Asas Capital

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Preparing for the change

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CIO View (1/10)

The outperformance by the U.S. economy likely to fade

The ascent in the S&P 500 is approaching six straight weeks, and inflation worries are creeping back into the Treasury market. The yield on the 10-year US Treasury note is hovering not far from 4.11%, the highest since late July, and gold has set a fresh record.

Recent data showed that US consumers and the labor market are holding up well. September retail sales strengthened more than forecast, while applications for jobless benefits fell further than economists were expecting. Among the smattering of earnings released so far, most have surprised to the upside on metrics like sales. Banks issued almost unanimously strong guidance on their outlooks.

The U.S. economy distinguished itself in 2023 and 2024, achieving growth rates of 2.5%–3%, while DM peers largely stagnated at 0%–1%.

This was attributable to two main drivers:

- Fiscal policy: **A larger cumulative fiscal stimulus** since 2021 has led to greater private wealth accumulation in the U.S., which has taken longer to dissipate.
- Monetary policy: The **pass-through of higher interest rates to households has been slower** in the U.S., largely due to the existing stock of low-rate, long-term mortgages.

Additionally, **the prominence of U.S. private credit markets** has likely kept financial conditions more accommodative. An influx of investor capital in lower-quality corporate lending has intensified competition for deals while providing financing for weaker companies that may struggle to access other markets.

The U.S. has also been **less affected by international spillovers from Chinese economic weakness**. European countries have been hurt by weaker trade with China and greater Chinese import competition. Financial gains and capital accumulation from generative artificial intelligence (AI) have also relatively benefited the U.S.

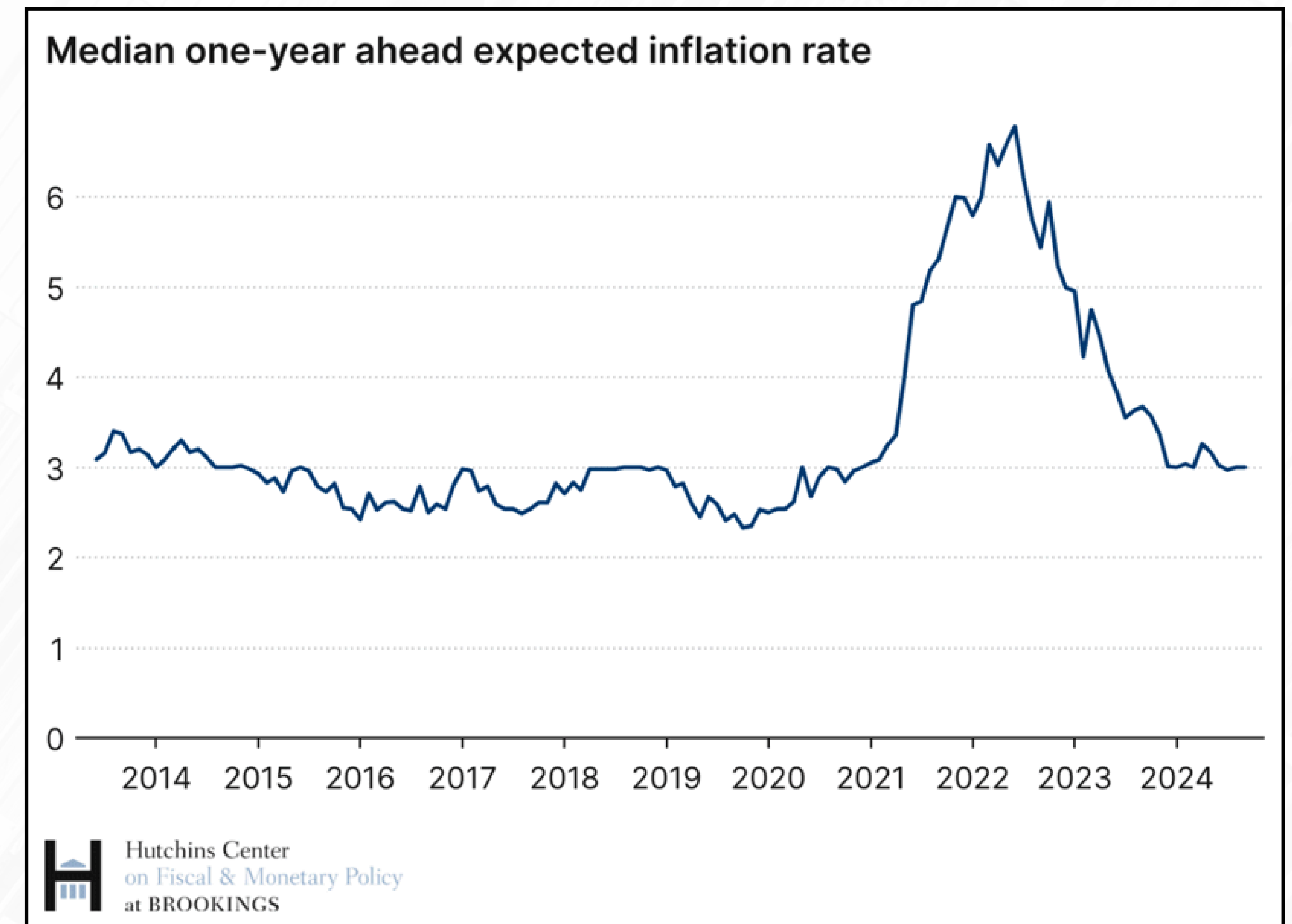
CIO View (2/10)

On the flipside, U.S. core personal consumption expenditures (PCE) inflation, the Fed's preferred gauge, is expected to finish this year near where it ended 2023, as tough base effects are likely to lift the reported year-over-year rate in the next several months.

Overall, **the factors that supported U.S. outperformance are fading**, while the monetary policy shocks that have impeded growth elsewhere are abating, thereby suggesting some recoupling with the global economy.

More resilient U.S. growth and inflation delayed the Federal Reserve in commencing its rate-cutting cycle relative to other central banks. However, **forward-looking inflation indicators suggest that further progress toward the Fed's 2% inflation target is likely in 2025**. Factors supporting this outlook include unit labor cost inflation nearer to 2%, a vacancy-to-unemployed ratio lower than 2019 levels, and a rising unemployment rate that may risk overshooting the Fed's comfort zone of around 4.2%.

One related question that comes up is what is the neutral rate for interest rates?



Factors that could support a somewhat higher neutral rate than a decade ago include higher government debt levels, potentially higher defense spending, generally stronger private sector balance sheets, and increased investment needs associated with secular global transformations, such as realigned trade relationships and the rapid development of AI. These are somewhat offset by longer-term trends in demographics and wealth disparity, and the uncertain pace and magnitude of investment cycles. On balance, **we estimate the long-run neutral real rate at 0%–1%, and a neutral nominal policy rate in the range of 2%–3%.**

The main risk is that slower activity and labor market growth fuel self-stoking cycles, ultimately resulting in a more pronounced downturn.

CIO View (3/10)

Market implications of the U.S. elections

The race between former President Donald Trump and Vice President Kamala Harris is bound to lead to a tense election night — and potentially days after. The latest polls find the two candidates running in a virtual dead heat - **polling margins are even closer than they were at this point in 2020 or 2016.**

As we look into our crystal ball to try to anticipate the impact of these elections, it would be instructive to look at the past record of both candidates (with the usual caveat that past performance does not guarantee future results).

✓ GDP: The country's **economic output grew strongly under both Biden and Trump**, with real gross domestic product, which tracks the inflation-adjusted value of all goods and services produced by the U.S., expanding at an annualized rate of 2.7% during Trump's first three years and 3.5% during Biden's.

