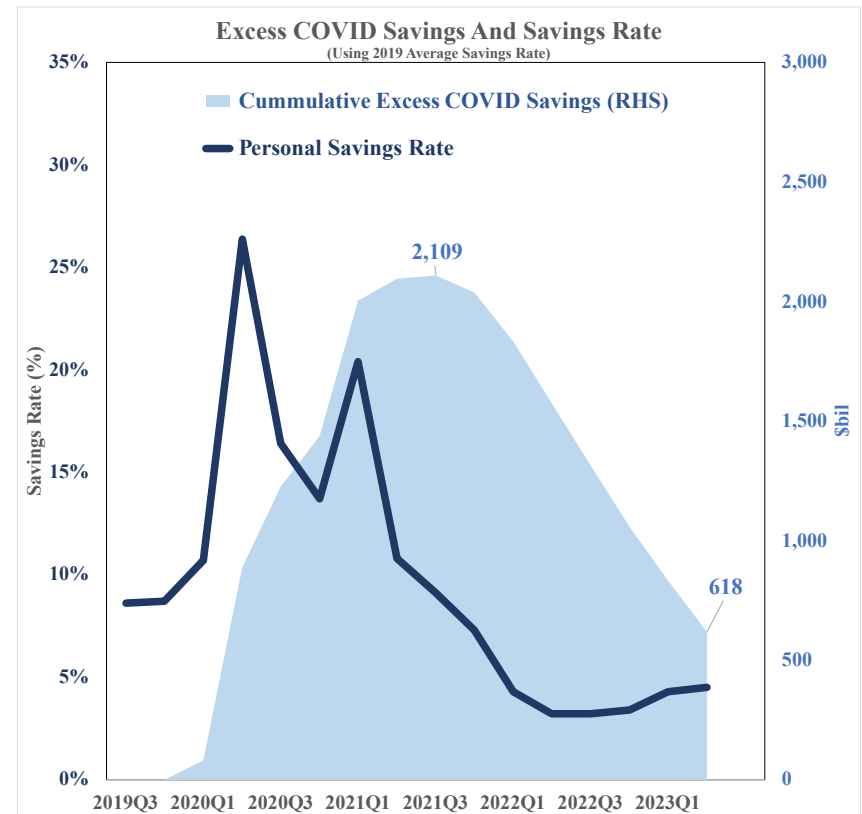
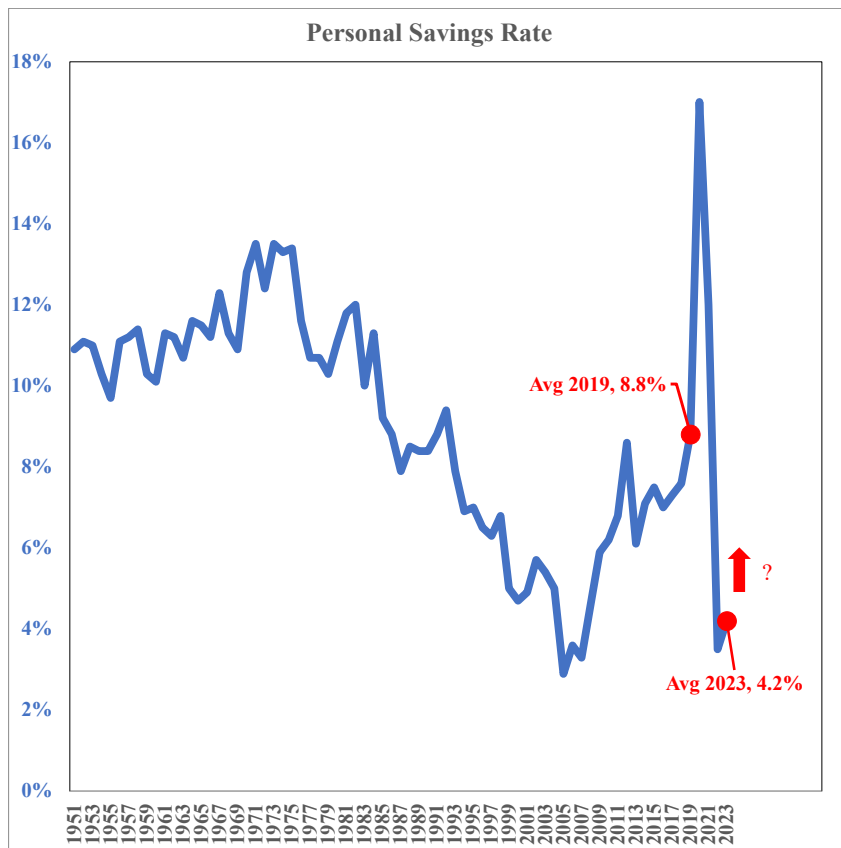
Higher For Longer--Consumer Spending Is Strengthening As Are Inflationary Pressures

Step 1: Identify A Macro Theme

Will Consumer Spending Slow To Push Up Savings As Excess COVID Savings Goes Away?.. Nope...

Will Savings Rates Move Back Up To Higher Historical Levels....

And Consumption Slows As Their Excess COVID Savings Ebbs?



1. Federal Reserve Bank of St. Louis FRED data base
2. Excess savings based on 2019 average savings rate

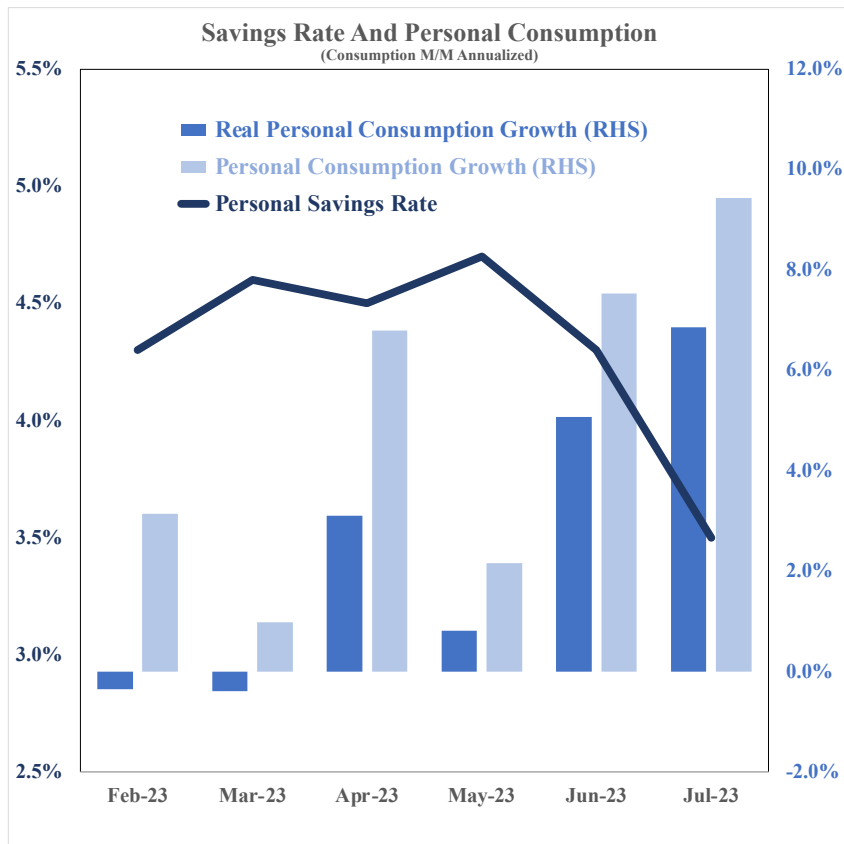
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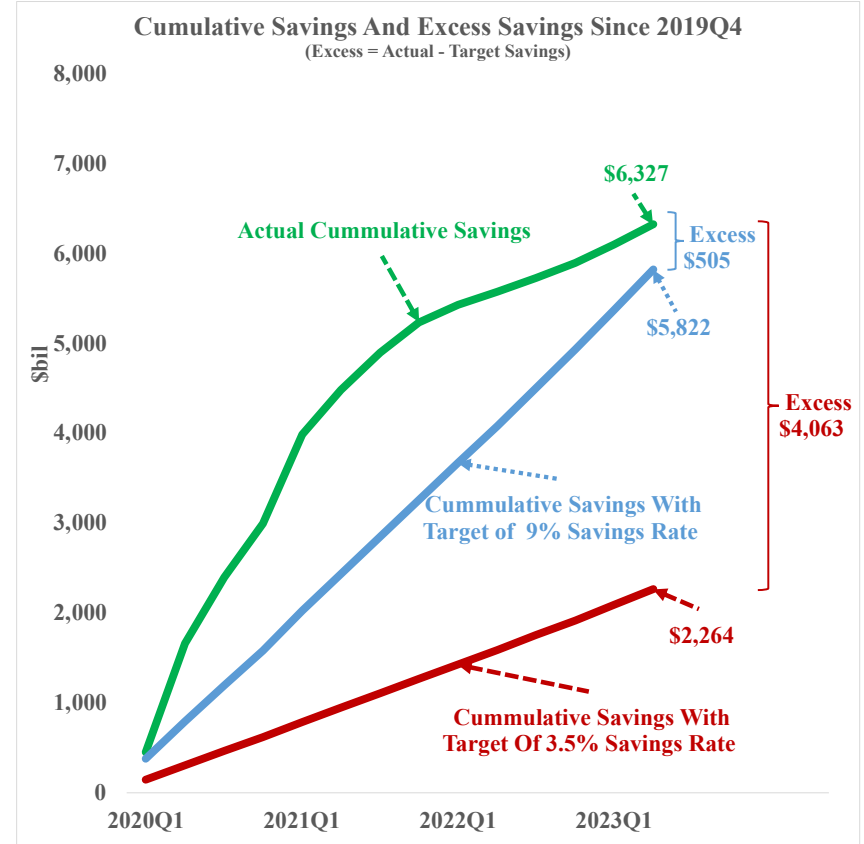
Step 2: Fundamental Economic Framework

Excess Savings Does Not Matter, Households Still Have Substantial Capacity to Fund Their Spending

Recent Data Says Just The Opposite Because.....



The Consumer Has Plenty Of Savings And.....



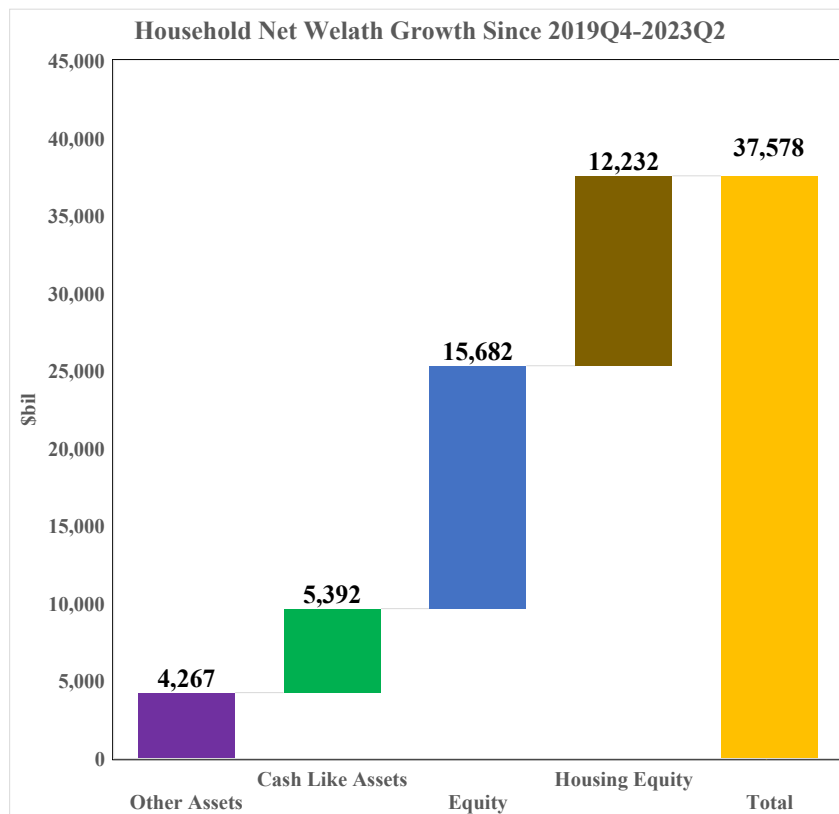
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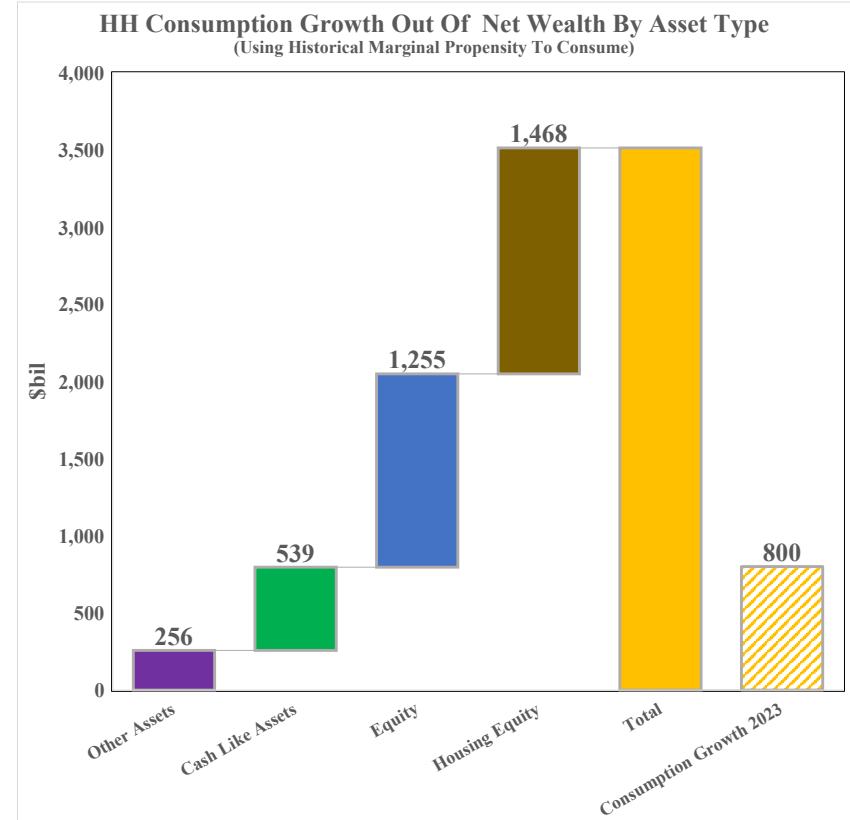
Step 2: Fundamental Economic Framework

Consumer Has “COVID” Net Wealth Growth And That Could Fund Multiples Of Current Spending

Household Wealth Growth Has Surged Since 2019..



And this Could Lead to Substantially Higher Consumption vs History



1. Board of Governors z1 Database

2. I use marginal propensity to consume of 0.12 for housing wealth, 0.08 for equity/other asset wealth, and assume that cash holdings vs wealth returns to normal

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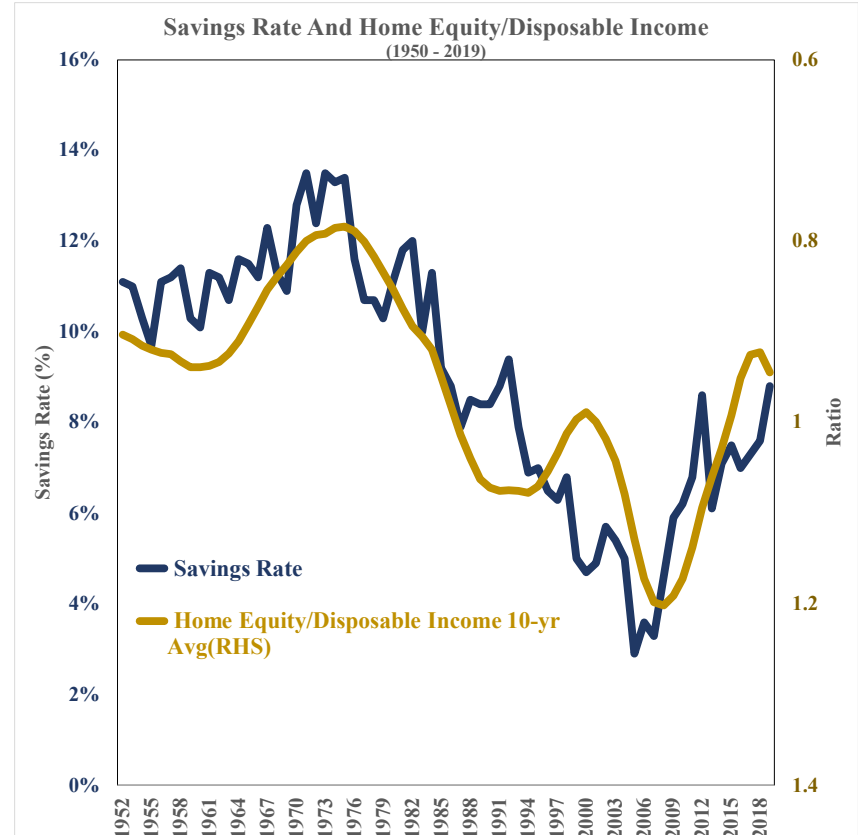
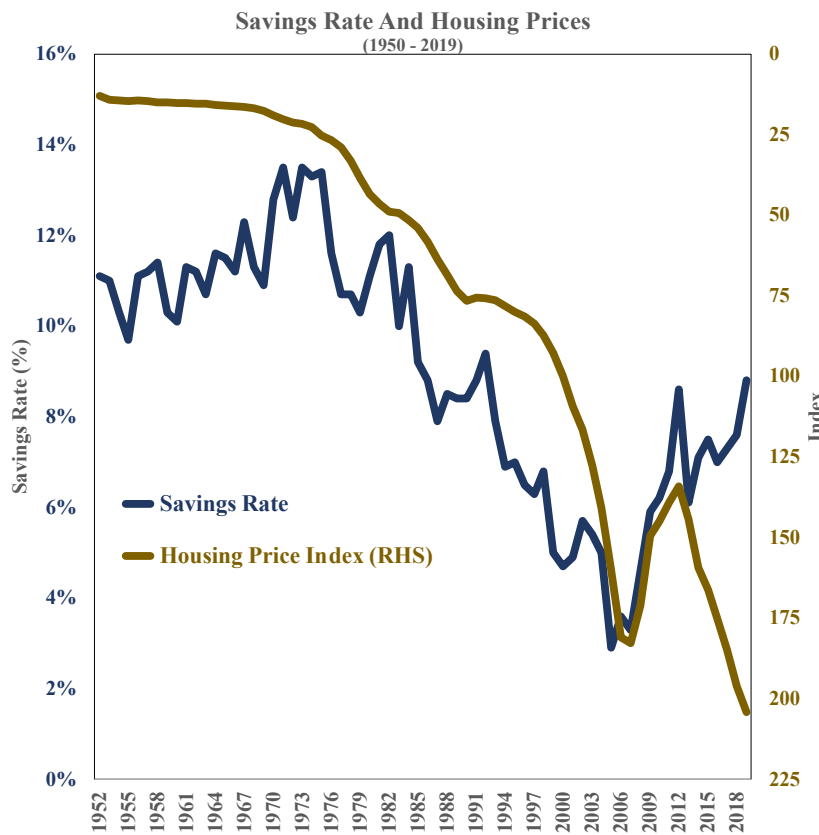
Higher For Longer--Consumer Spending Is Strengthening As Are Inflationary Pressures

Step 2: Fundamental Economic Framework

For Example, Home Equity Has Been A Strong Driver of Savings Rates And Hence Consumption

Savings Rates Tend To Be Inversely Related Housing Price...

Not Surprisingly, A Measure of Home Equity Explains Savings Rates



1. Federal Reserve Bank of St. Louis FRED data base
2. Shiller data base on housing prices
3. Board of Governors z1 Database

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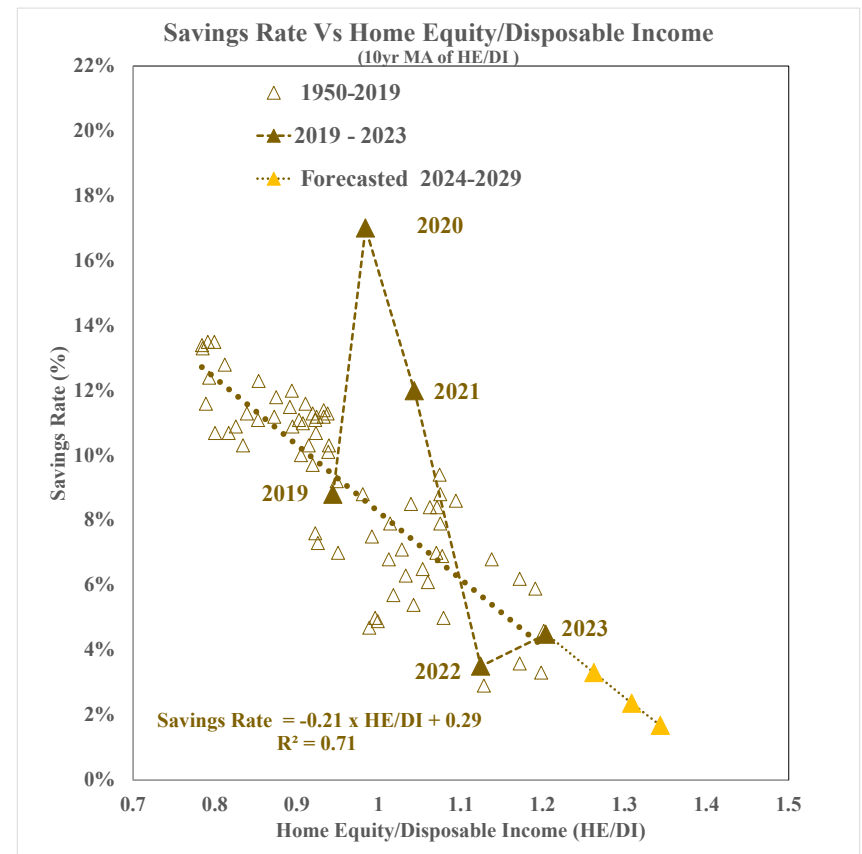
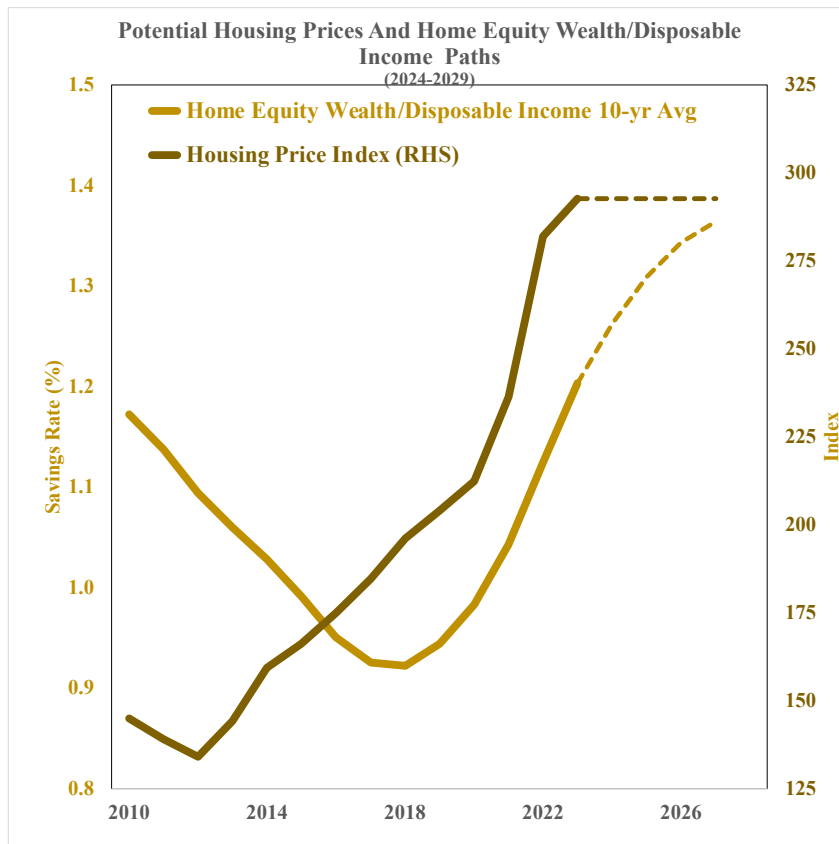
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Step 2: Fundamental Economic Framework

Savings Rates Could Go Even Lower As It Still Does Not Fully Reflect The Growth In Home Equity

The Lagged Nature of HE Implies That Savings Rates Could Fall...

Given Built In HE, Savings Rates Could Go Close To Zero Over Time



1. Federal Reserve Bank of St. Louis FRED data base
2. Board of Governors z1 Database
3. Uses disposable income growth at 5% per year

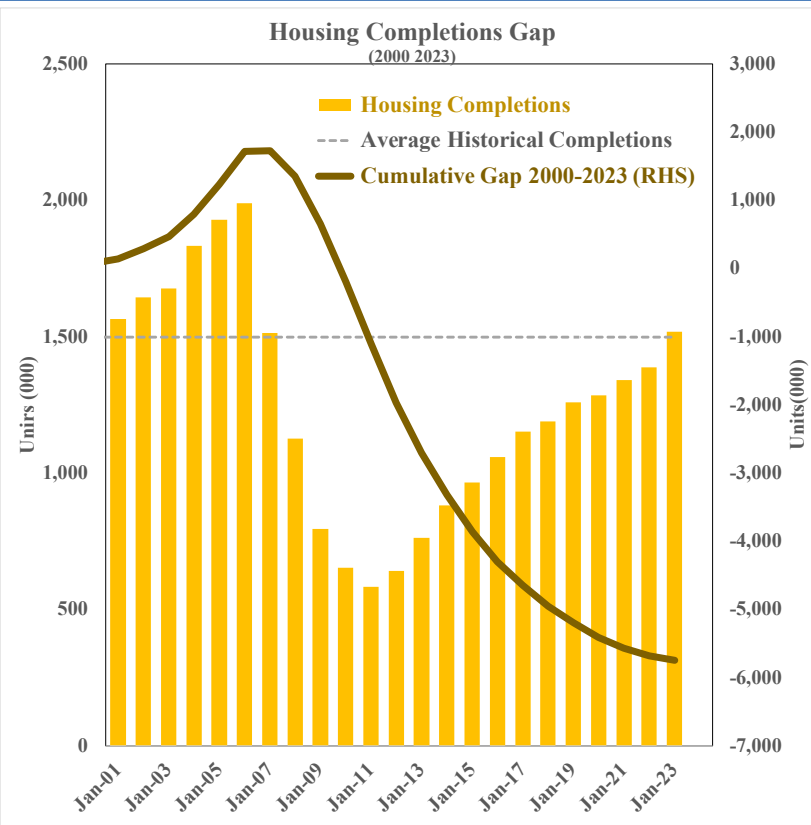
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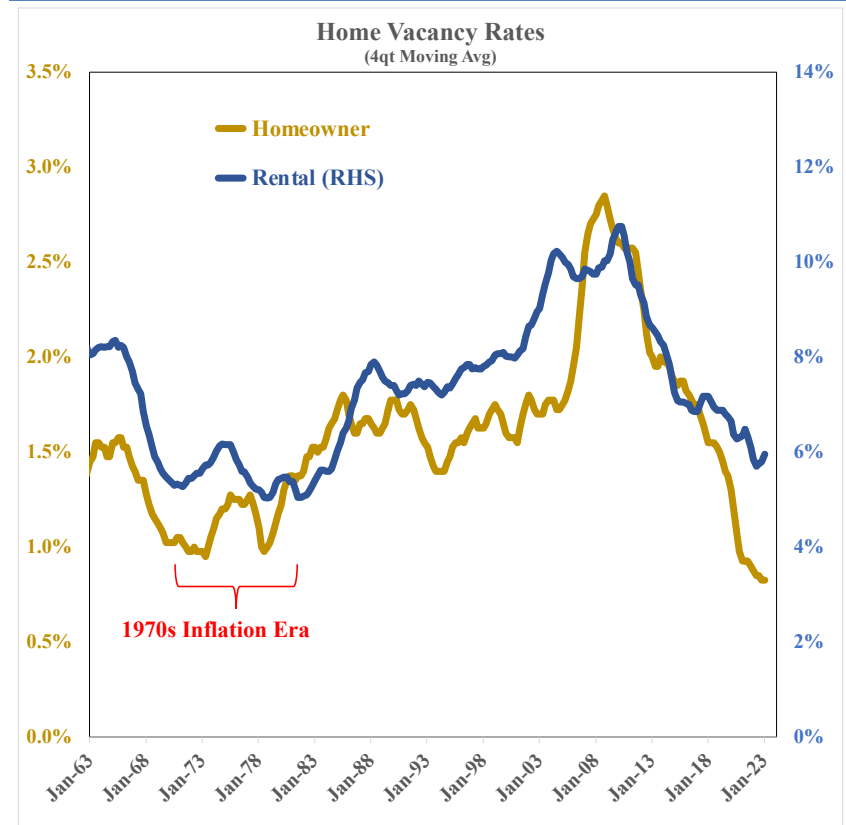
Step 2: Fundamental Economic Framework

Strength In The Housing Market Reflects Too Much Demand And Not Enough Supply

Starts Have Fallen Below Demand Creating A Shortage of 5.5 Million Homes



As A Result , Vacancies Are At Or Below Historical Lows



1. BLS
2. Federal Reserve Bank Of St. Louis, Fred Data Base

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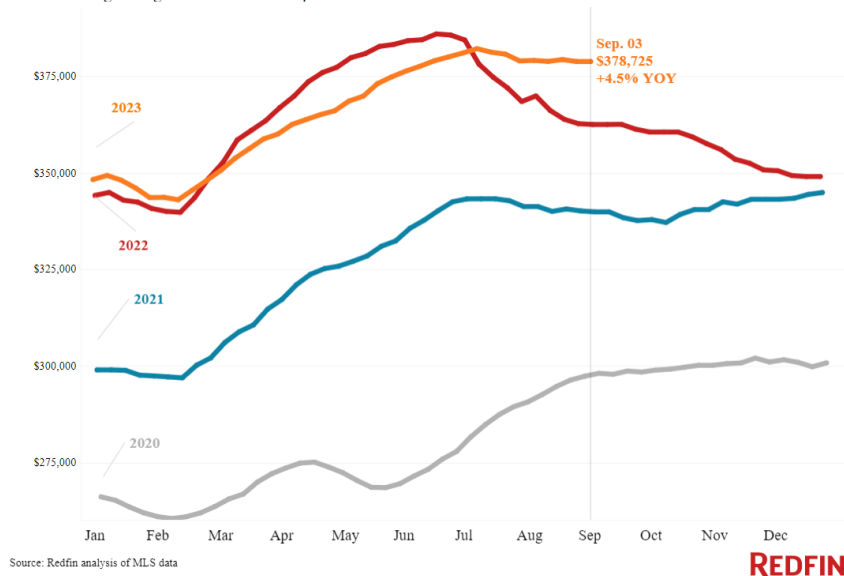
Step 2: Fundamental Economic Framework

Home Equity Is Unlikely To Crater Given Positive Fundamentals Even With Higher Mortgage Rates

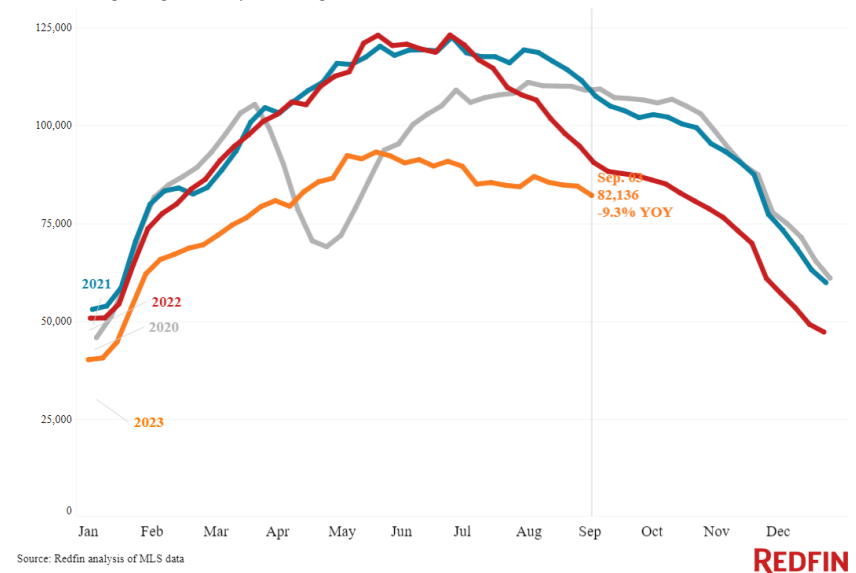
After A Decline Last Year, Housing Prices Are Up this Year....

