The Chinese Dream

Home ownership. Education that helps children get accepted into a good university and ultimately secure a well-paying job and upward financial mobility. Quality of life.

It’s the American Dream. Increasingly, though, it’s also the Chinese Dream. While the United States and China continue to have stark differences including style of government, population and geographic size, and human freedoms, the convergence over the last decades of per capita incomes has in turn led to a similar merging of experiences, goals, and day-to-day anxieties between the middle classes of these economies (Exhibit 1).

This author saw the convergence firsthand over the summer, during a research trip that included four Chinese cities and meetings with academics, government advisors, business leaders, and everyday citizens. Bessemer Investment Department professionals frequently travel to better understand the countries and securities we invest in. In this case, the goal was to get on-the-ground perspective as to how the economy is performing and where it is headed. Such insights help Bessemer more successfully allocate capital — whether to mainland Chinese public or privately held firms, or securities outside of China that could be influenced by trends in what is now the world’s second-largest economy.

Executive Summary

- On-the-ground research helps shape our investment decisions, both macroeconomic and security-specific.
- A recent trip to China deepened our understanding of key consumer and technology trends, both of which play into the increasingly noteworthy U.S.-China trade war.
- While we do not see any immediate need to increase direct or indirect Chinese exposure in portfolios, we do believe such exposure is likely to grow over the coming years as the local economy and markets develop further.
- With overall economic trends consistent with late-cycle dynamics, Bessemer portfolios retain market weight positioning to equities, with modest underweight exposure to high-quality fixed income in favor of other opportunistic and defensive assets.

Key Takeaway: Incomes in China have risen swiftly over the past two decades, allowing more of the population to enter the middle class.

Source: World Bank
In this edition of our Quarterly Investment Perspective, we consider China’s future with a focus on the consumer and technology, and what that future could mean for our clients’ portfolios. While the trip did not compel us to make any immediate allocation shifts, it reinforced our conviction around sectors and companies to consider further for investment, and shined a brighter light on risks associated with Chinese assets and the country more generally.

To Know Where You’re Going, Look at Where You’ve Been

Forty years ago this December, China’s then leader, Deng Xiaoping, announced what he called the country’s “second revolution,” a process of reform and “opening up.” His goals were straightforward: Strengthen the country through reform-driven economic growth, ensuring social stability and in turn solidifying the Communist Party’s political control. Since 1978, that process has transformed China, with 2001 membership in the World Trade Organization (WTO) only adding more fuel to China’s modernization. This author was based in Singapore and frequently traveled to China when WTO was signed. The differences even between then and now are remarkable. Consider just a few examples:

• Especially in cities, traditional homes are being replaced with skyscraper condominiums. Young Chinese parents told us that they often need parents’ help to make down payments, especially if they want housing in a good school district (similar to U.S. public school zoning).

• Except for fleets of rental bikes in larger cities, which are great for just-in-time delivery of internet-ordered lunch, the transportation of choice is increasingly luxury automobiles and high-speed rail. Between 2013 and 2017, the percent of Chinese living in cities who owned cars more than doubled to roughly 21%. Meanwhile, the country has about 15,500 miles of high-speed train track.

• Old-fashioned markets are being displaced by modern malls showcasing both local and foreign brands, upscale food courts, and entertainment. Chinese consumers say that while they now buy many basic goods online, they still prefer going to a mall or store for more expensive items that they want to touch/try on, and that they avoid shopping online for anything that could be easily counterfeited. Last year, online retail sales topped $1 trillion for the first time, according to government data, and now outpace online U.S. sales. Online payments in China are generally made via mobile apps (dominated by Tencent’s WeChat Pay and Alibaba’s Alipay); last year mobile payments totaled around $5.5 trillion, about 50 times greater than the U.S., where credit cards are more frequently used.

All of these anecdotes and smaller trends can be summed up with a broader macroeconomic one: The Chinese economy, before driven largely by cheap exports (in turn helped by an undervalued currency and low wages), is now driven by the services sector, similar to the United States (Exhibit 2).

