INVESTMENTS PENSIONS OVERSIGHT COMMITTEE: GLOBAL ECONOMIC INVESTMENT OUTLOOK

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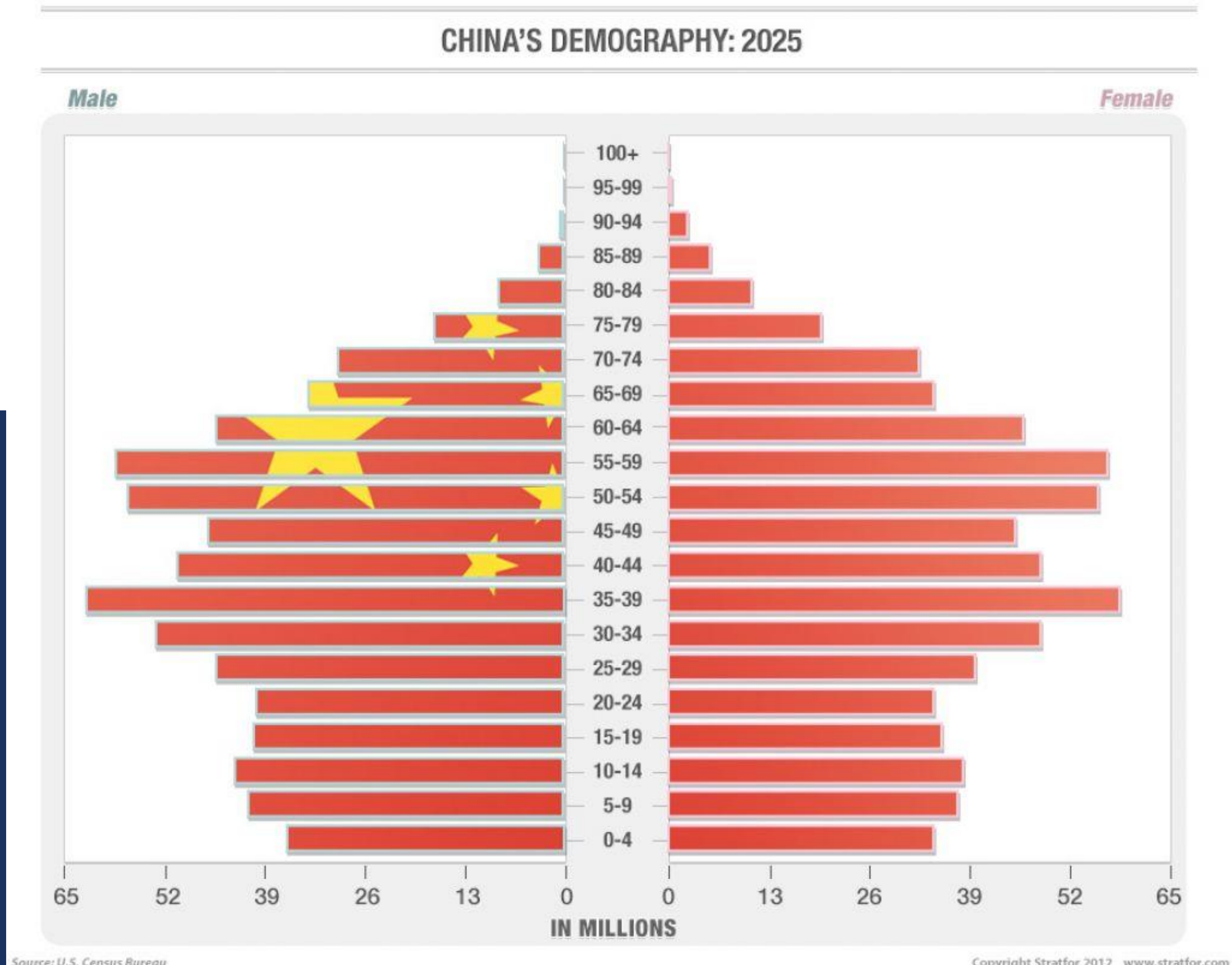
NEW MEXICO STATE INVESTMENT COUNCIL



