
WILL CHINA TENSIONS LEAD TO A NEW ECONOMIC COLD WAR?

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Last week's *Behind the Markets* podcast featured a special guest, Maria Bartiromo of Fox Business, alongside Leland Miller, CEO of China Beige Book, with Wharton Professor Jeremy Siegel, discussing the May jobs report, the reopening of the economy and the increasing tensions with China.

Given that the coronavirus originated in China, and China was the first country to shut down segments of its economy, the readings of Chinese economic activity are important input to gauge how economies of other countries may perform following their own reopening. Miller's firm has its own proprietary metrics to gauge China activity. His data shows manufacturing and services in expansionary territory. Retail is still in the doldrums, so we are not seeing a rebound in consumer spending yet. Miller's intuition says that where the government could direct the economy to get it humming again, it is bouncing back, but discretionary demand is still slow.

New Economic 'Cold War' with China

For the global economy and financial markets, the tensions brewing with China were a major focus of our discussion with Miller and Bartiromo.

Bartiromo believes the biggest long-term fallout of the coronavirus will be supply chains moving back to the United States and elsewhere. In February, we discovered 90% of active ingredients in prescription drugs were dependent on China manufacturing. Bartiromo heard reports in February of ships being directed to return to China when they were on their way to the U.S with critical supplies.

Bartiromo does not believe China will fulfill its commitment in the Phase 1 trade deal, but the potential positives from the deal prevent even harsher tariffs from being enforced.

Bartiromo discussed a number of key concerning issues, from intellectual property (IP) theft and forced technology transfers to militarizing the South China Sea, border tensions with India and the security rules in Hong Kong. She sees the overall relationship with China deteriorating, and Professor Siegel agrees this is apt to become the new economic "Cold War."

The Impact of Restricted Access from China

China and the U.S. are the two biggest economies in the world, and if the U.S. restricts access, China will retaliate on our goods as well. Professor Siegel sees President Trump clearly making an anti-China stance a key election issue, but the Democrats also echo similar sentiments, so there may just be nuanced differences in the policy rhetoric.

For investors, we are focused on new laws requiring Chinese firms listed in U.S. exchanges to be held to the same accounting standards as U.S. firms. Many of the large Chinese technology firms, in particular, have the same auditors as U.S. firms, like an Ernst & Young in China. But the records must remain in China, and this may become an issue. Miller does not see this as a short-run performance issue and thinks over time it may be resolved. There are three years before firms are required to delist. We will be watching that story closely.

Professor Siegel thinks we need China and they need us. The markets clearly want to see

a resolution of tensions, so this will be a major dominating issue that we will be coming back to on Behind the Markets and in our commentaries.

We thank Bartiromo and Miller for sharing their thoughts with us. Please listen to the full conversation below.

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