Reflecting The Fall In Housing For Sale

Median Sale Price +4.5% Year Over Year
4-week rolling average of the median sale price of homes sold



New Listings of Homes -9% Year Over Year
4-week rolling average of weekly new listings of homes for sale



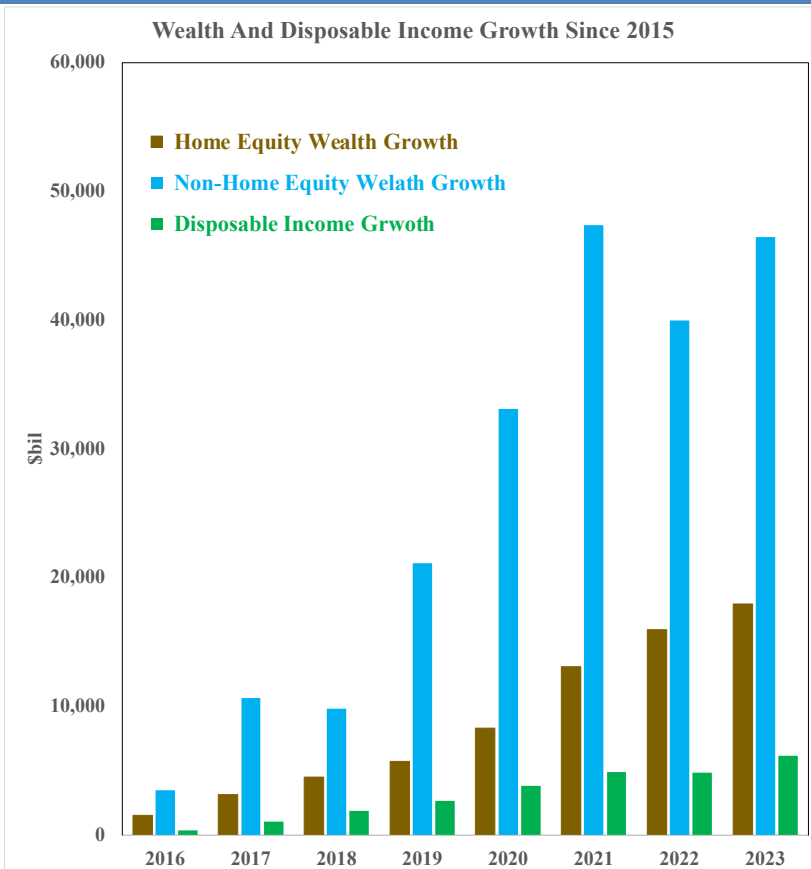
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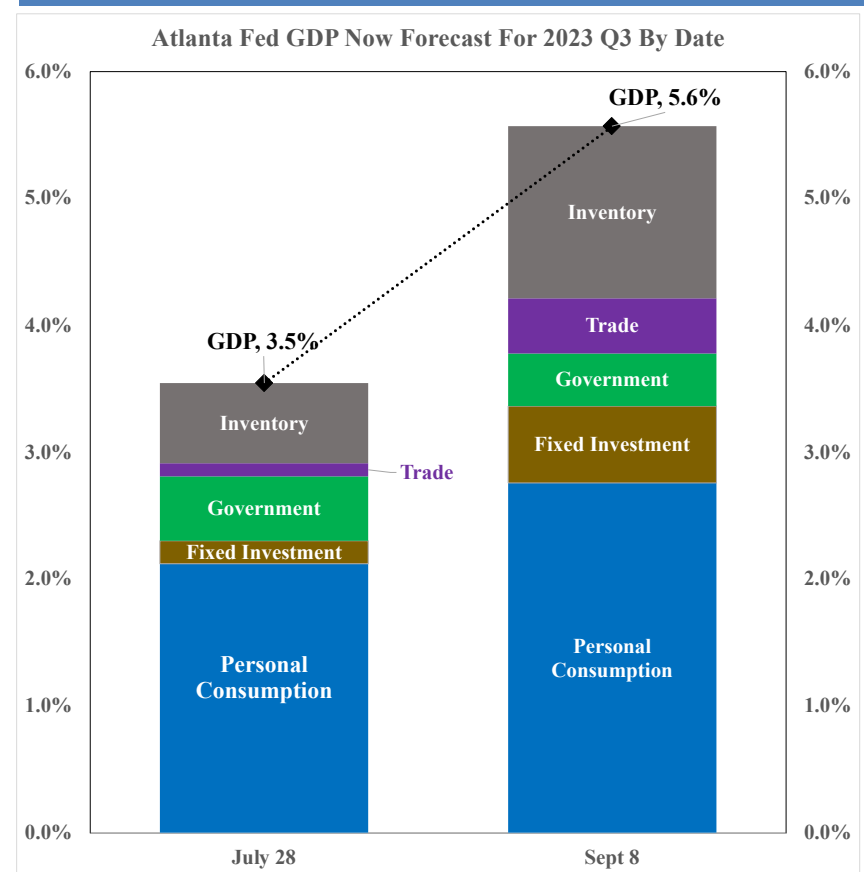
Step 2: Fundamental Economic Framework

Wealth-Fueled Consumption Growth Is Driving A Surge In Near-Term Forecasts of Q3 GDP

Net Wealth Growth Dwarfs Disposable Income Growth...



Increase In GDP From PCE and Business Setting Up For PCE



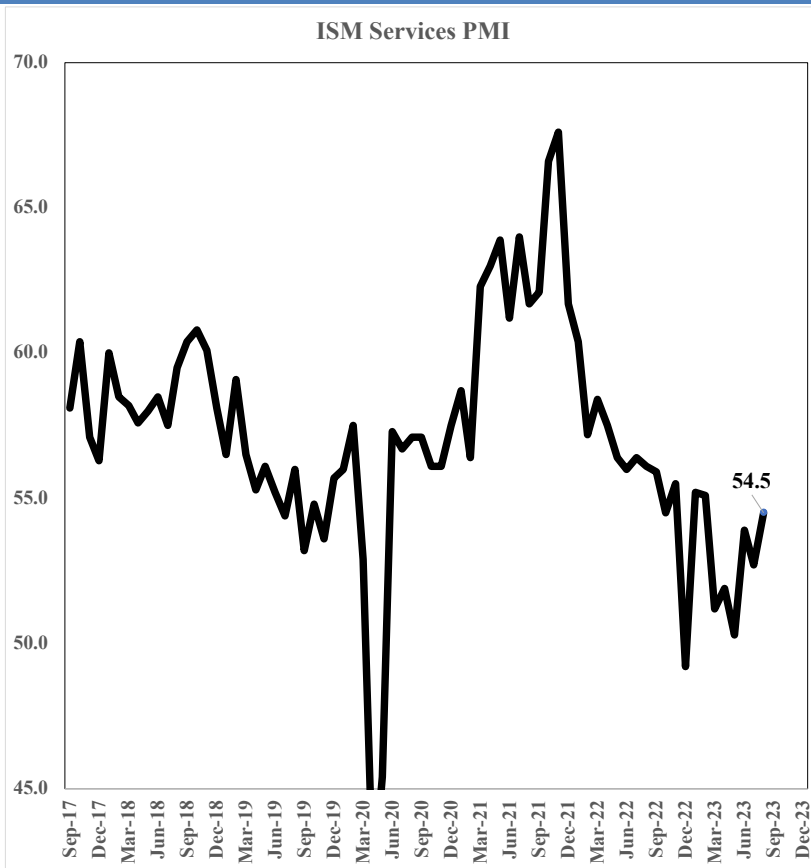
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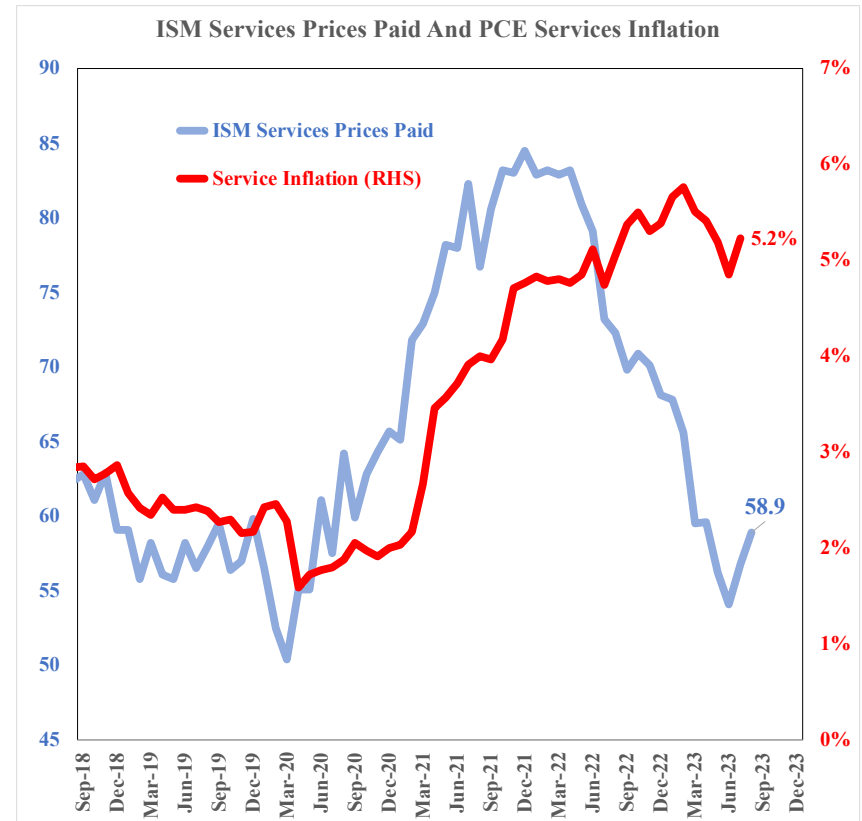
Step 2: Fundamental Economic Framework

Strength In Consumer Spending On Services Is Driving In Part The Uptick In Inflationary Pressures

Companies Are Reporting An Uptick On Spending On Services..



Increased Spending Is Creating Inflationary Pressures



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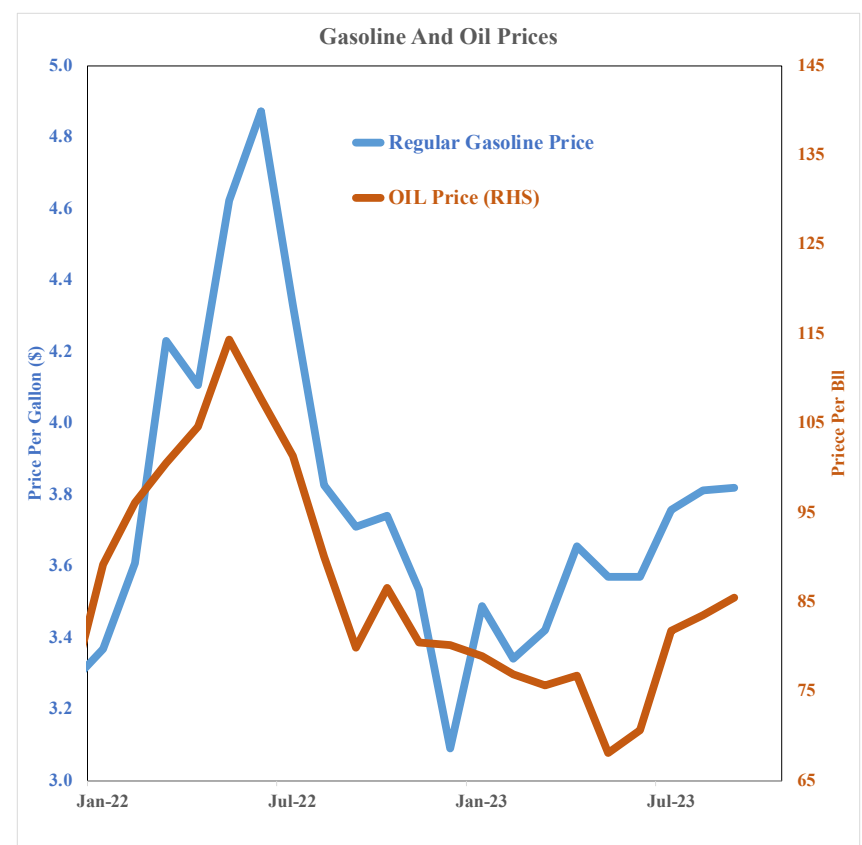
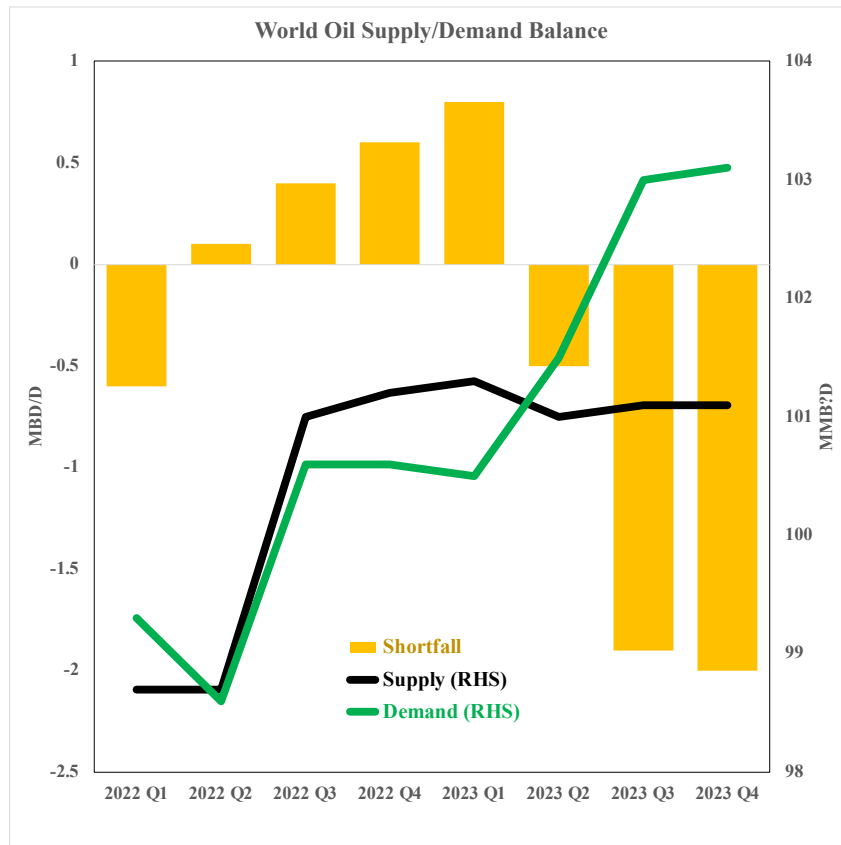
Higher For Longer--Consumer Spending Is Strengthening As Are Inflationary Pressures

Step 2: Fundamental Economic Framework

Energy Inflationary Pressures Are Rising Driven By Increase In Demand With Flat Supply Growth

Oil Demand Is Projected To Excess Supply By 2 MMB/D...

Creating Upward Pressure On Energy Prices For The Consumer



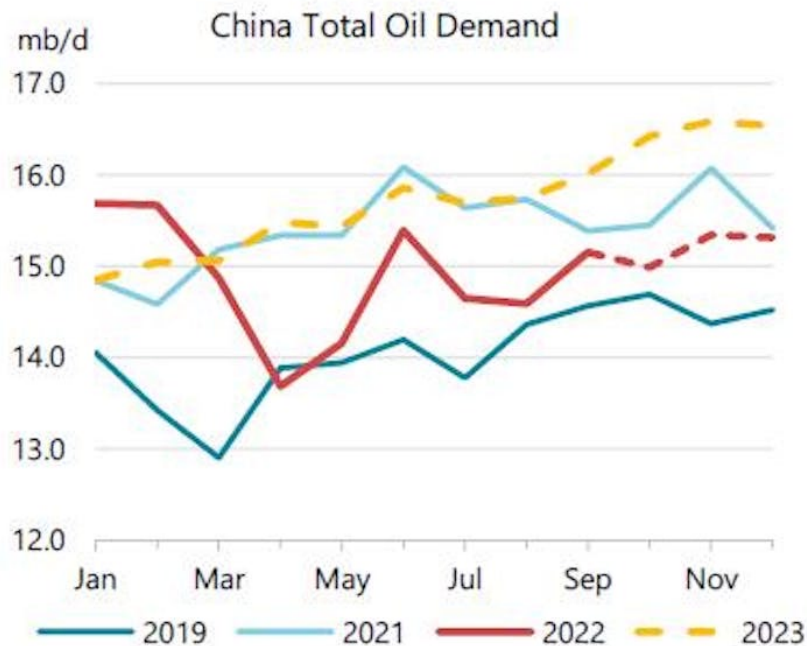
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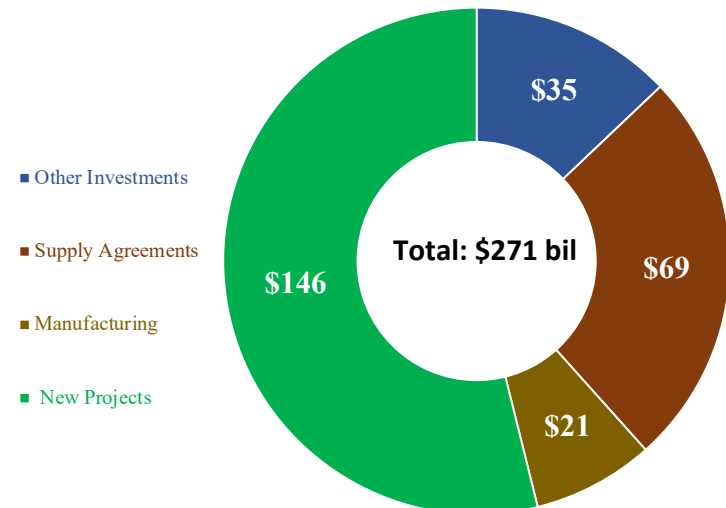
Demand Is Increasing From China, While Renewable Investment Has Choked Off Fossil Supply Growth

China Demand For Oil Is Finally Coming On Line...



US Fossil Supply Growth Is Facing The Headwinds From The IRA

Company Spending On New Clean Energy Projects In First Year of IRA



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Higher For Longer--Consumer Spending Is Strengthening As Are Inflationary Pressures

Step 2: Fundamental Economic Framework

Growing Strength In the Labor Market Could Translate Into The Start of Another Inflationary Cycle

Union Wage Increase Reflect Their Growing Strength

Eight Consecutive Quarters of Union Wage Acceleration

Average first-year wage increase in ratified labor contracts, 2007-2023



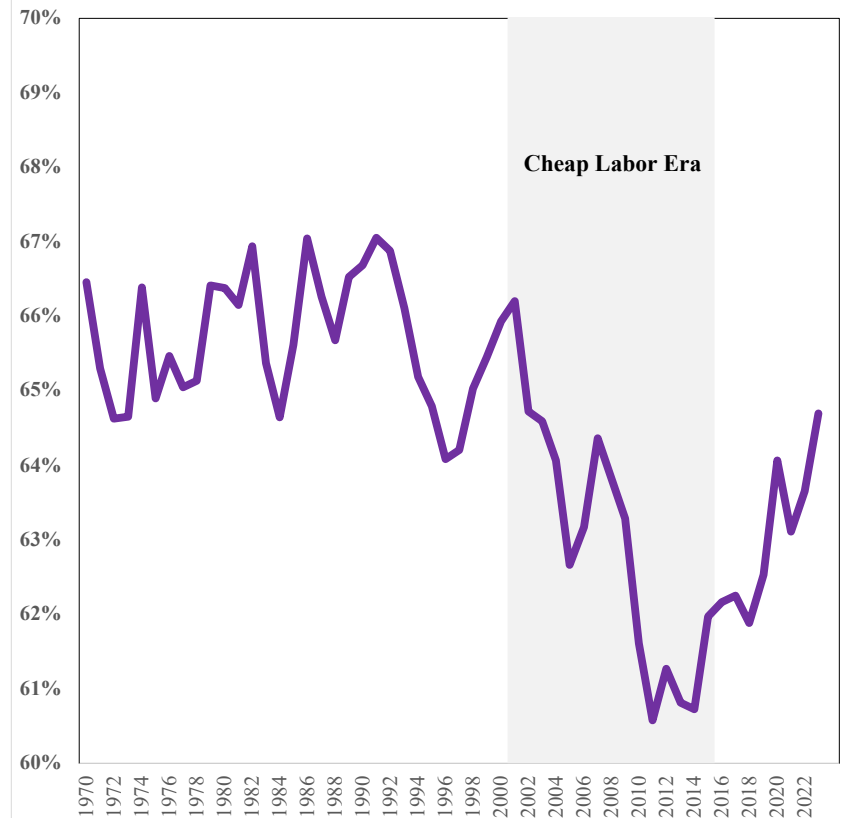
Source: Bloomberg Law labor data.

Note: Starting with Q1 2016, averages are based on each contract's ratification date. Prior to 2016, averages are based on the date each contract was added to Bloomberg Law's database.

Bloomberg Law

Labor Income Is Growing Now That The Cheap Labor Era Is Over

Labor Income As Percentage of National Income



1. Bloomberg Law Law Data Base
2. Federal Reserve Bank of St. Louis FRED data base

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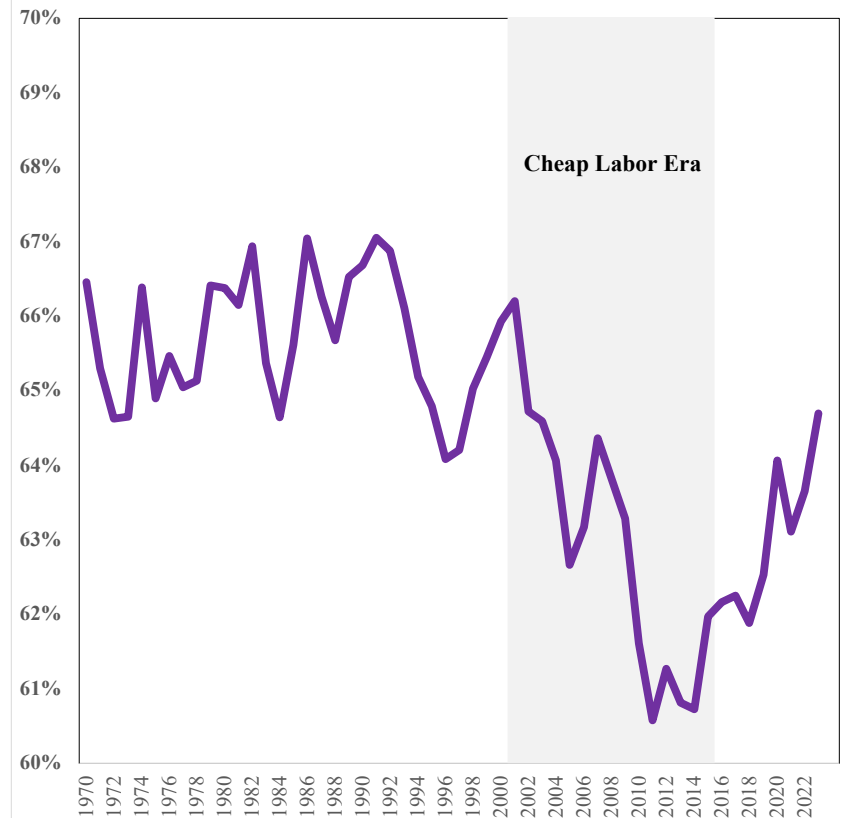
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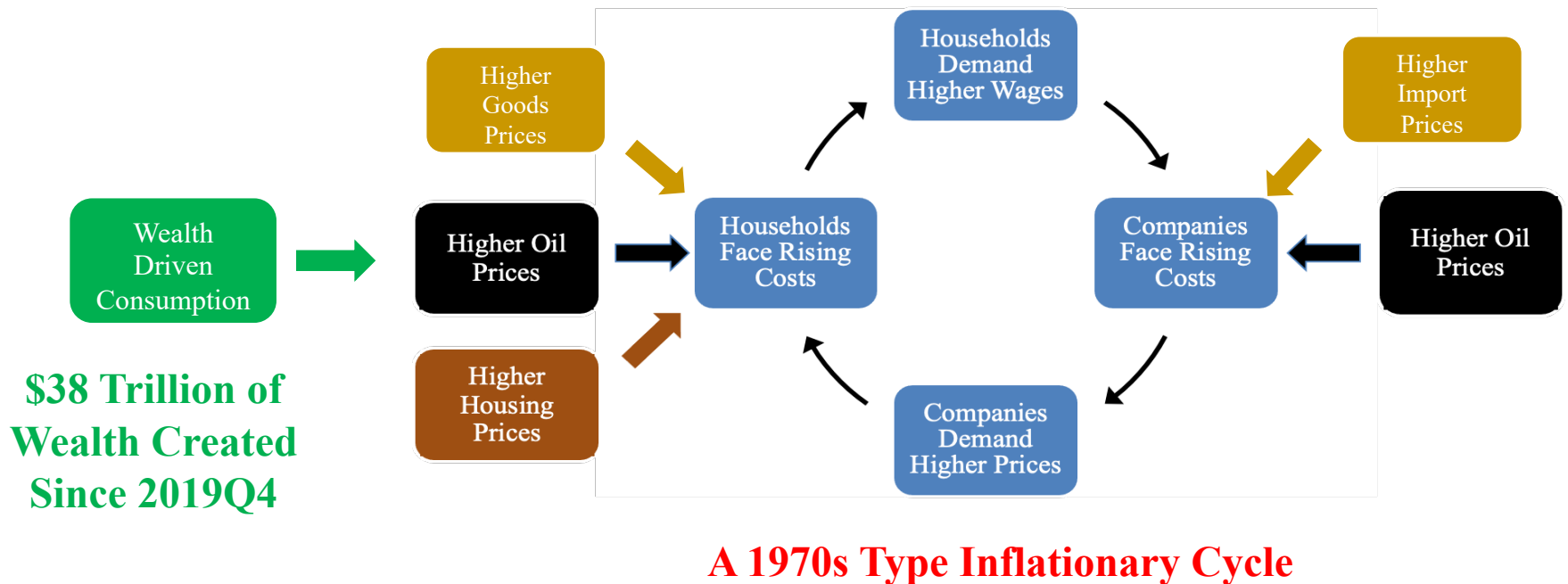


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Higher For Longer--Consumer Spending Is Strengthening As Are Inflationary Pressures

Step 3: Find Potential Catalysts

Fed Does Not Cut Rates Because The End Of The Cheap Labor Era Allows A 70s Inflation Cycle To Start



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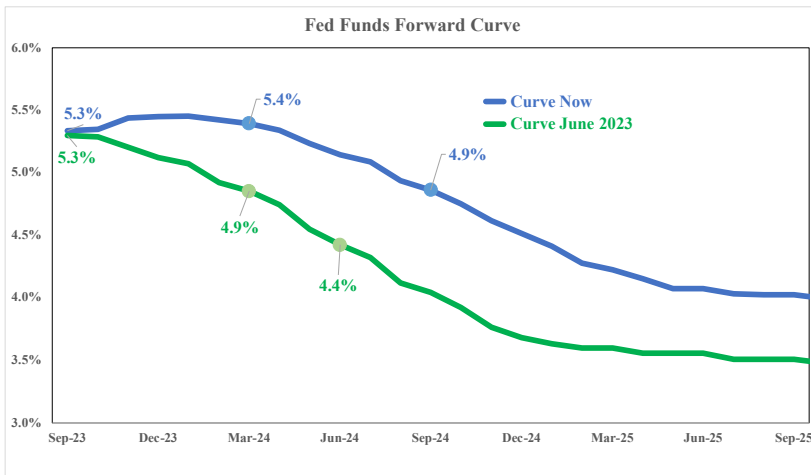
Step 4: Identify Asymmetric Trades

Buy 6-month Forward, 1-year ATM Payer Swaps

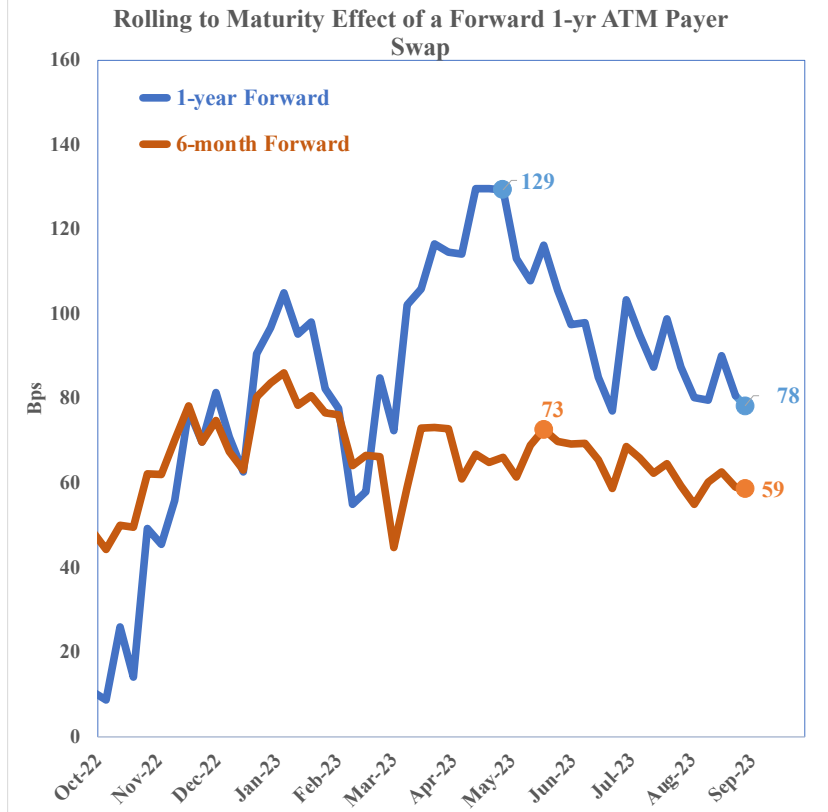
Trade Thesis

- Trade returns increase as it rolls to maturity up given expectations of Fed rate cuts
- Rolling to maturity after 6-months still remains attractive even with the change in Fed futures repricing
 - Returns can still be attractive even if the cuts rates given the steepness of the curve
- Cut may not happen an economic soft landing
- The Fed could even raise rates further and faster if inflation rebounds

