



China - What is Everyone Missing?

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by Matthew Daley, Steven Abernathy
of The Abernathy Group Family Office

The investment community is wrestling with the market's current challenges of being overvalued, with inflation increasing rapidly, and with speculative activity at levels rarely seen over the last 30 years. Nothing is being mentioned about the increasing geopolitical risks. If we are not careful, the United States may be facing a decline, similar to great dynasties of the past, due to our wealth, comfort, and investors' complacency. Intelligent Investors will keep a wary eye on the world's developments beyond our shores. Our point: Winston Churchill used to quote the Roman General Vegetius "If you want peace, prepare for war". The corollary to this quote for investors would be "If you want to avoid investment losses, prepare for risks". While we don't know the answers to questions posed below, we firmly believe the answers to these questions should be considered.

Remember foreign policy? It was something that people used to talk about here in the United States, especially investors. While we have been consumed with challenging domestic issues, America's adversaries have been capitalizing on our absence from the world stage. We may already be too late, and, if we don't start paying serious attention to geopolitical challenges, and China specifically, our financial assets will be at risk along with our safety and security.

There are abundant macroeconomic crises building momentum around the world. America and the rest of the western world are asleep at the wheel while China takes action. It is hard not to notice the tightening of relationships between autocratic nations into a joint alliance led by China and aimed at countering long existing democratic partnerships in the west. China is using its tremendous economic power and geographic location to propagate these alliances.

What is China Up to?

Let's start by looking closely at the geopolitics of the 'One Belt One Road' (OBOR) initiative in order to hypothesize China's motives, beyond a simple increase in trade. Djibouti, Ethiopia, Pakistan, and Mongolia are probably not on your short list of vacation destinations; So why should we care what's going on there? Short Answer. China.

The OBOR initiative is no secret. China's Xi Jinping announced the project to the world in 2013 and has since consistently expanded the scope. Between 2020 and 2030 it is expected to increase China's trade by approximately \$1.7 trillion. It is obvious that allowing China to continue this effort, unopposed, gives them an economic edge. However, the important questions we should be asking are much more complex. What are their true motives? What do these countries involved in the project have in common, and why were they chosen? What are the geopolitical implications? Are my U.S. assets at risk from foreign input exposure?

Power in the Balance

Ever since Deng Xiaoping, aka the General Architect, transitioned China to a socialist market economy in the late 1970's, the Chinese economy has ballooned. Xi Jinping has accelerated China's momentum as a leading global economy during his tenure. The United States has a real competitor for world supremacy for the first time in several decades. Graham Allison's *Destined for War* rolls through historical examples of Thucydides trap; when two powers compete for hegemon status, war is virtually inevitable. In other words, China and The United States are likely heading toward some sort of conflict in the near future. Investors must begin to take geopolitics very seriously again, in order to protect themselves from the coming conflict and ensure their assets aren't sitting on the wrong side of the proverbial line in the sand.

To use an example from recent memory, we can look at the Cold War to see what happens when two world superpowers compete for absolute power.

The United States and The Soviet Union spent decades recruiting countries to their respective sides, in several cases resulting in military conflict. The Soviet Cold War was all about ideology; communism vs democracy. That theme is still prevalent, but no longer the dominating factor. China has learned from the failings of the Cold War and, thus, has avoided focusing their efforts on spreading ideology. Instead, they

have focused their initiatives toward more objective forms of recruitment using a combination of financial, political, and infrastructural leverage. We appear to be heading towards a world where countries once again will be choosing sides. This time between China and the United States. I make the assertion that China's OBOR initiative is their way of beginning this process. Anyone who has read "The Art of War" knows that conflict is won before it begins. War is about preparation. Right now, China is taking a page out of the 20th century U.S. foreign policy playbook. *Their chief export is no longer manufactured goods, it is influence.* Remember this every time you consider an investment with foreign exposure. Ask yourself, "when the time comes to pick a side, who will each country choose?" Some countries are easy to determine. For example, the U.K. will likely side with the United States, while Iran will probably side with China. However, other countries may fall into grey areas, which is where investors will need to focus their analysis.

The Impact of One Belt One Road

The 66 countries involved in the OBOR initiative are a good place to begin. A quick glance at the list and one can see many of these countries siding with China because of their system of government or their anti-western ideology, and frankly, there is not too much The U.S. can do about that. India and the Baltic States are generally pro-America, but nonetheless fall on the list. If China were to engage in predatory loan practices in these places, like they have done already in Djibouti, Ethiopia, and Pakistan, they could be forced to side with China as well. That is the power of the OBOR initiative. China is purchasing influence and exporting it across Asia, the Middle East, Eastern Europe, and Africa. The United States must focus its energy on expanding influence in South America to protect our sphere of influence in our proximate geography. Afterward, we can divert our energy to countering China's power in places they already have a presence.

An example of a recent event that should sound alarms because of its proximity to our shores, is the attempt by Iran to send a warship filled with weapons to Venezuela. Iran may not share exact ideology with China, but they definitely share a loathing for the West. These are the types of considerations investors need to start noticing. We would be fools not to consider the connection between this action and the 21st century's version of the Axis of Evil. Venezuela is our only real enemy in the Western Hemisphere. A coalition of China, Iran, Russia, North Korea, and Venezuela would be a formidable leadership group to begin pushing for a new world order. There have been a number of other small provocations by this group in the recent past. Look for these types of events to pick up in pace and severity. South America is yet unclaimed (other than Venezuela), but one could see many of the nations there as a coin flip as to which side they could be compelled or strong-armed to join.

A Geopolitical Tinder Box

A single trigger event could accelerate into a broader conflict in an instant. For example, if significant evidence were to arise that China accidentally leaked Covid-19 from the Wuhan lab and then covered it up, this could be a trigger. Faced with reparations, debt cancellation, or any litany of additional penalties from the global community, China may be forced to move prematurely into direct contention for world dominance with the United States. For example, if China increased its aggressiveness toward Taiwan, the U.S. would likely be forced to take a side against China. If China decides to become more assertive regarding its claims of ownership in the South China Sea, which would likely start a conflagration of some magnitude with Japan, what would the U.S. do? Other possibilities include an act of aggression by North Korea with China's backing, a devastating cyberattack, or a new war in the Middle East. Russian military aggression in Ukraine or other bordering states, the battle for Arctic military capabilities, instability in Turkey, and a 21st Century Space Race, are all on the list of conflagrations which could take place, among many others. Recall World War I to remind yourself that seemingly insignificant events, completely unrelated to China, are also plausible catalysts for launching a conflict. Archduke Franz Ferdinand's assassination by a Serbian assassin in Sarajevo on June 27, 1914 led to the deaths of millions across the world. Something yet unimagined may be the force that brings us to conflict. It is important to stay nimble and to pay close attention. If a triggering event occurs and your assets are in a country that sides with China, might those assets be seized by the Chinese Communist Party (CCP) or even by the host country as payment for their loyalty to the regime? If you have U.S. based investments that are heavily reliant on foreign resources, labor, or support, you should also consider which side those resources may be on, and the risk you are taking depending on the degree of certainty you can have in such a prediction.

For decades China has been a reliable machine for investors to put a dollar in the slot and have it spit back a twenty. That was a China heavily supported by U.S. development efforts because we didn't see them as a threat. When the student becomes the master, expect the rules to change.

Authors:

Matthew Daley is a former management consultant in bankruptcy & restructuring.

Steven Abernathy is a financial analyst, General Partner and CIO of The Abernathy Group Growth Funds

and Chairman of Abernathy Group Family Office.