✓ Inflation: **Inflation has been far worse during the Biden Administration**, up 19% over the first 42 months of Biden's term compared to 6% during Trump's first 42 months, according to the government's consumer price index.

✓ Job Market: **Both Biden and Trump oversaw strong labor markets**. Since Biden took office, overall employment is up 11%, average pay is up 18% and unemployment is down from 6.7% to 4.1%. Perhaps Trump's most impressive labor market feat was unemployment declining from 4.7% to as low as 3.5% in late 2019 and early 2020, which tied its lowest level since 1969.

CIO View (4/10)

Looking ahead, some implications that look probable include:

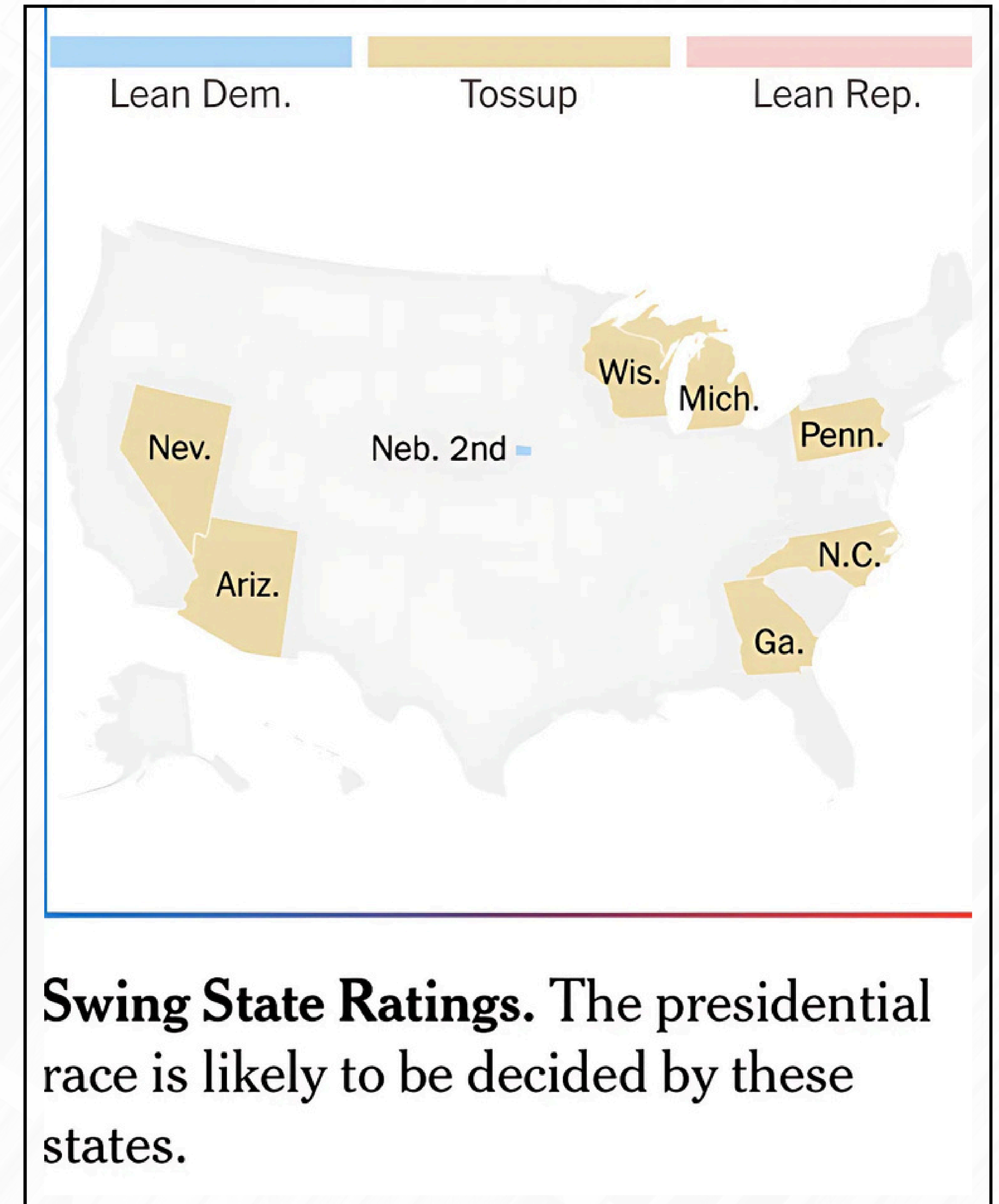
- **U.S. deficits will be the biggest loser no matter which party wins**. Tax reform will dominate Washington next year, when the individual provisions of the 2017 Tax Cuts and Jobs Act are set to expire. Given likely narrow majorities or a divided government and lack of fiscal space, much additional fiscal stimulus is unlikely but nor is fiscal consolidation expected. Annual deficits are likely to remain high (6%–7% of GDP) before any additional policy changes, due to lack of political will to curb entitlement spending as well as few offsets to pay for extending most of the 2017 tax cuts. **This will put pressure for the U.S. yield curve to steepen.**

- **The direction of travel of tariffs is also clear** regardless of who wins. However, the potential for globally disruptive trade policies appears greater under a second term for former President Donald Trump, while Vice President Kamala Harris seems more likely to continue the current more targeted approach should she prevail. **In the short run, higher tariffs would likely be inflationary and drag on growth.** Tariffs could make tangible U.S. investments more expensive, hurt U.S. export sectors by making them less competitive, and weigh on demand. **The relative implications of tariffs will create a tough economic environment for the Fed**. Monetary policymakers will have to be mindful that higher short-run inflation (as the additional costs of tariffs are passed on to consumers) risks rising inflation expectations, despite the downside risks to growth as real incomes fall.

CIO View (5/10)

It's worth remembering that elections are notoriously hard to call, and many things can change. Polls could underestimate either candidate. Late-breaking events, such as escalation in the Middle East or new opposition research, will impact perceptions of Harris far more than Trump. Harris will be helped by her generational change message, Democrats' early and mail-in voting advantage, fundraising and abortion ballot measures. Trump may benefit from his policy advantages and voters' doubts that Harris is up to the task. If Trump wins, the GOP will likely have unified control of Congress given a favorable map in the Senate and limited split-ticket voting in the House. If Harris wins, she will likely face a split Congress and thus more legislative constraints.

Additionally, give the electoral dynamics in the U.S., seven swing states with only 62mm population are likely to decide the fate of the election.



Swing State Ratings. The presidential race is likely to be decided by these states.

CIO View (6/10)

How should portfolios position themselves?

Uncertainty, global dispersion, and potential volatility create a favorable environment for active fixed income investors, especially as falling interest rates provide a tailwind for bonds. Historically, bonds tend to perform well during soft landings and even better in harder landing scenarios. Recently, bonds have resumed their traditional inverse relationship with equities, offering diversification and hedging benefits for portfolios. Additionally, bonds appear inexpensive compared with other assets such as stocks.

We prefer locking in attractive yields on intermediate-duration bonds, which can benefit from price appreciation and historically have tended to perform well during rate-cutting cycles. We remain cautious on long-duration bonds as high government deficits could push long-term yields higher over time.

We adopt a cautious stance on corporate credit, and prefer higher-quality credit and structured products over lower-quality credit at this point in the cycle, with an emphasis on liquidity, flexibility, and robust positioning against potential macroeconomic downturns.