Market Pricing In Substantial Fed Rate Cuts Even After Repricing



Rolling To Maturity Effect On A Forward 1-yr Payer Swap



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China is Becoming Japan With A Baby Bust, A Property Bust, And Deflation

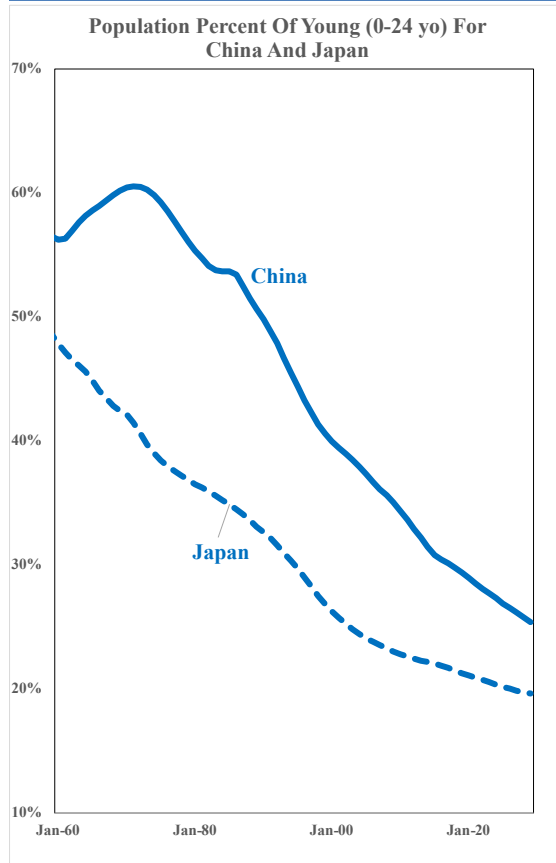
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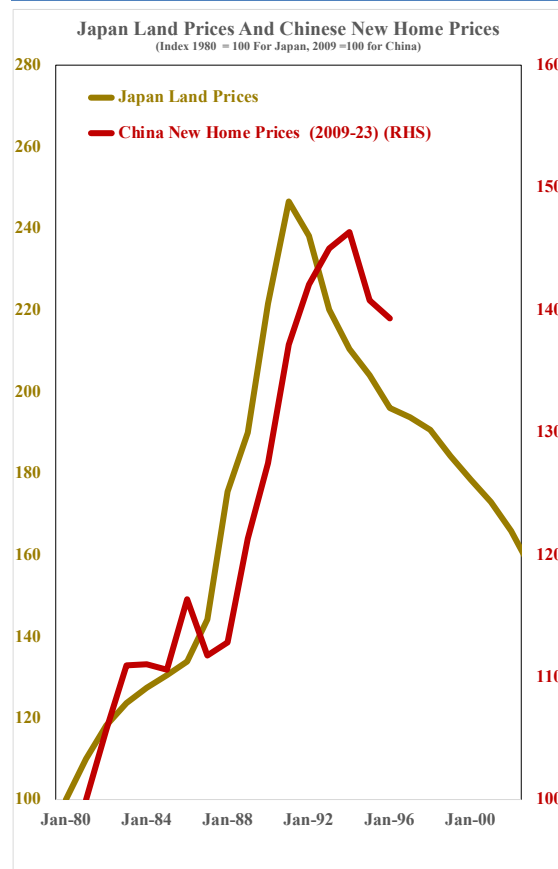
Step 1: Identify A Macro Theme

China Is Now Faced With Same Baby Bust, Property Bust And Deflation As Japan

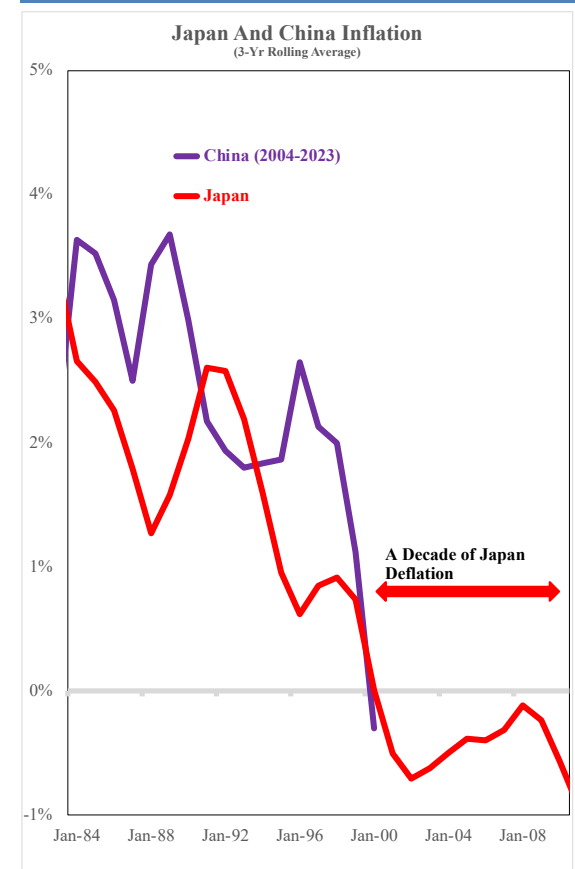
Baby Bust



Property Bust



Deflation



1. Bloomberg
2. BOJ
3. IMF

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China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 2: Fundamental Economic Framework

China's One-Child Policy Effectively Created A Baby Bust Shaping Their Demographics To That of Japan

One Child Policy Created A Baby Bust From Falling Fertility Rates

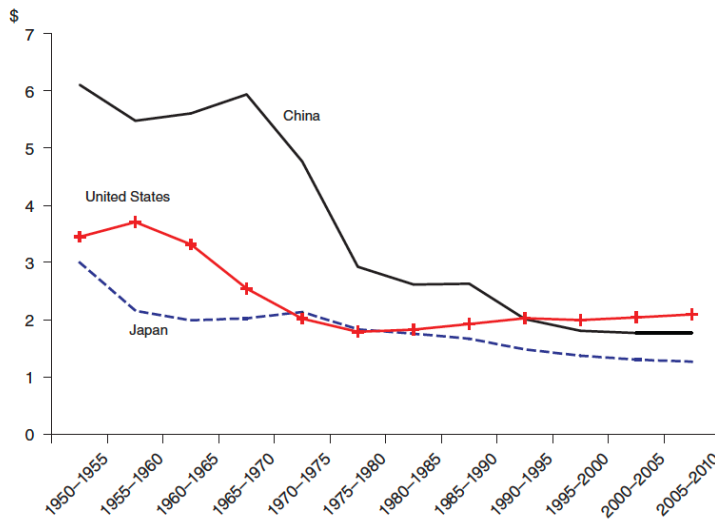
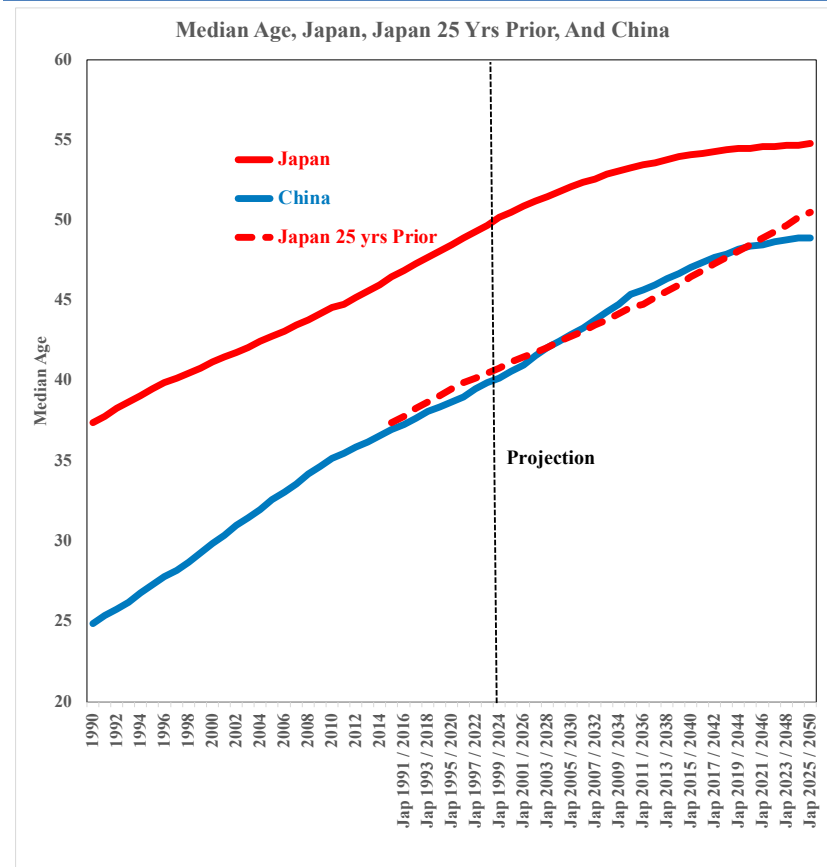


FIGURE 4. TOTAL FERTILITY RATES FOR CHINA, THE UNITED STATES, AND JAPAN, 1950-2010

China's Median Age Is the Same As Japan's Prior to Their Bust



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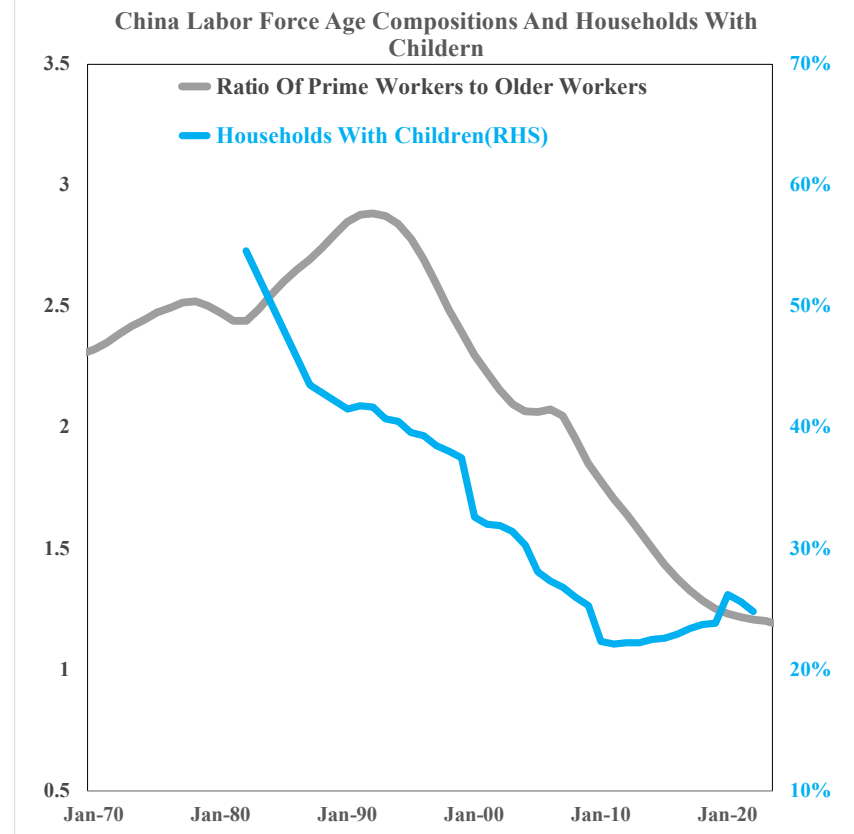
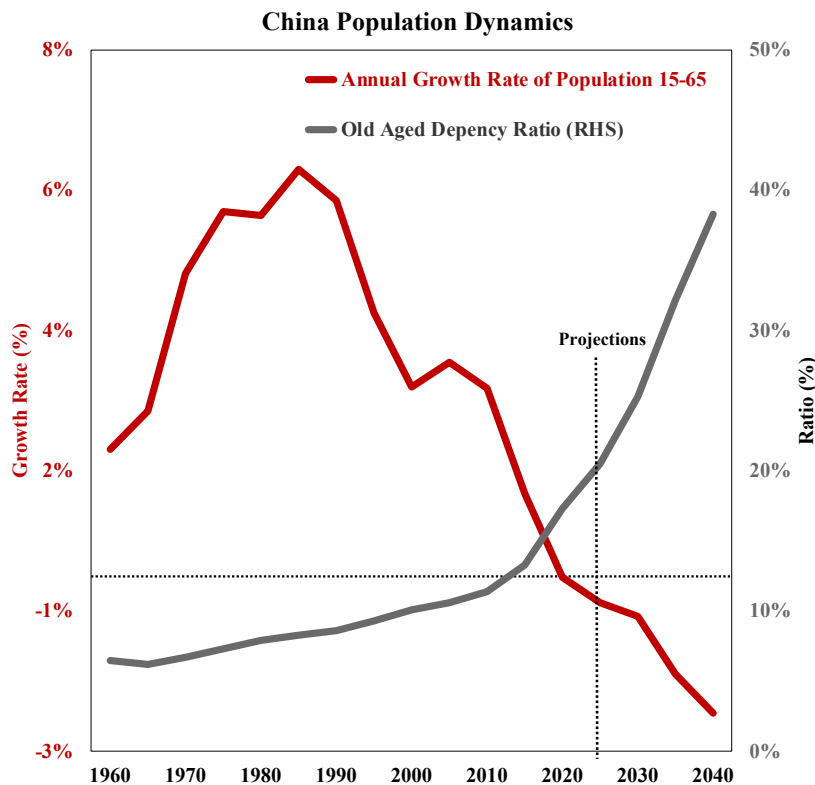
China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 2: Fundamental Economic Framework

The Baby Bust Has Turned Chinese Demographic Into a Headwind For Their Economy

Young China Has Now Become An Aging China Like Japan...

And they Will Get Older Still With Falling Number of Prime Workers



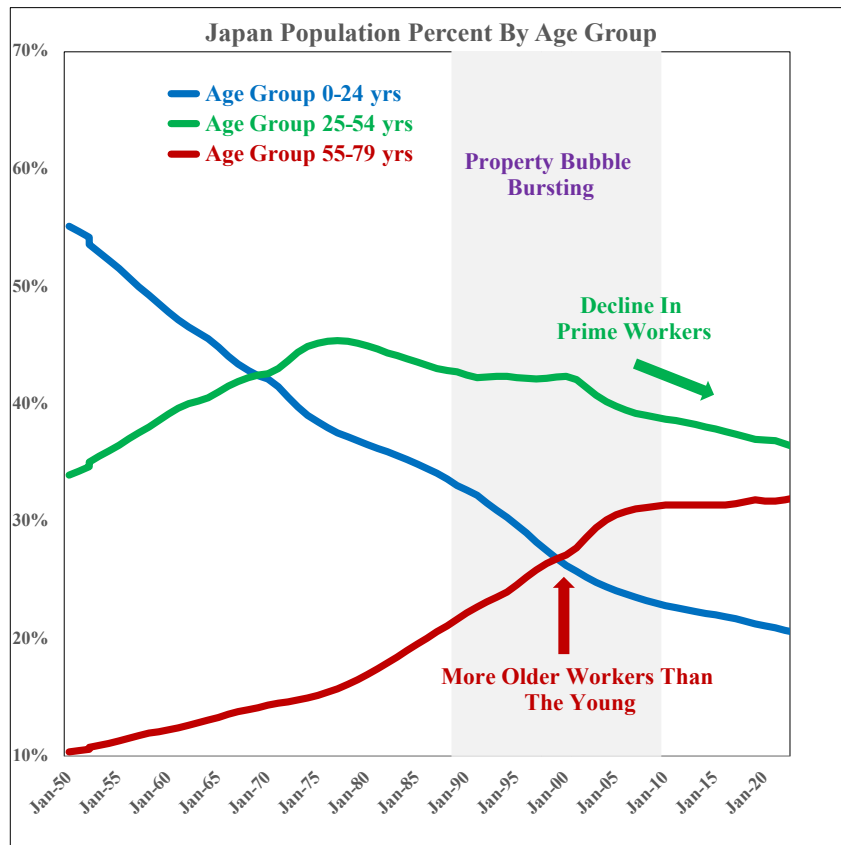
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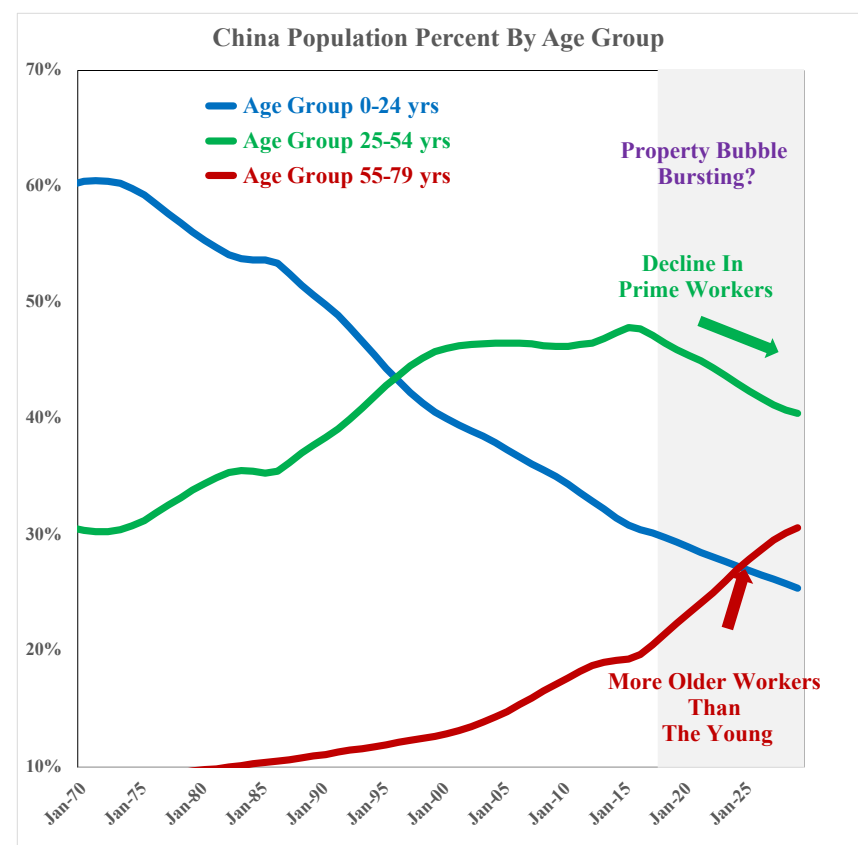
Step 2: Fundamental Economic Framework

China's Demographics Look Similar to That of Japan's Prior To Their Baby Bust, Property Bust And Deflation

Japan's Demographics



China's Demographics



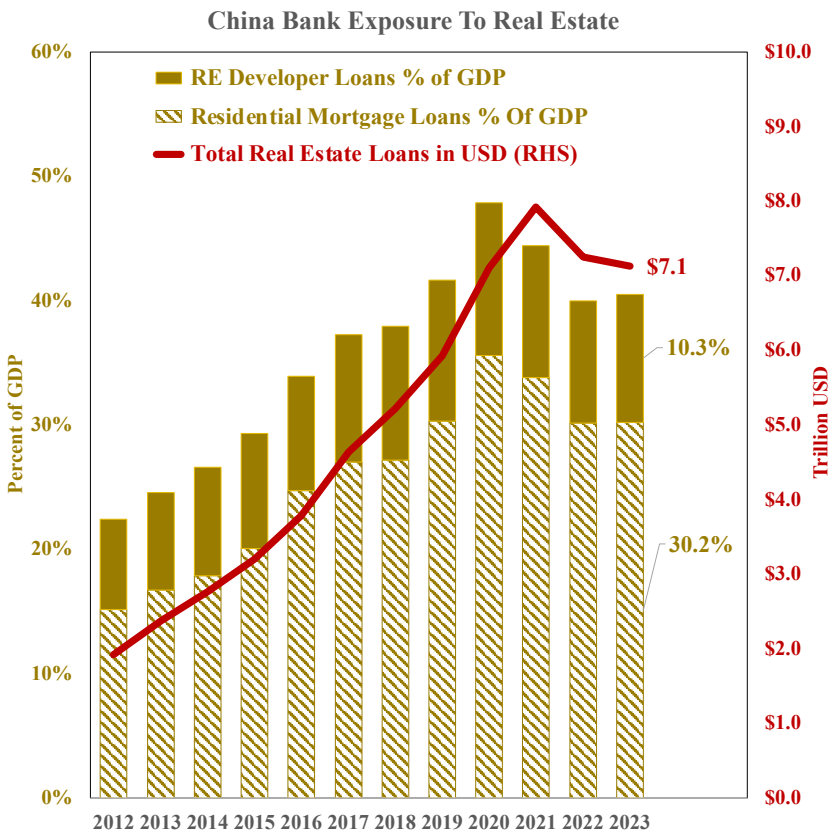
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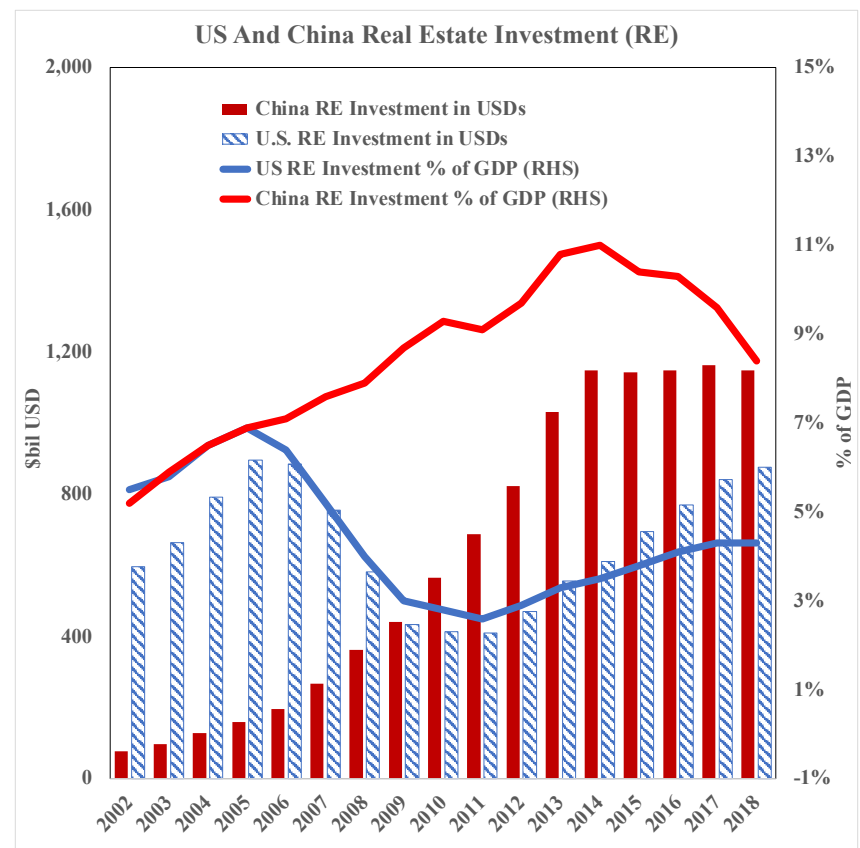
Step 2: Fundamental Economic Framework

Chinese Investment In Real Estate Has Surged To Almost Double the Level Of the US Bubble Peak

RE Investment Has Financed By Credit Growth--40% of GDP



Annual Investment in RE Is Over A Trillion A Year—9% Of GDP



1. Rogoff, Yang, "Peak China Housing," NBER Working Paper 27697, August 2020
 2. Bloomberg

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Step 2: Fundamental Economic Framework

Chinese Real Estate Has Been Driven By The Demand For Investment Other than Equites or Debt

Chinese Households Hold Most of their Wealth In Housing....

90% of Purchases Are From Those Who Already Have A Home

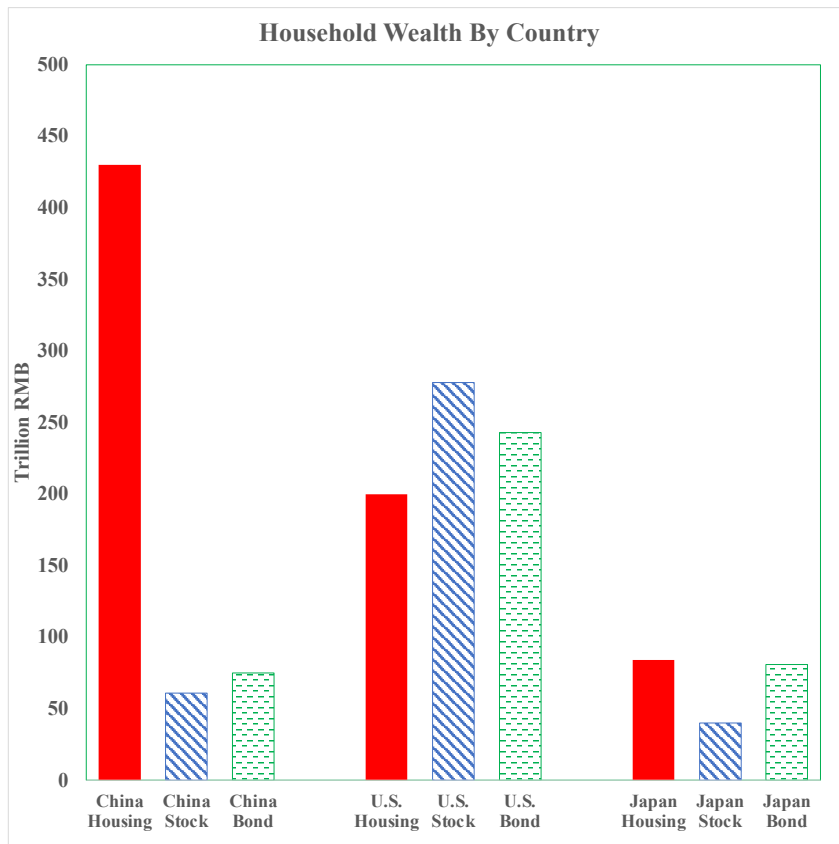
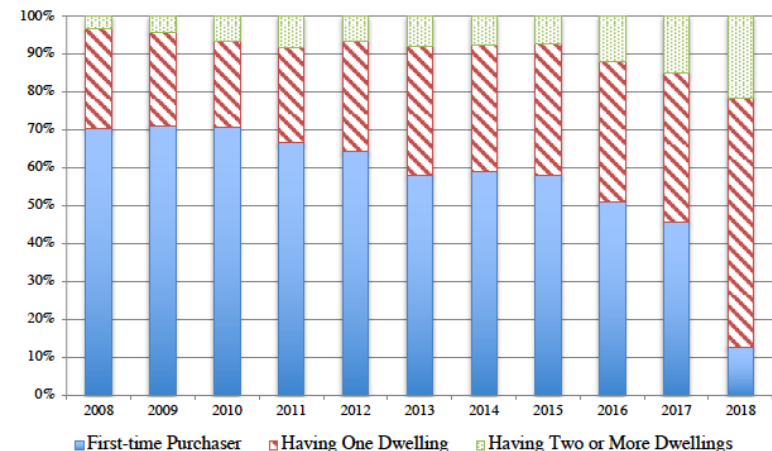


Figure 16. Number of Dwellings of New Homebuyers

This figure presents the breakdown of new homebuyers based on the number of dwellings that they already own at the time of new home purchase.



Source: Survey and Research Center for China Household Finance

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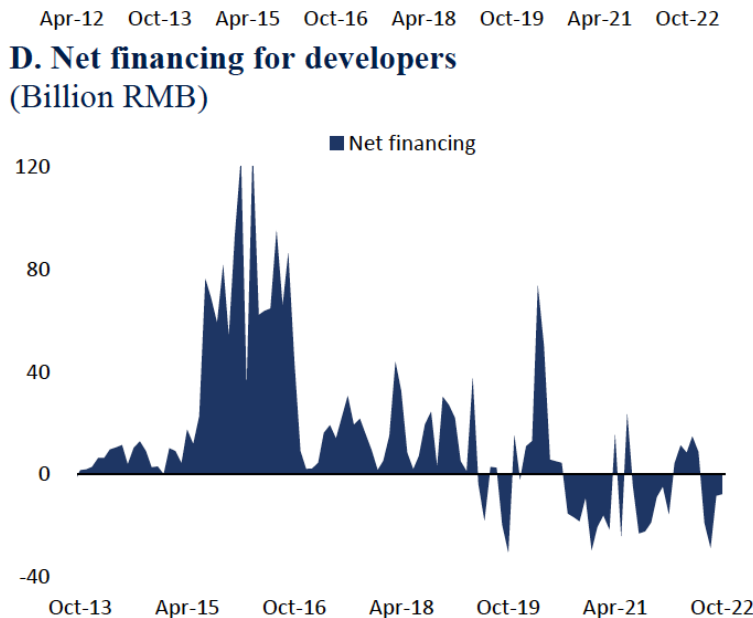
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Step 2: Fundamental Economic Framework

Chinese Property Bust Began With The “Three Red Lines (TRL)” Of For Developer Financing

Developer Financing Became Negative After TRL

Most Developers Were Closed Out Of Financing Due To TRL



1. China Article IV Report, IMF Country Report 22/21 January 2022
2. China Economic Update. “Navigating Uncertainty, China’s Economy in 2023”, December 2022, World Bank

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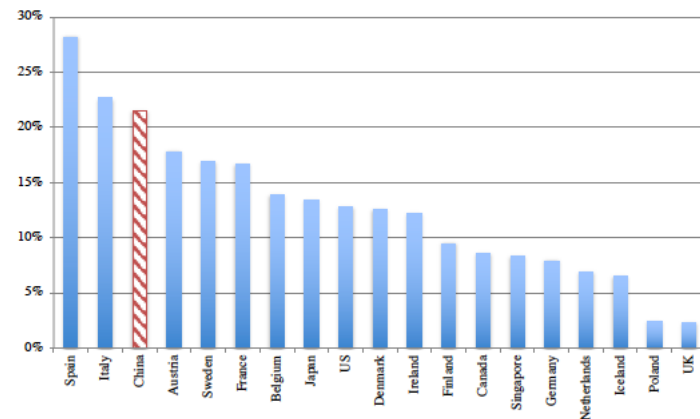
Weakness in the Housing Market From Vacancy Compounded The Funding Shortfall For RE Developers

Chinese Housing Vacancies Are Amongst The Highest In the World..

