MONTHLY COMMENT

September 2021

MARKET REVIEW

Swirling winds from China

September proved to be a whirlwind month. The FED's willingness to reduce its interventions, the debt ceiling discussions and concerns from China and its real estate market all led to a gradual increase in nervousness. The markets are in turmoil and have suffered significant declines. Switzerland was not spared and despite the defensive nature of its flagship index, the SMI, Swiss stocks finished among the worst performers of the month. China, against all expectations, posted a positive performance.

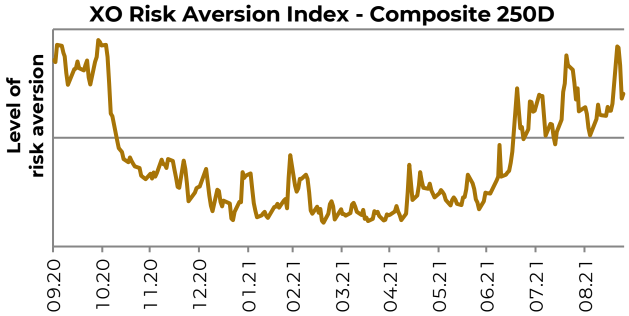
The movement in interest rates was significant in almost all markets. Even Switzerland saw its 10-year rate rise by almost 20 basis points. The consequence is obviously a fall in the value of bonds, with indices plunging into the red since the beginning of the year. The rise of real estate is also slowed down.

As for commodities, oil has reached a high since the beginning of the year, exceeding $75 per barrel. As for gold and precious metals, they are suffering following the statements of the U.S. Federal Reserve, and this despite real interest rates still extremely negative.

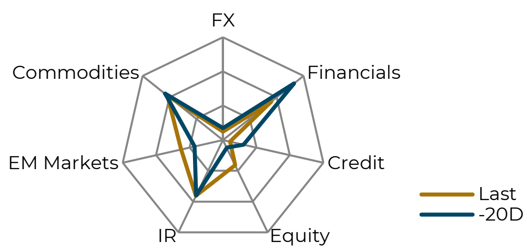
Our risk indicators continue to rise on all components.

	Value	September	2021
Equity markets			
Switzerland (SMI)	11 642	-6,19%	8,77%
United States (S&P500)	4 308	-4,76%	14,68%
Europe (Euro Stoxx 50)	8 917	-3,41%	15,88%
Japan (Nikkei)	29 453	4,85%	7,32%
China (Shanghai SE)	3 568	0,68%	2,74%
Brasil (Bovespa)	110 979	-6,57%	-6,75%
Currencies			
USD/CHF	0,934	1,99%	5,52%
EUR/CHF	1,079	-0,21%	-0,23%
GBP/CHF	1,255	-0,29%	3,81%
EUR/USD	1,157	-2,00%	-5,35%
Other asset classes			
Swiss Real Estate		-0,28%	6,44%
Swiss Bonds		-1,29%	-1,68%
Foreign Bonds		-1,04%	-2,26%
Commodities		6,03%	38,27%
Oil	75,03	9,53%	54,64%
Gold	1 758,27	-3,08%	-7,18%
Rates / Indicators			**Δ**
10 years Swiss rate		-0,16%	0,39%
10 years US rate		1,49%	0,57%
US Unemployment		5,20%	-1,50%
US GDP		12,20%	14,50%
US CPI		4,00%	2,40%

XO Risk Aversion Index - Composite 250D



XO Risk Aversion Index - Components



IS CHINESE REAL ESTATE BUILT ON SAND ?

Real estate speculation in China is leading President Xi Jinping to take action to limit tensions resulting from skyrocketing prices.

A new regulation

The Covid crisis is gradually giving way to other issues. China has been delivering its share of surprises recently. The upcoming presidential elections in 2022, with the will of President Xi to extend his tenure, has been preceded with the implementation of extensive new regulations. While the luxury and education sectors were at the center of concerns until a few weeks ago, it is now the turn of the real estate sector.