Generally, **we favor high quality investment grade credit**, and are wary of deteriorating covenant protections in leveraged credits, which could lead to lower recoveries during idiosyncratic or systemic shocks.

In private credit markets, we believe that excessive growth and complacency has resulted in weaker lender protections and compressed compensation for illiquidity relative to similar returns available to active managers in public credit markets. In the event that the Fed has to lower rates to prevent a recession, floating-rate coupons will likely also decrease significantly. This means yields will drop just as economic and credit risks rise, which may benefit borrowers but hurt investors.

As for stock markets, a Trump victory is likely to mean tax cuts and deregulation, which boost expectations of business growth, especially in sectors such as oil, defense, and banking. Additionally, some of Elon Musk's projects – such as Starlink – may benefit. A Harris win, on the other hand, may mean greater emphasis on public spending and a possible tax increase for corporations and higher incomes. This could generate uncertainty in some sectors, such as finance and energy, but would benefit others, such as renewable energy and healthcare.

CIO View (7/10)

China starting to become 'investable', but tread carefully

China's economy expanded by 4.6% in the third quarter, compared to the year before, helped by a rise in factory output and surprisingly strong retail sales. But slower growth in the third quarter compared to the second suggested that the world's number two economy is still losing steam. For instance, while spending on roads, factories, and other "fixed assets" is up 3% this year, investment in the all-important property sector is down 10%.

Retail sales last month grew 3.2 per cent after a 2.1 per cent lift in August, both year-on-year comparisons. Month on month, retailing was also up 0.4 per cent in September over August. According to analysts, the jump was largely on the back of a government trade-in program that incentivizes purchases of cars and appliances. **Historically low consumer sentiment, coupled with a persistent property crisis, is likely to keep consumption growth in the single digits**. Consumer confidence remains at "dire" levels because falling property prices have hurt household wealth while "shaky" job prospects encourage people to save.

The People's Republic stepped in to prop things up with some fresh stimulus, in hopes that the economy won't fall short of its 5% growth target for the year. That included a program to help companies and major shareholders buy back stocks, and another that'll make it easier for big banks and investing houses to borrow money and pour it into the stock market. The idea is to get more moolah flowing into companies and jobs and help juice the economy. **There are expectations that Beijing could approve the sale of an extra 1 trillion to 2 trillion yuan in special sovereign bonds at the legislative meeting around late October to early November.**

Chinese equities have surged in recent weeks, following more than three years of a bear market, as China recently unveiled its biggest stimulus since the pandemic, aimed at pulling the economy out of a slump and back toward its growth target. The MSCI China Index, having been down some 60% from the beginning of 2021 to March 2024, soared nearly 40% between mid-September and the first week of October before settling down to a roughly 20% gain since the plans were revealed. But global investors now face the question: Will it be enough to ease the country's deflationary debt spiral and reinvigorate growth?

CIO View (8/10)

The wild market swings after the recent briefing by China's economic planner, the National Development and Reform Commission, shows the mismatch in what equity investors expect and the intention of policymakers in Beijing. Widely-held belief is that for the rally in Chinese stocks to continue, investors are looking for more aggressive fiscal stimulus. **Analysts have suggested that 10 trillion yuan or more might be needed to keep the market going given the range of economic issues that needs to be addressed.**

A nuanced approach to investing is warranted

Chinese stocks are cheaper and higher-yielding than their US counterparts: they're serving up a dividend yield of 3%, and benefit from relatively attractive valuations with a price-to-earnings (P/E) of 12.2 and price-to-book (P/B) of 1.3. They are, however, less profitable, with a return on common equity of only 10% – trailing US stocks.

"Green" is one key reason to invest in China. The theme aligns with the Chinese government's aim to reach net zero by 2060. Achieving this goal will require significant investment. The China Council for the Promotion of International Trade states that China's decarbonization efforts will require around $21.3 trillion in investment by 2060. The country dominates global renewable energy and storage manufacturing capacity, including 90% of solar production. China also produces a whopping 75% of the world's batteries. Furthermore, it has numerous leaders in areas like solar wafers, battery and other electric vehicle componentry, automation, and those upgrading electricity grids for a renewable future.

According to some accounts, China's AI industry is moving so swiftly it's already into a third generation of companies. The OG were Bytedance (of TikTok infamy) and the triumvirate of online retailers — Baidu, Alibaba and Tencent. The next cohort included SenseTime and others that specialized in facial recognition. Now, a handful of freshly minted enterprises are targeting the US market because China's consumers "have shown a reluctance to pay for AI apps, and strict regulation limits their utility." This is happening in spite of a bipartisan congressional effort to curtail, if not ban TikTok over fears of spying.

CIO View (9/10)

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Gold continues its shine

Readers of our newsletter know that **we have been bullish on Gold since late 2021, when the price was ~$1,800/oz.**

Gold's price has shot up over 30% this year, which is remarkable considering that the US economy has held up well and government bond yields have remained high. If the US economy was tumbling toward a recession and falling interest rates were reducing the income of other assets, that could explain gold's price rising. But those things aren't happening, so it suggests investors are more nervous about the future than they're letting on. And maybe they're right to be: geopolitical tensions haven't exactly eased, the risks of high inflation and a slowdown in growth still loom large, government debt is dangerously high, and central banks are stocking up on gold rather than greenbacks. The record price on the bricks is sending a message: uncertainty is brewing, so stay prepared.

CIO View (10/10)

