CIO View
CIO Flash

September 20, 2021

Marketing Material

A DIFFERENT SORT OF CHINA SHOCK?

WHAT TO MAKE OF MONDAY'S MARKET TURMOIL

IN A NUTSHELL

_ The looming debt restructuring of China's second biggest real-estate developer is not surprising.

_ Some of the market reactions are a little startling and there could be some knock-on effects in coming days and weeks.

_ Still, we do not expect a systemic financial crisis, since this still seems like an idiosyncratic event. It serves as a reminder, though, if any was needed, to be watchful of risk events originating in China.

The looming debt restructuring of China's second biggest real-estate developer is not surprising, but some of the reactions are.

Over the last 20 odd years, China has loomed as an increasingly important factor and a driving force of the global economy. The term "China shock" initially described the impact of rising Chinese exports to North America and Europe after its accession to the World Trade Organization in 2001. Increasingly, it has also been used as an explanatory variable for all sorts of other changes, from regional patterns in U.S. economic development to voting behavior. In financial terms, though, periods of turmoil originating in China have been relatively rare and comparatively contained. Following events of recent months and most recently over the weekend, fears of wider contagion are spreading. On Monday Hong Kong's Hang Seng index declined by 3.3% and the Euro Stoxx 50 Index was down by almost 3% in the early afternoon[1].

At least for now, that seems a bit out of proportion with the actual situation. The latest sell-off was triggered by the impending debt restructuring of Evergrande China's highly indebted and second biggest real-estate developer, (approx. 300 billion U.S. dollars in obligations). Those problems are neither new nor surprising. Between 2014 and 2018 there was a rapid increase in real-estate developers' debt. At Evergrande, this was also caused by an expansion into other business areas (from a soccer team and academy, to mineral-water and electric-vehicles).

The recent crisis began when the Chinese government started to implement restrictive measures to decrease / limit debt load in the real-estate sector. That too has been going on for quite a while. Since the summer, weak real-estate prices and subdued real-estate purchases as a result of the government restrictions have exacerbated the situation, leading Evergrande to cancel its interest-rate payment on September 20. Both the equities and bonds of other highly indebted Chinese property developers have also been hammered in recent months – again highlighting that the potential of a credit event originating in the segment can hardly count as a major surprise among most market participants.

Much of the immediate negative news may already have been priced in now. Still, the situation remains fluid and there are likely to be some knock-on effects in coming days and weeks.

What then, explains the relatively severe market reactions? Part of the reason may be technical. Most Asian markets were closed on Monday, except for Hong Kong. It remains to be seen how the broader Chinese markets will react on Tuesday. And

[1] Bloomberg Finance L.P. as of 9/20/21

while we think that most probable scenario remains a fairly orderly debt restructuring, instead of payment defaults or delays, worries about a looming bond payment on Thursday could further fray nerves.

In any case, we expect that the main priority of Chinese authorities is likely to be to limit the potential for social unrest, not stock market jitters. The two are not mutually exclusive, but if there are trade-offs in terms of timing, the former is likely to prevail. Chinese property developers typically charge homebuyers large upfront payments, often a year or two before a project is finished and representing much of those homebuyers accumulated savings. Those are the creditors likely to be at the top of the mind of Chinese decision makers. We would expect authorities to step in at the regional or municipal level to take over such projects and finishing them in due course. Organizing and orchestrating such responses, though, is unlikely to happen overnight.

Still, the Chinese government (especially at the central level) has strong incentives to avoid the negative scenario of large scale liquidations triggering potential domino effects and the damage to the financial situation of Chinese households more broadly. After all, prosperity and social security are in focus for Chinese politics at the moment, especially ahead of the 20th National Party Congress of the Chinese Communist Party (CCP) next year.

Also worth keeping in mind is that the direct exposure of foreign bond holders to Evergrande appears relatively modest. Even among domestic banks, exposure looks fairly widely scattered and the high indebtedness should have already led to high write-offs, perhaps limiting further pain. Individual smaller banks could be harder hit, i.e. their non-performing loans (NPLs) could rise significantly. That said, Chinese banks and financial institutions also have high exposure to the suppliers of Evergrande.

That highlights the potential for knock-on effects. For most Chinese banks their Evergrande exposure would be manageable in itself, but not if it drags down others. Deteriorating growth forecasts would further hurt sentiment, and not just among Chinese home buyers. Moreover, and speaking globally, the latest news out of China hits a market that is already facing difficulties from other sides, such as ongoing problems in global supply chains, or a sharply rising natural gas price. As a result, a slowdown in economic momentum can now be observed, which has already led to the first downward revisions of forecasts.

