Investment Strategy Update

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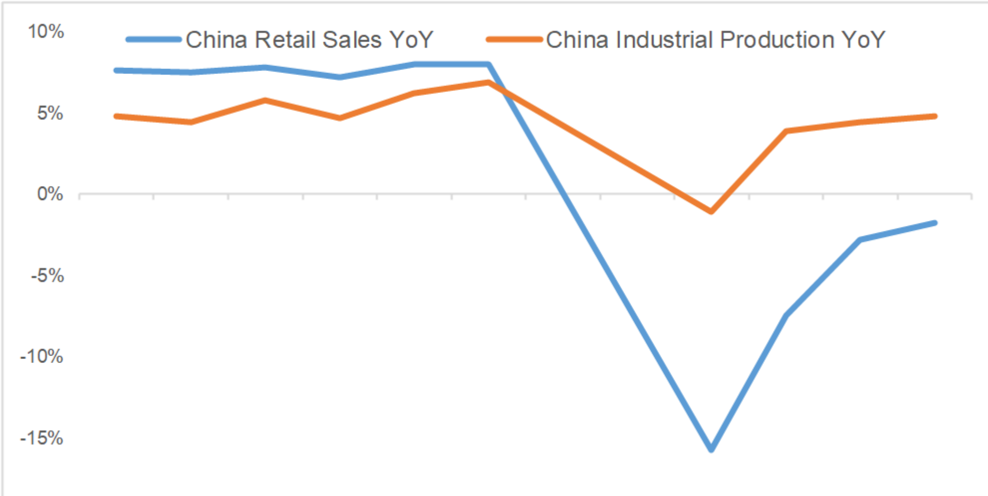
If China is the roadmap for recovery, then it will be uneven

- **The country's industrial production has started to normalize but retail sales continue to shrink.**
- **Trade has recovered but imports are still 11.7% below year-end 2019 figures and exports are 10.5% lower .**
- **Similarly, the manufacturing measure for New York has recovered faster than expected, but the services sector continues to lag.**
- **As new cases increase in the US, the recover in services may be elusive.**
- **FAB AAC remains overweight high-quality investment grade bonds.**



Sources: National Bureau of Statistics, Bloomberg, FAB

China was the first country to suffer the new coronavirus pandemic, the first to lockdown and the first to reopen for business. Since the virus appeared in the nation and spread through the world, politicians, company officials and investors have all turned to China for clues on how to deal with the virus and to expect from it.

In that sense, there has been a lot of celebration around the latest economic numbers from China, many of which show that not only the country's economy is very quickly on the mend, but some measures, such as auto sales in May and June, are even better than they were before. The second quarter GDP numbers confirmed that, showing the country had expanded 3.2% year-on-year, reversing some of the 6.8% drop in GDP seen in the first quarter.

The devil, however, is in the detail. The country's recovery has been uneven, with some sectors accounting for a bigger part of the growth than others, and that is bad news for the rest of the world.

For instance, this morning the National Bureau of Statistics said that industrial production expanded 4.8% in June compared to a year ago, accelerating from the 4.4% recorded the previous month. Retail sales, however, continued to shrink and were down 1.8% year-on-year, better than the 2.8% drop the month before but worse than estimates.

Similarly, exports have recovered faster than imports, in a sign that consumer demand in China is lagging manufacturing output. A similar dynamic was seen in the data from New York, which, like China, was one of the first states in the US to close down. Retail numbers from for the New York Metropolitan area were still shrinking at a 32.2% rate in June, according to SpendTrend, while the Empire Manufacturing Survey of the New York Fed returned to the green, surprising economists, yesterday.

That is a major concern for the US economy which depends on services for nearly three quarters of its growth.

While Chinese factory output has started to grow again, retail sales are still shrinking

Extrapolating the Chinese economic data to the US may cause some questions about the strength and timeframe of the American recovery, but it also underscores the fact that China seems to be past the worst. That fact may be part of the reason why Chinese stock markets are rallying.

Part of it too, naturally, is the fact that the government has indicated through a recent editorial in a local newspaper that it would like to see a "healthy bull market". Retail investors have taken that as a cue to go back into stocks and have driven a 20% rally in the month ended yesterday.

That dynamic reversed today as a newspaper criticized Kwaichou Moutai, the biggest listed company in China. Yet, the momentum is clear. That does not mean the west will follow the same path.

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