

Conversations with Commerce Trust Podcast

June Episode: Emerging Trends in the Global Economy — June 3, 2024

David Hagee: Hello and welcome to *Conversations with Commerce Trust*, our show about the markets, investment themes, and economic insights that matter to you. I'm your host, David Hagee, chief investment officer with Commerce Trust. Today we're discussing the global economy and trade and the investment opportunities available. I'm joined today by Kelly Jernigan, senior portfolio manager and team leader here at Commerce Trust. Welcome to the podcast, Kelly.

Kelly Jernigan: Hi, David. Thanks for having me. It's great to be here.

David: I'm excited to have you here. This is a topic that (I) love to go into, really talking about the global economy and sort of the changing dynamics here. I'm struck by over the past, say, three decades or so, we've really seen a sea change inside the global economy, moving from a very isolated economy into this era of globalization around the '90s (1990s). Can you help us define a little bit what globalization has meant?

Kelly: Absolutely. If we look at the '90s and the early 2000s, there's really a couple of catalysts that solidify the trend of globalization. One, of course, is NAFTA, the North American Free Trade Agreement, between Mexico, the U.S., and Canada. Another thing that occurred, of course, is the emergence of the Euro bloc and the Euro as a currency and the unification of Germany. Finally, China entering the WTO (World Trade Organization) and really coming onto the world stage as a global economy, which now rivals the U.S., certainly in terms of size.

David: Yes, that you have all these events going on. I think China is a great story to be able to illustrate this, is that certainly inside the '80s (1980s), China was really defined as a rural economy. What changed inside of this globalization era for China? Where did they go?

Kelly: One of the things that happened was a big shift of population from rural to urban China. This is of course because of the attractiveness of jobs. Even though low-cost labor benefited the American consumer, it definitely shifted people from rural to urban China. With that, of course, you had an explosion in both property development, infrastructure spend to bring China onto the world stage.

David: You have China emerging, and as we talked about, that they go through this rapid growth where they become the world's factory floor and they have all these jobs inside the urban space now. They become the second-largest world economy, but with that, you've seen different issues emerge around China. Maybe we could talk through a few of those, starting around the Great Financial Crisis (of 2007-2009).

Kelly: Absolutely. One of the things you saw with the Great Financial Crisis is you saw a lot of foreign direct investment come in not only in China, but, in the U.S. housing market. With the Great Financial Crisis, that really led to direct foreign investment slowing down because global investors, of course, were certainly hurt by the downturn in the U.S. housing market.



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Then, another thing you saw with China (is) with growth can come with pain, and we talked about ghost cities at that time where you have cities that were built where nobody lived in them. You had cities that were growing in size, and so you certainly had issues there. Some of those effects have lingered. Also, you have large youth unemployment and youth underemployment in China, which has resulted in part in this global slowdown. And throw in Zero-COVID with that, and then we have supply chain issues.

David: I think that's really an interesting topic to spend a little time on, is that as China emerged and as they became wealthier, from a savings vehicle point of view, people chose to use property as their primary vehicle to store their excess savings. With that, it's a leverageable asset class. Evergrande had the distinction of being a property developer that was the largest amount of debt held by a property developer. It has since cratered along, with another one called Country Gardens.

China is still working through this little bit of a housing hangover. Whether it be ghost cities or the government demolishing some of these buildings because they were probably more speculative than they were actually housing. They have this hangover now and then you throw COVID on top, it's just made it a little bit more challenging. As we've worked through this globalization, the great benefits to China, what were the benefits to the rest of the world in the globalization period?

Kelly: One of the things you saw was the American consumer certainly benefited, even though manufacturing of goods went overseas. You think about what happened to the textile industry in the U.S. We benefited; clothing actually went down in price. If you're in an emerging market, you would benefit because you're making although a relatively small salary, but in comparative terms, you're better off certainly than you were.

The semiconductor supply chain is a great example of that where chips are designed in the U.S., materials come from Japan, and manufacture happens in China and Taiwan. With Zero-COVID policy, that really just accelerated the fact that supply chains when they're that fragile can be broken. We've seen a little bit of reshoring and “slobalization” (the slowing of economic globalization) of the economy because of that.

David: The era of globalization starts to fade around the Great Financial Crisis. One of the more tangible ways that you can see that has been inside tariff policy. Certainly, since Smoot–Hawley in the '20s and '30s (1920s and 1930s), we hadn't seen great tariffs inside the United States. Kelly, just describe what we've seen in terms of tariff policy as well as trade restriction going on in this period post-Great Financial Crisis.

