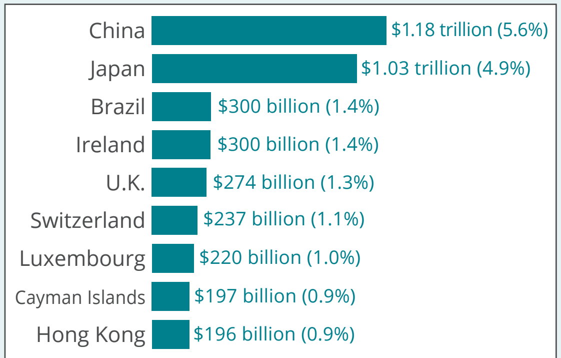
Brinker Capital

WEEKLY WIRE | JULY 1, 2019

Why we're not concerned China will "go nuclear" on US debt

Top foreign owners of US national debt

China and Japan are still the bigger holders



Note: Foreigners owned $6.21 trillion in debt at end of June 2018. Source: US Treasury

As US/China relations remain troubled, we are increasingly asked if China might seek to punish the US by liquidating its portfolio of US Treasuries, a course of action often referred to as the "Nuclear Option." Given that China is the largest foreign holder of US Treasury debt (see above), it is a reasonable question and concern.

While no one outside the circle of senior Chinese government officials can predict the country's course of action, we don't see China exiting our bond market en masse for a few reasons.

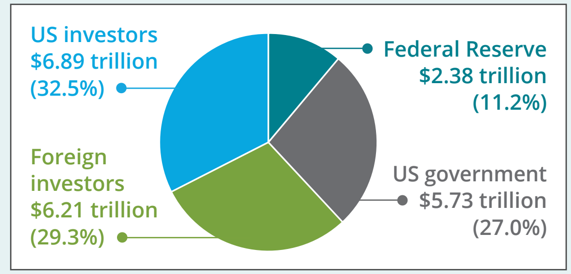
- Any such move would create meaningful financial instability, likely damaging the Chinese economy more than ours.
- The US bond market is the world's largest, most liquid and, importantly, pays a positive yield; a transition from US to German or Japanese debt is an unattractive option.
- Selling US debt should drive any remaining Chinese holdings down in value and push the US dollar lower versus the Chinese Renminbi, making Chinese exports more expensive and less competitive.

We think it is important to put the US/China debt dynamic in perspective. There is about $21 trillion of US debt outstanding, and while China is the largest foreign owner, they hold just 5% of debt outstanding. Their portfolio of US Treasuries has already decreased, having peaked at about $1.4 trillion in November 2013. Finally, approximately 70% of US debt is held by domestic borrowers, who have no interest in seeing our bond market and our currency come under pressure (see above right).

We continue to believe that the US and China will solve for trade before the year is out.

Who owns the US national debt

US debt stood at $21.21 trillion at end of June 2018



Source: US Treasury

Equities, oil & natural gas (6/28/19)

Security name	Last	QTD chg	YTD chg	12mo chg
S&P 500	2941.76	0.00%	17.35%	8.22%
Russell 2000	1566.57	0.00%	16.17%	-4.66%
Russell 3000 Growth	1282.04	0.00%	20.64%	9.23%
Russell 3000 Value	1648.98	0.00%	14.56%	4.60%
Crude Oil WTI (NYM $/bbl)	58.20	-0.46%	28.17%	-21.51%
Natural Gas	2.32	0.35%	-18.77%	-20.79%

Treasury rates (6/28/19)

	Price	Yield
2Y	99.240 / 99.24	1.749
3Y	100.034 / 100.0	1.707
5Y	99.292 / 99.29	1.766
7Y	99.306 / 99.31	1.880
10Y	103.092 / 103.0	2.005
30Y	107.056 / 107.0	2.530

Weekly reports

This week
- Hourly Earnings Y/Y
- Unemployment Rate

Last week
- Chicago PMI 49.7
- Michigan Consumer Sentiment 98.2

Brinker Capital Market Barometer

JUNE 2019

The weight of the evidence still leans positive which is in line with our slight overweight to risk in moderate to aggressive portfolios.

SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum	←		●		Market momentum weakened
Trend	←←	●			Global equity indices generally below ST and LT moving averages
Investor sentiment	→		●		Investors more pessimistic but not yet reached capitulation
Seasonality				●	Seasonality more supportive in second quarter

INTERMEDIATE-TERM FACTORS (6-36 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy				●	Fiscal stimulus continues in 2019
Monetary policy				●	Fed on an extended pause and will end balance sheet reduction
Inflation			●		Fed sees inflation as running below target
Interest rate environment			●		Longer-term rates range-bound; yield curve inversion at short end
Macroeconomic	←		●		US growth solid but ex-US growth weaker; global trade war concerns
Business sentiment			●		Small biz confidence off record high; CEO confidence little improved
Consumer sentiment				●	Remain at elevated levels; still supportive
Corporate earnings				●	US earnings growth still solid; softer outside US
Credit environment				●	Slight widening of corporate credit spreads but few signs of stress

LONG-TERM FACTORS (36+ months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Valuation			●		US equity valuations at long-term averages; more attractive ex-US
Business cycle				●	Long recovery but has been muted; few signs point to recession
Demographics			●		Mixed (US and emerging markets positive; developed int'l negative)