ECONOMIC INSIGHTS

Principal Global Investors

BY INDRANEEL KARLEKAR, BINAY CHANDGOTHIA, AND THE ECONOMIC COMMITTEE

WEEK OF NOV. 9 - 13, 2015

MORE JOBS THAN EVER

Having languished for much of this economic expansion, the U.S. labor market is looking a lot healthier. October's payroll data (277,000 new jobs) reaffirmed the robust state of the labor market. On Wednesday, the JOLTS report delivered more positive news with job openings increasing more than expected. This is a rebound from the steep decline in August and remains near the historic high reached in July.

Parsing Through the JOLTS Report:

Parsing through the report, job openings increased to 5,526k in September (vs. consensus 5,400k), though changes were mixed across sectors. The largest increases occurred in the professional and business services (+126k to 1,165k) and retail trade (+64k to 671k) sectors, while accommodation and food services posted the largest declines (-40k to 649k). Over the past year, job openings have increased 848k. Elsewhere in the report, the quit rate was unchanged in September at 1.9%, while the hiring rate declined one-tenth to 3.5%.

More Support for Consumer Spending?

Continued strength in the labor market holds the key to consumer spending. The JOLTS report clearly indicates that the job market continues to tighten, which should drive the unemployment rate down. As the labor market tightens there are increasing signs that wage gains are beginning to stick. Further, the consumer comfort index rose to 41.6 for the week ending November 8 from 41.1 the prior week. It had fallen for three consecutive weeks.

Continued strength in the labor market should be a boost to consumer sentiment and spending. In fact, the preliminary estimate of November's University of Michigan's measure of consumer sentiment was stronger (93.1) than expected, rising from 90 in October. Both components of the index rose; consumers' assessment of current conditions moved up by 2.5 points to 104.8,

WEEKLY HEADLINES

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CHINDIA - THROUGH THE LENS OF INVESTORS

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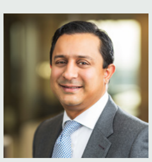
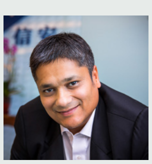
MEET THE AUTHORS



Indraneel Karlekar
Managing Director, Global Research and Strategy



Binay Chandgothia
Managing Director, Portfolio Manager

and household expectations strengthened by 3.5 points to 85.6.

Thankfully, a bright spot in an otherwise disappointing third-quarter headline GDP print was strength in personal consumption expenditure (PCE), which increased by 3.2% in the third quarter despite weak payroll data in August and September. If payroll growth remains strong heading into the tail end of 2015, there is some hope that fourth-quarter GDP will be an improvement over a disappointing third-quarter print.

CHINDIA – THROUGH THE LENS OF INVESTORS

China and India, the two largest economies in Asia and probably the fastest growing ones as well, have caught significant investor attention in the last decade. China's structural advances in manufacturing over the last 20 years catapulted it to become the manufacturing hub of the world with significant gains in its global manufacturing and trade market shares. Global manufacturers rushed to set up shop in the country to take advantage of its robust investment infrastructure, extremely low wages, and managed cost of capital. The resulting boom in China's economic growth brought millions of its workers into the global workforce, creating a virtuous cycle for the global economy. Indeed, the Chinese middle class is expected to become the largest incremental source of consumption in the global economy in coming years. Exports, investment, and manufacturing became dominant engines of Chinese growth. Capital-market development, however, took a back seat.

On the other hand, India was painfully slow to advance its industrial skills. However, it outscored China in the export of software services (helped by a very large English-speaking population) and has quickly become a dominant force, with several global players outsourcing servicing needs to India (software services, business-process outsourcing, call centers etc.). It also made rapid strides in liberalizing its capital markets, embracing banking sector reforms (free interest rates, new private sector banks, etc.), opening up its equity markets to foreigners (they own about 20% of its market capitalization), and adopting world-class standards in running them. Consumption became a big driver of domestic growth with rising dependence on imports to meet domestic needs, especially as it related to energy and new technology items.

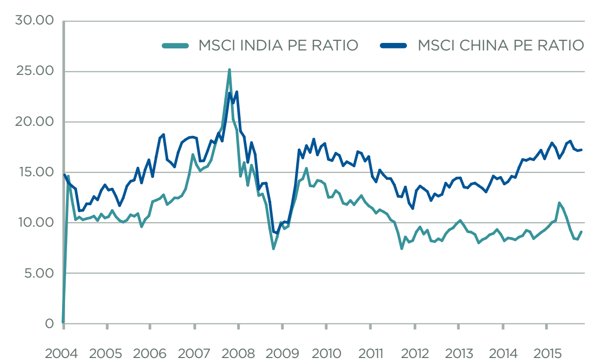
The two countries stand at a critical juncture. While China is trying hard to increase the share of consumption in its growth, India's trying to do the reverse (i.e., increase the share of manufacturing). Demographics are obviously playing a big role in this role shift. With China ageing fast, its labor population will start plateauing before 2020, putting limits on its manufacturing growth engine. Also, its workers are finally getting a larger share of the total pie, with noticeable wage gains in the last five years, which means lower profit margins for its corporate sector, which has the effect of slowing down its ability to keep gaining global market share in manufacturing and exports. Indeed, China is most likely to see its growth ease further but still grow respectably.

On the other hand, India ranks high on the demographic front, with a very young population that can be fruitfully deployed in creating manufacturing capacity. As we have seen from experiences in parts of Africa/Middle East, demographic dividends can quickly turn into demographic liabilities if employment generation isn't adequate. So for India, the shift towards a "Make in India" isn't a choice, it's a necessity. With a reformist government in place, investors are hoping, indeed betting, that India should usher in an era of high growth, both in absolute and relative terms in the coming decade as its workers get a greater share of the global pie.

Another area of diversity between the two countries is that while China is still a command economy with large state-owned enterprises dominating almost every aspect of economic activity including stock markets, India has been home to large private-owned enterprises that dominate its economic and investment landscape.

Clearly, investors perceive India to be on a stronger footing today and it may well turn out to be true. However, India may find itself in trickier situation if it slips — the growth premium could disappear soon. On the other hand, if China can prevent a hard landing for its financial and industrial sectors, a lot of the pessimism built into its valuations can disappear quickly. Only time will tell if the two countries continue to diverge or a convergence occurs at some point. We don't have a crystal ball that can predict the course, but are watching the space with fascination. One thing is for sure — that CHINDIA is well on course to play a very very important role in the global economy in coming years!

Comparative PE Ratios: India and China



Source: *based on Price to Next 12 months Earnings for MSCI India and MSCI China respectively, sourced from Factset

The diversities are best exemplified in investor expectations from each market. As of October 31, 2015, the P/E* (price-earnings) ratio for stocks in India was 17.4, whereas that for China was just 9.2. Admittedly, some of the difference stems from issues like index composition (India has more private-sector companies in its index, whereas China has a far greater share of state-owned enterprises whose economic motives need not always align with investor interests; India has more diversity in sectors, whereas China's concentration in old economy sectors is higher), but a big chunk also stems from difference in future growth expectations.

There will not be an Economic Insights for the week of November 16 - 20, 2015 due to the Thanksgiving holiday. Please watch for our next edition on December 2, 2015.

DISCLOSURES

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Pensions & Investments, "the Best Places to Work in Money Management", 12/08/2014.