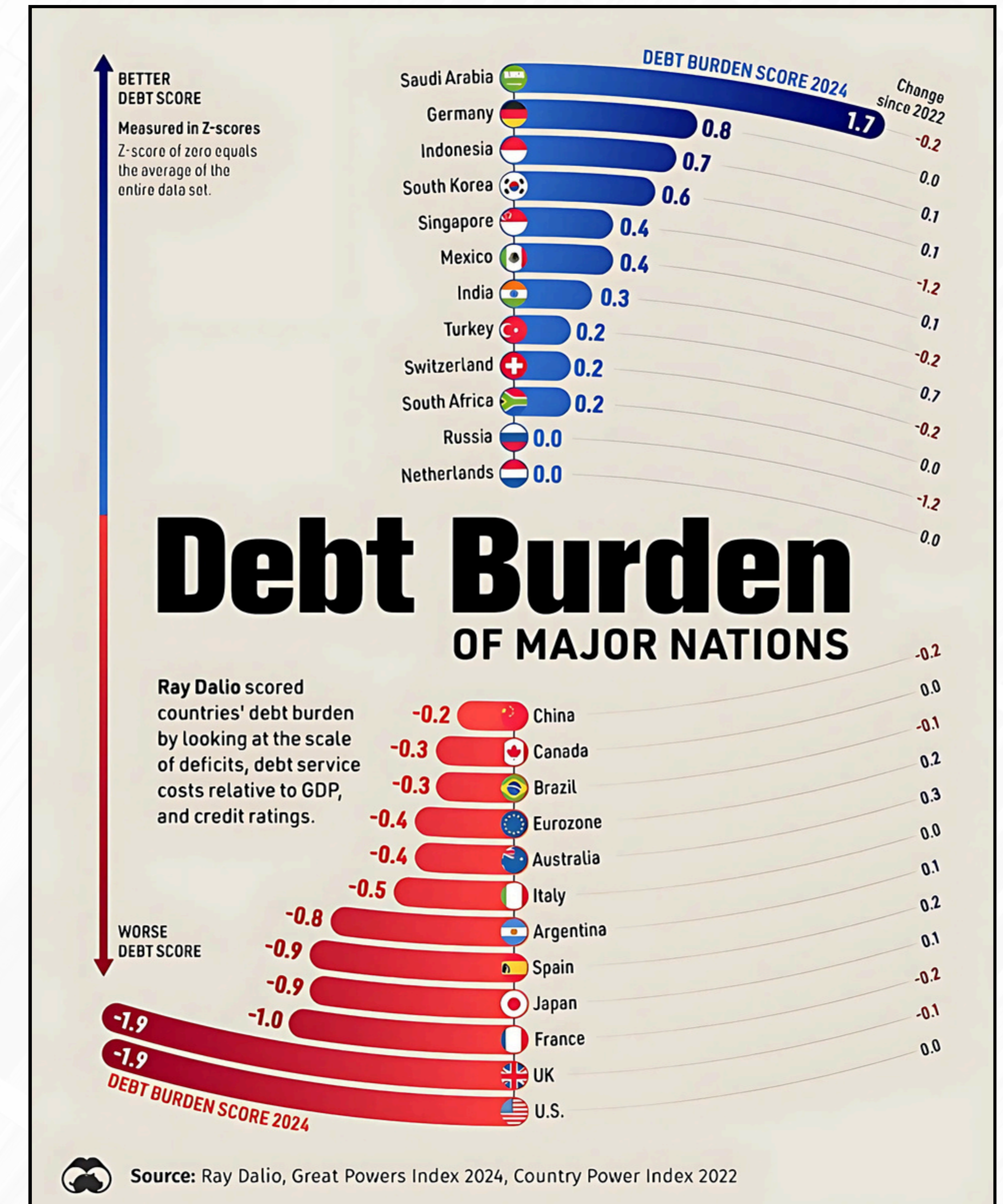
Developed markets are drowning in debt

Finally, I leave you with a chart depicting the debt burden of some of the world's major economies. More than almost anything else, it explains the state of the global economy today.

This graphic shows the debt burden score of major world economies, based on analysis from Ray Dalio's Great Powers Index 2024. To evaluate the debt conditions of leading economies, Dalio looked at the following factors:

- *Debt relative to assets*
- *External and internal surpluses and deficits*
- *Debt service costs relative to GDP*
- *Level of debt in domestic currency or foreign currency*
- *Debt held by citizens versus foreigners*
- *Credit rating*

Overall, debt burden ratings are expressed as z-scores, with a z-score of zero representing the dataset's average.



Unpacking The China's Stimulus Blitz

On 24th Sep, to address weak sentiment, Beijing announced a wide-ranging stimulus package that was welcomed by the market.

Monetary support

- 20 bps reduction in the short-term 7-day reverse repo rate, the central bank's main policy rate.
- 30 bps cut in Medium-term Lending Facility rate (MLF).
- 20-25 bps cut in LPR and deposit rates.
- 50 bps cut in the reserve requirement ratio which adds $142B in liquidity in the banking system. A further 25-50 bps cut is earmarked for this year.
- Mortgage down payments for second home lowered from 25% to 15%.

Support for property sector

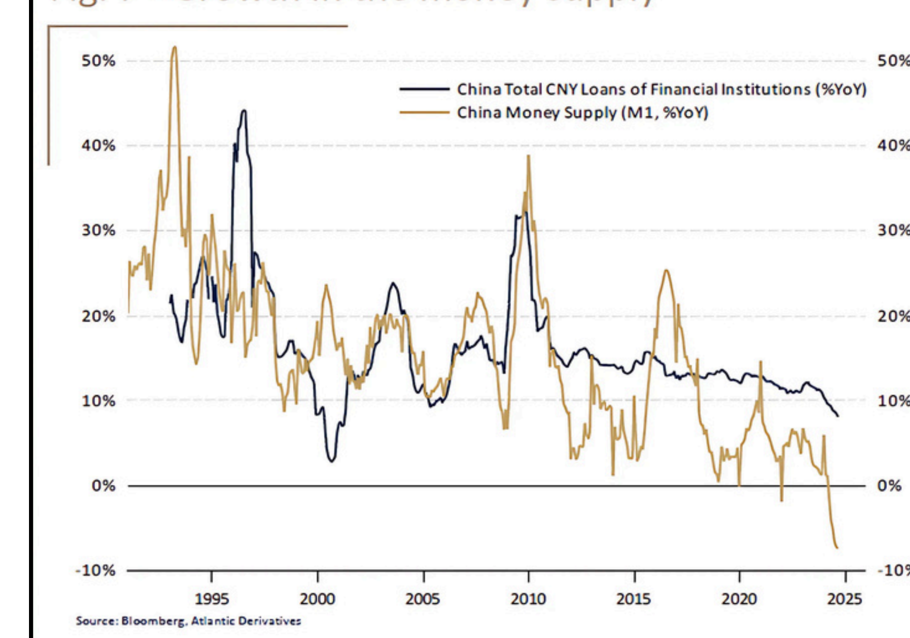
- The PBOC to cover 100% of loans for local governments buying unsold homes with cheap funding, up from 60%.
- The central bank also said it would improve the terms of a program under which it has made Rmb300B available to local government-owned enterprises to help them buy unsold inventory from property developers.

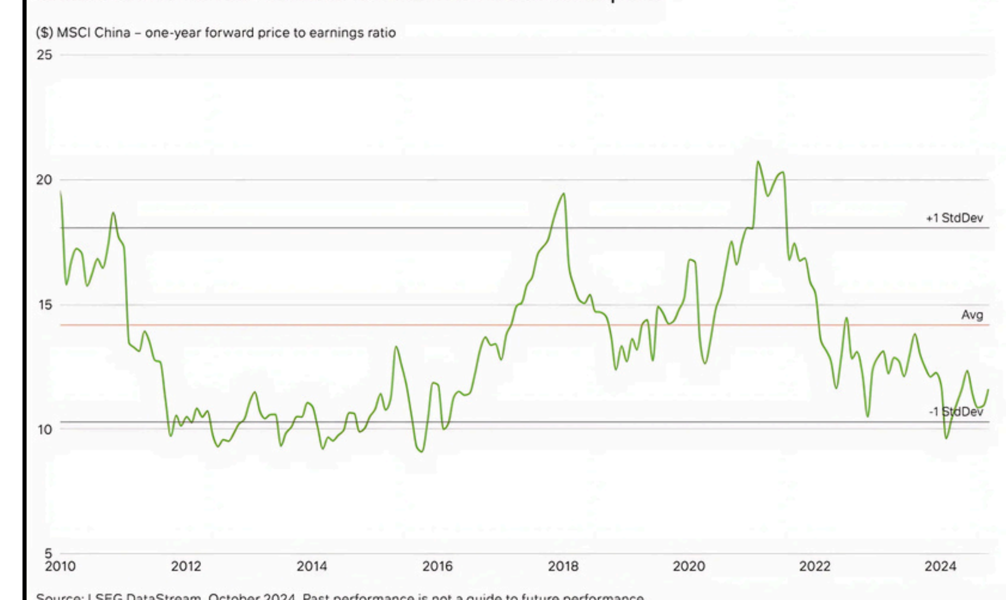
Support for Equity markets

- Rmb800B fund announced to help brokers, insurance companies and funds buy stocks and conduct share buybacks.

Stats post announcement

- Spending per capita in the golden week was recorded at 2% below pre-pandemic levels. The decline was an improvement from a gap of more than 10% during 2024 spring holidays.
- The benchmark CSI 300 Index climbed more than 30% before it lost close to 1/3rd of those gains amid doubts that Beijing will follow through with large scale fiscal stimulus. The PBOC intends to announce capital injection in the coming weeks.
- As per Chinese officials, they are seeing recovery in the property markets of the country's top cities. Sales of new homes in China rose 3% from a year earlier during Oct. 8 to Oct. 16—the first increase since late June, as per Macquarie economists.