CHINA'S DEMOGRAPHY: 2025
Male
Female
100+
95-99
90-94
85-89
80-84
75-79
70-74
65-69
60-64
55-59
50-54
45-49
40-44
35-39
30-34
25-29
20-24
15-19
10-14
5-9
0-4
65 52 39 26 13 0 0 13 26 39 52 65
IN MILLIONS
Source: U.S. Census Bureau
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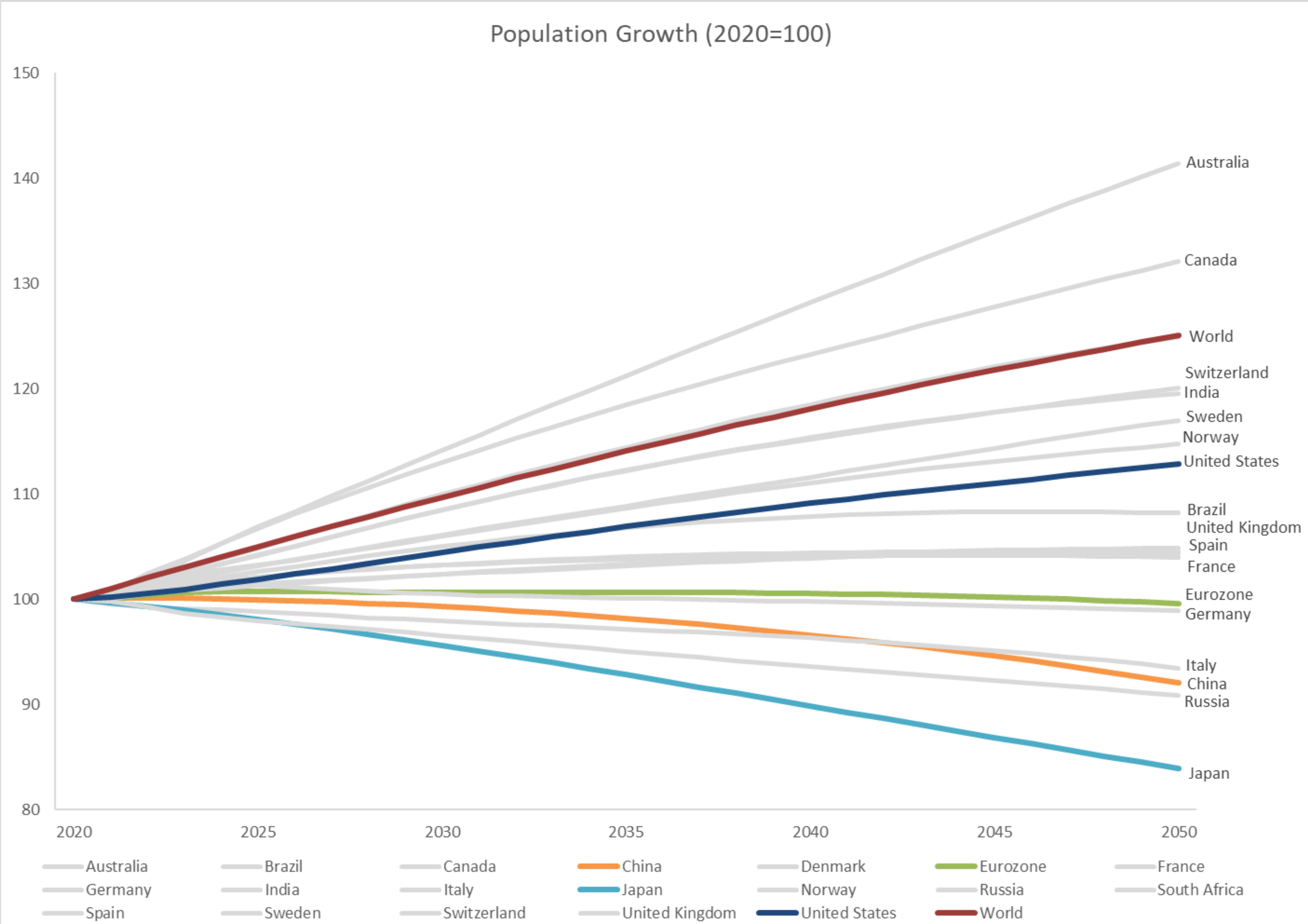
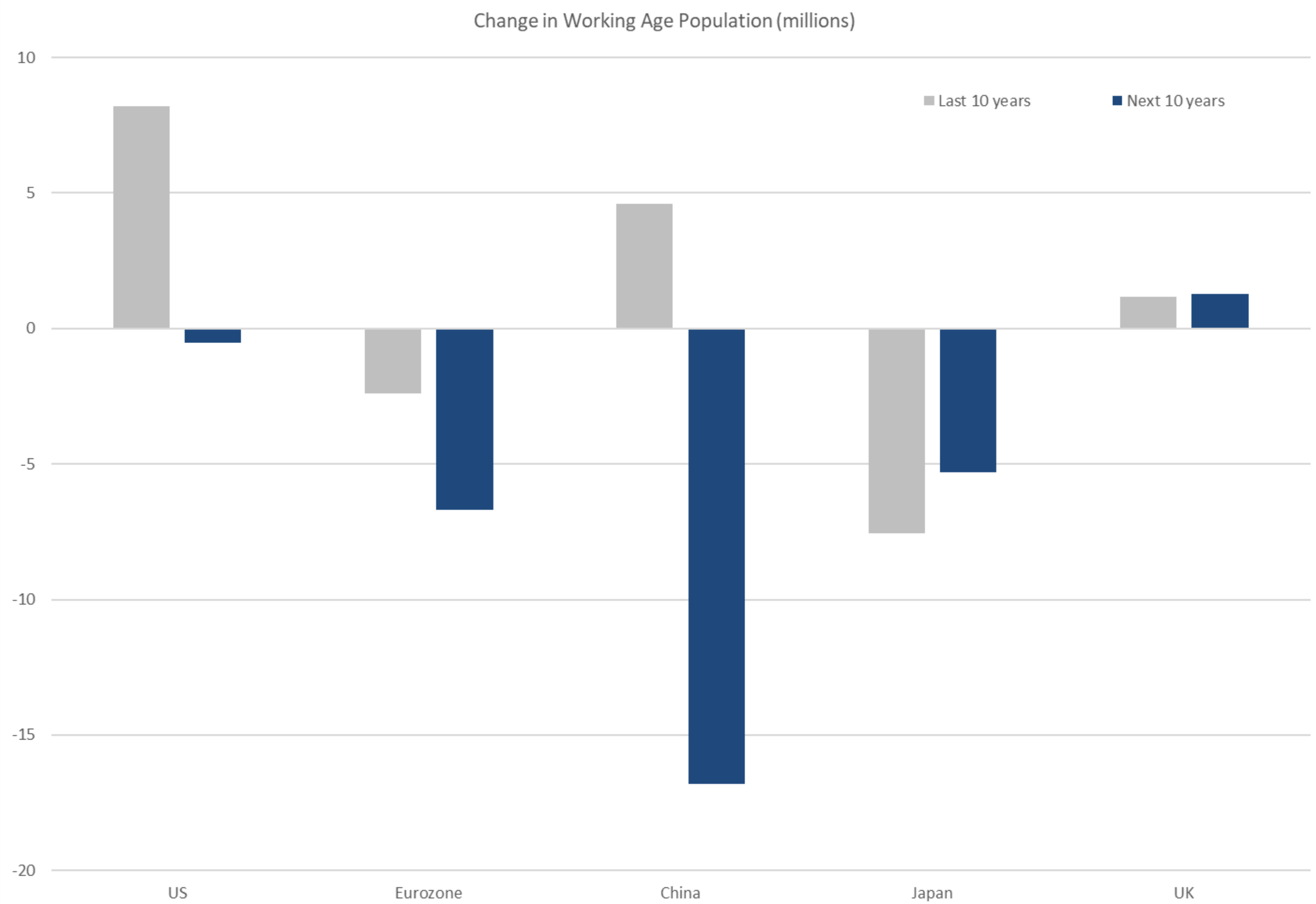
CHINA'S DEMOGRAPHIC PROBLEM