Asset-class implications

Fixed Income & Currencies: We have been extremely wary of debt issued Chinese property developers for quite a while, especially at the riskier, high-yield end of the spectrum. Obviously, we see no reason to change that stance in the light of recent developments. As for broader, investment-grade Asian credit, we will be monitoring events and market movements carefully in coming days and weeks. Certainly, there could be attractive entry points ahead of any recovery, but that remains a topic for the medium term. Nor are we changing our calls for major currencies.

Equities: The travails of its property developers again follow on the heels of China's crackdown on its technology champions and online tutoring providers in recent months, just as Chinese equities had shown some signs of stabilization. For now, we think it is too early to call the bottom just yet. In any case, recent events serve as a reminder, if any was needed, that careful selection at both the sector and the issuer level is crucial when investment in China, and that this needs to take into account broader political considerations as well.

Glossary

The Hang Seng Index (HSI) is a freefloat-adjusted market-capitalization-weighted stock-market index in Hong Kong. It tracks the 50 biggest and most traded companies on the Hong Kong stick exchange.

Investment grade (IG) refers to a credit rating from a rating agency that indicates that a bond has a relatively low risk of default.

A knock-on-effect is the effect which an action will have on other situations.

Non-performing loans (NPLs) are loans on which scheduled payments have not been made for (usually) at least 90 days.

The Euro Stoxx 50 is an index that tracks the performance of blue-chip stocks in the Eurozone.

High-yield bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

IMPORTANT INFORMATION – EMEA, APAC & LATAM

DWS is the brand name of DWS Group GmbH & Co. KGaA and its subsidiaries under which they do business. The DWS legal entities offering products or services are specified in the relevant documentation. DWS, through DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively "DWS") are communicating this document in good faith and on the following basis.

This document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as investment advice.

This document is intended to be a marketing communication, not a financial analysis. Accordingly, it may not comply with legal obligations requiring the impartiality of financial analysis or prohibiting trading prior to the publication of a financial analysis.

This document contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements. Past performance is no guarantee of future results.

The information contained in this document is obtained from sources believed to be reliable. DWS does not guarantee the accuracy, completeness or fairness of such information. All third party data is copyrighted by and proprietary to the provider. DWS has no obligation to update, modify or amend this document or to otherwise notify the recipient in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

Investments are subject to various risks. Detailed information on risks is contained in the relevant offering documents.

No liability for any error or omission is accepted by DWS. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid.

DWS does not give taxation or legal advice.

This document may not be reproduced or circulated without DWS's written authority.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

For institutional / professional investors in Taiwan:

This document is distributed to professional investors only and not others. Investing involves risk. The value of an investment and the income from it will fluctuate and investors may not get back the principal invested. Past performance is not indicative of future performance. This is a marketing communication. It is for informational purposes only. This document does not constitute investment advice or a recommendation to buy, sell or hold any security and shall not be deemed an offer to sell or a solicitation of an offer to buy any security. The views and opinions expressed herein, which are subject to change without notice, are those of the issuer or its affiliated companies at the time of publication. Certain data used are derived from various sources believed to be reliable, but the accuracy or completeness of the data is not guaranteed and no liability is assumed for any direct or consequential losses arising from their use. The duplication, publication, extraction or transmission of the contents, irrespective of the form, is not permitted.

Issued in the UK by DWS Investments UK Limited which is authorised and regulated in the UK by the Financial Conduct Authority.

In Hong Kong, this document is issued by DWS Investments Hong Kong Limited. The content of this document has not been reviewed by the Securities and Futures Commission.

In Singapore, this document is issued by DWS Investments Singapore Limited. The content of this document has not been reviewed by the Monetary Authority of Singapore.