Beijing has finally shown intent while Chinese equities are still cheap compared to historic average

China’s Production Shift (1/2)

A growing number of Chinese companies are adopting a crafty way to evade U.S tariffs imposed & remove the **"Made in China"** label with BRI (Belt and Road initiative) .

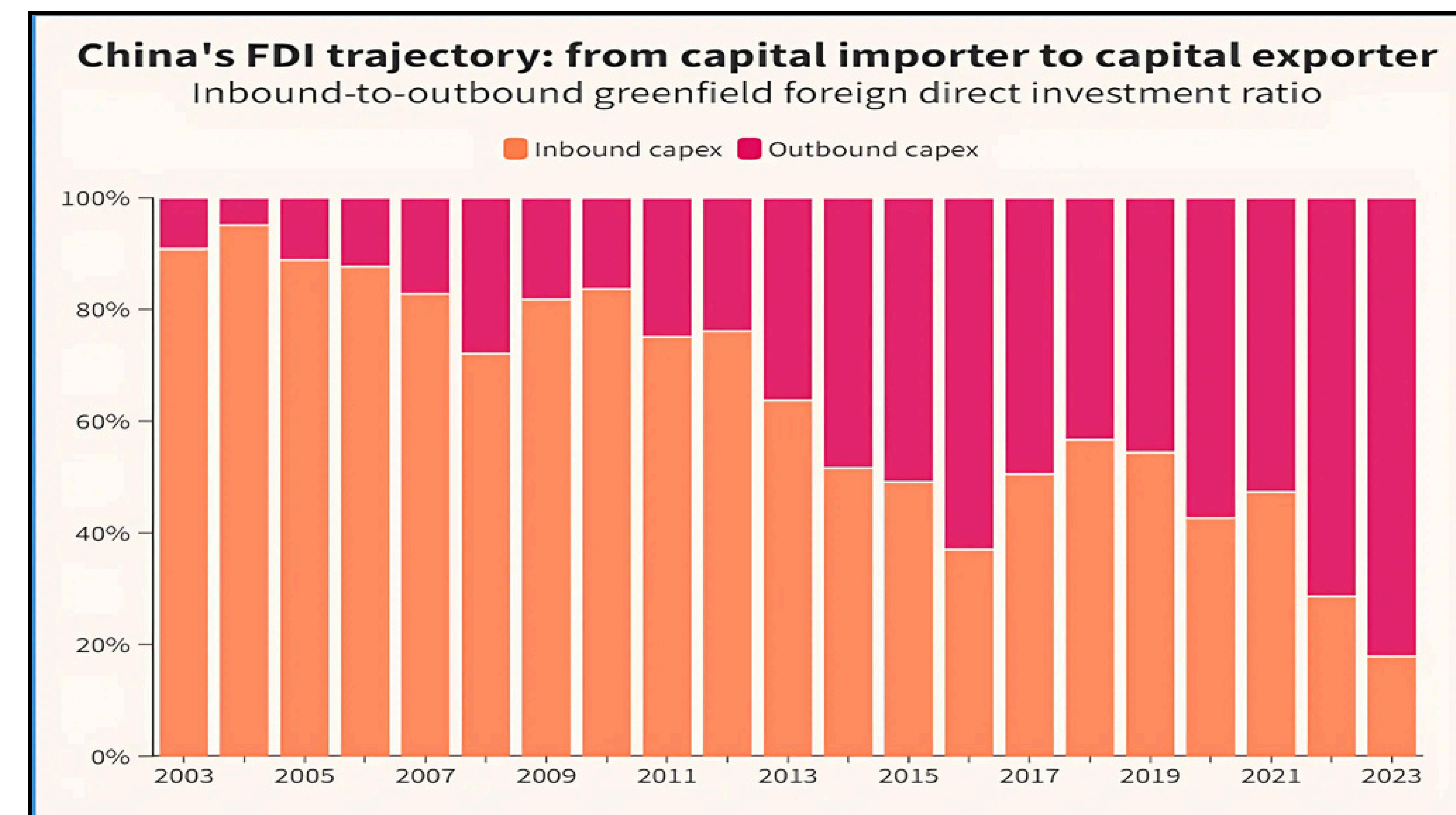
The source of new renewable energy is also a battleground over China’s cheap exports of panels that has split US firms.
According to US government investigation that concluded in 2023, China was using offshore manufacturing plants in Malaysia, Vietnam, Cambodia and Thailand to circumvent trade rules designed to prevent dumping and unfair competition.

Chinese outbound **greenfield foreign direct investment (FDI)** reached a new high in 2023. Announced outward capital investment by China-based companies was propelled to an estimated $162.7bn last year, according to FDI Markets.

In 2023, the top three sectors by deal value were **TMT, advanced manufacturing & mobility and health care & life sciences.**

Is Mexico the New China hub?

In 2024, China’s investment in Mexico has seen a significant increase. According to recent reports, Chinese Foreign Direct Investment (FDI) in Mexico rose by about **$225 million annually.**



source : FDI Markets

China's Production Shift (2/2)

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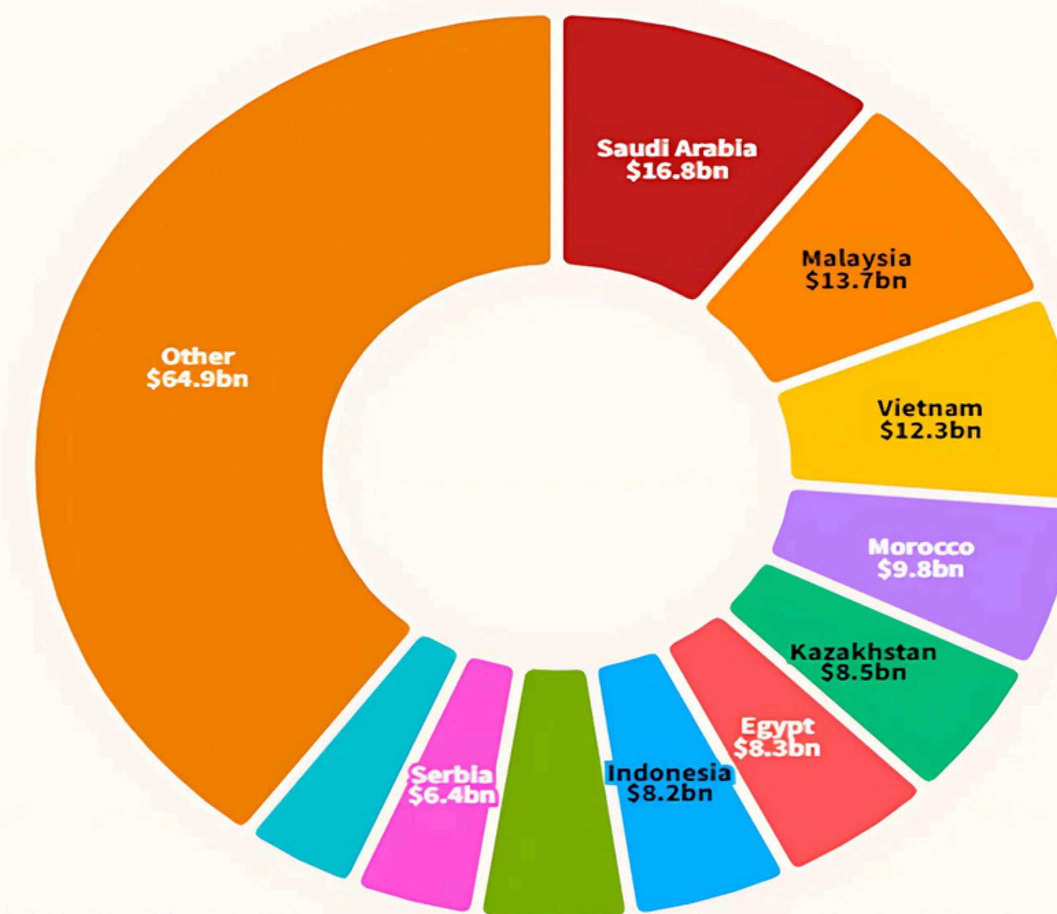
2024 US elections impact :