- "One Child" Policy
  - Initiated in 1980, without the benefit of much understanding of demographics and society
  - Preceded by population control policies in the 1970s calling for later marriage, longer birth intervals, and fewer births--which together already had fertility rates in steep decline
  - Draconian enforcement
  - Partially lifted in 2016 (two child policy)
  - Three-child policy initiated in 2021, as births slipped to 10 million annually from 25-30 million in 1960-1980
- Societal Preferences
  - 20-40 million "excess men"
  - Half or more aged 20-40
- Industrialization (1980 forward)
  - Mass migration from rural areas to urban areas as China entered the global economy
  - Overall Total Fertility Rate (TFR) in China is 1.4 (0.7 in Shanghai) versus 2.1 for replacement and one of the lower TRFs in the world.



Source: NM State Investment Office; Oxford Economics



Source: NM State Investment Office, Oxford Economics

ECONOMY | ASIA ECONOMY

Chinese Exports Fall at Steepest Pace Since February 2020

Slide in outbound shipments reflects fraying trade ties with the Western world, even as exports to Russia boom

By Stella Yifan Xie Follow

Updated Aug. 8, 2023 1:16 pm ET

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China's exports to the U.S. and European Union plunged by more than 20% each in July. PHOTO: CFOTO/ZUMA PRESS

Economy

China Slips Into Deflation in Warning Sign for World Economy

The lifting of Covid-19 pandemic curbs has been followed by an unusual bout of falling consumer prices instead of a surge

By Stella Yifan Xie Follow

Updated Aug. 9, 2023 2:18 pm ET

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China is in deflationary territory for the first time in two years. PHOTO: MARK R CRISTINO/SHUTTERSTOCK

HONG KONG—China's consumer prices tipped into deflationary territory in July for the first time in two years, as a deepening economic malaise in the world's second-largest economy enters a potentially dangerous new phase.

China Turns to Well-Honed Playbook: Cut Rates, Hide Data

Move to stop publishing youth unemployment data raises concern about opacity around China's downturn

By Jason Douglas Follow and Stella Yifan Xie Follow

Aug. 15, 2023 10:28 am ET

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As the latest crop of graduates completed their studies this summer, economists had expected a higher youth unemployment reading. PHOTO: CFOTO/ZUMA PRESS

MARKETS

China's Deepening Housing Problems Spook Investors

Stocks in Hong Kong and mainland China drop after developer Country Garden flags more debt problems

By Weilun Soon Follow and Rebecca Feng Follow

Updated Aug. 14, 2023 9:24 am ET

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The financial struggles of Country Garden have been front-and-center since it missed interest payments on two U.S. dollar bonds. PHOTO: STR/AGENCE FRANCE-PRESSE/GETTY IMAGES

SOME IMPLICATIONS OF THESE DEMOGRAPHIC SHIFTS

- *Slower economic growth globally* -- according to the World Bank, globally, the potential economic growth rate—theoretically the maximum level of growth over the medium term that can be achieved without igniting inflation—is set to soon fall to the lowest levels of the past three decades and stay there over the rest of this decade. This is happening as the populations in the most economically-impactful economies age and shrink.
- *Change/downshift from the consumption-led global economic model to "what comes next"*
  - Three critical times in people's economic lives:
    - Ages 25-35 (consumers) – high spending years—building families. Lower income, but they lever it through borrowing, and they buy high-economic-impact things:
      - Borrowing a mortgage to buy a house
      - Borrowing a car loan(s) to buy a car(s)
      - Using consumer credit to fill the house with things
    - Ages 45-55 (capital providers) – high income years—the kids leave the nest and retirement saving and investing begins in earnest.
    - Ages 65+ (retirees) – withdraw of capital from the risk markets, much reduced spending, and "mortality table exposed".
  - The populations of the most economically-relevant countries are running low of the 25-35 age group (relative to the broad population) and it is changing the consumption-led nature of the global economy.