With A Substantial Inventory Overhand of Over 2.5 Years

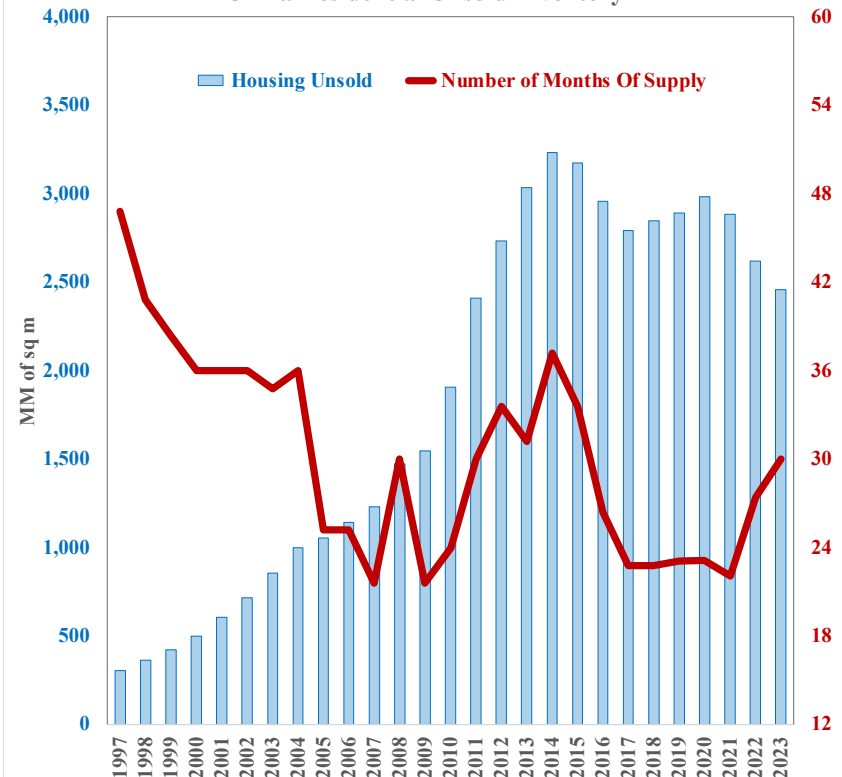
Figure 11. Housing Vacancy Rates by Country

This figure reports the housing vacancy rates in Spain, Italy, China, Austria, Sweden, France, Belgium, Japan, U.S., Denmark, Ireland, Finland, Canada, Singapore, Germany, Netherlands, Iceland, Poland, and U.K., respectively.



Source: European Union

China Residential Unsold Inventory



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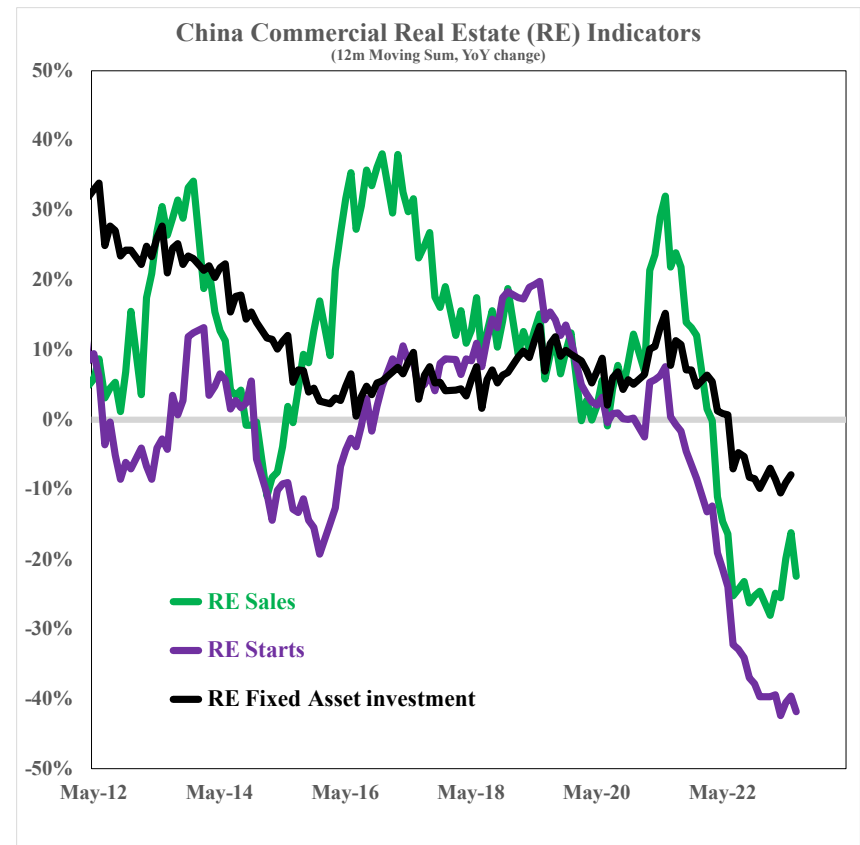
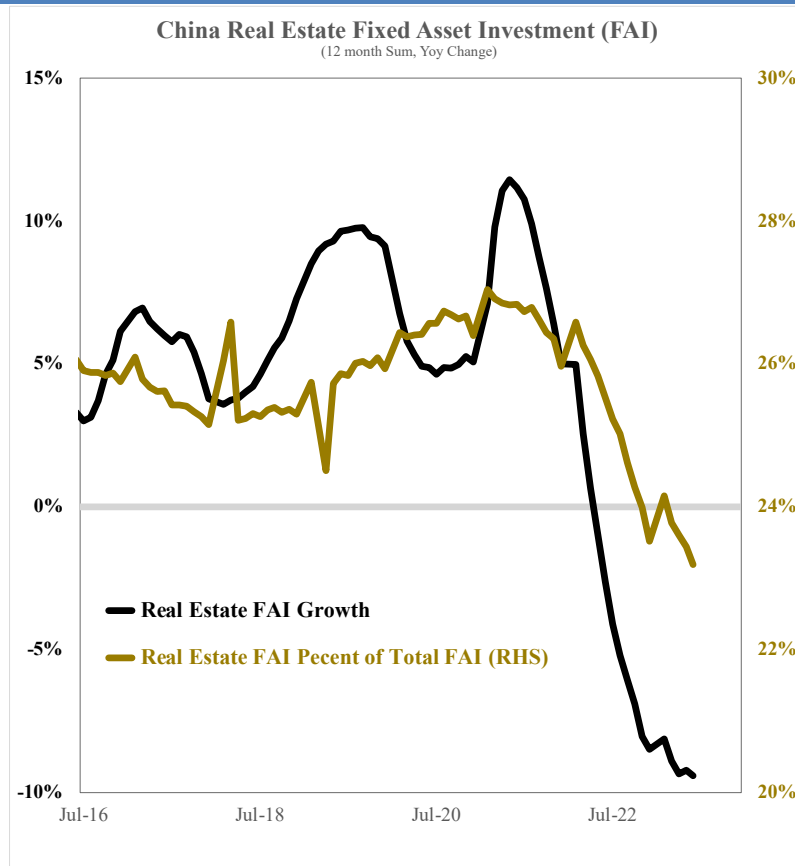
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Step 2: Fundamental Economic Framework

Weakness In Housing Combined With Headwinds For Developers Have Created A Bust In RE Investment

RE Investments Is Now Negative And A Drag on GDP...

Starts Have Fallen 40%, And Sales By 25%



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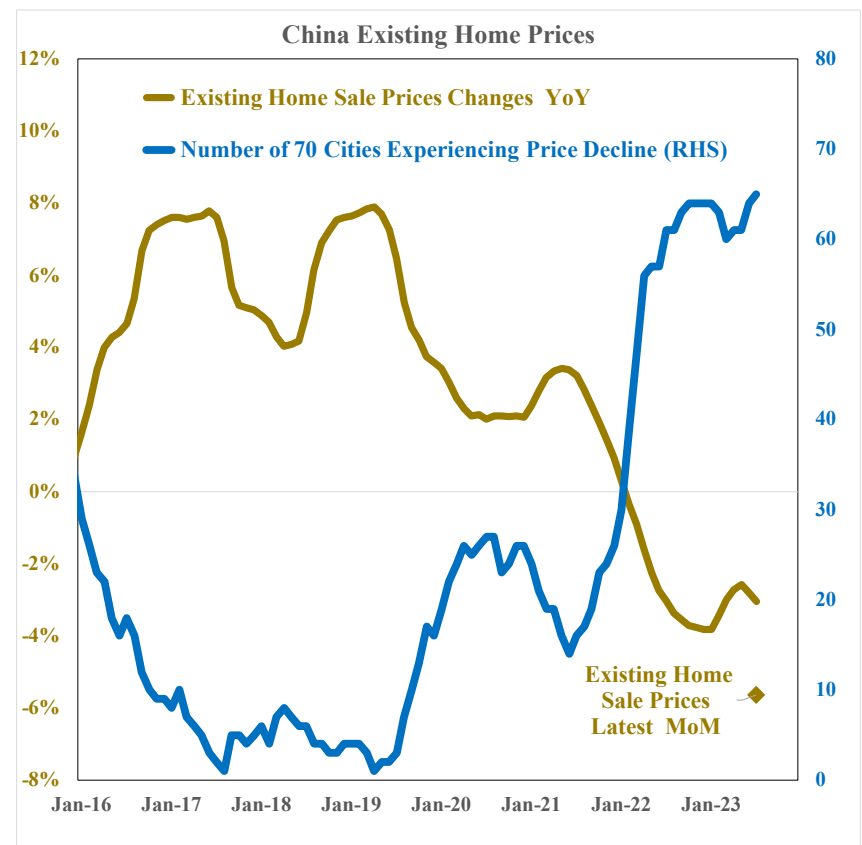
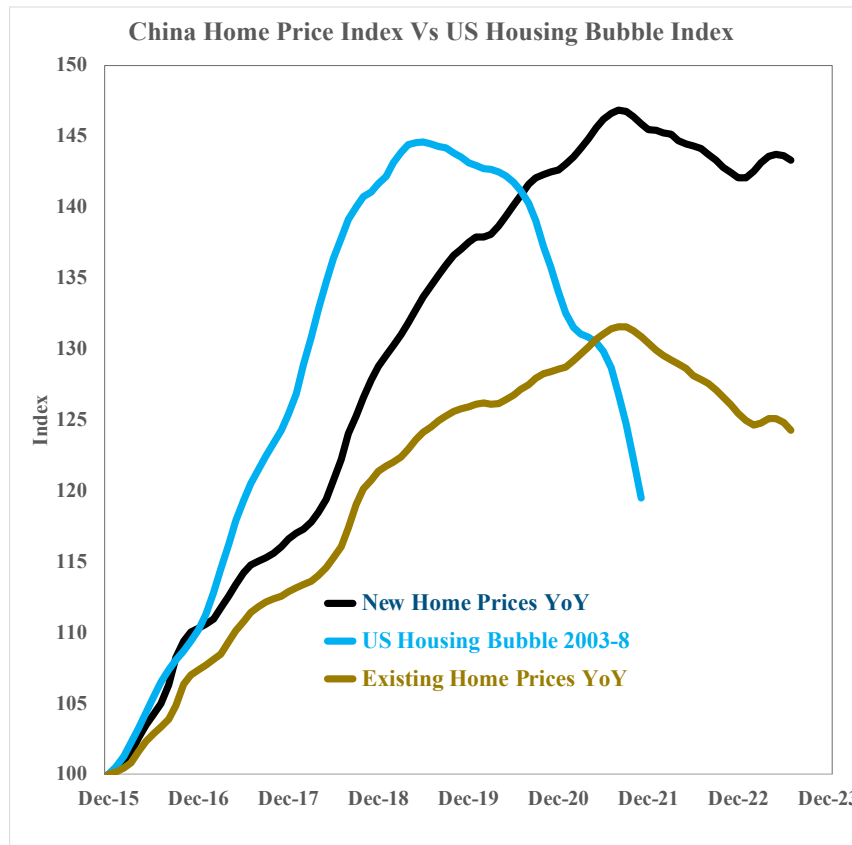
China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 2: Fundamental Economic Framework

Chinese Housing Prices Are At Bubble Levels And Are Starting To Fall

Chinese New Home Prices Are At US Bubble Peaks...

Prices Are Starting to Fall In Almost All the 70 Major Chinese Cities



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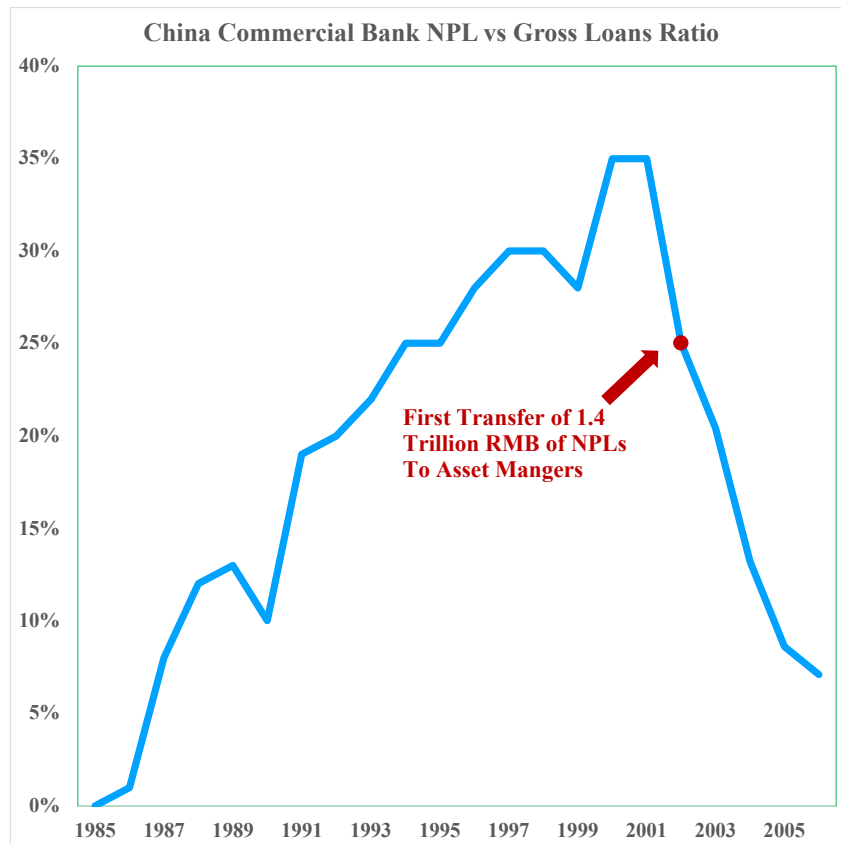
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Step 2: Fundamental Economic Framework

Bank Losses On Real Estate Loans Could Be Substantial if The Last China NPLs Cycle Is Any Gage

NPLs On Chinese Bank Grew to 35% of Loans

Losses Then And Losses Now Could Be Substantial



Sector	Loans Outstanding (RMB Billions)	NPLs Percent of Loans	NPLs	Value of Underlying Asset	Cash Recovery	Recovery Rate	Losses % of GDP
Big Four Banks 2001	6,600	42%	3,400	300	60	2%	34%
China Property Loans 2023	13,174	42%	5,533	487	98	2%	4%
China Mortgage Loans 2023	38,370	42%	16,115	1,418	284	2%	12%

1. Fung & Ma, "China's Asset Management Corporations", BIS Working Paper no 115, Dec 2005
2. Turner, tan and Sadeghian, "The Chinese Banking System", Reserve Bank of Australia, September 2012
3. Bloomberg

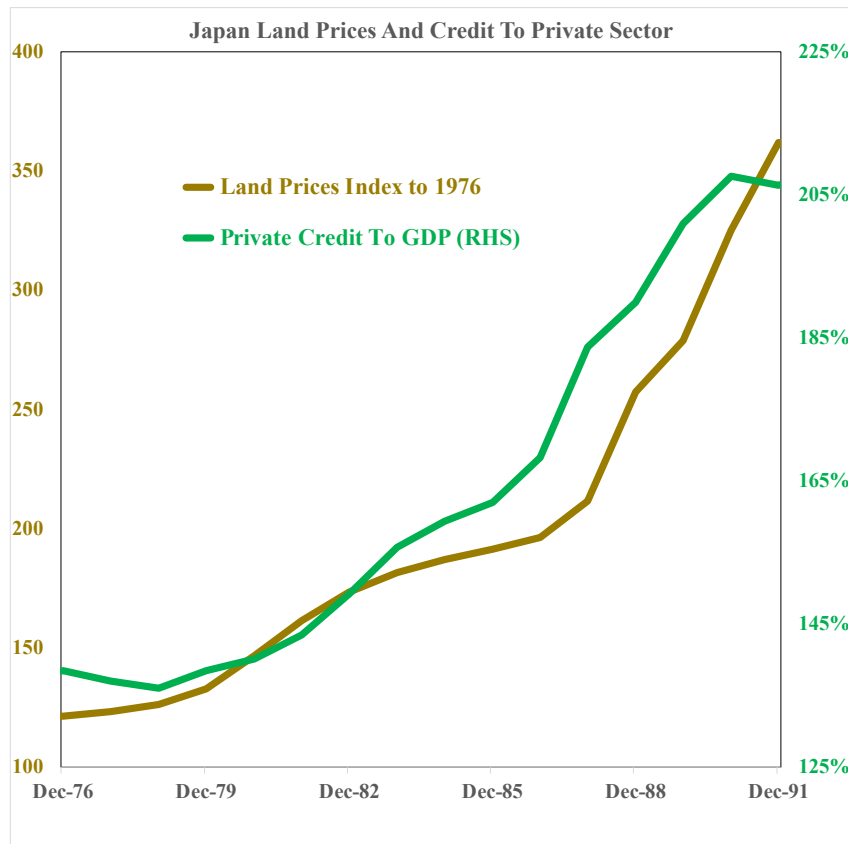
State Of the Markets: Best Long And Short Strategies 2023Q4

China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 2: Fundamental Economic Framework

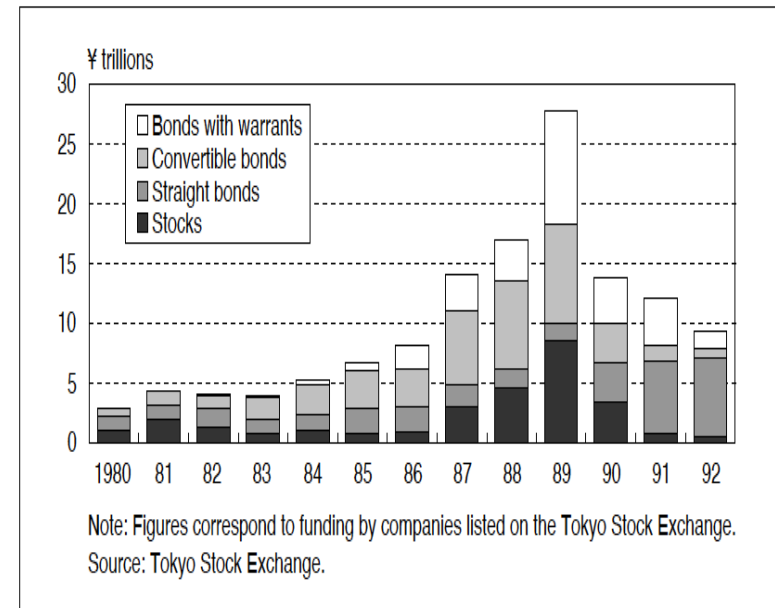
Before China, Japan Had A Property Bubble And Subsequent Bust

Japanese Land Prices Quadrupled Supported By Credit...



Credit Was The Primary Source Of Funding For Capital Markets

Figure 8 Fund-Raising In Capital Markets by the Private Sector



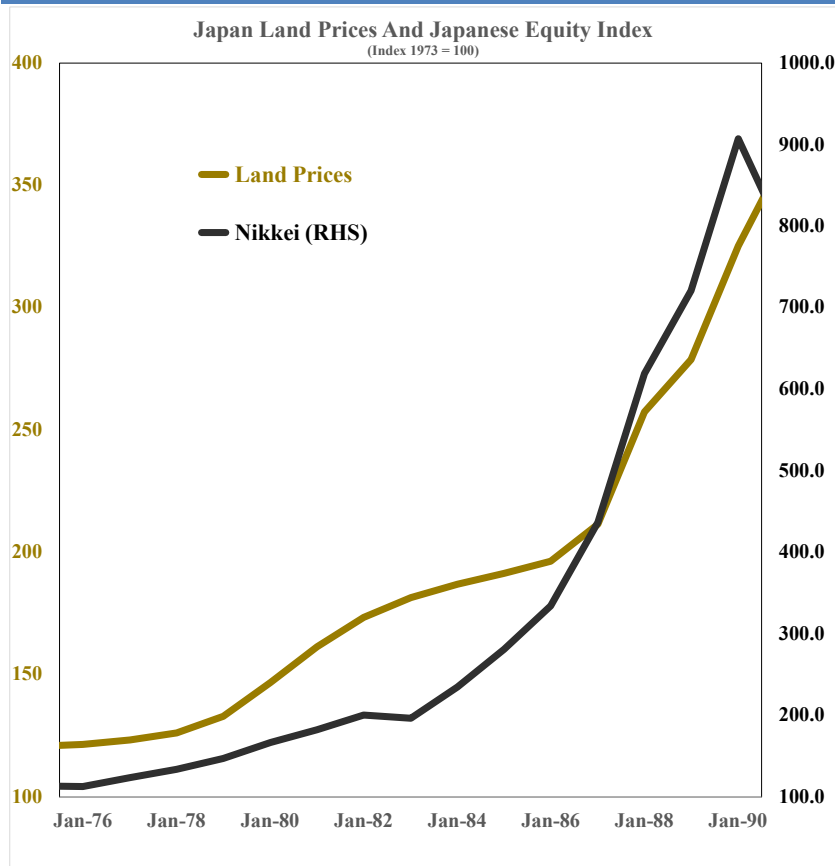
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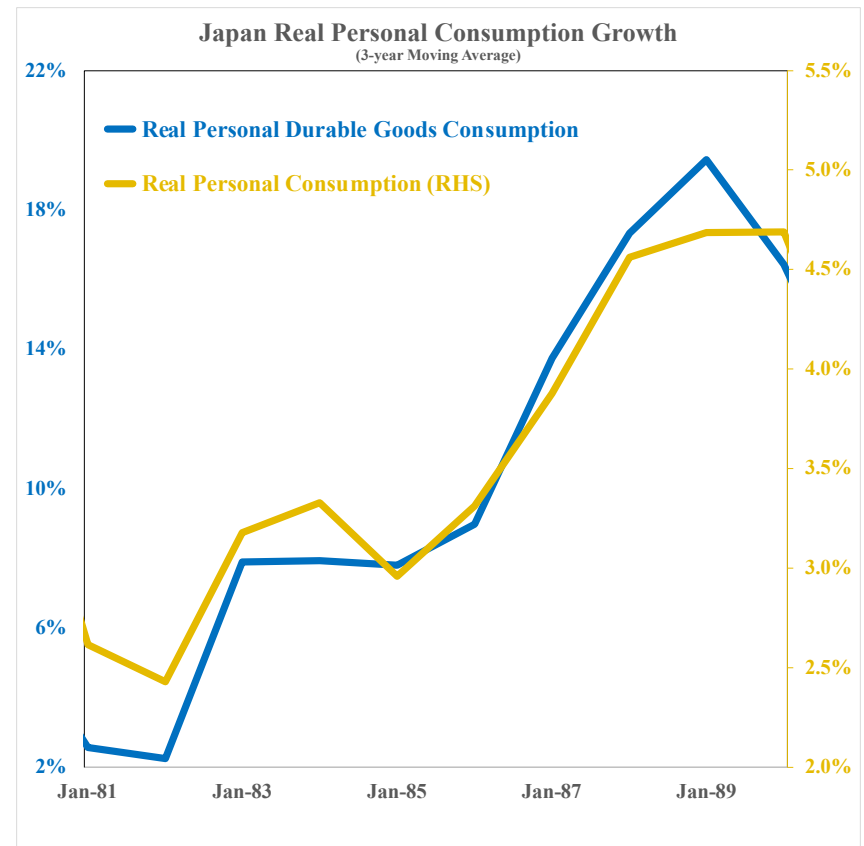
Step 2: Fundamental Economic Framework

Japanese Wealth Growth Led To Unustainable Levels of Consumption

All Assets Followed Land Prices Higher Creating Wealth That



Supported A Doubling In Real Personal Consumption



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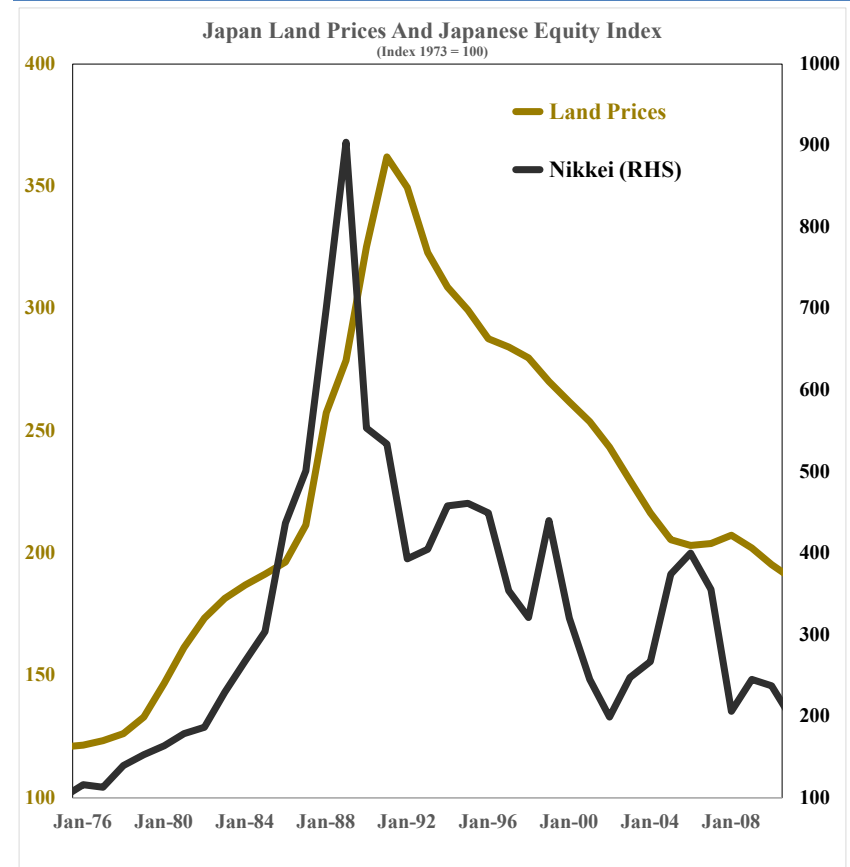
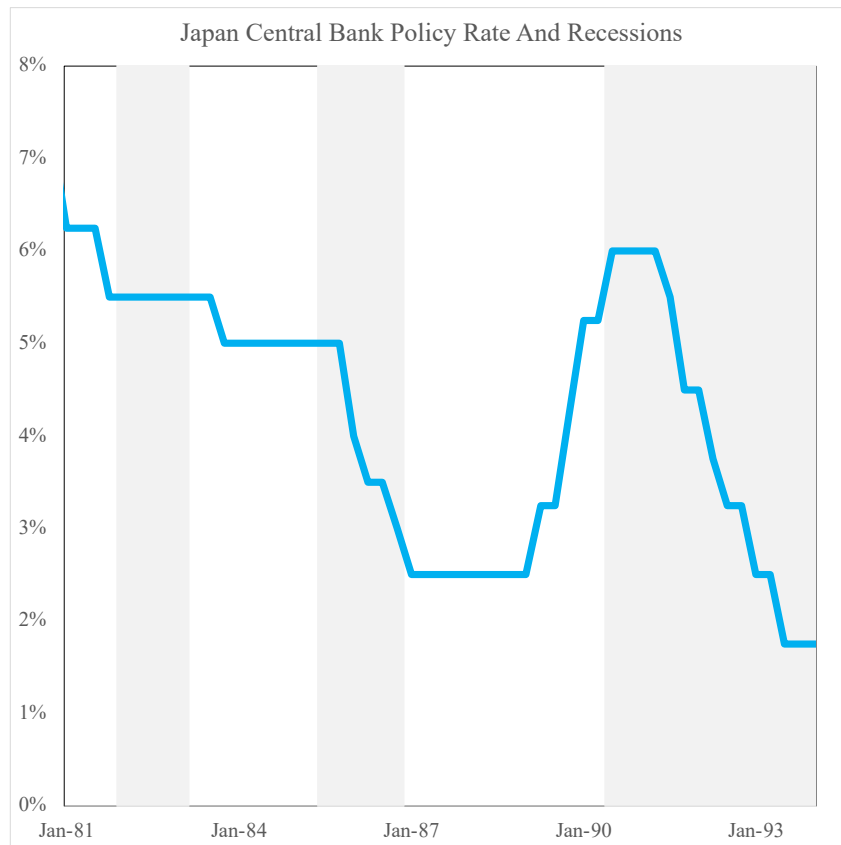
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Step 2: Fundamental Economic Framework

BOJ Popped the Asset Bubble With A Rapid Increase in Rates But BOJ Rate Cuts Could Not Stop the Bust

Policy Rates Reached Pre-Bubble Levels Then Were Cut As Fast,,,

Yet, Land And Asset Prices Continued Their Free Fall



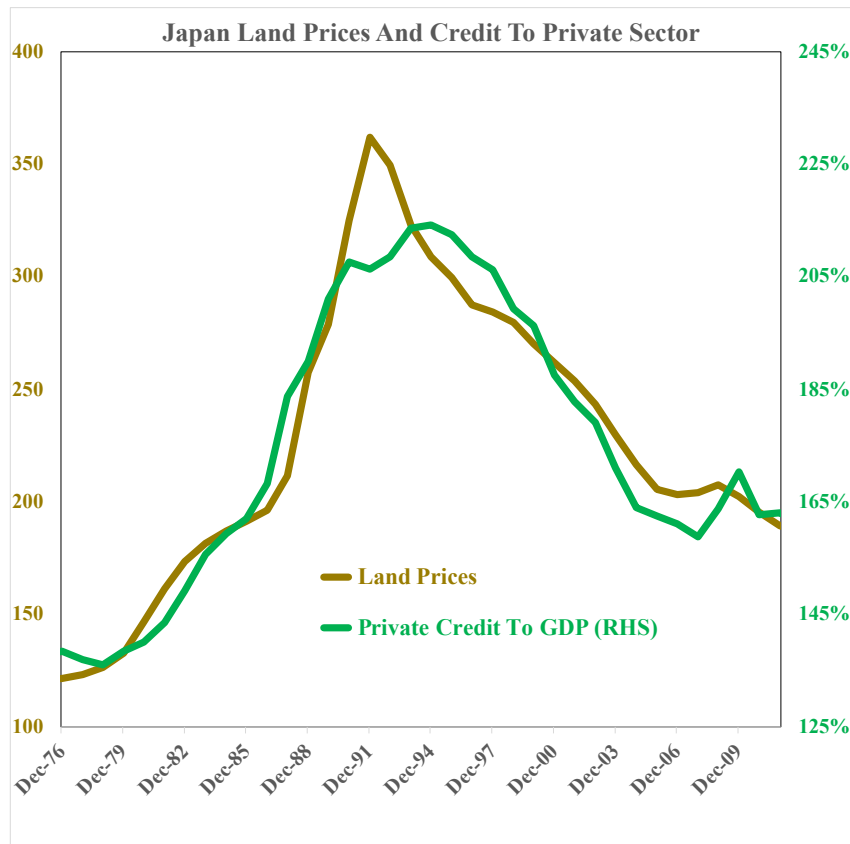
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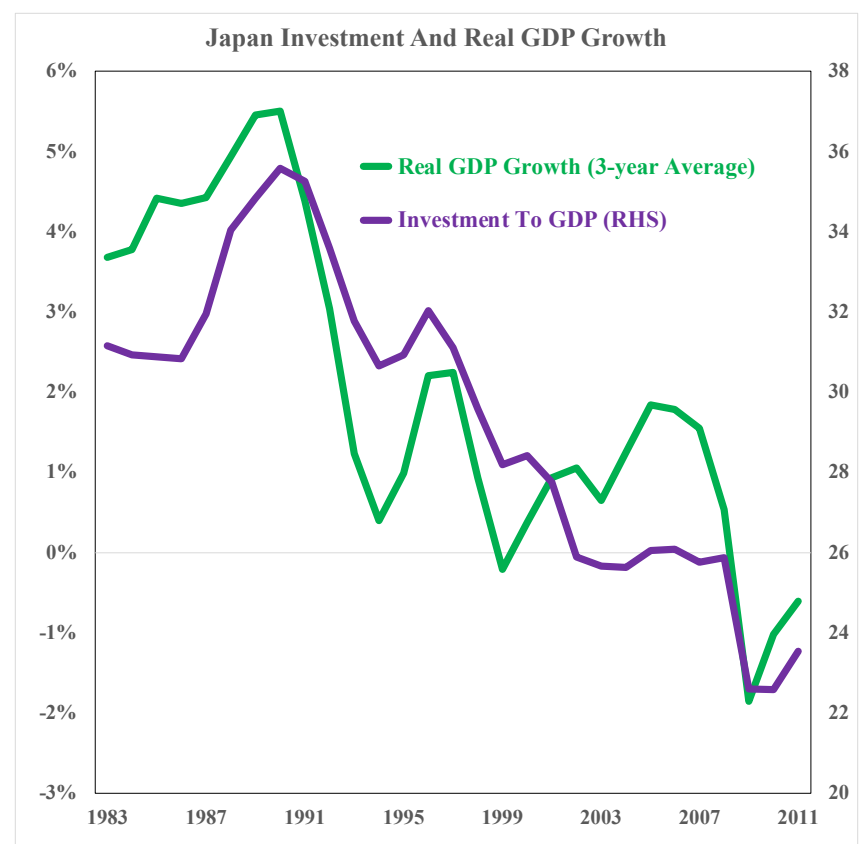
Step 2: Fundamental Economic Framework

The Japanese Economy Collapsed As Credit, Investment, And GDP Fell With Asset Prices

Credit Supply Fell With Asset Price Declines....