“Watching an odometer at the front of the car from my fully reclining seat, I noticed that my high-speed train from Qingdao to Beijing topped 187 miles per hour, versus around 136 miles per hour for the less-roomy Washington, D.C.-New York City Acela.”

– Rebecca Patterson

Exhibit 2: Service Sector and Exports of Goods as a Percent of Nominal GDP

Key Takeaway: Chinese consumers and the service sector are now driving GDP growth.

As of December 31, 2015, for Exports and December 31, 2016, for Service Sector. Source: Bloomberg, National Bureau of Statistics of China
Chinese President Xi Jinping, who earlier this year got approval from the National People’s Congress to govern indefinitely (basically leader for life), finds himself with a very different China than his predecessor, Deng, but with similar challenges: What will be the engine for Chinese growth for the next decades, and how can the government keep a 1.4 billion, dispersed, and diverse population content? Ultimately, how can Xi ensure that the Communist Party survives and thrives — at least while he is at the helm? Of course, political leaders must assess domestic issues together with international geopolitical and strategic ones. In the interest of brevity, this Quarterly is focused more on the domestic side of the equation.

So what is Xi’s plan? First and foremost, he has to support and encourage economic growth with three main levers: labor, capital stock (buildings and machines), and technological advancement. In China’s case, labor was a key driver of growth since Deng’s reforms. Hundreds of millions of Chinese moved from rural farms to cities, providing labor for more productive, better-paying, expanding industries. While there is still scope for that rural-urban shift to continue, broader demographics are turning into a headwind. Government data suggests that the labor force has now been slowly shrinking since 2014. Looking ahead, about a third of China’s population is expected to be over 60 by 2050, compared with about 17% of the population today and about 20% of the U.S. population expected to be 65 and over by 2050. A recent relaxation in the one-child policy is not expected to help much or soon (Exhibit 3).

Capital stock looks like it can be a relatively larger growth support in coming years. China will continue to invest in infrastructure such as transportation as well as improve industries. Funding will come from abroad as well as local private and government sources — although recent actions by Xi’s government suggest reluctance to over-rely on government credit to back projects, given the country’s already large debt overhang. (While official central government debt was under 40% of GDP as of 2017, corporate debt including local government-financed debt vehicles added another 161% of debt as a percent of GDP to the mix, based on data from the International Monetary Fund.)

If labor and capital stock can be additive for growth but not to the same degree as in the past, Xi will need to lean more heavily on technology to get more out of China’s existing labor and capital — that is, greater productivity.

### “Made in China” Takes on a New Meaning

Growth via technology is where “Made in China 2025” comes in. In a nutshell, China is hoping to help the local population achieve its Dream and strengthen the broader economy by moving up the value chain. Instead of relying on cheaply priced exports, it wants to produce more value-added goods that are attractive for quality rather than a low price. It has seen its Asian neighbor South Korea successfully make that transition in recent decades — consumers around the world today buy Samsung, LG, and other Korean brands for quality more than price. The population has benefitted: South Korea’s per capita GDP has risen from roughly $6,500 in 1990 to around $27,500 today (World Bank data).

To replicate the success of countries like South Korea, China’s Xi and his cabinet launched Made in China 2025 (MiC2025) in May 2015. It’s an industrial policy that sets specific goals to boost growth, with funding and incentives created to reach those goals. Industrial policies have been used for many decades by emerging and developed economies. Back in the early 1980s, worried about the Cold War as well as the rise of Japan,
In its Made in China 2025 initiative, the government has identified 10 sectors where it wants to develop domestic competency and ultimately create globally competitive, leading firms.