OTHER VERY BROAD THINGS WE ARE CONCERNED ABOUT (NEXT 7-10 YEARS)

- Food shortages (related to impacts of the Russia/Ukraine war)
- Energy shortages, and the path of the energy transition
- Heightened geopolitical tensions (beyond Russia/Ukraine)
- De-globalization (and regional economic alliances)
- Global debt levels in a rising/higher interest rate environment
  - Inflation
  - Deflation

OTHER VERY BROAD THINGS WE ARE CONCERNED ABOUT (NEXT 7-10 YEARS)

- Geopolitical theme: we think the U.S. is in a much stronger position going into this set of geopolitical/economic/demographic changes:
  - Good demographic profile relative to most other large, developed countries
    - The U.S. has a Millennial generation that most other do not
    - The fertility rate in the U.S. is 1.7 – one of the better rates (2.1 is required for replacement)
    - Immigration is strong and in the right age groups – the U.S. is a destination for young people
    - Our largest trading partner—Mexico—has a beautiful, consumption-oriented demographic profile
  - We can feed ourselves—the U.S. exports about 1/3 of the food we produce
  - We can provide our own energy needs—most other large, developed countries
  - The U.S. has huge natural defense barriers (Atlantic and Pacific oceans) and the world's most powerful military
  - While the U.S. benefitted (on the whole) from globalization, we are less dependent upon it continuing at the current level to remain prosperous.
  - The U.S. has a debt problem like the rest of the developed world, but we own the world's reserve currency (though we expect that to be increasingly challenged)

THE CHANGING ECONOMIC AND INVESTMENT ENVIRONMENT IN WHICH WE INVEST

- We're of the belief (as detailed in our last two Annual Investment Plans—2023 and 2024) that we have moved into a new and different economic and investment environment/regime, due in part to the geopolitical/economic/demographic changes we outlined earlier. Previous regimes:

  - 1982 to 2007 (25 years): an economic and market environment of falling interest rates, above-average economic growth, disinflation, massive increases in per-share corporate profits and rising equity market (and other) multiples. This was a great time to invest!
  - 2008 to 2021 (14 years): an economic and market environment of dramatically falling growth rates, poor productivity growth, very low interest rates, low inflation. Extreme monetary policy (ZIRP, QE, massive expansion of the money supply) and fiscal policy (in the U.S., the federal government deficit-spent $16 trillion from June 2009 through September 2021) were used to try to stimulate the economy, and had the effect of distorting business investment, capital allocation, and sent investment market multiples to near-records.
  - 2022/2023 to 2030-2033 (last year plus our forward 7-10 year expectations horizon): Our expectations regarding this new environment are for more-or-less a reckoning of the 2008 to 2021 period, and are detailed in the sections above: a nearer-term recession, very slow economic growth, structurally higher inflation, modest interest rates, shrinking market valuation multiples. We allow ourselves some cautious optimism regarding the years toward the end of the period as the Millennial generation in the U.S. come into their full economic power, and the wealth transfer from the Boomer generation to the Millennials matures.

BROAD INVESTMENT STRATEGY

- In the longer run, as institutional investors of long-term growth portfolios, it is important to stay 'realistically optimistic', always be looking for opportunity, and stay invested in a well-considered portfolio of risk assets.
- Given the long-run 20-30 year+ geopolitical/economic/demographic themes discussed and the medium term 7-10 year+ economic and financial market regime changes, very broadly the Council is pursuing some of the following strategies:
  - Diversifying our risk assets into an array of assets beyond just stocks, with particular attention to cash-flow generating investments and asset-backed investments
  - Being inflation-aware in our portfolio construction and investment choices
  - Staying aware that the U.S. is well-positioned to weather and prosper in the changed environment we see, and focusing on U.S. dollar-denominated, U.S.-based assets
  - Understanding that the U.S. and the global economy and markets are cyclical, and there will be both good markets and bad markets in our future. The Council, therefore, maintains robust liquidity in order to handle this natural variability.