Without Credit, Investment Shrank Driving Down GDP



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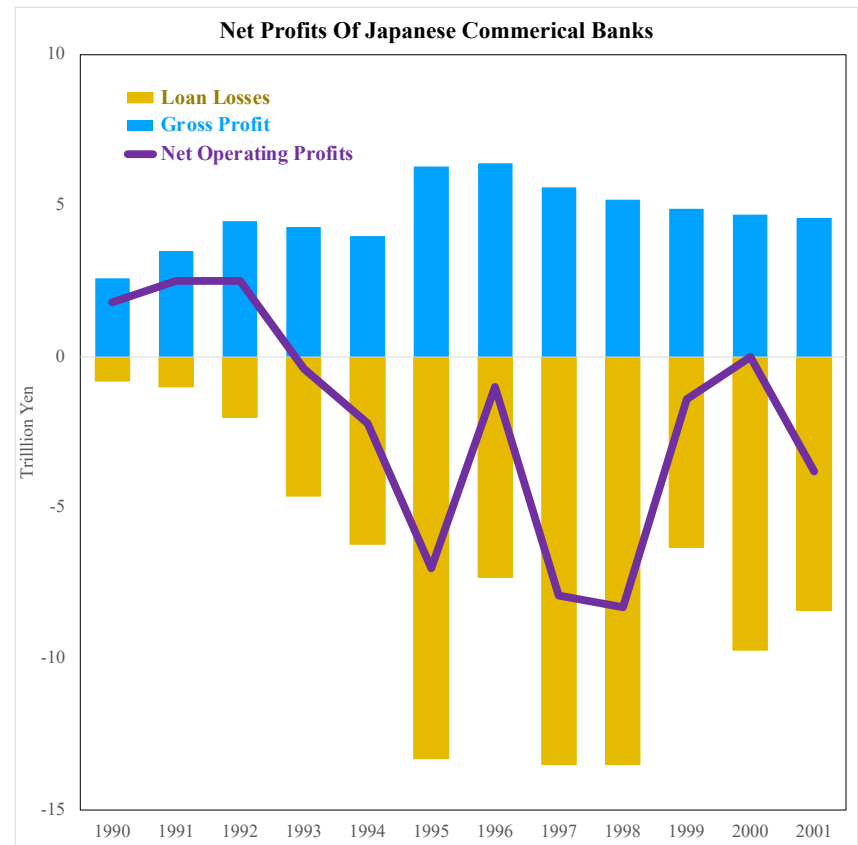
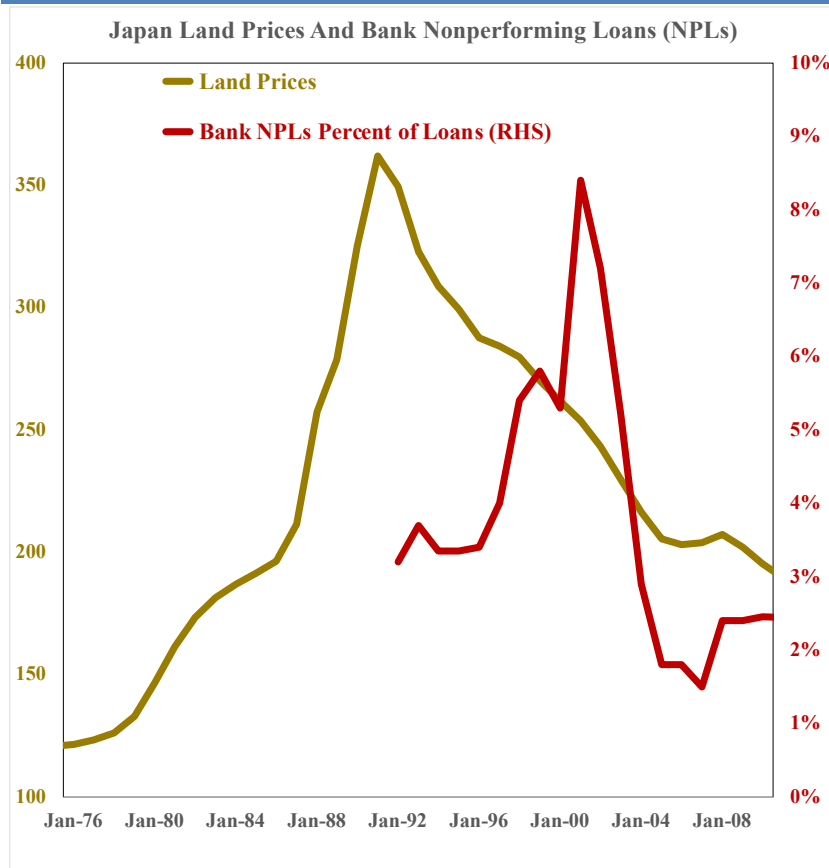
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Step 2: Fundamental Economic Framework

The Fall In Asset Prices Led To a Surge In Bank NPLs And Losses--“The Japanese Lost Decade”

Reported NPLs Grew Ultimately And Bank Recognized Bad Loans

Loan Losses Wiped Out 10 Years of Bank Profits



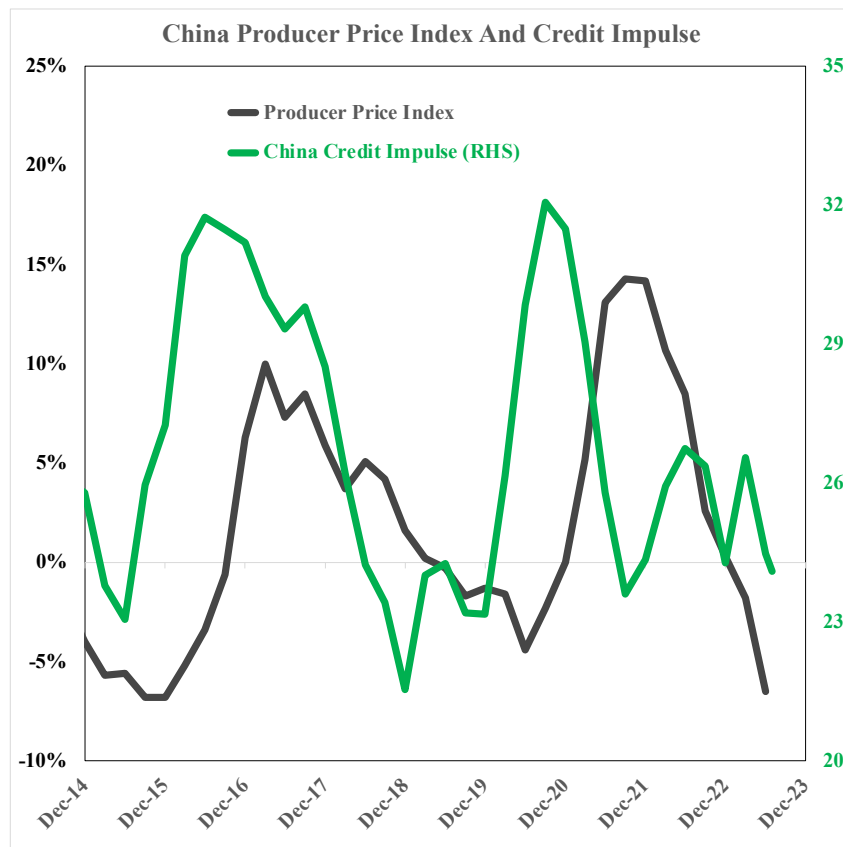
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Step 2: Fundamental Economic Framework

Deflation Is Evident In All Sectors of the Chinese Economy

Deflation to Some Degree Reflects The Lack Of A Credit Impulse



Export Prices Are Free Falling To Levels Not Seen Since The GFC



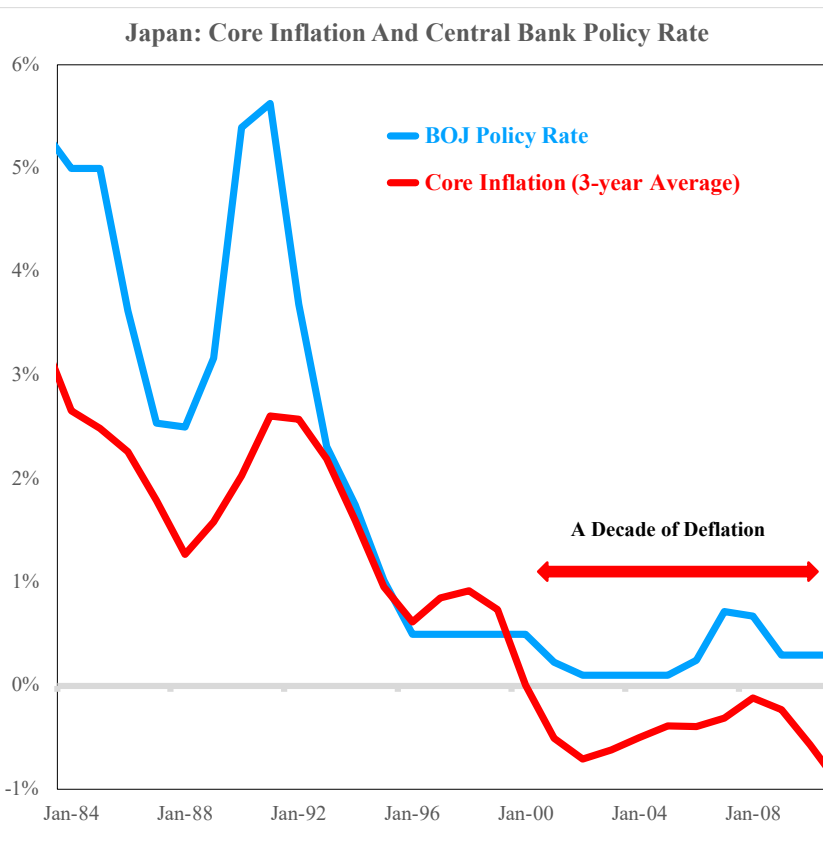
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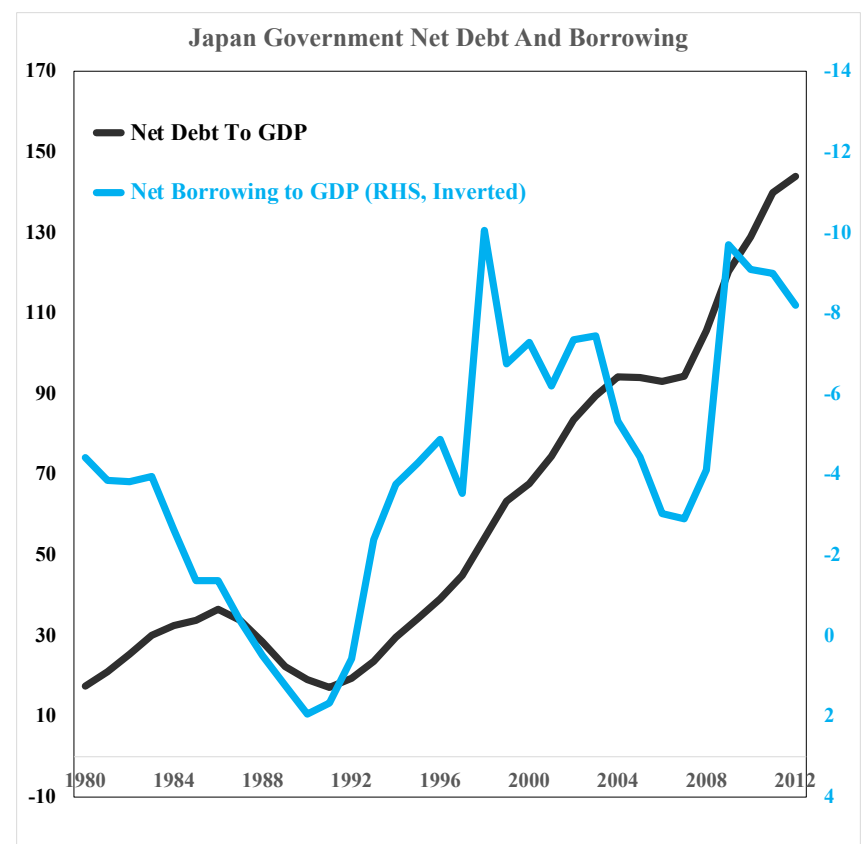
Step 2: Fundamental Economic Framework

China Faced Similar Pressures Which They Fought With Lower Rates And Government Spending

Demand Did Not Rebound Nor Inflation Even With Zero Rates



Government Failed to Push Up Inflation Even With More Spending



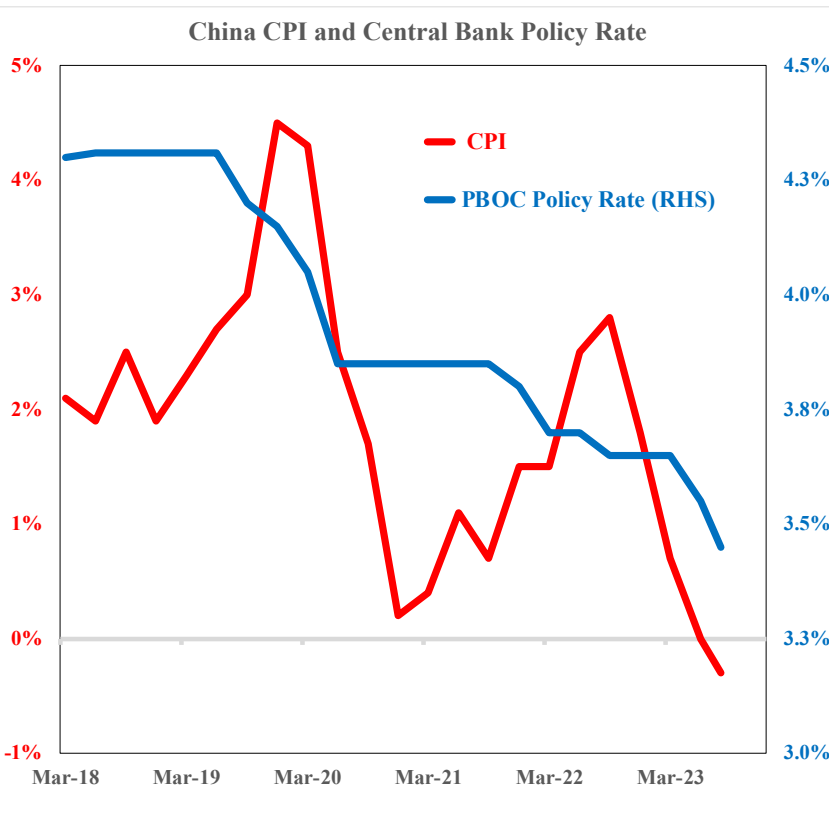
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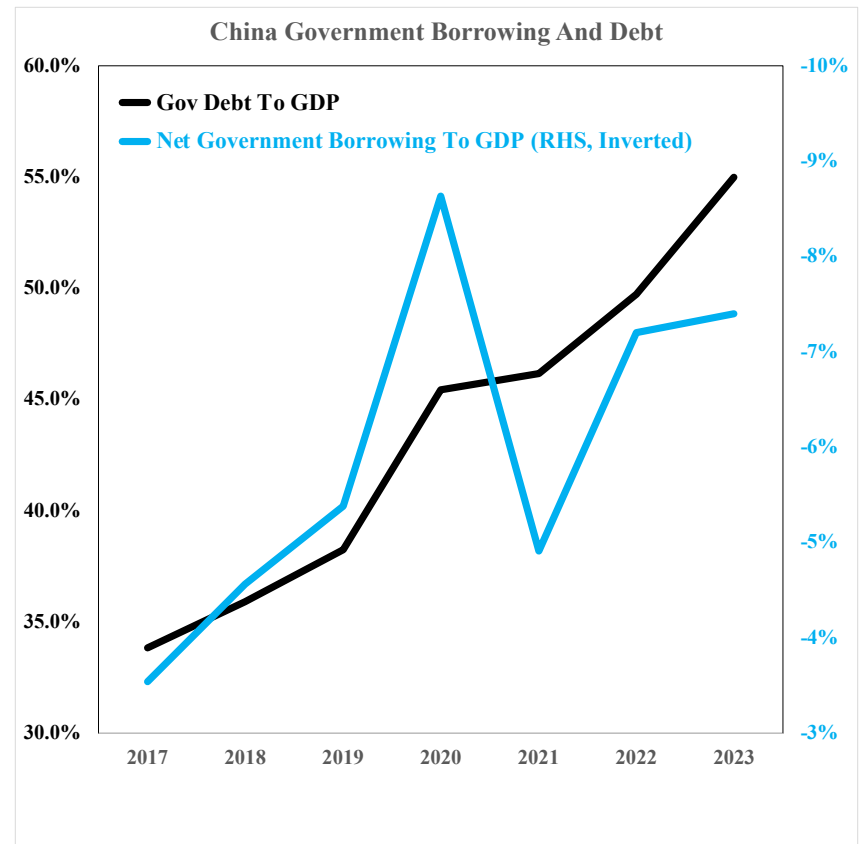
Step 2: Fundamental Economic Framework

China Seems to Headed In the Same Direction as Japan

Inflation Is Falling Even With Lower Policy Rates...



With Government Trying To Spur Growth With Spending



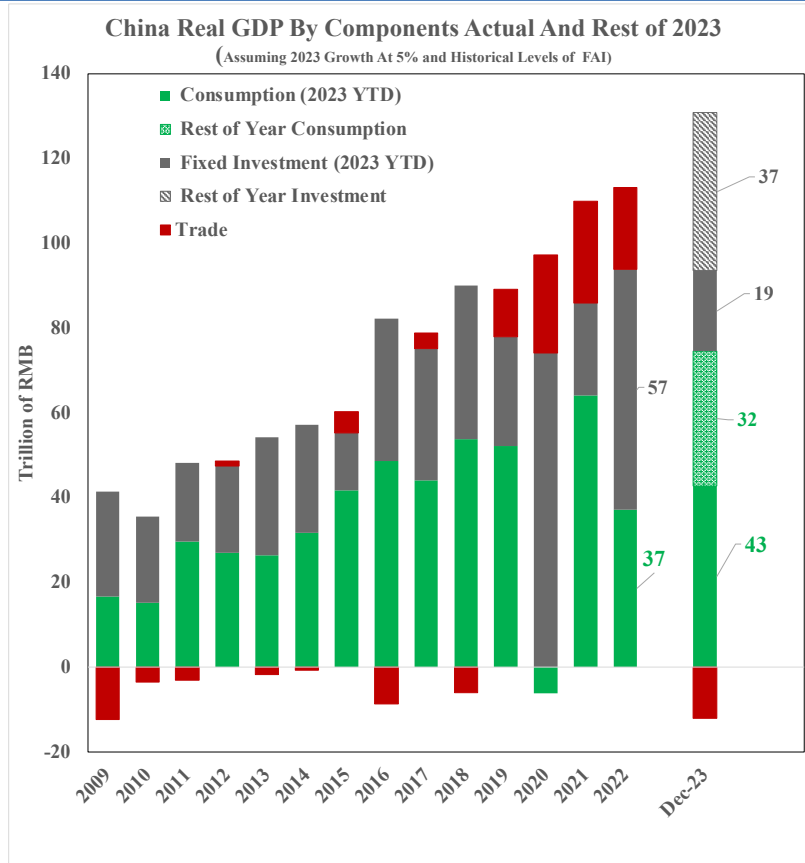
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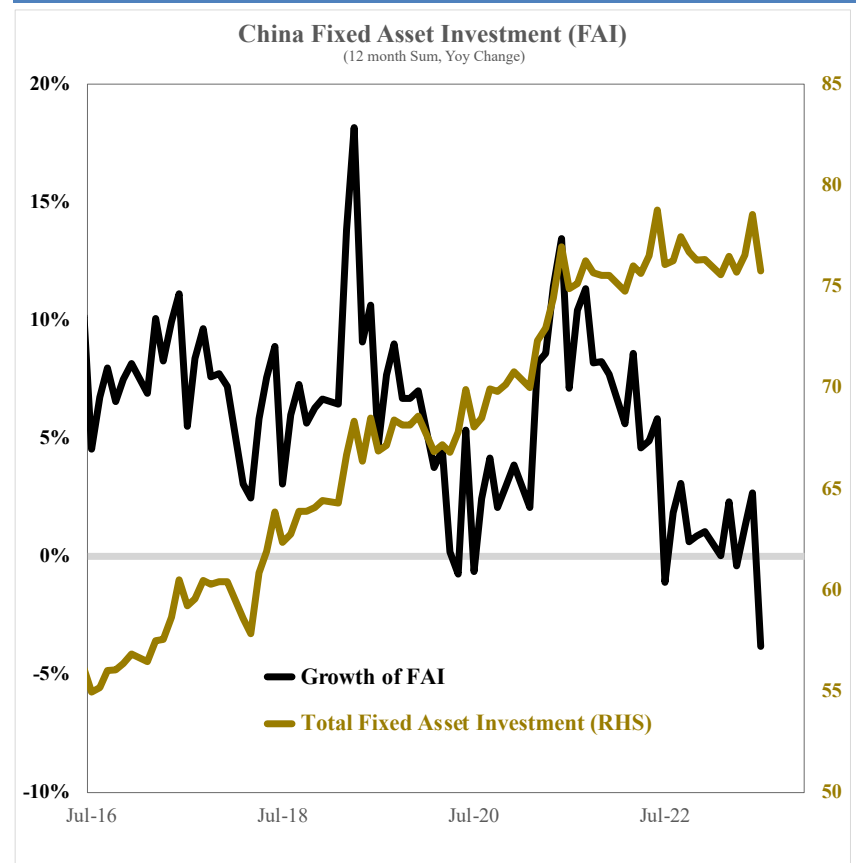
Step 2: Fundamental Economic Framework

A Rebound Of Investment To Spur Growth Seems Unlikely Given The Slowdown In FAI

Fixed Asset Investment Needs To Accelerated To Reach 5% Growth



FAI Has Flatlined the Last Two Years And Is Now Falling



1. Bloomberg
2. Author's scaling up 2023YTD to achieve 5% real growth

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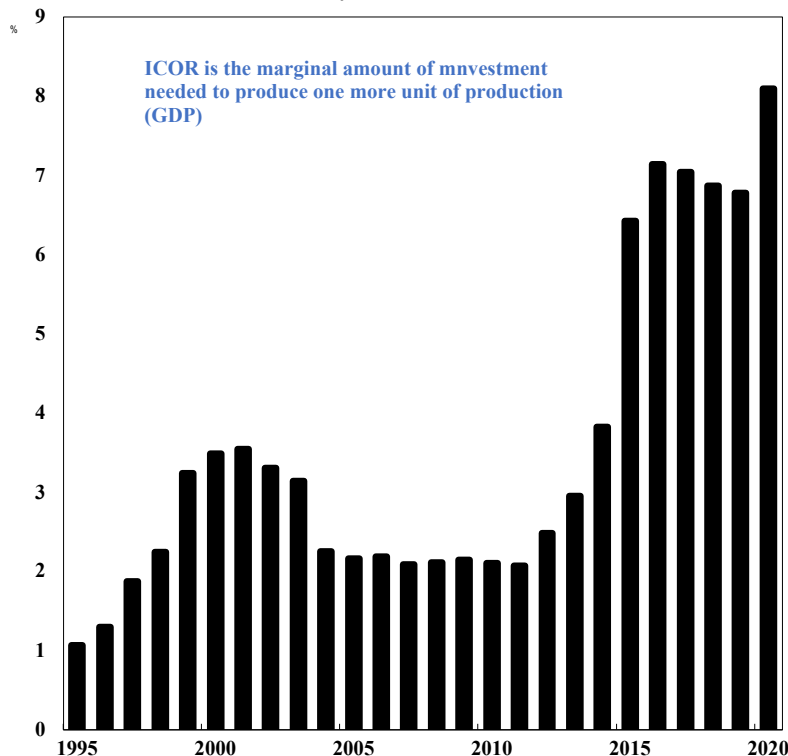
Step 2: Fundamental Economic Framework

Capital Investment And More Of It Is The Source of Growth In The Chinese Economy

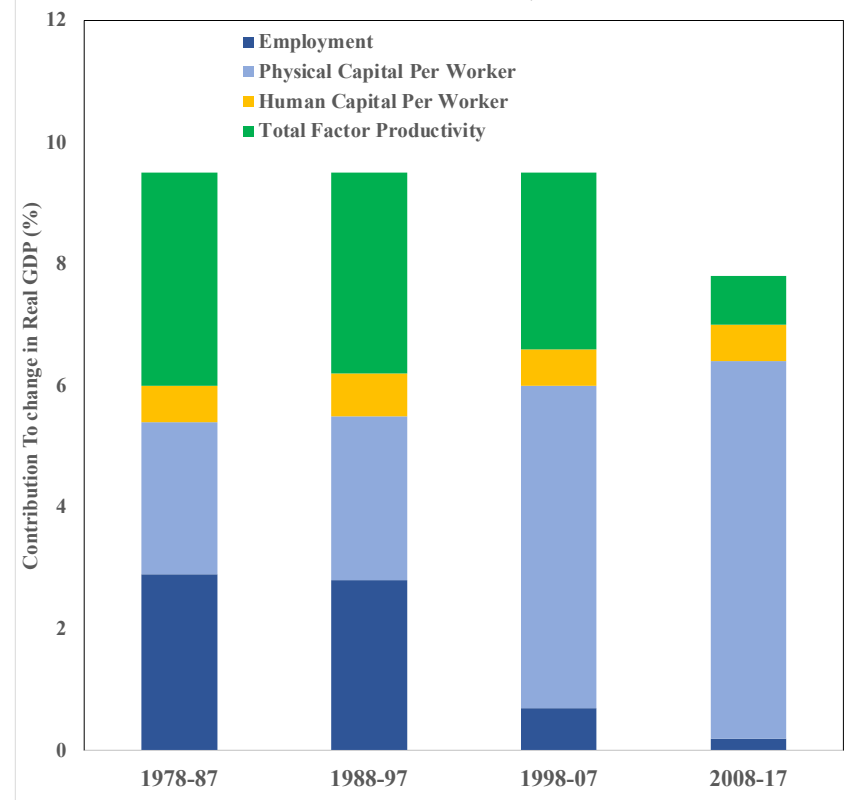
Growth Needs To Accelerate Given Low Output Per Unit of Capital

Chinese Growth = Capital Growth

China's Incremental Capital Output Ratio (ICOR)
5-year m.a.



Sources of Growth In China, 1978-2017



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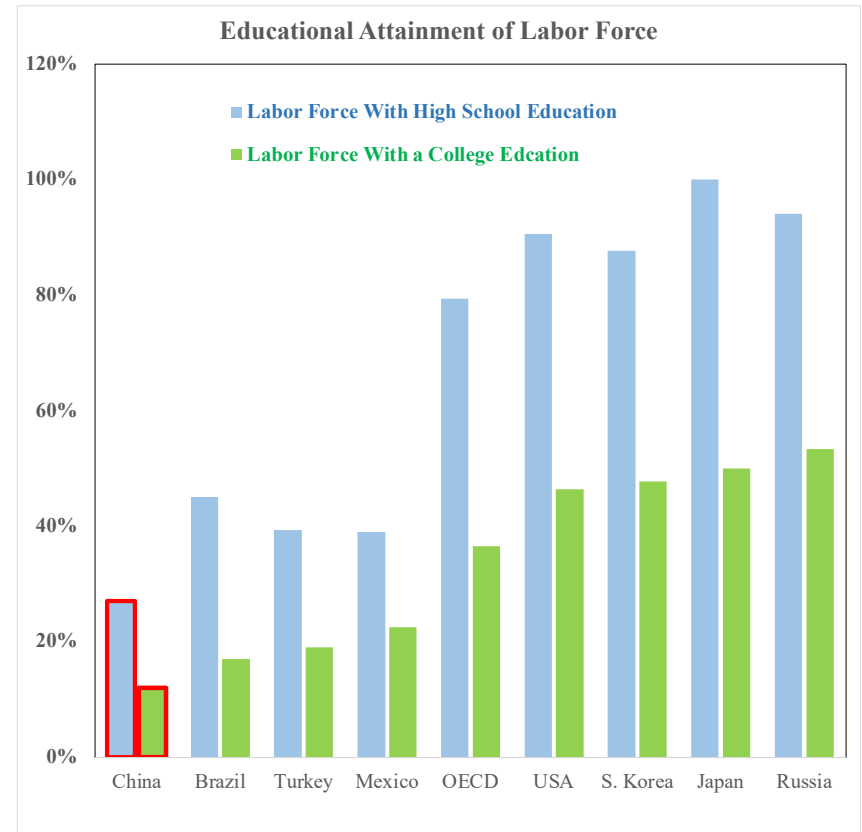
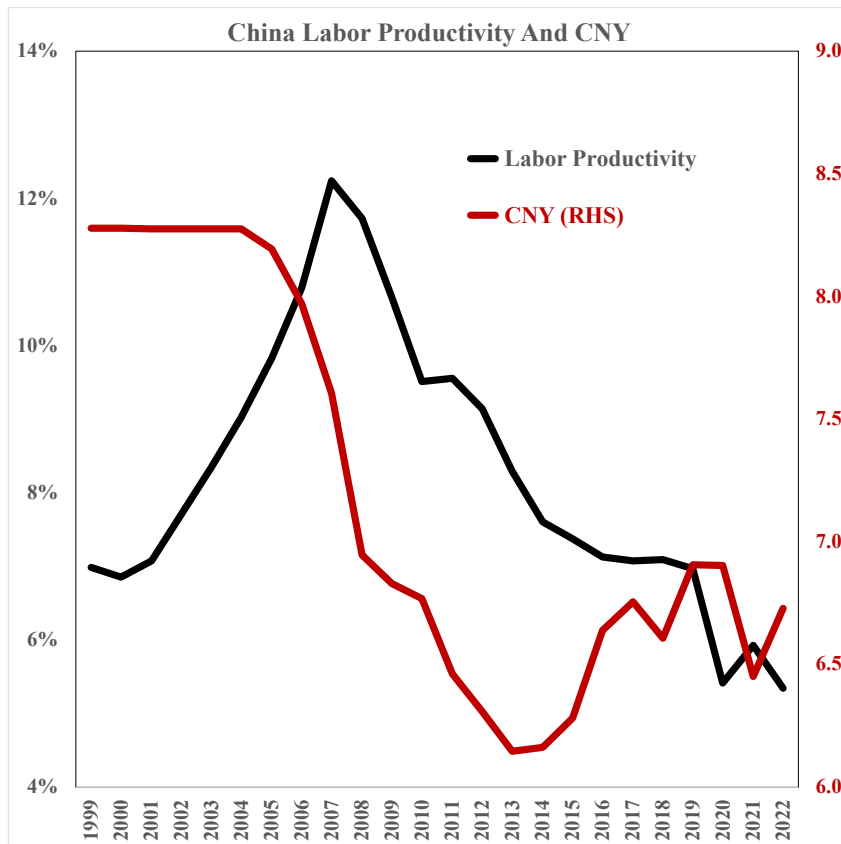
China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 2: Fundamental Economic Framework

Chinese Human Capital Still Lags Behind Other EMs Which Is A Headwind To Labor Productivity

Currency Appreciation Has Been A Headwind As Well

Their Labor Force Is Undereducated Vs Both EMs And DMs..