Specific to MiC2025, the government has identified 10 sectors — including information technology, machinery and robotics, aviation, ships and maritime components, rail, new energy vehicles, biomedicine and medical devices, mobile phone chips, and agricultural machinery — where it wants to develop domestic competency and ultimately create globally competitive, leading firms. It calls for doubling self-sufficiency rates for core infrastructure components and key materials. For example, it aims to locally produce 40% of mobile phone chips sold in China by 2025 as well as 70% of industrial robots. Put another way, it wants to significantly reduce its reliance on foreigners to produce goods in these identified sectors (Exhibit 4). To meet these goals, China needs to develop related technology and a deeper Research and Development (R&D) culture, build credibility for its products, and then grow global market share.

Certainly, more value-added goods sold by globally competitive Chinese firms could result in higher wages and corporate profits, and stronger economic growth, helping Xi meet his goal of social stability and enduring

Exhibit 4: Semiofficial Targets for Percent of Domestic Market Share of Chinese Products

**Key Takeaway:** The Chinese government wants to reduce foreign reliance for key industries.

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<tr>
<th>Sector</th>
<th>2020</th>
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<td>New energy vehicles</td>
<td></td>
<td></td>
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<tr>
<td>High-tech ship components</td>
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<tr>
<td>New and renewable energy equipment</td>
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<td>Industrial robots</td>
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<td>High-performance medical devices</td>
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<td>Large tractors and harvesters</td>
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<td>Mobile phone chips</td>
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<td>Wide-body aircraft</td>
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As of February 2, 2016.

Source: U.S.-China Business Council
political control. But how to get there? The government appears to be relying heavily on two main factors: generous financing and technology transfer (Exhibit 5).

Initially, MiC2025 seemed to take a scattershot approach — find lots of businesses or even business ideas in the selected sectors, provide financing, and hope that a few are home runs (the next Alibaba or Tencent). The capital for this policy is massive and frankly could not be easily achieved (or achieved at all) with a democratic, checks-and-balances government. According to research from CLSA, China’s government has provided 800 billion renminbi in subsidies annually to local firms since the start of Made in China 2025, with almost all publicly listed companies receiving some subsidy last year.

The approach came with risks, both of overcapacity in certain subsectors, and misallocation of capital, especially through local government channels trying to help respective regional economies. Beijing took notice and has adjusted. Indeed, it is increasingly complementing its direct funding with private-equity-like strategies in the hope of channeling funds more effectively, as well as attracting private-sector capital to the identified firms. By the end of last year, around 1,500 government guidance funds reportedly had been established with nearly 3.5 trillion renminbi of paid-in capital and another 9.6 trillion of committed capital — mainly aimed at MiC2025 sectors. Guidance funds are usually launched by the central or a local government, often with co-investments from large banks or Chinese state-owned enterprises. They in turn can invest in private equity or venture capital companies (which have other public- and private-sector investors, including foreign investors) that ultimately source and finance the businesses in question.
While a lot of renminbi can help MiC2025 firms find a path to success, money is not sufficient — the technology focus of the policy means that firms need expertise as well, either domestically created or transferred from overseas. One avenue for such transfer is education. Rising wages and overall wealth have allowed more and more Chinese to send children overseas to study, with about 80% coming back to China and, in a sense, transferring intellectual technology. According to China’s Education Ministry, nearly 550,000 Chinese students studied overseas in 2016, up from 180,000 in 2008 (primary through postgraduate education). (It is worth noting that many educational institutions, including in the U.S., rely on these usually full-fee-paying students to meet budgetary targets.)

Relevant overseas education and job experience can help China reach its goals as well as create a structurally more robust R&D culture, but to reach goals quickly, even more is needed. To that end, China has for years had a policy that effectively requires foreign firms to share technology with Chinese partners as a sort of entrance fee to the huge local Chinese market. Chinese Premier Li Keqiang in March said, “we will fully open up the manufacturing sector, with no mandatory technology transfers allowed, and we will protect intellectual property.” Li also said the government would open sectors such as elder care, education, and financial services to foreign firms; remove equity caps on foreign firms in some areas; and gradually reduce market-access restrictions on foreign investment. He did not, however, provide details as to the timing of these changes.