Kelly: One of the things that occurred during the Great Financial Crisis, of course, is that you saw a rise of populism. With that can come tariffs, but then with COVID, you really saw an acceleration of that with the breakdown in global supply chains, the need for reshoring. You saw a number of things, and particularly with EVs, with electric vehicles, correct? China has become a leading global manufacturer of EVs, of electric vehicles, and as a result, we want to prevent dumping of cheap cars into the U.S. market.



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It's something that Germany has struggled with in their manufacturing, and it's something that the Biden administration has recently put tariffs on EVs, as well as restrict chip exports into China. These, of course, have had an impact of slowing global trade.

David: I think that's a really interesting pivot point to move to next, is that as we go through this era of globalization where it seems like everyone's benefiting from it, as we know, there's some push and pull. Certainly, the U.S. economy's shifted from having a lot of manufacturing to having significantly less manufacturing over that time period, to more of a service economy.

Now as we're looking today at repercussions from the pandemic has been that we've had to see this redundancy in our supply chains, that no longer could we rely on a single source. Additionally, you've wanted to have some resiliency in your supply chain as well, and that's been nearshoring or onshoring. Maybe you could talk through a little bit about what that's meant for the U.S. economy and more specifically our broader regional trading block. I'm thinking North America here.

Kelly: Sure. One of the things that we've seen is the fact that more government subsidy in the U.S. has gone to industry both through the Green Act, the CHIPS (Creating Helpful Incentives to Produce Semiconductors) Act, the Inflation Reduction Act. Again, going back to that global supply chain for semiconductors, Taiwan Semiconductor is opening up fab, or fabrication, factories in Arizona because of investment from the CHIPS Act.

Samsung, which is a South Korean company, is benefiting from the CHIPS Act. There are benefits in terms of diversifying the supply chain, manufacturing renaissance in the U.S., as well as companies like Apple who used to manufacture 100% of iPhones in China is now diversifying that, and around 14% of iPhone manufacture is now in India, which is an increasingly emerging story on the world stage.

David: I think that's interesting to look at the new trends moving forward as we're looking-- You mentioned India, very fast-growing economy, is currently the world's most populous country as well. I'm thinking the rest of Southeast Asia as well is that you started to see the clothing trade move from China to the next low-cost country, Vietnam, out there to be able to drive some of this trade. What are we thinking for the trends currently emerging inside the global economy?

Kelly: India I think is a great example of this diversification of supply chain. It is a world service center. It's become the fifth largest stock market. Then you mentioned Vietnam. It used to be when you bought a shirt, it'd be manufactured in China. Now we're seeing, of course, made in Vietnam. We're seeing Indonesia, we're seeing Malaysia. Countries will continue to benefit, and their populations will continue to benefit from the diversification of supply chain. India, with this population growth, they've really accelerated their presence on the world stage, and so that will continue to be something that we watch here at Commerce Trust.



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David: We've talked mostly about the global economy today. How's that translated in the U.S.? I'm struck by how dynamic the U.S. economy is, that it has morphed from being a manufacturing to a service-led economy. Any other thoughts around where we're headed with the U.S. economy and what's been our drivers?

Kelly: We're certainly a service-driven economy, but one of the things I think that's been notable is our robust employment, and the fact that (un)employment has remained rather low, especially historically, so there's certainly opportunities there.

Then if you look at the leading sectors of our economy really driving global growth overall. We've talked about the Magnificent Seven in the past, the leading tech industries, the consumer discretionary and Apple, Meta, communication services. The market cap of these companies actually equals the market cap of the U.K., Japan, and Canada. If you look at those drivers, we certainly have the ability to continue to see the U.S. lead the economic world stage.

And then the (U.S.) dollar continues to grease the world's economy. Even though there's been some things at the periphery, there's no substitute for the U.S. dollar when it comes to global trade.

David: Yes. The dollar continues to have a significant amount of strength. In fact, it's even grown in terms of its transactional acceptance globally here. As we talk about the global economy and the shifting sands and the benefits in globalization accruing to U.S. corporations that had access to lower cost labor, and then maybe as we've transitioned through a period of “slobalization” into this current period of deglobalization, where are you seeing the investment opportunities right now?

Kelly: I think it's important to remain diversified across both equity asset classes and fixed-income asset classes in order to take advantage of opportunities that we see in India, for example. It's important to remain diversified to take advantage of these opportunities, and that's something that we'll continue to do.

David: Yes, it's definitely been a changing investment environment for us as we've seen this replumbing of the global economy out here.

Thanks very much for the interesting conversation today, Kelly. Truly enjoyed it.

If you've enjoyed what you've heard, you can subscribe to our show on Apple Podcasts, Spotify, Amazon Music, or wherever you get your podcast from. Thank you for joining us on *Conversations with Commerce Trust*. I'm David Hagee. We'll talk again soon.



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