



## **CIO OFFICE MORNING MARKET WRAP – Monday September 20<sup>th</sup>, 2021. ALSO AVAILABLE ON ALEXA**

Stocks and US equity futures are falling this morning, as Hong Kong property developers slump, following a report that Beijing could extend its crackdown to the city's real estate firms. Investors are also assessing contagion risks from giant developer Evergrande's debt crisis and looking ahead to the Fed meeting expected to provide clues to the tapering of stimulus.

In yesterday's note we mentioned some of China woes and why, from a top-down point of view, the outlook is not as bad as one would think when using a rear-view mirror. As far as Evergrande's woes are concerned, the indebted property developer in desperate need of restructuring, it is exactly the opposite: one would wish they were never to look ahead and they could just look back, as the restructuring seems now to be inevitable, and most likely painful, especially for international bondholders. With more than \$300bn in liabilities and not even \$15bn in cash, Evergrande will not be able

to make loan interest payments due Monday, that is today. The big headache for the government is the degree of interconnectedness of the debt of this 'too big to fail' company with the rest of the economy. Hence, whatever the restructuring path, it must follow a well-devised plan, considering its inevitable knock-on effects on other developers and the end market. The restructuring is inevitable, as Evergrande's working capital consists mainly of tier 2 and tier 3 unfinished projects, which the company has been unable to sell as the sector started to slow down, so turning land and projects into cash is a non-starter, unless offering massive discounts and wiping out the entire company's equity is an option. As for the interconnectedness: Evergrande not only owes billions of dollars to suppliers, often paid in unfinished units, and to clients, who bought on pre-sale agreements, but it also sold wealth management products to employees, suppliers and apartment buyers, thereby getting a form of off-balance sheet funding. For a government implementing the new "Common Prosperity" economic model aimed at supporting the middle class, it would not be possible not to bail out small business and retail creditors, so international bond-holders will have to bear the brunt of the painful restructuring. Evergrande has not been on our recommended bond list.

On a different note, at its new-product event last week Apple unveiled a new iPhone 13, trying to entice customers with an improved camera and processor, rather than with fanciful, innovative design. Also, Apple is counting on the introduction of other upgraded devices, including bigger watches and speedier iPads, to boost growth. The 5G upgrade cycle this year should also help the company push the new products to consumers. The event was in line with expectations in terms of new-feature launch, although limited surprises in new features should result, if history is any guide, in post-event share price weakness. Yet, longer term positives continue to stand out for Apple: enhancement of camera and battery, as well as 5G capabilities should drive consumer interest; consistent pricing versus previous models should entice upgrades; the new features of the Apple Watch should enhance its positioning within the wellness segment; the major upgrade to the iPad mini should drive a demand of its own. This is all still quite impressive for products with no new blockbuster features!

We are yet again approaching that time of the year when Congress will have to decide to lift the debt ceiling for the US Treasury to be able to finance government expenditures. Larry Summers, ex Treasury Secretary, said that there would be "a lot of ... posturing" by politicians in the coming weeks over the raising of the debt limit, before they agree to do it in the end. Treasury Secretary Janet Yellen urged Congress to increase the limit as soon as possible, as the extraordinary funds to avoid a breach of the limit could run out as soon as October. Republicans on their side are digging their heels in, as the Democrats are working to push through Congress the \$3.5tn tax

and social spending bill via the so-called reconciliation process, which would not require Republican support for the package. As a result, Mitch McConnell, the Senate's top Republican, said that the Democrats will have to raise the debt ceiling on their own, even as Janet Yellen warned of a financial crisis if the ceiling is not raised. Larry Summers may be right, in the end it will be done as it has always been, but the increased polarization of US politics is raising the stakes, hence market volatility is anything but guaranteed as the deadline approaches. Janet Yellen has reiterated today in a Wall Street journal article that failing to act soon would cause a “catastrophe”. Stay safe.

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