

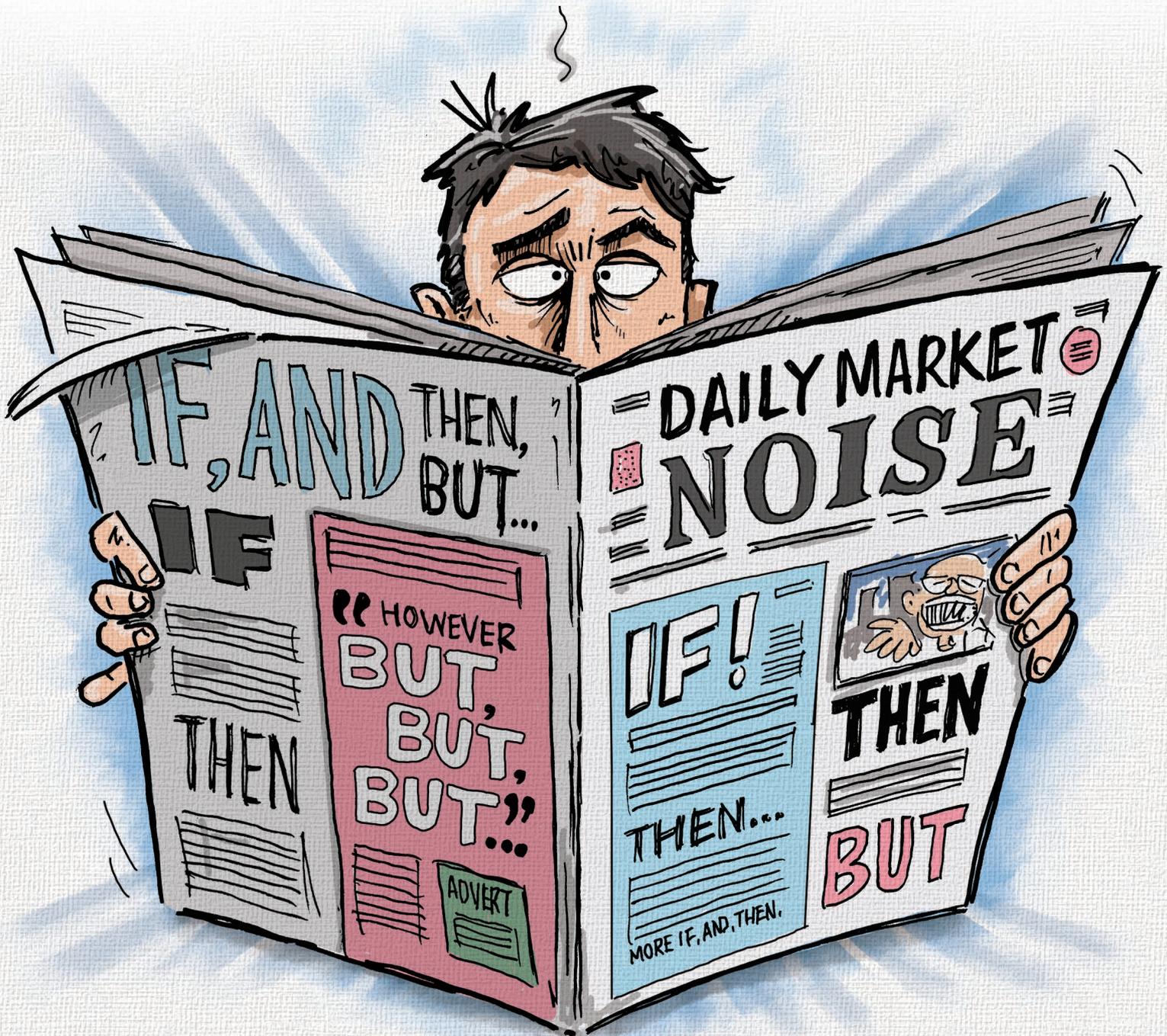
# INSIGHT

THE GREATEST WEALTH IS **YOUR PEACE OF MIND...**



BARNETT  
RAVENSCROFT  
WEALTH MANAGEMENT

## If, and, then, but...



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## If, and, then, but...

**For those readers interested in financial news (some might call it noise), the unfolding story of Chinese property developer Evergrande (a name which is ironic given its dire financial position) has spooked global equity markets.**

The short version of the story is that the company is very highly leveraged i.e. it has borrowed US\$300 billion from banks to fund its property developments and has hit material cash flow problems, leaving suppliers and debt repayments at risk. Property prices have risen dramatically in urban China over the past few years and the Chinese Communist Party (CCP) is now clamping down on bank lending to slow the boom, which is part of Evergrande's problem. To add to the drama, Evergrande has also sold high risk retail products to its wealth management arm's clients, which it appears to have misrepresented as low risk investments. Some of these investors' funds have been diverted to shore up the company's own working capital and some have allegedly been used to pay off other investors, which is the hallmark of a Ponzi scheme. More acutely, the company needs to meet an interest payment of US\$84 billion this week and the markets are waiting with bated breath to see if they manage to do so. Its bonds are trading at 25 cents on the dollar and its equity has fallen by 85% in value in 2021. Not pretty.

**IF** Evergrande default - some have suggested this could be the equivalent of Lehman Brothers collapse that set off the market falls leading into the Global Financial Crisis - **AND** if this then leads to the collapse of the company with repercussions for lending banks (most of which are Chinese), **AND** if there is a resultant fire-sale of properties, **AND** suppliers go unpaid **AND** this all precipitates a collapse of other development firms, **THEN** this could cause a major challenge for the CCP (not least that 1.4 million buyers who have put down deposits on unfinished properties) **AND** impact on Chinese growth on which the world depends. Could it **THEN** cause a contagion in global markets resulting in a major decline in stock markets around the world?

**BUT**, hold on a minute, what started as a potential corporate default has grown – in this story – into a major decline in world growth and a stock market crash! **BUT** in this case, much of the debt is in local currency and lent by banks that are mostly owned by the CCP, which can force them to roll or forgive debt and provide unlimited liquidity to the banking system. It does not mean that things will be easily resolved, **BUT** it does not mean that the conflated **IF, AND, THEN** story of conditional probabilities is likely to occur.

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It is important to remember that many material world events occur on a regular basis, but do not always end up in negative market outcomes. Even COVID, which put a dent in equity market valuations in early 2020, has failed to turn into a prolonged downturn. Global markets are now well above their highs before the COVID-induced falls. Certainly it is true that on occasion a single event precipitates a market fall, but the problem is that we, as investors, have absolutely no chance of knowing which event this might be and position portfolios ahead of any anticipated fall. If this were possible, the market would already have fallen! In this particular case, it is important to note that Evergrande's market cap is under USD6 billion - or put another way, Apple is over 400 times larger - so any portfolio holding would be miniscule at worst. The company represents around 0.01% of global equities and China is only 4% of the global equity markets. Our suggestion: don't pay too much attention to the financial 'news'!

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