The Chinese real estate market has been in a golden age for almost 20 years. Many companies have emerged and become capital giants. This is the case of the Chinese company Evergrande which, in this month of September, is paying the price of an unbridled expansion policy. With debts of up to EUR 260 billion, the company is under pressure, due to a new regulation requiring the sector to complete construction of the property before it can be sold. With 1.4 million unfinished homes, Evergrande is trapped by its own expansion, and future owners left worried about losing their property.

The stock has seen its share price pummeled almost 10-fold, with its bonds verging on default in September.

Evergrande Stock Price

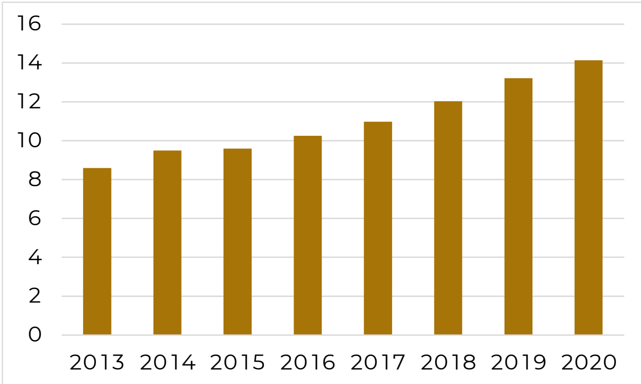
Source : Bloomberg, XO Investments SA

It is therefore the entire Chinese real estate sector that is in trouble through this colossus with feet of clay.

A gigantic expansion of the sector

Chinese real estate is emerging from a decade of massive investment. The urbanization and the still positive demography of these first two decades of the century have allowed the development of gigantic cities. In the year 2020 alone, 14 trillion Yuan have been invested, which is more than 2 trillion USD.

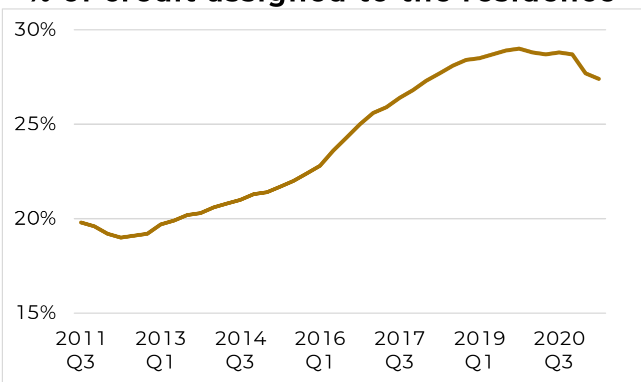
Real estate investment in China (RMB trillion)



Source : CRU Group, XO Investments SA

This growth is also driven by credit expansion. Between 2011 and 2020, household credit allocated to their residence increased by 10 percentage points.

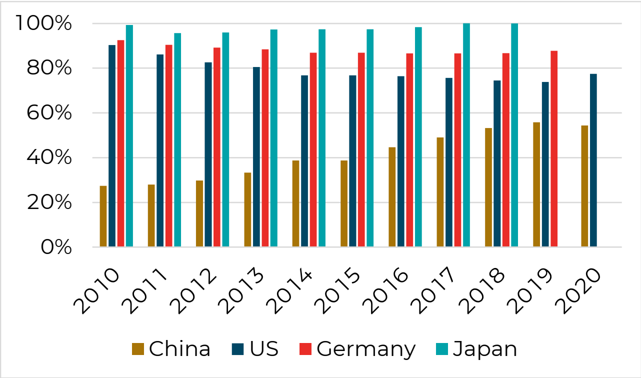
% of credit assigned to the residence



Source : Bloomberg, XO Investments SA

Chinese household debt was barely 30% of GDP in 2010. It has doubled in 10 years. China is gradually approaching the debt levels of Western countries. It is interesting to note that even American or German households are gradually reducing their leverage, which is not the case for Chinese households.