Until such changes occur, foreign firms are faced with a number of hurdles when operating in China on the technology or intellectual property (IP) front. Two in particular are frequently mentioned:

• Joint venture (JV) restrictions. China’s government, formally and informally, requires certain foreign firms to partner with a local firm to do business in China, often capping a foreign firm’s share of the JV at 50%. In the course of business, the foreign firm has to share technology with its partner.

• Licensing. In some sectors, the Chinese government will only grant licensing approvals in exchange for an agreement to share technology.

For its part, China argues that domestic and foreign companies can choose whether to establish business partnerships, that no local laws or regulations explicitly force foreigners to transfer technology, and that the central government has instructed local governments not to require technology transfer. During this author’s recent trip, Chinese advisors and investors said that when Chinese leaders ask foreign firms to name the Chinese firms that are stealing technology, the foreign firms demur. Without such details, the Chinese insist it is hard for them to punish bad behavior. Foreign firms respond (not to the Chinese) that they fear they could be effectively kicked out of the country if they highlight specific transgressions.

“The Chinese Dream”

“A manager at a tutoring firm told me that parents who want kids to study in the West include sports, whereas parents of kids studying locally use their after-school tutoring investment more exclusively for academic topics. She also said the latest trend in tutoring is coding.”

– Rebecca Patterson
Foreign firms face a dilemma: risk losing near-term profits from business in a large, growing Chinese market by not accepting Chinese (implicit and explicit) rules, or risk losing longer-term competitiveness by sharing technology to gain that access. For the moment, most U.S. firms are staying in China and hoping for the best longer term — the immediate profit motive is just too great. Consider General Motors (GM) as an example. The U.S. automaker sold a record four million vehicles in China in 2017, up 4.4% from 2016 and about one million more units than what was sold in 2017 in the United States. Indeed, GM China Inc. earned about $2 billion in 2017, representing 18% of the company’s global profits. Last year wasn’t a one-off: China has now been GM’s largest retail market for a sixth consecutive year. An increasing portion of that success has come via a Chinese joint venture brand, Baojun, launched in 2010.

Another avenue China has pursued to fast-track its technology development is foreign direct investment (FDI), often via mergers and acquisitions (M&A). China’s government for the last several years encouraged and at times subsidized outbound FDI as a way to quickly gain access to technology. According to Commerce Ministry data, such FDI flows reached a record $196 billion in 2016 globally (up from roughly $21 billion in 2006). However, increased overseas scrutiny of Chinese firms along with tighter Chinese regulations at home saw FDI decrease more recently. Chinese FDI to the U.S. fell in 2017 to $29 billion and in the first five months of 2018 was less than $2 billion (Exhibit 6).

“A tour of an immaculate auto parts manufacturing plant in Jiangyin showed global supply chains in action. The workers were Chinese, chemical inputs came from South Korea, and robots came from Japan — all for German, U.K., and U.S. brands to be sold in China. The firm’s chairman built a German beer hall nearby (delicious, by the way), in part to entertain his German clients.”

— Rebecca Patterson

**Exhibit 6: Chinese Foreign Direct Investment in the U.S.**

**Key Takeaway:** Chinese investment in the U.S. skyrocketed in the last decade as local firms sought access to U.S. technology. Increased scrutiny and regulation have caused a sharp pullback.

<table>
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<th>$ Billions</th>
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<tr>
<td>2000</td>
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<td>2012</td>
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<td>2015</td>
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<td>2018 YTD</td>
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As of May 2018. 2018 includes cumulative total for January to May 2018. All other figures are annual.

Source: Rhodium Group
Outsiders Looking In

Periods of frustration with China’s way of doing things are nothing new and probably should not be surprising. A centrally controlled, “top down” economy with a culture of foreign mistrust going back to the 1800s is bound to approach policy differently compared with more democratic, capitalism-centric governments — that creates conflict. Past decades have seen those conflicts addressed via formal and informal working groups. And when needed, countries have gone to the international bodies such as the WTO to seek justice. Since China became a WTO member in 2001, the U.S. has filed 23 complaints against the country, in addition to 19 cases filed by the rest of the world. (A lack of modernization and adequate staffing at the WTO, slowing complaint resolution, have likely added to China-related frustration in recent years.) (Exhibit 7.)

