



Zanetti Monday Missive 2022.08.22 What's Up With China?

Hello Everyone,

Today's missive takes a shot at explaining what is going on in China, and what it means to us here in the USA.

Most of us see China as an ascending power that cannot be stopped. It may be a power, but China certainly has its weaknesses.

In fact, the headlines out of the "Middle Kingdom" are getting more and more curious. And they don't paint a pretty picture.

So, let's get to it.

"China is a sleeping giant; let him sleep, for if he

wakes, he will shake the world.”

~ Napoleon Bonaparte

Well, China is clearly awake...and in a bad mood.

I know Speaker Pelosi's visit to Taiwan is now old news. But debate about the wisdom of her visit still rages. By some accounts, her visit brought us to the brink of World War III. By others, it was political theater by both the China and US.

What perplexed me was the fact that American VIPs have visited Taiwan for years. China didn't seem to care too much about those previous visits.

Then...suddenly...this time...an American politician's visit precipitated the following actions:

- China's navy surrounded Taiwan... and conducted live fire (!) exercises.
- China's air force breached Taiwanese airspace multiple times.
- China's army openly prepped for an amphibious assault.
- Foreign diplomats were summoned and threatened.
- China's Foreign Ministry stated that the visit would have a “severe impact on the political foundation of China-US relations.”
- PetroChina, Sinopec, China Life, Aluminum Corp. of China, and Sinopec Shanghai Petrochemical (all giant Chinese firms) announced plans to de-list from the New York Stock Exchange.
- China accelerated its sales of US treasury debt.

There is more, but you get the idea.

So, what gives? Why the dramatic escalation? What does this mean for the US? And how might this affect your portfolios?

Let's try to view the situation through China's eyes. To do so, we must engage in a bit of speculation (always a dangerous proposition) as to why the CCP (Chinese Communist Party) reacted to Pelosi's visit as they did.

When things are not going well for a country, it is a time-honored practice for politicians to divert a population's attention to something else -- something bigger -- if possible, an existential threat.

In other words: Rally the people!

And things are not going well for the CCP. Let's look at some recent headlines. (*My comments in italics*):

- **China Has Huge Demographic Problems** (*China hit the demographic wall in 2020. China's "One Child" Policy of 1979-2015 has come home to roost.*)
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- **Several Cities in China Add COVID Curbs As Millions Still Under Lockdown** (*Millions have renounced their CCP membership based on the draconian lockdowns.*)
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- **Could the Housing and Banking Crisis Be China's Lehman Moment?** (*China's housing and banking*

issues are exponentially bigger than our Lehmann debacle of 2008.)

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- **China's Banking Crisis, Explained: Tanks Move In to Quell Protests** (*Tanks! Some speculate the CCP kept the Covid lockdowns in place to prevent bank runs.*)
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- **China's Hidden Debt Crisis** (*I'll bet you didn't know China's Total Debt to GDP ratio exceeds that of the US.*)
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- **China's Trillion-Dollar Research Funds Squandered On Travel and Leisure** (*Corruption.*)
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- **China's Power Crisis Worsens As More Factories Suspend Operations** (*Energy issues driven by corruption, nepotism, and incompetence.*)
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- **Xi Jinping Addresses China's Food Shortage Concerns** (*Drought, pollution, and more corruption. Food issues are what the CCP fears most.*)

Again, I could go on, but you get the idea.

Governments that must simultaneously deal with demographic, housing, banking, debt, energy, and food issues, are not likely to feel very secure.

So, what is the CCP to do?

Before we get to that, it's important to recognize that all communist/socialist countries are dishonest, amoral, and inefficient.

They are parasitical in nature. And all parasites will suck their hosts dry.... even if it means the eventual death of the parasite itself. Thus, parasites are always looking for new hosts.

Enter Taiwan.

Taiwan was used by the Japanese in World War II as a staging base to invade China. Taiwan is now occupied by the Chinese who fled the communists in the 1940's. Everyone in China knows this.

But as far as the CCP is concerned, Taiwan is rich.

So, what better way to divert an unhappy population's attention than by invoking past wars and injustices? Then you can stoke those emotions to get what you really want...power and more wealth.

Moreover, you can vilify those (think Pelosi) who are preventing China from reuniting and assuming its rightful place as "the center of the world."

Yes, "center of the world" is their term.

The point is, the CCP has every motivation to respond in these ways:

- Escalate militarily.

- Seek new commercial, financial, and military alliances with:
 - Russia—natural resources and nuclear capabilities.
 - India—high tech, refined petroleum, and agriculture.
 - And oil-rich Middle East countries.
- Weaken its “enemies” in the west---Europe and the US.

So, what does that mean for the US economically?

Perhaps the most important take-away is that the era of globalization is dead.

And globalization was deflationary. Cheap labor and resources led to lower-cost products.

That means de-globalization will be inflationary.

Expensive labor and more expensive resources will lead to higher-priced products.

Therefore, in a consumer-driven economy like the US, it is not hard to predict the economy will slow down as consumption abates. After all, as prices rise, consumers can't buy as much “stuff.”

Hmmmm. Slowing/stagnant economy accompanied by rising prices.

Translation: Stagflation.

And stagflation is the bane of a central banker's life. If you raise rates, an already slowing economy slows down even more. But, if you lower rates, you fan the flames of inflation.

Stagflation is also very bad for corporate profits. Rising input costs (inflation) means corporate America's products will cost more. But it is tough to pass on rising costs to a population struggling with inflation and possibly a stubborn recession....or worse.

Commodities, however, tend to outperform in such an environment. People must eat and tank up their cars. They don't have to buy a new iPhone every two years.

I suspect that by year's end, this summer's stock market rally will be a distant memory. Conversely, the correction in the commodities space will be over as well.

Signed, Your If-We-Have-0%-Inflation-Why-Do-We-Need-An-\$800-Billion-Inflation-Reduction-Act? Financial Advisor,

Greg

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