Donald Trump : Known for his "America First" policy, Trump has proposed significant tariff hikes on Chinese goods , **potentially more than 60%**. His approach includes imposing a **10% or 20%** levy on all imports, which could be highly disruptive to the global trading . This would likely lead to increased costs for American consumers and businesses, and could provoke retaliatory tariffs from China.

Kamala Harris : Harris is expected to maintain many of the current trade policies under Biden administration's targeted tariffs on only certain Chinese imports – such as a **100% rate on electric cars and a 50% rate on solar panels** – arguing it will bolster domestic manufacturing without causing wider economic damage.

China, have made significant **investments in several European Countries** such as **Germany** (automotive and tech sector) , **UK** (real estate , Finance & tech) **France** (energy , tourism & luxury goods) , **Hungary** (battery plants and EV production facilities) .

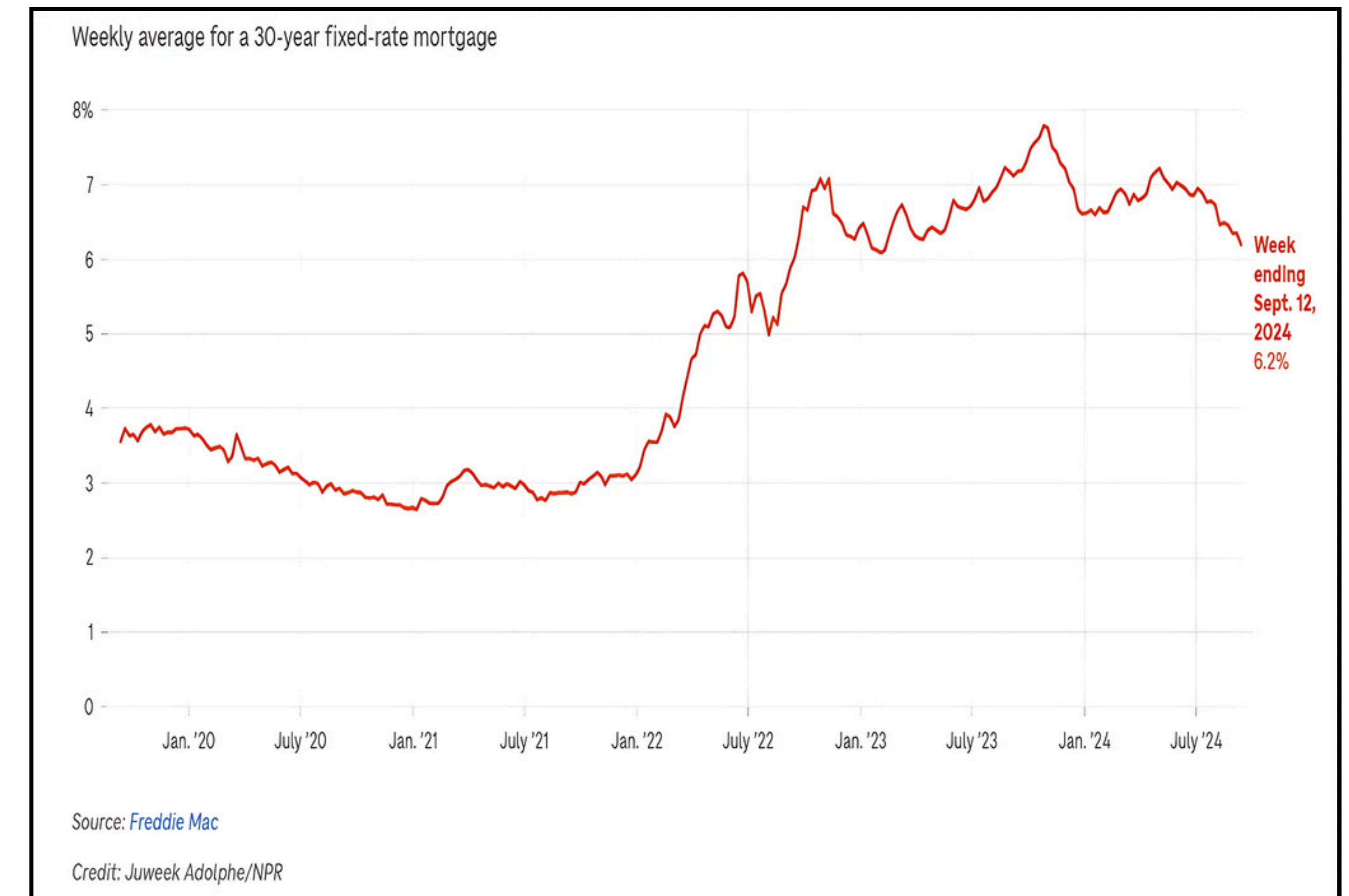


source : FDI Markets

A non-viable task for U.S to monitor Chinese investments across the Globe

Mortgage rates impact on housing market and REIT's (1/2)

- Mortgage rates have been high for the last couple years, especially compared with the historic lows they reached during the peak of COVID-19. Rates bottomed out below 3% for a 30-year fixed-rate mortgage during 2020 and 2021 when the pandemic led to lockdowns, but they then climbed to nearly 8% last year amid a robust economy and rising inflation.
- The prospect of rate cuts has already helped send mortgage rates lower, even before the Fed announced its actual decision on Wednesday. Long-term fixed-rate mortgage rates are now at 6.2%, the lowest since February 2023.



Impact on the housing market

A key reason for high home prices currently is the lack of housing supply as the U.S. is short millions of housing units. Supply has not kept pace with demand, especially as the large millennial generation is forming households and trying to buy homes. This is due to the current homeowners who have financed this at much lower interest rates are still holding on.

- High interest rates made it harder for some homebuilders to get projects off the ground, especially smaller, private developers. That's because the rates that builders get for acquisition, development and construction are closely tied to the rate set by the Fed.
- By the end of 2025, we can expect mortgage rates to be in the 5% range. So while mortgage rates have fallen from highs of 8% and are expected to fall even more, they remain well above the rates enjoyed by most current homeowners, who may be reluctant to put their homes on the market and risk a much higher rate on their next mortgage.

Mortgage rates impact on housing market and REIT's (2/2)

Impact on Mortgage REITS

- Historically, following periods of rising interest rates, REITs have outperformed the S&P 500 over the subsequent 90-, 180-, and 365-day periods.
- Mortgage rates, while related to interest rates, affect REITs differently, particularly within the self-storage and residential sectors. If mortgage rates were to decline further from today's 6.1%, we expect both SFR and multifamily REITs to continue to benefit from strong rental demand, a prolonged housing supply shortage, and accretive external growth due to a favorable cost of capital. On the flip side *the affordability gap between renting and owning may begin to narrow.*
- Another effect on the REITS would result in lower Financing Costs for REITs, which often rely heavily on debt to finance property acquisitions and development projects, benefit from lower borrowing costs when interest rates are cut. This can improve their profitability as interest expenses decline.