Anecdotally at least, it feels like the focus on China has grown much sharper in recent years. The 2008 financial crisis may have been an inflection point: With a slow-going post-crisis recovery in jobs and wages, anxiety mounted across developed economies that technology and globalization (the latter often seen as synonymous with China) were to blame. Add to that (1) China’s relatively opaque and centralized policymaking, (2) potentially under a leader for life, (3) the very real prospect that China will become the world’s largest economy in the coming decades, and (4) use of advanced technology not just for economic but also military purposes, and it’s less of a surprise that politicians have gone on the offensive.

In the U.S., the offensive has taken shape primarily as a trade war. (As of late September, the U.S. has imposed tariffs on over $250 billion worth of Chinese goods and threatened significantly more.) In addition, the U.S. and other countries (including the U.K., European Union, and Australia) are considering or have already taken steps to more carefully scrutinize foreign (especially Chinese) direct investments as a way to limit potential technology transfer and protect local firms’ competitive advantages. In August, for instance, the U.S. passed legislation that broadened the mandate of the Committee on Foreign Investment in the U.S. (CFIUS; see our Investment Insights, “Still Open for Business?”).
It’s difficult to forecast with any conviction exactly how or when the trade war will get resolved. We are, however, confident in our view that whatever happens on trade or FDI, China will not abandon MiC2025, as some U.S. officials have recommended should occur. We believe that to resolve tensions, China may instead offer to open more markets to foreign firms (as Premier Li suggested earlier this year), offer to buy more foreign products to address trade imbalances, and provide more transparency around intellectual property rights. At the end of the day, the Chinese view their policy initiatives as a sovereign right or FDI, China will not abandon MiC2025, as some U.S. officials have recommended should occur. We believe that to resolve tensions, China may instead offer to open more markets to foreign firms (as Premier Li suggested earlier this year), offer to buy more foreign products to address trade imbalances, and provide more transparency around intellectual property rights. At the end of the day, the Chinese view their policy initiatives as a sovereign right and imperative for the country and leadership’s future. Indeed, they feel that they, not us, often get the short end of the stick (China has filed 22 WTO complaints of its own against other countries, including 15 against the U.S.; it also notes that the U.S. provides its own subsidies for domestic firms through government-spending programs and organizations like the Export-Import Bank). The U.S. and other countries, in our view, will likely be limited to steps that might slow things down and shape how (but not if) China moves ahead. The best outcome might be “collaborative competition” with both the U.S. and China developing technology and nurturing globally competitive firms, but with more transparent, open markets to all and realistic, enforced global rules that allow for peaceful, global growth.

Lessons from 1980s Japan

Listening to some of the rhetoric about China today, one cannot help but be reminded of a similar conversation 30-some years ago — about Japan. The early 1980s saw an increase in Japanese direct investments and M&A in the U.S. — including auto parts, steel, and real estate (recall the Rockefeller Center investment). Japan seemed to own the global electronics space — everyone wanted a Sony Corporation Walkman cassette player and camcorder. Japan started to feature more frequently in culture as well, from early video games (Donkey Kong) to cartoons (Transformers) to movies (the 1986 movie “Gung Ho” with Michael Keaton featured a U.S. car manufacturer bought by a Japanese firm with U.S. workers needing to learn Japanese ways).

Japan’s rising influence and strong economic growth, with annual GDP during the decade averaging 4.3% and nearing 7% in 1988, created anxiety in America. A strong dollar (the dollar/yen rate near 280 in the 1980s, in part following higher U.S. interest rates), making U.S. goods less competitive overseas, and a widening U.S. current-account deficit added to the negative political and economic tone. (The trade deficit with Japan in 1984 was equal to almost a third of the total U.S. trade deficit.) A series of books hit U.S. shelves with titles like “Yen! Japan’s New Financial Empire and Its Threat to America.”