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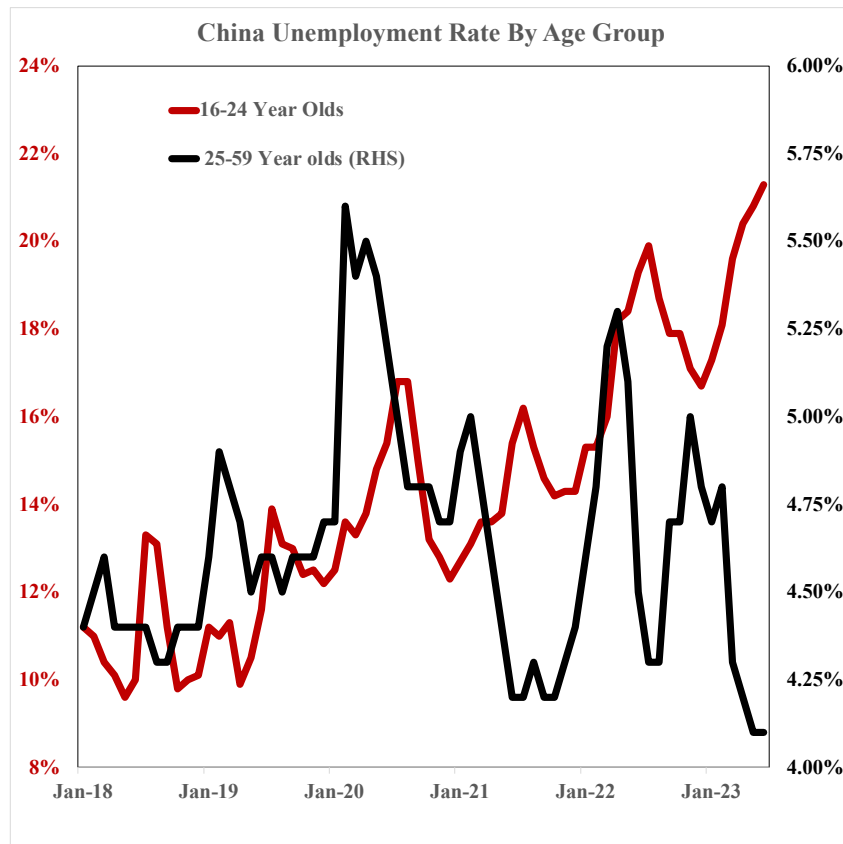
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Step 2: Fundamental Economic Framework

Pressure Points Are Growing On the Government to Do Something

Job Shortage For Younger Age Group Has Grown....

Potentially Over 100 MM Young Chinese Do Not Have Job



China 15-24 Age Cohort (MM)						
USA Labor Force	Cohort Size	Out of Labor Force (A)	In the Labor Force (B)	Unemployed (A + B)	No Jobs (A + B)	Rate of No Job/ Cohort
167	161	84	77	16	100	62%

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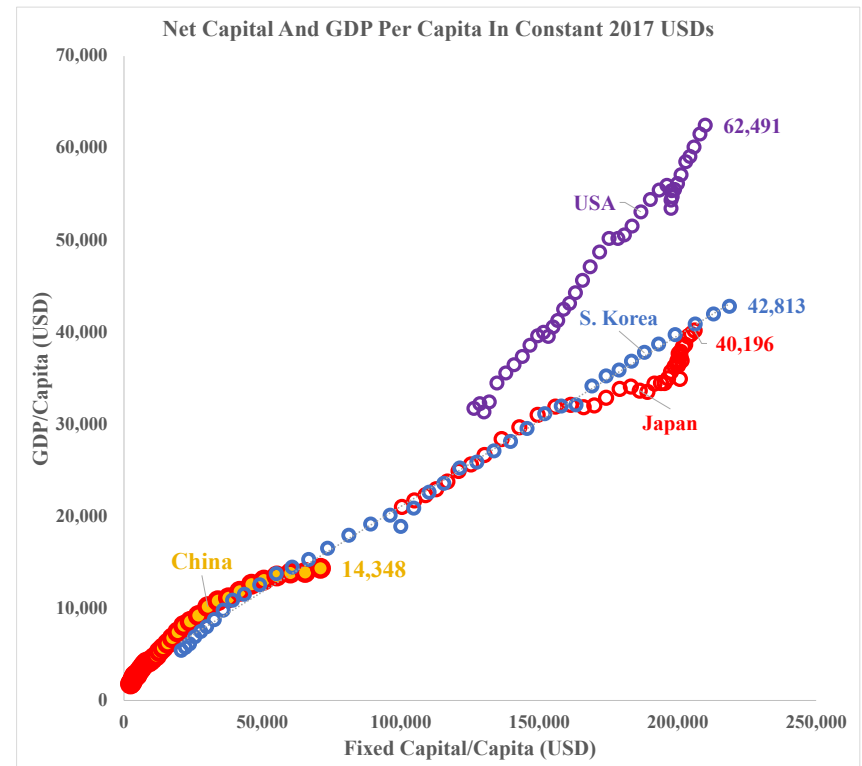
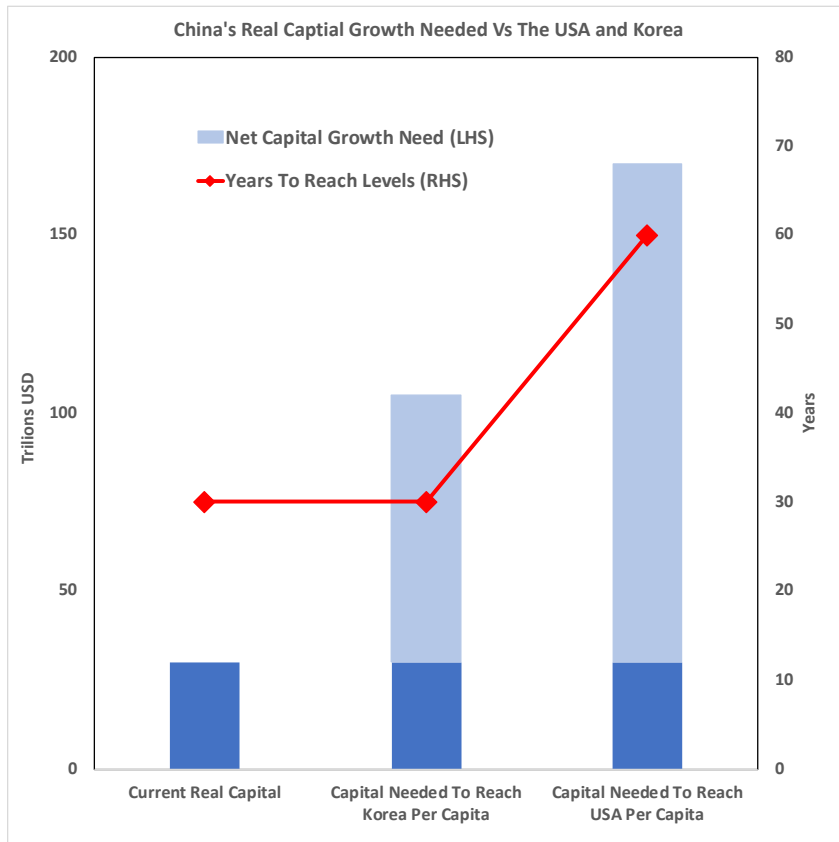
China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 2: Fundamental Economic Framework

And There Continues To Be Pressure To Invest All Of Their Savings To Continue Grow

China Needs 30 Years of Current Investment to Reach Korea

Chinese Capital Stock Is Still Less than 1/3 of South Korea



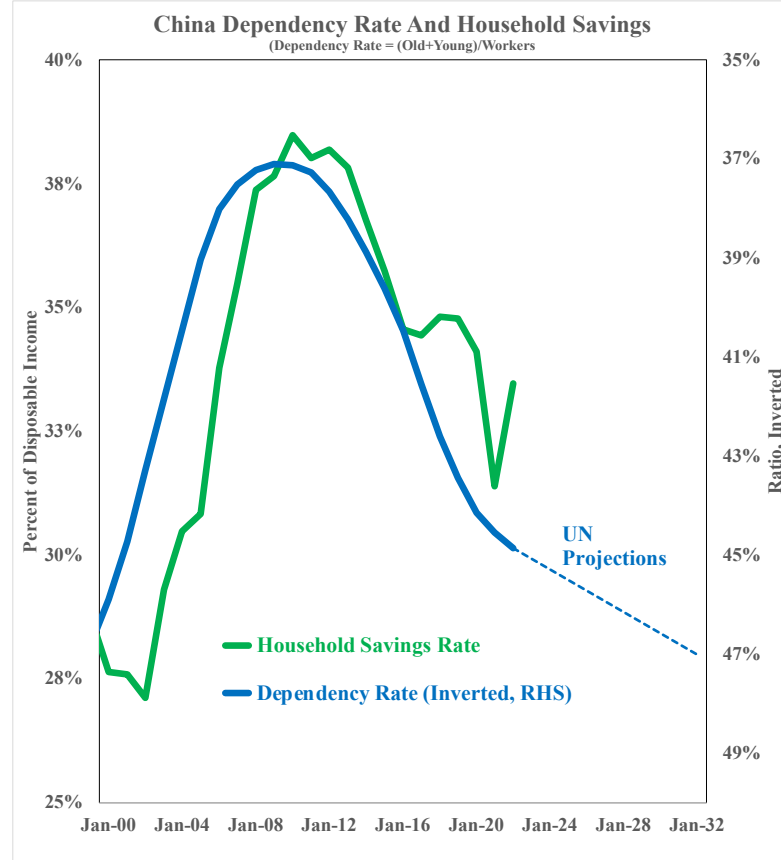
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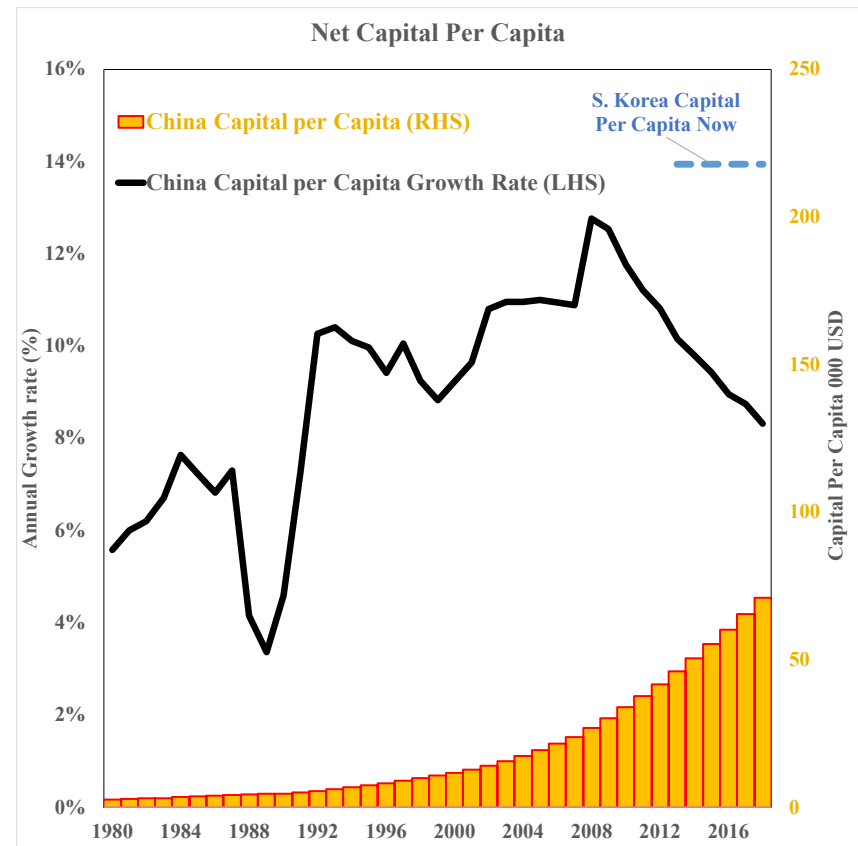
Step 2: Fundamental Economic Framework

Even Current Investment Levels Are Not Enough And Funding Will Be Tight Because of Demographics

Chinese Demographics Is Push Down Savings Over Time



Historical Investment Is Not Enough, Given Depreciation



1. World Bank Database
2. OECD China Economic Survey 2022

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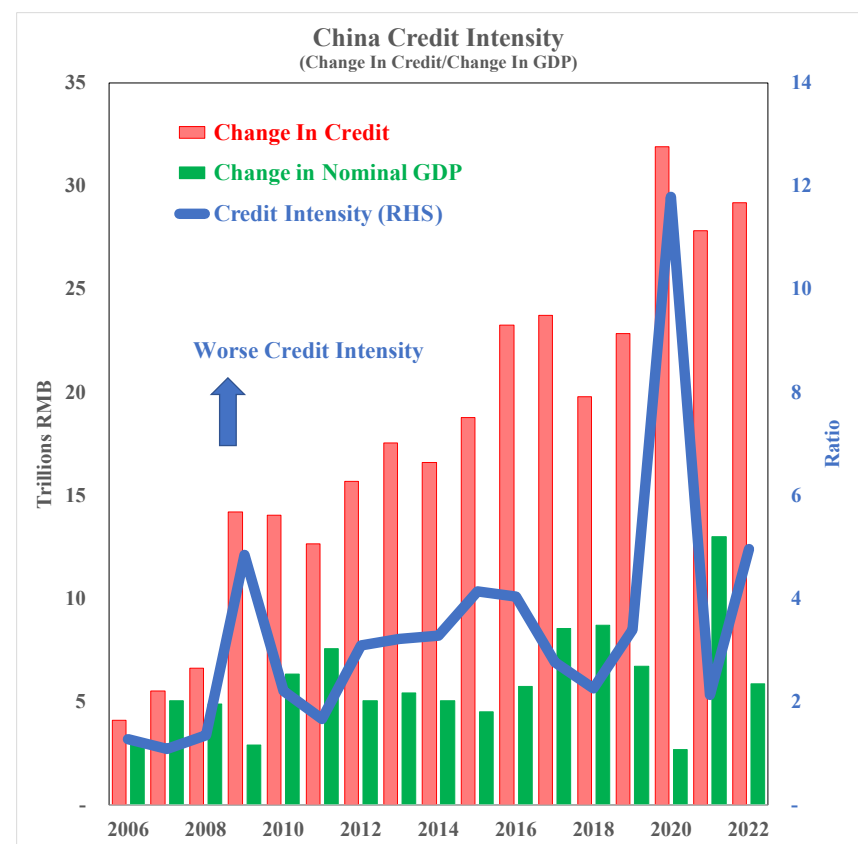
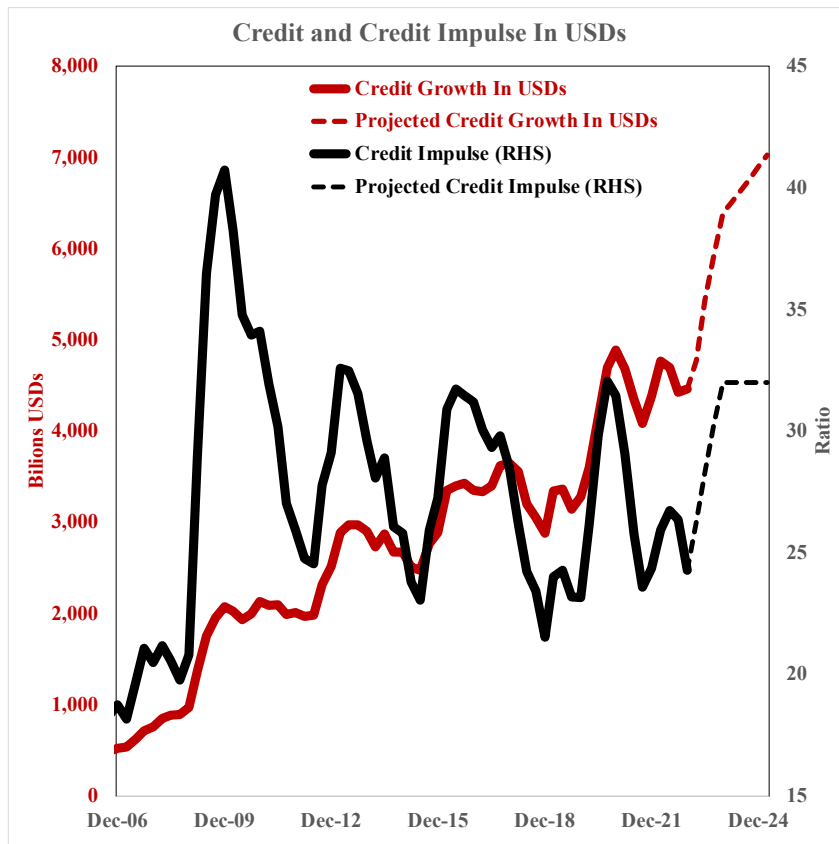
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Step 3: Identify Potential Catalysts

Another Credit Impulse Is Not An Option. It Would Dwarf Historical Levels Given Growth Of China

However, Even A Normal Impulse Would Be Massive in USDs

Even More Credit Growth Is Now Necessary To Spur Growth



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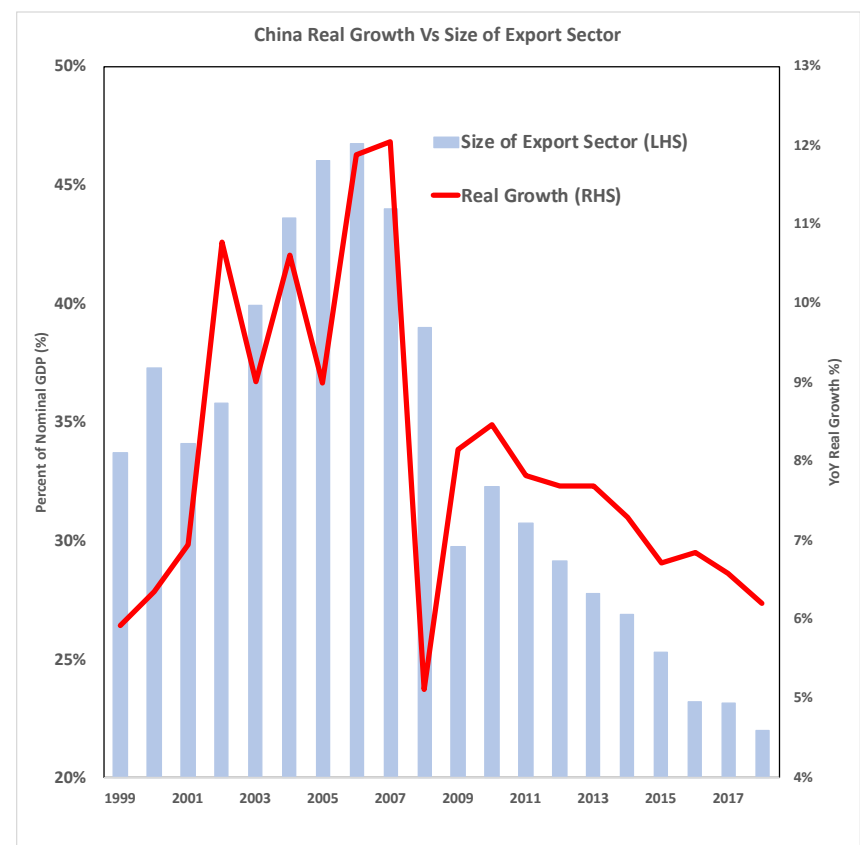
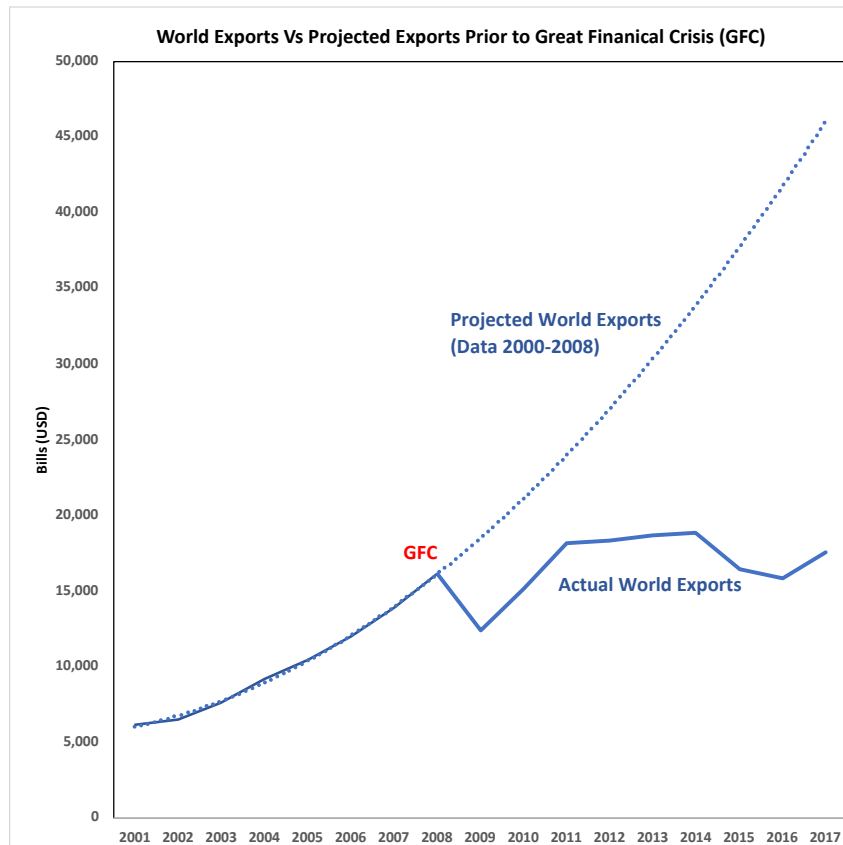
China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 3: Identify Potential Catalysts

So, What Will They Do? The Only Path Is To Go Back To The Trade Model For Growth, But How?

The GFC Put An End To the Trade Cycle For China^{1,2}

The End of The Trade Pushed Growth To A Lower Trajectory³



1.. IMF Direction of Trade
 2. Author's calculation based on exponential regression of export data prior to 2008
 3. Bloomberg

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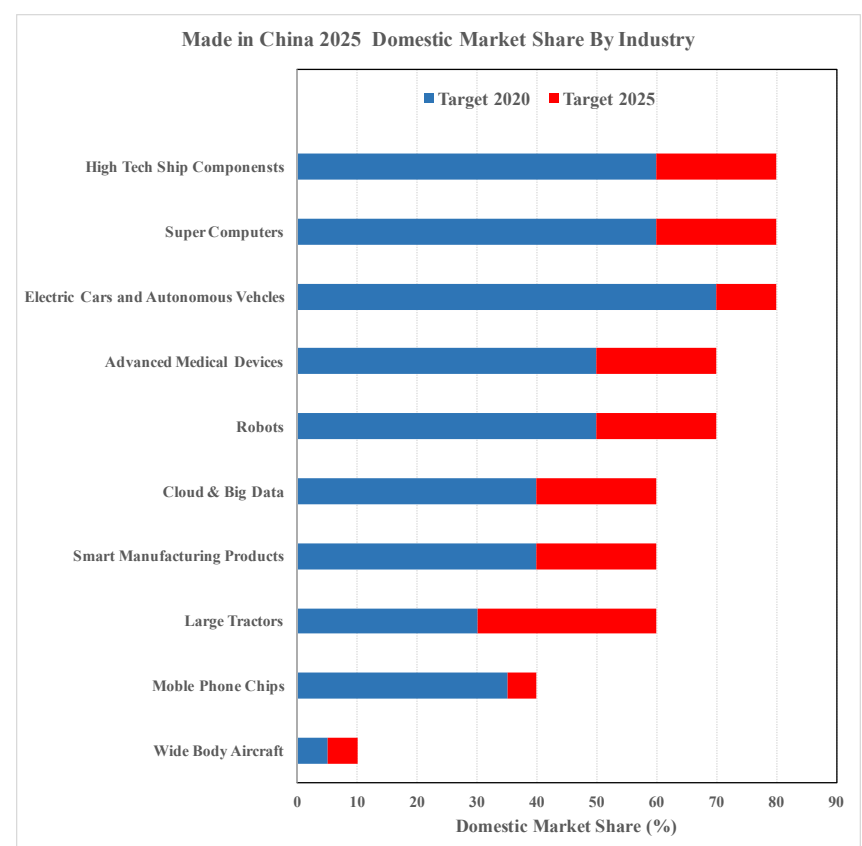
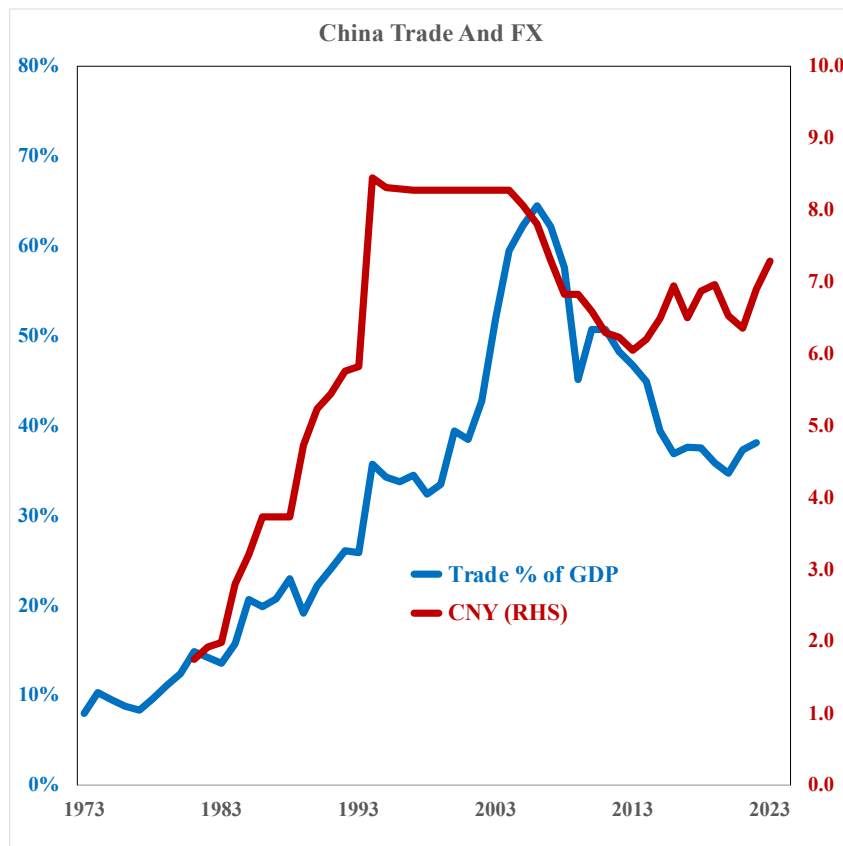
China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 3: Identify Potential Catalysts

Depreciating the RMB, Can Unlock Trade Model Using The Products From "Made in China 2025"

