SECOR

May 2022

Potential Impact of China Developments

By Edgar Sullivan, CFA and Anja Needham, CFA

The differences between the China-Taiwan situation and the Russia-Ukraine situation far outweigh the similarities. In this paper, we explore the impact and exposure to these geopolitical risks.

China is committed to reunification with Taiwan, but it is also committed to its common prosperity and growth objectives – e.g., 5.5% this year. The leaders of China feel that time is on their side and precipitous action is not required. For example, in 2019. Xi linked reunification with Taiwan with his overarching goal of achieving China’s “national rejuvenation” as a world power by 2049, the centenary of the People’s Republic of China.

China may cooperate with Russia in areas of common interest and welcome gaining preferential access to Russia’s natural resources. However, we believe that China’s support is likely to measured -- particularly as we witness the seeming success that the Ukraine is achieving in repelling Russia’s aggression, the responses of Western Europe and the US, and the devastating effects that the sanctions appear to be having on Russia’s economy. China is unlikely to explicitly declare support for Russia’s invasion of Ukraine, and unless they do, the risk of direct sanctions on China or on Chinese entities appear limited.

However, there is a risk of sanction spill-over, relating to the activities of Russian entities in China. Given the complex and evolving links between trade and investments, assessing the potential impact is not entirely straightforward – but is something our managers are closely monitoring. Additionally, Russia’s invasion of Ukraine has set off a chain of events including surging commodity prices, sanctions, and new trade bottlenecks that are requiring economists to revisit their global outlooks. For example, the OECD has recently reduced their outlook for 2022 global growth to 3.4% from 4.5%. Although the views of China’s leaders on the invasion may be nuanced, it’s reasonable to conclude that their policymakers entrusted with meeting this year’s 5.5% growth target – already burdened by virus-related shutdowns and weakness in the property market – did not welcome the collateral damage of sharply rising commodity prices and slowing international trade.

Our clients' direct exposure to China is relatively low and we believe indirect effects are likely to have a greater impact than direct exposures. Since China is the world's second largest economy and a key linchpin in global trade, the potential indirect effects of geopolitical events involving China could have far-reaching implications in the global economy and markets. Against this background, Equity Hedging programs should be a strong mitigant against indirect risks that could lead to an equity market downturn.

Taiwan's exposures are also low and currently not a major concern. While we acknowledge that Taiwan will continue to face considerable geopolitical risks over the longer term, we concur with the consensus view that an invasion by China in the foreseeable future is unlikely. Correspondingly, we believe that China's domestic economic considerations will foster policies that avoid being subject to debilitating sanctions for actions related to Russia's conflict with Ukraine.

In general, we do not view the direct exposures in China (or Taiwan) as a significant risk to our manager's performance – given their direct exposures are moderate at the client total portfolio level, and we do not view sanctions being imposed on China (due to invasion of Taiwan, or more outspoken support of Russia) as a base case. Indirect effects from geopolitical risks associated with China could be more concerning, so SECOR continues to closely monitor the situation.

Disclosures

Except where otherwise indicated, the information contained in this presentation is based on matters as they exist as of the date of preparation of such material and not as of the date of distribution or any future date. This document does not constitute advice or a recommendation or offer to sell or a solicitation to deal in any security or financial product. It is provided for information purposes only and on the understanding that the recipient has sufficient knowledge and experience to be able to understand and make its own evaluation of the proposals and services described herein, any risks associated therewith and any related legal, tax, accounting or other material considerations. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to their specific portfolio or situation, they are encouraged to consult with the professional advisor of their choosing, and recipients should not rely on this material in making any future investment decision.

We do not represent that the information contained herein is accurate or complete, and it should not be relied upon as such. Opinions expressed herein are subject to change without notice. Certain information contained herein (including any forward-looking statements and economic and market information) has been obtained from published sources and/or prepared by third parties and in certain cases has not been updated through the date hereof. While such sources are believed to be reliable, SECOR does not assume any responsibility for the accuracy or completeness of such information. SECOR does not undertake any obligation to update the information contained herein as of any future date.

Any illustrative models or investments presented in this document are based on a number of assumptions and are presented only for the limited purpose of providing a sample illustration. Any sample illustration is inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond SECOR's control. Any sample illustration may not be reflective of any actual investment purchased, sold, or recommended for investment by SECOR and are not intended to represent the performance of any investment made in the past or to be made in the future by any portfolio managed or advised by SECOR. Actual returns may have no correlation with the sample illustration presented herein, and the sample illustration is not necessarily indicative of an investment that SECOR will make. It should not be assumed that SECOR's investment recommendations in the future will accomplish its goals or will equal the illustration provided herein.

The statements in this presentation, including statements in the present tense, may contain projections or forward-looking statements regarding future events, targets, intentions or expectations. Due to various risks and uncertainties, actual events or results may differ materially from those reflected or contemplated in such forward-looking statements. Past performance is no guarantee of future results. Investments are subject to risk, including the possible loss of principal. There is no guarantee that projected returns or risk assumptions will be realized or that an investment strategy will be successful. No representation, warranty or undertaking is made as to the reasonableness of the assumptions made herein or that all assumptions made herein have been stated. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this document, will be profitable, equal any corresponding indicated performance level(s), or be suitable for your portfolio.