In Australia, this document is issued by DWS Investments Australia Limited (ABN: 52 074 599 401) (AFSL 499640). The content of this document has not been reviewed by the Australian Securities and Investments Commission.

as of 9/20/21; 085479_1 (09/2021)

IMPORTANT INFORMATION – NORTH AMERICA

The brand DWS represents DWS Group GmbH & Co. KGaA and any of its subsidiaries, such as DWS Distributors, Inc., which offers investment products, or DWS Investment Management Americas Inc. and RREEF America L.L.C., which offer advisory services.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not and is not intended to constitute an offer, recommendation or solicitation to conclude a transaction or the basis for any contract to purchase or sell any security, or other instrument, or for DWS to enter into or arrange any type of transaction as a consequence of any information contained herein and should not be treated as giving investment advice. DWS, including its subsidiaries and affiliates, does not provide legal, tax or accounting advice. This communication was prepared solely in connection with the promotion or marketing, to the extent permitted by applicable law, of the transaction or matter addressed herein, and was not intended or written to be used, and cannot be relied upon, by any taxpayer for the purposes of avoiding any U.S. federal tax penalties. The recipient of this communication should seek advice from an independent tax advisor regarding any tax matters addressed herein based on its particular circumstances. Investments with DWS are not guaranteed, unless specified. Although information in this document has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness, and it should not be relied upon as such. All opinions and estimates herein, including forecast returns, reflect our judgment on the date of this report, are subject to change without notice and involve a number of assumptions which may not prove valid.

Investments are subject to various risks, including market fluctuations, regulatory change, counterparty risk, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you may not recover the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of the investment are possible even over short periods of time. Further, investment in international markets can be affected by a host of factors, including political or social conditions, diplomatic relations, limitations or removal of funds or assets or imposition of (or change in) exchange control or tax regulations in such markets. Additionally, investments denominated in an alternative currency will be subject to currency risk, changes in exchange rates which may have an adverse effect on the value, price or income of the investment. This document does not identify all the risks (direct and indirect) or other considerations which might be material to you when entering into a transaction. The terms of an investment may be exclusively subject to the detailed provisions, including risk considerations, contained in the Offering Documents. When making an investment decision, you should rely on the final documentation relating to the investment and not the summary contained in this document.

This publication contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this material. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein. We assume no responsibility to advise the recipients of this document with regard to changes in our views.

No assurance can be given that any investment described herein would yield favorable investment results or that the investment objectives will be achieved. Any securities or financial instruments presented herein are not insured by the Federal Deposit Insurance Corporation ("FDIC") unless specifically noted, and are not guaranteed by or obligations of DWS or its affiliates. We or our affiliates or persons associated with us may act upon or use material in this report prior to publication. DB may engage in transactions in a manner inconsistent with the views discussed herein. Opinions expressed herein may differ from the opinions expressed by departments or other divisions or affiliates of DWS. This document may not be reproduced or circulated without our written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries. This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

Past performance is no guarantee of future results; nothing contained herein shall constitute any representation or warranty as to future performance. Further information is available upon investor's request. All third party data (such as MSCI, S&P & Bloomberg) are copyrighted by and proprietary to the provider.

For Investors in Canada: No securities commission or similar authority in Canada has reviewed or in any way passed upon this document or the merits of the securities described herein and any representation to the contrary is an offence. This document is intended for discussion purposes only and does not create any legally binding obligations on the part of DWS Group. Without limitation, this document does not constitute an offer, an invitation to offer or a recommendation to enter into any transaction. When making an investment decision, you should rely solely on the final documentation relating to the transaction you are considering, and not the [document – may need to identify] contained herein. DWS Group is not acting as your financial adviser or in any other fiduciary capacity with respect to any transaction presented to you. Any transaction(s) or products(s) mentioned herein may not be appropriate for all investors and before entering into any transaction you should take steps to ensure that you fully understand such transaction(s) and have made an independent assessment of the appropriateness of the transaction(s) in the light of your own objectives and circumstances, including the possible risks and benefits of entering into such transaction. You should also consider seeking advice from your own advisers in making this assessment. If you decide to enter into a transaction with DWS Group you do so in reliance on your own judgment. The information contained in this document is based on material we believe to be reliable; however, we do not represent that it is accurate, current, complete, or error free. Assumptions, estimates and opinions contained in this document constitute our judgment as of the date of the document and are subject to change without notice. Any projections are based on a number of assumptions as to market conditions and there can be no guarantee that any projected results will be achieved. Past performance is not a guarantee of future results. The distribution of this document and availability of these products and services in certain jurisdictions may be restricted by law. You may not distribute this document, in whole or in part, without our express written permission.

For investors in Bermuda: This is not an offering of securities or interests in any product. Such securities may be offered or sold in Bermuda only in compliance with the provisions of the Investment Business Act of 2003 of Bermuda which regulates the sale of securities in Bermuda. Additionally, non-Bermudian persons (including companies) may not carry on or engage in any trade or business in Bermuda unless such persons are permitted to do so under applicable Bermuda legislation.

as of 9/20/21; 085477_1 (09/2021)