Goal : 70% of Core Materials Produced in China by 2025

Made In China Will Be Supported By A Every Area of Their Society



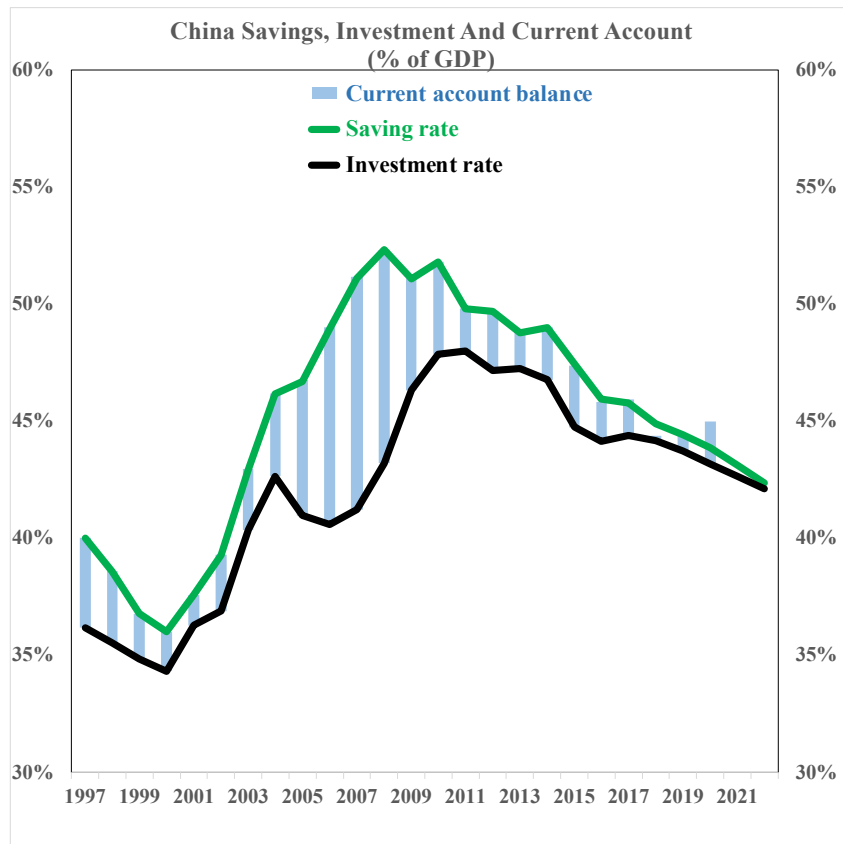
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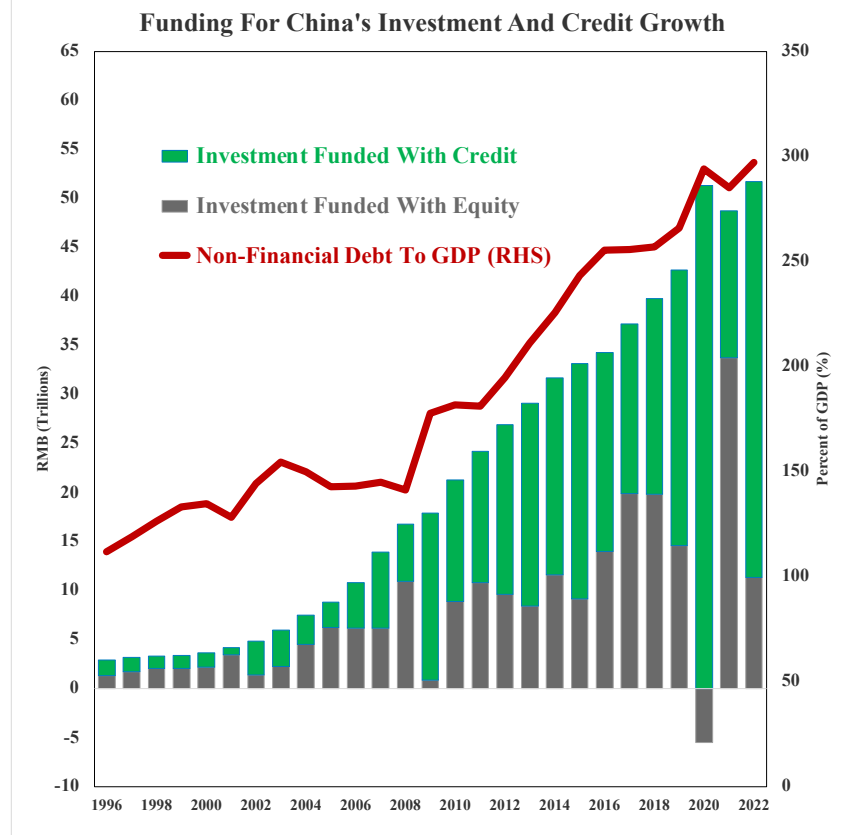
Step 3: Identify Potential Catalysts

The Trade Model Created Sources Cash To Support Investment

Current Account Reached Almost 10% of GDP



After The GFC, Investment Needed Increasing Amount Of Credit



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China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 3: Identify Potential Catalysts

China Has Supported The Development of the "2025" Products

Selected Government Funds to Support Strategic Sectors¹

State Funding For Chinese Tech Suppliers is Substantial²

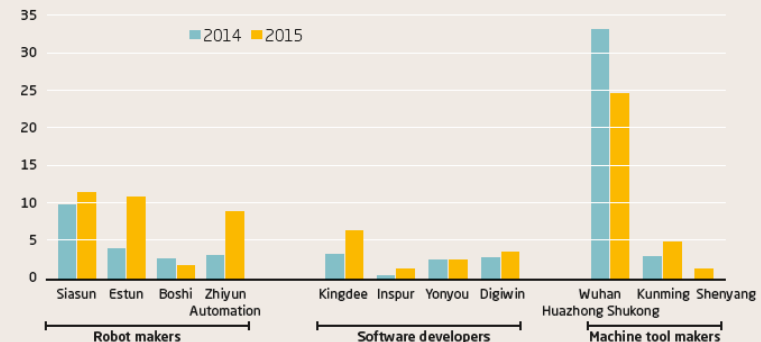
Table 2: Select Government Funds to Support Strategic Sectors since 2014

Fund	Date Announced	Amount (billions)
National Integrated Circuit Fund	June 2014	\$107.5 (RMB 720)
Emerging Industries Investment Fund	January 2015	\$6 (RMB 40)
Advanced Manufacturing Fund	June 2016	\$3 (RMB 20)
Venture capital fund for state-owned enterprise innovative technology and industrial upgrading fund	August 2016	\$30 (RMB 200)
China Development Bank support for Made in China 2025	November 2016	\$44.8 (RMB 300)
China Internet Investment Fund	January 2017	\$14.9 (RMB 100)
Credit lines for China Internet Investment Fund participants	January 2017	\$22.4 (RMB 150)
State-owned enterprise fund for strategic sectors	May 2017	\$22.4 (RMB 150)
TOTAL		\$250.7 (RMB 1,680)

Source: Various.³⁶

China's tech suppliers receive generous subsidies

Size of reported government subsidies as percentage of total operational revenue in selected enterprises for robotics, industrial software and digitised machine tools



Source: MERICS calculation based on various enterprise reports

© MERICS

1. "U.S. – China Economic And Security Review Commission", 2017 Report To Congress

2. "Made In China 2025, The making of a high-tech superpower and consequences for industrial countries", MERIC Papers on China, December 2016

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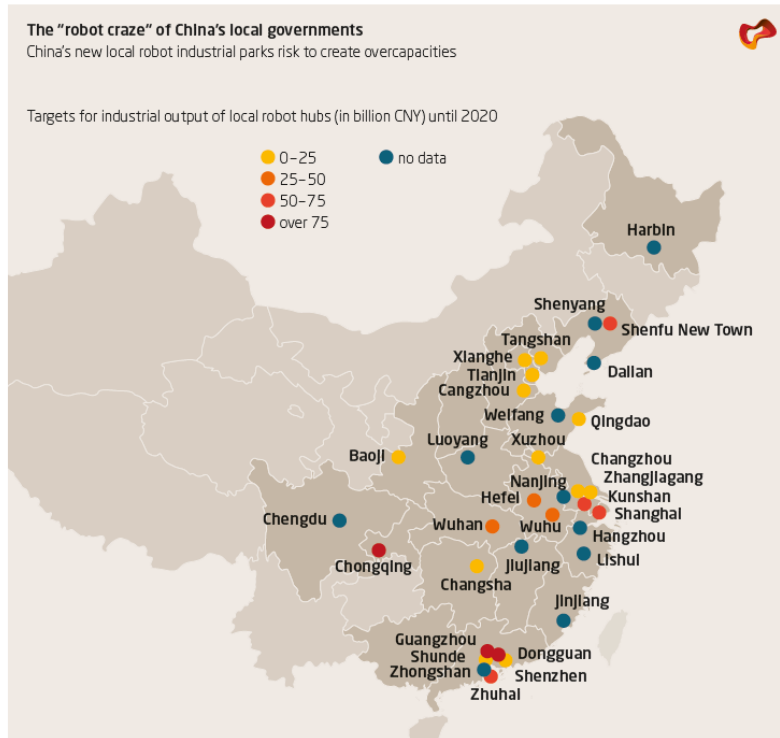
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Step 3: Identify Potential Catalysts

One Outcome of the "Made in China 2025" Is China Exporting Robotics to The World

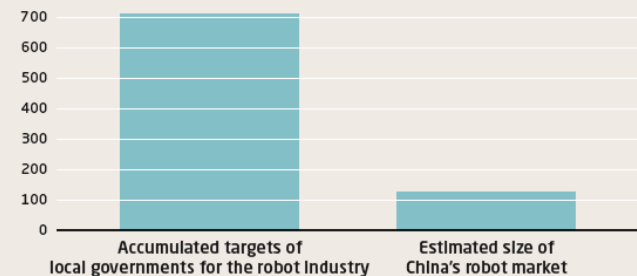
Robotics Production Capacity In China Will Grow Substantially

Planned Capacity Growth Dwarfs Growth in Chinese Demand



More robots than needed

Local targets for robot industry exceeds actual demand (in billion CNY) until 2020



Source: MERICS research, MIIT

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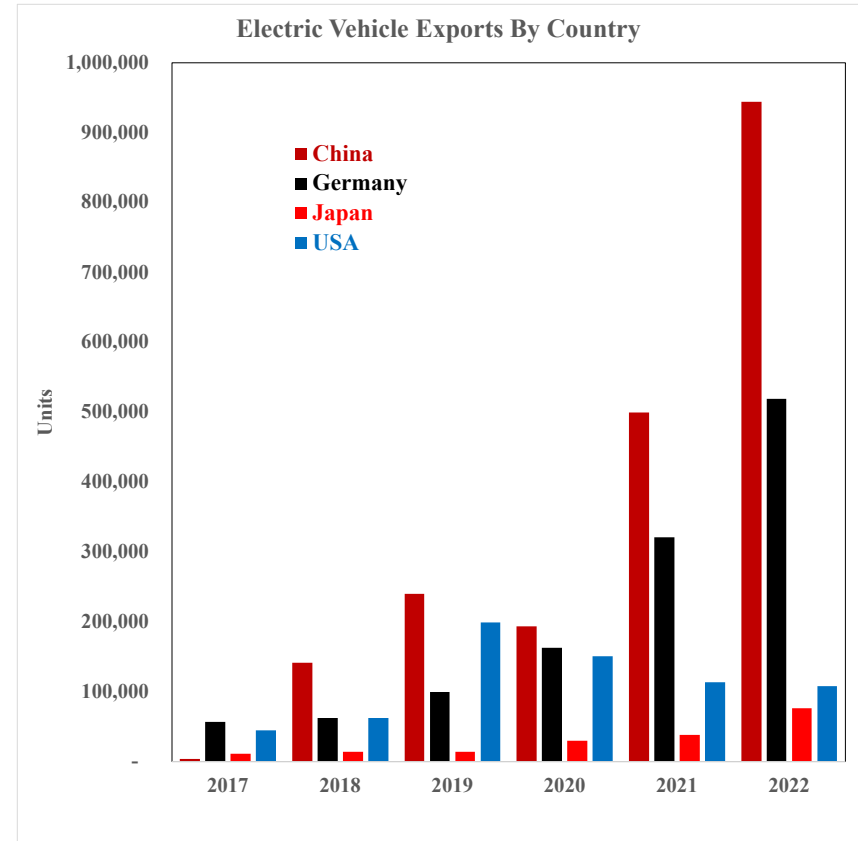
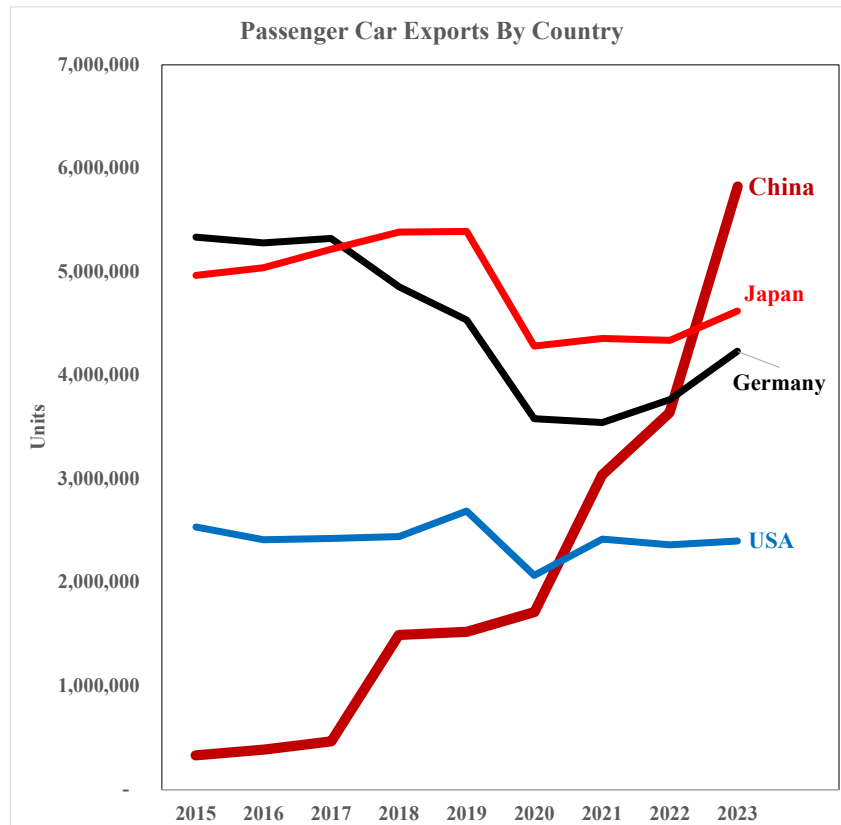
China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

Step 3: Identify Potential Catalysts

Another Example Is the Growth of Chinese Auto Exports, Particularly Electric vehicles

China Is Now Exporting More Cars Than Japan and Germany

They Export Almost Double The EVs of Germany



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China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

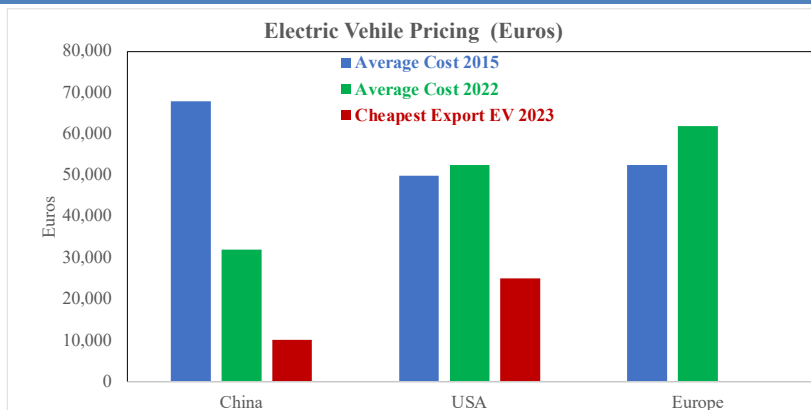
Step 4: Identify Asymmetric Trades

Buy 1-yr 5% OTM CNY Puts/USD Calls

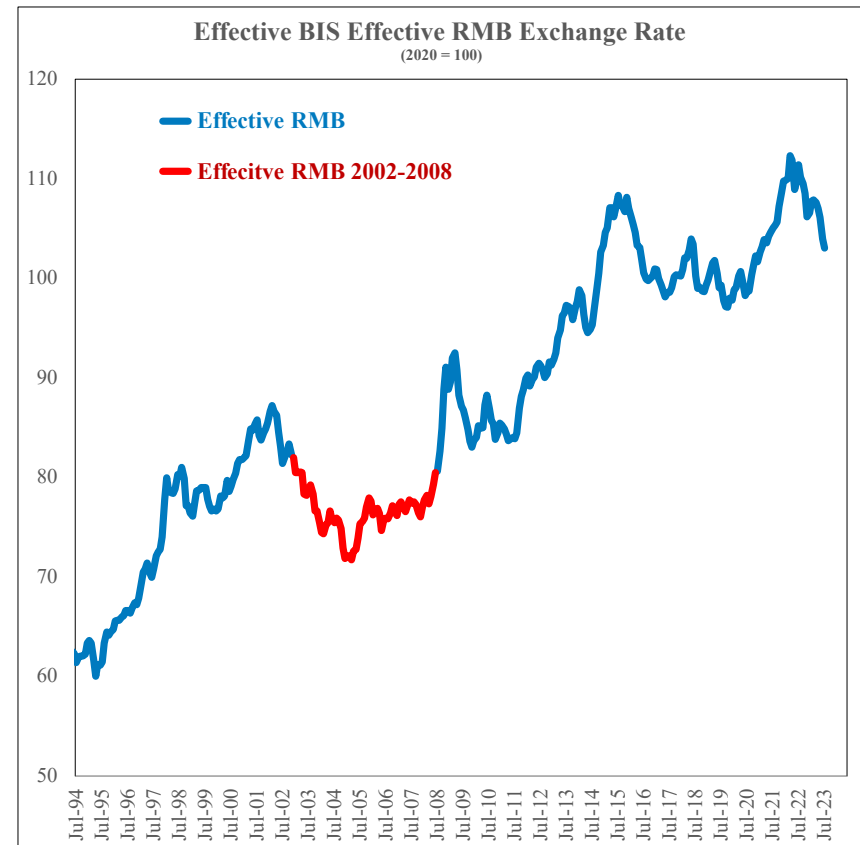
Trade Thesis

- China's current growth model is not sustainable
 - Baby bust, property bust, and now inflation are significant headwinds to China's existing growth model
 - Capital growth and consumption growth cannot support a 5% growth target without credit growth
 - A credit growth impulse to pull China out of deflation is too large to be realistic and causes too many imbalances
- China needs to return to its trade model for sustainable growth
- China needs to depreciate its currency for trade to become an alternative to investment growth alone
 - RMB would need to depreciate close to 20% or more to get back to levels during the trade boom in 2002-2008

China Already Produces the Cheapest EV, What Happens With It Devalue?



The RMB Needs To Devalue 20% To Get Back to GFC Levels



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China Is Becoming Japan With A Baby Bust, A Property Bust And Deflation

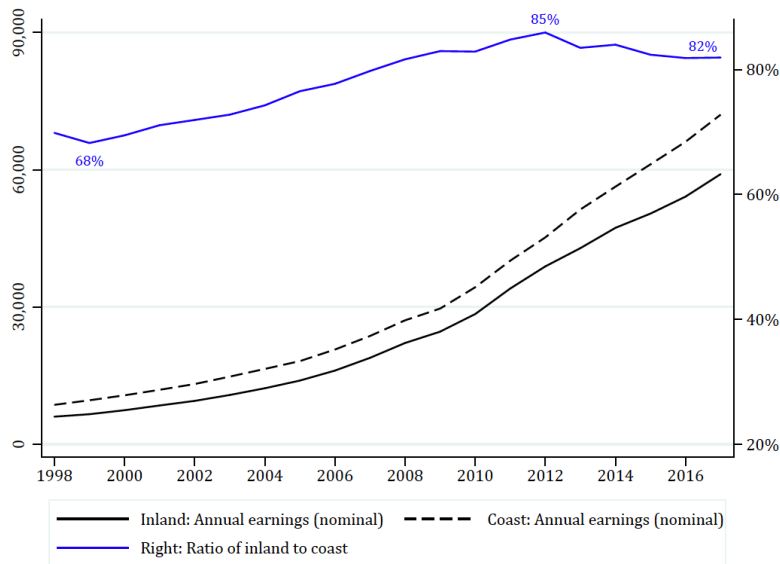
Step 3: Identify Potential Catalysts

Depreciating the RMB Would Offset Make Chinese Workers More Competitive Vs Rest of EM

One Reason Is The Wage Discount For Inland Workers Has Vanished

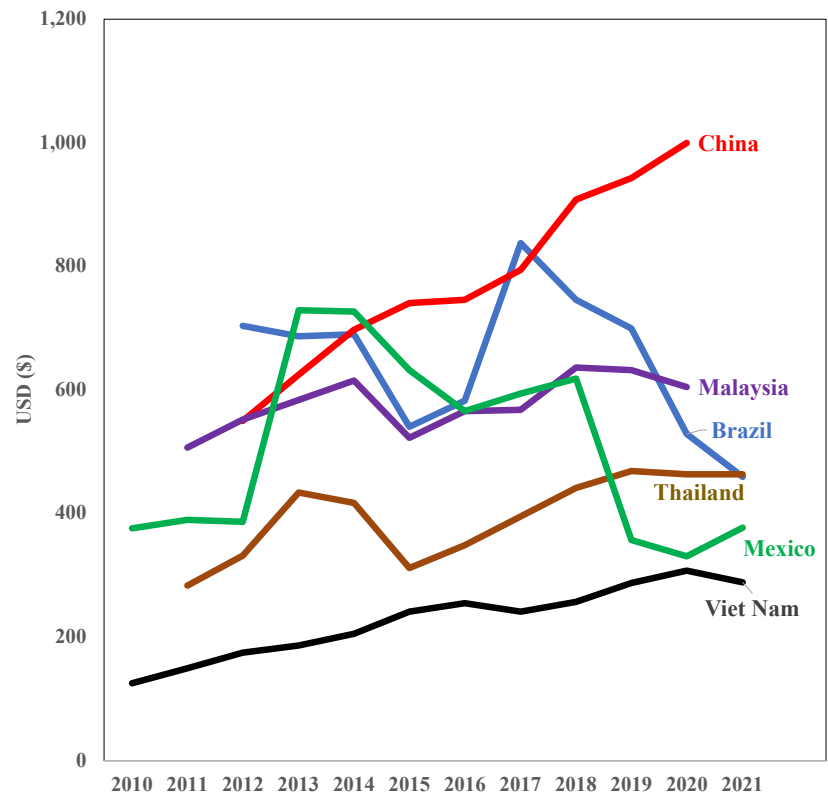
Chinese Labor Intensive Sectors Are Now Uncompetitive

Figure 18: Wage differentials between inland and coastal regions



Source: China Labor Statistical Yearbook

Average Monthly Earnings



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Buy Equity Puts--Valuations Do Not Reflect Higher Rates

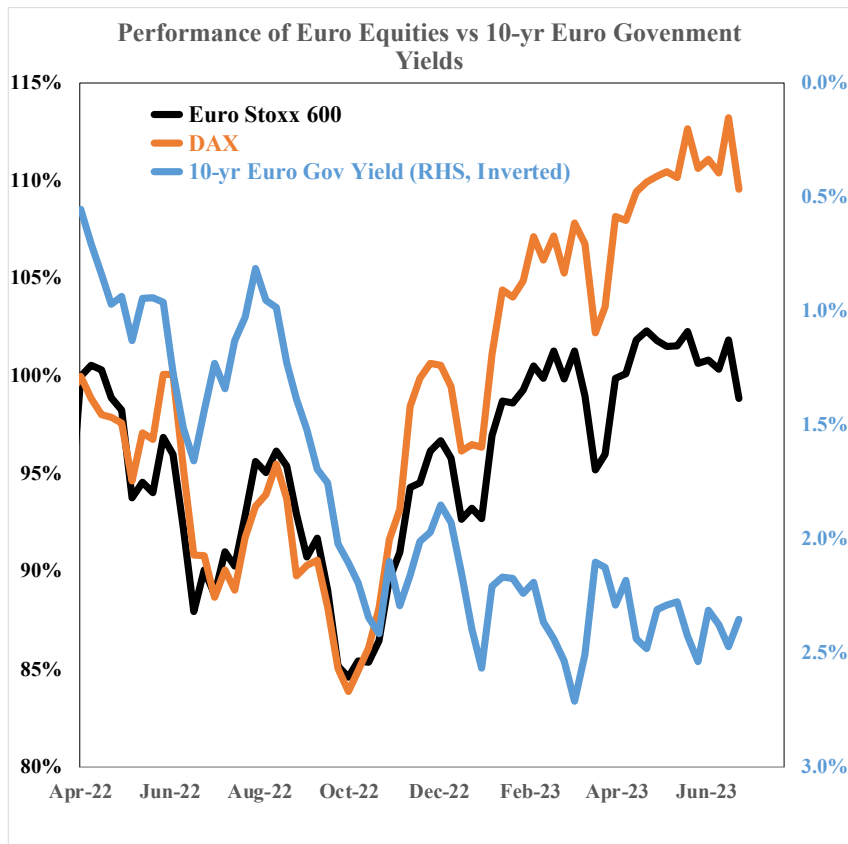
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Buy Equity Puts---Valuations Do Not Reflect Higher Rates

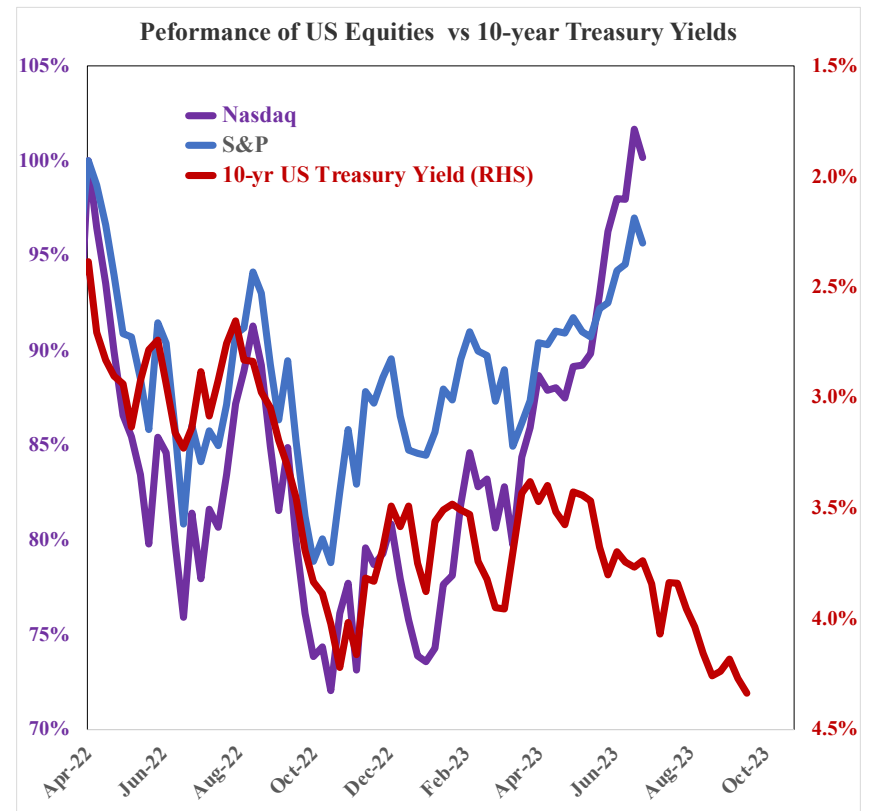
Step 2: Fundamental Economic Framework

Equity Valuations Are Back To Levels Before CB Hikes, Even Though Rates Are Substantially Higher

Euro Area Equity Valuations Vs Pre-ECB Rate Hikes



US Equity Valuations Vs Pre-FED Rate Hikes



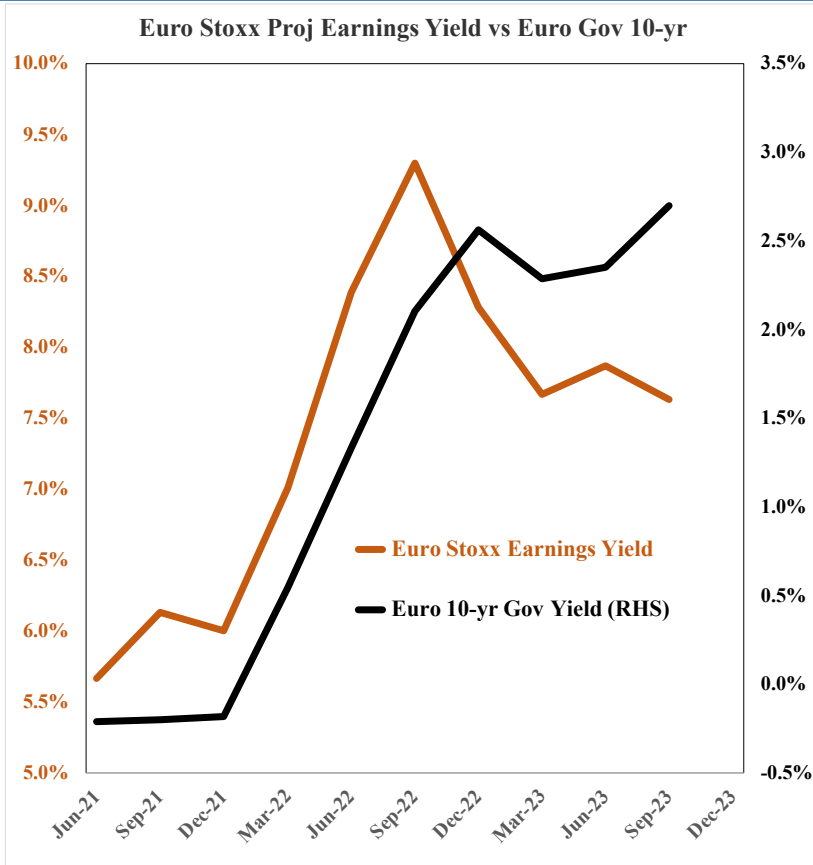
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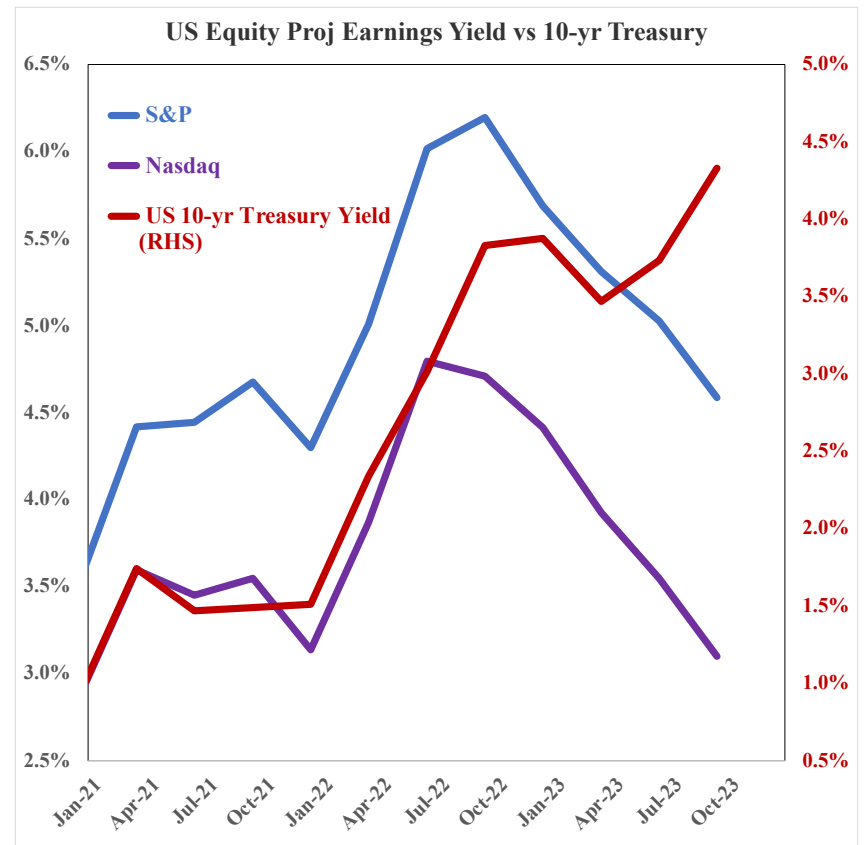
Step 2: Fundamental Economic Framework

Valuations Have Rebound Even Though Earnings Have Fallen Based On Earnings Yields

Euro Area Earnings Yields Have Fallen As Rates Have Risen...



