

Market Commentary Third Quarter 2024

Singaporean leader Lee Kuan Yew fascinates me. As Singapore's prime minister from 1959 to 1990, he transformed a poor, developing nation to a First World country.

"When Lee took over, per capita income was about \$400 a year; it is now more than \$50,000," as Henry Kissinger points out in his forward to *Lee Kuan Yew: The Grand Master's Insights on China, the United States, and the World*.¹ Published in 2013, the book is a collection of interviews and selected quotations from Lee, which are particularly interesting on the topic of China. I believe Lee's insights still apply today, although he died in 1990.

I've sometimes thought about China surpassing the U.S. in terms of influence and economic power. Lee has a measured view. He agrees that, "It is China's intention to be the greatest power in the world."² However, "The Chinese are in no hurry to displace the U.S. as the number 1 power in the world and to carry the burden that is part and parcel of that position. For now, they are quite comfortable in being part of a larger group like the G20 [Group of Twenty] where their views will be taken seriously and economic interests safeguarded, but the responsibility is shared amongst 20 member states."³ Moreover, self-interest will restrain China's interactions with the U.S. As Lee says, "China knows

that it needs access to U.S. markets, U.S. technology, opportunities for Chinese students to study in the U.S. and bring back to China new ideas about new frontiers. It therefore sees no profit in confronting the U.S. in the next 20 to 30 years in a way that could jeopardize these benefits."⁴

China needs the U.S. partly because of differences in the two countries' cultures. "China will inevitably catch up to the U.S. in absolute GDP [gross domestic product]. But its creativity may never match America's, because its culture does not permit a free exchange and contest of ideas," says Lee.⁵

Still, Lee notes that, "The 21st century will see Asia recover its place in the world," possibly referring to the traditional view of China as the "Middle Kingdom" that the rest of the world revolved around.⁶ His confidence was probably reinforced by his assessment of China's President Xi Jinping: "I would put him in Nelson Mandela's class of persons. A person with enormous emotional stability who does not allow his personal misfortunes or sufferings to affect his judgment."⁷

President Xi has determined that technology will be among the commanding heights of the Chinese economy. In a 2017 speech to Chinese tech titans and party leaders, President Xi called for China to

focus on “gaining breakthroughs in core technology as quickly as possible” and to “...assault the fortifications of core technology research and development.”⁸

This could be a “Sputnik moment” for China’s government as it sees itself falling behind the United States.⁹ The dominance of the U.S. and restrictions on the chip industry have “boosted Beijing’s quest for tech dominance,” says China tech policy analyst, Dan Wang.¹⁰ Export controls on critical technologies were introduced by the current U.S. administration and should continue regardless of the presidential election results in November. We consider this scenario when making investments.

Shifting to look at more immediate developments, I see that many Americans face a difficult economic environment. Layoffs continue, with major employers like Microsoft, Verizon, Lyft, Tesla, Alphabet, and Amazon announcing layoffs in 2024.¹¹

Are these layoffs a recession indicator? The Sahm Rule suggests that, invariably “the initial phase of a recession has started when the three-month moving average of the U.S. unemployment rate is at least half a percentage point higher than the 12-month low.”¹² The economy met this condition in August. Although the rule’s originator, Claudia Sahm, says we’re not yet in a recession, she does think the economy is heading toward recession, which would hurt the outlook for global financial markets.

Another possible concern for the future of global financial markets is the potential sequel unwind of the yen carry trade, in which investors borrow a cheap yen at Japan’s low interest rates to invest for higher returns elsewhere in the world. If Japanese interest rates rise and the yen strengthens, this could pressure non-Japanese markets. We saw a glimmer of this after the Bank of Japan (BOJ) raised its target interest rate to 0.25% in July, boosting the value of the yen and triggering a market sell-off.¹³ On Sept. 16, the dollar hit its lowest level versus the yen in more than a year.¹⁴ The BOJ is in a wait and see period but uniquely among global central banks could raise overnight interest rates again next year.

In the few short weeks since I first drafted my commentary above, the Federal Reserve lowered interest rates by 50 basis points (0.50%), China added fiscal stimulus, and no further rate cuts are indicated for the remainder of 2024. The Federal Reserve’s aggressive move of lower rates at the first sign of slowing feels different from previous regimes. The environment is dynamic, with pieces changing in different ways than we have seen historically.

Amid this environment, I’ve reduced risk in client portfolios. The portfolios’ beta—the extent to which asset prices swing in tandem with markets—is now lower versus the beginning of the year. However, if markets do correct, I’ll view that as an opportunity to increase risk by buying assets at newly attractive prices.

As I discussed in my previous letter, earlier this year, I added to bond portfolios' duration by laddering in bonds with longer maturities to take advantage of anticipated Fed rate cuts and a further flattening of the yield curve. That move has already paid off. Now, I'm holding duration steady but will consider adding to duration again at higher rates.

When portfolios are underweight stocks, I'm mostly adding in sectors that will benefit from lower interest rates. I'm also looking selectively elsewhere. For example, I'm monitoring a promising company with innovative medical technology. I also continue to seek attractive stocks that are smaller than the well-known mega-cap stocks.

As always, thank you for the trust you have placed in me and in 7Summit Advisors. We work hard to earn that trust each day.

Sincerely yours,

Li Chang

¹Henry Kissinger, Forward, *Lee Kuan Yew: The Grand Master's Insights on China, the United States, and the World: Interviews and Selections by Graham Allison and Robert D. Blackwill with Ali Wyne* (Belfer Center Studies in International Security, The MIT Press, 2013), vii.

²*Lee Kuan Yew*, 1.

³*Lee Kuan Yew*, 11.

⁴*Lee Kuan Yew*, 11.

⁵*Lee Kuan Yew*, 7.

⁶*Lee Kuan Yew*, 16, 3.

⁷*Lee Kuan Yew*, 18.

⁸*Chip War, The Fight for the World's Most Critical Technology* by Chris Miller, 248, 252.

⁹Chris Miller, 320.

¹⁰Chris Miller, 320.

¹¹Joseph De Avila, "Layoffs in 2024: A List of Companies Cutting Jobs This Year," *The Wall Street Journal* (Sept. 12, 2024), <https://www.wsj.com/business/layoffs-2024-companies-tracker-list-6acb4e95?page=1>

¹²Samuel Meredith, "Everyone is talking about the Sahm recession indicator. Here's what you need to know," *CNBC* (August 5, 2024), <https://www.cnn.com/2024/08/05/recession-what-is-the-sahm-rule-and-why-is-everyone-talking-about-it.html>

¹³Nishanth Vasudevan, "ET Explainer: Why unwinding of Yen carry trades can rattle global financial markets," *The Economic Times* (August 5, 2024), https://economictimes.indiatimes.com/markets/forex/et-explainer-why-unwinding-of-yen-carry-trades-can-rattle-global-financial-markets/articleshow/112274532.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

¹⁴Chibuike Oguh and Samuel Indyk, US dollar hits more than one-year low versus yen as market eyes aggressive Fed rate cut "" Reuters (Sept. 16, 2024), <https://www.reuters.com/markets/currencies/currencies-listless-markets-waffle-over-fed-rate-cut-2024-09-16/>