Falling rates might Positively affect the housing market to increase supply, but can adversely affect the REIT's due to high levels of Leverages

Oil Market Surge: Geopolitical Tensions, Central Bank Moves, and Supply Strains

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Geopolitical Risk Premium Drives Price Recovery

- The geopolitical risk premium has risen to **$5-10/bbl**, supporting a recovery in benchmark prices from the low **$70s** to **$78-80/bbl.**
- Ongoing tensions in the Middle East, especially concerning Iran and Israel, keep prices below average levels of **$82/bbl** in **2Q24** and **$85/bbl** in **3Q24.**

Central Bank Policies Under Pressure

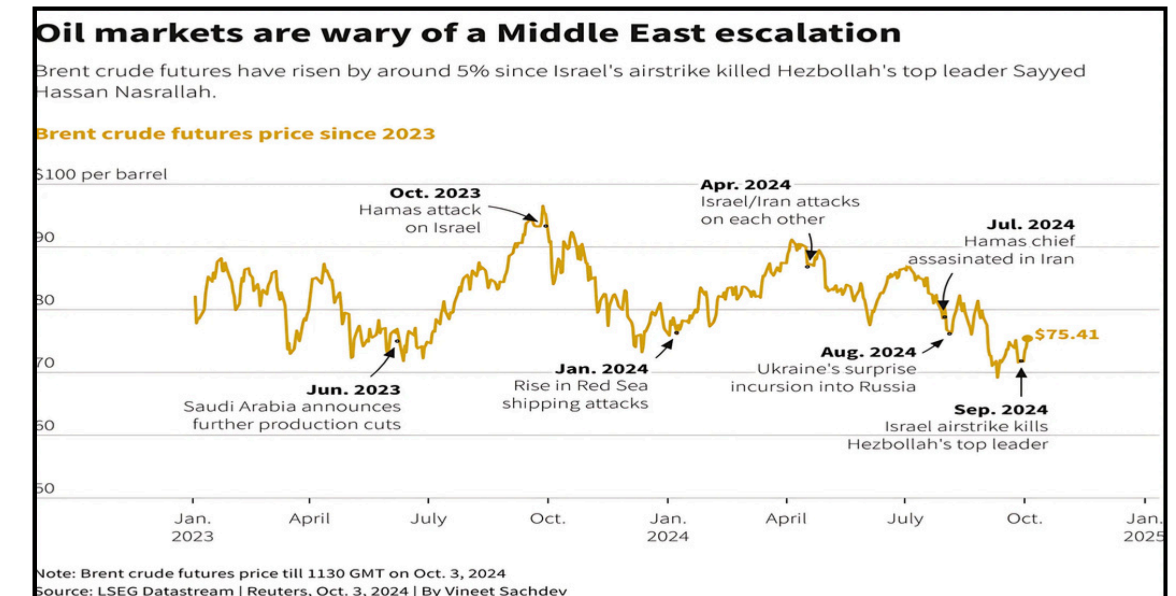
- Rising oil prices intensify inflation concerns, influencing the Federal Reserve's consideration of interest rate cuts despite a **336,000** increase in September nonfarm payrolls.
- The **European Central Bank** and **Bank of England** are monitoring inflation above **4%**, with energy prices affecting their rate-setting strategies.

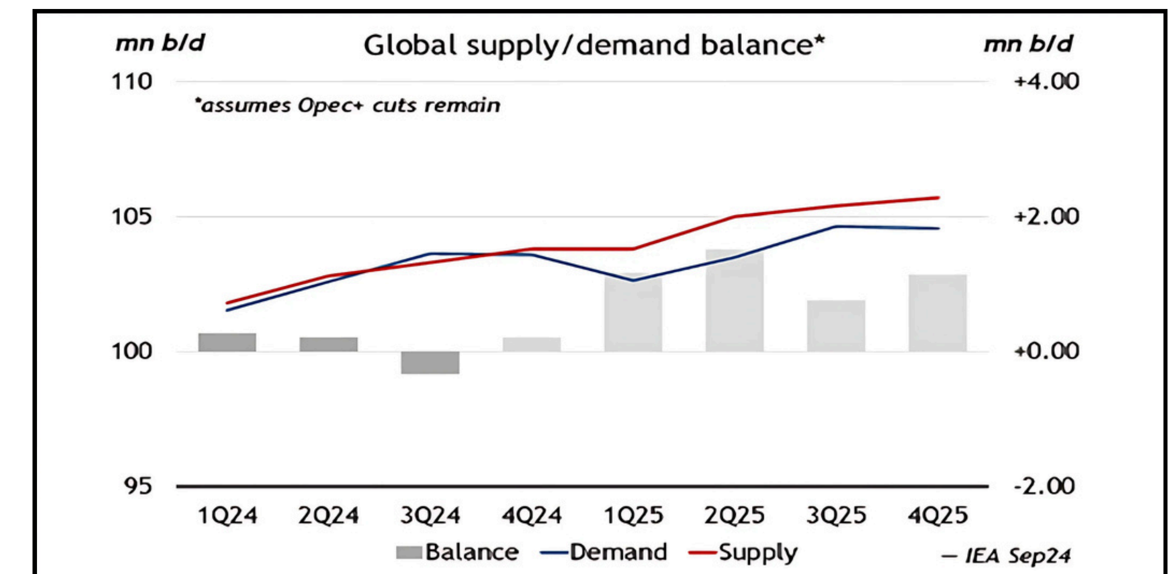
Inventory Trends Indicate Market Dynamics

- Global oil inventories fell by **22.3 million bbl** in August, primarily due to a **16.5 million bbl** draw in crude stocks.
- **OECD** industry stocks decreased by **13.4 million bbl** to **2,811 million bbl**, now **102.7 million bbl** below the 5-year average, indicating tighter supply conditions.

Supply Constraints and Structural Overhang

- OPEC's spare capacity exceeds **5 million bpd**, with **2.2 million bpd** of voluntary cuts set to unwind gradually, contributing to a structural overhang in the market.
- Russian crude exports have decreased by **370,000 bpd**, while Libya's production has risen to **1.13 million bpd**, adding complexity to the supply dynamics influencing global oil prices.