Same in the US Equity Market



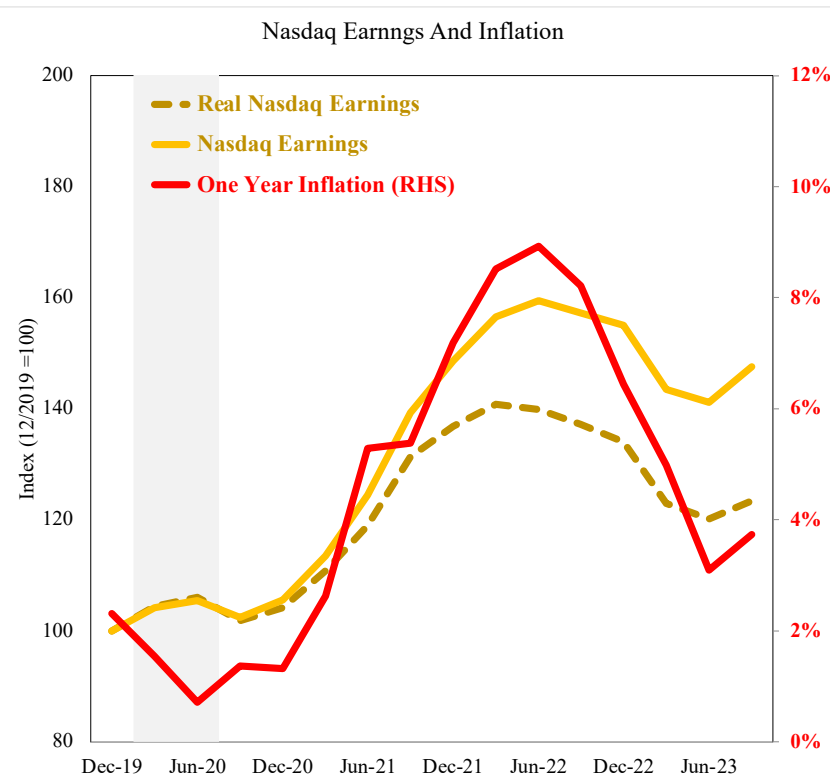
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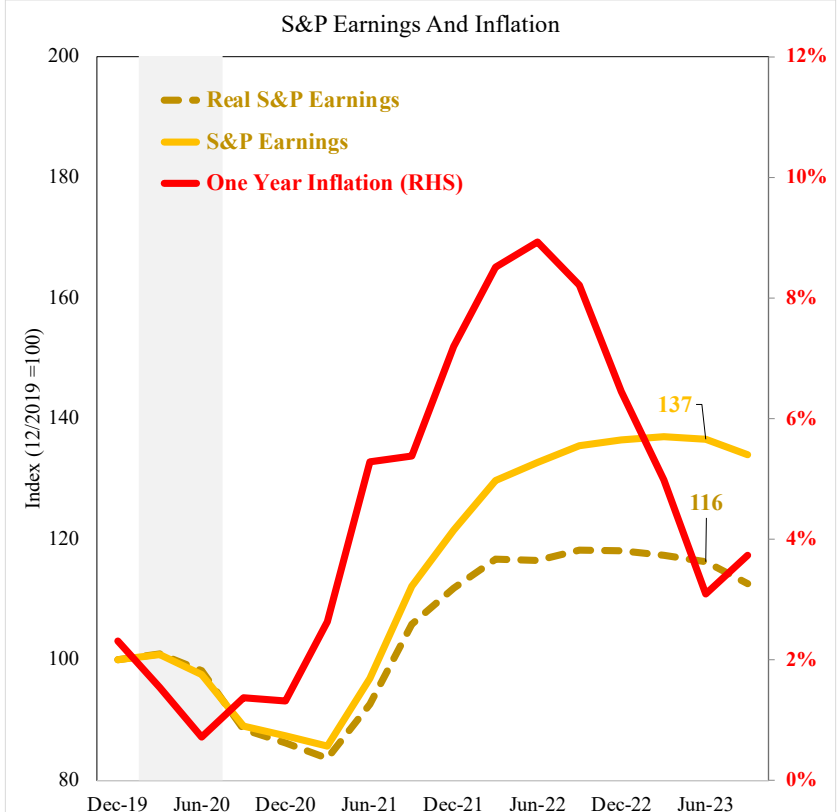
Step 2: Fundamental Economic Framework

US Equity Earnings Have Risen On Real Basis But Has Falling Recently As Rates Have Gone Up

Nasdaq Earnings Have Fallen On Both A Real And Nominal Basis



While S&P Earnings Have Been Flat

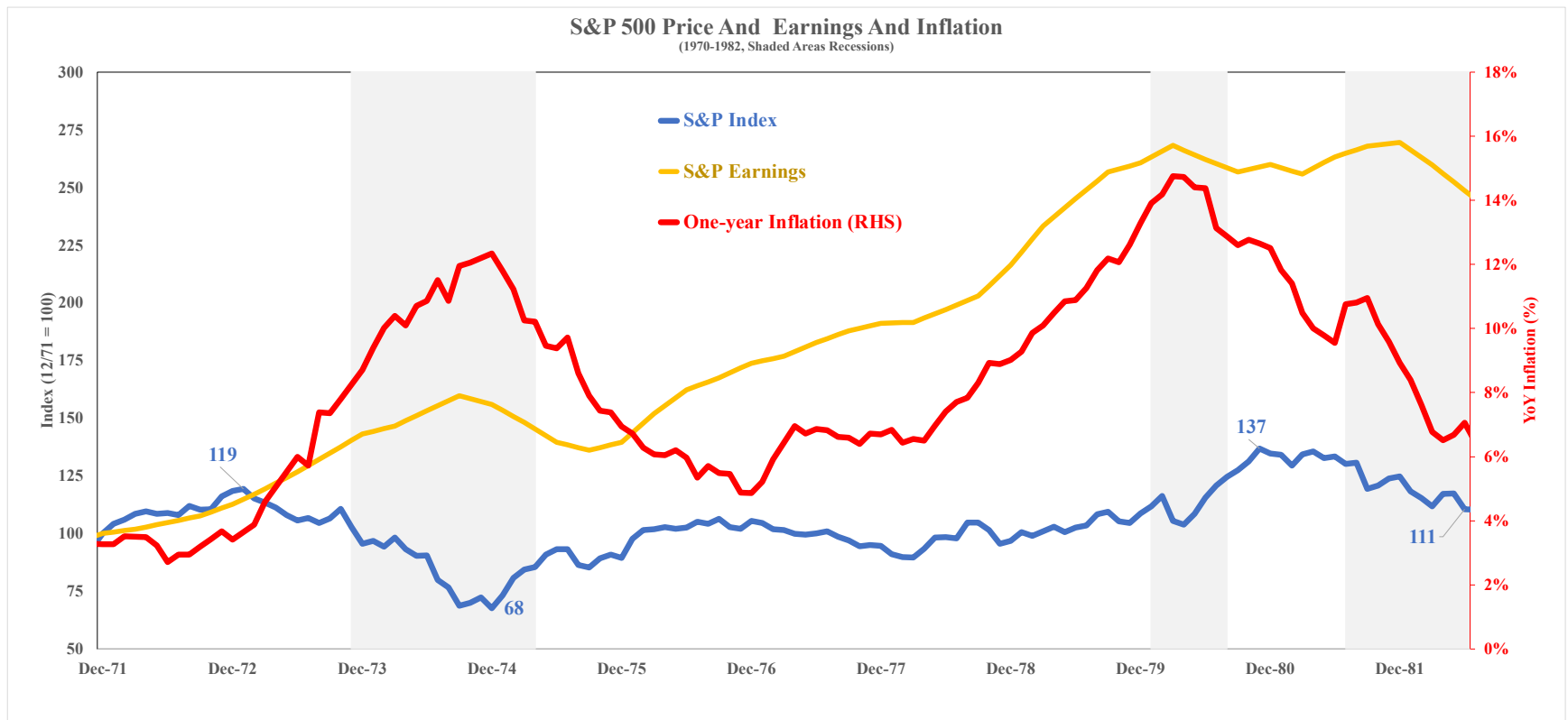


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Buy Equity Puts---Valuations Do Not Reflect Higher Rates

Step 2: Fundamental Economic Framework

S&P Earnings Also Went On A Nominal Basis As Inflation Surged During the 70s

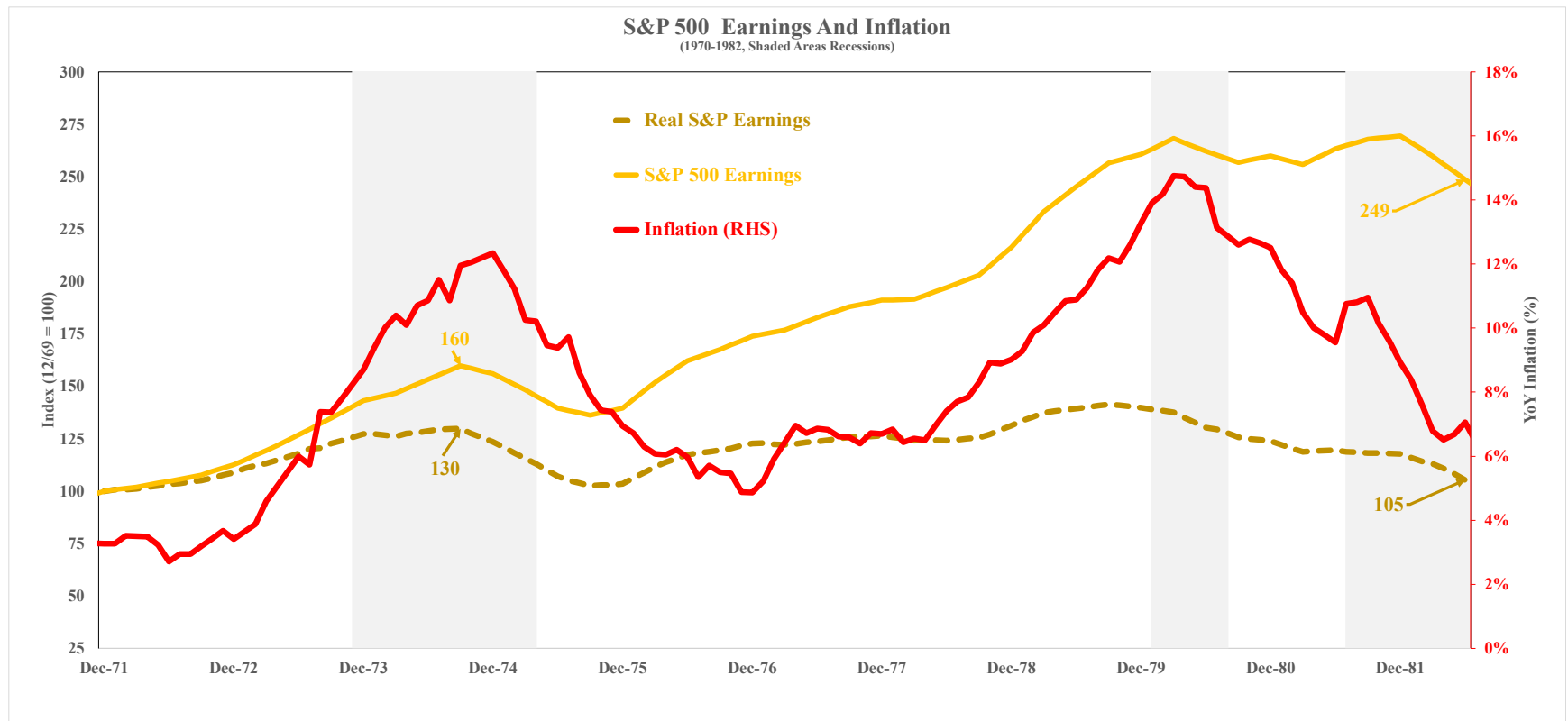


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Buy Equity Puts---Valuations Do Not Reflect Higher Rates

Step 2: Fundamental Economic Framework

In Contrast to Today, Real Earnings Were Flat Vs Stat of the 70s Inflationary Cycle

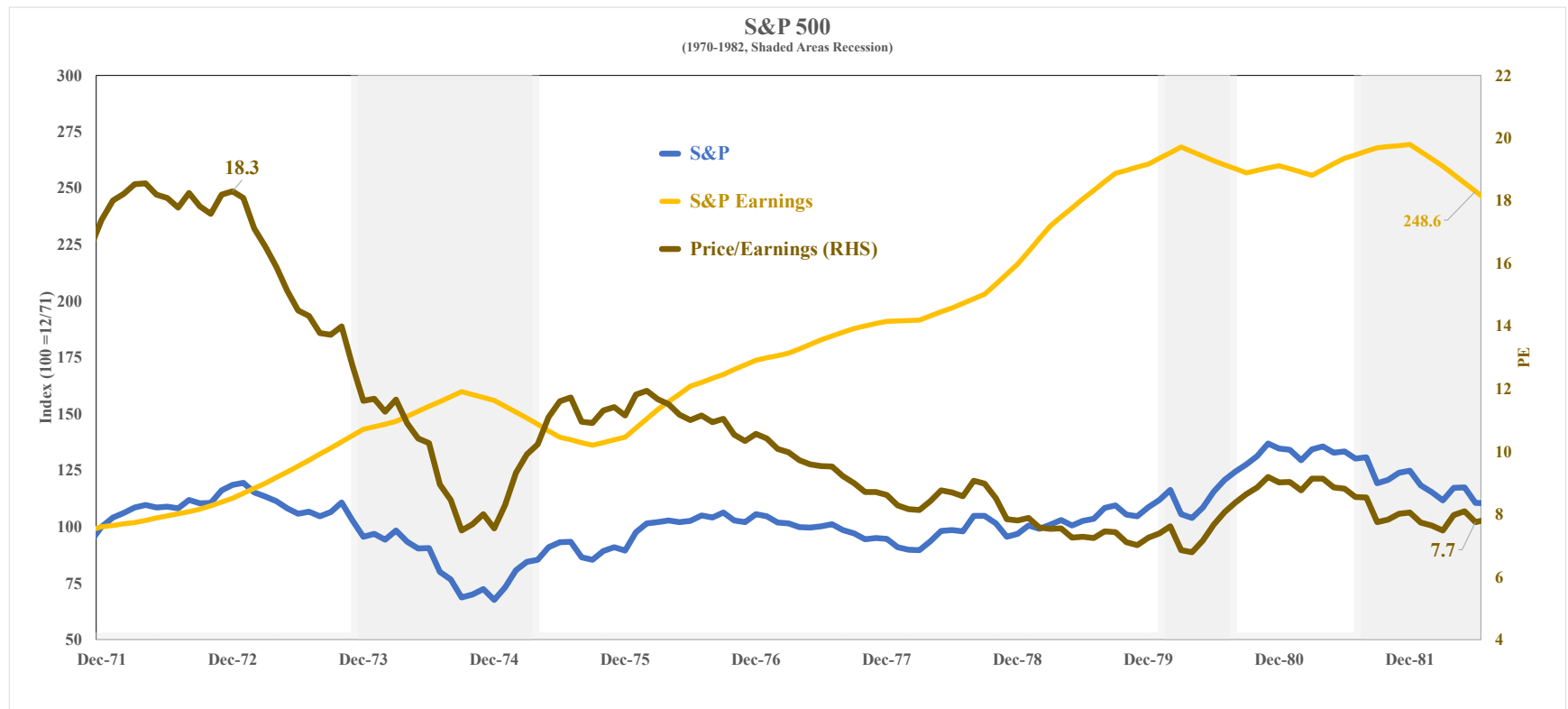


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Buy Equity Puts---Valuations Do Not Reflect Higher Rates

Step 2: Fundamental Economic Framework

In Contrast To Today, Earnings PE Valuations Fell

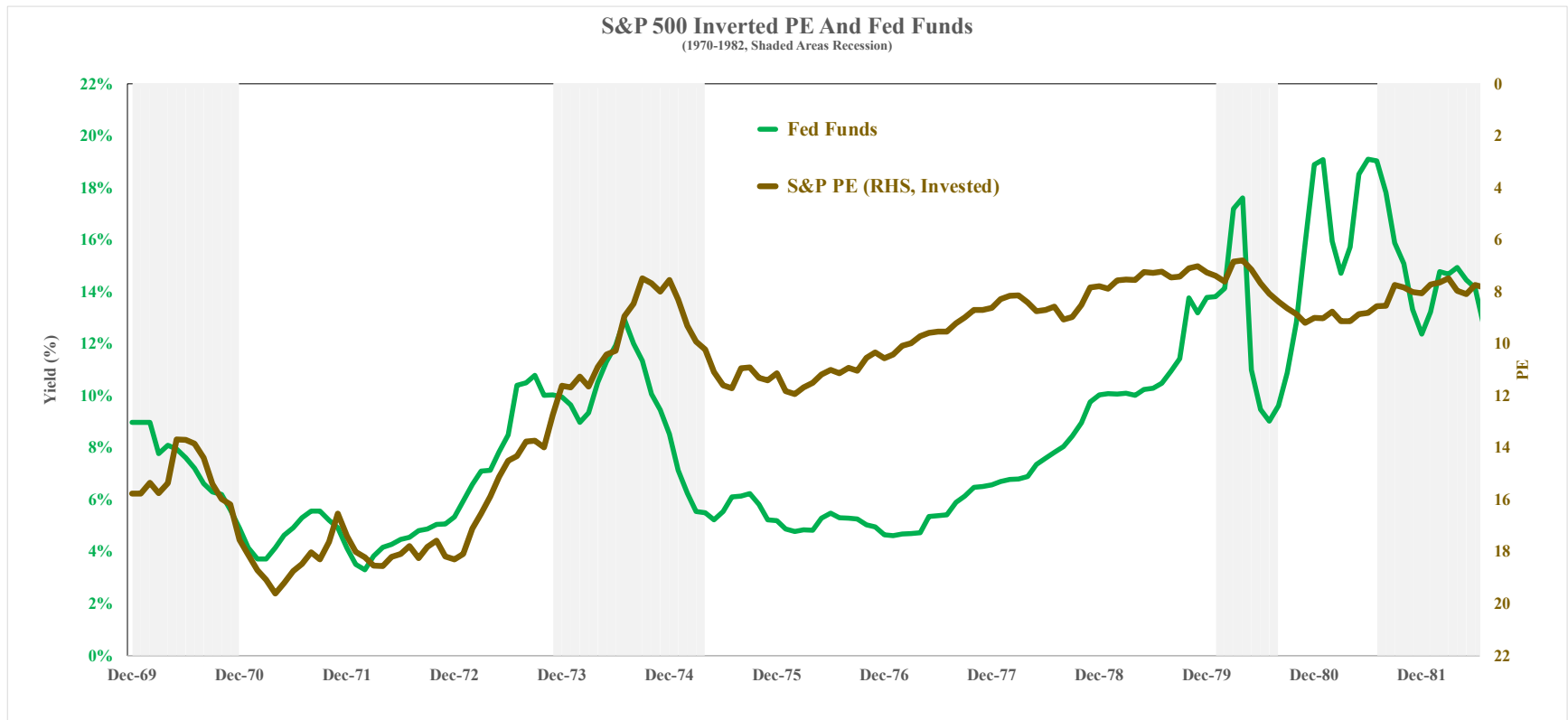


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Buy Equity Puts---Valuations Do Not Reflect Higher Rates

Step 2: Fundamental Economic Framework

As Interest Rates Rose



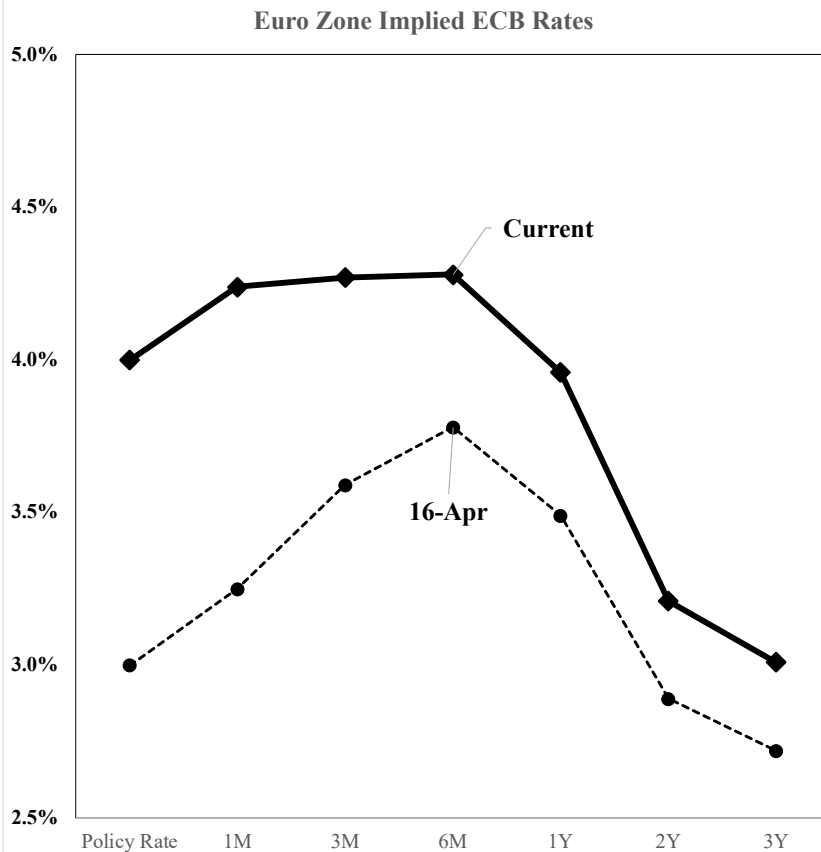
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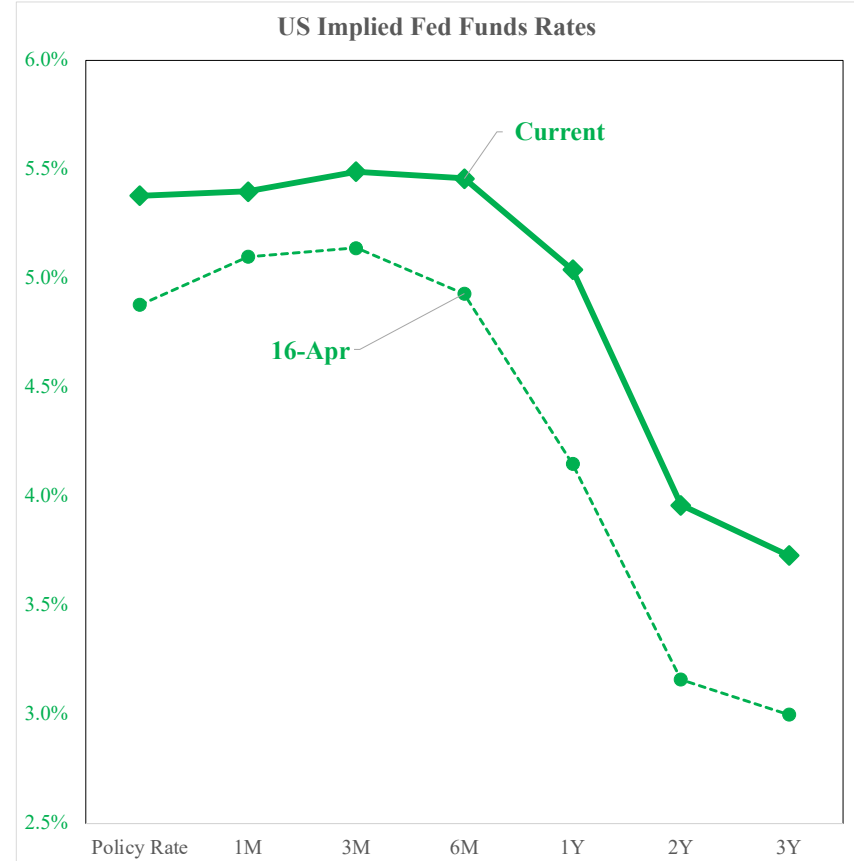
Step 3: Identify Potential Catalysts

Equities Could Fall if Central Banks Keep Rates Higher For Longer To Deal With Persistent Inflation

ECB Policy Rates Have Moved Higher For Similar Reasons



Fed Funds Pricing Has Already Moved Higher With Hawkish FED



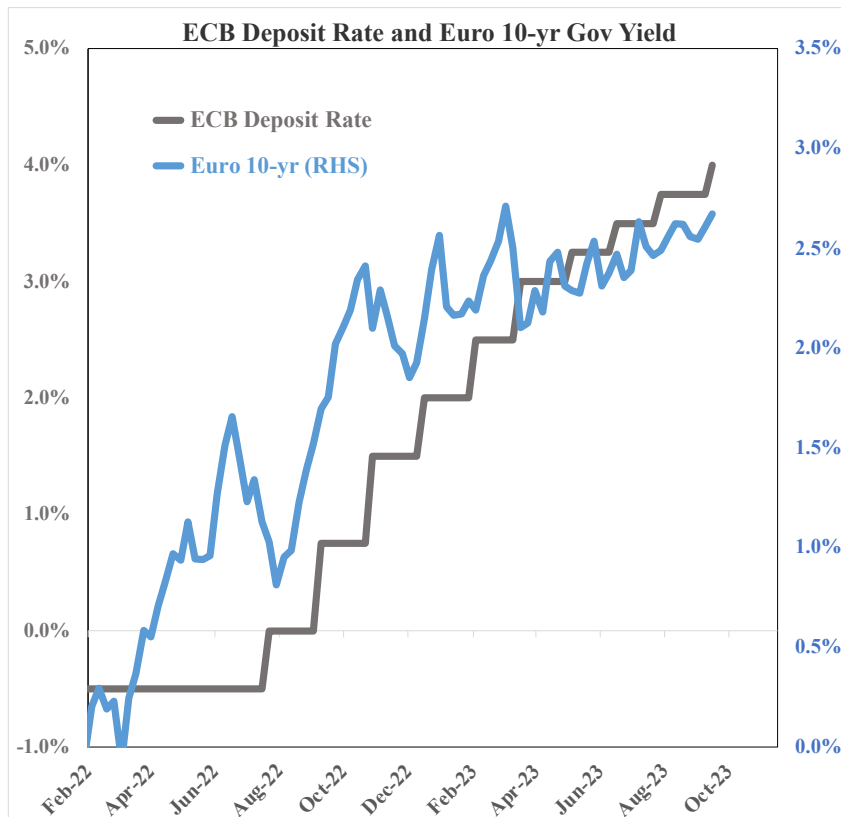
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Buy Equity Puts---Valuations Do Not Reflect Higher Rates

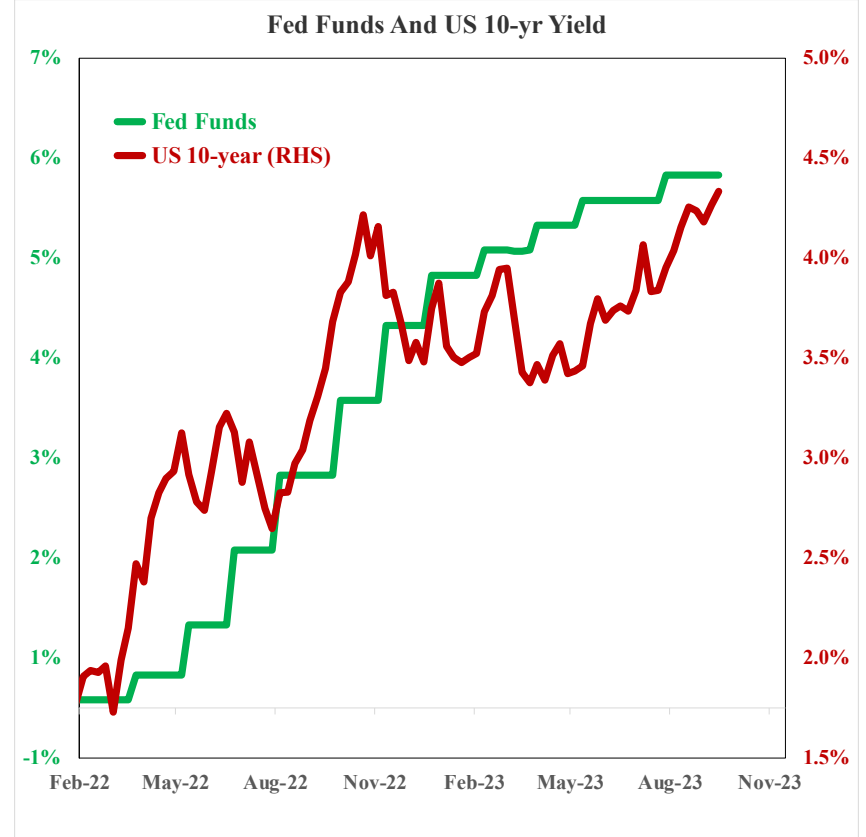
Step 3: Identify Potential Catalysts

Long Maturity Interest Rates Used To Value Equities Have Followed Policy Rates Higher

ECB Policy Rates And 10-yr Euro Government Yields



Fed Funds And US 10-yr Treasury Yields



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Buy Equity Puts---Valuations Do Not Reflect Higher Rates

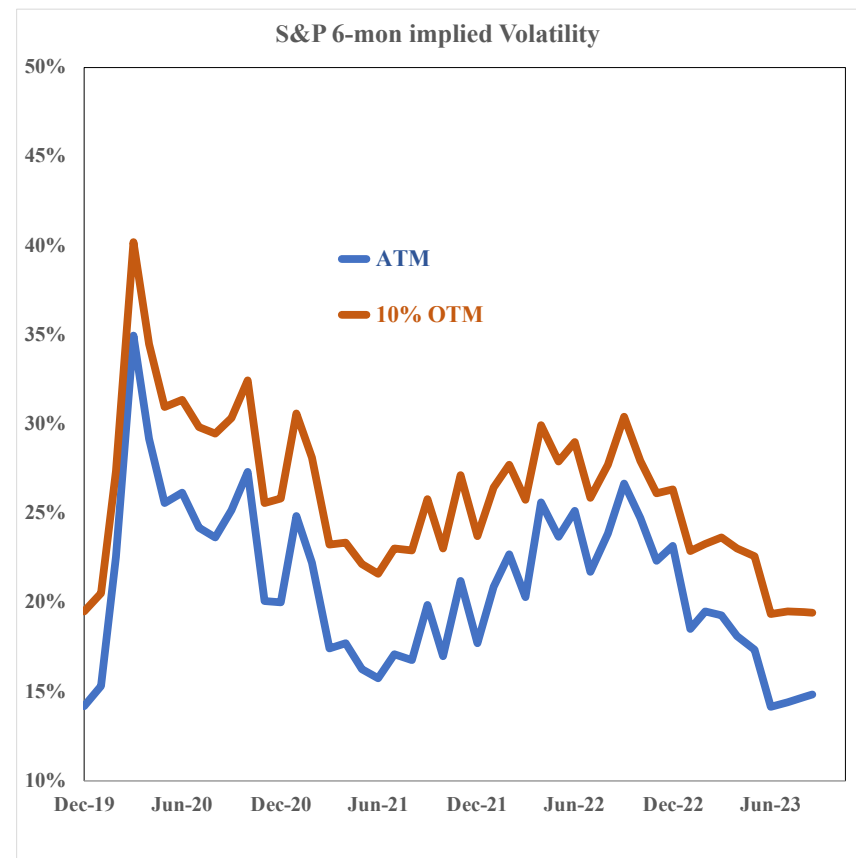
Step 4: Identify Asymmetric Trades

Buy 6-month 5% OTM Puts On S&P

Trade Thesis

- **Buy 6-month 5% OTM S&P puts**
- **Catalysts**
 - Equities could fall if central banks keep rates higher for longer to fight inflation
 - Equities could fall with stagflation economy or in a recession
 - Equities could fall if the market starts pricing in falling profit margins, particularly for S&P
- **Why S&P puts?**
 - Shorting US, not European equities to avoid the potential of an uptick in China stimulus
 - S&P could be repriced down substantially without the Nasdaq PM tailwind
 - Puts not an outright short with a stop because implied vol is near a 10-year low

Implied Vols Near Lows



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