With growing pressure from U.S. manufacturers, including automakers, Washington took up the torch. In addition to the U.S. launching an industrial policy, the U.S. and Japan agreed to voluntary restraints on car and steel exports. The U.S. also imposed tariffs on other Japanese goods, and Japan agreed to open markets more to foreign competition. Perhaps the most significant step was taken in September 1985, when policymakers from the Group of Five (U.S., Japan, West Germany, France, and the U.K.) adopted the Plaza Accord, agreeing to jointly intervene in currency markets to reduce the dollar’s value (and strengthen the yen).

Fast forward to 1990. The dollar weakened (indeed, so quickly that additional Group of Five steps had to be taken in 1987 to slow the dollar’s descent). The U.S. current account deficit narrowed, helped in part by Japanese automakers increasing plants in the U.S. Strength in Japan’s economy ultimately forced local policymakers to raise rates, in turn “popping” what became a bubble in local equities (the Japanese Nikkei peaked in 1989). While the economic backdrops between Japan then and China now have similarities, we believe that many of the U.S.-China issues today cannot be easily solved using 1980s policies. Consider:

- Japan in the 1980s was more dependent on the U.S. military for security than China is today, encouraging the government to negotiate over trade. China is in a relatively stronger position to retaliate against the U.S., economically and geopolitically.

- Global supply chains are much more complicated today — trade actions aimed at a specific country are much more likely to impact many other countries, often unintentionally.

- More U.S. firms today get a significant part of their revenues from China; China is the U.S.’s third-largest export destination, so any steps taken by the U.S. that weigh on Chinese consumption could also hurt U.S. firms.

- In the 1980s, trade frictions were resolved in part by Japanese firms moving operations to the U.S. and creating U.S. jobs. While that is also happening today, American officials seem less keen on the strategy due to fears over technology transfer and cyber security.

- While global institutions (the Group of Five is now the Group of Seven and Group of 20) continue to regularly meet today, the political environment makes a large joint effort like the Plaza Accord seem less likely.
China and Bessemer Portfolios

Successful investing starts with understanding economic, geopolitical, and policy trends around the world and how all those trends interact. Trends then need to be considered in context of specific security and market valuations to identify the best opportunities.

Bessemer portfolios today are overweight the U.S. As discussed in past research notes, we see this exposure as both opportunistic (corporate profits and overall GDP growth fueled by recent fiscal stimulus) and defensive (more liquid U.S. markets tend to outperform in periods of stress). That U.S. tilt results in an underweight exposure to the rest of the world, including China. That’s not to say we do not see attractive opportunities in China but simply that the risk-reward appears more favorable for now in the U.S.

In terms of our portfolio exposure to China, we achieve it today through four main channels: (1) publicly traded, mainland Chinese firms, (2) Chinese firms that trade on foreign equity exchanges, (3) investments that are highly sensitive to Chinese macroeconomic trends, and (4) Chinese private equity investments.

Our publicly traded, mainland China exposure today is limited in part because of practical issues. Specifically, we see the onshore Chinese market as less liquid than many peers and therefore more volatile; we also are aware of the tendency of the Chinese government to intervene in equities (often without warning). Because of those challenges, some Chinese firms list overseas in more liquid, more regulated markets. Chinese tech giant Alibaba, as an example, is listed on the New York Stock Exchange.

In public markets, we also consider companies with significant portions of their revenues coming from China, even if the company in question is based elsewhere (with better market liquidity and corporate governance practices). Qualcomm is a good example: Based in San Diego, the technology firm gets around two-thirds of its sales from China.

Finally, we gain exposure to China via private markets, again both directly (privately held onshore Chinese firms) and indirectly (private firms that will benefit in different ways from China-related trends).

To be frank, given all the global connections between economies and markets today, an investor's exposure to China is almost guaranteed to be significantly greater than what just a domestic public-equity number would suggest.