Following geopolitical issues, surplus in oil supply is projected to significantly lower prices

Eyes On Asia: Taiwan

Taiwan is world's chip making factory holding a dominant position is semiconductor space

- Taiwan is a key link in the global technology supply chain for companies such as Apple and Nvidia, and is home to the world's largest contract chipmaker, Taiwan Semiconductor Manufacturing Co. Ltd. (TSMC)
- Dominance of the global market for chips means the industry is hugely important to Taiwan's economy, accounting for 13% of its GDP(TSMC alone makes up 8%) and 40% of exports last year.
- GDP expected to grow at 3.9% vs 3.94% budgeted due to weaker than expected exports primarily due to China slowdown. 2024 export estímate +8.71% y/y, from +10.06%
- The PMI for Taiwan stood at 50.8 in September, falling from 51.5. Manufacturing activity shrank in Vietnam, Malaysia and Indonesia (in alignment of world manufacturing slowdown)

Risks:

- Political threat from 'motherland' China resulting in a volatile situation for Taiwan and its economy. The number of PLA ships operating around Taiwan has steadily risen, too, doubling from 142 in January to 282 in August.
- Concentration on technology especially chip – making. 90.4% of Taiex (Taiwan's index) is dominated by technology-based companies
- Upcoming competition leading to a gradual decline in Taiwan's centrality to the chip industry. TSMC's share of chip wafers smaller than 10 nanometres fell from over 90% in 2019 to 70% in 2022, and is expected to drop to 47% by 2032

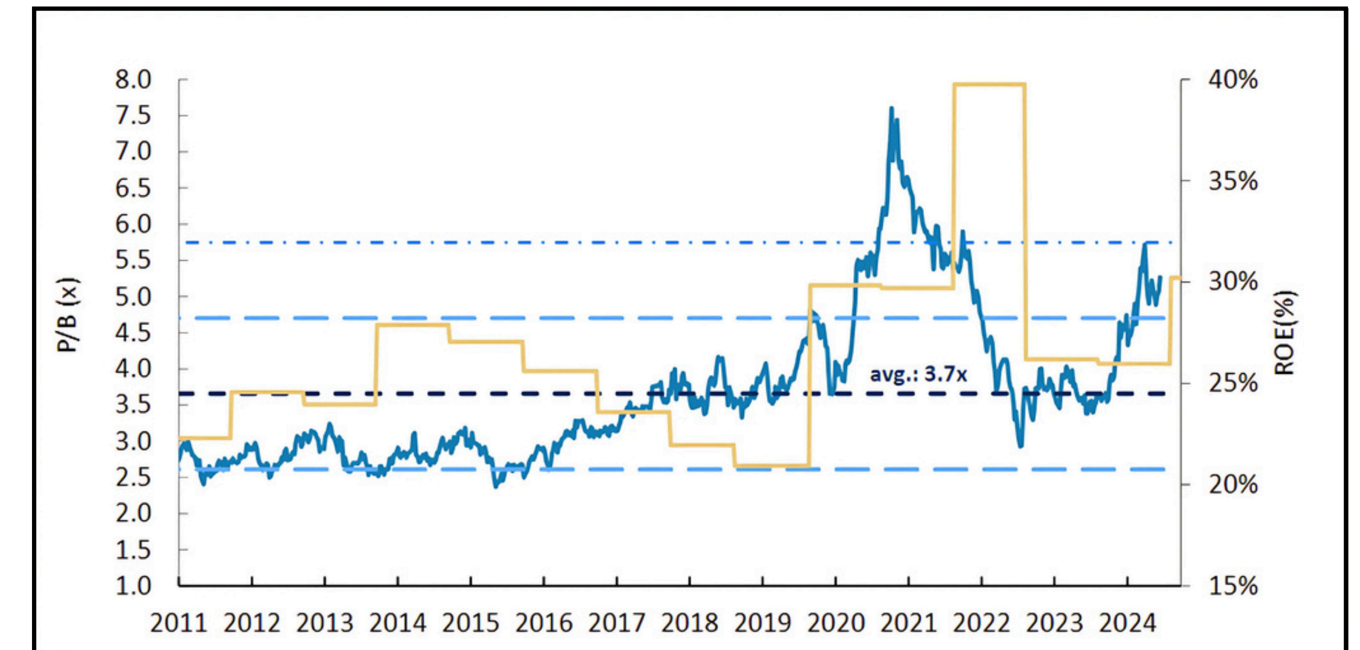
How to invest:

- **ETF** : EWT which has 24% concentration in TSMC and 6% in Foxconn
- Direct equity or options : The largest 2 players in Taiwan are TSMC and Foxconn

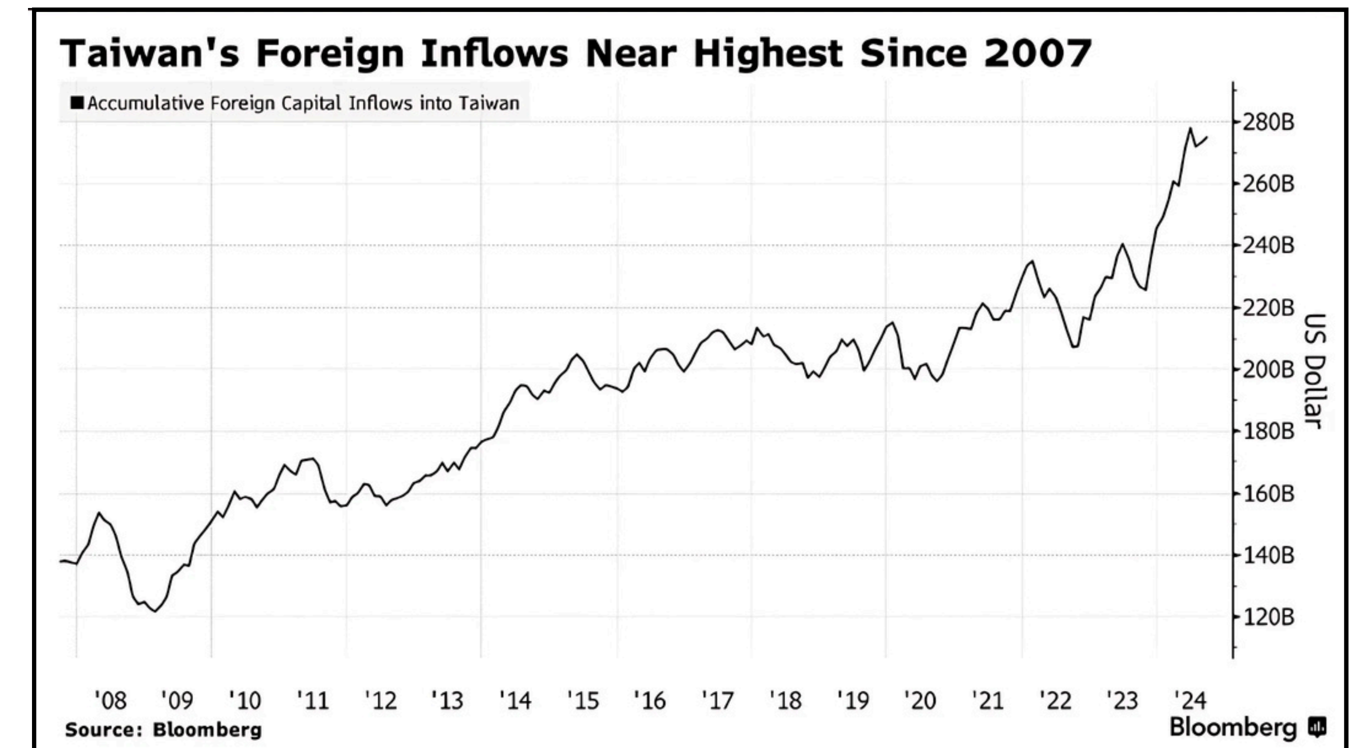
	3m	6m	9m	1yr
EWT	4.98%	21.35%	31.37%	27.37%
SP500	5.77%	17.03%	22.67%	35.93%

Source : Reuters

TSMC P/B and ROE trend



Source : Morgan Stanley



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Get In Touch

ASAS CAPITAL
أساس كابيتال

702 South Tower PO BOX 506806 Emirates Financial Towers, DIFC Dubai, UAE

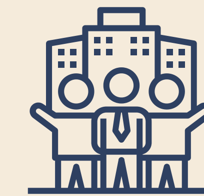
+971 4346 4700

inquiry@asascapital.com

www.asascapital.com

Asset Management

Private Equity


Corporate Advisory