Household debt as % of GDP



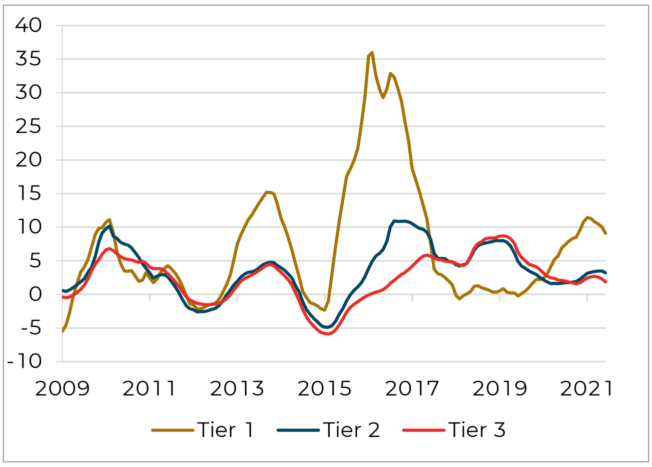
Source : Bloomberg, XO Investments SA

High prices

So much investment coupled with high demand has led to a massive increase in prices over the last decade.

The growth rate of real estate prices is still around 3% per year in cities with less than 15 million inhabitants. This figure has been declining over the past three years. As for the annual growth rate of real estate prices in megacities with more than 15 million inhabitants, it reaches almost 10%.

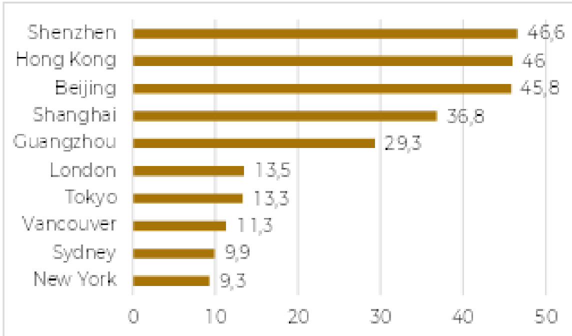
Annual growth of residential prices in China[1]



Source : CRU Group, XO Investments SA

With such high growth rates, real estate prices are reaching levels that make it difficult to buy real estate. One statistic that helps to clearly understand this phenomenon is to study the multiple of real estate price to income. This figure reaches 45 times in China! It is 3 times higher than in cities like London, Tokyo or New York which are themselves known to be expensive for their inhabitants.

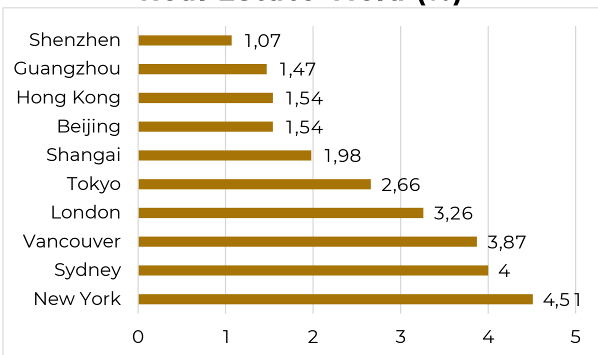
Real Estate prices as a multiple of income



Source : Bloomberg, Numbeo, XO Investments SA

As a corollary, real estate yields are collapsing and are barely above 1%! This figure is all the more striking as the basic interest rate in China is not negative as in Western countries but is currently over 4%. The real estate risk here is therefore no longer remunerated at all. With such low returns and potential taxes to pay, many investors choose to leave apartments vacant. 60 million homes were vacant in 2017 as a result.

Real Estate Yield (%)



Source : Bloomberg, Numbeo, XO Investments SA

Measures to cool the sector

The Chinese government is therefore trying to act to limit the real estate problem. Many cities have suspended the sale of land and a real estate tax is also being considered. President Xi is doing everything he can to reduce the inequalities created by the rise in property prices, arguing that "property is for living, not for speculation".

China, torn between communism and capitalism, is facing not only a real estate problem but also a financial problem and a problem of social model.

[1] Tier 1 : cities with more than 15 million inhabitants, Tier 2: cities with 3 to 15 million inhabitants, Tier 3: cities with 15'000 to 3 million inhabitants.

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