Looking longer term, we would expect Chinese exposure in client portfolios to increase, for a few reasons.

First, as China continues to develop its local financial markets, open them to foreign participation, and adopt global corporate governance practices, it will play a larger role in widely adopted equity indexes and should garner more global investor confidence and trust as well as improve underlying liquidity. This year, MSCI added Chinese “A shares” (securities denominated in renminbi and traded on the Shanghai and Shenzhen stock exchanges) to its indexes for the first time, with an intention to increase that inclusion in the years to come.

Second, the development of an Initial Public Offering (IPO) market and M&A culture will also make Chinese private equity more attractive, as investors will be able to more easily monetize those investments at exit.

Third, we expect that, even with some foreign pushback, China will continue to pursue MiC2025 as a way to support broader economic growth — these efforts should create new businesses and investment opportunities along the way.

Final Word: Third-Quarter Performance

The third quarter of 2018 was a study in contrasts. The U.S. economic backdrop was very strong. Thanks in part to a large fiscal boost (tax cuts and increased spending), GDP growth came in at 4.2% for the second quarter and was on track for another above-trend print for the third quarter (as of late September, consensus estimates suggested Q3 GDP growth around 3%). Strong growth with modestly rising inflation created a very supportive environment for cyclical assets. Not surprisingly, then, the U.S. dollar, Treasury yields, and equities all continued to move higher, with the S&P 500 up almost 8% for the three-month period. Meanwhile, other equity markets and currencies
lagged or weakened outright. Europe saw growth momentum slow while policy concerns rose again, this time centered on Italy and the potential for the new government to break fiscal-deficit guidelines for the monetary union. Emerging markets faced both cyclical challenges from the stronger dollar and rising U.S. interest rates, but in some countries, idiosyncratic challenges as well. Among those under pressure were Brazil, facing greater uncertainty ahead of an October election; Argentina, struggling to secure a financial-aid package from the International Monetary Fund and raising interest rates to 60% in an effort to stabilize the currency; and Turkey, also combating currency weakness and sharp capital outflows.

Trade negotiations remained a market focus throughout the quarter, with September seeing the U.S. move ahead with a new round of tariffs against China (10% tariff on $200 billion worth of imports) but hope that a refined NAFTA deal could be concluded, at least with Mexico. While market reactions to trade developments were limited, investors did appear to be using more equity options to protect portfolios against losses, reflected in the difference between pricing for puts and calls.

A representative Balanced Growth portfolio (70/30 equity/bond risk) preliminarily finished the quarter with a return of 3.5%, taking year-to-date returns to 5.2% versus a benchmark return of 2.5%. An underweight to high-quality fixed income alongside market-weight equity exposure contributed to returns. Within equities, performance was helped by an overweight to the U.S. as well as an overweight to technology. Portfolios remained underweight emerging markets and developed Europe during the quarter.

Entering the final quarter of 2018 and looking ahead to 2019, Bessemer expects tightening monetary policy to incrementally hamper growth, especially when fiscal stimulus in the U.S. starts to fade and depending on trade-war dynamics. While we do not see a U.S. recession as likely in the coming quarters, we expect the next major change in asset allocation to be a further reduction of risk, likely including a decrease in equity exposure.

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**Bessemer’s Positioning (70/30 Risk Profile with Alternatives)**

Positioning as of October 1, 2018. This model displays Bessemer’s Balanced Growth with Hedge Funds and Private Assets target portfolio allocation guidelines. Each client situation is unique and may be subject to special circumstances, including but not limited to greater or less risk tolerance, classes, and concentrations of assets not managed by Bessemer, and investment limitations imposed under applicable governing documents and other limitations that may require adjustments to the suggested allocations. Model asset allocation guidelines may be adjusted from time to time on the basis of the foregoing or other factors. Alternative investments, including Bessemer private equity, real assets, and hedge funds of funds, are not suitable for all clients and are available only to qualified investors.
The Chinese Dream

Our Recent Insights

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