China in a Bull Shop

When there is mention of concerns over the global growth backdrop, one of the main areas of focus is China. The Chinese economy experienced an extremely strong expansion through the 1990s and first decade of the 2000s, fueled by the country's rapid urbanization and industrialization, which, in turn, were underpinned by a surge in credit growth.

History shows, however, that such booms are not sustainable and rarely end well. Accordingly, virtually every official international body began waving the red flag over debt. Chinese policymakers responded and worked to clamp down on those areas of excesses, specifically on non-bank lenders.

China's growth was already moderating (10%+ growth rates are not sustainable forever and eventually growth converges with a rate equal to the growth in domestic labour forces and technology) with the deceleration becoming more notable over the last year. Growth in the world's now second largest economy in 2018 hit its slowest rate since 1990 (though still in excess of 6%) as domestic credit growth slowed, pressuring business investment as well as consumer spending (particularly among big ticket items such as autos and housing).

Policymakers in Beijing have the capacity to offer support for the economy and are showing an increasing willingness to provide it. The People's Bank of China recently cut the reserve ratio for all banks, freeing up more than $100 billion for new lending, while the government indicated it will soon roll out targeted policies to support domestic consumption, including tax cuts and infrastructure plans. While more stimulus is expected to be introduced to further underpin growth, there are worries that China will not be able to successfully navigate a "soft landing" without sacrificing the progress made on financial stability.

These internal issues are compounded by the ongoing tensions between China and the US. While undoubtedly weighing on sentiment and market performance, the negative impact of the added trade barriers has been somewhat muted so far but given how deeply intertwined global supply chains are, the longer the trade uncertainties persist, the more significant the direct hit to activity. Moreover, fallout will likely widen given that the importance of China and the US means that the reverberations are felt across all corners of the globe — particularly among developing countries in Southeast Asia and Latin America that are heavily dependent on exports to and investment from China and the US as a driver of growth.

There is a shared interest in reaching a resolution and there have finally been some signs of progress on this front. China has offered up some concessions by way of reducing auto import tariffs, increasing its imports of US-produced goods and opening up market access, while the US has agreed not to follow through on the planned tariff increases as part of the 90-day ceasefire agreed to in December. Both parties have agreed to resume talks over the coming months in hopes of reaching some sort of compromise that permits both sides to save face.

Of course, there is seemingly no such thing as a sure thing right now and as such, uncertainty and volatility are likely to persist. While this can lead some investors to avoid exposure to the potential downside risks associated with China, the growing importance of its economy means that it cannot just be ignored. The focus needs to be in managing exposures by maintaining a focus on high quality global companies that have a foothold in China rather than necessarily investing directly in the still maturing Chinese market — lest investors be stuck outside looking in.

It makes sense that the clouds on China's outlook carry material implications for the global growth backdrop — and with it, the direction of the performance of risk assets. While risks abound, the market is arguably being overly pessimistic and the data seems to suggest that reports of the death of the second largest economy are greatly exaggerated. In other words, despite the concerns, in a reversal of the old adage, China has not yet broken the bull (market).

This document includes information and commentary concerning financial markets that was developed at a particular point in time. This information and commentary are subject to change at any time, without notice, and without update. This commentary may also include forward looking statements concerning anticipated results, circumstances, and expectations regarding future events. Forward-looking statements require assumptions to be made and are, therefore, subject to inherent risks and uncertainties. There is significant risk that predictions and other forward looking statements will not prove to be accurate. Investing involves risk. Equity markets are volatile and will increase and decrease in response to economic, political, regulatory and other developments. The risks and potential rewards are usually greater for small companies and companies located in emerging markets. Bond markets and fixed-income securities are sensitive to interest rate movements. Inflation, credit and default risks are also associated with fixed income securities. Diversification may not protect against market risk and loss of principal may result. This commentary is provided for educational purposes only. It is not offered as investment advice and does not account for individual investment objectives, risk tolerance, financial situation or the timing of any transaction in any specific security or asset class. Certain information contained in this document has been obtained from external parties which we believe to be reliable, however we cannot guarantee its accuracy. Guardian Capital Advisors LP provides private client investment services and is a wholly-owned subsidiary of Guardian Capital Group Limited, a publicly traded firm listed on the Toronto Stock Exchange.